REVENUE ACT OF 1951

HEARINGS

BEFORE THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

EIGHTY-SECOND CONGRESS

FIRST SESSION

ON

H. R. 4473

AN ACT TO PROVIDE REVENUE, AND FOR OTHER PURPOSES

PART 2

JULY 5, 6, 9, 10, 11, 12, 13, 16, 17, 18, 19, AND 20, 1951

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REVENUE ACT OF 1951

THURSDAY, JULY 5, 1951

Committee on Finance,
United States Senate,
Washington, D. C.

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

Present: Senators George, Kerr, Millikin, Taft, and Williams.

Also present: Elizabeth B. Springer, chief clerk. Colin F. Stam, chief of staff, Joint Committee on Internal Revenue Taxation.

The Chairman. The committee will please come to order.

Mr. Sligh, you are the first witness.

Mr. Sligh. Yes, sir.

The Chairman. Will you have a seat and identify yourself for the record, please.

STATEMENT OF CHARLES R. SLIGH, JR., CHAIRMAN, TAXATION COMMITTEE, NATIONAL ASSOCIATION OF MANUFACTURERS, ACCOMPANIED BY HARLEY L. LUTZ, TAX CONSULTANT, AND JOHN C. DAVIDSON, DIRECTOR, GOVERNMENT FINANCE DEPARTMENT

Mr. Sligh. Thank you, sir.

My name is Charles R. Sligh, Jr. I am a furniture manufacturer, and president of the Charles R. Sligh Co. of Holland, Mich.

I am chairman of the taxation committee of the National Association of Manufacturers, and appear here on behalf of the association.

The taxation committee is made up of 204 businessmen. I would like to offer for the record, if I may, our program for paying as we go, and I would like to read a condensed version of my testimony, and offer the full account for the record.

The Chairman. You may do so, Mr. Sligh.

Of course, this committee agrees with the pay-as-you-go theory; but whether it is a fact depends on how far you go and how fast you go, of course.

Mr. Sligh. Yes, sir.

The Chairman. All right.

You can talk about pay-as-you-go, but if you have not any terminal facilities as to where you are going, why, it is just not one of those things that you can realize very quickly. I hope you take that practical view of it.

Mr. Sligh. I think we have taken a practical view, sir.

The Chairman. All right, sir.

Mr. SLIGH. The study and reports of the taxation committee are passed upon by a board of directors numbering 160 businessmen. Through its committees on taxation and on Government spending the association has consistently proposed measures to put the Government on a sound financial basis.

It has consistently advocated a balanced budget, and has recommended a pay-as-we-go tax program for the present defense emergency.

Senator MILLIKIN. We will have a deficit in fiscal 1953; that starts a year from now, and we will have a deficit in fiscal 1953 of probably 20 to 30 billion dollars. Do you think we can do that on a pay-as-you-go?

Mr. SLIGH. We believe it should be done on a pay-as-you-go.

Senator MILLIKIN. Do you believe we can do it?

Mr. SLIGH. Yes, I believe we can.

Senator MILLIKIN. How.

Mr. SLIGH. Well, we have a detailed statement —

The CHAIRMAN. You are prepared to tell us this morning, I assume?

Mr. SLIGH. We think we are, sir, yes.

Senator MILLIKIN. We want very much to know about that.

Mr. SLIGH. Good.

Senator MILLIKIN. Despite this third bill if it becomes law, we would have a deficit of 20 or 30 billion dollars in fiscal 1953; how are you going to meet it?

Mr. SLIGH. Well, if I may read a statement here, sir: In connection with the expenditures, Assistant Director of the Budget Staats, and Secretary of the Treasury Snyder agree on a probable budget expenditure total of $68.4 billion in fiscal 1952.

The minority of the Ways and Means Committee has asserted that the reductions voted by Congress will approximate $1 billion.

On the other hand, Mr. Wilson has said that some $3 billion normally falling in 1953, fiscal 1953, may be brought forward into 1952.

On the basis of these estimates, total expenditures in fiscal 1952 appear likely to be some $70 billion.

Our only light on the probable expenditures in fiscal 1953 is provided by the statement of Mr. Staats who gave the wide range of 80 to 90 billion, with $85 billion probable.

If we accept Mr. Wilson's transfer of $3 billion into 1952, Mr. Staats' figures become a range of $77 to $87 billion, with an $82 billion probable.

The extent to which continued determination to avert unnecessary spending would result in reduction of the 1953 total is not now clear. If we assume, however, no more than a 5-percent cut, the 1953 projections become, in round figures, a range of $73 to $83 billion, with $78 billion probable.

In connection with revenues, we begin with the actual net budget receipts of fiscal 1951, which are $48,146 million.

Revenue increases in 1952 and 1953 would come from, one, normal increase of receipts under present laws and, two, additional receipts from changes in the tax law, the present law.

We have two recent estimates of 1952 revenues under the present law. The Treasury has put the total at $58.5 billion, assuming 1951 personal income of $245 billion.

The joint committee staff, using a personal-income estimate of 250 billion in the calendar year of 1951 estimates revenue in fiscal 1952 at 60.9 billion.

Thus, we have an estimated increase of $10.4 billion by the Treasury under the present law, and of $12.8 billion by the joint committee. It seems proper to raise a question as to the validity of these projections, particularly the higher one.

They evidently assume a further rise of incomes, especially corporation profits, which is not too certain to be realized.

In connection with tax increases, the net contribution of H. R. 4473 to the revenue is estimated at $4.4 billion in fiscal 1952, and at $6.8 billion in a full year of operation, which would be fiscal 1953.

This brings us to the relation of probable expenditures and receipts. The fiscal year 1952 probable expenditures of $70 billion, anticipated revenue under the present law $58.5 billion to $60.9 billion, and 1952 deficit under present law of $11.5 billion to $9.1 billion, yield of H. R. 4473 in 1952, $4.4 billion, and the 1952 deficit under H. R. 4473 would be $7.1 billion to $4.5 billion; then, in the fiscal year 1953, the probable expenditures would be $78 billion, and the full-year receipts under H. R. 4473 would be $65.3 to $67.7 billion, and a deficit then in fiscal 1953 under H. R. 4473 would be $12.7 to $10.3 billion.

Now, you ask how——

Senator MILLIKIN. That is the most optimistic figure, by all odds, that any witness has testified to here.

Mr. SLIGH. Yes.

Senator MILLIKIN. But assume it is correct. Do you think we can add $12 billion to the present scale of taxes, just assuming that we take the House version?

Senator KERR. In order that I might understand, is the estimate that the witness has given us here as to the deficit over and above the statement that you have made of the revenue, is that what is to be received both under present law and under the one now under consideration?

Mr. SLIGH. H. R. 4473; yes, sir.

Senator KERR. All right. Now, then, I understand it better so that he can answer your question.

Mr. SLIGH. I think it would be, perhaps, a little better if I may continue with the testimony.

The CHAIRMAN. Yes, sir.

Mr. SLIGH. I think it would be better if I would continue with the testimony I have, and I think we can come to the point, perhaps a little clearer, and then come back to that particular point, if that is agreeable.

The CHAIRMAN. Yes.

Senator MILLIKIN. That is all right.

The CHAIRMAN. That is a very important point.

Mr. SLIGH. Yes, sir; and we have figures on that which we will present.

We are as seriously concerned—the committee and the board of directors of the National Association of Manufacturers—with the spending of the taxpayers' dollars as we are concerned with the collection of those dollars. The association has published many reports

calling for the elimination of wasteful and unnecessary Government spending.

This year, we have distributed a report of the Government spending committee, showing in detail how a minimum of $4.6 billion can be cut out of the $14.6 billion of civilian expenditures recommended by the President for fiscal year 1952, and urging the most painstaking scrutiny of military and foreign-aid spending requests.

The tax bill before this committee, H. R. 4473, is, in our judgment, unsound because, one, the bill does not provide enough revenue on the basis of official estimates to assure pay-as-we-go during the military emergency and, hence, does not safeguard against further inflation.

Tax insurance against inflation at this time requires more than provision for the budget requirements of the current fiscal year. It should aim now at covering the anticipated spending at the peak of the rearmament program.

Two——

Senator MILLIKIN. You do not mean that, do you?

Mr. SLIGH. Yes, sir.

Senator MILLIKIN. That we should put a tax bill on now that will cover the peak in 1953?

Mr. SLIGH. That we should aim at covering that peak when it arrives.

Now, the effective dates——

Senator MILLIKIN. There is no use aiming at it if you do not aim to hit it.

Mr. SLIGH. We would hit it by making the effective dates of the various taxes coincide with the peaks as they come.

Senator MILLIKIN. But you would cover the peaks with the taxes now.

Mr. SLIGH. We would cover the peak with the tax bill. The tax bill would cover the peak. Now, it would be up to the Congress when the effective dates were made, to have the effective date set so that as we went along it would cover the increasing expenditures.

Senator MILLIKIN. Well, that is simply a timing of additional taxes.

Mr. SLIGH. That is correct.

Senator MILLIKIN. And that brings us back to the point that you would want to cover the whole thing——

Mr. SLIGH. Yes, sir.

Senator MILLIKIN (continuing). By taxes; cover the peak by taxes.

Mr. SLIGH. Yes, sir.

Senator MILLIKIN. And you think it can be done?

Mr. SLIGH. Yes, sir.

Senator MILLIKIN. It would not hurt the economy?

Mr. SLIGH. We do not think so, sir. We think that the greater danger to the economy would come from deficit financing and the resultant inflation.

We feel that paying as we go—in other words, taxing to pay for Government expenditures—is not the real hardship to the people. The real hardship on the people, we feel, in this period of defense and partial mobilization, is rather the amount of goods that are taken out of the economy for defense purposes. In other words, regardless of the amount of money the people have in their pockets, there is a limited amount of goods left for them to buy.

Senator MILLIKIN. Have you studied the burden tables of what will happen to income-tax payers in different brackets of income on up the line?

Mr. SLIGH. I have not studied that table.

Senator MILLIKIN. If this tax bill before us becomes effective?

Mr. SLIGH. No; I have not studied that particular table.

Senator MILLIKIN. I suggest you do.

Mr. SLIGH. Perhaps one of our staff has.

The CHAIRMAN. We closed this last fiscal year with a budget surplus of more than 3½ billion dollars. Failure to tax has not done anything to the inflationary pressure during this last past year, has it?

Mr. SLIGH. Well, as I understand you, you said that we have a surplus——

The CHAIRMAN. Maybe we did not tax in the right place, but so far as the total tax raised, the Government ended with a surplus of——

Mr. SLIGH. That is right.

The CHAIRMAN (continuing). Three and a half billion dollars in the fiscal year that ended last week. So the failure of taxation has not contributed to the inflation in recent months, has it?

Mr. SLIGH. Well, haven't we paid as we have gone, in the past few months?

The CHAIRMAN. Oh, yes.

Mr. SLIGH. So we have not failed to pay as we go during the past few months.

The CHAIRMAN. We have raised additional 10 billions of dollars, a little more on the level of the economy, since the Korean War started already—$10 billion in new money in less than 12 months, not counting this House bill.

Of course, it is yet an unhatched chicken.

Mr. SLIGH. Well, as I understand it, though, we have paid as we went along in the last few months.

The CHAIRMAN. Yes; you had a surplus, and I just simply——

Mr. SLIGH. That is what we are advocating.

The CHAIRMAN. I think it worth while to stop and take a view that in taxing or failing to tax during the last fiscal year, has not greatly contributed to your inflationary pressures. Now, something else has done it, other things have done it. I am not minimizing the necessity for meeting the problem hereafter.

Mr. SLIGH. I think I see what you are getting at.

I think a great deal of that inflationary pressure has been removed in recent months.

Now, whether it reasserts itself is dependent, I think, to a great extent, on what the Congress does in connection with paying as you go from here on.

The CHAIRMAN. I imagine there may be some force in what you have to say, but it is pretty discouraging to look at a problem that has been developing over a period of years, and then attribute your present inflationary pressures to failure to tax in the last fiscal year, when we had an actual surplus of $3½ billion last week in the Treasury.

Mr. SLIGH. Well, that, if I understand it correctly, would indicate that we have not failed to tax enough, to pay as we go on the past fiscal year.

The CHAIRMAN. I believe we have. It is not solely responsible for these conditions, but there are a lot of people around town who seem to think it is.

Mr. SLIGH. May I continue then, sir?

The CHAIRMAN. Yes, sir; go ahead.

Mr. SLIGH. Two, the bill fails to provide for a broad consumption tax which should be used not only to supply the bulk of the additional revenue required, but also to correct the existing selective and discriminatory excises.

Senator KERR. Illustrate the meaning of your term "consumption tax."

Mr. SLIGH. We advocate a manufacturers' tax.

The CHAIRMAN. He is going to reach that now. Are you going to reach that point?

Mr. SLIGH. Yes. I will explain that later.

Senator TAFT. You mean a sales tax, in fact, in one form or another.

Senator KERR. You mean a sales tax?

Mr. SLIGH. I mean a manufacturers' uniform excise tax, which might be called a sales tax at the manufacturers' level.

Senator KERR. I know what an excise tax is, and I know what a sales tax is. If a consumption tax is synonymous with those, then I know what a consumption tax is.

Mr. SLIGH. Yes.

Finally, the bill compounds the economic destructiveness of the present law by a further concentration of the tax load on savings, investment, and production.

In our view, the shortcomings of H. R. 4473 can be adequately weighed only against a background of the long-range objectives of sound tax policy.

The vital fiscal problem before the Congress is keeping the Federal budget in balance.

Senator MILLIKIN. Does not your consumption tax weigh on production on the manufacturers' level?

Mr. SLIGH. I do not think that it does, sir, in this sense: That we feel that income, individual income taxes, for instance, are much more liable to kill incentive to earn than are consumption taxes. Taxing income as it is received is more liable to kill incentive than taxing income as it is spent, and also taxing income at the corporate level to a point where the corporation does not have the ability to replace worn out equipment, and to expand and increase our production in this country, also is destructive of production.

Senator MILLIKIN. I think there is a big difference where you put the tax.

Mr. SLIGH. Yes.

Senator MILLIKIN. But when you put it on the manufacturer's level it compounds as it goes on up the scale, and the fellow who has the income, the fellow who has the income, I repeat, has to pay the burden, does he not? If so, you are putting a burden on him. He uses his income to buy stuff.

Mr. SLIGH. That is correct. But I think that if a tax is taken from him as he receives the income, if a man sees that when he gets his income check it is going to be cut by 30 percent before he even gets it, it is going to rob him of more incentive than if he is allowed to receive

his income, and then decide himself whether he wants to buy the standard model of the product or the de luxe model, and if he buys the standard model, of course, he would be able to save some tax or he might forego purchasing certain items and invest that money in productive facilities, so that it would not be as liable to kill production and incentive as would corporate income taxes and individual income taxes.

Senator MILLIKIN. Well, you are arguing the old proposition; I think there is a lot of soundness in it. You are arguing the old proposition of taking the feathers but do not kill the goose.

Mr. SLIGH. We believe in that, sir.

Senator TAFT. What difference does it make to a man whether he gets less income and has to choose between what he spends it on or whether he gets more income and has to pay more for the stuff he buys? What difference does it make? I cannot see the difference in incentive.

Mr. SLIGH. I understand a lot of incentive is psychological.

Senator TAFT. It may be psychology.

Mr. SLIGH. Psychological to a great extent, plus the fact that when he has it taken from him when he receives it he has no choice whatever in the matter. If he receives it, at least he has a choice as to how he can spend it and whether he pays a large——

Senator TAFT. If you take it away from him he has a choice on how he spends what is left, and he has less to pay on what he has to buy, because you have a tax then, a sales tax. I do not see the point, frankly. It seems to me a personal income tax is the only logical method of taxation. I agree it is bad psychologically and politically, and maybe we do not want him to know that he is being taxed. I can see that point; but I cannot see your point about any effect whatever on his incentive to produce. It seems to me that is exactly the same, one way or the other. I cannot see it.

Mr. SLIGH. Well, that certainly is a matter of opinion. We feel it is a definite——

Senator TAFT. Either way, what he has left, he has a choice of spending in buying or not buying this or that.

Mr. SLIGH. I might point out that as I go along I will develop further the point on this broad consumption tax which would not, for instance, affect food and food products, and does not affect services, and so on.

Senator TAFT. That is another question. But, as I say, I do not see any effect on his productivity; I cannot see that.

Mr. SLIGH. Well, you mentioned a moment ago it did not matter where it was taken. If it is taken before he receives it, it covers everything. If it is a broad consumption tax applied on all end products, except food and food products, he would not have to pay on any food that he bought or any food products. He would not have to pay on rental, and so on; while if you take it before he receives it, it is all gone.

Senator MILLIKIN. All those taxes ultimately get around to food. You may take it out on the first bounce, but it reaches food on the second; and I suggest to you that unless you are going to pass on the type of tax you are talking about, that it is a direct burden on production.

Mr. SLIGH. It would be passed on.

Senator MILLIKIN. Unless you pass it on.

Mr. SLIGH. We would pass it on.

Senator MILLIKIN. All right.

The CHAIRMAN. All right; go ahead.

Mr. SLIGH. In our view, the shortcomings of H. R. 4473 can be adequately weighed only against a background of the long-range objectives of sound tax policy.

The vital fiscal problem before the Congress is keeping the Federal budget in balance. The principal private sources of inflation are now well under control by the Federal Reserve Board and the member banks.

The wave of scare buying which began after Korea had subsided, and there is no early prospect of a resumption, barring a renewal of the psychological influences which were then chiefly responsible.

Senator MILLIKIN. When the inventories are gone, will there not be a renewal in buying, in view of the increased Federal spending?

Mr. SLIGH. I do not think there will be a renewal of scare buying That is, the statement I made there, is that there will not be an early prospect of the resumption of scare buying, which was largely brought on by the psychological influences at the time of the Korean War.

Senator KERR. Isn't that going to be augmented by the fact that as we go along it is going to be apparent that the inventories are not going to be gone?

Mr. SLIGH. I do not quite follow that, sir.

Senator KERR. Well, the Senator asked if, when the inventories were gone, there would not be a resumption of the upward pressure of prices. Is there any indication even in the face of the recent price reductions and the resultant increase in purchases; is there any indication of the probability that inventories are going to be gone?

Mr. SLIGH. Well, of course, I do not think—probably inventories will not be gone; I think that inventories will drop off from here on. I think that every retailer certainly is making a very definite attempt to reduce his inventories, and I think that as we go through the year, inventories will be reduced.

Senator WILLIAMS. There is a possibility that will be carried over to below normal, too, is there not?

Mr. SLIGH. It could be, sir.

Senator MILLIKIN. Will you not say, as the Government increases its requisition powers, takes more and more goods out of the market, it is going to make shortages and, therefore, people will try to cover their inventories?

Mr. SLIGH. Yes. People will certainly try to keep their inventories at a proper level; but I repeat, I do not think there will be the scare buying that there was.

Senator MILLIKIN. That is a matter——

Mr. SLIGH. Yes.

Senator KERR. Do you have an estimate of the inventories of July 1 this year, as compared to that of July 1 last year?

Mr. SLIGH. No, sir; I do not have that right here. We may have it here. I do not have it right here with me at the moment.

Senator KERR. Is it not a fact that in spite of the recent accelerated buying at reduced prices, there is a greater inventory all the way from the manufacturer through to the retailer today than there was a year ago?

Mr. SLIGH. I think that that is probably true. Here are the figures. You mentioned—no, we do not have July; we have April.

Inventories in April 1951 were $68,271,000,000, and in April 1950 were $52,906,000,000.

Senator KERR. What were they in July of 1950?

Mr. SLIGH. July 1950, they were $53,243,000,000.

Senator KERR. So that as of today, in all likelihood, they are considerably above a year ago.

Mr. SLIGH. I would say they were probably above a year ago, although I do not have the exact figures with me.

Senator KERR. The capacity to produce those inventories is still back there at work, is it not?

Mr. SLIGH. The capacity to produce, I believe, is there; yes.

Senator KERR. And as of now the net left of the production of civilian goods is above what it was a year ago.

Mr. SLIGH. I would believe that would be true.

Senator MILLIKIN. How much was the national product increased in the last year?

Mr. SLIGH. Well, again, offhand I cannot quote that.

Senator MILLIKIN. Just roughly?

Mr. SLIGH. Total gross national product—first quarter is all I have of 1950, was $263.3 billion, and the first quarter of 1951 was $313.9 billion.

Senator MILLIKIN. Yes.

Mr. SLIGH. From this point on, while these favorable factors continue, the chief danger of further inflation lies in the field of fiscal policy. If Government spends more than it takes in, whether for necessary or wasteful purposes, it will create the additional purchasing power that is the basis of inflation. In order to prevent deficit financing and a further increase of the public debt, broad-gage plans for adequate taxation must be made now.

In urging the development of an adequate tax program, I emphasize that the continuing stress which has been given to the reduction of nonessential spending must be heeded.

We are not urging tax increases because we approve the prospective level of public spending. We are simply saying that if Congress is going to authorize the spending, it should levy the necessary covering taxes.

The current rate of Federal spending is not a proper guide to the ultimate rate of spending. Much of the first year since the Korean War began has been given over to industrial retooling, the placing of contracts, and some acquisition of inventories to be processed into military matériel.

But neither the Congress nor the people have been kept currently informed as to the magnitude of the obligations that must eventually be met.

While some of us may have had inklings, it was not until the Assistant Director of the Budget testified before this committee last week that we had an authoritative projection of the probable Federal budget for 1953.

We do not accept as final the projection of 1953 budget expenditures ranging from $80 billion to $90 billion, with $85 billion probable. We insist that there will be a considerable amount of water in the 1953 budget which can and should be squeezed out.

I am going to read the next paragraph even though it is marked out, because I do feel it is important.

Our criticism of the tactics that have been pursued goes further than the absolute amount of the budget. It is that until it was brought out at this late date there was available no authoritative indication of the administration's views on the magnitude of the financing job.

The President and the Secretary of the Treasury have made numerous statements regarding the importance of paying as we go But neither has been forthright as to the kind and amount of taxation that will be required to accomplish this. They have not supported the goal of the pay-as-we-go with a realistic, complete, and sound tax program.

Senator KERR. Well, getting down to that, is the formulation of the elements of a tax program the responsibility of the executive or the legislative branch?

Mr. SLIGH. Well, I understand that it is the responsibility of the Legislature.

Senator KERR. Then if you would have a criticism that it has not been done, it would be just as much in order to level it at the legislative as at the Executive, would it not?

Mr. SLIGH. I would be glad to include them, sir, if you wish. [Laughter.]

Senator KERR. I notice you have laid it at the door of the Executive.

Mr. SLIGH. That is right.

Senator KERR. And it is the responsibility of the legislative, and personally I would appreciate a little expression of your thought there as to the reasons making that point of criticism of the Executive, not that it is not your privilege to do that, that is fine, and I think that is all right. I just am trying to make up my mind as to how much persuasive power there should be in a criticism if it is misdirected.

Mr. SLIGH. Well, we feel that it is within the authority of the administration to propose or to suggest a plan. It is certainly up to the Legislature to levy the tax.

Senator TAFT. Isn't their sole responsibility to suggest how much we are going to spend? Are they not making this whole military program? Is it not up to them to tell us about 3 years ahead what they expect to do? We finally got it out of them in this committee.

Senator KERR. His criticism was not as to the amount that was to be spent. His criticism was to the kind and amount of taxation.

Mr. SLIGH. What I said exactly is that they have not supported the goal of pay-as-we-go with a realistic, complete, and sound tax program.

Senator KERR. That is what you said.

Senator MILLIKIN. They supported it for 1952; that is, they had a proposal for 1952.

Mr. SLIGH. Proposals, though we do not feel they were sound.

Senator MILLIKIN. But they have no proposal for 1953 that will be adequate, and they decline to enter into that field.

Mr. SLIGH. We do not agree with this hesitant, piecemeal approach to a job that everyone knows must be done.

Our first recommendation as to broad tax policy objectives is, therefore, that present taxes should be revised sufficiently to cover the anticipated peak of defense spending. It is not too soon to begin prepaprations for the peak of the spending, for these reasons:

1. There is a normal delay in getting full results from new taxes or increases in existing taxes. The fiscal year 1953 would be the first full year of operation under any new tax legislation enacted during the present session.

2. We must assume that any effort to cover a new inflationary gap by a further tax bill next year would be too late.

Failure to tax realistically now means a new inflation flood when the spending crest comes. Once we permit another wide inflation gap to appear it will never be possible thereafter to bridge it. We therefore face a fateful decision at this time. Further inflation involves such peril to our American institutions that we dare not fail to make the right choice.

The burden of inflation is greater than the burden of taxes. It is limitless and uncontrollable. The only way to control inflation is to prevent it.

Since the chief danger of further inflation is in the field of fiscal policy, my statement to you is devoted mainly to tax policy. Before I proceed with this major topic, I want to make brief reference to certain provisions of H. R. 4473 that are not dealt with in my subsequent statement.

Senator MILLIKIN. I would like to ask the witness now, Mr. Chairman, he says the chief danger of further inflation is in the field of fiscal policy.

I am not minimizing the fiscal policy, but what will stop the operation of the other inflationary factors?

The CHAIRMAN. I do not know that I altogether agree with your philosophy that the doctor ought to tell the patient he is going to die 4 years hence, and give him the exact date on which he may look for his own demise.

I do not know whether it would be too encouraging or not. Do you think so?

Mr. SLIGH. I do not think that would be very encouraging; no, sir.

Well, we mention here that we feel that the principal private sources of inflation are already now well under control by the Federal Reserve Board and the member banks.

Senator MILLIKIN. Have you documented that?

Mr. SLIGH. Well, no; I have not. We have not documented it.

Going back to the statement, I want to make brief reference to certain provisions of H. R. 4473 that are not dealt with in my subsequent statement.

1. Withholding on dividends, interest, and certain royalties. There are some persuasive reasons for this provision. However, it will work hardship on small-income recipients who are dependent on these forms of income.

As the minority report in the bill points out, the Government will have permanently the use of some $100 billion belonging to tax-exempt institutions and to those with small incomes. To the extent that persons in the latter group fail to apply for refunds, whether from ignorance of their rights or for any other reason, the injustices to them will be aggravated.

Senator MILLIKIN. They tell us they will make about $200 million a year out of these dividend and interest withholdings. Do you believe that?

The CHAIRMAN. I believe it is estimated above $300—$323 million, almost a third of a billion dollars.

Mr. SLIGH. Well, our feeling on that is that, as I say, we admit there are, and there are, some persuasive reasons for the provision.

On the other hand, we feel that there will be many people who sorely need that dividend income, who depend on it, and who will be forced to wait to receive all of their rightful income until they have made a refund claim, if they ever make it.

Senator MILLIKIN. I do not think there is the slightest question about that. But on the question of balances, can that inconvenience be balanced by a projected revenue gain of $323 million, which is not hay?

Mr. SLIGH. No, it certainly is not.

2. Capital gains: (*a*) The application of the 12½-percent increase on individual income taxes to capital gains is of questionable logic from a revenue standpoint. The realization of a capital gain is peculiarly within the control of the taxpayer, and hence there is room to believe that the additional rate will discourage sales. The net result might well be less rather than more revenue.

(*b*) For several years, we have advocated relief from the capital-gains tax in the case of gains realized from the sale of a bona fide residence of a taxpayer. Accordingly, we endorse the provision included in H. R. 4473.

3. Depletion: The association has long been on record in favor of adequate provisions for depletion, and we are gratified that H. R. 4473 contains an extension of this principle.

4. Multiple exemptions and credits.

Senator TAFT. What is that extension, coal?

Mr. SLIGH. What did you say, sir?

Senator TAFT. What is that extension, coal?

Mr. SLIGH. Some metals, I understand; certain other products, some clay products, I believe, and several other products of that nature.

4. Multiple exemptions and credits: We do not favor the provision which would limit to one each the surtax exemption of $25,000 and the excess-profits credit of $25,000 in the case of a group of "related" corporations. The provisions of section 45 and section 129 of the Internal Revenue Code appear to be adequate to deal with cases of corporate split-ups and acquisitions designed to avoid or evade taxes, and it should be relied upon. This would leave each case of split-up and other acquisitions to be determined, as to motives, on the merits of the case.

However, if this limitation on exemptions and credits should be continued in the bill, there could be no excuse for the continuance of the additional tax of 2 percent on the net income reported in consolidated returns.

It is desirable at this point to dispose of certain arguments that have been advanced in regard to a pay-as-we-go policy.

The CHAIRMAN. Let me ask, Mr. Stam, was this a recommendation of the Treasury, of the Joint Committee, or of the Ways and Means Committee?

Mr. STAM. I think it was a recommendation of the joint group, to prevent split-ups and avoidance of tax through the creation of these multiple corporations.

Senator TAFT. Each one of which got $25,000 of small-business exemption; is that right?

Mr. STAM. That is right.

The CHAIRMAN. I wanted to get the historical background.

Mr. STAM. You see, beginning with the last act, the act that was passed last year, the $25,000 surtax exemption was first allowed, and the minimum excess-profits tax was first allowed, and it was designed to try to meet the problem of corporations splitting up so that each one would get a separate exemption.

The CHAIRMAN. But it is applied in the House bill to all separate corporations that could file a joint return, broadly speaking.

Mr. STAM. That is right.

The CHAIRMAN. Although they may be in existence for 10 or 15 years?

Mr. STAM. That is right.

Senator MILLIKIN. Was not the original history of that, Mr. Stam, associated with the earlier agitation against holding companies? Was it not connected with that in some degree?

Mr. STAM. Every time you have a graduated tax or anything of that sort or separate exemptions for corporations based on size, you have this problem, of course, that you have to deal with.

Senator MILLIKIN. How much revenue is involved?

Mr. STAM. I think about $70 million are involved.

Senator MILLIKIN. That is what I wanted to know. Thank you very much.

Mr. SLIGH. Our whole feeling in that connection is that the present provisions, section 45 and section 129 are adequate to handle the case where a corporation is trying to evade taxes by splitting up.

It is desirable at this point to dispose of certain arguments that have been advanced in regard to a pay-as-we-go policy. These arguments are that the people cannot afford the taxes required for full payment, that such taxation would disrupt the economy, and that levies of the magnitude required would not be tolerated by the people. Involved are questions of fact and also of attitude.

The facts of the case show that it is not a question of affording or not affording. The real burden, which is the deprivation and sacrifice caused by the shortages and scarcities ensuing from large Government consumption of goods and services, is a present burden. The people afford it and endure it because they have no way of escaping it. It cannot be avoided or postponed. Increasing the debt will not lighten the burden, but it will add a future burden to that which must be carried now.

Such disruption of the economy as may occur will be caused by the large diversion of product to Government use. To the extent that this may happen, it will happen now, and happen anyway. Pay-as-we-go taxation will not be its cause, nor will the resort to inflationary borrowing in lieu of taxation avert it. In fact, the distortion incident to the plain economics of the defense program will be magnified by another round of run-away inflation.

Therefore, in referring to a tax policy to prevent inflation, we are speaking of the ways of drawing off private income in an amount equal to the spending. Such a tax policy, we submit, should fit these rules.

Senator TAFT. May I ask a question, Mr. Chairman?

The CHAIRMAN. Yes.

Mr. SLIGH. Yes, sir.

Senator TAFT. How far would you carry this principle? You think we should have taxed fully to pay for the Second World War by taxation?

Mr. SLIGH. Our feeling is that if we had done so we would have been in much better shape than we are today.

Senator TAFT. I say, do you think we should have done it?

Mr. SLIGH. Yes; I think we should have done it.

Senator TAFT. Here is the difficulty: On any basis of uniform taxation that I know of you cannot levy taxes heavier than a certain amount without tremendous injustices, not perhaps to everybody in that class, but to certain of them.

We have to levy taxes on a uniform basis. I went into it in the World War, and I came to this conclusion, that there was only one way in which we could have raised the money necessary to pay for the World War, and that was by rationing income, by rationing income, if you think what that means. In other words, we had to take away from everybody every cent they could possibly afford and still maintain a reasonable living.

Now, when you come to the problems of rationing income and saying this man must live on $5,000 or this man can have $10,000 to live on, it is an almost hopeless problem without an absolute arbitrary control, and I came to the conclusion it could not be done under our present economy, that you could not possibly tax enough to take 50 percent of the national income, that is what we had in time of war.

I say there is a point at which that impossibility to balance the budget by taxes occurs. It can occur under this program. In other words, even though you do not want the result of inflation, I do not think you can escape the results of inflation if the Government is going to spend one-third of the entire national income.

I think your attention should be devoted to saying we cannot afford it. I think that we can only afford a certain amount without inflation, without the evils and difficulties that arise.

Now, where that point is, I do not pretend to say. I do say that if you go beyond a certain level of taxation you cannot prevent inflation. It is the spending that does it; and you can levy all the taxes you please, yet they are passed right on into inflationary prices after you get beyond a certain point. I am not saying where that point is.

I think your thesis is unsound; I do not think you can tax indefinitely to pay for a Federal program, and still maintain any freedom whatever of the national economy.

Mr. SLIGH. Of course, I think the people have paid for World War II through inflation and taxation.

Senator TAFT. Certainly, and I say the failure to tax more during the war did not make any difference. You could have taxed the full amount needed, and they would have paid for the war anyway in inflation. I say after you get beyond a certain point of taxation it is just as inflationary to go on taxing as it is to borrow in the right way.

Mr. SLIGH. Under certain conditions it could be, but I do not think it necessarily has to be.

Senator TAFT. I think it has to be. I just do not think the Government in a free economy can hope to maintain the level of its currency

if it is going to spend more than some certain proportion of the national income. That is a conclusion of my own.

Mr. SLIGH. I want to point out——

Senator TAFT. That is, perhaps, my own conclusion, and maybe I am wrong, but, as a practical matter, we run up against it. During World War II we taxed about 25 percent of the national income, roughly speaking, and we spent 50 percent in the war, and borrowed the rest. We did it because we thought we could not find the taxes that would go beyond where we were without tremendous injustices to an awful lot of citizens.

As I say, I did not see personally any way to do it except this rationing income theory, and I certainly shuddered at that. That seemed to me to be——

Mr. SLIGH. I would like to point out, first, the fact that we certainly do not endorse—when we say we should tax as we spend, we do not endorse unnecessary spending.

Senator TAFT. I know, but you really do not protest against the spending. You say let us go ahead and spend it if it is all right—it is all right if we tax it, pay for it. That I do not think is so. I do not think you can escape that spending is resulting in some disturbance. Maybe it is worth it; maybe we can say, "All right, we have got to spend that much more and we have got to stand the consequences of it."

If you do that, I think you are bound to have inflation, and you might as well realize that now, that is the result of the spending, and it is not anything you can stop by a tax policy or fiscal policy, in my opinion, beyond a certain point.

The CHAIRMAN. It is obvious you would have to crucify certain classes of your taxpayers on your theory, and your theory would work only if you have a uniform income, and a uniform increase, and a uniform benefit from the inflationary economy in which you are operating, which is not true.

We have too many people of fixed incomes, of definitely limited incomes, that hardly respond to the inflationary economy in which you are now actually living. Some do not respond at all; and you could not retain the principle of uniformity of taxation unless you have uniformity of income increases.

Mr. SLIGH. May I point out, sir, that the——

The CHAIRMAN. At least, I do not see how you can.

Mr. SLIGH (continuing). Very people you mention who are subject to the disaster of inflation, those with fixed incomes, have already been hurt tremendously out of all proportion to wage earners and salary workers.

The CHAIRMAN. Oh, yes, there is no doubt about that.

MR. SLIGH. All right—through the fact and because of the fact that we did not pay as we went along, and they will be hurt more as we go along if we continue that policy.

The CHAIRMAN. Yes, sir. But if you are not to have a limitation upon your spending, you are going to crucify them anyway because they obviously cannot stand a uniform tax rate that will bear upon those people, without destroying them.

Our danger in America now is that we are destroying the middle classes.

Mr. SLIGH. I agree with you, and I think the whole answer——

The CHAIRMAN. And we have taken some very long steps in that direction.

Mr. SLIGH. If the Congress has the courage to cut spending, that will do away with a tremendous amount—a part of this problem. But if they do not have that courage, and if they insist on appropriating the money, then I think they should also have the courage to tax enough to pay the bill.

The CHAIRMAN. You cannot stick to your conventional uniform method of taxation without certainly crippling beyond repair certain classes of your taxpayers, and that is a matter that always concerns us. It is obliged to concern us. I do not agree with your other thesis, Mr. Sligh. I might as well say to you that you would impose these taxes up to your peak.

When you get up to the peak, then you are going to fall off in your production; you are going to fall off in all production goods; you are going to drastically alter your economy, and it seems to me that you had better level it off, and I think you have got to do it by a gradation of tax levies rather than run up to a peak, and risk the dangers of what that peak will do the economy.

Mr. SLIGH. Well, again I would like to explain that a little further.

The CHAIRMAN. Of course, I got your point that you do not intend to suggest you would impose all the tax levies up to the peak.

Mr. SLIGH. That is right.

The CHAIRMAN. But you would put them in and time them as you reach the peak.

Mr. SLIGH. That is right. In other words, the framework should be built——

The CHAIRMAN. Well, in that theory——

Mr. SLIGH (continuing). To cover the entire problem.

The CHAIRMAN (continuing). In that sense, you might escape what to me would be the inevitable consequence of going up to your peak taxation at that time, and I caught your point on that, but I think you can pay as you go, and I think it is desirable to do so. But that does imply a limitation of what you are going to spend and, as I said in the beginning, your pay-as-you-go program—I do not care who advances it—does not seem to me to be realistic unless you know how far you are going and how rapidly you are going to travel to that point.

Now, if you do not get those assumptions, given those fixed assumptions, then this talk about pay-as-you-go just blindly means, I think, that you crucify a very large number of your people numerically.

Mr. SLIGH. It seems to me that you tend to crucify a large segment of the people of the country more effectively through inflation, and also that those people are the least able to stand it. They are the people who are, perhaps, living on income trust funds and fixed incomes or pensions that are now, perhaps, beyond their peak of capacity to earn, and those are the very people who need the money the most.

The CHAIRMAN. I am sure that every member of this committee realizes the destructive effects of inflation on these people; that is true. But, if your only alternative is a uniform system of taxation that will destroy them outright, I do not see that you have helped very much. You may have saved some groups, but you have not saved them all, by any means, if that is your alternative.

Mr. SLIGH. Of course, we do not feel that is the alternative. In other words, we do not feel that our tax program will destroy the economy, and naturally we do not or we certainly would not advocate it.

The CHAIRMAN. You come back necessarily to what I have said as to how far you are going and how rapidly you are going to reach that end, because in the first place if you do not know those things, you cannot tax; in the second place, if it is a uniform tax, you are bound to hit some people. I think, if I may say so, the House bill is a tremendously burdensome tax on all unmarried people who are not the heads of households.

They did try to soften it with respect to that particular group, which is commendable, but then it is a terrific blow on all single people and a heavy burden on your middle-income taxpayers.

Mr. SLIGH. May I continue, sir?

The CHAIRMAN. Yes, sir.

Mr. SLIGH. Going back one sentence, therefore, in referring to a tax policy to prevent inflation, we are speaking of the ways of drawing off private income in an amount equal to the spending.

Such a tax policy, we submit, should fit these rules:

1. There should be a minimum interference with production. The tax burden always exerts a restrictive effect on economic effort. Therefore, the tax methods used should be such as to involve the least possible interference with production.

2. The tax increase should have a universal impact on purchasing power. The burden of whatever deprivation is involved in Government's withdrawal of a large volume of goods and services from current product should be universal.

If the foregoing rules are valid for the formulation of a sound tax policy, a basis is provided for appraising the options for additional tax revenue. Such an appraisal involves income taxation first, and consumption taxation second.

The income taxes: First, further severe increases of the income taxes will interfere with production. This proposition is valid in the case of both the corporation- and the individual-income tax, but its application is somewhat different in the two taxes.

The corporation-income tax: The important question involving the corporation-income tax is its effect on corporate plans and ability to expand productive capacity, not only in the present emergency but for the long-run future.

The large total dollar amount of corporate profits has led some to advocate dipping much more deeply into these profits than would be done by the present or even the proposed tax rates. The facts are, however, that additional taxes on corporations as a whole result in (1) a cut-back in expansion plans, (2) a reduction of dividends, or (3) a further use of debt financing which, in effect, would be corporate-deficit financing of the additional taxes.

Let me put it another way. The anticipated rise of profits from 1950 to 1951 is some $6 billion. The increase of tax liability under present law is the same amount. The tax increase under H. R. 4473 is $9 billion. Obviously, the additional $3 billion of taxes can be paid only by increasing debt in the same amount or by a corresponding reduction in the planned rate of expansion of our productive facilities.

Senator TAFT. Perhaps a slight decrease in the dividends; there is an alternative.

Mr. SLIGH. But a decrease in dividends, of course, will not necessarily enable you to increase your taxes because, of course, dividends are taxed as they leave the corporation, under this new bill, as high as 94.5 percent; so that the loss of revenue would be very great probably by taxing them at the corporate level.

Thus the issue is posed. If the tax increase is paid by debt increase, the inflationary danger is intensified. If it is paid by curtailing productive capacity, our productive bulwark against communism will be impaired.

We believe the only sound course to follow is to hold corporate taxes at approximately the present level. Above all, there should not be, as provided in H. R. 4473, any increase in the combined corporate and excess-profits limitation of 62 percent, the combined excess-profits marginal rate of 77 percent, or any reduction of the excess-profits credit.

Change in the excess-profits tax should be toward relief, not increase, of its burdens. This tax stifles growth when growth is the greatest weapon we have to use against communism.

In fact, even the present 85-percent excess-profits credit is wholly unrealistic in view of the inflation which affects corporations as well as other segments of our economy.

The individual-income tax: The burden of the individual-income tax has also been increased by the Revenue Act of 1950. The danger to the Nation in excessive rates of income tax is in their effect on the incentives to get income and on the ability to accumulate venture capital. To the extent that these incentives are weakened and capital accumulation is deficient, production declines and both the Government and the people suffer the consequences.

There are various procedures for increasing the revenue yield of the individual-income tax. The two most usually considered are: (1) the addition of certain percentage points throughout the rate scale, as recommended by the Treasury; (2) a reduction of the exemptions allowed to the taxpayer, his spouse and specified dependents. A third procedure is to levy a flat rate of tax on the surtax net income remaining after present tax. We favor this plan because it does not further intensify the progression.

We oppose the method finally adopted in the House bill, which is the increase of the tax by a stated uniform percentage thereof. Both the addition of percentage points to the rate scale and the percentage increase of the tax intensify the progression, a condition which has already been carried too far unless one is to accept the Karl Marx doctrine that the main function of severe tax-rate progression is to destroy the basis of private capitalism.

We recommend against reduction of the exemption as a means of increasing the revenue, except as a last resort. It is our judgment that there is a better way than reducing exemptions to broaden the tax base and to secure some tax from those now liable for income tax as well as all other citizens: that is, a broad-based consumption tax.

Consumption taxation: Before I outline our thinking on this method of taxation, I must direct your attention to the fact that the individual-income tax, levied on income as it is presently defined in the tax law, does not reach the major part of total personal income.

There is a gap of $130 billion or more between the total of personal income as estimated by the Department of Commerce and the amount of taxable income as defined in the tax law.

The large amount of personal income not subject to income tax provides strong support for the second result of our appraisal of available revenue options. It is that a substantial part of the additional revenue needed to "pay as we go" should be secured from a broadly based consumption tax rather than from a heavier concentration of the tax increases on the income taxes. This is certainly the most effective way to spread a part of the tax load over all income and all citizens and combat inflation.

Senator TAFT. I understand you oppose the reduction of exemptions. Why do you do that?

Mr. SLIGH. We do not propose it.

Senator TAFT. Why do you oppose it?

Mr. SLIGH. We feel that the exemption is now lower than it was in real dollars during World War II.

Senator TAFT. I agree with you. But it is not fair to tax those people; is that it? Is that the theory——

Mr. SLIGH. No.

Senator TAFT (continuing). Because then you turn around and say, "No; we will get at them with a sales tax." That is, as I get it, your program.

Mr. SLIGH. It is a better method.

Senator TAFT. The reason for your opposing exemptions is not because you oppose taxes, because you come along on the next page and say you are going to tax them.

Mr. SLIGH. I think I can explain it this way, Senator Taft: In our tax, which I come to in a moment, in a broad consumption tax on all products except food and food products, the very low income groups would be favored under that method of taxation because over 50 percent of the cost-of-living items are made up of food and food products and rent, in low-income and moderate-to-low-income groups.

Senator TAFT. As a matter of fact, I agree, but I do it on the ground that I do not think the income tax is a good way to reach those people having incomes below a certain figure.

Mr. SLIGH. We agree with you.

Senator TAFT. But I only want to point out that you are going to get them another way.

Mr. SLIGH. Yes, but not to the same degree, not to the same extent.

Senator TAFT. It depends on what—if you give them a choice——

Mr. SLIGH. We have a fairer method.

Senator TAFT. I think, as you go down the percentage of income used for food prices, there is still a large element of expenditure even in the low-income groups that would be affected by your production tax or consumption tax.

Mr. SLIGH. Less than 50 percent of their expenditures would be taxed.

Senator TAFT. But, as long as you tax that 50 percent high enough, you get as much as you would get with an income-tax increase at a lower rate.

Mr. SLIGH. I must say I do not know there is any way to pay for this need that we have been asked to carry except by taxing the people of the United States. We cannot tax any other people.

Senator TAFT. If it is going to be a general 10-percent sales tax or general 10-percent excise tax, which has been the level of the other excise taxes, then you reach more than half the income of the low-income taxpayer, and that is more than increasing the rate by 5 percent of net income.

Senator MILLIKIN. Have you figured out your burden tables under your own system, so far as the lower brackets are concerned, assuming the imposition of your tax, how much taxes——

Mr. SLIGH. No, sir.

Senator MILLIKIN (continuing). Would people in that bracket be paying, not only directly by virtue of your type of tax, but together with State sales taxes and all other taxes?

Mr. SLIGH. I am sorry, I cannot answer that question. I do not have that detailed information.

Senator MILLIKIN. We ought to have something on that because there is a limit to which you can press those people on taxes.

Mr. SLIGH. We will check that, sir, and see if we can get some information on it.

The following information was subsequently supplied for the record:

NATIONAL ASSOCIATION OF MANUFACTURERS,
New York 20, N. Y., July 20, 1951.

The Honorable WALTER F. GEORGE,
Chairman, Senate Finance Committee,
Senate Office Building, Washington, D. C.

MY DEAR SENATOR: When I testified before your committee on July 5, Senator Millikin asked if we could provide information on the burden, by income brackets, of a manufacturers' uniform excise tax, and also of all present taxes.

Attached is an analysis, prepared by Dr. Rufus S. Tucker, economist for General Motors Corp., and a member of the NAM taxation committee, which provides this information. May I ask that this statement be included in the formal record of the hearings.

Because of Senator Millikin's expressed interest in this subject, I also am taking the liberty of sending a copy of Dr. Tucker's analysis direct to him.

I appreciated the opportunity of appearing before your committee, and especially the extensive consideration which you and the other members present gave to our views.

Sincerely yours,

CHARLES R. SLIGH, Jr.,
Chairman, Taxation Committee.

THE INCIDENCE OF A MANUFACTURERS' EXCISE TAX

By Dr. Rufus S. Tucker

An argument against proposals for a general manufacturers' excise tax is that such a tax would fall with proportionately more weight on consumers with small incomes than on wealthier consumers. This argument is supported by the generalization that poor people spend all of their incomes, or more, while wealthy people spend only a small part of their incomes and save the rest. Even in such a general form the statement is exaggerated, and the statistics commonly cited are unreliable. But aside from that, the generalization is irrelevant since the manufacturers' excise recommended by the National Association of Manufacturers would not fall on all kinds of purchases for consumption, and the kinds that would be affected are in about the same relation to consumers' income in all income classes up to $10,000.

A manufacturers' excise tax could not apply to expenditures for taxes, money gifts, or savings. Neither would it apply to expenditures for rent, insurance,

medical care other than the actual cost of medicine, education, or any form of personal service, or any kind of home-produced goods, such as garden produce, firewood, ice, or home-made clothing (except the cost of materials), or food, clothing, or lodging received as compensation, or gifts of food or clothing or other articles.

The items of expenditure just enumerated constitute altogether a larger proportion of the consumption expenditures of the lower income classes than of the higher. They also add up to a higher proportion of the incomes of the lower income classes. Food is by far the most important part of the expenditure of the poor, and takes a much larger part of their income than in the case of persons with higher incomes. If food (and medicines) are specifically exempted, a manufacturers' excise tax will fall with about equal weight on all income classes up to $10,000. The exact incidence, as a percent of income, cannot be calculated with absolute accuracy. The available information is presented in tables I and II, and the combined effect of existing direct taxes and a hypothetical tax of 10 percent on the sale of all manufactured goods except foods and medicines is presented in table III.

Although there are considerable discrepancies in the figures derived from different sources, the general picture is plain. A manufacturers' excise tax such as is contemplated would in itself be nearly proportional to incomes up to $10,000, perhaps moderately progressive.

The figures shown in table III for the burden of existing taxes are derived from those published by R. A. Musgrave et al. in the National Tax Journal for March 1951. They have been corrected, however, for obvious errors caused by Professor Musgrave's use of inaccurate statistics and false assumptions concerning the importance of wages and the amount of consumption in the lower income brackets, and his disregard of the large amount of nonmoney income received by persons in the lower money income brackets. Estimates have also been added for income classes above $7,500, which were lumped together by Professor Musgrave.

The specific recommendation of the NAM does not include the exemption of medicines. In the various source studies from which the data given in the following tables are drawn, the cost of medicines is included, without segregation, in the total cost of medical care. As noted above, medical care expense, other than medicines, would not be taxable in any case. Hence, in excluding this item it was necessary to exclude also the specific component of medicines. It is believed that this does not seriously affect the relationships shown.

TABLE I.—*Proportion of consumers' incomes affected by a tax on manufacturers' sales (if foods and medicines are exempted)*

ALL CONSUMER UNITS

Income class	Percents of total income affected			
	NRC, 1935-36	BLS, 1941 [1]	BLS, 1941 [2]	BLS, 1942 [1]
Under $1,000	35.5	25.0	27.4	27.3
$1,000 to $1,500	36.0	29.6	29.6	27.3
$1,500 to $2,000	37.9	30.4	32.4	29.9
$2,000 to $2,500	38.5	33.7	34.7	27.1
$2,500 to $3,000	38.7	33.7	34.7	27.1
$3,000 to $4,000	37.4	33.9	36.2	28.2
$4,000 to $5,000	36.3	33.9	36.2	28.2
$5,000 to $10,000	34.6	31.9	36.2	31.5
$10,000 and over	22.9	27.2	28.9	20.9

[1] Classified by money income.
[2] Classified by total income.

Sources: NRC: National Resources Planning Board, Family Expenditures in the United States. BLS: Family Spending and Saving in Wartime, United States Bulletin of Labor Statistics No. 822.

Expenditures for food, medical care, housing and nonautomobile transportation deducted from total consumption; also where possible all items representing income and consumption not involving purchase (i. e., income in kind). Tobacco has also been deducted since the NAM proposal does not affect existing taxes on tobacco. A deduction should also have been made for liquor, but there are no reliable figures.

TABLE II.—*Proportion of consumers' incomes affected by a tax on manufacturers' sales (if foods and medicines are exempted)*

FAMILIES OF TWO OR MORE

Income class	Percents of total income affected		
	NRC, 1935-36	BLS, 1941 [1]	BLS, 1942 [1]
Under $1,000	38.0	28.7	30.0
$1,000 to $1,500	38.0	32.8	29.6
$1,500 to $2,000	39.1	33.2	28.9
$2,000 to $2,500	37.9	37.5	30.2
$2,500 to $3,000	39.4	37.5	30.2
$3,000 to $4,000	38.5	37.9	31.8
$4,000 to $5,000	37.7	37.9	31.8
$5,000 to $10,000	33.9	35.8	35.7
$10,000 and over	23.9	31.3	23.9

[1] Classified by money income.

Sources: NRC: National Resources Planning Board, Family Expenditures in the United States. BLS Family Spending and Saving in Wartime, United States Bulletin of Labor Statistics, No. 822.

Expenditures for food, medical care, housing and nonautomobile transportation deducted from total consumption; also where possible all items representing income and consumption not involving purchase (i. e., income in kind). Tobacco has also been deducted since the NAM proposal does not affect existing taxes on tobacco. A deduction should also have been made for liquor, but there are no reliable figures.

TABLE III.—*Effect of 10-percent manufacturers' excise (as proposed by NAM) on the distribution of the tax burden by income classes*

ALL CONSUMER UNITS

[Taxes as percent of total income]

Money income classes	1948 taxes	Manufacturers' excise	Total
	Percent	*Percent*	*Percent*
$1,000	16.8-18.7	4.6	20.4-22.3
$1,000 to $2,000	20.0-20.8	3.7	23.7-24.5
$2,000 to $3,000	22.6-23.9	3.9	26.5-27.8
$3,000 to $4,000	24.1-25.0	3.7	27.8-28.7
$4,000 to $5,000	25.6-26.3	3.6	29.2-29.9
$5,000 to $7,500	26.2-28.6	3.6	29.8-32.2
$7,500 to $10,000	31.1-32.8	3.6	34.7-36.4
$10,000 to $15,000	34.5-36.5	3.6	38.1-40.1
$15,000 to $20,000	36.5-40.5	3.6	40.1-44.1
$20,000 and over	60.1-61.6	2.4	62.5-64.0

The amount of manufacturers' excise is 10 percent of the expenditures of each income class on the commodities subject to it. The amount of such expenditures has been taken as the highest ratio of such expenditures to the total income of each class reported by the National Resources Planning Board for 1935-36, or the Bureau of Labor Statistics for 1941 or 1942.

Senator MILLIKIN. I think it is important from your own standpoint to show your burden tables on your own type of tax, and there should also be added to that the taxation which those people already pay by way of local sales taxes and transaction taxes, and all of the other State burdens which they meet directly, not to mention indirect taxes.

Mr. SLIGH. I don't know whether the joint staff is working on that or not.

The CHAIRMAN. They have been working on the general problem, yes.

Senator KERR. I wonder if he can provide us with information on that.

The CHAIRMAN. What do you say?

Senator KERR. Would not their studies in that regard enlighten us on that question?

The CHAIRMAN. I do not know whether you are going into it now, Mr. Stam.

Senator KERR. I understand they are.

The CHAIRMAN. We will have that study.

Mr. STAM. We have been working on some material in relation to that question.

The CHAIRMAN. You do to an extent go into it because you say 50 percent of the purchases of the people of the lowest income brackets——

Mr. SLIGH. I think that is a Government study that stated that those in the moderate and low-income groups spend approximately 50 percent or a little more of their income on food, food products, and rent.

The CHAIRMAN. So there would be something less than 50 percent of the income——

Mr. SLIGH. That would be taxed. In fact, we could add to that, because under our tax we do not tax any services, any services except a few, which I will list here in a few moments.

The CHAIRMAN. Yes, sir.

Mr. SLIGH. But there are many that we do not; most of them are not taxed.

Senator MILLIKIN. You anticipate if your tax were imposed that it will not generate a new round of wage rises?

Mr. SLIGH. We do not think it should, and we think it can be controlled in this manner: that, as I said before, the only way we are going to raise this money is to tax everybody in our country. I think we all recognize that. We think that the people should not be allowed to include those in the cost-of-living figures. In other words, we have checked with the people here in Washington, our staff has, and we have been told that it would be possible to exclude any such tax as we are proposing from the cost-of-living data, so that it would not increase the cost-of-living figures upon which are based certain escalator clauses, and so on.

Senator MILLIKIN. Well, you could exclude if from the data, but you could not exclude it as a fact.

Mr. SLIGH. That is correct. It could not be excluded as a fact, and we don't think there is any way to exclude the fact that the bill we are running up must be paid for in one way or another. It is an unpleasant fact.

Senator MILLIKIN. Yes.

Mr. SLIGH. We have got to decide, I think, whether we really want to make our country secure, and if so, we are willing to pay for it, and, of course, not spend any more money than is absolutely necessary in so doing it.

Senator MILLIKIN. One of the end points of our job here is to provide some kind of an equitable—as equitable a tax as is possible.

Mr. SLIGH. That is right.

Senator MILLIKIN. And I suggest merely from the standpoint of your own presentation since we know what the burdens are so far as income taxes are concerned, we ought to know what the burdens would be if your tax were imposed, in addition to the direct taxes of the low-income people which they are already paying.

Mr. SLIGH. It has been our understanding that the joint staff has been working on that problem and will have those figures eventually.

Senator MILLIKIN. Then, of course, it is interesting to some of us as to whether there is a problem of generating another series of wage spirals which will bring you right back to where you were.

Mr. SLIGH. It could be unless it is properly handled, but we do not think it would necessarily have that effect.

Senator MILLIKIN. Has it been properly handled, in your judgment?

Mr. SLIGH. Well, this tax has never been imposed that we are advocating.

Senator MILLIKIN. I am talking about the wage spiral; has that been properly handled?

Mr. SLIGH. Well, you are getting out of my field, sir.

Senator MILLIKIN. I do not blame you for not answering.

Senator TAFT. It would have one direct effect in raising wages because of all of these escalator clauses which now cover millions of employees.

Mr. SLIGH. Those are based upon the cost-of-living index.

Senator TAFT. That is right.

Mr. SLIGH. And we would exclude such tax from the cost-of-living index, and we have been told that is feasible.

Senator TAFT. It is not feasible under those contracts, I do not think.

Mr. SLIGH. Well, that should be handled——

Senator MILLIKIN. Assuming it is feasible, you cannot hold this thing by a statistical basis. From our standpoint, one of the considerations we will have to concern ourselves with is where do we leave this low-bracket citizen after he pays all the taxes that he pays, including the one which you are imposing, and it will not answer our problem to say that by statistical hocus-pocus he is as well off as he was before.

Senator TAFT. You see, Mr. Johnston has now approved the escalator contracts. Those contracts cover the cost of living. Into that cost of living goes all results from excise taxes and everything else, except direct taxes. Income taxes do not go into it. But I don't think now they can back up on these excises—I pointed out from the beginning that Mr. Johnston ought not to have approved the contracts as is; he ought to have said, "Yes, but excluding from that increase anything brought about by an increase in excise taxes or sales taxes," but he did not do it, and I don't think he is ever going to get the Board now to reverse itself.

Mr. SLIGH. I would think that would be within the authority of the Congress to make such——

Senator TAFT. I think it is in Mr. Johnston's authority, but I don't think he will do it. He has not done it.

Senator WILLIAMS. In excluding the cost-of-living items, would you propose to exclude building materials for home construction, apartment houses?

Mr. SLIGH. No, sir.

Senator WILLIAMS. If you did not exclude those items from the tax, how could you say that rent would be excluded, because those items go to make that up.

Mr. SLIGH. There are some of it, perhaps, which would be found in rent, although under rent control, perhaps not as much as should would be found in rent.

Senator WILLIAMS. It would be carried through in rent if you allowed the cost increases, though, would it not?

Mr. SLIGH. To some degree; yes, sir.

Senator WILLIAMS. To be carried through.

Senator TAFT. You have got a tremendous tapping of rent already, because a large part of these local and State taxes, which are substantial, fall on rent and fall on sales, too, so far as that is concerned, so that these low-income people already pay a fair proportion of local taxes.

Senator WILLIAMS. What I was pointing out is you cannot strictly say that you could exclude the cost-of-living items, that is food or rent, because the same thing would be true, to a large extent, on food items indirectly, as Senator Millikin pointed out, even though you excluded them specifically; they would indirectly follow through.

Mr. SLIGH. To a small degree, but it certainly would be very much less than it would if it was taxed directly under the consumption tax.

The CHAIRMAN. All right.

Mr. SLIGH. I mean all these taxes have to be borne.

The CHAIRMAN. Suppose you proceed until you come to something else bearing on this.

Mr. SLIGH. First, the present degree of concentration on income taxes is too great. Together, these taxes now account for some 85 percent of total Federal tax revenues. In our judgment this is not sound fiscal policy.

Second, consumption taxes are relatively stable in yield. They are stable in yield while taxes on income are by comparison unstable.

There was a drop of $6.3 billion in corporation profits from 1948 to 1949. This shows up in the 1950 tax collections, which were down by $2.1 from those of the preceding year. The variation of individual income tax receipts is not comparable because of the changes made in the Revenue Act of 1948. It is significant, however, that the miscellaneous internal revenue, consisting principally of the excises, showed no effect of the business recession.

Senator TAFT. Is that so; none at all?

Mr. SLIGH. Practically none, I believe, sir.

Under a broadly based consumption tax, since the present Federal excise system is selective without logic, discriminatory without reason, and provocative of widespread industry friction and consumer complaints, it is our recommendation that there be substituted for it a broad excise or consumption tax applicable to all end products of manufacture except foods and food products.

In this recommendation we would exclude the taxes on tobacco and alcoholic beverages which should continue to be dealt with separately. We oppose any further increase of these taxes, however, on the ground that the rates are still at the highest levels imposed during World War II. These commodities are also subject to substantial taxes by the States. There is no good case, in our judgment, for imposing a still heavier tax burden on the consumers of these products while the excise system as a whole remains in its existing uncoordinated, discriminatory condition.

Having concluded that the present system of limited, selective, discriminatory excises is an inadequate, even improper, fiscal implement, our next task was to decide upon the form of general excise to be recommended. The choice obviously lies between a Federal retail sales tax and a tax at the final point of manufacture.

I can assure you that our numerous committee discussions of this matter were long and vigorous. There was full recognition of the desirable features of a Federal retail sales tax.

Our conclusion to recommend a general manufacturers' excise was reached only after a thorough exploration of all of the arguments for and against both the retail type and the manufacturers' excise type. I mention this to show you that our action has not been hasty, arbitrary, or lacking in due consideration of all sides of the problem.

In confining our recommendation last year to the end products of manufacture, our intention was that the taxes on the special services (telephone, telegraph, cable; leased wires; local telephone; transportation of persons; and admissions) should be repealed outright. This remains our long-range objective, but, as part of the special emergency financing, we believe these services should be subject to the same uniform tax as manufactured goods.

A manufacturers' uniform excise: Our reasons for deciding to recommend a manufacturers' uniform excise may be summarized as follows:

1. Federal-State tax duplication: A manufacturers' excise is well adapted to use at the Federal level, but not at the State level. A retail sales tax may be used effectively at either level. However, retail taxes are now levied in 29 States, as shown on the accompanying map. The shading on the map indicates the portion of State revenue derived from this tax. In the interest of avoiding duplication of tax methods whenever possible, we believe the soundest procedure would be for the Federal Government to use a manufacturers' tax, leaving the retail tax field to the States.

2. Administration: Administration of the tax would be more simple, assured, and inexpensive at the final point of manufacture than at the retail level. The number of final manufacturers, exclusive of food products manufacturers, is considerably less than 300,000. On the other hand, there are more than 3,000,000 retail outlets in the United States, ranging from large department stores to small shops and "hole in the wall" operators. The birth and death rates of retail establishments are both high. In many cases their business records are rudimentary, making difficult the audit and collection of tax withheld.

3. Familiarity of procedure: The manufacturers' excise is not a new Federal tax. Under existing law more than 20 classes of goods have been thus taxed, and extensions of this form have been proposed both by the Treasury and by the Ways and Means Committee in H. R. 4473. Bureau procedure is well established and a certain segment of the business community is already familiar with the rules and regulations.

4. Permanence in the Federal tax structure: We have stated above our reasons for permanent, long-range Federal dependence upon the excises for a substantial contribution to the Federal revenues. There is much better prospect of achieving this long-range objective by holding the Federal excise at the point of final manufacture.

I now conclude with a general summary of our proposals.

1. Tax legislation now should aim at covering the anticipated maximum of defense spending. In no other way can we assure pay as we go.

2. Move toward correction of the present excessive use of the income taxes by introduction of a broad consumption tax, levied at the manufacturers' level.

3. Hold increases of the individual income tax to a moderate level, and use a method which will not intensify the present rate progression.

4. Hold the corporation taxes at approximately the same level.

Senator MILLIKIN. How much money would you collect from the proposed tax?

Mr. SLIGH. We believe, sir, that generally speaking the excise taxes should produce approximately the same amount as produced by the individual income taxes. In other words, for instance, take Canada. It is my understanding that about 45 percent of their total Federal revenues are produced through excise taxes. At the present time I believe we are producing about 14 percent of our total Federal revenues through excise taxes.

Senator MILLIKIN. Your proposal is that we collect as much through your method as we do through personal income tax?

Mr. SLIGH. We think the amount should approach the amount produced by income taxes.

Senator MILLIKIN. How much would that figure expand as it reaches the ultimate purchaser?

Mr. SLIGH. We do not believe that this figure will be expanded to any appreciable extent. It is very different from a transaction tax, which might be pyramided as it went on up through the processes and which would favor very materially the highly integrated corporation. The manufacturers' uniform excise tax is applied only once, and that is at the end of the manufacturing process, before it moves on to the retailer, or the wholesaler.

Senator MILLIKIN. It is an item of cost?

Mr. SLIGH. It is. But we feel that the retailers of this country are a pretty smart group of people and that they recognize that they cannot be paid a full mark-up for collecting a tax. Their function in our economy is to distribute goods. And for that, they are paid. They naturally would have to take something in to pay them for the handling of that tax money and the carrying of it in inventory, and so on. And we believe they should have that, say, 1 percent. or something like, 1 or 2 percent, or something like that.

Senator MILLIKIN. This leaves the end manufacturer and it moves to the wholesaler, let us say.

Mr. SLIGH. Yes.

Senator MILLIKIN. The wholesaler has to pay a lump sum for it, does he not?

Mr. SLIGH. That is correct, sir.

Senator MILLIKIN. There is not any separate tax item there. He pays a lump sum.

Mr. SLIGH. No, sir.

Senator MILLIKIN. Why is that not subject to his customary mark-up?

Mr. SLIGH. As I say, I think competition will very soon point out the fallacy of that thinking. In other words, this is a uniform tax. Even in the case of the present discriminatory system, as far as I know, it is not pointed out as a problem.

Senator MILLIKIN. Yes. But this gentleman has to go to the bank to borrow money to pay for that tax just as he goes to the bank to borrow money to pay for the steel, we will say.

Mr. SLIGH. Yes. And we feel that he is entitled to whatever it costs him to carry that amount of money. But that would not be his normal mark-up on the tax.

Senator MILLIKIN. In view of the fact that he has to pay for his tax item the same as he pays for the rest of his goods, why should he not apply his conventional mark-up? It seems to me that you are going through a mental process of separation that does not occur to the citizen who is borrowing the money to carry these inventories, and it would not occur to the banker, either.

Mr. SLIGH. As I say, I think that the retailer is a pretty smart individual. I deal with them frequently, and I have always found them to be very intelligent.

Now, it seems to me that it will not be very long before a retailer, for instance, will realize that he is not entitled to a full 50- or 100-percent mark-up, or whatever it might be, on the tax. The tax itself does not take up any floor space in his establishment, and therefore it does not have to carry the overhead certainly that the item itself carries.

Now, he is entitled to whatever the financial carrying charge of that amount would be.

Senator MILLIKIN. Yes.

Mr. SLIGH. And we think he should be compensated for that. But it might be 1 or 2 percent of the tax.

Senator MILLIKIN. Do you think he should go through the same process of reasoning as to all of the items of cost in the goods that he receives? Some should carry one mark-up; some should carry another? Should he start in to analyze the proper mark-up on every item of the preceding man's cost and say, "Brother, you are charging too much here. You will have to set this down"?

Mr. SLIGH. Let me point out——

Senator MILLIKIN. I am suggesting to you that he will carry the mark-up.

Mr. SLIGH. I do not believe that it will.

Senator MILLIKIN. You are suggesting that, by some process of reasoning, the retailer will separate this particular item while not separating others and insist upon the reduction of price equivalent to the mark-up, making allowance for a financial carrying charge?

Mr. SLIGH. I think it will be handled by the competitive system, which has made this country great. I think that is what will determine it finally.

Senator MILLIKIN. Has not the competitive system of this country been made great on the mark-up?

Mr. SLIGH. Surely, but not on the mark-up of taxes.

Senator MILLIKIN. Is that not your profit system?

Mr. SLIGH. Not on the mark-up of taxes.

Senator MILLIKIN. I suggest to you that the mark-up applies to every item of cost. It may not apply in the same degree, and perhaps should not apply in the same degree. But if you have to go to the bank and borrow money, the cost of that tax is as much a part of your investment outlay to carry on your business as any other cost.

Mr. SLIGH. Absolutely. The only difference of opinion we have is this: We say that the man is entitled to the cost of carrying that additional inventory, moneywise. But I am in the furniture business——

Senator MILLIKIN. Yes.

Mr. SLIGH. Now, if I sell a piece of furniture that we will say, for the sake of argument, amounts to $100, that furniture takes up a given amount of space, and that space on the floor of the retailer must be met in his overhead charges.

Senator MILLIKIN. Yes.

Mr. SLIGH. The handling of that item must be met in overhead charges. The moving of it from the factory to the place of business, the getting it up on the floor, the cleaning of it, the getting it ready for shipment, the delivering of it to the customer, all are overhead charges.

Now, the addition of a $10 tax to that piece need not carry the same degree of mark-up as did the piece of furniture itself, which required all this handling and overhead work. But the dollar mark-up of tax should carry enough to make it not unprofitable for the retailer to have paid the tax.

In other words, if he has to borrow the extra $10, he should be allowed to retrieve the interest paid on the $10.

Senator MILLIKIN. There is one little piece of furniture that you have not mentioned that is very important, and it does not take up much space. That is the cash register. Do not forget the cash register.

Mr. SLIGH. I try not to forget that, sir, ever.

Senator MILLIKIN. Now, the retailer goes back to his jobber and he says, "Mr. Jobber, there is a big run-up in taxes in here. It is too much. It exceeds the normal carrying charge for money. This does not take up much room on your floor. You are not building big warehouses to take care of this money at all. Now, you are going to have to lop that off, to a reasonable carrying charge."

"O. K.," the jobber says, "I will lop it off."

Now he goes back to his wholesaler and says, "Gee, Brother, I have had to lop off this tax. So you have to lop off mine."

All right. The wholesaler goes back to the manufacturer, and he says, "Brother, you have to lop off the tax."

So you have no tax—except on the manufacturer.

Mr. SLIGH. Of course, the manufacturer has to pay the tax, because that is the law. But I think where we have forgotten somebody here, perhaps, in the American housewife, and she is the one that is going pretty much to decide on how much she is willing to pay. And I doubt whether she is going to be willing to pay a 50-percent or 100-percent or one-third mark-up on the tax. She will be willing to pay for the work done in getting the merchandise to her, and that is what she is paying that retailer for.

Senator MILLIKIN. Now, let me ask you this. You would not take the same position that this will not pass on up and compound except for a reasonable money carrying charge? You would not take that position would you?

Mr. SLIGH. Yes; that is exactly the position that I am taking, sir. Now, I might point out that the Treasury has proposed a $3 billion increase in excises. Would you believe that the Treasury is now expecting, then, that the American housewife will pay a mark-up, say, of 33⅓ percent on that? Do you think that the Treasury in proposing a $3 billion excise tax increase is expecting the American housewife to pay $1 billion more for the product?

Senator MILLIKIN. I do not know what the Treasury expects, but since the Treasury is dealing with the end figures of the end distributor,

to wit, the merchant, it is well aware of the fact of what his write-up is, and it is well aware of the fact of what enters into the write-up. I do not think that the Treasury has any magic to say, "Brother, you should not carry your normal mark-up on this."

Mr. SLIGH. Then under that assumption, the Treasury's proposal for a $3 billion increase in excises at the present time really is asking the American housewife to pay $4 billion.

Senator MILLIKIN. It may well be doing that; yes. Yes; I think that these other excise taxes that take place at the manufacturers' level will move up. I do not think there is any question about it. We have had all this experience you referred to. Show me illustrations where they have made an abatement in their charge because of the write-up on the tax item.

Mr. SLIGH. I do not think that it comes about by any notation on the invoice that we are allowing a discount because of the tax charged. But I point out that there are now over 20 items that are taxed under the manufacturers' excise tax.

Senator MILLIKIN. You have a field there of lots of experience to demonstrate that this tax is not passed on. Now, why don't you do it?

Mr. SLIGH. I have never heard a complaint that it is passed on in any of those items.

Senator WILLIAMS. Is it passed on in automobiles?

Mr. SLIGH. It seems to me that very shortly after the excise tax was put on television sets, the price of television sets dropped.

Senator MILLIKIN. Let me suggest to you that the burden of proof of making this argument is on you. Now, you have had all this experience in a manufacturers' excise tax. Why don't you show us that it has——

Mr. SLIGH. I just mentioned one item.

Senator MILLIKIN. What was that?

Mr. SLIGH. Television sets.

Senator MILLIKIN. What was that?

Mr. SLIGH. I said that after the excise tax was placed on television sets, the price on television sets dropped.

Senator MILLIKIN. Because the warehouses were full and bulging with them.

Mr. SLIGH. Competition.

Senator MILLIKIN. Because the warehouses are full.

Mr. SLIGH. That is right.

Senator MILLIKIN. Which not only overrides the write-up for taxes, but every other write-up, if you have to clear your inventories so that you can go down and talk to the president of the bank about a renewal of your loan.

Mr. SLIGH. In other words, competition is the governing factor.

Senator MILLIKIN. I would not disagree with that.

Mr. SLIGH. And not the amount of tax.

Senator MILLIKIN. The tax item is subject to competition the same as everything else, but there is no differentiation. That is the point I am making.

The CHAIRMAN. Mr. Sligh, let me ask you, did you suggest the rate of this tax?

Senator TAFT. It would be 10 percent.

Mr. SLIGH. No. That was an example that I was just giving for ease of illustration.

The CHAIRMAN. I thought you said you aimed to get as much out of this general manufacturers' sales tax as is now paid by the individual income tax.

Mr. SLIGH. That is correct, approximately that.

The CHAIRMAN. Did you figure the rate? Did you estimate the rate?

Mr. SLIGH. I think that the point is this. As I say, if it is up to the Legislature, really, as to how much we are going to spend. And it is also up to them as to how much we are going to tax.

The CHAIRMAN. I understand that. But I want to see what rate you would suggest that would be necessary to get approximately the same amount as is now realized from the individual income tax.

Mr. SLIGH. We feel that, according to our studies, one percentage point of excise tax at the manufacturers' level would bring in approximately $900 million.

The CHAIRMAN. One percentage point?

Mr. SLIGH. Yes. So that it just depends on how much money you are going to require.

Senator MILLIKIN. It would not be less than $10 billion under any bill, would it?

Mr. SLIGH. Let me put it this way——

Senator MILLIKIN. So you have an 11 or 12 percent tax at the manufacturers' level?

Mr. SLIGH. That is right.

Senator MILLIKIN. That would be under any figures which you want to play with?

Mr. SLIGH. That is right.

Senator TAFT. You will have to have more than 10 percent if you are not going to lose a lot under existing excises, are you not?

Mr. SLIGH. Remember that our uniform manufacturers' taxes do not cover liquor and tobacco, which are bringing in about $4 billion.

Senator TAFT. But outside of that, you are getting about $3 billion and what?

Mr. SLIGH. $3,500,000,000.

Senator TAFT. $3,500,000,000 from other taxes, and most of them are 10 percent and some 20 percent. You are going to lose something if you reduce your 20 percent to 10 percent.

Mr. SLIGH. That is right.

Senator TAFT. I have been in favor of extending excise taxes on the uniform 10 percent rate, but when yo uget through, how much more money are you going to get at 10 percent, say?

Mr. SLIGH. Well, 10 percent would bring you what? About $9 billion.

Senator TAFT. And we are now getting $3 billion out of the same thing; is that right?

Mr. SLIGH. Yes.

Senator TAFT. So you would be getting $6 billion net, leaving out liquor and tobacco?

Mr. SLIGH. Yes.

Senator KERR. What does that include that would not be covered by the excise tax?

Mr. SLIGH. I would like to ask Dr. Lutz if he would give you the answer.

Senator KERR. I would like for the record to disclose this.

Your estimate is $90 billion; that is your estimate, is it not?

Mr. LUTZ. That is right.

Senator TAFT. $9 billion.

Mr. LUTZ. Senator, the gentleman's question referred to the tax base.

Senator KERR. If you had 10 percent to get $9 billion, that means you would have to have a taxable amount of $90 billion; is that not right?

Mr. LUTZ. Yes.

Senator TAFT. Do you think that retail prices are at about twice the manufacturers' level, taking everything together? I suppose there is more than that on retail stuff.

Mr. LUTZ. I would not think that is true, Senator. It varies so greatly with different classes of goods.

Senator TAFT. Yes; that is true. But would there be an average of some sort?

Mr. LUTZ. I would not think it would be more than 50 percent on the general average.

The CHAIRMAN. Mr. Sligh, let me ask you just one more question to understand your proposal. You apply this to manufacturers only. Would that include the jeweler who merely takes the parts and puts them together and makes something? Would he be a manufacturer, or would he not?.

Mr. SLIGH. Yes; if he makes a finished product.

The CHAIRMAN. If he made a new product?

Mr. SLIGH. Yes.

The CHAIRMAN. Then he would become a manufacturer?

Mr. SLIGH. I want to be sure I understand your question correctly. You are not talking of the retail jeweler that repairs a watch, or something of that kind?

The CHAIRMAN. I am not speaking of repairing. I am speaking of anyone who takes parts, puts them together, fabricates them, and brings out a new product.

Mr. SLIGH. Yes.

The CHAIRMAN. You would treat him as a manufacturer; that is the point?

Mr. SLIGH. For instance, in the furniture business, again, many people buy their panel stock, or they may buy dimension stock, and they assemble those parts and finish them and deliver them to the retailer. At the point at which that was delivered to the retailer, the manufacturer would pay the excise tax. The manufacturer of the panel stock would not pay the excise tax.

The CHAIRMAN. I just wanted to find the theory on which you were proceeding. I think you would find that you would have to levy a pretty high manufacturers' tax if you were to get the same amount of money that is now paid by the individual income taxpayers. If you get only the amount of excise taxes, excluding liquor and cigarettes, you would have to have a sizable tax, if you were taking out food and food products.

Mr. SLIGH. It would be a sizable tax, there is no doubt about that.

The CHAIRMAN. I thought maybe you had computed it.

Mr. SLIGH. For instance, 15½ percent tax would bring in about $15,029,000,000.

The CHAIRMAN. Fifteen and one-half percent?

Mr. SLIGH. Yes.

The CHAIRMAN. Yes. That is what I was trying to see.

Mr. SLIGH. And a 19-percent tax would bring in about $19,411,000,-000. Now, it depends, again, as to where this spending is going and how much we have to tax to cover it. But we feel it should be covered. We are not in favor of unnecessary spending. I would like to leave that thought with you.

The CHAIRMAN. We realize that. But at the same time, this committee does not control that. It has a very small voice in saying how much the spending is to be, actually.

Mr. SLIGH. Yes.

The CHAIRMAN. That goes to another committee, which is larger than ours, and committees stick together more or less in the Senate and in the House, as you know.

Are there further questions?

Senator MILLIKIN. I would like to ask the gentleman, in your own business, in particular, what is the mark-up in the furniture business between the manufacturers and the retail, on an average?

Mr. SLIGH. The average mark-up would run from 80 to 100 percent, on cost.

The CHAIRMAN. You have a slow turn-over?

Mr. SLIGH. Very slow.

The CHAIRMAN. Are there any further questions?

Senator TAFT. Mr. Sligh, relating to this question of passing on, and dealing now with the general taxing and without this price-control business, do you not think that the ordinary retailer and wholesaler is determined to keep his mark-up, and add that on whether the taxes are in there or not? Now, there may be some industries where that is not so. But take your ordinary department store, in all soft goods, are not those things going to be passed on?

Incidentally, we had an amendment over here on the floor in this defense-production bill the other night sponsored by the retail federation, saying that they could not reduce the percentage of mark-up below what it was customarily. I voted against it. It was beaten. But certainly it was not beaten because the retailers contemplated that they were going to charge less. They did not say anything about excluding excise taxes, either.

I think there is something to be said when you have price control that you might put in regulations that would say you cannot include in the mark-up certain taxes. By the time it gets to the retailer, he may not even know what those taxes amount to, unless it is passed on in an information slip of some sort.

Mr. SLIGH. Could I point out that with a manufacturers' uniform tax, I doubt whether that would be true, because every retailer would know that on any end product he purchased, there was a certain percentage of tax. It would be universal. He would not have to wonder whether that electric-light bulb——

Senator TAFT. I do not think he would bother to figure what the percentage of his total cost is in the tax and add that in. I think that is contrary to human nature. Take every general store, take every little storekeeper, and there are nearly 1 million of them in the United States. They have pursued a historical mark-up, and they are going to mark that up whether the taxes are in it or not, unless by law or by price control you say they cannot do it.

Mr. SLIGH. Or unless Gimbel's decides not to do it and Macy's is trying to do it.

Senator TAFT. That might be so there, but it will not be so out through the 1 million small retailers and everybody else. They will pass the thing on. They recognize among themselves that a certain mark-up is fair. We had an awful fight in the World War because the administration tried to say to the automobile dealers, I remember, "Here. the price of automobiles has gone up a certain amount. Your cost of doing business we do not think is any more. You cannot take that same percentage."

There was an awful fight in the Congress here about it. The automobile dealers fought bitterly for the right to charge the same mark-up even though prices had gone up and perhaps their costs had not gone up. They fought that idea bitterly.

I do not think that you can assume that they are going to give up historical mark-up rates and try to figure out that they should not apply to the tax.

Mr. SLIGH. I think that they will not give up historical mark-up rates on goods they purchase and the labor and materials, and so on, that have gone into these goods, but I do think if a uniform manufacturers' excise tax is passed, which is easily recognizable as a flat percentage—it does not vary, it is 10 percent, 15 percent, or 20 percent, whatever it might be, on anything they buy—that competition will eventually drive them to change their historic mark-up so that they do not cover any more by their mark-up than the actual cost of the additional money, the carrying of that inventory.

Senator TAFT. I think you are optimistic about that.

Mr. SLIGH. I have seen the mark-up change in the furniture business over the years due to a new type of competition that has come into that business. The wayside store has forced a change in the historic mark-up. And I see no reason why another change in mark-up cannot be made if it is sound.

Senator TAFT. You referred to Macy's. But no other department stores in the country outside of New York have anything to say about that at all. They are practically all getting back to the same old rate.

Senator MILLIKIN. If these intermediate people are going to bargain it out, it leaves it only one place to pay it, and that is the manufacturer.

Mr. SLIGH. That could be. The manufacturer could be forced to carry some of it.

Senator MILLIKIN. If we put a tax of that magnitude on the manufacturers without any permission to pass it on, that would be true.

Mr. SLIGH. Yes; I agree with you. We do not say that the dealer should not pass the tax on. Remember that, please. We say that the dealer should and will pass the tax on. We merely say that he will not add another 90 percent or another 100 percent to that tax. That is all we are saying, not that he will not pass the tax on.

Senator MILLIKIN. He has to go and borrow the money for that the same as everything else.

Mr. SLIGH. And he will have to get the carrying charges for that back.

Senator MILLIKIN. And he will get that in his mark-up, because otherwise he cannot stay in business.

Mr. SLIGH. That is right.

Senator MILLIKIN. He uses his credit and takes risks when he goes to borrow money to pay the tax, just like everything else.

Mr. SLIGH. But, Senator, how much additional floor space does the tax take?

Senator MILLIKIN. There are lots of goods, I suppose, that take a mark-up that do not take up floor space.

Mr. SLIGH. Yes; some. But even nylon hose take up some space.

Senator MILLIKIN. That is what I talked to you about a while ago. When you give the retailer the option, competitively, if you wish, to say, "Now, this part of our end product takes up so much floor space as against this part, and so on and so forth," you cannot run a business that way. You know that.

Mr. SLIGH. I know that. But the mark-up is very different in a department store on different items because of different floor space and different turn-overs, and they have hundreds of items.

Senator MILLIKIN. Taking the suggestion Senator Taft made a little while ago, this preserving of the mark-up, the mark-up is not an inviolable thing, even to the merchant.

Mr. SLIGH. Correct.

Senator MILLIKIN. When he runs a clearance sale, if it is an honest clearance sale, he may do away with the mark-up entirely. He may go below his actual cost.

Mr. SLIGH. That is right.

Senator MILLIKIN. If his urgencies are sufficient. He may sell an item of jewelry with a 100-percent mark-up in a low-price bracket, whereas if he gets up into something that cost him thousands of dollars he may substantially alter that in order to be fair with the customer, and to meet competition.

Mr. SLIGH. I agree with you.

Senator MILLIKIN. So there is nothing inviolable about the mark-up. But the fellow who stays in business is the fellow who gets a mark-up that will permit him to do so, and he has to take account of the money even though it does not take up much floor space.

Mr. SLIGH. He has to take account of the money to the extent that that money costs him something.

Senator MILLIKIN. That is right.

Mr. SLIGH. But no more than that.

Senator MILLIKIN. That is right.

The CHAIRMAN. Thank you very much, Mr. Sligh.

Senator TAFT. Mr. Sligh, I want to go into one other thing, to get these figures clear. You said something about this tax covering how much percentage of the total? What is that 45 percent?

Mr. SLIGH. I said that the excise tax, as I understand it, in Canada brings in approximately—is that what you meant?

Senator TAFT. Yes.

Mr. SLIGH (continuing). Forty-five percent of their total Federal revenues.

Mr. LUTZ. That is all indirect taxes, and not just the manufacturers' sales tax.

Mr. SLIGH. All their indirect taxes, aside from income, corporate and individual.

Senator TAFT. You would have to have an awfully high rate to do anything like that here.

Mr. SLIGH. Yes. We are not asking that, Senator.

Senator TAFT. You figure with a 10-percent general tax, I notice here that the estimate for excise taxes this year is $8,200,000,000, of which how much is liquor?

Mr. SLIGH. $4 billion is liquor and tobacco, approximately.

Senator TAFT. So you have about $4 billion. And this would produce $9 billion. So you have an increase of $5 billion. The House has given an increase of $1,200,000,000, mostly, I guess, in liquor and tobacco.

If you did it at 20 percent, you would get all together $14 billion as against $47 billion of income taxes under present laws.

Mr. SLIGH. Twenty percent would bring in $18 billion.

Senator TAFT. So you are pretty far from any 45 percent, are you not?

Mr. SLIGH. Twenty percent would bring in——

Senator TAFT. $18 billion; $14 billion net.

Mr. SLIGH. Yes.

Senator TAFT. And $18 billion all together. Your income taxes are $46 billion, or so. So you are still a long way from the Canadian level.

Mr. SLIGH. I am not advocating that we go to the Canadian level. I just say that they get considerably more and that we historically, as I understand it, got a great deal more money from excises in the past, but we have been cutting it down gradually until it is now at the lowest point it has ever been, I believe.

The CHAIRMAN. We have raised the other taxes.

Mr. SLIGH. That is correct: We have an imbalance. Our thinking is that we now have, through that process, come to a place where we have an imbalance in the tax structure.

Senator TAFT. There is one other thing. You said that the NAM was on this thing, but when it came to expenditures, it was up to the courage of Congress; Congress lacked the courage to reduce expenditures.

I just wanted to suggest that as far as I know, the NAM has talked a lot about reducing nondefense expenditures, but in every single recommendation they have not suggested that any single thing for this military program is too big. They have not questioned it. They have not questioned anything as to whether we should be in Europe or whether we should be in all parts of the world. That is the thing that takes courage today, not to dodge defense expenditures.

I suggest that what takes courage today is to cut this $70 billion defense program. And as far as I know, the NAM has no more courage than Congress, or has not shown any up to date, in that respect.

Mr. SLIGH. Sir, I would disagree with you, in that we have advocated—and I did so here at the beginning of my statement—urging the most painstaking scrutiny of military and foreign-aid spending requests. That is just one of the times we have mentioned it. We have not gone into the detail that we have on civilian spending, because we have not had available to us the information that would make it possible for us to give detailed information or suggestions.

Senator TAFT. What I want to suggest is, if Congress is going to have the courage to do it, it takes the courage of public opinion behind it to do it, also.

Mr. SLIGH. That is right. And I would say that we want no unnecessary foreign aid or military spending. But it is pretty hard for us—in fact, it has been impossible for us—to get detailed information on just where they are going to spend it and how they are going to

spend it. Until we have that information, we cannot very well make constructive suggestions as to how it can be cut.

Senator MILLIKIN. Barring waste, assuming no waste, which is a very big assumption, we cannot cut the military less than the minimum required to protect this country, can we?

Mr. SLIGH. To secure this country against attack, certainly.

Senator MILLIKIN. That is a must. And that overrides everything else, does it not?

Mr. SLIGH. I would say to that extent; yes.

Senator TAFT. I do not think it overrides the destruction of the country at home by spending too much on defense. We have had recommendations of $150 billion a year for the expansion of our defenses.

Senator MILLIKIN. You have to determine what is a proper amount of military expenditure.

Senator TAFT. That is right.

Senator MILLIKIN. I think it would take the highest type of foolish courage to advocate spending less than that.

Senator TAFT. But up to date, the tendency has been just to accept whatever has been recommended as necessary. And as far as I know, the proposed expenditure of some $65 billion a year in fiscal year 1953 for military, foreign aid, and all the rest of the purposes, has not been subjected to any critical scrutiny by the NAM or by anybody else.

Mr. SLIGH. The NAM has not done so because of the lack of information. It just did not have the information. We have had the information on the tax proposals, and so on, and we have done our best to do something about it, and also in connection with civilian expenditures, we have had information, and we have prepared a pamphlet which is entitled, "Cut Government Spending Now," in which we point out the possibility of a $4,600,000,000 cut, and we itemize those cuts.

The CHAIRMAN. We thank you very much, Mr. Sligh.

Senator WILLIAMS. Mr. Chairman, I would like to ask just one question before Mr. Sligh leaves.

Relative to your theory that these excise taxes would not be carried over in marginal mark-ups, we already have today a 7 percent, I think it is, excise tax on automobiles.

Mr. SLIGH. Yes.

Senator WILLIAMS. And the automobile industry are members of your organization.

Mr. SLIGH. Yes.

Senator WILLIAMS. So how did they carry that over? They project a retail price for their dealers. It is a proposed retail price. Now, is this 7 percent carried over to the dealers without a mark-up, or is it carried over with a mark-up on their own recommendations?

Mr. SLIGH. I am not in the automobile manufacturing industry, and I cannot honestly answer that, Senator. I do not know. But I doubt very much whether it is carried over in the mark-up. I doubt that very much.

Senator TAFT. I agree. In the automobile business, I do not think they figure their mark-up on the tax.

Mr. SLIGH. I do not think they do.

Senator TAFT. That is carried on into the retail bill. But there, there is only one dealer, and he is practically a manufacturer's representative. So in a way, there is none of this in-between stuff, which exists in most things. In automobiles I do not think they figure the mark-up on their tax.

Mr. SLIGH. I would doubt it very, very much.

Senator WILLIAMS. How does it work in Canada?

Mr. SLIGH. Dr. Lutz could probably tell you in more detail. But we understand they have no problem whatever with that in Canada, have they, Doctor, with the pyramiding of the excise tax?

Mr. LUTZ. Not so far as any information that I have been able to get from officials and representatives of the Canadian Manufacturers' Association. Of course, they do not like the tax. They do not like any tax.

Mr. SLIGH. Neither do we, I might add.

Mr. LUTZ. But they have had it for 30 years, and whenever they begin to consider what other tax they would prefer as a substitute, they find that they are better off where they are than with any new tax that anybody could think of.

Senator MILLIKIN. Mr. Sligh, to refresh your recollection—I may be a little bit off on this, but I believe I am right—several years ago Congressman Gearhart, of California, proposed a tax at the manufacturers' level, and he proposed that in all statements from the manufacturer to the subsequent purchasers of the goods, there be an item included, "This amount covers the manufacturers' excise tax of blank percent or blank dollars."

The NAM appeared and said, "No, you must not do that; because that is a disclosure of a vital competitive factor."

Mr. SLIGH. Yes; I think it is. And we would not advocate that be done.

The CHAIRMAN. Thank you very much, Mr. Sligh.

Mr. SLIGH. Thank you, sir.

(The prepared statement submitted by Mr. Sligh reads, in full, as follows:)

STATEMENT OF CHARLES R. SLIGH, JR., CHAIRMAN, TAXATION COMMITTEE, NATIONAL ASSOCIATION OF MANUFACTURERS

My name is Charles R. Sligh, Jr. I am a furniture manufacturer and president of the Charles R. Sligh Co., Holland, Mich. I am chairman of the taxation committee of the National Association of Manufacturers, and appear here on behalf of the association.

The taxation committee is made up of 204 businessmen. Its studies and reports are passed upon by a board of directors numbering 160 businessmen. Through its committees on taxation and on Government spending, the association has consistently proposed measures to put the Government on a sound financial basis. It has consistently advocated a balanced budget and has recommended a pay-as-we-go tax program for the present defense emergency. But, it is as seriously concerned with the spending of the taxpayers' dollars, as it is with the collection of those dollars. It has published many reports calling for the elimination of wasteful and unnecessary Government spending.

This year, we have distributed a report of the Government spending committee showing in detail how a minimum of $4.6 billion can be cut out of the $11.6 billion of civilian expenditures recommended by the President for fiscal year 1952, and urging the most painstaking scrutiny of military and foreign aid spending requests.

The tax bill before this committee, H. R. 4473, is, in our judgment unsound because:

1. The bill does not provide enough revenue on the basis of official estimates to assure pay-as-we-go during the military emergency and hence does not safe-

guard against further inflation. Tax insurance against inflation at this time requires more than provision for the budget requirements of the current fiscal year. It should aim now at covering the anticipated spending at the peak of the rearmament program.

2. The bill fails to provide for a broad consumption tax which should be used not only to supply the bulk of the additional revenue required, but also to correct the existing selective and discriminatory excises.

3. Finally, the bill compounds the economic destructiveness of present law by a further concentration of the tax load on savings, investment, and production.

In our view the shortcomings of H. R. 4473 can be adequately weighed only against a background of the long-range objectives of sound tax policy.

The vital fiscal problem before the Congress is keeping the Federal budget in balance. The principal private sources of inflation are now well under control by the Federal Reserve Board and the member banks. The wave of "scare" buying which began after Korea has subsided, and there is no early prospect of a resumption barring a renewal of the psychological influences which were then chiefly responsible. From this point on, while these favorable factors continue, the chief danger of further inflation lies in the field of fiscal policy. If government spends more than it take in, whether for necessary or wasteful purposes, it will create the additional purchasing power that is the basis of inflation. In order to prevent deficit financing and a further increase of the public debt, broad-gage plans for adequate taxation must be made now.

In urging the development of an adequate tax program, I emphasize that the continuing stress which has been given to the reduction of nonessential spending must be heeded. We are not urging tax increases because we approve the prospective level of public spending. We are simply saying that, if Congress is going to authorize the spending, it should levy the necessary covering taxes.

Furthermore, we are deeply disturbed that economy proposals are not being carried out. The analysis of expenditure reduction included in the minority report of the House Ways and Means Committee on H. R. 4473 is particularly discouraging. It reveals that the possibilities of budget reduction that have been publicized are not likely to be carried out. Experience indicates that it is easier for the administration to request, and for Congress to authorize, the spending of deficit dollars than the spending of tax dollars. We believe that a vigorous demonstration by this committee of determination to tax as much as is spent would have a salutary effect on appropriation policy.

The current rate of Federal spending is not a proper guide to the ultimate rate of spending. Much of the first year since the Korean War began has been given over to industrial retooling, the placing of contracts, and some acquisition of inventories to be processed into military matériel. But neither the Congress nor the people have been kept currently informed as to the magnitude of the obligations that must eventually be met. While some of us may have had inklings, it was not until the Assistant Director of the Budget testified before this committee last week that we had an authoritative projection of the probable Federal budget for 1953. It is common knowledge that there has been an outgoing flood of orders, contract authorizations, and letters of intent. It is elementary that this outgoing flood will be succeeded by a return flood of bills payable. We do not accept as final the projection of 1953 budget expenditures ranging from $80 to $90 billion, with $85 billion probable. We insist that there will be a considerable amount of water in the 1953 budget which can and should be squeezed out.

Our criticism of the tactics that have been pursued goes further than the absolute amount of the budget. It is, that, until it was brought out at this late date, there was available no authoritative indication of the administration's views on the magnitude of the financing job. The President and the Secretary of the Treasury have made numerous statements regarding the importance of paying as we go. But neither has been forthright as to the kind and amount of taxation that will be required to accomplish this. They have not supported the goal of pay-as-we-go with a realistic, complete, and sound tax program.

We do not agree with this hesitant, piecemeal approach to a job that everyone knows must be done. Our first recommendation as to broad tax policy objectives is, therefore, that present taxes should be revised sufficiently to cover the anticipated peak of defense spending. It is not too soon to begin preparations for the peak of the spending, for these reasons:

1. There is a normal delay in getting full results from new taxes or increases in existing taxes. The fiscal year 1953 would be the first full year of operation under any new tax legislation enacted during the present session.

2. We must assume that any effort to cover a new inflationary gap by a further tax bill next year would be too late.

Failure to tax realistically now means a new inflation flood when the spending crest comes. Once we permit another wide inflation gap to appear it will never be possible thereafter to bridge it. We therefore face a fateful decision at this time. Further inflation involves such peril to our American institutions that we dare not fail to make the right choice.

The burden of inflation is greater than the burden of taxes. It is limitless and uncontrollable. The only way to control inflation is to prevent it.

Since the chief danger of further inflation is in the field of fiscal policy, my statement to you is devoted mainly to tax policy. Before I proceed with this major topic, I want to make brief reference to certain provisions of H. R. 4473 that are not dealt with in my subsequent statement.

1. Withholding on dividends, interest, and certain royalties

There are some persuasive reasons for this provision. However, it will work hardship on small income recipients who are dependent on these forms of income. As the minority report on the bill points out, the Government will have permanently the use of some $100,000,000 belonging to tax-exempt institutions and to those with small incomes. To the extent that persons in the latter group fail to apply for refunds, whether from ignorance of their rights or for any other reason, the injustices to them will be aggravated.

2. Capital gains

(*a*) The application of the 12½-percent increase on individual income taxes to capital gains is of questionable logic from a revenue standpoint. The realization of a capital gain is peculiarly within the control of the taxpayer, and hence there is room to believe that the additional rate will discourage sales. The net result might well be less rather than more revenue.

(*b*) For several years, we have advocated relief from the capital-gains tax in the case of gains realized from the sale of a bona fide residence of a taxpayer. Accordingly, we endorse the provision included in H. R. 4473.

3. Depletion

The Association has long been on record in favor of adequate provisions for depletion, and we are gratified that H. R. 4473 contains an extension of this principle.

4. Multiple exemptions and credits

We do not favor the provision which would limit to one each the surtax exemption of $25,000 and the excess profits credit of $25,000 in the case of a group of "related" corporations. The provisions of section 45 and section 129 of the Internal Revenue Code appear to be adequate to deal with cases of corporate split-ups and acquisitions designed to avoid or evade taxes, and should be relied upon. This would leave each case of split-up and other acquisitions to be determined, as to motives, on the merits of the case.

However, if this limitation on exemptions and credits should be continued in the bill, there could be no excuse for the continuance of the additional tax of 2 percent on the net income reported in consolidated returns.

I now turn to the main theme of my testimony.

THE ROLE OF TAXATION IN REGARD TO INFLATION

To the extent that taxation prevents deficit financing, it prevents inflation. On the other hand taxation, as such, is not deflationary when revenues and expenditures are in balance. It is a process of transferring income or purchasing power from the people to the government without changing the over-all total. As taxes are increased the people, individually and collectively, can spend less but government spends more. In the end there is the same amount of income and the same amount of spending. The significant fact is, however, that when tax receipts equal expenditures, there is no addition to total purchasing power by the creation of artificial income through public loans.

It is desirable at this point to dispose of certain arguments that have been advanced in regard to a pay-as-we-go policy. These arguments are that the people cannot afford the taxes required for full payment, that such taxation would disrupt the economy, and that levies of the magnitude required would not be tolerated by the people. Involved are questions of fact and also of attitude.

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TABLE I.—*Computation of income and excess profits taxes on total corporation profits of $45 billion, at present rates and at rates of H. R. 4473*

[In millions of dollars]

	Present law	H. R. 4473
Normal tax on $45,056 million [1]	[2] $11,264	[3] $13,517
Surtax on $39,828 million, [4] at 22 percent	8,762	8,762
Total income tax	20,026	22,279
Excess profits tax [5]	3,359	4,091
Total income and profits taxes	23,385	26,370
Capital gains [6]	300	338
Total corporate tax liability	23,685	26,708

[1] Corporate income in 1951 as estimated in report of the Committee on Ways and Means on H. R. 4473, table 10, p. 16.

[2] At 25 percent.

[3] At 30 percent.

[4] Calculated from data in table cited in (1). Corporations with net income up to $25,000 will not pay surtax. Total net income estimated at $2,161 million. Each corporation with net income over $25,000 will have an exemption from surtax of this amount. Estimated number of such corporations in 1951 is 122,491, and the total exemption from surtax would be $3,061 million. Total surtax exemption would be $5,228 million, and taxable surtax net income would be $39,828 million.

[5] This figure is a residual, being the difference between income tax as computed and total of income and excess profits tax as given in table 10 cited in (1) above.

[6] The amount of this tax is given in table 10 cited in (1) above.

The foregoing computations show that under present law corporations will be liable, as a whole, for more than $23.6 billions in Federal taxes on a total income of $45 billion. State taxes on corporate income will increase the total by at least $900 million in 1951.

In the calendar year 1950 dividends were $8.9 billion, or about 4 percent of personal income for the year. The historical ratio of dividends to personal income has been in the range of 5 to 6 percent. Assuming, however, that no more than $9 billion is distributed in dividends in 1951, there would remain for corporate reinvestment $11.5 billion after present Federal and State taxes, and only $8.4 billion after the tax increases proposed in H. R. 4473.

The large total dollar amount of corporate profits has led some to advocate dipping much more deeply into these profits than would be done by present, or even the proposed, tax rates. The facts are, however, that additional taxes on corporations as a whole result in (1) a cut-back in expansion plans, (2) a reduction of dividends, or (3) a further use of debt financing which, in effect, would be corporate deficit financing of the additional taxes.

We must consider here the lines of comparative resistance. Corporate management is not completely dictatorial. Stockholders expect, and are entitled to some return on investment. Through their ultimate control of management they are able eventually to impose their will. The relation of dividends to national income has declined, but increasing stockholder resistance may be anticipated to further substantial dividend cuts. On the other hand, we may expect equally strong stockholder resistance against widespread resort to management suggestions that programs for expansion be curtailed, for these would point directly to a decline of the profits out of which dividends are paid. It follows that the actual line of least resistance, as taxes are increased, is further addition to corporate debt.

As an illustration of how the present and proposed tax increases may be expected to operate in 1951 I present here a summary of a more detailed memorandum which is appended to this statement.

Summary of calculations on the effect of H. R. 4473 on corporate financing in 1951

Amount by which 1951 requirements of corporations will exceed 1950 needs:	
For additional expenditures on plant and equipment, as now planned	$5, 000, 000, 000
For higher tax liability under present law	6, 000, 000, 000
For added tax liability under H. R. 4473	3, 000, 000, 000
Total amount by which 1951 requirements will exceed 1950 needs	14, 000, 000, 000
This amount could be provided as follows:	
Higher profits before taxes (at most)	7, 000, 000, 000
Increased allowance for amortization of fixed assets (at most)	1, 000, 000, 000
Total from these 2 sources (at most)	8, 000, 000, 000
Leaving to be supplied by additional debt financing (at least)	6, 000, 000, 000
This will affect the amount of debt financing in 1951 as follows:	
Total debt financing in 1950	9, 000, 000, 000
Additional debt financing 1951, as above	6, 000, 000, 000
Total debt financing in 1951	15, 000, 000, 000

Let me put it another way. The anticipated rise of profits from 1950 to 1951 is some $6 billion. The increase of tax liability under present law is the same amount. The tax increase under H. R. 4473 is $9 billion. Obviously, the additional $3 billion of taxes can be paid only by increasing debt in the same amount or by a corresponding reduction in the planned rate of expansion of our productive facilities.

Thus the issue is posed. If the tax increase is paid by debt increase, the inflationary danger is intensified. If it is paid by curtailing productive capacity, our productive bulwark against communism will be impaired.

We believe the only sound course to follow is to hold corporate taxes at approximately the present level. Above all, there should not be, as provided in H. R. 4473, any increase in the combined corporate and excess profits limitation of 62 percent, the combined excess profits marginal rate of 77 percent, or any reduction of the excess profits credit.

Change in the excess profits tax should be toward relief, not increase, of its burdens. This tax stifles growth when growth is the greatest weapon we have to use against communism.

In fact, even the present 85-percent excess profits credit is wholly unrealistic in view of the inflation which affects corporations as well as other segments of our economy.

THE INDIVIDUAL INCOME TAX

The burden of the individual income tax has also been increased by the Revenue Act of 1950. The danager to the Nation in excessive rates of income tax is in their effect on the incentives to get income and on the ability to accumulate venture capital. To the extent that these incentives are weakened and capital accumulation is deficient, production declines and both the Government and the people suffer the consequences. We agree that it is possible to secure more revenue from the individual income tax, but we would emphasize that a calculated risk is involved in seeking this result by making further increases in the middle and upper ranges of the tax-rate scale.

In fact, there is not much more income left in these income ranges. The Secretary of the Treasury submitted an estimate of the surtax net income distribution in the calendar year 1951 with his statement to the Ways and Means Committee on February 5 that demonstrates this point.

TABLE II.—*Estimated distribution of taxable income, with tax yield derivable from each taxable income bracket, and additional yield derivable from confiscation of all taxable income above each bracket level*

[In millions of dollars]

Surtax net income bracket	Surtax net income	Normal and surtax	Surtax net income after tax	Additional revenue from tax rate of 100 percent on income above lower bracket limit
(1)	(2)	(3)	(4)	(5)
Under $2,000	$62,698.9	$12,539.8	$50,159.1	$68,047.1
$2,000 to $4,000	10,471.5	2,303.7	8,167.8	17,888.2
$4,000 to $6,000	4,335.5	1,127.2	3,208.3	9,720.4
$6,000 to $8,000	2,668.0	800.4	1,867.6	6,512.1
$8,000 to $10,000	1,779.9	605.2	1,174.7	4,644.5
$10,000 to $12,000	1,273.5	483.9	789.6	3,469.8
$12,000 to $14,000	966.5	415.6	550.9	2,680.2
$14,000 to $16,000	755.8	355.2	400.6	2,129.3
$16,000 to $18,000	609.6	304.8	304.8	1,728.7
$18,000 to $20,000	488.4	258.8	229.6	1,123.9
$20,000 to $22,000	396.6	222.1	174.5	1,194.3
$22,000 to $26,000	617.7	364.5	253.2	1,019.8
$26,000 to $32,000	633.5	392.8	240.7	766.6
$32,000 to $38,000	425.9	276.9	149.0	525.9
$38,000 to $44,000	302.9	209.0	93.9	376.9
$44,000 to $50,000	242.5	174.6	67.9	283.0
$50,000 to $60,000	266.8	200.1	66.7	215.1
$60,000 to $70,000	181.3	141.4	39.9	148.4
$70,000 to $80,000	129.0	104.5	24.5	108.5
$80,000 to $90,000	95.2	79.9	15.3	84.0
$90,000 to $100,000	80.2	69.7	10.5	68.7
$100,000 to $150,000	200.0	178.0	22.0	58.2
$150,000 to $200,000	96.2	86.6	9.6	36.2
Over $200,000	295.0	268.4	26.6	26.6
Total	90,010.1	21,963.0	68,047.1	

Source. Columns 2 and 3, Statement of Secretary Snyder before the Committee on Ways and Means of the House of Representatives, February 5, 1951, table 13. Columns 4 and 5 derived respectively by subtraction and cumulation.

This tabulation makes it clear that such additional revenue elasticity as there may be in the individual income tax is in the lower income ranges. The arithmetic of this statement is simple. There are $80 left out of every $100 of income subject only to the first bracket rate of 20 percent, but only $9 remain out of every $100 of taxable income subject to the maximum rate of 91 percent. Under H. R. 4473 there would remain only $5.50.

There are various procedures for increasing the revenue yield of the individual income tax. The two most usually considered are: (1) The addition of certain percentage points throughout the rate scale, as recommended by the Treasury; (2) a reduction of the exemptions allowed to the taxpayer, his spouse, and specified dependents. A third procedure is to levy a flat rate of tax on the surtax net income remaining after present tax. We favor this plan because it does not further intensify the progression.

We oppose the method finally adopted in the House bill, which is the increase of the tax by a stated uniform percentage thereof. Both the addition of percentage points to the rate scale and the percentage increase of the tax intensify the progression, a condition which has already been carried too far unless one is to accept the Karl Marx doctrine that the main function of severe tax-rate progression is to destroy the basis of private capitalism.

The extent to which a 3-percentage-point increase and a 12½-percent addition to present tax, respectively, would intensify the progression of the present tax-rate scale is shown for selected surtax net incomes in the following table:

TABLE III.—*Present tax, income after tax, and percentage relationship of 3 percentage points increase and 12½ percent of tax, respectively*

[Dollar figures in millions]

Surtax net income	Present tax	Surtax net income after present tax	3-percentage-point rate increase		12½ percent increase of present tax	
			Tax increase	Percent, tax increase of income after present tax	Tax increase	Percent, tax increase of income after present tax
$2,000	$400	$1,600	$60	3.7	$50	3.1
$6,000	1,360	4,640	180	3.8	170	3.6
$10,000	2,640	7,360	300	4.0	330	4.4
$26,000	10,740	15,260	780	5.1	1,342	8.8
$50,000	26,820	23,180	1,500	6.5	3,352	14.4
$100,000	67,320	32,680	3,000	9.1	8,412	25.7
$200,000	156,820	43,180	6,000	13.9	19,602	45.4

From this tabulation it appears that whereas the three percentage points increase in the tax rate across the board would cut into the taxable income remaining after present tax by percentages ranging from 3.7 percent at $2,000 of taxable income to 13.9 percent at $200,000, the 12½-percent increase of present tax would involve cuts in income after present tax ranging from 3.1 percent at $2,000 of taxable income to 45.4 percent at $200,000. The very slight advantage afforded to the small incomes by H. R. 4473 cannot possibly justify the terrific inroad which this method makes in the middle and larger incomes. Even so, the bulk of the total revenue increase to be secured by the H. R. 4473 procedure will come from the smaller incomes. The additions to revenue would be as follows:

TABLE IV.—*Distribution of revenue increase from 12½ percent addition to present tax*

[In millions of dollars]

Surtax net income brackets	Total tax at present rates	12½ percent of present tax
$50,000 and up	1,128.6	141.1
$10,000 to $50,000	3,458.2	432.3
$6,000 to $10,000	1,405.6	175.7
Total $6,000 and up	5,992.7	749.1
$0 to $6,000	15,970.7	1,996.3
Total	21,963.4	2,745.4

We recommend against reduction of the exemption as a means of increasing the revenue, except as a last resort. Any lowering of the exemption would subject to income tax persons who are presently not subject because of the existing exemption level. It is our judgment that there is a better way than reducing exemptions to broaden the tax base and to secure some tax from those not now liable for income tax as well as all other citizens, that is, a broad-based consumption tax.

CONSUMPTION TAXATION

Before I outline our thinking on this method of taxation, I must direct your attention to the fact that the individual income tax, levied on income as it is presently defined in the tax law, does not reach the major part of total personal income.

There is a gap of $130 billion or more between the total of personal income as estimated by the Department of Commerce and the amount of taxable income as defined in the tax law.

The large amount of personal income not subject to income tax provides strong support for the second result of our appraisal of available revenue options. It is that a substantial part of the additional revenue needed to pay as we go should be secured from a broadly based consumption tax rather than from a heavier concentration of the tax increases on the income taxes. This is certainly the most effective way to spread a part of the tax load over all income and all citizens, and combat inflation.

This conclusion has been reached by the taxation committee and the board of directors of the National Association of Manufacturers after extended research and active discussion during the past 3 years. It is a position that is deemed to be sound for both ordinary normal fiscal conditions and for meeting the added requirements of an emergency. The reasons for such a conclusion are, in brief, as follows:

The present degree of concentration on income taxes is too great. Together, these taxes now account for some 85 percent of total Federal tax revenues. In our judgment this is not sound fiscal policy. Too great concentration of the tax load on income as it is received tends to undermine both the capacity and the incentives to produce. This should be avoided by expanding Federal use of consumption taxes. By spreading part of the tax load over the spending of income it is possible to avoid as serious interference with production as would otherwise occur.

2. Consumption taxes are relatively stable in yield, while taxes on income are by comparison unstable. The reason for this difference is that the pattern of consumption spending is resistant to change, while net income is closely dependent upon current business conditions. The experience with the income taxes during the early 1930's is familiar to all. In 1949 there was a short, mild business recession. Despite its mildness and brevity, it caused a decline of both corporation profits and personal income, and a substantial decline of corporation income and profits taxes. On the other hand, the excise tax receipts were not affected. The figures are worth noting.

TABLE V.—*Corporation and personal incomes, and yield of corporation income taxes and excises, calendar years 1948–50*

[In billions of dollars]

Year	Corporation profits	Personal income	Corporation income and profits taxes	Miscellaneous internal revenue, principally excises
1948	$33.9	$209.5	$11.1	$8.3
1949	27.6	206.1	12.0	8.4
1950	40.2	222.4	9.9	8.3

Sources: Corporation and personal income from Department of Commerce; tax collections from Treasury Department.

There was a drop of $6.3 billion in corporation profits from 1948 to 1949. This shows up in the 1950 tax collections, which were down by $2.1 from those of the preceding year. The variation of individual income tax receipts is not comparable because of the changes made in the Revenue Act of 1948. It is significant, however, that the miscellaneous internal revenue, consisting principally of the excises, showed no effect of the business recession.

We hold that there should be greater Federal reliance upon consumption taxes in order to provide greater balance and greater stability in the revenues, and to avert the likelihood of deficits during periods of receding business activity. We had made this recommendation even before the developments which now render large revenue increase necessary. Under the present emergency circumstances, the the broadening of the Federal tax base by substantial use of consumption taxes becomes still more urgent.

A broadly based consumption tax

In our study of this subject over the past 3 years we have covered rather thoroughly all of the possibilities and have weighed carefully the considerations for and against them. The first matter to be dealt with was the choice between an extension of the present selective excises and some kind of broad, general excise tax. The present program of tax increase, both as recommended by the Treasury

and as embodied in H. R. 4473, provides for extension of the present excises to some additional classes of goods and for changes in existing rates.

This, in our judgment, is not the proper procedure. It perpetuates an indefensible series of discriminations and inequalities among the producers of different products and among consumers. It imposes a tax burden or grants a tax exemption according to the way a person decides to spend his money. This, we submit, is incompatible with the basic concept of a free economy in which all citizens are engaged competitively to improve their lot by achieving maximum production and distribution of goods and services, and in which all citizens are supposed to have access to the broadest possible market on equal terms.

Since the present Federal excise system is selective without logic, discriminatory without reason, and provocative of widespread industry friction and consumer complaints, it is our recommendation that there be substituted for it a broad excise or consumption tax applicable to all end products of manufacture except foods and food products

In this recommendation we would exclude the taxes on tobacco and alcoholic beverages which should continue to be dealt with separately. We oppose any further increase of these taxes, however, on the ground that the rates are still at the highest levels imposed during World War II. These commodities are also subject to substantial taxes by the States. There is no good case, in our judgment, for imposing a still heavier tax burden on the consumers of these products while the excise system as a whole remains in its existing uncoordinated, discriminatory condition.

Having concluded that the present system of limited, selective, discriminatory excises is an inadequate, even improper, fiscal implement, our next task was to decide upon the form of general excise to be recommended. The choice obviously lies between a Federal retail sales tax and a tax at the final point of manufacture.

I can assure you that our numerous committee discussions of this matter were long and vigorous. There was full recognition of the desirable features of a Federal retail sales tax.

Our conclusion to recommend a general manufacturers' excise was reached only after a thorough exploration of all of the arguments for and against both the retail type and the manufacturers' excise type. I mention this to show you that our action has not been hasty, arbitrary, or lacking in due consideration of all sides of the problem.

In confining our recommendation last year to the end products of manufacture, our intention was that the taxes on the special services (telephone, telegraph, cable; leased wires; local telephone; transportation of persons; and admissions) should be repealed outright. This remains our long-range objective, but, as part of the special emergency financing, we believe these services should be subject to the same uniform tax as manufactured goods.

A manufacturers' uniform excise

Our reasons for deciding to recommend a manufacturers' uniform excise may be summarized as follows:

1. *Federal-State tax duplication.*—A manufacturers' excise is well adapted to use at the Federal level, but not at the State level. A retail sales tax may be used effectively at either level. However, retail taxes are now levied in 29 States, as shown on the accompanying map. The shading on the map indicates the portion of State revenue derived from this tax. In the interest of avoiding duplication of tax methods whenever possible, we believe the soundest procedure would be for the Federal Government to use a manufacturers' tax, leaving the retail tax field to the States.

2. *Administration.*—Administration of the tax would be more simple, assured, and inexpensive at the final point of manufacture than at the retail level. The number of final manufacturers, exclusive of food products manufacturers, is considerably less than 300,000. On the other hand, there are more than 3,000,000 retail outlets in the United States, ranging from large department stores to small shops and "hole in the wall" operators. The birth and death rates of retail establishments are both high. In many cases their business records are rudimentary, making difficult the audit and collection of tax withheld.

3. *Familiarity of procedure.*—The manufacturers' excise is not a new Federal tax. Under existing law more than 20 classes of goods have been thus taxed, and extensions of this form have been proposed both by the Treasury and by the Ways and Means Committee in H. R. 4473. Bureau procedure is well established and a certain segment of the business community is already familiar with the rules and regulations.

28 states collected 35.3% of their total tax revenue in 1950 from retail sales taxes

percent of state revenue received from state sales tax

- under 20%
- 20 - 35%
- 35 - 50%
- over 50%

* occupational gross income tax
** collection figures not available

Source: Collection data based on "State Tax Collections in 1950", Bureau of the Census.

4. *Permanence in the Federal tax structure.*—We have stated above our reasons for permanent, long-range Federal dependence upon the excises for a substantial contribution to the Federal revenues. There is much better prospect of achieving this long-range objective by holding the Federal excise at the point of final manufacture.

RECOMMENDATIONS

I now conclude with a general summary of our proposals.

1. Tax legislation now should aim at covering the anticipated maximum of defense spending. In no other way can we assure pay as we go.

2. Move toward correction of the present excessive use of the income taxes by introduction of a broad consumption tax, levied at the manufacturers' level. This uniform general excise should be applied to all end products of manufacture, except food and food products, alcoholic beverages and tobacco. In addition to providing additional revenue, this tax should be substituted for all existing excises except those on alcoholic beverages and tobacco.

As part of the defense financing, the uniform tax also should be applied to the services now taxed (telephone, telegraph, cable; leased wires; local telephone; transportation of persons; admissions).

Since the taxes on alcoholic beverages and tobacco are still at the highest World War II levels, and since these commodities are also subject to heavy State taxes, no further increases should now be made in the Federal rates.

3. Hold increases of the individual income tax to a moderate level, and use a method which will not intensify the present rate progression.

4. Hold the corporation taxes at approximately the present level. There should not be any increase in the combined corporate and excess profits limitation of 62 percent, the combined excess profits and corporate marginal rate of 77 percent, or reduction of the excess profits credit. Change in the excess profits tax should be toward relief, not increase of its burdens. The present 85 percent excess profits credit is particularly unrealistic in view of the inflation which affects corporations as well as other segments of our economy.

APPENDIX A

EFFECTS OF H. R. 4473 ON CORPORATE FINANCING IN 1951 [1]

(The background to the following remarks is contained in two earlier research department documents: Financing Business Expansion—see especially the appendix; and A Note on the Sources and Applications of Corporate Funds in 1950—see especially table on page 4. The gist of these two documents is an essential preliminary to the present memorandum but it will not be repeated.)

Corporate expenditures for new plant and equipment are expected to be about 5 billion dollars greater in 1951 than in 1950. At the same time, under H. R. 4473, it is proposed to raise the tax liability of corporations to a figure about 9 billion dollars higher than the actual tax liability in 1950 and about 3 billion dollars greater than the tax liability in 1951 would be under present law. The question to be dealt with is whether, or how, these two sets of expectations can be made compatible. Will corporations be forced to forego, in part, their plans for expansion of plant and equipment? Will their only alternative be to resort to a large volume of debt financing, with a consequent inflationary pressure on the economy?

One way of studying these questions is to start from the year 1950 as a base, and examine the various ways in which corporations might obtain an additional 5 billion dollars for buying plant and equipment and an additional 9 billion dollars for paying their taxes in 1951. This might be accomplished either by a reduction in outlays for items other than plant and equipment or by an increase in one or another of the sources of corporation funds. The following possibilities suggest themselves as methods of closing the 14-billion-dollar gap:

1. An increase in profits before tax.
2. A reduction in dividend payments.
3. An increase in allowances for depreciation and depletion.
4. An increase in stock issues.
5. A reduction in corporate holdings of cash and Government securities.
6. A reduction in the rate of investment in inventories and accounts receivable.
7. Debt financing.

The feasibility of each of these methods will be discussed separately.

[1] Prepared by George G. Hagedorn, research associate, NAM research department.

1. Profits before tax

Profits before tax will almost certainly be greater in 1951 than in 1950. However, they will not be enough greater to provide the $14 billion of added funds needed for expansion of plant and higher taxes, or anything near that amount. In discussing this question, profits must be studied excluding inventory valuation profits, since the latter are not available for financing plant and equipment purchases or for paying taxes. The recent record is as follows:

Corporate profits before tax, after inventory valuation adjustment

[Billions of dollars, annual rate]

1950—I	$28.1
II	35.0
III	38.1
IV	42.2
1950—Year as a whole	35.8
1951—I	41.7

Source: Department of Commerce and Council of Economic Advisers.

Profits before tax rose rapidly in the last two quarters of 1950, but fell off somewhat in the first quarter of 1951. There seems to be no reason to assume that for 1951 as a whole they will be higher than in the last quarter of 1950, or in the first quarter of 1951; that is, profits may be expected to be about 6 or 7 billion dollars greater in 1951 than in 1950. Thus they will provide less than half of the $14 billion additional needed in 1951.

Increases in profits before tax have not been keeping up with increases in taxes. When the unreal book profit on inventory valuation is excluded, there has been an actual downtrend in profits after tax since 1949.

2. Dividends

It does not seem realistic to suppose that any additional funds could be raised in 1951 by reduction of dividends below 1950 levels. In 1950 dividends were 4 percent of national income compared with 6.6 percent in 1929, 5.3 percent in 1933, 6.4 percent in 1937, and 4.9 percent in 1940. Stockholders still are getting much less than their prewar share of the national income.

At this point it may be remarked that if profits before tax increased by 6 billion dollars, while tax liabilities increased by 9 billion dollars and dividends remain unchanged, there must inevitably be a substantial reduction in retained earnings in 1951.

3. Depreciation and depletion

There will be some increase in depreciation allowances in 1951 due both to the expansion of plant and equipment and to the accelerated amortization program. However, the latter increases the funds available to corporations only to the extent of the tax saving. In the long run there is no tax saving to corporations through accelerated amortization, unless it is assumed that tax rates will be lower after the 5-year period over which the assets are to be amortized. However, there may be some additional funds made available by this means in 1951, at the sacrifice of allowances which would normally be made in 1956 and subsequent years.

The exact amount to be realized in 1951 through added amortization is difficult to estimate with any precision. However, it will certainly be less than a billion dollars, since calculations based on the most extreme assumptions yield this figure. The computation by which this figure is derived is as follows:

So far, applications for certificates of necessity have totaled about 17 billion dollars; about one-third of this or 5 billion dollars has been approved, but only to the extent of 70 percent of the total outlay or 3.5 billion dollars. The latter figure means that accelerated amortization charges will be about 0.7 billion dollars annually, in place of 0.2 billion dollars of normal depreciation (assuming approximately 20-year life). The annual amount protected from taxes under the certificates already approved will thus be about 0.5 billion dollars, and therefore the tax saving will be about 0.3 or 0.4 billion a year. If, however, the applications still pending are approved in about the same proportion (which is unlikely, because the most pressing cases have been dealt with first), the total tax saving will be three times as great. To summarize, it seems that the total additional funds made available to corporations in 1951 as a result of the accelerated amortization provision will not be greater than a billion dollars, and probably will be much less.

4. Stock issues

Corporations have been able to raise only very small amounts of capital through new stock issues in the period since World War II. In 1950 net new stock issues

provided only 1.6 billion dollars. It is unlikely that this source could supply any important contribution toward the additional needs in 1951. This is especially so in view of increased personal-income taxes, and their impact on the types of personal saving which are usually available for venture capital.

5. Reduction in cash and Government bond holdings

Corporations can sometimes obtain funds by drawing down on their bank accounts or selling off the Government bonds they hold. However, there is no evidence that corporations have more cash than they need for operating purposes. Government bonds were accumulated in 1950, but only at about the same rate as accrued and unpaid income taxes. Additions to cash and Government bond holdings of corporations amounted to 6.5 billion dollars in 1950, compared with an increase in outstanding liability for income taxes of 7 billion dollars.

Despite the considerable accumulation of the war years, drafts upon these resources have been an important source of funds in only one postwar year—1946. Since then, despite the great need for funds, corporations have not drawn upon their existing holdings.

If the unpaid income tax at the end of 1951 is much greater than the corresponding unpaid balance at the end of 1950, then corporations will probably build up their liquid holdings to pay it. It is extremely unlikely that they will be able to draw down on their holdings for plant and equipment or for increased current taxes.

6. Inventories and receivables

In every postwar year, except 1949, corporations invested a substantial amount in current assets—inventories and receivables. This reflected the expansion of business in those years, and is a normal thing in any period of business growth. In 1950 the total spent for inventories and receivables came to 9.3 billion dollars. This is not an extraordinary amount, for in the years 1946 through 1948, an average of 8.6 billion dollars was used annually for these purposes. Since continued expansion is to be expected, about the same amount should be used in 1951 as in 1950. Thus no funds would be released for filling the 14 billion dollar gap with which we are dealing.

(The amount required for inventories includes only the cost of the actual physical expansion of stocks. The increased valuation of the existing inventory is omitted. This corresponds with the exclusion of inventory valuation profits from the sources of funds.)

7. Debt financing

To recapitulate the discussion so far: Corporations will require 5 billion dollars more for plant and equipment in 1951 than in 1950. Their income tax liability under H. R. 4473 is expected to be 9 billion dollars greater than their income tax liability in 1951. Thus they will require a total of about 14 billion dollars additional in 1951.

Present indications are that profits have leveled off, but are somewhat higher than in the first half of 1950. The increase in profits before tax should supply about 7 billion dollars of the funds needed. Increased amortization of facilities may save corporations as much as 1 billion dollars. The other sources so far discussed are unlikely to yield any substantial amount.

This leaves a remainder of 6 billion dollars to be found for meeting the 14 billion dollar requirement. Debt financing is the only source left for this purpose.

Debt financing in 1951 will not be a new development. Substantial sums have been raised by this means in every postwar year except 1949. In the period 1946 through 1948 corporations obtained an average of 9 billion dollars a year by increasing their indebtedness.

In 1950 corporate debt of all kinds increased by 16 billion dollars. However, this includes 7 billion dollars increase in liability for unpaid income taxes, matched by an approximately equal accumulation of liqiud assets. The increase in debt of other types, which may be considered a more relevant figure, was 9 billion dollars in 1950.

The previous analysis has indicated that, if present plans for corporate expansion are to be realized and if H. R. 4473 becomes law, 6 billion dollars would have to be borrowed in 1951, over and above the 9 billion dollars borrowed in 1950. This would mean that debt financing—excluding accrual of income taxes—would total 15 billion dollars in 1951.

The alternative to such an increase in debt financing, assuming H. R. 4473 goes into effect, is an abandonment of plans for expansion of corporate plant and equipment.

The net conclusion is that the 3 billion dollar rise in corporate income taxes proposed in H. R. 4473 will come either out of borrowed funds or out of a reduction in the prospective expansion of industrial capacity. Either way, it will intensify the inflationary danger.

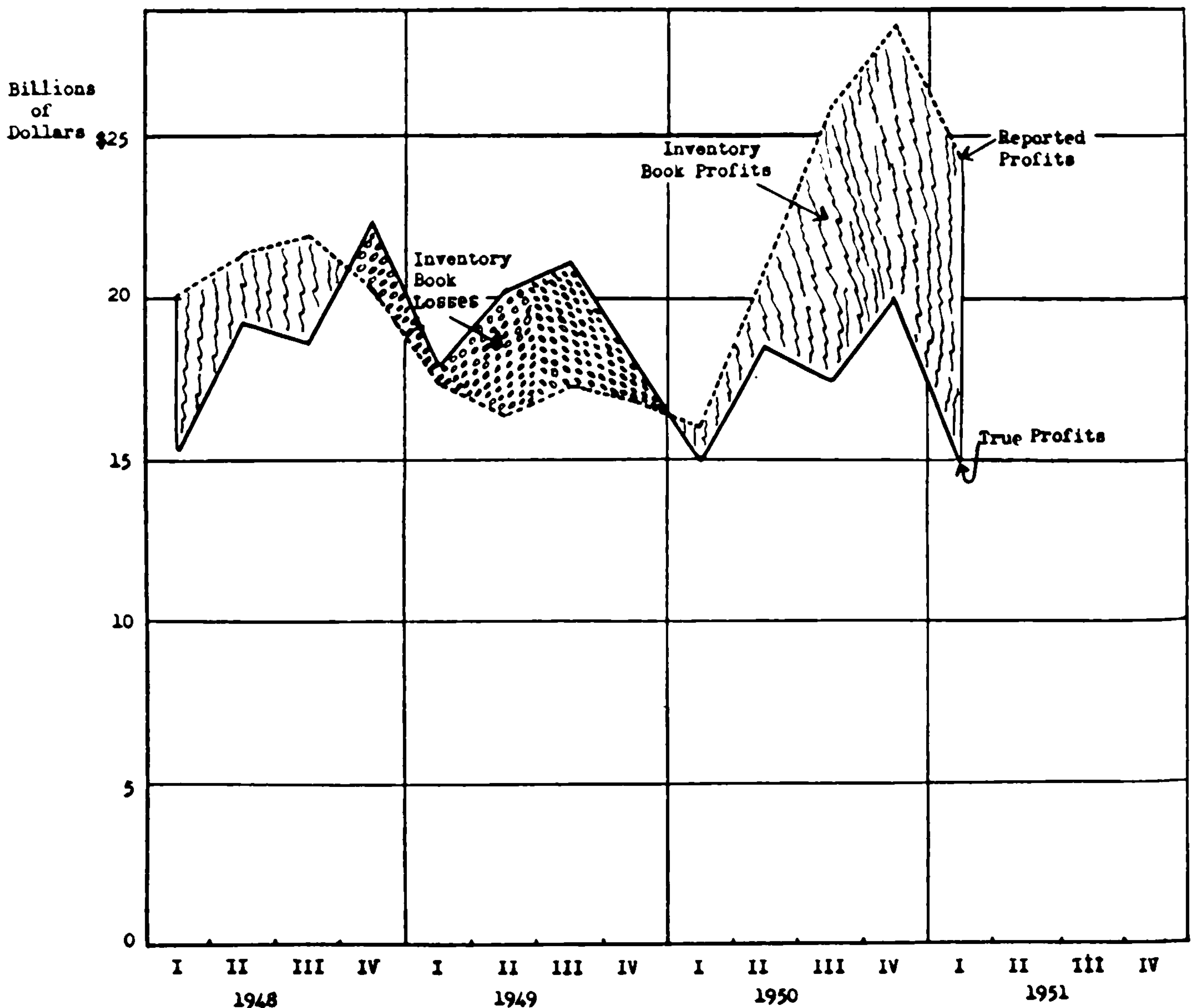
CONDENSED TABLE—*Sources and applications of corporate funds, 1950 and 1951 (all corporations except banks and insurance companies)*

[In billions of dollars]

	1950 (actual)	1951 (expected under H. R. 4473)
Applications		
Plant and equipment	$17	[1] $22
Inventories and receivables	9	[2] 9
Other applications	1	1
Total	[3] 27	32
Sources		
Retained earnings	7	[4] 5
Depreciation and depletion	8	[5] 9
Stock issues	2	[6] 2
Debt financing	[7] 9	[8] 15
Other sources	1	1
Total	27	32

[1] 5 billion dollars greater than in 1950, according to present plans.
[2] Assumes same amount as in 1950, and an average of years 1946 through 1948.
[3] Excludes 7 billion dollars of additions to holdings of cash and Governments. See also footnote 7 below.
[4] Assumes increased tax of 9 billion dollars, increase in profits before tax of 6 billion dollars, dividends unchanged.
[5] Assumes increase of 1 billion dollars as a result of accelerated amortization.
[6] Assumed unchanged over 1950.
[7] Excludes 7 billion dollars of increased liability for unpaid income tax. See footnote 3 above.
[8] Assumed sufficient to make up needed funds in 1951.

(Items do not add exactly to totals because of rounding.)
Source: Based on Commerce Department data.



The CHAIRMAN. Dr. King, you may proceed.

STATEMENT OF WILLFORD I. KING, CHAIRMAN, COMMITTEE FOR CONSTITUTIONAL GOVERNMENT

Mr. KING. It is a pleasure to have the opportunity of appearing once more before this committee with its outstanding membership.

I believe you will all agree with me that one of the paramount questions confronting the Nation today is how to finance current and prospective war without inflating the currency and thus filching away the hard-earned savings of the thrifty and worth-while members of our population.

Senator KERR. Do you mean all of the worth-while members of our population?

Mr. KING. I think the thrifty people are the most worth-while members of our population in general, yes. I think that is a fair statement.

Senator KERR. Now, you do not say the most worth while. I gather from what you said that you included all of them. Would he have to be a member of your organization to be worth while?

Mr. KING. No; we do not have many members, and I would not put that in as a qualification, I assure you.

Senator KERR. I appreciate that. I do not recall having joined the organization.

Mr. KING. No. We only have about a dozen members. So I think that that would not put you in the list, probably.

The CHAIRMAN. You have an exclusive club?

Mr. KING. Very exclusive, yes.

The CHAIRMAN. I see.

Mr. KING. Professor Frederick Roman told me of a dramatic portrayal by a French lady of the situation existing in her country at a time when the bottom was dropping out of the franc. She said: "We French people have been taught to build our house upon a rock—but in France today there is no rock." It is your responsibility to see that such a statement does not soon apply to our own United States.

I believe also that you gentlemen fully understand the following three facts:

1. That rising prices are not, in themselves, inflation, but that they commonly result from inflation of the currency.
2. That, when serious inflation has occurred, nowhere at any time have direct price controls prevented, or even lessened noticeably, the upward movement of the price level—their chief effect being instead to curtail production and generate shortages.
3. That, in practice, the only source of serious inflation is an unbalanced budget.

You also are keenly aware of the fact that, at present, the national budget can be balanced either by cutting expenditures or by raising more revenue. At least one of the distinguished members of your committee has shown that it is entirely feasible to trim 6 or 8 billions of dollars from the proposed Federal expenditures for the coming year without in any way weakening our military program. But, in my opinion, there is no likelihood of accomplishing this highly desirable end merely by clipping a little more from the demands of each of the

multitudinous agencies which represent the beginnings of a completely socialized state. The thing needed is to eliminate completely many of these agencies and turn back their functions to free, competitive enterprise.

Presumably, the problem which is immediately of most concern to you is the revenue bill which has recently come to you from the House. Doubtless, the easiest course for you to pursue is to give it perfunctory attention, pass it, and send it along to the President.

Senator TAFT. This committee has never given "perfunctory attention" to anything, Mr. King, in my experience in the last 13 years.

Mr. KING. I am very glad to hear that.

The CHAIRMAN. We may have made some fast judgments, but we have studied something about it.

Mr. KING. As I say, I believe that you gentlemen are so patriotic and conscientious that you will sacrifice at least part of your potential summer vacations and scrutinize with great care the provisions of this bill in order to ascertain whether they do or do not conform to sound economic principles.

Senator KERR. Sacrifice a part of it?

Mr. KING. I think that you are entitled to some summer vacation.

Senator TAFT. I suggest that if we did not sacrifice any of it, we would be a good deal better off. I mean, if we were to take the vacation, we would not have any new tax bill.

The CHAIRMAN. We will get our summer vacation, Doctor, in the winter.

Mr. KING. I hope that you will have some, at any rate.

In my opinion, the conclusions which you come to as regards that bill will depend upon your views concerning the comparative merits of two diametrically opposed philosophies. One—the communistic philosophy—I am not talking in this case about Mr. Stalin and his crowd, but I am talking about the communistic philosophy from the economic standpoint—holds that individuals are actuated mainly by the desire to serve the common weal, that their energies and abilities do not differ widely, and that, therefore, best results can be secured by giving to all approximately equal rewards, regardless of their respective expenditures of effort. The opposing philosophy—that first fully expounded by Adam Smith—assumes that individuals differ vastly in energies and abilities, and that, as a rule, they can only be induced to use these skills to the fullest in producing goods for society if they are rewarded in proportion to their outputs.

The best basis for judging which of these philosophies is the more defensible is to see how they have stood up in the field of experience. Lenin gave the communistic philosophy a thorough test in Russia. England is today trying out a much watered-down version of it. The United States, by contrast, experimented for some 140 years with a system of largely uncontrolled competition and free enterprise. Which system, as you see it, brought the greater progress and prosperity?

Obviously, the revenue bill which the House has sent to you for consideration is based almost entirely upon the Communist philosophy. It implicitly assumes, for example, that corporation executives are of about equal ability, that corporation profits come along almost automatically, and that managers of corporations seek mainly the

public weal, and have but a very secondary interest in making profits either for their stockholder or for themselves. Those House Members who voted for the bill apparently have taken it for granted that, therefore, very high taxes on the profits of successful corporations will give rise to no serious tendency on the part of corporate management to take life easy or to indulge in waste or extravagance, with resulting diminution in the output of goods needed for defense or war. Do you feel that these assumptions are tenable?

In the House bill now before you, tax rates on large individual incomes run up to 90 percent. And these high-bracket income recipients must, of course, also pay their respective State income taxes. If a taxpayer happens to live in my State—New York—the State income tax will amount to another 6 percent. To anyone who believes that the desire for reward is the biggest force stimulating human productive effort, it seems ridiculous to assume that anyone will strive much for gain if he knows that he can keep only 4 or 5 cents out of every dollar that he earns. So it appears obvious that the supporters of the House bill have wittingly or unwittingly assumed that most recipients of large incomes are persons of little more than average ability whose incomes flow in almost automatically, and whose contributions to the Nation's output are of no particular significance.

Do you think that these assumptions seem to correspond to the facts?

When confiscatory taxes on upper-bracket incomes were first proposed, those favoring such levies usually explained that these rates were imposed merely to meet an emergency. But, largely because many intelligent citizens, including economists and Members of Congress, have believed that these confiscatory income tax rates were urgently needed in order to balance the Federal budget, they have been continued year after year.

That this belief does not accord with the facts is clearly shown by the results of a study which I made about 3 years ago covering Federal income tax rates and revenues for the years 1913 to 1942, inclusive. A copy is on your desk. This analysis reveals the fact that the levying of confiscatory rates destroys the income from which the fiscal authorities have expected to gain revenue. Surprisingly enough, this destruction occurs to such an extent that income tax rates taking more than 26 percent of the incomes of individuals have succeeded in raising no more revenue than could have been obtained by a 26 percent rate—that is a 26 percent effective rate—the average rate over the entire income—not the rate on the top bracket.

The thing which the levying of rates higher than that level has actually accomplished is to prevent the possibility of saving by the wealthy, and thus to dry up what formerly was the chief source of venture capital for founding new enterprises and for expanding old enterprises.

The facts in this connection are set forth in my study, Raising the Workingman's Scale of Living. You will also find a copy of that on your desk. Furthermore, this increase in rates has, of course, lessened the effectiveness of individual initiative, and hence has thereby hampered industrial progress.

Since pushing up the tax rates on high incomes brings in no additional revenue for the Treasury, it therefore seems to follow that the only logical reason for wanting to continue the confiscatory taxation

of large incomes is either envy, and hatred of the successful, or the communistic urge to reduce everyone to the same economic level.

After you think the matter over carefully, does it not become evident that income taxes—whether corporate or individual—are not the best kind of levies for raising the prodigious sums needed to finance preparation for a major conflict? When one considers the fact that excise taxes, if levied on producers, are relatively inexpensive to collect, hard to evade, have no tendency to promote waste and inefficiency, and offer the minimum of inconvenience to the ultimate taxpayers, and bring in revenue promptly, can one logically avoid the conclusion that the most practicable way of obtaining the huge revenue required to finance a major war is to institute a broad system of excise taxes, earmarked solely for defense purposes or debt reduction, and covering most products other than the bare necessities of life? The problem can be simplified by imposing a uniform flat-rate percentage levy on the sales value of all products other than specified luxury goods and nonessential items such as tobacco and alcoholic liquors. On the latter categories, supertaxes can properly be imposed.

With such a broad tax set-up, all that would be necessary to raise more revenue would be to advance all rates proportionately. And the tax burden could be reduced to any extent desired by lowering all rates proportionately.

I have heard of no other method of obtaining the revenue required actually to balance the prospective Federal budget which would disrupt our economy as little as would the procedure just outlined. I trust, therefore, that you will give it your careful consideration.

That is all that I have in the way of written testimony, and I wish to thank you for your attention.

The CHAIRMAN. Thank you very much, Doctor. Are there any questions?

Senator TAFT. You say that this book contains the calculations on which you say that the higher rates have not produced any more money?

Mr. KING. The booklet on income-tax rates and revenues which is in your hand has in it the statistical proof. When we got notice that I was to come down for this hearing, my assistant, Mrs. Schwimmer, started to work up the data for the years since 1942—that is for 1943, 1944, 1945, 1946, and 1947, but she had completed data for only the upper brackets, that is, those above $500,000, before I left. Her computations show that in the last 5 years exactly the same principles held for those brackets as held before. That is, effective rates higher than 26 percent still produce no more revenue than do lower rates.

The higher rates merely destroy the basis of the income. Then the income does not exist in those brackets; so you do not get any more revenue.

Senator TAFT. The tendency, I imagine, of those people is to live on their capital, which cuts down their capital and consequently their future income, but they think that it will last all right until they die.

Mr. KING. That probably is true. I have not any statistical data on it, and I do not know just why it is. But the figures from the Income Tax Bureau show that, in one way or another, their incomes as reported simply go down as the tax rates go up, so that the Gov-

ernment, although it levies higher rates, does not get any more revenue for the Treasury.

What has happened during the last few years, obviously, is that with these high rates, the saving which formerly came from the high bracket incomes to finance new corporate expansion and new corporations has disappeared, so that now almost all the corporate expansion has to be financed out of corporate savings. It used to be that the corporations paid out about 60 percent of their earnings in dividends and kept about 40 percent. Now they pay out about 40 percent and keep about 60 percent. So expansion is mainly financed out of that additional 20 percent. It has shifted the financing of corporate expansion from individuals to the corporations.

The CHAIRMAN. Thank you very much, Doctor. Are they are further questions?

Senator MILLIKIN. Thank you.

The CHAIRMAN. Thank you very much, Doctor.

Mr. KING. Thank you.

(The following letter was subsequently received for the record:)

COMMITTEE FOR CONSTITUTIONAL GOVERNMENT,
July 9, 1951.

Hon. WALTER F. GEORGE,
United States Senate, Washington, D. C.

DEAR SENATOR GEORGE: I appreciated the courteous treatment which you and your committee gave me when I appeared before you on July 5.

When you were examining the previous witness, you raised a number of very interesting questions which went unanswered. I hope that I will not appear too presumptuous if I give you, now, what to me seem to be the correct answers to some of these queries.

You repeatedly came back to the question of how much total governmental spending the Nation can afford. As I see it, this question is, primarily, psychological and political rather than purely economic. Our real per capita national income is at least three times as great as it was a century ago. One might, therefore, assume that the Government could tax away, for war purposes, two-thirds of the income and still leave the people far better off than they were in Civil War days, but it does not follow that citizens, at present, might not resent so strongly such heavy taxation that they would throw out of office whom they held responsible therefor.

At present, we are engaged in an arms race with Russia. Usually, in such races, the nation which feels that it is losing out, attacks rather than to continue the crushing expense indefinitely. Is not this situation likely to be repeated in the present race? I take it that, when the American people feel that we are really engaged in a major war, they will stand for more taxation than they would in mere preparation for a potential war.

Available evidence seems to indicate that, not only can there be huge savings made by cutting off unnecessary civilian expenses, but that, also, a large fraction of the money appropriated for military purposes is frittered away.

You also inquired concerning the explanation of why prices have been rising although the national budget has recently shown a surplus. To this question, the answer seems entirely clear.

According to the June 29 weekly supplement to the Survey of Current Business, the volume of demand deposits has risen more than 6 percent, and the amount of currency in circulation has increased about 2 percent during the past year. This has occurred despite the fact that bank loans, based on Government obligations, have shrunk by 17 percent. How does this happen? The answer is that the commercial, industrial, and agricultural loans of banks have run up more than 40 percent—thus overwhelming the shrinkage in Government loans. The inflation which we have been experiencing is, therefore, primarily private, not governmental, in origin. However, it must be recognized that an unknown fraction of the private loans doubtless has been used to finance defense projects.

You will, doubtless, feel that the events just specified directly contradict the statement which I made in my testimony "that, in practice, the only source of serious inflation is an unbalanced budget." However, I still believe that my statement is correct, for experience shows that inflations having their origin in

private borrowing are usually evanescent, being succeeded rather promptly by deflations. Events of the past few weeks seem to indicate that the present situation is conforming to the customary pattern. The flurry of buying in order to get ahead of controls has subsided and now retailers are slashing prices right and left in order to reduce overly large inventories. Furthermore, during the past year or so, millions of optimistic Americans mortgaged their future incomes in order to buy refrigerators, television sets, automobiles, and houses. Now, keeping up the payments hampers their ability to buy normal amounts of durable goods. It is, therefore, not surprising to find prices of raw materials declining rapidly. With facts as they are, if the Government continues to keep its budget in balance, it may well happen that the next few months, instead of being characterized by further inflation, may encompass a period of deflation, falling prices, and unemployment.

Part of the price rise during the last 12 months was caused, not by the increase in private borrowing from the banks, but by an advance in the velocity of circulation. The rate of turn-over of demand deposits in leading cities rose during the year by about 15 percent, and this upward movement, of course, facilitated the rise in the price level. But past experience indicates that the velocity factor is cyclical in nature, hence it is likely to decline in the not distant future.

While, therefore, it must be recognized that inflation and deflation caused by variations in the actions of individuals and corporations do give rise to booms and depressions, they never tend to destroy the value of the currency, a result which has in so many instances been caused by governmental borrowing resulting from unbalanced budgets.

You pointed out that escalator clauses in some wage contracts tend to raise, not only wages, but also the prices of goods made by union members. It does not follow, however, that, if the Government refrains from inflating the currency, these wage rises will raise the general price level. Suppose that the unions produce goods for the Government. Then higher union wages will increase Government expenses and make it necessary to raise more taxes. This will cut down the spending power of the taxpayers. Curtailed demand for the goods which they would normally buy will either reduce the prices of these goods or cause heavy unemployment. In either instance, the average price of civilian goods is almost certain to fall and such a decline will tend to offset the increase in the price of goods bought by the Government.

Of course, the fact which ought always to be kept in mind is that collective bargaining is monopolistic in nature, thoroughly antisocial, and unemployment-creating. Such bargaining should be absolutely prohibited by law.

You and some of the other members of your committee raised the question of whether the imposition of heavy excise taxes on producers would not tend to destroy the middle class and be ruinous to individuals living on fixed incomes. Of course, excise taxes, like all other taxes, are burdensome, but I do not believe that their impact upon the classes mentioned is anything like as severe as is the impact of inflation. An example may serve to clarify this point. Let us take, as an illustration, the case of a widow who, at the beginning of World War II, was living on the interest on a $30,000 4 percent mortgage. This brought her in $1,200 annually. Now, let us suppose that, at the beginning of World War II, excise taxes had been levied so heavy that, on the average, the prices of the things she bought were pushed up 25 percent, and that this continued for 5 years. This would mean that she would either have been compelled to earn additional income, reduce her scale of living, or use up her principal to the extent of $1,500. This would, doubtless, have been burdensome, but contrast this penalty with that imposed by the inflation which was used by our Government as a partial source of funds to meet war expenses. By borrowing from the banks, the Government doubled the price level—in other words it cut in half the real value of her mortgage and the purchasing power of her interest money. In brief, instead of the $1,500 loss which excise taxes would have caused her, she actually suffered a loss of $15,000—in other words, inflation burdened her 10 times as much as excise taxes would have done.

In my opinion, the above example demonstrates the fact that, from the standpoint of the thrifty members of the population, financing a war on the basis of excise taxes is always preferable to using inflation to any extent to meet the outlays involved.

Trusting that I have not infringed too much upon your good nature by giving you my views on these points, I remain, with best wishes

Very sincerely yours,

WILLFORD I. KING,
Chairman.

The CHAIRMAN. Mr. Carroll, we can hear you before we recess for lunch, I think.

STATEMENT OF MITCHELL B. CARROLL, SPECIAL COUNSEL, TAX COMMITTEE, NATIONAL FOREIGN TRADE COUNCIL, INC.

Mr. CARROLL. Mr. Chairman, I am Mitchell B. Carroll, representing the National Foreign Trade Council. In order to save time, I would like to present my statement for the record, and then I will summarize it for you.

The CHAIRMAN. You may present your statement.

Senator KERR. Would it be in order for Mr. Carroll to tell us what the National Foreign Trade Council is?

The CHAIRMAN. Yes.

Mr. CARROLL. Yes, sir. The National Foreign Trade Council is a trade association composed of American enterprises, primarily corporations, engaged in international trade and investment.

Senator KERR. Import and export?

Mr. CARROLL. Both import and export. I suppose it is predominantly export, but the council has laid special emphasis upon the need to import in order that foreign countries, through receiving the dollars, will be able to buy the products that we would like to export. So the emphasis has been placed on both.

Senator KERR. I see.

Mr. CARROLL. It represents a cross section of practically all the American corporations, small as well as large, that are interested in international trade.

Senator TAFT. Does it include the people engaged solely in the export-import business, or does it include the manufacturers?

Mr. CARROLL. Predominantly the manufacturers.

Senator TAFT. Is there another association of exporters and importers, people in the export-import business?

Mr. CARROLL. There are various trade associations that have to do with such business—for example, the United States Chamber of Commerce has a section devoted to foreign trade. But this is the National Foreign Trade Council, and it concentrates on the promotion of foreign trade primarily from the national viewpoint. It has a tax committee, composed of representatives of various corporations engaged in international business, and for a long time they have been considering the measures that might be adopted by the Congress to promote our international trade.

Another committee of the association has been interested in the so-called point 4 program, and one of the questions that has been given considerable attention is the tax measures that should be adopted to facilitate the carrying out of the objectives of that program by private enterprise.

Now, as you know, gentlemen, trading abroad is infinitely more difficult than trading at home. While the tax burden has been going up and up and it is getting to be very serious here at home, when you trade abroad, you continue to be subject to the home tax, because the principle in our revenue act is that you pay the same amount of tax whether you derive your income abroad or at home. In addition you have to bear many kinds of tax burdens and risks abroad that you do not have to encounter in the United States.

In a recent statement by the Treasury Department, the point was made that basic policy of the United States in regard to the taxation of income from abroad is that of tax neutrality.

In other words, they feel that our tax laws should impose the same burdens, whether income is derived from domestic sources or foreign sources. And in this statement, we point out that it is not true tax neutrality, because if you look at things as they are, you find that in doing business abroad, you have to pay taxes in many instances which are not similar to our own income tax, and therefore they are not allowed as credit against our income tax under section 131, I. R. C., which is intended to give relief from international double taxation.

Furthermore, there are many other kinds of burdens and costs in doing business abroad that are not incurred here. By and large, you have to have some kind of incentive to encourage people to go abroad.

PRINCIPLE OF TAX EQUALITY WHERE BUSINESS IS DONE ABROAD

We feel that if this were an ideal world and if you could really look at taxes from an international viewpoint in the way that other countries have looked at them, you would recognize that the fairest principle of taxation of international business is that of tax equality in the foreign country where business is carried on. In other words, the criterion of the tax burden should be the burden that the competitors in the foreign country bear. In other words, the income-tax burden should be determined by the rates in the foreign country.

Now, many foreign countries have recognized the principle that income should be taxed only where earned. In other words, if you are doing business in Brazil, the Brazilian corporation pays taxes only on income earned in Brazil, and the American corporation with an establishment down there would in accordance with that principle pay a tax only on income earned in Brazil; the British, the French, the German, and the Italian enterprise would pay taxes only on income earned in Brazil.

Brazil has an income-tax system which has an effective rate of less than 30 percent. If an American corporation operates in Brazil in competition with a Brazilian, British or French enterprise which pay taxes only at Brazilian rates, the American corporation has to pay the difference between the Brazilian rate and the United States rate, which the House bill would increase to 52 percent without regard to the excess-profits tax. This difference of over 20 percent makes a definite competitive disadvantage that the American corporation has to bear as compared with other enterprises operating in the country.

So we feel that that is the desirable goal to adopt eventually if you cannot adopt it now.

Senator TAFT. How do you divide it? Is the profit made from the sale of automobiles in Brazil, or is it made from the manufacture of automobiles in the United States?

Mr. CARROLL. Under our Internal Revenue Code, principles of allocation are recognized. The manufacturing profit would be taxed in the United States, and the balance attributable to the sale would be taxable in Brazil. In other words, the United States would get in substance the f. o. b. price Detroit, and leave to the dealer in Brazil the dealer's mark-up, or discount.

Senator TAFT. You do not hope to accomplish that in this bill?

Mr. CARROLL. We realize that.

Senator TAFT. You are pointing out what you would like to see?

Mr. CARROLL. That is the objective.

Now, the recent statement of the Treasury sets forth as the basic policy in regard to foreign income the application of our long established system of the credit of foreign taxes, and bilateral treaties for the avoidance of international double taxation. The chairman knows about those treaties. I understand that some 14 have just been reported out favorably.

The CHAIRMAN. Yes; with some changes.

Mr. CARROLL. Yes; with some changes. And we heartily endorse those treaties, and we feel that one could even be a little more liberal in these treaties in making concessions, especially in contemplated treaties with the Latin American countries.

We feel that it would be helpful if you could authorize in the Internal Revenue Code the Treasury to apply in tax treaties this principle of taxation of income only where earned, at least insofar as business establishments are concerned, just as you authorized a number of years back the reduction of the withholding rate to a rate not less than 5 percent in treaties with other countries of the Western Hemisphere.

EXTENSION TO OTHER AREAS OF TREATMENT FOR WESTERN HEMISPHERE TRADE CORPORATIONS

If you cannot adopt that now, then the next step for general policy would be to extend on a world-wide basis the reduction of 14 percentage points allowed Western Hemisphere trade corporations.

As you recall, in 1942 it was pointed out that the average rate in Latin American countries was then about equal to our normal tax of 25 percent, and we pointed out that there were numerous other taxes down there that were not pure income taxes and were not allowed as credits. Therefore it was finally decided to grant a sort of lump-sum relief in the form of an exemption from surtax, and that provision was incorporated into the Revenue Act of 1942, and it has been very helpful.

We think that it would be good policy to extend that regime around the world. It would be particularly helpful in encouraging the setting up of enterprises in underdeveloped countries.

Now, there are a number of specific amendments that would mean very little in revenue, but we feel would be helpful in encouraging international business.

REMOVAL OF MAJORITY REQUIREMENT IN SECTION 131 (F), IRC

As you know, in section 131 (f), IRC, there is a credit for a domestic corporation which owns a majority of the voting stock of a foreign corporation. The domestic corporation is treated almost as if it had a branch in the foreign country and it is allowed to credit against its tax the proportion of the taxes paid by the subsidiary which corresponds to the dividends distributed to it. That provision has given satisfaction over the years.

But now there are many foreign countries which do not permit foreigners to own a majority of the voting stock in certain types of enterprises, particularly in mining enterprises and public utility and various other enterprises.

Therefore, the fact that a minority stockholder cannot get this credit has been inhibitory to the development of certain enterprises in various countries and we urge that you eliminate the requirement for holding a majority of the voting stock of the foreign corporation.

For example, in the case of mining, it frequently happens that the risk is so great that two or three American enterprises will get together in organizing a foreign corporation, and each will have only a minority of the stock. Consequently, each corporation does not obtain the relief from double taxation that a majority stockholder would enjoy.

In other cases, American enterprises simply cannot under local laws hold a majority of the voting stock in a foreign company. That is true in the case of many industries in Mexico. It has been increasingly true in Brazil and other countries.

Senator MILLIKIN. Mr. Stam, what is the reasoning on which you give the credit where a majority is held and you deny it to a minority interest?

Mr. STAM. I do not know. That has been in the law for many years.

Senator MILLIKIN. I know it has. But what is the reason for that discrimination?

Mr. STAM. Generally speaking, the thought was that if you owned control of the stock, you controlled the corporation, and therefore it was deemed to be the tax paid by you if you owned the corporation, that is, if you controlled it. But if you did not control it, then it was a question of determining what part of the tax could be allocated to you.

In the Eightieth Congress, I think in the H. R. 6712 bill that came over but was not acted on, it was agreed that we should try to take care of this problem of these American corporations where they had a minority interest. We tried to work out a rule for that, which I think is very satisfactory, and I think the Treasury has approved of the plan, and I do not think there is any disagreement.

Senator TAFT. It is not in the bill now?

Mr. STAM. No; but when you get around to this particular problem, we thought you ought to take care of it.

Senator KERR. Is it not a fact that these rules in the foreign countries to which you refer have largely been put into effect since the passage of the bill that we now have, which gives exemption to the majority ownership?

Mr. CARROLL. Yes; that is prefectly true. In other words, as Mr. Stam has said, this provision has been in the Revenue Acts since 1921.

Senator KERR. Actually, the problem that you are talking about in the main has developed since——

Mr. CARROLL. Yes; that has developed primarily since the interwar period and since World War II. That is perfectly true. And as Mr. Stam has pointed out, that was actually approved by the Treasury and was incorporated in H. R. 6712 in 1948, which was passed by the House.

So if the Senate wishes to act on it, I think it would be a definite incentive for private enterprise to get behind the point 4 program.

Senator TAFT. The only possible objection I can see to it would be the possibility of trying to apply it to an individual who had a lot of investments in 100 shares of stock here and 100 shares of stock there in corporations. But this proposal, I suppose, applies only to corporations with related business, so to speak, does it not?

Mr. CARROLL. Yes.

Senator TAFT. So that would not be an objection.

Mr. CARROLL. And the probabilities are that unless the corporations were so related that the stockholder could bring influence to bear on the subsidiary, it would not get the information necessary to justify its credit for the underlying taxes that pertained to his minority interest. In other words, it would have to have a substantial minority interest in order to get the information as to the taxes paid by the foreign company.

Senator TAFT. I can say that it might meet some objections, but it would not serve your interests any, to exempt investments in foreign stocks and bonds just as investments, rather than in doing business. But you are interested in the American company being able to do business there on a profitable basis.

Mr. CARROLL. That is the idea; yes, sir.

As regards our general program of relief, we have asked the Treasury at various times for information as to the actual amount of revenue involved. So we have put in our report here the suggestion that you might ask the Treasury as to the actual amount of revenue involved in these various suggestions to which I have referred.

EXCESS PROFITS CREDIT FOR FOREIGN TECHNICAL SERVICE FEES

Turning to the excess-profits tax, when it was adopted, a credit was given for dividends from foreign corporations just as a credit was given dividends from domestic corporations. We asked previously, and we wish to repeat, that we feel that there are certain types of income from abroad that are not in any way due to the rearmament program here, and should be included in this credit from excess-profits tax. One of the most important categories is fees, royalties, and the like, paid for management and technical services rendered by domestic corporations to foreign corporations.

One of the principal features of this point 4 program is to spread American know-how, through having American companies supply, through engineers and the like, their knowledge of how to do things to foreign companies, and usually they get some fee for it. It hardly seems appropriate to subject that type of income to the excess-profits tax.

Senator TAFT. Is there an exemption now?

Mr. CARROLL. Now there is a credit for dividends from foreign corporations just as there is from domestic corporations.

The CHAIRMAN. They are not considered income in computing the excess profits?

Mr. CARROLL. We are just suggesting that this credit idea be extended to cover management and technical service fees.

The CHAIRMAN. Would that be a large item, Mr. Carroll?

Mr. CARROLL. No; it would not be a large item. It could not be a large item because there are not very many American corporations engaged in giving technical advice and services to foreign corporations.

Senator MILLIKIN. Those are foreign companies in which they have an interest?

Mr. CARROLL. Yes: usually that is the case.

Senator TAFT. They might not have an interest, though?

Mr. CARROLL. There may be cases where they do not have an interest. For example, there is some company in France that is not related at all to an American corporation but it wants to modernize its processes, and so it makes a deal with the American company to send over engineers and the like, and the American company says, "I will do it, but for a fee to cover the cost of this service, and make a little profit."

Senator TAFT. Many companies license foreign corporations. They license them to use a certain process or a certain product or something of the kind.

Mr. CARROLL. Yes; that is perfectly true.

Senator TAFT. And then they furnish expert advice to those licensees to tell them how actually to do it.

Mr. CARROLL. That is perfectly true, sir. Often a patent, just by itself, means nothing. If you license a patent, it means little unless you send along an expert to teach the foreign company how to operate under the patent.

CLARIFICATION OF SECTION 131, IRC

Another point that we are making is that in 1942, the Senate adopted a liberalizing amendment to this credit for foreign taxes to take into account the rather primitive and rudimentary taxes that were adopted primarily in Latin American countries before the more nearly perfect concept of an income tax was adopted and superimposed on the earlier taxes.

We feel that the Treasury in its regulations has adopted too narrow a construction of what was intended by the Senate in adopting this provision in 1942.

In the Senate report, there appears a very categorical statement:

> Thus if a foreign country in imposing income taxation authorized, for reasons growing out of the administrative difficulties of determining net income or taxable basis within that country, a United States domestic corporation doing business in such country to pay a tax in lieu of such income tax but measured, for example, by gross income, gross sales or a number of units produced within the country, such tax has not heretofore been recognized as a basis for a credit. Your committee has deemed it desirable to extend the scope of this section.

We feel that the Treasury has in its regulations delimited this amendment so as to prevent the allowance of the credit in many cases where it should be allowed. And we are asking that possibly you might put in your report some reference to this previous statement in 1942 and some clarification which would lead the Treasury toward the path of liberality.

The CHAIRMAN. Some days ago the chairman of the committee asked the Treasury for certain information on this particular point, Mr. Carroll, and I am advised that the Treasury has telephoned they are working on it, and will give us a report.

Mr. STAM. That is right.

Mr. CARROLL. That is fine. That is very helpful.

DEFERMENT OF TAX ON FOREIGN BRANCH INCOME UNTIL RECEIVED

There are a few minor things to which I would like to give mention, in the hope that possibly your experts might give consideration to them. One is a proposal made by the Treasury that income of foreign branches should not be taxed until received in the United States, the idea being that if it is kept abroad and utilized in developing a business, it should not be subjected to our higher taxes here.

The Council feels that while this measure alone is an insufficient solution to the problem, nevertheless it urges that you give favorable consideration to this proposal.

CREDIT FOR FOREIGN ESTATE TAXES

Individuals who go abroad and acquire property are often subject to foreign estate taxes and also subject to our estate taxes, and under our present law, they do not even get a deduction for the foreign estate taxes against the estate taxes here. And that form of double taxation should be eliminated by a credit.

The CHAIRMAN. We are trying to do that in the particular treaties that deal with that sort of thing.

Mr. CARROLL. Yes. But we are hoping that one could make progress more rapidly by just putting a credit in the revenue act similar to the one for the income tax.

The CHAIRMAN. I see, yes.

EXEMPTION FOR AMERICAN BUSINESS REPRESENTATIVES AND TECHNICIANS ABROAD

Mr. CARROLL. Then the Treasury has been very narrow in its construction of section 116 (a) IRC which is intended to encourage Americans to go abroad and help in running the business of American enterprise abroad or in technical, engineering or other projects. Under the rulings of the Treasury, which have been upheld by some of the courts, the term "bona fide residence" abroad, is construed to be practically equivalent to "domicile" abroad. Unless a man goes abroad and definitely establishes his permanent home abroad, he may be held not entitled to this exemption. Even if he comes back after a stay in a foreign country of 3 or 4 years, the individual has been held not to have acquired a bona fide residence abroad dur-that period.

We feel that a more definite criterion is necessary, such as 12 consecutive months.

WAR LOSS RECOVERIES

There are two situations arising out of the war which we feel need attention. For some time we have been urging some technical amendments to section 127, which deals with losses in World War II. One is that there should be a ceiling placed on the value of the recovery, which would be the lesser of the adjusted basis at the time of the loss or the fair market value at the time of the recovery.

Another is that if no loss were deducted in respect of any item of property, there would be no tax on recovery and no change in the base for tax purposes.

LOSSES IN KOREA AND CHINA

Since World War II, there has been war in Korea, and property has been seized or confiscated during the "cold war" in China. The provisions in section 127 regarding war losses should be adapted to cover the situation in China and Korea.

EXTENSION OF TIME FOR RETURNS OF DOMESTIC CORPORATIONS OPERATING IN CHINA

Furthermore, China Trade Act corporations have not been able to get from China the information needed to meet the requirements of section 261, and therefore we urge that they be granted a moratorium for filing returns, such as was granted during World War II under section 3805, IRC. A similar delay should be granted to other domestic corporations with branches in China.

Those, sir, are the principal points. They certainly do not involve a great deal of revenue, but they would help the individual enterprises carrying on trade abroad in the face of tremendous odds in the present circumstances.

The CHAIRMAN. Thank you very much, Mr. Carroll.

Are there any questions?

Senator TAFT. Did you present all these matters to the House committee?

Mr. CARROLL. Yes, we did, sir.

Senator TAFT. But they were too busy, or something?

Mr. CARROLL. As a matter of fact, some of the points were taken up in committee, and I have been informed that they were passed without prejudice. I think that you know what that means better than I do.

Senator TAFT. No, I do not. It means, I suppose, that they approve them in principle, but not enough to include them in this bill.

Mr. CARROLL. I hope it means without prejudice to the Senate doing something about it.

Thank you.

The CHAIRMAN. Thank you.

(The prepared statement of Mr. Carroll is as follows:)

STATEMENT OF MITCHELL B. CARROLL, SPECIAL COUNSEL, TAX COMMITTEE, NATIONAL FOREIGN TRADE COUNCIL, INC.

Mr. Chairman and gentlemen, our tax committee is aware you have before you a bill intended primarily to raise a large amount of additional revenue to meet the costs of rearmament, but in its behalf I ask your forbearance in pointing out that although the effect is to impose a staggering burden on domestic enterprises, the effect will be even more crushing on domestic enterprises which are engaged in foreign trade and will be most discouraging to those who might otherwise be disposed to assist in carrying out the administration's declared policy of helping to develop the economic resources of foreign countries. The handicap now borne by domestic enterprise in competing with those of foreign countries where the income-tax load is much lighter will be seriously aggravated.

After very careful consideration of all the angles of the problem, our tax committee has come to the conclusion that in order to permit American enterprises to compete on a satisfactory basis with the enterprises of other countries, which in general have a much lower effective rate of taxation, the guiding principle should be that of tax equality in the foreign country where the business is carried on. Especially in less developed countries where the science of taxation is not developed to the fine point prevailing in the United States, and where recourse

is had to rudimentary taxes which are easy to collect, adequate relief from double taxation is not assured under the Treasury's interpretation of the foreign tax credit, which is allowed only for income taxes and taxes in lieu of income taxes. We are heartily in favor of supplementing the credit for foreign taxes by bilateral tax treaties, but hitherto the Treasury has not shown any disposition to adopt a realistic approach to providing an offset of taxes which are not pure income taxes in the American concept against the United States tax. Furthermore, even if the foreign country does have a pure income tax, it is frequently superimposed upon older levies that from its viewpoint were precursors of the income tax, but are levied upon income determined by prevailing market prices or units produced. The allowance of the credit only for the superimposed income tax obviously does not provide the relief from double taxation that should be within the scope of section 131, IRC.

A large number of foreign countries tax only income from sources within their territory at a scale of rates considered by their legislators as appropriate for what the economy of the country can bear. Enterprises of the taxing country and of third countries which follow this principle of territoriality bear only the tax imposed in accordance with this scale of rates. However, the local establishment of an American corporation must bear, in addition to the local tax, the difference between its rate and the increasingly high United States rate. This constitutes a serious competitive disadvantage. Moreover, the local effective rate of income taxes and taxes in lieu of income taxes is not the only consideration the American enterprise must face. It frequently has to bear local license taxes, social-security taxes, stamp taxes, sales taxes, import and export taxes, and if it wishes to bring home any income, it frequently has to bear exchange taxes such as the 17 percent exchange tax recently adopted by the Philippine Government. In addition, the costs of doing business in various foreign countries are frequently relatively higher than in the United States. In some cases the social-security taxes alone are said to attain about 50 percent of the payroll. There are risks of losses through devaluation of the currency, nationalization or expropriation. In some cases enterprises have not been able to bring back their earnings for years because of exchange restrictions. These are items which, generally speaking, do not have their equivalent in the United States and therefore account should be taken of them in formulating an appropriate tax regime to encourage American business and investments abroad.

In addition, with the increasing growth of nationalism in many foreign countries, there is a tendency to limit the holdings of foreigners in extractive industries, public utilities, and certain other enterprises to a minority of the voting stock of local corporations. The credit for foreign taxes does not allow any relief in such a case.

Although the Congress has enacted a provision in section 116 (a), I. R. C., to encourage individuals to go abroad in the interest of American commerce by exempting from United States tax the income earned in a foreign country or countries by a United States citizen while a bona fide resident of a foreign country or countries during the entire taxable year, the Treasury has so limited the application of this provision by restrictive rulings that an individual may not enjoy its intended benefits unless he goes abroad on a "career" basis. The business representative or technician who gives up a safe job in the United States to incur the discomforts and hardships incident to life in an underdeveloped country consequently may find himself faced with a large deficiency assessment when he returns to the United States after a stay of only 2 or 3 years.

1. PROPOSED REGIME FOR INCOME FROM FOREIGN PERMANENT ESTABLISHMENTS AND SUBSIDIARIES

After thorough consideration of all the problems involved in connection with foreign trade and investment, the National Foreign Trade Council has come to the conclusion that the only way to assure tax equality with competitors in foreign countries is to adopt the principle that income should be taxed only in the country in which it is derived. Particularly, the National Foreign Trade Council would prefer an enactment in the Internal Revenue Code of a general provision recognizing that income allocable to the foreign permanent establishments of domestic corporations should be taxable only in the country where such income is produced. However, if Congress is not disposed to adopt this proposition at this time, we urge that it enact a provision authorizing the inclusion of such a provision in tax conventions. The term, "permanent establishment," has been defined in a number of tax conventions already in effect, such as those with

France, Sweden, the United Kingdom, Canada, the Netherlands, and Denmark, and the term is also defined in a number of income-tax conventions awaiting ratification by the Senate, including those with New Zealand, South Africa, Norway, Ireland, and Greece. All of these conventions embody the principle that the foreign country should tax only the income attributable to such permanent establishment and, therefore, the foundation has been adequately laid for embodying in income-tax conventions the principle that the tax imposed by the foreign country on the income of such permanent establishment will be the only tax paid, thereby assuring competitive equality with local enterprises and with the permanent establishments of enterprises of third countries applying the principle of territoriality.

Inasmuch as it is frequently expedient, if not necessary to incorporate the local business, the same principle should be extended by law or by treaty to dividends received by domestic corporations from such foreign corporations, and preferably to other income from such foreign corporations in the form of interest paid on loans, royalties, management, and technical service fees.

2. INTERMEDIATE REGIME FOR INCOME FROM FOREIGN SOURCES

If your committee does not now consider it opportune to adopt the foregoing regime, we submit for your consideration the generalization on a world basis of the regime now allowed Western Hemisphere trade corpotations, i. e., domestic corporations operating almost exclusively in other countries of the Western Hemisphere, in the form of a credit against normal tax and surtax net income, which has the effect of reducing the combined rate of normal tax and surtax on such domestic corporations by 14 percentage points. Such corporations are also exempt from excess profits tax. When the pertinent provisions were originally enacted in the Revenue Act of 1942, it was recognized that the average income tax rates in Latin-American countries were rarely higher than the United States normal tax, and consequently the imposition of the surtax on the income from these countries was, in effect, tantamount to the United States exploiting the tax preserves of our good neighbors to the South. The relief was originally given in the form of an exemption from surtax, and this was justified, in part, as being equivalent to a lump-sum relief for the various taxes that were not allowed as credits against the United States tax.

Extension of this regime to cover other areas and particularly those in Africa, the Near East and South east Asia, where the tax rates are much lower than the United States rates, would provide a definite incentive for American corporations to get behind the Administration's point IV program. As in many of these areas income is largely blocked by exchange restrictions, and as the Treasury in mimeograph 6475 has adopted the policy of not taxing such blocked income until it is convertible into dollars, the enactment by Congress of this regime should not involve, at the present time, a great loss of revenue.

It is also urged that this regime of the reduced rate, with allowance of the foreign tax credit, should be applied in the case of dividends from foreign corporations meeting the same test as Western Hemisphere trade corporations and other income from foreign corporations in which domestic corporations have a substantial interest, such as interest on loans, royalties, management, and technical service fees.

3. CREDIT FOR DOMESTIC CORPORATIONS WITH MINORITY HOLDINGS IN FOREIGN CORPORATIONS

Mention has been previously made of the nationalistic restrictions in various foreign countries whereby American corporations may acquire only a minority interest in local corporations engaged in extractive industries, public utilities, and other types of enterprise. Moreover, the risks incident to mining for strategic materials, exploring and drilling for oil, and initiating other enterprises to obtain the raw materials are frequently so great in a given country that two or more domestic corporations sometimes join in organizing a foreign corporation. In his statement before the Committee on Ways and Means on February 3, 1950, Secretary Snyder stated that there has been an increasing emphasis in foreign countries on the participation of local capital in the ventures of United States businessmen. Although a domestic corporation owning a majority of the voting stock of a foreign corporation, from which it receives dividends, may take credit under section 131 (f), I. R. C. for the income taxes paid by the foreign corporation which correspond to the dividends received, a domestic corporation owning 50 percent or less of the stock in such a foreign corporation is not entitled to any such

relief from double taxation. H. R. 6712 of 1948, which passed the House of Representatives but was not acted on by the Senate, recognized that this requirement to hold a majority of the stock is arbitrary and definitely inhibitory to the acquisition of minority interests in foreign corporations, and contained an amendment which omitted the majority requirement and allowed the credit under section 131 (f) in the case of "a domestic corporation which owns stock of a foreign corporation from which it receives dividends in any taxable year."

We earnestly urge your committee to incorporate this amendment in the pending tax bill as it would remove the discrimination against minority holdings, and would provide a definite incentive to participation by American corporations in foreign corporations carrying on activities in furtherance of the point IV program.

4. SENATE COMMITTEE REQUEST TO TREASURY FOR REVENUE STATISTICS

Our tax committee believes that the adoption of the foregoing proposals would not involve a serious loss of revenue and we therefore strongly urge your committee to request the Treasury to give you figures on the amount of revenue involved in each one of them.

5. EXEMPTION FROM EXCESS PROFITS TAX OF MANAGEMENT AND TECHNICAL SERVICE FEES

In connection with the point IV program emphasis has been placed particularly upon having American corporations assist foreign corporations in modernizing and otherwise improving their production through placing at their disposal the "know how" developed in the United States. The fees received for such services are sometimes in the form of a flat sum or based upon production in the foreign country, and are not predicated upon production in the United States which results from the rearmament program here. Hence, the inclusion of such fees in the basis for the United States excess profits tax is not justified in principle, and it serves as a definite deterrent to the making of arrangements with foreign corporations to give them the benefits of American advanced technology. A credit is allowed against excess profits tax net income for dividends from foreign operating companies and it is therefore urged that this credit be extended to cover such management and technical service fees.

6. CREDIT FOR FOREIGN TAXES IN LIEU OF INCOME TAXES

In the report of your committee on the revenue bill of 1942 (S. Rept. No. 1631, 77th Cong., 2d sess., p. 131) explaining the amendment in section 131 (h) to allow a credit for foreign taxes imposed on empirically determined income in lieu of income taxes to which I have previously alluded, there appears the following statement:

"Thus if a foreign country in imposing income taxation authorized, for reasons growing out of the administrative difficulties of determining net income or taxable basis within that country, a United States domestic corporation doing business in such country to pay a tax in lieu of such income tax but measured, for example, by gross income, gross sales or a number of units produced within the country, such tax has not heretofore been recognized as a basis for a credit. Your committee has deemed it desirable to extend the scope of this section."

Although it seems to be now well established that taxes on gross income may be allowed as credits, primitive income taxes "based on gross sales or number of units produced within the (foreign) country" may not enjoy the same treatment especially where under the regulations such a levy is not imposed in complete substitution for an income tax which conforms to the United States tax. In the eyes of the foreign government these taxes often preceded the income tax and are kept as a practical means of taxing income and have, together with the superimposed income tax, constituted the tax on income which should be allowed as an offset against the United States income tax; otherwise, the complete relief from double taxation intended by section 131 is not assured.

It is therefore urged that the report of your committee should contain language removing any doubt that credit should be allowed for any tax which is intended to reach income but is based on the number of units produced at established market prices, or some other empirical factor, or serves as a minimum tax on income.

7. TAXATION OF FOREIGN BRANCH INCOME AT TIME OF RECEIPT IN THE UNITED STATES

The proposal has been made that a United States corporation should be allowed to treat income of foreign business establishments as nontaxable until actually

received in the United States. The council has been informed that the Treasury Department is in favor of the objective of this proposal. The council has expressed the view that the treatment contemplated in this proposal would be desirable. The position has been taken, however, that such a measure alone is an insufficient solution for the problems of taxation of foreign trade and should not be considered in any sense as a substitute for the other measures recommended by the council. On this basis the council recommends that favorable consideration be given to this proposal.

8. REPEAL OF "PER COUNTRY LIMITATION" ON FOREIGN TAX CREDIT

In order to encourage American enterprises to extend their operations abroad in a number of foreign countries it would be desirable to return to the original form of limitation on the foreign tax credit which treats the foreign business as a whole and permits the averaging of the high rates of some countries with the low rates of others. This can be done by removing the so-called per country limitation in section 131 (b) (1), Internal Revenue Code but retaining the so-called over-all limitation in section 131 (b) (2), Internal Revenue Code. This would permit the offsetting of losses in one foreign jurisdiction against gains in another foreign jurisdiction and, in general, the treatment of foreign operations on a geographical area or world basis rather than on a restricted per country basis. Furthermore, the over-all limitation prevents the relief from double taxation from reducing United States tax on domestic income.

9. CREDIT FOR FOREIGN ESTATE TAXES

If an American citizen goes abroad in the interest of foreign commerce and dies abroad, in many cases his property acquired abroad may be practically consumed by liability not only to death taxes in the foreign jurisdiction, but also the Federal estate tax. Not even a deduction for foreign estate taxes is allowed in computing the United States estate tax. The inequity of this situation has been recognized in estate-tax conventions with the United Kingdom, Canada, and France, and we heartily urge, as the Treasury has previously done, that a provision for a credit for foreign estate taxes, similar to that allowed for foreign income taxes, be incorporated in the pending legislation. Such a provision was found in section 210 of H. R. 6712 of 1948, which was passed by the House of Representatives, but died in the Senate.

10. PROVISIONS TO ENCOURAGE AMERICANS TO SERVE ABROAD

The Treasury has previously recommended that the exemption under section 116 (a), Internal Revenue Code for income earned by citizens of the United States who are bona fide residents of the foreign country or countries during the entire taxable year should be amended so that the exemption will run as from the date in a given taxable year when the individual becomes a resident of a foreign country or countries. In endorsing this recommendation we urge that your committee go a step further and prevent the encroachment upon the intended relief which results from construing bona fide residence as being practically tantamount to acquiring a domicile abroad. If Congress desires technicians to go abroad on private missions under the point IV program, it will be necessary to replace the concept of "bona fide residence" by a more definite term, such as living in a foreign country for business purposes for at least 12 consecutive months.

11. UNBLOCKED INCOME ATTRIBUTABLE TO BASE YEARS FOR THE EXCESS PROFITS TAX

The Excess Profits Tax Act of 1950 contains a very laudable provision to exclude, from excess profits tax net income, income derived abroad in previous years, but which has been blocked and is released after the beginning of the taxable years to which the excess-profits tax is applicable (sec. 433 (a) (1) (M), I. R. C.). However, this provision does not cover the case of corporations claiming their excess profits credit on an income basis which receive income attributable to base-period years which has been unblocked and should be included in the income of those years.

It is therefore urged that the provision in question be amended so as to permit the inclusion of income unblocked in the excess profits tax years, but allocable to the base-period years in the income of those years for the purposes of the income credit.

12. PROVISIONS TO COVER SITUATIONS ARISING OUT OF WAR

In addition to the foregoing provisions, we ask Congress to take cognizance of not only the certain amendments needed to improve legislation pertaining to World War II, but also to introduce legislation concerning war losses which will fit the present situation.

Under section 127, Internal Revenue Code there is need for certain amendments regarding the recovery of property lost, or deemed lost under that section during World War II. The principal amendments needed and on which representatives of business are generally agreed are as follows:

1. There should be placed a ceiling on the value of the recovery of property lost, or deemed lost under section 127, Internal Revenue Code, which would be the lesser of the adjusted basis at the time of loss, or the fair market value at the time of recovery.

2. Moreover, the code should be amended so as to provide that if no loss has been deducted in respect of any item of property there will be no tax on recovery and no change in basis for tax purposes.

In view of the fact that American property may have been lost in Korea as the result of war, and has been seized or confiscated in China, provisions similar to the war-loss provisions in section 127, Internal Revenue Code, should be adopted which are applicable to those areas and to any other areas subjected to hostilities or Communist domination.

Finally, in view of the ineluctable fact that the China Trade Act corporations cannot obtain from China the information needed to meet the requirements of section 261, and that other domestic corporations operating in China cannot meet requirements as to reports relating to the activities in China, a general postponement of liability to file returns or pay tax should be granted for the duration of the present situation as was done during World War II for China Trade Act corporations (sec. 3805, I. R. C.).

The CHAIRMAN. The committee will stand in recess until 3 o'clock.

(Whereupon, at 12:45 p. m., the committee recessed, to reconvene at 3 p. m., the same day.)

AFTERNOON SESSION

The CHAIRMAN. The committee will come to order.

Mr. Silverson?

Mr. SILVERSON. Present.

The CHAIRMAN. Come around, Mr. Silverson, please, sir. Have a seat there, if you wish to, and identify yourself for the record.

STATEMENT OF HARRY SILVERSON, MEMBER, COMMITTEE ON TAXATION, NEW YORK COUNTY LAWYERS' ASSOCIATION

Mr. SILVERSON. Thank you, sir.

My name is Harry Silverson. I am a member of the committee on taxation of the New York County Lawyers' Association, and have been asked to present the views of this committee to your honorable body. We appreciate the opportunity.

The CHAIRMAN. Yes, sir.

Mr. SILVERSON. The New York County Lawyers' Association is an association which was formed some 43 years ago, and which includes in its membership approximately 7,500 attorneys practicing or residing within the city of New York. It is believed to be the largest local bar association in the world.

The committee on taxation of the association is composed of attorneys who specialize in the law of taxation. Its members include many of the well-known practitioners in that field. The committee regularly considers tax bills which are pending before the Congress, and

after careful study submits such recommendations as are believed appropriate.

Our appearance here today is not to advocate measures for revenue, but rather to advocate a single proposition, which at one and the same time we believe will correct a long-standing inequity and will be extremely helpful in siphoning off the purchasing power that is a part of the current anti-inflationary campaign. Specifically, we are here to urge upon this honorable body the incorporation in H. R. 4473 of provisions which will have the effect of permitting those taxpayers with earned income who are not now covered by qualifying pension plans to create, within certain limits, self-operating pension funds to be funded through the periodic purchase of special type nonassignable United States Government bonds. We believe that adoption of this proposal would not only eliminate a glaring inequity which presently exists, but would also be of considerable assistance to the Treasury in selling individually owned bonds as part of the general anti-inflationary campaign presently in effect.

As H. R. 4473 passed the House, it provided for an increase in personal income-tax rates equal to 12½ percent of the combined normal tax and surtax. We make no recommendations concerning the increase, since questions of rates involve policy questions with respect to which we do not feel specially qualified to pass an opinion. We do, however, strenuously urge that the level of personal income-tax rates has now reached a point at which, taking into consideration the vast growth of employer-funded pension plans, it is imperative that those persons within the earned-income group who are not now eligible to participate in the benefits of a qualifying plan be given an opportunity to do so.

At the outset of our argument we submit that a given amount of earned income, that is, income from salaries, wages, professional fees, does not reflect the same ability to pay taxes as does the same amount of investment income. For earned income, by its very nature, is not as permanent in character as investment income; it is too dependent on the continued life and well-being of the earner. As Secretary Mellon once put it, and I quote:

> The fairness of taxing more lightly incomes from wages, salaries, and professional services than the income from business or from investment is beyond question. In the first case, the income is uncertain and limited in duration; sickness or death destroys it and old age diminishes it. In the other, the source of the income continues; the income may be disposed of during a man's life and it descends to his heirs.

In an article appearing in the August 1949 issue of Survey of Current Business, which is a periodical published by the United States Department of Commerce, the following statement appears, and I quote:

> In any given occupational group, age is clearly one of the most significant factors affecting the size of income. Moreover, in practically all occupational pursuits, the age-income pattern is basically the same; namely, at the low ages income is at its lowest point, and, as age rises, income also rises until a peak is reached; thereafter, income gradually declines with increasing age.

This age-income pattern appears most graphically in a chart in an earlier issue of the same publication, May 1944, which I have photostated and attached to the bottom of my statement. I think it is a most significant chart to prove the point that I am about to make.

As appears from this chart earned income of professionals is parabolic in nature, that is, it moves up to a peak at approximately the age of 37, flattens out in a plateau which continues until approximately the age of 52, drops somewhat from that age to age 62, and then catapults down. The pattern for lawyers is somewhat different in that the peak period appears to run from the ages of 47 to 57. Actually this chart is overly liberal in that it takes into account only the incomes of persons actually practicing, thereby ignoring those who do not practice because of ill health. The chart equally ignores the families of deceased practitioners whose income terminated with death.

A taxpayer enjoying investment income need not suffer a decline in his income because of advancing age. On the contrary, if he has accumulated capital and greater investment sagacity over the years, he is likely to fare even better in the winter of life than previously. Nor need his death cut off his family from income, as does the death of a professional or other taxpayer deriving all his income from personal services. Furthermore, during life the recipient of investment income has in many instances been able to shield substantial portions of such income from the full impact of the graduated surtax by appropriate use of corporations and gifts of income-producing property to members of the family or to trusts for their benefit.

While our tax law fails to give direct recognition to these inherent differences between earned and investment income, partial recognition has been given by indirection through the provisions covering pension trusts. Under these provisions, an employee for whose benefit his employer pays amounts into a pension trust need not report such amounts until he actually begins to receive his pension income. Originally these plans were set up by employers of their own volition and covered only a very small minority of the working population. In more recent years, following the growth of strong unions, and coupled with their inability during an inflationary period to obtain direct salary increases, the unions have concentrated on bargaining for so-called fringe benefits, the chief one among which has been pension funds. As a result, it is estimated that such plans now cover over 8 million persons, with aggregate contributions in excess of $1,500,000,000 annually.[1]

This growth of pension funds has tended to alleviate the discrimination between earned and investment income with respect to the many millions covered by qualifying plans. However, it has not only effected no such alleviation for the many more millions within the earned-income group not covered by pension plans, but by its very partial application has had the effect of creating further discrimination.

As an example, let us compare two wage earners, both of whom are in the lowest bracket. One receives an increase in his wages in the form of a straight dollar increase; the other obtains the same amount in the form of a contribution to a qualifying pension trust. The first

[1] New York Herald Tribune, June 19, 1951, p. 32.

wage earner, under existing laws, pays 20 percent of his increase in taxes; the second pays no tax presently. Furthermore, he will in all probability never pay a tax on the increase because, when he retires at age 65, his personal exemption will be $1,200 and his wife's exemption will be either $600 or $1,200, depending upon her age. This total exemption is more than likely to equal his pension and other taxable income. If, because of restrictions against salary increases, the first employee can obtain no increase while the second nevertheless obtains his pension contribution, the discrimination is even more marked.

The American Bar Association has urged that the pension trust provisions be broadened so as to permit sole proprietors and partners to be included in a pension plan. We believe that this proposal is much too limited in its coverage. Furthermore, while such an amendment might be of interest to some firms, which are of sufficient size to warrant the adoption of a pension plan, it is hardly suited to the needs of the average lawyer, physician, dentist, writer, or other professional practicing alone or as a small unit. Neither does the American Bar Association proposal offer any relief for the many employees whose employers do not choose to inaugurate a qualifying pension plan.

The proposal of the committee on taxation of the New York County Lawyers' Association is that taxpayers be given the right to create their own pension plans by investing up to 15 percent of their net earned income in any 1 year, subject to some dollar maximum, in a special-type 2-percent-interest-bearing nonassignable United States Government bond. Amounts so invested would be excluded from gross income in the year of purchase of the bonds. However, in the year of redemption, the face amount of these bonds, together with accumulated interest thereon, would be fully taxable. In the event of death prior to redemption, redemption by the named beneficiary or the estate would be permitted over a period of 10 years, thereby avoiding the bunching of income in 1 year which would otherwise result.

It is our considered opinion that not only is this proposal highly equitable but that it would be most simple to administer. In the year of purchase of a bond, the taxpayer would attach to his return the slip or slips evidencing the purchase, which slips could be furnished him by the bank or other authorized institution through which he acquired the bonds. In the year of redemption, the bank or other institution through which the bonds are redeemed would forward an information slip to the appropriate section of the Bureau of Internal Revenue. No further administrative machinery would be necessary.

We respectfully submit that our proposal is particularly appropriate at this time when personal income-tax rates are about to be further increased. It is simple of operation, easy to administer, and would remove an inequity which has become of growing importance. Nor should we lose sight of the fact that it would aid the efforts of the Treasury to increase that portion of the public debt which is held by individuals rather than institutions.

(The chart referred to follows:)

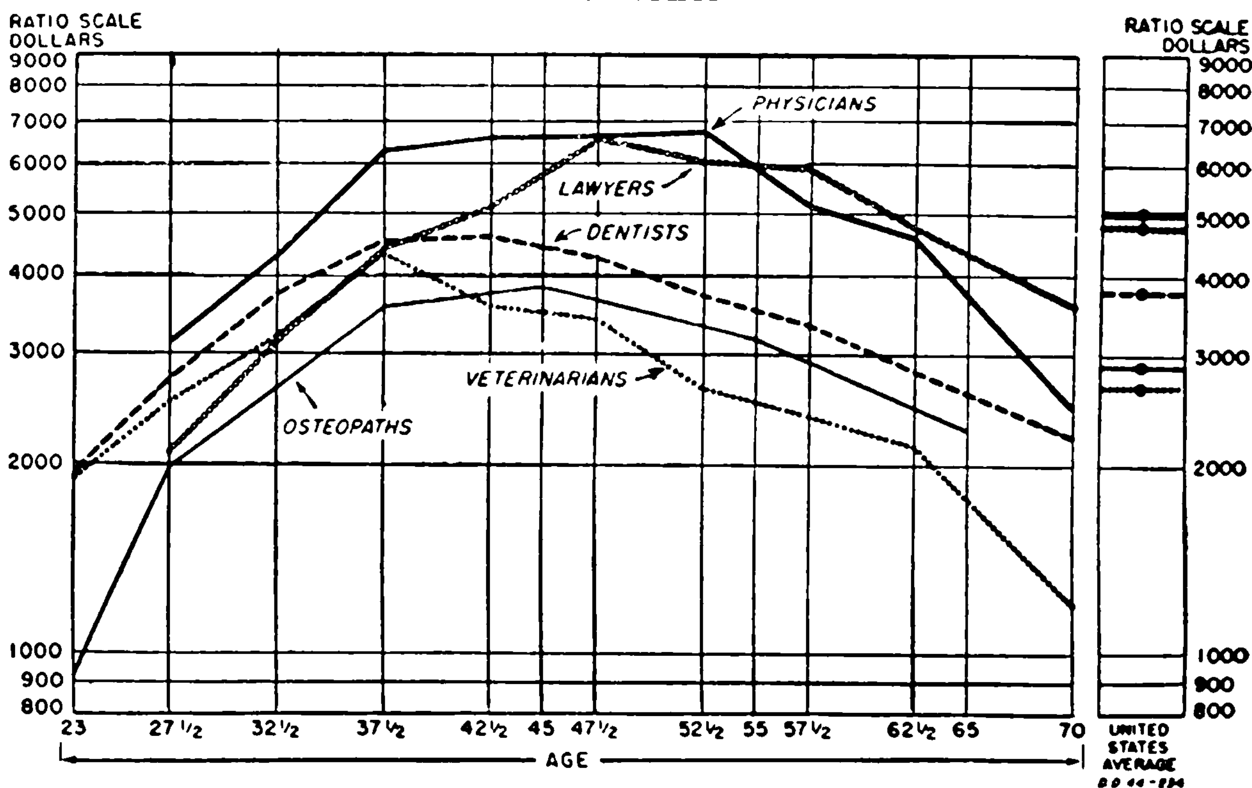
Reprint from
SURVEY OF CURRENT BUSINESS
A U.S. DEPARTMENT OF COMMERCE PERIODICAL

Incomes in Selected Professions

Part 6. Comparison of Incomes in Nine Independent Professions

By Edward F. Denison, National Income Unit, Bureau of Foreign and Domestic Commerce

Chart 1.—Average Net Income in 1941 for Selected Professions, by Age of Practitioner[1]



[1] See page 19, statistical notes to charts.
Source: U. S. Department of Commerce.

The CHAIRMAN. You suggest nonnegotiable bonds, do you?

Mr. SILVERSON. Yes, Senator. It would be a registered nonassignable bond.

The CHAIRMAN. Nonassignable; yes, sir.

Are there any questions, Senator Millikin or Senator Taft?

You refer to the American Bar Association plan. Are you familiar with that?

Mr. SILVERSON. I am, Senator; yes.

The CHAIRMAN. Really the only criticism of that, as compared with your suggested plan here, is that it is too restrictive, and lacks wide application.

Mr. SILVERSON. Well, we believe that it is so restrictive that it would tend to increase the present discrimination by simply including a relatively few more taxpayers in the pension fund group.

The CHAIRMAN. I see.

Mr. SILVERSON. Most attorneys throughout the country practice alone, as do physicians and others with earned income; and it just is not feasible to say to a doctor in some small town, "Form a pension plan."

The CHAIRMAN. No, sir; he cannot do it.

Aren't your office employees under social security?

Mr. SILVERSON. Office employees are.

The CHAIRMAN. They are under. You would have been under it, but you would not, of course—the professional people did not want us to put them under last year when we had social-security benefits before us.

Mr. SILVERSON. Well, the social-security benefit is very small in relation to what we are talking about here.

The CHAIRMAN. That is true with respect to the earnings of professional men like doctors, lawyers, dentists, artists, and so on.

Any questions, Senators? Thank you very much.

Mr. SILVERSON. Thank you.

The CHAIRMAN. Thank you very much for your appearance.

Mr. Carl Wittichen, it looks like to me, on this list. Is that correct?

Mr. WITTICHEN. Yes, sir.

The CHAIRMAN. Come around, Mr. Wittichen.

STATEMENT OF CARL WITTICHEN, JR., WITTICHEN CHEMICAL CO.

Mr. WITTICHEN. I have a little trouble with it myself, sir.

The CHAIRMAN. You do? Well, have a seat.

Mr. WITTICHEN. Thank you, sir.

The CHAIRMAN. Identify yourself for the record, and then we will have you tagged.

Mr. WITTICHEN. My name is Carl Wittichen. I operate a small corporation in Alabama known as the Wittichen Chemical Co.

I appear here as a small-business man employing 23 people. I represent no organization of any sort; I am just a taxpayer.

The CHAIRMAN. You just keep up the organization; that is, the Government organization.

[Laughter.]

Mr. WITTICHEN. Yes, sir; I keep up some part of it, not much, but a little bit.

Gentlemen, I am seriously concerned with the impact of the present tax law, and especially the increases in the corporate excess-profits taxes that have been proposed in the new tax law.

It is putting little fellows like myself, and other corporations that exist, as my neighbors of a smaller nature, in a bad psychological frame of mind.

We have for years, when we built these little businesses, been as efficient and as careful and as thrifty as we can in our organization in dealing with our employees. But now our employees know that we are paying a good portion of our earnings out in income taxes; they just know that. They pretty well know what goes on, and they are becoming wasteful. It is difficult to discipline them.

You know, the relationship between management and the employee, and they know that, for instance, my salesmen traveling out, they know and they see competitive salesmen traveling in Buicks

and Cadillacs, and so on, and my men, traveling in Chevrolets, it is just a bad psychological situation, and they are demanding those same luxuries from us because, as they put it to me, why, the Government is paying the freight, and "We don't see why you should worry."

It is not that blunt, but it is a bad psychological picture that is existing among my people that I have to depend on to operate my business.

The CHAIRMAN. What is your investment, your coporate stock?

Mr. WITTICHEN. My capital investment?

The CHAIRMAN. Yes.

Mr. WITTICHEN. My net worth, sir, is slightly less than $200,000.

The CHAIRMAN. How long have you been in business, you say?

Mr. WITTICHEN. I started this chemical business as part of a business that my father left in 1935.

The CHAIRMAN. 1935?

Mr. WITTICHEN. That is right. I have been in that business myself, and I built it myself.

Senator MILLIKIN. What kind of chemicals do you make?

Mr. WITTICHEN. Industrial chemicals, sir.

Senator MILLIKIN. Any particular type?

Mr. WITTICHEN. Yes, sir; we supply the municipal waterworks primarily with water-treatment chemicals, textile mills, dairies, bakeries, large creameries, and things of that sort.

The CHAIRMAN. You are subject to the excess-profits tax?

Mr. WITTICHEN. Yes, sir. We are, sir; we surely are.

The CHAIRMAN. We call it an excess-profits tax, but this House amendment removes it from that category and it just becomes a supertax on your normal income.

Mr. WITTICHEN. Yes, sir; it is really a supertax, sir.

The CHAIRMAN. That is what it is. [Laughter.]

Mr. WITTICHEN. It is having the effect on slowing down production, not only with my business, but with other little firms scattered around me.

The employees lose the incentive of producing any more. They know that I cannot pay them any more because I am restricted under the wage laws, and there is no incentive on my part as a manager to put any more capital investment and improve our facilities to get more out of what we are doing now. There is just no incentive for doing that, sir.

It just means tying up capital, and we get nothing from it whatsoever; and, in addition to that, there is no incentive even to make our present operation any more efficient. We just do not want to do any more, and it completely obviates any expansion.

It is also causing a slight hoarding of manpower. We find ourselves where in normal times in a competitive business we operate shorthanded, now since the Government, with the tax picture, it is paying a good portion of what we pay any new employees we employ, why, naturally, we tend to staff ourselves as well as we can, and I do not like to do those things. It is not the way I was raised, not the way this country was built, but still, as a psychology of this tax situation, it is changing us into that; it is just what is happening to me.

Particularly, in my concern, the new rates that have been proposed in the House bill, coupled with our State of Alabama income tax,

brings us up right at 85 percent of the few dollars we are making now, to be paid out, which means that we are spending 15-cent dollars in the operation of our business. I just believe, with the increase of inefficiency that is creeping into the operation of our enterprises, and with those things that are coming along, that the new tax rates will not get the revenue they are supposed to, because people, like myself, would just tend to be wasteful, and we will not make the profits we have been making regardless of our volume of business. They just will not be that way, regardless of how we try not to be wasteful. We are forced into a lot of those things by the pressure from our employees. That is——

The CHAIRMAN. What is your Alabama corporate rate?

Mr. WITTICHEN. Three percent, flat 3 percent, sir. It means we are paying approximately 84 cents out of the dollar under the new proposed rates, if I remember exactly, because the two taxes are balanced against each other for deduction purposes.

Senator MILLIKIN. Do you have an income tax in Alabama?

Mr. WITTICHEN. Yes.

Senator MILLIKIN. What is the range on that?

Mr. WITTICHEN. It ranges from 1½ to 5 percent. That is personal income.

Senator MILLIKIN. And with sales tax?

Mr. WITTICHEN. Yes, sir; we have a 3-percent sales tax. It was 2, and it was raised to 3.

Senator MILLIKIN. Service tax, transaction taxes?

Mr. WITTICHEN. No, sir; not that I know of, sir.

Now, I am here complaining about what it is doing to us, and there are one or two things I want to offer sort of as a remedy. I do not know whether this will have any bearing or not.

We little fellows that are having to pay these taxes, just see a tremendous amount of waste in the operation of governmental offices in our areas, and everybody that we deal with. We see the red tape that is involved, and it hurts us to see those things because we know we are paying the bills, and if there is some way that efficiency can be brought back into the governmental employees' offices in those areas, it would create a different psychology of doing as efficient a job as they can, and we sure would appreciate it. That, to me, would stop a lot of these taxes, a lot of what we little fellows are having to pay.

Senator MILLIKIN. Do you have any war activities—what is your home town?

Mr. WITTICHEN. Birmingham, Ala. It is a steel center primarily; coal, and steel, and iron.

Senator MILLIKIN. May I ask what does a man in your business pay a stenographer, a good stenographer?

Mr. WITTICHEN. Like in my little business?

Senator MILLIKIN. Yes.

Mr. WITTICHEN. My stenographer gets $300 a month, sir, but she is more than a stenographer. She is sort of an office manager, and keeps up a lot of little things.

Senator MILLIKIN. What, then, would an office stenographer——

Mr. WITTICHEN. Straight stenographer?

Senator MILLIKIN (continuing). Neither the best nor the worst receive?

Mr. WITTICHEN. Sir, I would guess around $180 to $200, not over that.

Senator MILLIKIN. Do you know what the Government pays for the same kind of a stenographer in Government activity?

Mr. WITTICHEN. I know what they paid during the last war because I had some of them working for me, but I do not know now, sir. It is considerably higher, I imagine. It used to be a CAF-3 to 5 in the last war; I do not know what it is now.

Senator MILLIKIN. That has a tendency to take away stenographic help from the businessman, does it not?

Mr. WITTICHEN. If we were faced with a tremendous influx of governmental operations, but we do not have that yet, sir, and that has not bothered us too much.

(Discussion off the record.)

Mr. WITTICHEN. The next thing that has concerned me—it has not affected me directly, but I see it happening in lots of fields of business, commerce, and industry, and that is the cooperatives.

Sir, they are operating in competition to legitimate business in all sorts and types of enterprise, in the petroleum industry, in the chemical industry.

I know that it is happening in the chemical industry, and that tends to put a heavier tax burden on their competitors to pay their taxes for them in essence, of course. That is a little roundabout way, but that is what I mean, and it also keeps them from paying any taxes, and puts them in a much better competitive position to those companies that are really trying to operate legitimately, and pay their share of taxes, and I hope this committee can see some way or other to do something to these cooperatives because they are getting wider and wider spread every year. You gentlemen probably know more about that than I do, much more; but I know it would certainly be a blow to a little business like mine if a cooperative chemical company should start up down the street and not have to pay any income taxes, city, county, State, or Federal. It would certainly be a blow, sir, and I can see what is happening.

Now, gentlemen, as a last resort to the tax situation, I would like to propose a general manufacturers' excise tax. I heard the presentation of the first gentleman this morning, and I had this written out before I came in here. I did not even know what they were going to propose, but that is my last proposal, to take up the slack in the revenue that might be lost should the excess-profits tax be either repealed in whole or the increased new provisions not be added on.

I certainly appreciate you gentlemen listening to me and giving me the time, a small individual operator.

The CHAIRMAN. We are very glad to have you.

Mr. WITTICHEN. Thank you for permitting me to come up here.

The CHAIRMAN. Because yours is the problem of this country, by and large. It is not the few big people everywhere; it is the multitude of small people.

Are there any questions, Senators? Senator Taft, any questions? Senator Kerr?

Thank you very much for appearing.

Mr. WITTICHEN. Thank you, sir.

The CHAIRMAN. Mr. Walinsky? You may be seated, if you prefer. Please identify yourself for the record.

STATEMENT OF LOUIS J. WALINSKY, AMERICANS FOR DEMOCRATIC ACTION, WASHINGTON, D. C.

Mr. WALINSKY. My name is Louis J. Walinsky. I am an economist engaged in practice here in town with Robert R. Nathan Associates.

The CHAIRMAN. Who?

Mr. WALINSKY. Robert R. Nathan Associates, consulting economists, and I should like to thank you on behalf of the Americans for Democratic Action for this opportunity to present our views on the tax measure before you.

I should like to state very briefly the philosophy upon which the domestic policies of the ADA—including its taxation policies—are based. ADA believes that we are engaged in a world-wide struggle with communism; that this struggle is basically a war between two ideologies, two ways of life; that we can win this struggle with world communism only by (1) building an invincible strength at home and throughout the free world, and (2) by continuously extending at home the democratic freedom and opportunity we are striving to create abroad. Our success in achieving freedom and more fruitful living for all our own citizens will greatly influence other peoples to array themselves with the causes of democracy in the deepening struggle which engulfs the world. Our tax policies—how much money we raise, and how equitably the burden is distributed—play an important role in this world struggle.

In approaching the problems of a new tax measure at this time ADA believes that we must keep clearly in mind the following major objectives:

1. We must raise as much money as is required to pay for the added costs of defense.

2. We must maintain a balanced budget and pay as we go——

Senator KERR. Would you read a little louder? Would you mind?

Mr. WALINSKY. Not at all; I would be happy to.

We must maintain a balanced budget and pay as we go, so that the soundness of our Government's currency and credit are protected.

3. We should, if possible, run a budgetary surplus, so as to minimize inflationary pressures in the period ahead.

4. We must distribute the tax burden equitably among all groups in accordance with the principle of ability to pay, so that home-front morale may be strengthened, and our foreign policy objectives may be furthered.

What are our additional revenue needs at the present time? The revised estimates presented by Secretary Snyder on June 28 indicate that we may expect some $58 billion in revenue from present taxes in fiscal year 1952. Expenditures are expected to be about $68 billion, or $10 billion higher. The deficit we face would seem, therefore, to be some $10 billion.

Senator KERR. That would be less than the surplus we went into the year with.

Mr. WALINSKY. If you are referring, sir, to the surplus with which we ended fiscal year 1951, I believe the cash surplus was in excess of $7 billion, but the budgetary surplus was about three and a half billion.

The CHAIRMAN. 1952. He is referring to the surplus with which we entered 1952, last June 30.

Mr. WALINSKY. That was my understanding.

The CHAIRMAN. You said 1951; 1952 fiscal.

Mr. WALINSKY. I said with which we finished 1951.

The CHAIRMAN. Oh, finished.

Mr. WALINSKY. And that would be entering fiscal year 1952.

The CHAIRMAN. Well, that would be three and a half billions there.

Mr. WALINSKY. That is correct.

The CHAIRMAN. The Secretary's estimate of expected income was only $58 billion; our staff estimates 60.9 or roughly 61 billion.

Mr. WALINSKY. I am aware of that, Senator.

The CHAIRMAN. Of course, that is a difference in estimate.

Mr. WALINSKY. Yes. Actually, the next sentence in our statement recognizes that difference in the estimate, sir.

The CHAIRMAN. Yes, all right.

Mr. WALINSKY. The ADA realizes that revenues from existing taxes may prove to be somewhat higher than the $58 billion estimated by the Treasury. We realize, too, that expenditures may not reach $68 billion even if the Congress approves. On the other hand, a deterioration of the international situation, or a further increase in domestic price levels, might increase Federal expenditures to levels above the Treasury's estimate. Equally important, in our view, is the desirability of raising even more revenue than we may spend, in order to reduce inflationary pressures and to reduce the Federal debt. We therefore urge your committee to aim at increasing Federal tax revenues by at least $10 billion at this time, even though, in your opinion, this amount may not be needed in full to balance the Federal budget.

The question of the timing of a new tax measure goes hand in hand with the question of the amount to be raised. As Secretary Snyder pointed out in his recent testimony, the early passage of new tax legislation is particular important, because much of the additional revenue it is proposed to raise cannot be obtained on a retroactive basis. Only corporate tax increases can and should be made retroactive to January 1. The ADA urges that the earliest possible target date for the completion of this legislation be set and that all increases other than those in corporate taxes go into effect by September 1 at the latest.

With respect to the specific measure before you—H. R. 4473—we believe that the House committee has made considerable progress toward preparing the kind of tax measure we need. The ADA believes, however, that the bill needs further improvement. In broad, the major changes we urge your committee to make in the House bill are:

1. As we have just said, to increase the total revenue to be raised from some $7 billion to at least $10 billion, on annual basis.
2. To eliminate the many loopholes which exist throughout our tax structure—in corporate, in individual income and in estate and gift taxes—which the House measure in our opinion makes no real attempt to tackle, and which must be eliminated in the interest of both equity and substantially increased revenue.
3. To increase the revenue to be obtained from corporate income and excess profits taxes.
4. To deemphasize excise taxes in this tax measure.

Senator KERR. What do you mean by that? I guess you explain that.

Mr. WALINSKY. Yes. It is actually to play down excise taxes at this time.

Senator KERR. What you mean is to reduce the amount of excise taxes provided in here?

Mr. WALINSKY. No. We are saying that in our opinion we would not like to see any attempt made to obtain substantial increases in revenue from excise taxes at this time.

Senator KERR. You think the House bill did that?

Mr. WALINSKY. Well, the amount would seem substantial to some. It is not—the proposal of the House is not for a very substantial increase proportionate to income and corporate taxes.

Senator KERR. Then, I take it, that you either are not very serious about No. 4 or that you could not mean anything other than to reduce the amount provided to be collected even under the House provisions.

Mr. WALINSKY. May I answer in this way, Senator, if the first three recommendations we are urging were to be followed, we would say that there would be no need to increase excise taxes at this time.

I shall briefly go into these points.

We have already mentioned the possibility of expenditures larger than those presently contemplated in fiscal 1952, and the desirability of a Federal surplus, if possible, in the coming fiscal year. In this connection, let us keep in mind that a balanced Federal budget is no assurance or guaranty against inflation. We had inflation during 1948 and again during the last year, in spite of Federal surpluses. A budgetary surplus, however, can help counteract inflationary forces in other sectors of the economy.

Another reason for raising the maximum additional revenue possible at this time lies in the outlook for fiscal year 1953. Expenditures in fiscal year 1953 may be larger than we shall be able to finance on a pay-as-we-go basis. This provides added reason in our opinion for holding the Federal debt at its current level, or reducing it during the coming fiscal year.

The higher tax rates become, and the greater the burden on the tax-paying public, the more intolerable become the inequities incorporated within the existing tax structure. This is equally true whether the inequity exists in the corporate tax structure, in the individual income-tax structure, or in the structure of any other tax. We cannot expect a business or individual taxpayer to accept higher taxes without resentment when he knows there are business firms or individuals who are unduly favored by special privileges in the law. It just isn't fair to impose higher rates on some, when those higher rates are due in large part to the special privileges enjoyed by others. If these special and unwarranted privileges were eliminated, we could raise a great deal more money and reduce much of the resentment created by higher tax rates. Americans are willing to pay higher taxes if they are necessary, and if they are fairly distributed.

The CHAIRMAN. Would your organization favor requiring consumer cooperatives to pay on their dividends, not paid out in cash, or other cooperatives to pay upon undistributed earnings and profits?

Mr. WALINSKY. I cannot speak for the organization, Mr. Chairman, on that, because it has never taken a position on that question. I can answer for myself, and I can guess at what the position of the organization would be.

The CHAIRMAN. Yes, sir.

Mr. WALINSKY. I think the ADA would be sympathetic to the tax exemption of cooperatives which are not profit-making organizations. I do realize, however, that with cooperatives——

Senator KERR. Did you understand the chairman to say that his question was addressed to the taxing of undistributed profits?

Mr. WALINSKY. No; I did not.

The CHAIRMAN. Profits or earnings; strictly with respect to undistributed earnings not paid out in cash by a consumer cooperative or others.

Senator KERR. To the extent that they had undistributed profits, it would be a profitable operation, would it not?

The CHAIRMAN. Yes.

Mr. WALINSKY. I would say to the extent that the undistributed profits were in excess of that required to provide for normal growth, I think the answer to your question would be, "Yes," that such earnings should be taxed, because obviously they would be something further than was contemplated by the very purpose of the organization.

The CHAIRMAN. Why would you qualify it by other than the profits or earnings required by normal growth? We do not allow other corporations that privilege. They must pay taxes on all their earnings and profits, and if they cheat too much, in the opinion of the Treasury, they are likely to suffer a special penalty tax.

Mr. WALINSKY. Well, I was in the process of saying before, Mr. Chairman, that I recognize were cooperatives to grow so far beyond their present state of development as to play a really significant role in the economy, the policy question involved would become much more difficult than it is at the present time because of the tax distribution.

The CHAIRMAN. My question did not relate to taxing earnings and profits, except the earnings and profits that are actually undistributed.

Mr. WALINSKY. Well, we do think of consumer cooperatives, I think, in somewhat the same way we do of other tax-exempt organizations. We do not tax the income of Yale University to an extent that will prohibit it from growing.

Senator KERR. We tax their business activities that are unrelated to Yale University's——

Mr. WALINSKY. Yes; I understand that.

Senator KERR (continuing). Unrelated to the scholastic operation of the school.

Mr. WALINSKY. Yes.

Well, Mr. Chairman, may I say that I am not especially well versed on the ground into which you have now taken me, and in view of the fact that our organization does not have a stand on that question, I would appreciate it if you could leave me in the morass in which you have already placed me.

The CHAIRMAN. That is all right. I thought maybe you had taken a position on it.

Mr. WALINSKY. No, sir; we have not.

I would like to say that we do not believe the problem raised is comparable in importance from a tax point of view with some of the others that we have spoken to specifically in this statement.

The CHAIRMAN. I do not know what other loopholes you have in mind among the competitive advantage of the cooperatives. I think you will find, if you will examine it, that they do present a very large problem on their actually undistributed profits.

Mr. WALINSKY. I understand.

The CHAIRMAN. It is true those profits belong to their members, but after all, it is a corporation. It is in a corporate form, and it has the advantages of a corporate entity.

Mr. WALINSKY. I shall try to learn a little more about that problem.

The CHAIRMAN. All right, sir.

Senator KERR. I think the chairman was impressed, as I was, by your reference to the fact that certain adjustments in the tax rate, and certain applications of it, might reduce much of the resentment created by higher taxes. It is entirely possible that he was thinking about competitive corporations who saw others operating on the same basis and in a competitive field, tax-exempt, when they were not.

Mr. WALINSKY. I can understand that.

The CHAIRMAN. I can understand, and I have never questioned these social and economic benefits that come from a truly organized and operated cooperative. But I am referring only to their earnings and profits, because they do become enormous in many organizations, and in many of the so-called cooperatives they do certainly pinch their competitors, and especially if you have a corporate tax rate going up to 52 percent, as the House is proposing, plus the excess profits tax.

Mr. WALINSKY. Yes. May I continue?

The CHAIRMAN. Yes; you may.

Mr. WALINSKY. Your committee is familiar, I am sure, with the specific areas of special tax privilege, commonly called loopholes. There is the loophole of the community property and split income privilege in the individual income tax. This postwar created tax advantage constitutes a gross inequity to persons with annual incomes below $5,000 and favors especially those with incomes over $10,000. The revenue lost due to this provision alone approaches in magnitude the $2.9 billion which the House measure proposes to obtain by increases in the individual income tax rates.

It is obvious that the House committee recognized the inequity of the split-income provision for married couples, because it provided that single individuals who are heads of households should be granted one-half the benefit of such provisions. Instead of closing this loophole, it recommended it be widened. The way to treat inequities, in our view, is to eliminate them, not to extend them.

Other glaring loopholes in the existing tax structure are to be found in capital gains taxes; depletion allowances; estate and gift taxes; undeclared dividends, interest, and royalties; income from tax-exempt state and local securities; stock options, et cetera. It has been estimated that the complete elimination of all the loopholes in the existing tax structure could raise close to $5 billion. This is about 70 percent of the total additional revenues proposed by the House measure.

The House measure would make some progress toward closing loopholes in capital gains and in dividends, interest and royalty incomes. It would go backward with respect to split income and depletion allowances. Some loopholes it would not touch at all.

Senator MILLIKIN. Prior to the time we went into split income, I think there were then 13 or 14 States that already had split incomes under the State set-ups, and a wild rush of other States to get into the same thing occurred. There was an existing inequity, you could argue, between those States, which had split income and the other States which did not, and the States were overcoming that inequity by joining the parade.

Mr. WALINSKY. I recognize your point, Senator. I am not sure that the number of States involved was 13. I seem to recall that it was 7 or 8.

Senator MILLIKIN. Oh, no, it was 13.

The CHAIRMAN. It was up to 14.

Senator MILLIKIN. I was just going to say it was about to become 16 or 15 under local situations that would have matured had we not gone into split incomes.

The CHAIRMAN. It actually reached 14 while we had the bill under consideration, is my recollection.

Mr. WALINSKY. I know that some question of constitutional law was raised with respect to this question, and I understand that the best judgment is that there is no such real question of law, and that it is perfectly within the competence of the Congress to ignore or to eliminate the split-income privilege, if it so desires.

Senator MILLIKIN. Well, you have got grave questions. They go beyond——

The CHAIRMAN. You mean in the community property States? You do not mean that, surely. In the community property States it is within the competency of the Congress to ignore them and tax them as if they were not community property States?

Mr. WALINSKY. It was my understanding that that is within the competence of the Congress, sir.

The CHAIRMAN. Well, your understanding, I am afraid, is not right in that regard.

Senator KERR. Is the witness a lawyer?

Mr. WALINSKY. No, sir. I am not speaking of personal convictions.

The CHAIRMAN. There might be some lawyers who take that view, but the courts and the States do not share it. We found ourselves powerless here to do anything about it anyhow.

Senator MILLIKIN. You are just talking theory. I was at that time the chairman of this committee, and we tried to—I will not say we tried to hold it off, but there was no hurry in getting into it prior to most careful consideration. But the demand in both Houses was overwhelming for it, and if there was any difficulty in getting it into the law, you would find 10 times the difficulty in getting it out. You just cannot get it out, that is my advice on the subject.

But in addition to that the constitutional question, I think is a very grave one if we do not allow it in the community property States, and they base themselves upon a legal division of the income——

Mr. WALINSKY. Yes.

Senator MILLIKIN (continuing). Whether earned by either of the spouses. To say that you should not recognize split income in those States, would raise a very gross and obvious question of discrimination. But I rest myself now on the proposition that you could not get it out of the law if you tried to do so.

Mr. WALINSKY. Well, with respect to that particular point, sir, I can only answer that we are urging what we think ought to be done irrespective of what the feasibility may be politically.

Senator KERR. Irrespective of whether or not it could be done?

Mr. WALINSKY. No, sir.

Senator KERR. What else does "feasibility" mean?

Mr. WALINSKY. The political feasibility in this instance, I meant, because that, I think, was the point mentioned by Senator Millikin.

But with respect to the law, I can only repeat, I understand that the legal opinion is divided on the question, at least, and that there are some very good legal opinions to the effect that it is within the competence of the Congress.

Senator MILLIKIN. Supposing it were—I am pointing out to you that you would be compounding inequities, if that would be true, because you would not be recognizing the legal division of income that appertains in the 13 or 14 States that had split income prior to the time we enacted the national law.

But, passing that, I respectfully submit you are on your own home grounds now, and perhaps I should not make any suggestions to you, but ADA concerns itself with political feasibility.

Mr. WALINSKY. Yes; and it does its best, I think, and it is happy with whatever successes it is able to achieve.

Senator TAFT. What is the membership?

Mr. WALINSKY. The membership, sir, I think is about 35,000, exclusive of the membership of the student affiliate. There is a Students for Democratic Action in many of the schools.

Senator TAFT. Would you file with this statement the officers of the association?

Mr. WALINSKY. Would you like us to file it? We would be happy to.

Senator TAFT. Yes; file it if you will.

Mr. WALINSKY. Yes.

(The information referred to is as follows:)

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- Mrs. Arthur G. Rotch
- Alfred L. Scanlan
- Rt. Rev. William Scarlett
- Mrs. Gertrude W. Scheft
- Harry Schwartz
- Mrs. Marion Silverstone
- Otto L. Spaeth
- Peter B. Spruance
- Monroe M. Sweetland
- Telford Taylor
- James A. Wechsler

The CHAIRMAN. I do not care to belabor the point. I think Senator Millikin has correctly stated it is not only politically difficult but it is politically impossible to take out this split-income provision, because in 1943, if you will review the history of taxation before this committee, you will find that we tried to reach the income in the so-called community property States, and we got nowhere with it. We were compelled to abandon it on the floor.

Senator MILLIKIN. It provoked one of the great filibusters.

The CHAIRMAN. It threatened to tie up a whole tax bill for a whole season; so we just had to eliminate it. We get around it by putting all the taxpayers and all the States on the same basis for tax purposes, and maybe there could be objections raised to that, but that was the only feasible way that we could find to do it.

Mr. WALINSKY. May I make one point which arises out of the comment you made, Senator Millikin? I appreciate the apparent inequity as between the residents of community income and property States, were they to remain so, and the other States.

On the other hand, here is a situation where some 34,000,000 taxpayers are in an income level which can gain no advantage from the split-income provision, and something less than 2,000,000—I think a million and three-quarters income receivers—who get relatively the largest benefit in the income bracket above $10,000.

Senator MILLIKIN. Yes. But let me remind you also that in the last distribution of a downward scale of taxes that we had anything to do with, the lower income tax brackets, which have the largest percentage of national income, had larger benefits than the percentage of national income would call for, if you put it on that basis, so you cannot play it both ways.

Mr. WALINSKY. There were advantages, I recognize.

The CHAIRMAN. And the States may not be too numerous at this time.

Senator MILLIKIN. We took over 7,000,000 taxpayers off the rolls. You advocate putting them back on?

Mr. WALINSKY. I think your action at that time in that respect was very well warranted.

Senator MILLIKIN. And, as I say, the whole proposed scale of benefits was larger to the group that you are talking about than their economic contribution in terms of dollars of taxable income warranted.

The CHAIRMAN. I merely want to call your attention to this fact, and I know it because it was confirmed and brought home to me repeatedly, that many of the taxpayers in the so-called higher brackets are paying more taxes because of the split-income provision than they would otherwise pay; and that is the case wherever the wife and the husband have some separate property, and the income is reasonably large, and by splitting it they are both put up into the high bracket. Under this House bill, when they will go into the higher bracket—when they reach $79,000—why, there will be many, many more of those extremely high bracket payers who do not think that we did them any good by splitting the income.

Mr. WALINSKY. Well, Mr. Chairman, I was looking at a compilation or a comparison of the effective tax rates paid at various income levels by single persons and married persons, for example, during the last war, in 1944, and the rates proposed now.

The CHAIRMAN. When you come to single persons, you have quite a problem there, that is a point.

Mr. WALINSKY. There is another comparison. I know we can never achieve perfect equity; that is too——

The CHAIRMAN. No, sir; that is quite impossible.

Mr. WALINSKY (continuing). Far-fetched.

The CHAIRMAN. It is quite impossible, but I agree with you in the case of single persons we must find some way to equalize the tax advantage.

Now, it is quite true that if we are on incomes of less than $5,000, it does not ordinarily, at least, make any difference whether the income is split or not. It does not give any advantage, I mean.

Mr. WALINSKY. That is correct.

The CHAIRMAN. That is correct.

All right, you may proceed.

Mr. WALINSKY. The ADA urges your committee to tackle the entire field of special privileges and tax loopholes, and to eliminate them wherever they exist. This will restore equity throughout the tax structure, recapture revenue which rightly belongs to the Government, and prepare the ground for increased tax rates to the extent necessary.

3. Increase corporate income and excess profits taxes:

The House measure, the ADA believes, has improved somewhat on the Treasury's recommendations of last February with respect to corporate taxes by providing for both a flat rate increase and for an increase in excess profits taxes by reducing the excess profits credit from 85 percent to 75 percent of the average profits earned in the best 3 years of the 1946–49 period. It is weaker, however, in that it seeks less revenue. We believe the additional revenues to be raised from corporations should be more substantial.

Corporate profits are today at an annual rate of $50 billion—more than double the wartime peak, and about 50 percent higher than they were in the first half of 1950, pre-Korea. On an after taxes basis, at an annual rate of $24 billion, they are almost 2½ times the wartime peak, and about one-third larger than they were during the first half of 1950, before Korea. If we wish to take the excess profit out of the national emergency, we should hold corporate profits to the pre-Korean level. With this objective, we should seek to raise considerably more in corporate profits taxes than the $2.8 billion proposed in the House measure. We can do this by raising the flat rate increase from 5 percent to 6 or 7 percent, by keeping the excess profits tax credit at 75 percent of the base period, by making the average of 1946–49 the base period, and by eliminating some of the loopholes in the excess profits tax law.

A number of protests have been raised concerning the recent and contemplated increase in corporate taxation. There can be no question, however, that these increases are justified. Even after the imposition of the increases now proposed, our corporations will be earning exceedingly handsome returns; and they will have left ample funds for the payment of rich dividends, for incentive, and for expansion purposes.

Senator KERR. How many corporations do you run, Mr. Witness?

Mr. WALINSKY. I beg pardon, sir?

Senator KERR. How many corporations have you run, Mr. Witness?

Mr. WALINSKY. None at all, except that the firm which employs me is incorporated.

Senator KERR. Well, you speak about the fact that there would be ample funds for the payment of rich dividends, for incentive, and for expansion purposes. I just wanted the record to show how much experience you had had in expanding corporations and responding to incentive, and in payment of rich dividends.

Mr. WALINSKY. No actual experience on that score, sir.

Senator KERR. On either item?

Mr. WALINSKY. That is correct.

At the same time, I would like to suggest that is is not necessary to have that operating experience to arrive at some judgments in that regard.

Senator KERR. It is not necessary to arrive at some conclusion, but I am of the opinion that it would not hurt any to help arrive at a correct conclusion. [Laughter.]

Mr. WALINSKY. There has been particular protest against the proposal to reduce the excess profits tax credit to only 75 percent of base-period profits. This, it is alleged, means that 25 percent of so-called normal profits are to be taxed at excess profits rates. As we see it, profits during the 1946–49 base period were not normal. They resulted from the pent-up buying power and demand accumulated during the last war, when many consumers goods were not available, and extraordinary consumer savings resulted. The release of this pent-up wartime demand, plus the unrestrained pricing policies of our corporations, resulted in huge and abnormal profits during the 1946–49 period, far in excess of what would otherwise have been the case. We are perfectly justified, therefore, in allowing, during this period of emergency, a credit of only 75 percent of these base period profits against excess profits rates.

The statement of the minority of the House Ways and Means Committee declares that one result of higher corporate tax rates—

> is that a substantial part of the increased taxes is inevitably passed on to the rank and file of consumers through higher prices. This has historically been the case. * * * It will be the case again.

The ADA agrees that corporations in the past have succeeded to a large degree in escaping from the income taxes imposed upon them by passing them on in higher prices. To the extent that this is true, it would indicate that the corporations have till now escaped from paying their legitimate tax burden, and have acted instead merely as a collection agency to enforce payment of their taxes by consumers. We trust that firm price controls, during this emergency period, will prevent the corporations from passing these new taxes on to the consuming public.

Corporations must be required to pay the new taxes proposed. Unless they do, individual taxpayers all over the country will rebel at the injustice of being required to pay higher taxes, and cut into their modest or even inadequate modes of living, while the corporations continue to profit by the emergency.

Senator KERR. Is this statement on your part a suggestion or is it a reflection and opinion?

Mr. WALINSKY. We are offering our opinion, sir.

Senator KERR. On what do you base the opinion that indivduial taxpayers all over the country will rebel?

Mr. WALINSKY. Well, we happen to be rather close to organized labor, the organized labor movement, and I think we are familiar

with their views and feelings on this, as in similar questions, and they certainly represent taxpayers all over the country, and I think they certainly feel this way.

Senator KERR. Are you speaking for them

Mr. WALINSKY. No; but we are describing what we think is their attitude, and what we know to be their expressed attitude.

Senator KERR. In other words, then, your statement about individual taxpayers all over the country rebelling is based on what you know of the opinion and contemplated action of the labor unions?

Mr. WALINSKY. In large part, and a certain amount of it, sir, is assumption. Insofar as it could not be supported or substantiated factually, it is interpretation.

Senator KERR. Then it is speculation?

Mr. WALINSKY. I think I must concede that.

Senator KERR. All right.

Mr. WALINSKY. The ADA believes the House measure is a distinct improvement over the Treasury recommendation. The Treasury requested a flat increase of 4 percent at each and every level of taxable income. The House measure is more progressive, and more in accord with the principle of equality of sacrifice. It proposes a special "defense tax," in the form of a flat increase of 12½ percent in existing tax rates at all income levels, thereby requiring larger percentage increases for the larger incomes. We urge your committee to concur in the House committee recommendation, with one qualification, namely, that the first $1,000 of taxable income be exempted from the special defense tax.

Senator KERR. Do you know how much that would reduce the amount of revenue collected under it?

Mr. WALINSKY. I do not have an exact estimate of that, Senator, but I think it would be fairly substantial.

Senator KERR. Do you have any figure that is based upon a calculation that you have made?

Mr. WALINSKY. Yes; a number of them, sir.

Senator KERR. Would you tell me what it is?

Mr. WALINSKY. Which, let me make sure I understand, of the statements or figures cited here are based on calculations, for example——

Senator KERR. No; you said:

> We urge your committee to concur in the House committee recommendation with one qualification, namely, that the first $1,000 of taxable income be exempted from the special defense tax.

Mr. WALINSKY. Yes.

Senator KERR. Have you made an estimate as to what that qualification would change the amount of——

Mr. WALINSKY. No, sir.

Senator KERR (continuing). Revenue received under the bill?

Mr. WALINSKY. No, sir. I thought I said a moment ago I did not have such an estimate. I think it would be sizable.

Senator MILLIKIN. Yes.

Senator KERR. Your opinion there is a conclusion based on general reasoning and not upon the application of any specific known fact?

Mr. WALINSKY. No; it is based on some familiarity with the distribution of income receipts and the numbers of people in the individual income categories, and so on.

As a matter of fact, I should have liked to prepare an estimate of this.

Senator KERR. It will not be necessary. We will have that prepared if we get to the point of considering the action. The thing I was wondering about is whether or not you had made such a calculation.

Mr. WALINSKY. No; I had not.

Senator KERR. All right.

Senator MILLIKIN. $100 of general exemption, Senator Kerr, is a loss of two billions of taxes. Since this is only applied to the special defense tax, I cannot quite relate the two, but it would be terrific.

Senator KERR. I thought it would.

Senator MILLIKIN. Yes.

Mr. WALINSKY. The ADA, in principle, is opposed to a broadening system of excise taxes. Excise taxes, by their very nature, tend to be regressive, falling more severely on persons of lower incomes.

Senator KERR. What does "regressive" mean, Mr. Witness?

Mr. WALINSKY. It means exactly what is said in the following clause, sir, where the incidence of a tax is higher on the lower income, and relatively lower on the higher income; that is called regressive as against progressive, which has the opposite tendency.

Senator KERR. Do we have a dictionary there?

Senator TAFT. It is progressive to tax the rich. That is the answer.

Senator KERR. Either the witness or I, one, do not know what "regressive" is.

Senator MILLIKIN. Well, the customary definition of it is where you put the burden on production, is it not?

Mr. WALINSKY. No; I don't think so, sir, necessarily.

Senator MILLIKIN. Well, I do not say necessarily; I said the customary meaning. A regressive tax is regressive if it puts the burden on production. If you had a sales tax, it is considered a regressive tax and applies directly and immediately to increase the cost of goods.

The CHAIRMAN. All right, Senator Kerr.

Senator KERR. Here is a definition:

> Return of the libido to earlier stages of development or to infantile objects of attachment. [Laughter.]

(Discussion off the record.)

The CHAIRMAN. All right, go ahead; you may proceed.

Mr. WALINSKY. We disapprove, too, of the tendency to use excise taxes during a period of emergency, to curtail the use of scarce materials, facilities, and manpower. Direct production and materials controls are more suited to achieve these objectives, and higher prices are not the fairest way to ration scarce consumer items.

If all other sources of revenue were exhausted, and excise taxes were the only remaining source of additional needed revenue, the ADA would support excise taxes, provided they were limited to clearly nonessential or luxury items, and did not attempt to tax utility goods and lines necessary to maintain a decent standard of living.

At the present time, however, we see no need to broaden the coverage or increase the rates on existing excise taxes. The elimina-

tion of loopholes throughout the existing tax structure and the higher corporate and individual income tax rates we have recommended, will more than meet our present revenue needs.

Senator MILLIKIN. What Federal tax would you favor on incomes of less than $5,000? I mean, you have exempted the first $1,000 of taxable income for the purpose of this special defense tax. You do not want to widen the excise tax. What kind of a tax would you recommend?

Mr. WALINSKY. Well, with respect to the individual income taxes, sir; we have said that we go along with the House committee measure, except that we would like to see the $1,000—the first $1,000, of taxable income exempted from that increase.

The CHAIRMAN. In all brackets?

Mr. WALINSKY. Sir?

The CHAIRMAN. In all brackets?

Mr. WALINSKY. For those who have the first $1,000.

Senator KERR. Everybody has that or some part of it, or they are not on the rolls.

Mr. WALINSKY. I see what you mean. That point had not occurred.

The CHAIRMAN. Yes. I think you would find that you would lose far more revenue than the House bill would bring in, so far as individuals are concerned.

Mr. WALINSKY. Does that mean that first $1,000 would have to be carried through every income group?

The CHAIRMAN. Yes.

Mr. WALINSKY. Well, I do not think we would want to urge that.

Senator KERR. As I understand it, you just want to urge it for those that have no more than that?

Mr. WALINSKY. That is right.

Senator MILLIKIN. And you would not disturb the other taxes. That is an exemption that goes simply to this additional 12½ percent tax.

Mr. WALINSKY. Yes, sir; and I would like to answer your question with respect to specific amount, but that would vary, depending on whether the person is single or married, and how many exemptions he has.

Senator MILLIKIN. Have you gentlemen ever made a study of the tax burden, including the State and local burdens of the people in the lower income tax brackets?

Mr. WALINSKY. No: I am afraid our organization does not have the means to support the research activities it would very much like to carry on.

Senator MILLIKIN. Do you know anybody who has made a competent study in that field?

Mr. WALINSKY. Off hand I cannot say, but I am sure there are such studies.

The CHAIRMAN. Any further questions? If not, Mr. Walinsky, we thank you, sir, for your appearance.

Mr. WALINSKY. Thank you, Mr. Chairman and members of the committee.

(The following letter was subsequently supplied for the record:)

ROBERT R. NATHAN ASSOCIATES, INC.,
Washington 5, D. C., July 9, 1951.

Hon. WALTER F. GEORGE,
Chairman, Senate Finance Committee,
Senate Office Building, Washington, D. C.

DEAR SENATOR GEORGE: May I submit for the record, on behalf of Americans for Democratic Action, the following information to supplement the testimony I was privileged to present before the Senate Finance Committee on July 5? In each case the information offered bears on a point raised by the committee during the course of my testimony.

1. With respect to the ADA recommendation that split-income privileges be eliminated, question was raised concerning the authority of Congress to eliminate this loophole in the tax structure, so far as community property States are concerned. In 1942, tax amendments were enacted by the Congress which in effect set aside the provisions of community-property laws, in those States having such benefits, with respect to estate and gift taxes. The Supreme Court of the United States has upheld the validity of these 1942 amendments. Would not the Supreme Court ruling apply as well to amendments bearing on the split-income question? In any case, we submit that unwarranted tax benefits due to the split-income provision can be eliminated, if Congress so desires, by establishing a special rate schedule for married couples which would compensate for the split-income provision.

2. Question was raised concerning my statement that, even after the imposition of the higher corporate tax rates proposed, our corporations will still be earning exceedingly handsome returns, and that they will have left ample funds for the payment of rich dividends, for incentive, and for expansion purposes. On this question, the facts speak for themselves.

According to the Securities and Exchange Commission, all manufacturing corporations earned the following average rates of return on their investment, before and after taxes, in the last 3 years:

[In percent]

	Before taxes	After taxes
1948	25.6	16.1
1949	18.5	11.7
1950	27.8	15.4
1950 (fourth quarter)	35.6	16.4

The tax increases proposed would cut the average rate of profit earned after taxes back to levels approaching those which prevailed in the first half of 1950, before Korea, when they averaged about 14 percent. They might be reduced to some 12 percent. I submit these are handsome returns.

So far as dividends and funds for expansion are concerned, the following figures for all corporations are significant:

Profits

[In billions of dollars]

	Before taxes	After taxes	Dividends paid	Undivided profits
1939	6.5	5.0	3.8	1.2
1944	24.3	10.8	4.7	6.1
1948	33.9	20.9	7.5	13.4
1950	41.0	22.8	9.4	13.5

The increases proposed for fiscal year 1952 would apply against estimated corporate profits of $45 to $47 billion, and would leave some $18 to $20 billion after taxes for the payment of dividends and for expansion purposes. Certainly this compares most favorably with the historical record, particularly when we keep in mind that during the emergency period, corporate expansion essential to the defense effort is enjoying the benefit of accelerated amortization through the liberal certificate of necessity program.

3. Question was raised concerning the tax loss which would result from our proposal that persons in the first $1,000 of taxable income bracket be exempted

from paying the 12½ percent tax rate increase proposed by the House measure. This exemption, it is estimated, would result in a loss of about $400 to $500 million of the increased revenues proposed by the House in the individual income tax field.

4. Question was raised as to the total tax burden comprised by Federal, State, and local taxation.

Measured against the total value of all production—the gross national product—Federal, State, and local taxation combined, represented less than 14 percent of our total output in 1941. During 1944, at the peak of the war effort, this increased to almost 25 percent. In 1950 it was about 19 percent. The additional $10 billion of Federal taxation proposed for fiscal year 1952 would raise the combined tax "take" to some 25 or 26 percent, depending on the level of gross national product achieved during the coming fiscal year.

We submit that, with a much larger gross national product than we had in 1944, we can devote approximately the same share to taxes that we provided during 1944 without undue hardship and without damage to the economy, provided the burden is equitably distributed.

5. Finally, some question was raised concerning my use of the word "regressive" in describing the character of excise taxes. I quote therefore from a standard work in the field of public finance:

"Some taxes, like those on property and sales at uniform rates, are regressive in their effects because they place relatively heavier burdens upon the poorer rather than the richer taxpayers" (Buehler, Public Finance, McGraw-Hill, p. 215).

Permit me to thank you once again, on behalf of Americans for Democratic Action, for this opportunity to present our views.

Sincerely yours,

LOUIS J. WALINSKY.

The CHAIRMAN. Mr. Walter E. Barton? Mr. Barton, you may be seated, sir, if you wish, and identify yourself for the record.

STATEMENT OF WALTER E. BARTON, ATTORNEY AT LAW

Mr. BARTON. Thank you, Mr. Chairman.

My name is Walter E. Barton. I am an attorney at law in Washington, and I am appearing here on behalf of three comparatively small corporations, Plumbers Supply Corp. of Indianapolis, Plumbers Supply Corp. of Evansville, and the E. & I. Realty Corp. of Indianapolis.

I would like to file about a seven- or eight-page statement, and just orally touch the high spots.

The CHAIRMAN. You may do so.

Mr. BARTON. If you will turn to page 2 of my statement, I think I can explain in short order what we are interested in. It is section 461 of the Internal Revenue Code, which is written into the code by the Excess Profits Tax Act of 1950, which became effective last January.

It defines an acquiring corporation as a corporation which has acquired certain properties from other corporations, which we have omitted here, because we are interested in the definition of a sole proprietorship.

Senator KERR. Of what?

Mr. BARTON. Of a sole proprietorship.

Senator KERR. Yes.

Mr. BARTON. Now, (a) (1) (D) and (b) (5), and (f) on that page are the exact language of the Excess Profits Tax Act, which was enacted in 1940, but these particular provisions were written in by the excess profits tax amendments of 1941.

You will observe that a corporation is an acquiring corporation if it acquires substantially all the properties of a partnership—that is under (D), and (f) says that a sole proprietorship shall be deemed to

be a partnership under (a) (1) (D); that is where substantially all of the property is taken over by the corporation from a sole proprietorship.

Now, (E) is an entirely new provision that was written into the Excess Profits Tax Act of 1950, and that provides that if a corporation takes over property, either from one or more corporations or from one or more partnerships, or from one or more corporations and one or more partnerships, then that corporation is an acquiring corporation.

When that was written into the law, the definition of a sole proprietorship was not expanded to cover that situation, and I am inclined to think it was a mere oversight, because there certainly is not any logical reason why a corporation taking over a part of the properties of a sole proprietorship should not be an acquiring corporation, if it is one when it takes over part of the properties of a partnership; and the thing we are interested in, if the committee thinks it is equitable, and we believe it is, is to bring a sole proprietorship into the law on the same basis as a partnership.

Now, I have looked into the committee reports and in this statement I have quoted them, and there is nothing whatever in the reports or in the statements put out by the staff of the joint committee, which indicates why that definition of a sole proprietorship was not expanded to put it on the same parity with a partnership in this 1950 law.

Now, there is just as much reason, it seems to me, why it might not be possible or desirable for a corporation to take over substantially all the properties of a sole proprietorship any more than to take over substantially all of the properties of a sole proprietorship.

What we propose is an amendment which we have set out on the last page, to include in 461(f), these additional sections or subsections which are underlined.

In other words, as the law now stands, if a corporation takes over substantially all of the properties of a sole proprietorship, it is deemed to be a partnership.

Senator MILLIKIN. May I ask, have you had this matter up with Mr. Stan?

Mr. BARTON. I have not. As a matter of fact, I had hoped to before I came here, but I got a notice hurriedly, and I did not have an opportunity to. I spoke to him today, and I would like to see him a little later, and I hope that the Treasury and the joint committee may concur in this.

I just cannot see any reason why it was not done or any reason why it should not now be done, because it is certainly equitable to put sole proprietorships into the same category as partnerships.

Senator KERR. Explain briefly again to me what your hope is if you are successful in getting this amendment.

Mr. BARTON. Well, Senator Kerr, the situation is that these corporations took over a part of the properties of a sole proprietorship, and I imagine there are others that did the same thing before the excess-profits law was passed, and I am not sure whether it can be proven that they took over substantially all to bring them under (a) (1) (D), which is the first paragraph which is referred to on page 2.

Senator KERR. Is it your position that the law now applies to a corporation which has acquired properties from a partnership, and properties from a corporation, and both, but does not apply where

the acquiring corporation makes the acquisition from a sole proprietorship?

Mr. BARTON. Unless the corporation acquires substantially all the properties. You see, Senator Kerr——

Senator KERR. What you are saying, what you are suggesting, is an amendment that would make the law applicable to acquiring corporations which acquire either all or part of the acquisition——

Mr. BARTON. Part of the properties.

Senator KERR. From a sole proprietorship.

Mr. BARTON. That is right.

Senator KERR. But on a percentagewise basis equal to that which it might have been either from a corporation or partnership, or both, if it had then been under the law.

Mr. BARTON. That is right. In other words, under the 1950 act they added this (E), a new provision, to permit a corporation to qualify as an acquiring corporation to take over part of the assets from a corporation or a partnership, but they did not amend the definition of a sole proprietorship to give that same benefit in the case——

Senator KERR. If it had said "properties either from one or more corporations or sole proprietorships or from one or more partnerships, or all three"——

Mr. BARTON. It would have been all right then, but the way the law has handled the matter under the Second World War Act, they did not use the word "proprietorship" in any section up here. They merely defined it in (f) to refer back to it.

Now, what we want——

Senator KERR. If that is what you mean, I understand it.

Mr. BARTON. That is right.

Senator KERR. I would like to second the suggestion of the Senator from Colorado that you discuss it with Mr. Stam.

Mr. BARTON. Yes, sir.

The CHAIRMAN. I expect that the great difficulty will be to allocate the income from only a portion of the sole proprietorship's ownership.

If a partnership owns a hotel and then owns an oil well, and part of that property is taken over, you may be able to allocate the income from that particular property. But anyhow we will be glad to look into it.

Mr. BARTON. Well, Senator George——

The CHAIRMAN. You raise a very serious question, however, and one which this committee has to discuss, and that is how far we are going into the excess-profits tax. If we go into it, we may get a holiday much later in the year than we expect.

Senator KERR. Than we hope.

The CHAIRMAN. And the Treasury said to us, the Secretary of the Treasury, that they were not yet ready to make any recommendations about relief provisions in the Excess Profits Tax Act, and would not be until they had a chance to study the returns, the first returns——

Mr. BARTON. Yes, sir.

The CHAIRMAN (continuing). And analyze them and see just what recommendations they would have.

If there was any way for us to keep out of the excess-profits tax, we would keep out of a tremendous lot of work and a long delay here

for the committee, because there are many, many taxpayers who think they have found trouble with the excess-profits tax.

Mr. BARTON. Yes; I have not any doubt, Senator George.

The CHAIRMAN. And perhaps they have, just as you have.

Mr. BARTON. I would like to, if I may, take a moment——

The CHAIRMAN. Yes, sir.

Mr. BARTON (continuing). To answer your suggestion that perhaps it might be, did I understand you to say, more difficult to allocate in the case of a sole proprietorship than a partnership.

The CHAIRMAN. I thought, perhaps, the matter of allocation there of income, properties taken over——

Mr. BARTON. Well, it does not seem to me that it would be any more difficult where one man owns a business and where two or three in a partnership own it.

The CHAIRMAN. Maybe it would not.

Mr. BARTON. And in any event——

The CHAIRMAN. At any rate it would require some real investigation, I think.

Mr. BARTON. Some real what?

The CHAIRMAN. We would have to take a real look at the thing.

Mr. BARTON. Yes; that is right.

The CHAIRMAN. Yes.

Mr. BARTON. And in further reference to that, in the law it already provides that if substantially all the property is taken over, why, it provides to a sole proprietorship——

The CHAIRMAN. I understand that.

Mr. BARTON. So it seems to me it would be easier, if anything, to determine what is a part of the properites of a sole proprietorship than it would be to determine what is substantially all, because that is already in the law, because the courts have gone into that question a lot as to what constitutes substantially all.

The CHAIRMAN. Yes. It is a question of determining what part of the income is attributable to a portion of the property taken over.

Anyhow, Mr. Stam would be glad to go over it with you, and would be very glad to give it consideration, assuming that we will have to go into this whole matter of the excess-profits tax at this session. The House having dealt with this matter and raised the tax by lowering the exemption, why, of course, it presents us with a pretty serious problem.

Any further questions of Mr. Barton?

Mr. BARTON. I wish to thank you, sir.

The CHAIRMAN. Thank you for your appearance.

Mr. BARTON. Thank you, sir.

(The prepared statement of Mr. Barton is as follows:)

STATEMENT BY WALTER E. BARTON, ATTORNEY AT LAW, WASHINGTON, D. C.

This statement is being made on behalf of the Plumbers Supply Corp., of Indianapolis, the Plumbers Supply Corp., of Evansville, and the E. & I. Realty Corp., of Indianapolis.

We are interested in having section 461 (f) of the Internal Revenue Code amended so that a corporation acquiring less than substantially all of the properties of a sole proprietorship shall be deemed to be an "acquiring corporation" under section 461 (a) (1) in the same manner that a corporation acquiring less than substantially all of the properties of a partnership is now deemed to be an "acquiring corporation" under section 461 (a) (1). In other words, we are interested in an amendment which will place sole proprietorships and partnerships in the same category under section 461 (a) (1) insofar as acquiring corporations are concerned.

A corporation qualifying as an "acquiring corporation" under section 461 (a) (1) is permitted to use the base-period experience of the predecessor business, the properties of which it acquired in a nontaxable transaction described in section 461 (a) (1).

The applicable part of section 461 reads as follows:

"SEC. 461. DEFINITIONS.

"For the purposes of this part—

"(a) ACQUIRING CORPORATION.—The term 'acquiring corporation' means—

"(1) A corporation which has acquired—

* * * * * * *

"(D) substantially all the properties of a partnership in an exchange to which section 112 (b) (5), or so much of section 112 (c) or (e) as refers to section 112 (b) (5) is applicable.

"(E) properties either from one or more corporations or from one or more partnerships or from one or more corporations and one or more partnerships, other than from a corporation exempt under section 101, in an exchange, not otherwise described in this subsection, to which section 112 (b) (4) or (5), or so much of section 112 (c) or (e) as refers to section 112 (b) (4) or (5), is applicable.

* * * * * * *

"(b) COMPONENT CORPORATION.—The term 'component corporation' means—

* * * * * * *

"(5) In the case of a transaction specified in subsection (a) (1) (D), the partnership whose properties were acquired.

"(6) In the case of a transaction specified in subsection (a) (1) (E), the partnerships or corporations whose properties were acquired.

* * * * * * *

"(f) SOLE PROPRIETORSHIP.—For the purposes of sections 461 (a) (1) (D), 461 (b) (5), and 462 (k), a business owned by a sole proprietorship shall be considered a partnership."

According to subsection (f), a sole proprietorship is deemed to be a partnership for the purpose of subsection (a) (1) (D), but not for the purpose of subsection (a) (1) (E). Accordingly, for a corporation acquiring properties of a sole proprietorship to qualify as an "acquiring corporation," it is necessary for it to acquire substantially all of the properties of the sole proprietorship, as provided in subsection (a) (1) (D), although it would qualify as an "acquiring corporation" if it were to acquire less than substantially all of the properties of a partnership, as provided in subsection (a) (1) (E).

Sections 461 (a) (1) (D), 461 (b) (5), and 461 (f) are identic with former sections 740 (a) (1) (D), 740 (b) (5), and 740 (h), respectively, of the Internal Revenue Code. Former sections 740 (a) (1) (D), 740 (b) (5), and 740 (h), pertaining to partnerships and sole proprietorships, were incorporated into the code by the excess-profits tax amendments of 1941.

The report of the Committee on Ways and Means, H. R. 146, Seventy-seventh Congress, first session, accompanying that bill, contains the following statement regarding these amendments:

"6. Under supplement A [1] of existing law, corporations resulting from certain tax-free exchange. or reorganizations during or after the base period are permitted the use of their predecessor's earning experience in the computation of their excess-profits credit based on income. *The bill extends this privilete to corporations growing out of partnerships or sole proprietorships in tax-free exchanges during this same period.* The resulting corporation wo ld thus be allowed to use the earnings history of the predecessor partnership or sole proprietorship, after first converting such earnings to a corporate basis." [Italics supplied.]

Section 461 (a) (1) (E), which pertains to the acquisition of less than substantially all of the properties of a partnership, is an entirely new provision, which has never been incorporated into any previous internal revenue law.

The reports of the Committee on Ways and Means and the Finance Committee and the statement prepared by the staff of the Joint Committee on Internal Revenue Taxation covering the Excess Profits Tax Act of 1950 merely state that subsection (a) (1) (E) is a new provision which was not contained in the Excess Profits Tax Act of 1940, as amended. For instance, House Report No. 3142, Eighty-first Congress, second session, at page 64 [2] states:

"Except for one addition, part II transactions are the same as and are defined in the same terms as the transactions specified in supplement A of the World War II

[1] Supplement A included secs. 740–743. I. R. C.

[2] The statements made by the Finance Committee of the Senate, S. Rept. 2679, p. 37, and the staff of the Joint Committee on Internal Revenue Taxation, p. 24, are of the same tenor.

law. The one addition made by your committees is the inclusion in the six listed transactions of *a transaction in which a corporation acquires part, as distinguished from substantially all,* of the properties of one or more corporations or partnerships in an exchange to which section 112 (b) (5), or so much of section 112 (c) or (e) as refers to section 112 (b) (5), is applicable. Since all part II transactions involve a sufficient continuity of interest to justify treating the acquiring corporation as standing in the place of its predecessors, such transactions must satisfy the requirements of section 112 with respect to such transactions in order that the transferee corporation may be treated as an acquiring corporation." (Italics supplied.)

Thus, there is no explanation in the committee reports as to why the definition of a sole proprietorship, which was recopied from former section 740 (h), was not expanded to include the new provision of section 461 (a) (1) (E), which was made applicable to partnerships. In any event, the prerequisite stated by the committees in charge of the bill to permitting an acquiring corporation to stand in the place of its predecessor, viz., " a sufficient continuity of interest," applies to a corporation acquiring part of the properties of a sole proprietorship as much as it does to a corporation acquiring part of the properties of a partnership.

There are as many practical reasons why a corporation might wish, or be able, to acquire only part of the properties of a sole proprietorship as there are why it might wish, or be able, to acquire only part of the properties of a partnership, such as having the business taken over by more than one corporation, continuing a part of the business by the predecessor, or discontinuing a part of the business altogether.

Nor does there appear to be any sound objection from the standpoint of administration of the internal revenue laws to applying section 461 (a) (1) (E) to a sole proprietorship any more than there is to applying it to a partnership. Congress has already provided in section 461 (f) that a sole proprietorship shall be considered to be a partnership under subsection (a) (1) (D), where substantially all of the properties are transferred to a corporation. If it be administratively feasible to determine what constitutes substantially all of the properties of a sole proprietorship under subsection (a) (1) (D), it would be equally administratively feasible, if not more feasible, to determine what constitutes part of the properties of a sole proprietorship under section 461 (a) (1) (E).

We submit that as a matter of equity and fairness, section 461 (f) should be amended to provide that a sole proprietorship shall be deemed to be a partnership for the purpose of section 461 (a) (1) (E), as well as section 461 (a) (1) (D). We are submitting a proposed amendment of section 461 (f), which merely inserts "461 (a) (1) (E)" and "461 (b) (6)" We trust that the committee will adopt it as an amendment of the House bill.

PROPOSED AMENDMENT OF SECTION 461 (F) OF THE INTERNAL REVENUE CODE

Insert on page 152 of H. R. 4473, just before section 503, the following:

502A. DEFINITION OF SOLE PROPRIETORSHIP.

(a) Subsection (f) of section 461 (relating to definition of sole proprietorship) is amended to read as follows:

"(f) SOLE PROPRIETORSHIP.—For the purposes of sections 461 (a) (1) (D), *461 (a) (1) (E)*, 461 (b) (5), *461 (b) (6)*, and 462 (k), a business owned by a sole proprietorship shall be considered a partnership."

(b) The amendment made by subsection (a) shall be effective as of the date of enactment of the Excess Profits Tax Act of 1950.

(Amendment of subsec. (f) shown in italics.)

The CHAIRMAN. That completes the list of witnesses for the afternoon.

The next session will be tomorrow at 10 o'clock.

(Whereupon, at 4:30 p. m., the committee recessed, to reconvene at 10 a. m., Friday, July 6, 1951.)

REVENUE ACT OF 1951

FRIDAY, JULY 6, 1951

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

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

Present: Senators George, Connally, Byrd, Johnson of Colorado, Hoey, Kerr, Frear, Millikin, Taft, Butler, and Williams.

Also present: Elizabeth B. Springer, chief clerk; Colin F. Stam, chief of staff, Joint Committee on Internal Revenue Taxation.

The CHAIRMAN. The committee will come to order. Mr. Ralph Button.

Mr. Lebor is listed first, but I understand that you are to precede him.

Mr. BUTTON. That is right, sir. He is in agreement.

The CHAIRMAN. Will you please identify yourself for the record?

STATEMENT OF RALPH W. BUTTON, CHAIRMAN, TAXATION COMMITTEE, NATIONAL RETAIL DRY GOODS ASSOCIATION

Mr. BUTTON. I am Ralph W. Button, assistant secretary, Allied Stores Corp. I am chairman of the taxation committee of the National Retail Dry Goods Association and am appearing as their representative. The National Retail Dry Goods Association is a voluntary organization that is registered under the Lobbying Act. The association's registered agent in Washington is John C. Hazen. The National Retail Dry Goods Association is composed of approximately 7,000 department and specialty stores throughout the United States. The annual sales of the members of this association exceed $10 billion.

In less than 12 months, the American people have seen two revenue-raising measures enacted into law which are estimated to raise $10 billion in taxes. We are now faced with the third revenue-raising bill, H. R. 4473, by which it is intended to raise an additional $7.2 billion. Thus, 17 billions in increased taxes is the proposed increase in less than 1 year's time.

The House Ways and Means Committee's report estimates that receipts including those from H. R. 4473 together with those under existing law will result in collections in the fiscal year 1952 of $66.3 billion. This amount is still short of the President's proposed budget of $71.6 billion by approximately $5½ billion. In addition, there are various Government estimates that fiscal 1953 will demand an even larger budget than the proposed $71.6 billion. It seems obvious that if we are to pay as we go and these estimates are correct, then the

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American public can expect even further demands for more taxes before many more months elapse.

How onerous the tax burden may become before the form of government we know and its system of free enterprise is destroyed, I cannot answer. But I do believe that unless the strongest efforts are exerted by our Government to follow the advice it is giving its citizens to curtail unnecessary spending, we shall soon find that we have as effectively destroyed our form of government from within as could be accomplished by our enemies without.

The CHAIRMAN. The Government gives out lots of precepts, but very few examples in this field.

Mr. BUTTON. That is right, sir.

H. R. 4473 contains several commendable improvements in the tax structure, but no where in the majority report do we find any comment regarding the urgent need for the reduction of or curtailment of nonessential Government and military expenditures.

Senator MILLIKIN. You understand that primarily it is not our function to deal with the expenditure side, although we are not precluded from making recommendations?

Mr. BUTTON. That is correct, sir. But I am hoping that the comments that I do make will have some effect somewhere along the line of the various congressional committees.

Our people are asked to make further sacrifices and to willingly endure the deprivation of many of the things to which they have become accustomed. Our great Nation has been built up through the savings and thrift of our people. This fine heritage is being squandered away by an extravagant Government.

Our people have had the utmost confidence in the integrity of their elected Representatives in Congress with respect to giving them absolute freedom in raising tax revenues and the spending thereof. Failure on the part of Congress to put the brakes on nonessential spending will give added impetus to the movement now under way to limit the Federal Government's revenue take to 25 percent of the national income. Such a limitation would be most regrettable in my opinion, but continuance of such waste and extravagance leaves the American people no other alternative.

The proposed Revenue Act of 1951 indicates that Government is to be conducted as usual.

We are convinced that the amount of additional revenue proposed by H. R. 4473 can be obtained through the elimination of nonessential Government and military expenditures. Entrenched bureaucracy will bitterly oppose a reduction of any kind. Such opposition should be met with a keen determination to place nonessential Government expenditures on a level we can afford under present circumstances.

Reduction of Government expenditures is therefore the item of first importance in our opinion.

Individual income taxes under existing law, when combined with the increase in the cost of living, probably now exceed the peak war years of 1944 and 1945. Present tax rates provide little incentive to produce and save. Now comes H. R. 4473 inflicting additional heavy burdens on all taxpayers with special emphasis on the middle and upper income brackets. Venture capital and the financing of new business enterprises come largely from the middle and upper income

groups. We believe that this bill will further dam up the flow of risk capital to the irreparable damage of our economy.

We urge this committee to reconsider the House proposal and its effect on the productivity of the people against whom it is principally directed.

Section 121 of the House bill further increases the normal tax on corporations from 25 percent to 30 percent, raising the total normal tax and surtax to 52 percent. This represents a 30-percent increase over the rate in effect during World War II. It is believed that a normal and surtax rate of 52 percent plus an excess-profits tax of 30 percent has reached or exceeded the point at which the law of diminishing returns becomes operative. It is generally agreed that large scale production and production efficiency are great weapons not lightly to be considered by an adversary. Yet, it is proposed to limit or curtail the incentive to expand plant and facilities, to develop new products and processes by increasing already too high taxes. There is not much point in trying to cut costs, avoid waste and extravagance when the Government, in effect, will bear 70 to 82 cents of every dollar spent. Managerial decisions relating to the expenditure of money, which under normal circumstances would be considered imprudent and unwise, become sound.

It is believed unwise, at this time, to increase the normal corporate tax as proposed by H. R. 4473.

Section 123 (a) (2) and section 123 (c) of the bill propose to limit related corporations to one surtax exemption and one minimum excess-profits tax credit. We strongly protest the enactment of this provision. Many businesses are operated by multiple corporations for many reasons not related to Federal tax consequences. My own company, for instance, operates through subsidiaries and has so operated from the date of its organization in 1928.

Senator MILLIKIN. What is your company, please, sir?

Mr. BUTTON. Allied Stores Corp., sir. I mentioned my own company because that is the one that I am familiar with, sir.

Can it be said that a group of related companies in existence for many years was formed for the purpose of availing itself of multiple surtax exemptions and minimum excess-profits taxes? The answer is obviously "No." Here are some of the reasons for operating through subsidiary corporations:

1. In acquiring an existing corporation, the only way in many instances that such a company may be acquired is by purchase of its outstanding capital stock.
2. A particular lease situation may make it mandatory that a particular store be operated as a separate corporation.
3. Many State tax costs are unfavorable to a foreign corporation when compared with the tax costs of a domestic corporation.
4. Good will built up over a period of years is an important factor in maintaining the separate corporate entity.
5. Isn't it a prudent business decision to incorporate a new business to safeguard the rest of the business in the event the new venture is a failure?

The provisions of section 123 should not be applied to the above situations. The House bill's reason for limiting related corporations to one surtax exemption and one minimum excess-profits tax credit

is that it "confers an unwarranted tax advantage on businesses carried out by means of a series of corporations, rather than a single corporation." We do not believe that this is a completely true statement. It appears to have been completely forgotten that existing law creates additional tax liabilities on multiple corporations. First, dividends paid by a subsidiary to its parent are subject to normal and surtaxes on 15 percent of such dividends. The taxation of intercorporate dividends is double taxation. A single corporate enterprise does not bear this tax. Second, the filing or a consolidated return by a group of related corporations carries a 2-percent penalty. Where is this "unwarranted tax advantage" the House speaks of?

Bona fide business practices should not be penalized by the enactment of section 123. Adequate remedies for the protection of the revenues are provided for in existing statutes expressly designed to prevent sham arrangements. We urge that this provision be dropped from the bill.

Section 502, title V of the House bill, provides for a further increase in the excess-profits tax by reducing the excess-profits credit based on income to 75 percent. A great deal of testimony has been received by this committee within the last 12 months concerning the evils and inequities of an excess-profits tax. I do not believe it desirable to reiterate all of those arguments. It is my understanding that the excess-profits tax was designed to place an additional tax on those profits resulting from defense expenditures as compared with a normal or base period. The Excess Profits Tax Act of 1950, in general, selects as a base period the average of any three of the calendar years 1946, 1947, 1948, and 1949 reduced by 15 percent. If the use of a base period is a logical method for the measurement of excess profits of some future period, then, it follows that 100 percent of such base period earnings should be used. A percentage reduction in such base-period-earnings credit is purely arbitrary. It was admitted by Secretary Snyder, in his appearance before the Ways and Means Committee in November 1950, that the cut-back of 25 percent in the base-period-earnings credit will subject normal profits to an excess-profits tax. It may be said, then, that the percentage reduction in base-period-earnings credit is actually a hidden increase in the normal tax directed solely at those corporations who will be liable to pay an excess-profits tax.

Table 10 of the House committee's report indicates that approximately 70 percent of the corporations fall into the $25,000 bracket. Therefore, the hidden increase in the normal tax will be paid by 20 to 30 percent of the corporations. The objections we have set forth above with respect to the increase in normal tax are equally applicable to the reduction of the base-period-earnings credit to 75 percent.

We firmly believe that any increase in taxes should not be applied retroactively. Taxpayers should have an opportunity to rearrange their affairs in order to be able to meet new tax burdens. Taxes retroactively applied do create hardships. Tax payments under present economic circumstances require advance planning.

The manufacturers' excise tax has been expanded to include certain additional items and the rates are increased on some items and decreased on others. Retailers, historically, have always been opposed to taxes on consumption on the ground that such taxes are regressive.

Senator MILLIKIN. Senator Kerr is interested in what you mean by the word "regressive." Would you mind explaining that to him?

Mr. BUTTON. I might say that "anti-inflationary" would be another word. It curtails consumption. It takes more of the purchasing power of the dollar.

Senator KERR. Would you spell it?

Mr. BUTTON (spelling). R-e-g-r-e-s-s-i-v-e.

Senator KERR. Have you got a dictionary?

Mr. BUTTON. Isn't that correct, sir?

Senator KERR. If it is, I would like to know it, and if it is not, you ought to know it.

Mr. BUTTON. That word has been customarily used in describing this type of tax in the retail industry, sir.

Senator KERR. Is "regressive" that which identifies regression, or has to do with regression?

Mr. BUTTON. Having to do with what, sir?

Senator KERR. Regression.

Mr. BUTTON. The term the way I use "regressive" means "going backward." Regression also means the same thing, does it not?

Senator KERR. I suggest you look it up in the dictionary and then see if you want to leave it in your statement.

Mr. BUTTON. I would be perfectly willing to change that to "anti-inflationary."

Senator KERR. I guarantee that they are entirely different. It does not make any difference to me. It is your statement. If you want to leave a word in there that refers to infantile matters, and the libido, which goes back to the prepuberty stage, that is all right with me.

Just as a matter of courtesy, I thank the Senator for calling it to your attention.

Mr. BUTTON. Thank you, sir. I shall take your advice.

It is recognized that for many years to come excise taxes, of necessity, will be an important source of revenue. While the National Retail Dry Goods Association Taxation Committee offers no objection to the House's proposal on excise taxes, we do not agree with the principle of selective excises.

If, however, Congress considers the enactment of general manufacturers' excise tax or further broadens the base for manufacturers' excise taxes or retailers' excise taxes or both to an extent that amounts to a general sales tax at the manufacturers' level, then retailers would propose that the manufacturers' excise taxes, except on liquor, tobacco, and gasoline, be repealed and a national retail sales tax be enacted.

Senator MILLIKIN. Yesterday we had considerable testimony to the effect that a manufacturers' excise tax does not pass on to the retailer. What is your opinion of that?

Mr. BUTTON. My opinion very definitely is, sir—and that is a point of difference between me and the National Association of Manufacturers—that where you have a tax at the manufacturers' level, that tax is passed on. It is pyramided through all the channels of distribution, and we cannot help but include in that tax a mark-up. That is why we are, sir, opposed to it.

Arguments for and against both the manufacturers' excise tax and the retailers' excise tax have been previously presented to this committee. We do not believe it is necessary for us to repeat these arguments except to remind you that manufacturers' excise taxes tend to be pyramided throughout the channels of distribution. The consumer pays more under this form of tax than under the retail sales tax.

The impact of the taxes already imposed and proposed by H. R. 4473 and to be proposed next year makes it imperative that all segments of our economy equitably share in the costs of Government and the Military Establishment. The costs of civilization are heavy and all must share in these costs. It is no longer possible to raise all the required revenue from great corporations or from well-to-do individuals.

We earnestly and sincerely suggest to this committee that it reappraise section 101 which grants tax exemption to various organizations. Particular reference is made to section 101 (12) relating to farm cooperatives. We fully realize that this is a difficult problem but fairness and equity to all demand serious consideration of the problem. The exemption for one group increases the tax burden on the others. Cooperatives do not now have the same characteristics they had many years ago. They have developed into big business and are in competition with tax-paying enterprises.

The need for revenue is so great that it is time to reexamine the whole list of tax-exempt organizations. The exemption provisions should be narrowed to include only those organizations which make a clear case for such indirect Government support.

If the Treasury Department believes that withholding on dividends and interest is necessary to force compliance with the internal revenue laws, then we believe that the House proposal should be enacted.

We endorse and urge the enactment of section 303 of the House bill relating to gain on sale of personal residences.

We are not unmindful of the great need for revenue and that the foregoing remarks are not productive of additional revenues. We are convinced that much can be done in the way of reducing nonessential Government expenses. However, we recognize that budgetary reductions are not quickly made. With this in mind we attach hereto as appendix A a summarized copy of our testimony before the House Ways and Means Committee on February 28, 1951, which outlined a tax program estimated to produce about $10 billion.

Thank you.

(Appendix A, referred to, is as follows:)

Appendix A

Summary of Testimony of Ralph W. Button, Chairman of the Taxation Committee of the National Retail Dry Goods Association

There are four basic principles which must be followed in the adoption of a sound and equitable tax program. With tax imposts becoming increasingly more severe, it is doubly important that any new tax program be tested by these four principles.

1. The program must be fair and should fall equitably on all groups without fear or favor.
2. The program should not stifle incentive but rather should encourage production and savings, thus resulting in the further expansion of production and the economy.
3. The program should be long-term and realistic.
4. The program should be shaped to produce adequate revenues in the light of the conditions now confronting us.

With these principles in mind, we recommend the following programs:

1. Loopholes

The President has repeatedly requested and we heartily concur that Congress should act to close existing loopholes. While time does not permit a detailed account of all of them, I would like to make reference to at least three of them.

(*a*) *Tax-exempts*

State and municipal securities are presently exempted from the payment of income taxes. As you are all aware, it is not the small-income taxpayer who makes an investment in this kind of security but rather the well-to-do. There seems to be no valid reason why this income should continue tax-free, no matter what the historical reasons may have been.

(*b*) *Cooperatives*

Many types of cooperatives still remain outside the scope of our tax structure. In many instances these cooperatives compete directly with private industry and engage in the type of business which is normally conducted for profit, but they are at present exempted from paying any part of the cost of Government which is as essential to their continued existence as to yours and mine.

(*c*) *Withholding dividends*

A careful study should be made of the desirability of requiring corporations to withhold 10 percent of the dividends and interest paid by them to individuals.

A cursory examination indicates some revenue loss from the failure of individuals to report the full amount of dividends and interest received.

All segments of our economy should share equally in the tax burdens imposed upon us. True democratic principles require the participation of all groups in defraying the costs of defense. It has been estimated that tax receipts from this source would be $12 billion.

2. PERSONAL-INCOME TAXES

We agree with the President's recommendation that the personal-income tax should be increased by 4 percentage points in all brackets. It is estimated that this increase will produce $3.6 billion.

(*a*) The individual exemptions should be reduced from $600 to $500. It is estimated that this reduction in exemptions will produce $2.5 billion.

We may be criticized for suggesting the reduction in the personal exemptions. A quick analysis of the distribution of income will show the necessity for this reduction. It is reported that 42,965,200 returns were filed in 1950. Of this number, 90.6 percent were from individuals earning $5,000 a year or less. The total net income reported was $140.8 billion, of which 69.4 percent is in the $5,000-or-under bracket, 13.5 percent is in the $5,000-$10,000 bracket, and 9.2 percent in the $10,000-$25,000 bracket, or a total of 92.1 percent.

It should be obvious that if large amounts of revenue are to be raised it must come from the lower-income brackets.

The foregoing recommendations have thus far produced $7.3 billion of the $7.5 billion needed to balance a budget of $62.6 billion as reduced above. However, it is recognized that the reduction in expenditures advocated may fall short of the $9 billion suggested above. We therefore make further recommendations as follows:

3. CORPORATE TAX

The corporate normal and surtax is now levied at the rate of 47 percent. We believe that this rate could be increased to a maximum of 50 percent. This increase, it is estimated, would produce approximately $1.2 billion.

We believe that a tax rate of more than 50 percent coupled with the present excess-profits tax would tend to encourage waste and extravagance. A higher rate would stifle incentive to reduce expenses and might result in management treating certain expenditures as prudent which under other circumstances would be frowned upon.

Further expansion and growth of small business would be curtailed.

Financing avenues open to large corporations are not usually available to small business. Their expansion and growth must be financed out of retained earnings.

4. EXCISE TAXES

The President has recommended the inclusion of certain additional items to be taxed under the manufacturers' excise tax, the retailers' excise tax, and the miscellaneous excise-tax classifications. It is estimated that these changes and increases will produce $3 billion.

The tax program we have thus far advocated will produce an estimated amount of $8.5 billion. This is in excess of the $7.5 billion we have previously stated as being necessary to balance the $62.6 billion budget by $1 billion. We therefore recommend that Secretary Snyder's proposal be adjusted to produce $1.5 billion.

Retailers, historically, have always been opposed to taxes on consumption on

the ground that such taxes are regressive. Retailers have accepted these taxes because of the great need for revenue.

The National Retail Dry Goods Association Taxation Committee has approved the President's recommendation concerning excise taxes provided that the additions to the list of taxable articles and the rates specified are limited to those proposed by Secretary Snyder.

If, however, Congress further broadens the base both for manufacturers' excise taxes and retailers' excise taxes to an extent that amounts to a general sales tax at the manufacturing level, then retailers would propose that the manufacturers' excise taxes, except liquor, tobacco, and gasoline, be repealed and a national retail sales tax be enacted.

Arguments for and against both the manufacturers' excise tax and the retailers' excise tax have been previously presented to this committee. We do not believe it is necessary for us to repeat these arguments except to remind you that manufacturers' excise taxes tend to be pyramided throughout the channels of distribution. The consumer pays more under this form of tax than under the retail sales tax. It has been stated that a 10-cent tax at source becomes an 18-cent price to the consumer.

The additional amount of revenue to be raised by the foregoing program amounts to $10 billion.

We sincerely believe that this additional revenue plus a reduction in Government nondefense expenditures by at least $7 billion will amply meet our defense needs.

Senator MILLIKIN. Can you tell us the gist of that?

Mr. BUTTON. The gist of that provides, or rather I should say accepts, the President's recommendation of a 4-percentage-point increase in all brackets of individual-income taxes. It has made some comment with respect to dividend withholding. It also provides for an additional increase on corporate-income taxes to 50 percent, that being the maximum amount.

It also requests——

Senator MILLIKIN. Irrespective of the excess profits?

Mr. BUTTON. That is right, sir, but no more than 50 percent in addition to the excess-profits tax.

Senator MILLIKIN. It is included?

Mr. BUTTON. It is included. It also accepts Secretary Snyder's proposal on excise taxes, but adjusts it to an amount not to produce more than $1,500,000,000, and I covered in that statement, too, tax-exempt organizations, sir.

So, I estimated that, with the sum of all those items, it would produce about $10 billion. And that is my own personal estimate, sir.

The CHAIRMAN. Are there further questions of the witness?

(No response.)

The CHAIRMAN. If there are no questions, we thank you, sir, for your appearance.

The CHAIRMAN. Mr. Lebor.

Please identify yourself for the record.

STATEMENT OF JOHN F. LEBOR, AMERICAN RETAIL FEDERATION

Mr. LEBOR. My name is John F. Lebor. I am treasurer of Federated Department Stores, Inc., with offices at 707 Race Street, Cincinnati, Ohio.

I appear on behalf of the American Retail Federation and the Retail Industry Committee, an emergency committee organized shortly after Korea to coordinate the retail industry on a wide basis in the handling of the issues and problems arising out of the defense effort and to make available to Government the experience and technical knowledge of the industry.

The rosters of the American Retail Federation and the Retail Industry Committee are attached to this statement.

(The rosters referred to are as follows:)

MEMBER ASSOCIATIONS, AMERICAN RETAIL FEDERATION

STATE ASSOCIATIONS

California Retailers Association
Colorado Retailers Association
Delaware Retailers Council
Florida State Retailers Association
Georgia Mercantile Association
Idaho Council of Retailers
Illinois Federation of Retail Associations
Associated Retailers of Indiana
Associated Retailers of Iowa, Inc.
Kentucky Merchants Associations, Inc.
Louisiana Retailers Association
Maine Merchants Association, Inc.
Maryland Council of Retail Merchants, Inc.
Massachusetts Council of Retail Merchants
Michigan Retailers Association
Missouri Retailers' Association
Nevada Retail Merchants Association
Retail Merchants Association of New Jersey
New York State Council of Retail Merchants, Inc.
North Carolina Merchants Association, Inc.
Ohio State Council of Retail Merchants
Oklahoma Retail Merchants Association
Oregon State Retailers' Council
Pennsylvania Retailers' Association
Rhode Island Retail Association
Retail Merchants Association of South Dakota
Retail Merchants Association of Tennessee
Council of Texas Retailers' Associations
Utah Council of Retailers
Virginia Retail Merchants Association, Inc.
Associated Retailers of Washington
West Virginia Retailers Association, Inc.

NATIONAL ASSOCIATIONS

American National Retail Jewelers Association
American Retail Coal Association
Associated Retail Confectioners of the United States
Association of Credit Apparel Stores, Inc.
Institute of Distribution, Inc.
Limited Price Variety Stores Association, Inc.
Mail Order Association of America
National Association of Chain Drug Stores
National Association of Music Merchants, Inc.
National Association of Retail Clothiers and Furnishers
National Association of Shoe Chain Stores
National Retail Dry Goods Association
National Retail Farm Equipment Association
National Retail Furniture Association
National Retail Hardware Association
National Shoe Retailers Association
National Stationery and Office Equipment Association
Retail Credit Institute of America, Inc.
National Luggage Dealers Association
Retail Paint and Wallpaper Distributors of America, Inc.
National Retail Tea and Coffee Merchants Association

ROSTER—RETAIL INDUSTRY COMMITTEE

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Vice chairmen:

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Vincent D. Kennedy, California Retailers Association, 1508 Central Tower, San Francisco, Calif.

Secretary: James C. Lucas, American Retail Federation, 1625 I Street, Washington, D. C.

ASSOCIATIONS

American National Retail Jewelers Association
American Association of Nurserymen
American Booksellers Association, Inc.
American Hotel Association
American Institute of Laundering
American Retail Federation
American Retail Coal Association
Association of Credit Apparel Stores, Inc.
Associated Furniture Dealers of New York
Associated Retail Bakers of America
Associated Retail Confectioners of the United States
California Retailers Association
Chamber of Commerce of the United States
Eastern Gasoline Dealers Association
Grain and Feed Dealers National Association
Illinois Federation of Retail Associations
Independent Grocers' Alliance of America
Institute of Distribution
Limited Price Variety Stores Association, Inc.
Linen Supply Association of America
Mail Order Association of America
Master Photo Dealers and Finishers Association
National Appliance and Radio Dealers Association
National Association of Chain Drug Stores
National Association of House to House Installment Companies
National Association of Ice Industries
National Association of Independent Tire Dealers
National Association of Music Merchants
National Association of Retail Clothiers and Furnishers
National Association of Retail Druggists
National Association of Retail Grocers
National Association of Retail Meat and Food Dealers, Inc.
National Association of Shoe Chain Stores
National Automobile Dealers Association
National Congress of Petroleum Retailers
National Consumer-Retailer Council
National Industrial Stores Association
National Institute of Cleaning and Dyeing
National Luggage Dealers Association
National Office Machine Dealers Association
National Restaurant Association
National Retail Dry Goods Association
National Retail Farm Equipment Association
National Retail Furniture Association
National Retail Hardware Association
National Retail Lumber Dealers Association
National Retail Tea and Coffee Merchants Association
National Shoe Retailers Association
National Sporting Goods Association
National Stationery and Office Equipment Association
National Voluntary Groups Institute
Northwestern Lumberman's Association
Pennsylvania Retailers' Association
Retail Credit Institute of America, Inc.
Retail Tobacco Dealers of America, Inc.
Society of American Florists
Super Market Institute, Inc.
Virginia Retail Merchants Association

Mr. LEBOR. We do not question the need for balancing the budget. We commend the policy of proceeding on the premise that a high level of military expenditures may be necessary for a protracted period. To the extent that tax increases are necessary to meet these conditions, we favor them. We believe, however, that two prerequisites are essential: First, that increased taxation be resorted to only after every effort has been exhausted to balance the budget by reducing unnecessary or deferrable expenditures in lieu of additional taxation; as a second prerequisite, that the form of taxation be designed to maintain and stimulate a high level economy without which even our existing taxation will be repressive and unbearable.

We do not believe the Revenue Act of 1951, as enacted by the House of Representatives, meets these criteria and therefore welcome this opportunity to urge upon the Senate the desirability of major revisions.

We are not impressed with the fact that all has been done that can be done to reduce revenue needs by reduction of nonessential expenditures. On the contrary, we are impressed with the untouched opportunities in this direction which have been pointed out on many occasions by competent experts, including members of this committee. With Federal, State and local taxes now consuming more than 30 percent of national income, we cannot emphasize too strongly the necessity of abandoning a free and easy spending policy before additional tax burdens are thrust upon the economy.

Senator KERR. Would you break down that 30 percent?

Mr. LEBOR. I do not have the breakdown here, Senator Kerr.

Senator TAFT. Does it not, roughly speaking, take $60 billion from the current Federal taxes and about $18 billion from State and local, which is $78 billion? I suppose that is supposed to be 30 percent of what? $260 billion?

Mr. LEBOR. That is just about right.

Senator KERR. Is it your position that it will be 30 percent if the House bill is enacted?

Mr. LEBOR. No. It is now.

Senator KERR. Very well.

Mr. LEBOR. Neither do we believe that the House bill will help maintain a high level of economy. On the contrary, it imposes additional tax burdens at the point where they will do most to retard, if not contract, a high level of production and distribution.

Turning to the individual income tax, the proposed flat 12½ percent increase on individual income taxes is unsound. It reduces the percentage of retained income after Federal income taxes by greater proportions in the brackets that already are bearing the greatest burden. By so doing, the driving force of the individual incentive is stultified in the area in which the leadership for a sound and expanding economy must come. In addition, if the Congress continues to close its eyes to the fact that the real reservoir of income is in the lower brackets, it can only further restrict the initiative of individuals whose pretax incomes are indicative of the fact that they are the builders of an economy which up to this time has had ever widening horizons. We believe it would be a great mistake to continue the trend of the past decade to continually squeeze the take-home pay of the middle and upper income groups to the greatest degree.

Senator KERR. You think that Congress has its eyes closed, do you, Mr. Lebor?

Mr. LEBOR. Yes, Senator Kerr. It is evident——

Senator KERR. Do you think that is a matter of a voluntary shutting out of the light on their part, or do you think it is on account of their being blind to start with?

Mr. LEBOR. Certainly not the latter, Senator. The basis of that statement is the fact that the history of the trend of taxes in the last decade has been in periods of rising taxation to increase the relative burden——

Senator MILLIKIN. Hold on. Do not forget the Eightieth Congress, which reduced taxes. That has been within the decade.

Mr. LEBOR. I accept that, Senator Millikin.

Generally over the period, the trend has been to place the additional tax burden in period of rising taxes to the greatest degree on the middle and upper income brackets, and in effect to do the reverse in periods of reduced taxes.

Senator KERR. Do you think that this blindness on their part is a result of their ignorance or just a premeditated purpose on their part to refuse to see what the realities of life are?

Mr. LEBOR. Certainly not ignorance, but an apparent policy of not being willing to——

Senator KERR. If they are blind to the facts, it must be because either they are ignorant or are premeditatedly refusing to look at what the facts are, must it not?

Mr. LEBOR. I would say between the choice of those two items, it is an unwillingness to tax where the incomes are.

Senator KERR. Now, if they know where the revenue is and deliberately decide not to tax there, do you think that that is blindness or just perverse stubbornness?

You have made quite a statement here, and I am interested in knowing what your thought is.

Mr. LEBOR. May I paraphrase it, Senator?

Senator KERR. You do not have to paraphrase it. I know what the line means. How would you paraphrase that to make it any softer?

Mr. LEBOR. An evident reluctance on the part of the Congress to assess the taxation in the areas in which the incomes exist.

Senator KERR. Now, then, do you want to change your statement to read that way?

Mr. LEBOR. I would like to have it so interpreted.

Senator KERR. If you want to have it so interpreted, you had better have it so delineated.

Mr. LEBOR. I shall be very happy to change the language, Senator, as long as the thought is preserved. That is my principal objective.

Senator KERR. That was your thought?

Mr. LEBOR. That is right.

To make it more specific, this House bill, as I recall it, proposes to lay about 35 percent or thereabouts of the proposed increase in personal taxation on the area of incomes that produce about 60 percent. I believe that is the area of incomes up to $5,000. The figures are in the House report. You gentlemen are undoubtedly familiar with them. I am speaking from memory.

Senator KERR. If we have our eyes closed to the facts, it is possible that we might not be familiar with them. As I understand your

indictment, it applies to Congress for a decade, with a slight blue-nosed interval during the Eightieth Congress; is that not about your attitude?

Senator TAFT. That is not a bad statement.

Mr. LEBOR. The question that I would like to leave, Senator——

Senator KERR. Do not leave any questions. Tell us what you are trying to say, and we will make our own impressions.

Mr. LEBOR. I am trying to be specific, Senator, in answering your questions. There has been a trend over a long period of time that has had the result of continually placing a greater burden on the middle and upper income brackets, and it is that trend to which I am speaking in opposition. I am expressing my personal opinion that there has been a reluctance on the part of the Congress to lay the tax burden in the areas where the incomes are produced.

Senator KERR. Then what you are trying to say is that this action on the part of Congress has been something that they have taken with their eyes open and knowing what they are doing, but with which you do not agree, rather than something that they just either ignorantly blundered into or premeditatedly had been wrong on?

Mr. LEBOR. Yes; I will agree that they know what they are doing.

Senator KERR. All right.

Mr. LEBOR. But I would disagree with the wisdom of it. That is the point I am trying to make.

The CHAIRMAN. Will you proceed with your statement, Mr. Lebor?

Mr. LEBOR. Going on with my present point, this trend is particularly undesirable, since the amount of revenue raised is trifling compared with the adverse effects on the economy. Not only is the individual incentive for greater effort and risktaking smothered, but also high individual rates in the middle and upper brackets dries up sources of venture capital by eliminating savings among the groups that have historically provided the capital necessary to an expanding economy.

Senator MILLIKIN. Has your association any statistics on the total tax burden, Federal, State, and local, on persons who are in the categories of less than $5,000 of income?

Mr. LEBOR. As an association, we have not. I believe, Senator Millikin, that those figures are in the House report. If not, I have seen them in numerous other studies.

You are speaking about not just taxable income, but total income?

Senator MILLIKIN. I am speaking primarily to the point of the total tax burden, Federal, State, and local, on people with incomes of less than $5,000. In that category that you are talking about.

Mr. LEBOR. Yes.

I believe, Senator, that those figures are in the House report.

The CHAIRMAN. You do not have them.

Mr. LEBOR. I do not have them; no.

The CHAIRMAN. Very well.

Mr. LEBOR. The individual income tax is a business tax to the great majority of the members of the retail industry. About 80 percent of the retail businesses in this country are individual proprietorships or partnerships. These businesses finance their operations, their improvements, and their expansion out of profits. To these businesses, most of which are small, an additional 12½ percent income tax will be a severe blow. It will make it difficult to finance increased working

capital required by the new higher price level now prevailing and it will effectually prevent improvements and expansion.

Senator MILLIKIN. Would it be also fair to say, taking a look at the other side of the coin, that if we reduced the spendable income of the lower brackets that you are speaking of, the volume of retail sales would be reduced?

Mr. LEBOR. That is right. There is an effect of that kind, Senator Millikin. But we believe that the retail sales of the country are affected primarily by the level of the entire economy, and we believe that what is good for the national economy is best for retail sales. We therefore think that the broad view is the sound view, and in some of these policies that I am urging today, if you look just at the immediate effect of taxation on our particular customers, you would be right.

Senator MILLIKIN. That is a very fine statement that you have just made.

Mr. LEBOR. But we are inevitably bound up with everything we do in the prosperity and the economic health of the country. And this whole statement, Senator Millikin, is keyed to that approach. We are trying to look at it as if we were sitting on your side of the desk and with the responsibilities that you gentlemen have.

What is good for the country is good for us.

With respect to corporate income taxes, just as high individual rates sap incentive to individuals to "excess" earnings. As a matter of fact, even 100 percent is inadequate because a dollar of pretax income today has less economic value than a dollar in the base period because of the intervening inflation. We searched in vain the House Ways and Means Committee report for any explanation or justification for the proposed reduction in the credit, and have been unable to find a single word. In fact, this 65-page report devotes only 4 lines to this important proposal, and that consists merely of a statement on page 13 that such a reduction is proposed.

On the subject of ceiling rate on corporate-income and excess-profits tax, for reasons inherent in our opposition to the proposed changes in corporate rates, we urge that the ceiling rate on these taxes not be increased above the 62 percent now in effect.

In the absence of all-out war conditions, we see no justification for a higher rate if, indeed, a rate as high as 62 percent is desirable. Bearing in mind that during World War II corporate taxes were equal to approximately 50 percent of pretax income, and facing the prospect that currently all corporate-tax payers will be subject to an even higher rate, we believe that it would be wise on the part of Congress to hold out assurance that corporate-tax payers may retain at least 38 cents out of each dollar of pretax income they are able to generate. Such an incentive is probably already too small for the best results. To reduce the amount of pretax income a corporation is allowed to retain by an additional 22 percent—as would result from the ceiling of 70 percent in lieu of 62 percent—is, in our judgment, short-sighted and not to the benefit of the country.

On the subject of retroactivity, one of the worst features of the House bill is the proposal that corporate taxes be retroactive.

Senator MILLIKIN. May I ask whether you intend to comment on a theory of your own for raising additional taxes?

Mr. LEBOR. Yes, sir.

We are opposed to retroactive taxation in any form. Business decisions must be made daily. Tax effects, particularly at today's extremely high levels, exert a major influence and frequently are the controlling factors in the most important of these decisions. It is self-evident that, if the "rules of the game" are subject to change after the decision has been implemented, the end of the road can only be chaos.

We are deeply disturbed by the resort to retroactive taxation in the two tax bills of 1950, and the further proposal in the current House bill. The latter is not only subject to the objection of any retroactive taxation but is even more objectionable because it would increase taxation for most retailers on part of last year's operations which have long since been reported to stockholders and covered by income and excess-profits tax returns already filed.

The administrative complications are self-evident, but we base our objection primarily on a matter of principle. If this principle is not accepted, we fail to see how taxpayers can be expected to have continued respect for and an attitude of cooperation with tax-law making and administration.

The explanation of that is that January 31 is the traditional fiscal-year end in the retail business.

Senator MILLIKIN. Do most of your members set up reserves for retroactive taxes?

Mr. LEBOR. No, sir. And the big point that I want to emphasize here is that the thing that we are disturbed about is this new theory that has come into taxation in the last year or two, of retroactive taxation. And now here is one that proposes to dip back into the last year's earnings, which we have published; we have filed our tax returns; we have paid our dividends; we have complied with the sinking-fund requirements, and every other thing for the last year.

Senator MILLIKIN. This does go back to the House bill, but retroactive taxation is not a new feature in our economic system. It may not always be fair, but it is not a new feature. The theory has always been that, if people have adequate notice that something of that kind might happen, then they have notice to protect themselves, which I admit has certain defects in it.

Mr. LEBOR. I would say, Senator, that the principal defect is that we do not have notice of what is going to happen, but we cannot make our decisions with the knowledge of anything other than the existing law.

Senator MILLIKIN. As one member of the committee, and generally speaking, I would agree with you entirely.

Mr. LEBOR. We feel that the implications of retroactivity are far more important——

Senator MILLIKIN. Let me come back to my original question.

Mr. LEBOR. Yes.

Senator MILLIKIN. Are you sure that it is not quite widespread for your clients to set up reserves for retroactive taxes?

Mr. LEBOR. Are you speaking, Senator, from one year to another or from one month to another?

Senator MILLIKIN. I am quite familiar with the practice of corporations to set up reserves for contingent taxes.

Mr. LEBOR. The practice in individual companies may vary. I may also say that, for internal reports for internal consumption and

management guidance, some taxpayers may attempt to guess what the Congress is going to do and attempt to reflect it in their statements and attempt to guess what is going to happen; and, if they are forced to make a business decision today, they hope their guess is about what the tax law that is going to apply to today's acts will be.

In most companies that I am familiar with, and certainly in my own company, we proceed on the premise that we do not have that good a crystal ball, and we have to work under existing legislation. Certainly, we would never make a report to our stockholders, nor, I am sure, would our auditors certify a report at the end of the fiscal year, in which taxes were provided on any basis other than the law applicable to that year at the time the report is issued.

More specifically, Senator——

Senator MILLIKIN. I do not challenge anything that you say, but I happen to know of many exceptions to what you say.

Mr. LEBOR. I would surmise that most of them would be internal statements for management's guidance in some effort to guess what the effects might be, rather than for public consumption. Would that be a fair conclusion?

Senator MILLIKIN. No. My understanding of the fact is that corporate management sits down and says, "There is a threat of retroactive taxation that may affect us to the extent of X number of dollars; and, therefore, we should set up reserves to meet that tax."

Mr. LEBOR. Our own view is that we have an obligation to our stockholders to report the facts to them rather than to guess on things of that kind, and that we might mislead them if we did not guess what the Congress would ultimately do.

Senator MILLIKIN. You are not guessing that your establishment will burn down, but you take out some insurance on it. So, that is not a complete answer. So far as the uncertainty of taxation is concerned, perhaps there should not be any uncertainty.

Mr. LEBOR. That is the thing that is the important point that I am trying to make, Senator.

Senator MILLIKIN. But in these times we have the necessity of getting revenue, and a lot of the punctilios that might be normal necessarily have to go by the board.

Mr. LEBOR. Yes, sir. Our position is that it should not be necessary to resort to retroactive taxation to raise revenue; that the rates and methods should be adopted applicable to the future, to whatever extent necessary, to raise the revenue, but they should not be applied retroactively.

Senator TAFT. Mr. Lebor, when you say it is retroactive into these other years, in the case of retailers ending their year on January 31st, what do they do? Do they take one-twelfth of the past year? Of course, they do not make much money in January if you were to take just January.

Mr. LEBOR. That is not the way it would apply. I am glad you raised that question, because if you will permit me, I would like to elaborate on how it will end in our company.

We end on a January fiscal year. If this House bill were to remain law, the taxes applicable to our fiscal year ended January 1951 would be raised $165,000 more than we so provided in our tax return filed for that year and so applied.

Senator TAFT. That is one-twelfth for your total tax roughly for the year 1950?

Mr. LEBOR. That is right. And the point that I want to make there is that that is by no means a measure of the January profit. As you indicated, January is customarily a loss month. So, in effect, what the House bill is doing is reaching back into our pre-Christmas business in 1950.

In fact, they are reaching into some of the business that we did as early as February 1950, and saying that one-twelfth of that whole year's business is applicable to January, and sometime in September or October 1951 we are going to go back and tax you on some of the results of your operations a year and a half before.

Senator MILLIKIN. Of course, the one-twelfth is arbitary, but is really done for the convenience of business.

Mr. LEBOR. It is the only practical way, Senator Millikin, because the only other way you could do it would be to require corporations to close their books at the end of every fiscal month and open up a new set of books at the end of every month. It is the way Congress has, to the best of my knowledge, always provided for the application of retroactive taxation, to take a full fiscal year——

Senator MILLIKIN. We have done that at the suggestion of business.

Mr. LEBOR. I think it is the only practical way, if retroactive taxation is to be utilized, but its effects are very detrimental.

The CHAIRMAN. Very well.

Mr. LEBOR. I would like to proceed to point out and develop this thought a little more, if I may.

We understand that the Revenue Act of 1951 which you gentlemen are now considering is not likely to become law until at least after 9 months of the current calendar year have passed. Assuming that a corporate-tax payer's income is equally divided by months during the year, it would have operated for 9 months when the normal and surtax rates under then existing legislation would be 47 percent. If the entire year is to be subject to a 52 percent rate, this means that the final 3 months of the current year must bear a 67 percent normal and surtax rate. An additional 30 percent would apply to any income subject to excess-profits tax, thus making the effective rate applicable to operations after the enactment of tax legislation 67 percent on a portion of "normal earnings" and 97 percent on the balance.

May I interpose there to say that if the earned-income credit under the excess-profits tax imposed by the House was reduced from 85 percent to 75 percent, so that there was also a retroactive feature on the excess-profits tax, then more than 100 percent—in fact, 109 percent, as I compute it—of the income in the portion of the year after October 1—in other words, the last quarter—would be taxed in order to end up the year with the necessary rates.

I hope I have not made that too complicated. The point I am trying to make is that, if we accrue our taxes on the basis of the law in effect at the time this transaction was entered into and immediately upon the enactment of new legislation, follow the new legislation, then we have a situation where we have more than 100 percent tax on the excess-profits portion and 67 percent on the normal.

We think that there is no justification for such rates and similarly that there is no justification for imposing them in disguise by accomplishing the same result through resort to retroactive taxation.

I do not want to be understood to be taking a negative position. Our view is that, if it is necessary to raise this amount of dollars from corporations, the rates ought to be higher, but they ought to be applied prospectively, and not retroactively.

With respect to the proposal in the House bill under section 123 relating to the surtax and minimum credit of related companies, the House bill contains a provision which would limit a group of related corporations to one surtax exemption and one minimum excess-profits credit. This appears to be an unwise provision of the bill which would produce very little revenue, and it should be completely eliminated.

The provision is apparently designed to prevent tax avoidance through corporate manipulations. If that is the case, the present statutes contain ample authority for the Treasury to prevent such actions without the addition of a provision which would bear so heavily on business.

Although doubtless aimed at larger corporations, this provision would in reality bear most heavily on smaller businesses. Small business over the years has expanded through the use of incorporating new ventures separately. Taxing away retained earnings will not encourage growth.

In addition to retarding growth the provision will penalize many retail businesses which operate in more than one State and which have incorporated in each State to make compliance with State laws easier and more efficient.

Furthermore, many companies which now have a multiple corporate set-up have made their loan arrangements on this basis. To impose a new and severe tax liability on these corporations will prevent their amortizing their loans on schedule and may in many instances force defaults with unfortunate consequences.

I now come, Senator Millikin, to the portion devoted to our suggestions for raising additional revenues if our recommendations will not raise adequate amounts.

On the subject of excise taxes, historically, retailers have opposed all types of consumption taxes on the basis that they reduce consumption, that they fail to recognize the principle of ability to pay and that they constitute obstacles to the long-term national objective of maximum production and full employment.

Today, retailers, while still of the same conviction on a long-term basis, are now far more concerned about the hazards of inflation and its tremendous threat not only to the entire defense effort but to our basic national welfare as a whole.

Retailers believe that selective taxes, other than the traditional ones which have been embedded in our tax structure over the years, have no place in a well-designed and equitable tax system. Selective excise taxes either at the retail or manufacturer level are essentially discriminatory in nature. They single out classes of products for taxation produced by classes of producers and classes of workers, leaving other classes of products, producers, and workers in a preferred economic position. They penalize the industries and the workers involved, and the absurd situations they produce are endless.

All of the products now subject to excise taxes, with the exception of those which are traditional and make huge contributions to the total revenue, are products which, with few exceptions, many people

feel compelled to buy for one reason or another. In many cases they force diversion of spendable income curtailing the free choice of products to be purchased out of income by our citizens.

Many of these taxes have been defended on the basis that they are levies on luxuries. We suggest to this committee that ours is a luxury standard of living. Our high standard of living economy, in a very basic sense, is hung on the production and sale of goods which people are not compelled to buy. What some are pleased to call luxuries are simply the pluses of life which make people work harder to secure. The fact is that if it were not for the tremendous consumption in these so-called luxuries, even the necessities of life would be harder for our people to obtain. The difference between full production and full employment on the one hand, and closed plants and millions of unemployed on the other, lies in production and distribution of the vast numbers of products which the families of America can do without and still maintain a healthy existence.

In order to raise any important revenue from limited groups of products, high tax rates are necessary and the high rates result in decreased demand and decreased tax revenue, not only from the excise tax itself, but from individual and corporation income taxes from producers, distributors, and workers involved in those products.

Our retail tax committee has studied whether such a broad base tax, if it were imposed, should be at a manufacturer or retail level. Retailers have a vital interest in either case, since the retailer is called upon to collect the tax at the point of sale. While retail opinion is not unanimous, the large majority of retailers and retail groups would favor the tax as a retail sales tax as by far the lesser of two evils.

Senator MILLIKIN. Yes. But the tax group of the National Manufacturers Association gave us their opinion that a manufacturers' tax generally speaking would not be passed on, and would not multiply as it goes up; in other words, that the usual mark-ups would be disregarded, I think it was said, through force of competition.

What is your opinion of that opinion?

Mr. LEBOR. I do not agree with it. I unequivocally disagree.

The CHAIRMAN. How would you impose another retail tax on the 29 States that already have a retail sales tax?

Mr. LEBOR. It is possible, Senator George.

The CHAIRMAN. Would it not be pretty——

Mr. LEBOR. Burdensome?

The CHAIRMAN. Burdensome.

Mr. LEBOR. It would be burdensome to us, and in this respect: it would be burdensome to us administratively.

Senator CONNALLY. How about the consumer? It would be burdensome to him, would it not?

The CHAIRMAN. It would be burdensome all around.

Mr. LEBOR. In this respect we are taking the same position that we did in answering a question of Senator Millikin earlier. We are urging a form of taxation here that would be burdensome to us administratively, and which from perhaps the narrow point of view would be burdensome to our customers and therefore have an adverse effect on us. But we believe that what is best for the economy is best for us, and therefore we are urging that if revenue is needed, this method be used.

The CHAIRMAN. That is a very broad view of it. But I do not see how, when you have 29 States now with a retail sales tax, you can suggest that a Federal retail sales tax be imposed on top of that. It looks to me like an ethereal and impractical sort of proposition.

Mr. LEBOR. I agree that it has disadvantages, but we are approaching it from the standpoint of the lesser of evils. We feel that if the Congress concludes that it is necessary to raise substantial billions of additional revenue over and above what we have now, it is very important that the methods be used that will not throw our high-level economy into low gear.

The CHAIRMAN. I can appreciate that. I do not think there is any question about pyramiding a manufacturers' tax.

Mr. LEBOR. You are perfectly right. It would be administratively difficult.

The CHAIRMAN. Strong competition over a period might eliminate undue pyramiding, but I am completely stymied when you talk about putting another retail sales tax on top of the 29 retail sales taxes already in operation in the country, in 29 of the States.

Mr. LEBOR. We are now unfortunately faced with the circumstance of collecting multiple taxes at the sales level. We have exactly that now with respect to many products, all those that are subject to existing Federal excise taxes.

The CHAIRMAN. I know. But you do not have it with respect to all products.

Mr. LEBOR. It would be much simpler—in fact, what I urge later in this statement is a flat tax with minimum exemptions, because that is where the administrative burden would fall.

The CHAIRMAN. Proceed with your statement.

You can get around it whenever the States are perfectly willing to surrender their own power of taxation by letting one Federal tax be imposed and some of it sent back to the States. I never have wanted to accept that theory, because it has too many implications that I do not like. But you can do it that way.

Mr. LEBOR. We come to it, Senator, only approaching it from the viewpoint of the lesser of two evils, and also urge it only for a period of emergency.

Senator TAFT. Mr. Lebor, would you say that a 5-percent retail sales tax on the same products over the whole thing would raise as much as a 10-percent manufacturers' sales tax?

Mr. LEBOR. I do not have figures here to support that, but it is our judgment that it would, provided the exemptions are minimum, as we would urge.

Senator TAFT. I am saying, assuming the same exemptions, whatever they are, that it would be about half the rate on retail sales and would produce about the same amount as the manufacturers' tax?

Mr. LEBOR. If it would have to be that high. It might even be less than half.

Senator TAFT. In Ohio we have a 3-percent sales tax. If you had a 5-percent tax, I suppose you would just work it on an 8-percent sales tax and then you would divide the money?

Mr. LEBOR. That is right, if the exemptions were coordinated. Of course, as you know, Senator, in Ohio we have the bracket system, and so on. But if it was just a flat 8 percent of all gross sales, that is just what we would do.

Senator TAFT. Instead of taking a 3-percent tax, you would collect an 8-percent tax?

Mr. LEBOR. That is right.

On Sentor George's point, I would like to say that administratively it is much easier than what we have now. I happen to be in the department-store business. In department after department we now have the problem of collecting Federal excise taxes, but we have to organize ourselves to do it on a selective basis. We do it in this 10 feet of selling counter. Let us say we are selling drugs over here, and over here something that is not subject to the Federal excise tax. So we have to have a different organization and procedure. And so we go, all over the store. If we could do it on a simple, horizontal basis applicable to all sales, I think it would, if anything, minimize our administrative difficulties.

The CHAIRMAN. You proceed and develop your thoughts.

Senator TAFT. Of course, that is not quite true of a chain-food store, where presumably there would be, even among your minimum exemptions, a lot of exemptions.

Mr. LEBOR. Senator Taft, I believe that the food chain members of our committee feel rather strongly that the administrative problem would be the most important one to them, and they would urge no exemption to them if there is to be a Federal sales tax on food. I do not speak for that association as such.

Senator TAFT. I think if you considered it at all, you would have to exempt food. I do not see any other way to give the relief to the bottom of the income scale that would be necessary, I think, if we returned to this kind of law. I do not think we can escape exemptions on food. Of course, we have exemptions in Ohio on food today, as you know.

Mr. LEBOR. That is right. The food chain people agree that they would have a difficult administrative problem if they had to collect it on a selective basis, but the department-store industry had the same view when we had to start collecting Federal excise taxes on a selective basis. We have managed to survive so far.

It is a little burdensome at times. Maybe they would find ways and means of doing likewise.

Senator WILLIAMS. Is it your theory that a sales tax at the retail level would make the people a little more sensitive to Government waste?

Mr. LEBOR. Very much so, Senator Williams.

Senator WILLIAMS. And a little more conscious, and thereby it might cause them to be more critical.

Mr. LEBOR. We think so. We believe the tax should be out in the open. We would not recommend a tax solely for that reason, but I believe that is one of the advantages of a sales tax at the retail level rather than at the manufacturers' level.

The CHAIRMAN. Very well.

Mr. LEBOR. With respect to the retail sales tax, through experience, retailers have become convinced that there are basic defects in excise taxes at the manufacturing level. These objections are as follows:

First, the early incidence of the tax in the production-distribution system. The tax is due at the time of the sale of the taxed product by the manufacturer. It must be financed at each stage of distribu-

tion, through the wholesaler, the jobber, and retailer. The tax becomes as much a cost as the cost of the product itself.

The tax is of necessity pyramided and produces additions to the retail price far in excess of the tax imposed. Thus, the impact upon the price level is far greater than the amount of revenue produced by the tax. Because it is hidden, necessarily, in the price at the various levels of trade it has an impact on the cost of living, and on the Consumers' Price Index with all that this implies, and an impact greater than that of the tax itself.

Such a tax increases the costs of distribution. The manufacturer tax embedded as it must be in the price at all levels, increases the cost of financing inventory, insurance, property taxes, and rental and wages which are frequently based upon sales.

Second, the tax is hidden. Retailers believe that it is sound policy to bring all taxes out into the open where they can be seen and recognized.

Third, the tax would tend to become permanent. The imposition of manufacturer excise taxes at levels high enough to produce substantial revenue would in itself create serious problems when the need for emergency revenue has passed. A tax at the manufacturer level becomes a substantial part of inventory value, inflating that value to a degree that might easily result in tremendous financial losses at the time of removal. It is highly probable that retailers themselves would be forced by sheer necessity to oppose the repeal of the tax.

For these reasons retailers believe that a broad-base excise tax system at the manufacturer level contains serious disadvantages in comparison with such a tax imposed at the retail level.

The retail groups believe that if more revenue is needed to balance the budget a Federal retail sales tax offers the best additional source. If such a tax is considered by this committee it would not be opposed by most retailers who would have to handle the burden of collecting and accounting for tax collections on billions of individual retail transactions.

Such a tax should be written so as to be most easily collected and administered, having in mind that 29 States and many cities now impose retail sales taxes that are not uniform in rates or exemptions. The ideal tax to collect and administer is a tax at a uniform rate without exemption.

We have made our case against such a system imposed at the manufacturer level. Based on the considerations herein stated, the retail industry committee has taken the positon that if essential to a pay-as-we-go policy, the Congress should seek the revenue needed through a broad-based retail excise tax system. Our committee believes that such recourse is sound and equitable to all citizens under present circumstances. Our committee has not attempted to produce estimates of revenue from such a tax. It believes that a comparatively low percentage of tax on sales at retail would produce more revenue than a much higher tax at the manufacturer level and with less interference with normal trade practices. It recognizes the administrative problems involved in such a tax, but they have been solved in the 29 States now having retail sales taxes.

To repeat, the retail industry committee takes this position because reason and logic has forced it to this conclusion. It believes that the retail sales tax is far superior from every standpoint to either a selec-

tive system or to a broad base manufacturer tax. The prime moving force that has brought our committee to this conclusion is the threat of inflation involved in deficit financing. Our committee believes that the unavoidable impact of further deficit spending upon the price level, even with the most effective price controls possible, would cost the families of America far more in increased prices of all things, luxuries and necessities alike, than any retail sales tax your committee might in its wisdom determine to apply.

Should the Congress see fit to impose a broad base retail sales tax, it should be on a year-to-year basis with prompt repeal when the necessities of a pay-as-we-go policy permit.

Now, to summarize, gentlemen, the principles of this statement may be summarized very briefly as follows:

1. More emphasis should be placed upon balancing the budget by limiting expenditures rather than solely by increasing taxes.
2. Tax legislation should be designed to a greater extent to stimulate a high-level economy upon which existing tax collections are vitally dependent.
3. Numerous revisions should be made in the sources of revenue tapped and allocations of the tax burden upon different segments of the economy in order to minimize the otherwise deadening effect of taxation on enterprise.
4. Taxing prewar normal earnings at punitive excess profits rates is highly objectionable.
5. The impact of numerous provisions of the House bill should be softened and some entirely eliminated.
6. Retroactive taxation is unconscionable and should be rejected in a manner that will restore confidence in the future.
7. If as a result of adopting these principles there is a need for a substantial amount of revenue which cannot be made up by increased efficiency and real economy, and if consequently the Congress decided to raise this amount by the use of excise taxes, then a broad based excise tax, at the retail level without exemptions, is the proper method to select.

Thank you, gentlemen, for the opportunity of presenting the views of our industry and committees.

Senator CONNALLY. Have you got a sales tax in Ohio?

Mr. LEBOR. Yes, sir; we have a 3-percent tax, Senator Connally.

Senator CONNALLY. How much more do you want to put on top of that?

Mr. LEBOR. We are prepared to accept whatever level——

Senator CONNALLY. You are prepared to accept it. But what about the consumers? You do not represent all the consumers, do you?

Mr. LEBOR. We certainly have to be very conscious of their viewpoint, Senator Connally, because we would not stay in business very long if we were not very sensitive to the consumer viewpoint. We believe that the consumers' ability to buy and consume merchandise is affected by whatever kind of tax bill the Congress in its wisdom adopts, and we are expressing our view that they will be able to buy and consume more merchandise with the kind of tax program we are urging because we do not think that it would be——

Senator CONNALLY. Do you think that the buyer consumes more, the higher the tax?

Mr. LEBOR. No, sir, I did not say that. I say that that is the kind of tax program that we are urging in lieu of the tax bill.

The CHAIRMAN. Would you figure on putting a tax on goods purchased for use in the establishment?

Mr. LEBOR. We would consider that to be consumption. Our thinking is that the——

The CHAIRMAN. Would you subject that to the retail sales tax?

Mr. LEBOR. On that particular item, Senator George, personally I would see no objection to it. Our general philosophy is that the tax at the consumption level is the theory that we favor.

The CHAIRMAN. I see. Of course, you have a very impressive statement.

Mr. LEBOR. Thank you, sir.

The CHAIRMAN. It seems to me that the serious objection is the fact that you simply duplicate by piling on top of existing retail sales taxes in 29 States now a Federal sales tax. It may be that the administrative and practical difficulties would not be as great as I envision.

Mr. LEBOR. Senator George, may I say on that, we are 100 percent in agreement with you if ways and means can be found to effectively balance the budget without resorting to it. We hope that that is possible. We certainly agree that we would have a healthier economy, and that retailers, manufacturers, consumers, and everyone else would be better off.

The CHAIRMAN. I can see in the case of a department store, in your line of business, for instance, that you are collecting two taxes now in the States, a Federal tax on part of your merchandise and your products, and a state tax on all of it. But that is not universally true when you come down to the little corner store in a small village. They carry on the whole very few items on which there are Federal excise taxes. They have a few, but they do not have much trouble carrying those in their heads.

Mr. LEBOR. That is right, although the list has been broadening, Senator.

The CHAIRMAN. Very well, sir.

Senator TAFT. Mr. Lebor, do you know offhand just how much money is collected in Ohio from our sales tax?

Mr. LEBOR. About $165 million, as I recall it. I am more conscious of it from the standpoint of the amount that comes back to Cincinnati.

Senator TAFT. Thank you.

Mr. LEBOR. I would be glad to supply you with those figures rather than to rely on my recollection, Senator, if you will permit me. May I send them to your office?

Senator TAFT. I think I am really interested not so much in that as in some estimates on what the tax would produce in the Nation at large. I was just using that as a step to guess what it would produce and what different rates would produce. I should think that if this is to be considered at all, the people would like to know what the rates would be, if you have any figures on that, and what the results would be and what money we would get.

Mr. LEBOR. May I be permitted to file a memorandum with the committee, Senator?

The CHAIRMAN. We will be glad to have it if you do so.

Senator KERR. You will base one on the entire amount of consumption, and then base the other on the entire consumption but leaving out food.

Mr. LEBOR. I will do that, Senator Kerr.

(The following table was subsequently supplied for the record:)

Estimated revenue possibilities from a broad-based excise tax levied at the retail level submitted to U. S. Senate finance committee by retail industry committee

[Millions of dollars]

(1) Estimated 1951 retail sales:	
Nonfood	$107, 800
Food	[1] 32, 200
Total	140, 000

[1] 23 percent of total retail; this being the relationship existing in the 1948 census figures as indicated by attached figures.

(2) Estimated revenue per 1 percent retail sales tax, no exemptions, equals $1,400, estimated revenue per 1 percent retail sales tax, food exempted, equals $1,078.

(3) An additional substantial amount of revenue could be raised by taxing additional items (not sold through retail establishments) at the point of sale for consumption. The amount of revenue would depend upon the definition of consumption.

Senator MILLIKIN. They usually exempt drugs, too, do they not? Where they have exemptions, do they not usually exempt medicines and drugs?

Mr. LEBOR. That is not true in Ohio. Of course, you do get into administrative difficulties. For instance, grass seed is exempted in Ohio now. I have just been doing a little work on my lawn recently and I am conscious of that.

Those are the administrative problems that make it difficult, but drugs are not.

Now, in some other States—as a matter of fact, my company operates in a number of States. We operate in Ohio, New York, Massachusetts, Texas, Wisconsin, and Oklahoma, and we have some touch with some of these States, and it is the lack of uniformity that is the difficult part of the administrative problem.

Senator MILLIKIN. Mr. Chairman, I would like to say that, independent of what might be the merits of the proposal that has been made here, I think that the gentleman's statement has been a fresh breeze in this committee—for a business organization to come in here and put its main emphasis on the national welfare as distinguished from its own immediate welfare.

Senator TAFT. Even if they reflect on the blindness of Democratic Congresses.

Senator KERR. The committee is perfectly aware of the basis of the conclusions reached by our good friend.

Mr. LEBOR. Senator Kerr, may I say on your point of view, we are very, very conscious that with the 150 million people in this country, their reactions are the important factors to retailers. We have to be very sensitive to what we consider to be their best interests. We could be wrong. This is our reflection of what we think is right.

Senator KERR. I am perfectly aware of that. I assume that you go on the theory that if they do not trade with you, it is because they have deliberately closed their eyes.

Mr. LEBOR. I am willing to admit, sir, that in the haste of my preparing this, probably I chose some bad words. But the thought——

Senator KERR. I am sure I got your thought, yes.

Mr. LEBOR. There was no disrespect meant.

Senator CONNALLY. Do you think if there were a referendum held of the consumers in the United States, the people who buy your stuff, they would favor an additional sales tax?

Mr. LEBOR. I am not prepared to say on that. But I think that we in business management have to make our decisions on how they are going to act, and not on what they are going to say.

Senator CONNALLY. I am talking about the consumer now.

Mr. LEBOR. You are talking about the referendum?

Senator CONNALLY. I am not talking about these big fellows that own all these department stores.

Mr. LEBOR. Mostly retailers, Senator Connally.

Senator CONNALLY. You want to put the tax on the consumer instead of yourselves; is that not right?

Mr. LEBOR. We want to put the tax at the consumption level rather than relying so heavily on corporate income and excess-profits taxes and high level, middle, and upper income brackets.

Senator CONNALLY. You are against the excess-profits tax, of course?

Mr. LEBOR. Yes, sir. I think it is impossible to write a bill that adequately measures what is normal profit and what is excess.

Senator KERR. As I understand your thesis, it is this: The suggestion that you have made of the tax at the consumption level will actually produce more revenue at less cost to those who would eventually pay it than the others that have been suggested?

Mr. LEBOR. That is exactly right, because that additional cost will not be passed through the cycle, both in the cost effects and in the profit margin, or markup, that is added at each level of manufacturing and distribution.

Senator MILLIKIN. I was going to say, we have a couple of things to think of here. One is, when we get through with all these taxes, what is the total tax burden of the people in these lower brackets that are affected by this? And at what point do you have another cycle of wage increases that will start off another spiral of inflation?

I am anxious to have somebody come up with some figures that will show us what this total burden will be, Federal, State, and municipal, on those who are in the lower brackets.

Mr. LEBOR. By brackets?

Senator MILLIKIN. Yes.

Mr. LEBOR. We agree that that certainly is the critical question. That is the important thing. And the answer to that I think will throw great light on the question Senator Connally asked, what would be the effect.

Senator MILLIKIN. I can give you a quick answer on Senator Connally's question. If the Treasury thought that the consumers would approve this sales tax, they would be over here urging it.

Senator TAFT. There is another question, though, that I can raise. If the Treasury relied on the people to vote for taxes, they would never get any increased taxes of any kind, if that is going to be the criterion of whether we impose taxes or not.

Mr. LEBOR. That was in my thinking in answering Senator Connally's question.

The CHAIRMAN. You do not think that the income taxes are all passed on to the consumer, do you?

Mr. LEBOR. Yes, I do. I think that income taxes are an element of cost.

The CHAIRMAN. All income taxes?

Mr. LEBOR. Yes, I certainly do, for this reason, Senator George: The net profit that is retained after all disbursements have been made has to bear a relationship to the capital that is invested in a business to produce it. If that relationship is not right, new capital cannot be attracted for an expanding economy, and management cannot justify retaining earnings and reinvesting it in the business.

The Federal income taxes, as well as State, are just as much a cost of doing business as any other item of disbursement. It so happens that they happen to be measured against an accounting background of coming down to a figure that many people unfortunately call profit, or earnings, or something of that kind.

Senator MILLIKIN. Do not all taxes reach the consumer ultimately?

Mr. LEBOR. Certainly.

Senator MILLIKIN. There may be a lag or two, but ultimately all taxes are paid by the consumer; is that not correct?

Mr. LEBOR. That is correct, sir.

Senator MILLIKIN. Making allowance for degrees of repercussion. The first impact may not be paid by the consumer, but as you go along the line, ultimately the consumer pays it all; is that not correct?

Mr. LEBOR. That is correct. That is why at the beginning of my statement I said that we did not think that the House bill distributed that in the way that would have the best effect on a high-level economy. They all affect it, but they have different impacts.

Senator MILLIKIN. That is right.

Senator CONNALLY. You would repeal all income taxes if you had your way?

Mr. LEBOR. No, sir.

Senator CONNALLY. You said you were against them a while ago.

Mr. LEBOR. I did not intend to say that, Senator Connally.

The CHAIRMAN. We thank you very much, Mr. Lebor.

Senator TAFT. I would like to pass this on. I think a statement that was made was a little broad. I do not think that all income taxes are passed on. I think that that part of it that is deducted in the payroll, in the long run, becomes the cost of doing business pretty much, but the rate above that, I doubt if they are passed on.

Mr. LEBOR. I would accept that. I think when I answered Senator Connally, I was thinking more of corporate taxes. I think I would agree with Senator Taft on personal income.

The CHAIRMAN. Yes; I think you must have had that in mind. I do not think that all individual income taxes can be said to be passed on to the consumer. They are borne in part by the earner of that income. Of course, ultimately the whole burden of taxation comes to your whole group of consumers. There is no question of that.

Senator TAFT. That, at least, is one of the theories of taxation.

Mr. LEBOR We in retailing can feel it. I think we felt it very much in March of this year in the collections of our charge account customers. We had a very broad reduction in the rate of payment of charge accounts, and it was a little disturbing to some of us that our inquiry among our stores and members indicated that the March 15 payments fell with unexpected impact on some of our customers.

The CHAIRMAN. We thank you very much for your statement.

Mr. LEBOR. Thank you for the privilege of appearing.

(The following letter supplementing Mr. Lebor's statement was subsequently received for the record:)

AMERICAN RETAIL FEDERATION,
Washington, D. C., July 16, 1951.

The Honorable WALTER F. GEORGE,
United States Senator, Washington, D. C.

DEAR SENATOR GEORGE: Members of the American Retail Federation and of the Retail Industry Committee are concerned over repeated statements made to your committee to the effect that a manufacturers' sales tax would not be passed on to the consumer in an amount in excess of the acutal tax imposed, or in other words, be pyramided.

Mr. John F. Lebor, speaking for the Federation and the Retail Industry Committee before your committee Friday, July 6, definitely stated that manufacturers' sales or excise taxes are pyramided. This was done both in the formal statement and in reply to questioning.

The purpose of this letter, therefore, is simply to supplement Mr. Lebor's statement. A manufacturers' sales or excise tax, whether stated separately or not, becomes a part of the cost of goods to the retailer and as such is subject to the normal percentage mark-up for the particular item in question.

Over a long period of years retailers have found that to operate successfully they must have a definite percentage margin over cost, a margin which varies, of course, between kinds of retailers and for different items.

A manufacturers' excise tax is just as much a part of the retailer's cost as is a new increment of cost which might arise out of a manufacturer's wage increase, or in other increases on the cost of raw materials. Since no one could logically expect a retailer to refrain from placing his normal mark-up on cost increases arising from these causes, why therefore should a retailer be expected to refrain from considering the tax as a part of cost and treating it in precisely the same manner as any other cost would be treated?

A manufacturers' excise tax must of necessity be paid by the retailer when he purchases the goods to place in his inventory. The money invested in the tax part of the cost of the item must earn a return in the same manner, and at the same rate as money invested in other parts of the cost of the item.

There is one other aspect of this subject which I should like to call to your attention.

It was generally reported in the press that the American Retail Federation and the Retail Industry Committee in the presentation to your committee, urged the enactment of a broad based retail-sales tax in lieu of the proposed tax increases in the House bill. This was not the case.

Our position can be summarized briefly as follows:

Retailers are traditionally opposed to taxes on consumption, as contrary to the objective of increased production and an expanding economy.

They believe, however, that some of the increases in income taxation proposed by the House bill are too severe; that they are dangerous to our economy and therefore should be modified.

If as a result of these modifications there is a need for a substantial amount of revenue which cannot be made up by increased efficiency and real economy on the part of the Federal Government, and if consequently the Congress decides to raise this amount by the use of excise taxes, then a broad based excise tax, at the retail level without exemptions, is the proper method to select.

Sincerely yours,

ROWLAND JONES, Jr.

The CHAIRMAN. Mr. Thomas N. Tarleau? We are glad to see you back again, sir.

Mr. TARLEAU. Thank you, sir.

The CHAIRMAN. Please identify yourself for the record.

STATEMENT OF THOMAS N. TARLEAU, NATIONAL RETAIL FURNITURE ASSOCIATION

Mr. TARLEAU. My name is Thomas N. Tarleau, T-a-r-l-e-a-u, and I am appearing for the National Retail Furniture Association, which is an association of almost 9,000 furniture stores of all sales volume,

located throughout the United States, which account for approximately 70 percent of the furniture store sales in the United States.

The reason for our appearance before the committee is this: A large part of our membership uses the installment basis for reporting their income, and unless an equitable provision for the imposition of tax is provided, installment-basis taxpayers may pay a greater tax in a period of emergency than accrual-basis taxpayers, because of the technical operation of the installment method when distorted by emergency tax rates, governmental restrictions in credit terms, and supply conditions, as affected by governmental action and armament production.

In other words, installment-basis taxpayers will be paying at the rate of 52 percent if the House bill becomes law on incomes on which accrual basis taxpayers paid at rates varying from 38 to 42 percent.

This inequity is the same as moved the Congress to provide the relief for installment-basis taxpayers in section 455 of the Excess-Profits Tax Act of 1950, to avoid a gross and harsh discrimination which inevitably arises for installment-basis taxpayers under these emergency conditions.

We have a statutory provision which we believe is simple to administer, and which would meet this period of emergency, which we believe will last about 2 years; and, finally, the point I would like to stress before I get into the details of my statement is that the installment-basis taxpayer is not asking for any relief unless he pays at least as much tax as the accrual-basis taxpayer on identical income: in other words, this is not an attempt to lower the tax on installment-basis taxpayers—far from it. It is an attempt to equate the tax burden between installment-basis taxpayers and taxpayers that report their income on the accrual basis.

Senator CONNALLY. When you say installment taxpayers, you mean your customers pay on installments?

Mr. TARLEAU. Precisely; and I would like to explain just that.

Ever since the inception of the income tax, Senator, taxpayers doing an installment-basis business have generally found it necessary to avail themselves of the installment basis of reporting income, and that is provided for by the Internal Revenue Code.

Such businesses require this method so that they can pay their taxes as they collect cash from their outstanding accounts.

In other words, an installment-basis taxpayer on a sale which is consummated, let us say, in 1948, for a sale of a set of furniture, would pay his taxes as he gets the cash from his customer.

If the customer pays over a period of 24 months, he will report his profit ratably as the cash is received from his customer, instead of reporting the profit entirely in the year in which the transaction occurred.

He needs this method, and will continue to use it, despite the fact that the upward curve of tax rates since the inception of the Federal income tax has caused installment-basis taxpayers actually to pay more tax than if they had adopted the accrual basis. They do it because they need the cash from their customers in order to pay the——

Senator TAFT. Mr. Tarleau, what was done when they boosted the rates during the Second World War? Was there relief furnished at that time?

Mr. TARLEAU. No. Relief, as I recollect it, was not furnished at that time. If you will recollect, the increases were not as staggering as from 38 to 52 in the 24-month period.

The installment-basis taxpayer faces this problem: A transaction which takes place in an earlier year will be reported for taxation in some later period, as the amounts are collected. If the tax in the earlier period, the tax in the year in which the transaction took place, is lower than the taxes in the years in which the tax is collected on the same economic transaction, he will have to pay a higher rate of tax than someone who is in the position to pay the tax immediately at the time the transaction took place.

The installment-basis taxpayer enters into the installment basis with his eyes open. He realizes, or he should realize if he is at all alert, that, by and large, income taxes at the corporate level have been steadily going up, although not as markedly as they have during their period of emergency.

The problem is this: That in a period of emergency, not only do these tax rates go up sharply, more sharply than he could have anticipated, so that the inequity becomes very much more pronounced, but there is another difficulty, and that is that his income during that period of emergency is affected by circumstances, such as governmental regulations of credit, and supply conditions, which make the normal flow of his income further distorted, so that not only are the tax rates higher than he had anticipated at the time the transaction took place, but he has income bunched in a period which is a further distortion, and I would like to go into that.

Senator TAFT. In other words, they have to be paid faster.

Mr. TARLEAU. The installments have to be made faster, and the down payments have to be larger.

An installment-basis taxpayer in a given year will receive amounts from past years, and will be deferring amounts to future years. To the extent that an installment-basis taxpayer defers to future years the same amount as he collects from past years, he is in the same position as an accrual-basis taxpayer, except, of course, he has his big backlog that he will have to account for in future years. In other words, if his business keeps on being done on an even keel, and he defers about the same amount that he collects, his tax burden is not vastly different from the tax burden of an accrual basis taxpayer, but when he collects from past years and is not able to defer substantially a similar amount to a future period, he has all the proceeds of that year's sales, plus the proceeds of previous years' sales, both taxable at these high rates, and that is the problem that confronts us.

Senator TAFT. What is your proposal and, of course, how do you balance it if rates go down again? He gets an advantage when the rates go down.

Mr. TARLEAU. Yes. We have a simple amendment of which I would like to give the purport. Our proposal is this——

Senator MILLIKIN. I wonder if you would be good enough—I hope I have not been inattentive, but would you make the whole thing a little simpler by giving us two cases, one on one basis and one on the other?

Mr. TARLEAU. Yes; I will be glad to do that.

Senator MILLIKIN. Just give us two simple cases.

Mr. TARLEAU. Yes; I will be glad to do that.

Senator MILLIKIN. Will you do that?

Mr. TARLEAU. Yes, indeed.

Let us assume for the moment that we have an installment-basis taxpayer who at the end of the year 1950 still has owing to him from his customers on account of sales that took place during 1950 and 1949 and 1948, $200.

Senator MILLIKIN. You are not talking about the ultimate consumer; you are talking about the man who sells, the seller.

Mr. TARLEAU. I am talking about the seller.

Senator MILLIKIN. Yes; all right.

Mr. TARLEAU. Yes. That is the one that we call the installment-basis taxpayer.

Senator MILLIKIN. Yes.

Mr. TARLEAU. Let us assume that the taxpayer has still owing to him in what we call the unrealized gross profit account at the end of 1950, $200.

Senator MILLIKIN. Yes.

Mr. TARLEAU. We will assume in the year 1951 he makes certain sales. Let us say that during the year 1951 he sells, let us say, $1,000 worth of furniture on which he has a profit on 1951 of $350.

Senator MILLIKIN. Realized profit in 1951?

Mr. TARLEAU. A realized profit of $350.

Now, of that $350, of that realized profit of $350, let us assume that one-half of it, or $175, Senator Millikin, is not collected in 1951, and is deferred to a future period.

Now, that $175 which is deferred until a future period, being on installment basis, he does not account for in the year 1951. Let us assume that he collects in 1951 out of that $200 coming to him from previous years, $175. That $175 becomes part of his income in 1951 under the installment basis of accounting, even though it represents prior years' transactions.

That $175 exactly matches the $175 that he is deferring to a future period, so he will pay a tax at 1951 rates, whatever they be, 52 percent if the House bill becomes law, or whatever rates Congress finally enacts, on $350, the $175 being from past periods, and the $175 representing the collections actually made out of that year's sales.

That $350 puts him in exactly the same position that year as if he were on the accrual basis, the reason being that he deferred the same amount as he collected from a previous period.

He pays at 1951 rates on an amount of income which fairly reflects 1951 income. He pays on the same amount as an accrual basis taxpayer would pay.

Unfortunately, what happens on the installment basis of accounting during 1951 and 1952, or what is likely to happen because of the imposition of Government controls, like regulation W that went into effect in the last quarter of 1950, is that of that $350 profit, which I have assumed took place because of the 1951 transactions, he is not able to postpone $175 to a future year.

Let us assume, for example, that $200 is collected during the year 1951. In that event, the installment-basis taxpayer's income for 1951, instead of being $350, which is the same as the accrual basis taxpayer's, becomes $375. That $25 is the amount taxed in 1951 at 1951 rates, merely because of the use of the installment method of accounting. It is a distortion to that extent, and all that we are seeking is relief with respect to that $25.

In other words, we ask for no relief except in the event that we pay at least as much as an accrual-basis taxpayer does with respect to income earned in 1951.

It is only where the installment basis income is in excess of the income on the accrual basis that we seek any relief, and that takes place only because of the fact that more income is collected from previous years on the installment basis than can be deferred to future years.

Senator MILLIKIN. How do you answer Senator Taft's suggestion as to what you would so, assuming that the tax burden grows less?

Mr. TARLEAU. Yes. Well, that is a very pertinent question, and that is the first one that the joint committee staff, with whom we consulted, and others, asked us.

In the first place, let me point out that we ask for this relief for a period of 2 years, and the reason we ask for it is this: This is called for by reason of this bunching of income.

This bunching of income is called forth by credit restrictions, material shortages, and so on.

Now, we hope that these past amounts which we are collecting from previous years will iron themselves out within a period of the next 24 to 36 months, so that this problem should no longer exist to any great extent, we hope, after a period of the next 24 months.

Now, what our amendment provides, Senator, is this, and this is to protect against a situation that Senator Taft has in mind: that in no event shall an installment-basis taxpayer get any relief under this provision unless for the years—and this would only apply to 1951 and 1952—unless he pays for 1951 and 1952 the same amount of tax, at least, as he would pay if he was on the accrual basis of accounting.

In other words, the economic productivity due to the war, and which calls forth these high tax rates, and which is mentioned in the House Ways and Means Committee report, that we will have in 1951 and 1952, must be protected against any lowering of the tax, and that is the prime condition that we have put in our amendment.

In other words, the income for 1951 and 1952—I should say the income tax for 1951 and 1952 of an installment-basis taxpayer must be at least the same as an accrual-basis taxpayer. He cannot escape any wartime taxes by reason of this relief provision. That is the safeguard that we have put in.

Senator CONNALLY. What does it relieve him of?

Mr. TARLEAU. The relief we are asking for is that to the extent that he is receiving more income than is the income attributable to that period, because he is collecting from the prior periods, we ask that he be taxed at the rate in effect in 1950.

Now, it is true that some of that income will be coming from years prior to 1950, when the rates were lower than the 1950 rates, but for administrative simplicity rather than attempt to trace these sales actually, what we have been content with was not to ask to have that income taxed at the lower rates, but rather at the rates that prevailed in 1950.

The general purport of the amendment, therefore, is merely to see to it that the collections from prior years, which represent prior years' transactions, transactions which took place before the emergency, and before the emergency tax rates, should be taxed more nearly to what the tax would have been to an accrual-basis taxpayer.

The simplest thing, of course, would be to say, on behalf of the

installment-basis taxpayer, the installment-basis taxpayer should pay not at 1951 and 1952 rates on profits which he is now getting and which were earned in an earlier period, but should only pay at the rates that prevailed in the earlier period.

If we had asked for that amount of relief, which to some people may appear to be equitable, we would be running afoul of Senator Taft's objection. We, therefore, would not ask for that.

Senator TAFT. I have not raised an objection one way or the other. I am just trying to figure it out.

Mr. TARLEAU. It certainly would be open to the objection that we are gaining, perhaps, an unfair tax advantage and, therefore, we are not asking for that, and I want to impress that upon the committee, if I may. We are not asking that our profits from the period prior to 1951 and 1952 be taxed at the earlier rates, the rates in effect in the year in which the profit was made. That is not what we are asking for.

What we are asking for is that our profits from the years prior to 1951 and 1952 be taxed at the rate in effect in 1950 to the extent that those profits are in excess of what our income would be for the years 1951 and 1952, if we had reported our income in 1951 and 1952, the way any other taxpayer, other than an installment-basis taxpayer reports his income, and the reason that we have this bunching of the income, the reason why an installment-basis taxpayer during that period, on the installment basis, has a higher income, is because of the effect of these governmental regulations.

Senator MILLIKIN. Why should not generally similar relief be given to all forward transactions?

Mr. TARLEAU. In other words, why should not under the installment basis of accounting they have——

Senator MILLIKIN. Whether installment or not. If the point of relief is good in the field that you are speaking of, why is it not equally good so far as all forward contracts are concerned, where tax rates or restrictions have gummed up the works?

Mr. TARLEAU. Well, whatever equity may be in that proposal, it is only, so far as I know, in the case of an installment-basis taxpayer, that a taxpayer is confronted, for example, in the year 1951, Senator, with paying a tax on more profit than he actually has earned during the year 1951. That is, in essence, what our complaint is, that we have to pay a tax in 1951 and 1952 at emergency tax rates on more profits than we actually earned in 1951 and 1952, and that is because of the fact that we are collecting from previous years.

Now, to the extent that we can defer to future years the same amount as we collect from previous years, we have little to complain about. We are in the same position as anybody else, and that is generally the position of an installment-basis taxpayer under normal conditions.

Senator TAFT. Let us take an extreme case on the question I want to raise. Having paid in 1951 and 1952, in effect, on an accrual basis, some taxpayers, at least, will be paying their tax because you say it shall be at least that much, and pay in 1951 and 1952 on an accrual basis. Then assume that in 1954, all of a sudden, we have a millennium, and we take off corporation taxes, reduce them down to 45, and regulation W disappears, and you spread out your payments again. Is there not a year there where you will not have any taxes?

Mr. TARLEAU. No; if you will pardon me—I seem to be very abrupt in my answer, and I do not mean to be.

Senator TAFT. No.

Mr. TARLEAU. That will not happen for this reason, except with this one contingency, as I see it. Our accounts at the end of 1950, to the extent that we get any of the benefit of this provision, to the extent that anyone qualifies under this section, were earned at rates from 38 through 42 percent, because those were the tax rates, by and large, that were in effect during that period.

Unless you anticipate, Senator, that in the year—and remember this is only in effect for 2 years—that in 1953 the tax rates go below 38 percent, there cannot be a penny's worth of profit or a detriment to the Treasury.

Now, in other words——

Senator TAFT. It is too complicated for me to carry it out. I think you had better report to Mr. Stam.

Mr. TARLEAU. I think if you will consult with Mr. Stam you will find that to be so, that unless the tax rate drops below 38 percent we are not getting any advantage, or the Treasury is not suffering any detriment, because all that we are, in essence, asking is that the excess that we collect over the amount that we defer be taxable at 1950 rates.

The CHAIRMAN. Those that you defer will take the tax rate for the year.

Mr. TARLEAU. Precisely, and Senator Taft's question was, Will not that amount that is deferred get a lower tax rate than the 42 percent, which we are reconciled to pay for the year 1950? I do not believe that is likely to happen.

In other words, we think that the relief is so provided for in this amendment that there is no danger that the Treasury will be whipsawed because of anything that we have in here.

Senator WILLIAMS. Do not some firms charge up their profits in their entirety in these installments at the very beginning, anticipate instead of having them over a period?

Mr. TARLEAU. Well, Senator, the installment basis of accounting has proven over the years, Senator, an expensive way of accounting for your profits.

It has proven an expensive way because of the fact that the postponed profits which are taxed in the year in which the cash is realized always find themselves in a higher and higher tax year. That has just been the way our income-tax structure has worked.

Senator WILLIAMS. That is the point. Have they not anticipated that and been projecting their earnings in the years prior in most instances?

Mr. TARLEAU. In other words, if I correctly understand your question, do all taxpayers who sell on the installment basis use the installment basis of accounting.

Senator WILLIAMS. Yes.

Mr. TARLEAU. No, sir; they do not.

Senator WILLIAMS. That is what I was getting at.

Mr. TARLEAU. I would say that, by and large, it is a problem more of small business which needs the cash from those proceeds to finance their taxes.

The CHAIRMAN. They need additional capital.

Mr. TARLEAU. If you have enough cash to pay your taxes, why wait for the rates to go up.

Senator WILLIAMS. It is optional.

Mr. TARLEAU. Oh, yes; it was put in just for the benefit of those persons who had to finance their taxes out of the cash as they received it from the sales.

Senator BUTLER. This provision that you suggest on page 8 covers the situation entirely?

Mr. TARLEAU. Provision No. 1 on page 8 covers the situation that I have made mention of. Provision No. 2 is a technical amendment which is called forth because of the operation of the net operating loss provision, and which has for its purpose to see to it that where a net operating loss is involved——

Senator BUTLER. In line with a question asked by Senator Millikin, there is nothing in those provisions there that mentions installment buying or selling.

Mr. TARLEAU. No; except that section 44 to which we refer, these sections are appended, deals with installment-basis taxpayers.

Senator BUTLER. I see.

Senator MILLIKIN. Have you discussed this with Mr. Stam?

Mr. TARLEAU. Yes; we discussed it with Mr. Stam and Mr. Stam's group, and it is a rather technical point. It is an extremely important point to the taxpayers affected, but it is extremely technical, and we saw him first about it before we came here.

I had an appointment to discuss the same problem with the Treasury, and we hope to get their reaction to it. We were not able to make our point to the House, for one thing, because if the corporate tax rates had not gone up so precipitously, the amount of damage that is done by reason of this bunching of the income might not have been as severe.

We just did not have an opportunity to present it because the problem really was not adequately before us until the House bill was reported out, and by that time we had no chance to appeal it.

Senator CONNALLY. Your plan is pretty involved.

Mr. TARLEAU. The plan? In an installment-basis taxpayer's income-tax return, he has to show his income both on the accrual basis and on the installment basis.

That is necessary in order to properly audit the return. But he pays only on the installment income.

What this provision would say is in those instances where that computation shows an excess of installment income for 1951 and 1952 over the accrual income to the extent that there is that excess, that excess should be taxable at the rates prevailing in 1950 because that excess, again as I have tried to explain, comes from prior years' transactions.

Fortunately for us, due to the mechanics of the income tax return and the mechanics of the system of accounting, it is not administratively difficult; administratively it is extremely simple. It is much more difficult to explain than to administer.

Senator CONNALLY. You would pay less tax under your plan than you would now?

Mr. TARLEAU. We would pay less tax under our plan than we would have if——

Senator CONNALLY. If you do not have it.

Mr. TARLEAU (continuing). We do not have it.

Senator CONNALLY. Yes; I was sure of that. [Laughter.]

Mr. TARLEAU. Yes, sir; you are quite right. If this relief is granted, some taxpayers will be able to get the relief, the relief being the payment of less tax, but I do want to emphasize that we will be paying as much as the accrual basis taxpayer pays on his transactions that take place in 1951 and 1952.

Senator WILLIAMS. It would be a form of depletion allowance for installment buyers.

Mr. TARLEAU. You say, is it a form? Now, it is not, because depletion allowance—I don't think I ought to discuss that here.

Senator CONNALLY. I know what you are hitting at. [Laughter.] Don't look at me. It has nothing on earth to do with it except the depletion of taxes he was supposed to pay the Government.

Senator BUTLER. In substance, your plan would make it a little easier for the smaller-business man who has difficulty in financing his——

Mr. TARLEAU. In essence, the plan——

Senator BUTLER. But he still pays as much——

Mr. TARLEAU. As the big-business man. We want to see to it that the small-business man, the one who uses the instalment basis, does not have to pay an unconscionably greater amount of tax than a big-business man who is able to finance his taxes as the transactions take place, precisely.

The CHAIRMAN. Are there any further questions of Mr. Tarleau?

Thank you very much, Mr. Tarleau. Your prepared statement will go in the record at this point.

(The prepared statement of Mr. Tarleau is as follows:)

A STATEMENT ON PROVISIONS NEEDED TO PROVIDE AN EQUITABLE IMPOSITION OF TAX ON INSTALMENT BASIS TAXPAYERS DURING A PERIOD OF EMERGENCY

(Presented by National Retail Furniture Association on behalf of 8,973 furniture stores of all sales-volume classes located in all sections of the United States, which account for approximately 70 percent of all furniture-store sales.

SUMMARY OF STATEMENT AND RECOMMENDATIONS

1. Unless an equitable provision for imposition is provided, installment basis taxpayers will pay far greater tax, in a period of emergency, than accrual basis taxpayers because of the technical operation of the installment method when distorted by (a) emergency tax rates, (b) governmental restrictions of credit terms, and (c) supply conditions as affected by governmental action and armament production. Installment basis taxpayers will be paying at the rate of 52 percent on income on which accrual-basis taxpayers paid at rates varying from 38 to 42 percent.

2. The inequities are the same as moved the Congress to provide relief for installment basis taxpayers in section 455 of the Excess Profits Tax Act of 1950 to avoid a gross and harsh discrimination, which inevitably arises for installmen basis taxpayers under emergency conditions unless provision is made for equitable imposition of the tax.

3. A statutory provision, simple to administer, could be provided to meet this situation for a 2-year period. At the end of that time, if emergency conditions warrant, the problem can be given further consideration.

4. The installment basis taxpayer will not be entitled to use the proposed provision unless he pays at least as much tax as the accrual basis taxpayer on identical income.

5. Proposed statutory provision at conclusion of statement, immediately preceding appendix.

6. An appendix incorporates exhibits showing—

I. How the installment basis taxpayer pays greater taxes under emergency rates and conditions than the accrual basis taxpayer.

II. Position of the taxpayer and equity to the Treasury at end of emergency relief period.
III. Simplicity of conversion from installment basis to accrual basis.
IV. Accounting examples of the varying conditions that might be experienced during the period of relief as proposed.

A STATEMENT ON PROVISIONS NEEDED FOR INSTALLMENT BASIS TAXPAYER DURING A PERIOD OF EMERGENCY

This statement sets forth the situation that arises during a period of emergency tax rates to distort completely the position of the installment-basis taxpayer.

The technical operation of the method can operate to cause him to pay more tax than the taxpayer on the accrual basis, under identical conditions. (See exhibit I in appendix for an accounting demonstration of this fact.)

This situation is due primarily to the cumulative effect of the following factors:

1. The impact of a precipitate and abnormally high emergency rate on income from sales in prior years when relatively lower rates prevailed, at which rates the accrual basis taxpayer has paid.
2. Governmental credit restrictions (Federal Reserve Board, regulation W).
3. The direct effect, on taxable income of installment basis taxpayers, of supply conditions occasioned by the emergency and its governmental restrictions.

The correction that can be provided by statutory provision

A statutory provision, simple to administer, can be provided to meet this situation.

The effect of the suggested provision would be:

1. To provide that the income made in years before the emergency rates became effective would be taxed at rates more nearly comparable to the rates imposed on accrual-basis taxpayers.
2. To assure that the installment-basis taxpayer will not be entitled to use the proposed provision unless he pays at least as much tax as the accrual-basis taxpayer on identical income.

How the installment basis of reporting operates normally

It is useful in considering the emergency situation to inspect the normal operation of the installment basis.

Ever since the inception of the income tax, taxpayers doing an installment sale business have generally found it necessary to avail themselves of the installment basis of reporting taxable income. Such businesses require this method so they can pay their taxes as they collect cash from outstanding accounts.

They continue to need this method and will continue to use it, despite the fact that the upward course of tax rates since the inception of the Federal income tax has caused installment-basis taxpayers actually to pay more tax than if they had adopted the accrual basis.

Thus, a taxpayer on the accrual basis who makes a $100 sale, pays on the profit accruing from that sale at the rate prevailing in the year the sale was made.

By contrast, a taxpayer on the installment basis who makes a $100 sale, defers the tax on the gross-profit element in his uncollected installment receivables to the years in which the collections are made.

Because the income-tax rates, with relatively small sporadic down dips, have consistently been on a rising scale, the installment-basis taxpayer has paid higher taxes over the years than the accrual basis taxpayer.

Despite this adverse tax result the use of the installment method is necessary since it provides the means of obtaining the cash with which to pay the tax.

How the installment basis operates when emergency rates are imposed

When the year 1950 commenced, the corporation normal and surtax rates totaled 38 percent; now, in 1951, the Congress proposes that these rates be increased to 52 percent. As a result, installment basis taxpayers are confronted with the probability that they will pay taxes at a 52 percent rate (if that rate is adopted) on identical transactions on which accrual basis taxpayers have been taxed at 38 percent (1949) and 42 percent (1950).

That is a penalty of 37 percent (14 percentage points excess tax) and 23 percent (10 percentage points excess tax) over the tax of the accrual basis taxpayer on the income in the years 1949 and 1950, respectively.

For a more complete picture of how governmental credit restrictions, regulation W, and emergency conditions operate to bring about the abnormally heavy taxes on installment basis taxpayers, it is necessary to examine the technical device

entering into installment basis computation. That device is the "unrealized gross profit" element.

"Unrealized-gross profit" concept

For the purpose of deferring taxes on income not yet collected, the installment basis taxpayer sets up at the end of his taxable year a reserve for unrealized gross profit, which is the gross-profit element in installment accounts receivable.

Except to the extent it is influenced by normal rise or fall of business volume, or similar normal business risks, the unrealized-gross-profit element should be a relatively stable factor.

Thus, in a normal period, the installment basis technique amounts to adding into income from a given year an amount of income from prior years, and simultaneously deferring an approximately equal amount of income from the given year into subsequent years.

But note what happens when a governmental credit restriction such as regulation W exerts its influence.

The unrealized gross profit at the beginning of the year 1950, for example, includes profit on sales made in 1949, 1948 and even in 1947 in many instances. Normally the amount of such unrealized gross profit that would be realized during the year 1950, would be approximately counterbalanced by the amount of gross profit that would be deferred in connection with 1950 sales. But in September of 1950, Federal credit restrictions were imposed, and a month later the restrictions were made more stringent. That means that in subsequent years, with the down-payment requirement increased and the length of time to pay progressively tightened, the realized gross profit is accelerated as the reserve for unrealized gross profit shrinks.

Normally, any variation in unrealized gross profit reflects the normal rise and fall of sales and profits on the installment basis. It reflects the amount to be deferred * * * in other words, there was a relatively stable pass-through of X amount, representing a deferred tax liability; true at a probable higher rate, but a risk that the taxpayer took with open eyes.

It is important to note that, historically, installment accounts receivable, consequently unrealized gross profit, rise during a period of declining tax rates, and that unrealized gross profit declines during a period of increasing tax rates.

Thus at the present time the effect of regulation W is to bring about liquidation of accounts receivable much more speedily than normal and force the payment at 52 percent rates of a disproportionately high portion of the unrealized gross profit.

Experience shows approximately three years required for the unrealized-gross-profit element to again stabilize

We have the experience of regulation W during the World War II period as a guide of what to expect.

Herewith are Federal Reserve Board figures on the forced liquidation of accounts receivable, which occurred.

(Similar figures are not collected in detail for furniture stores by the Federal Reserve Board, but the experience is precisely parallel.)

Index numbers without seasonal adjustment

Averages of monthly date	Sales		Installment receivables, end of year
	Total	Installment	
1941	100	100	100
1942	114	82	78
1943	130	71	46
1944	145	66	38
1945	162	67	37
1946	202	101	50
1947	214	154	88
1948	225	192	142
1949	213	198	165

Effect of Government regulations on supply parallel to regulation W influence

The trades primarily affected by the installment basis tax problem deal for the most part in consumer durables. As restrictions on metal consumption and the resulting cutbacks in consumer goods production take hold, the effect will be

lower volume and the consequent corollary reduction in accounts receivable and unrealized gross profit.

While the accrual basis taxpayer might experience the same reduction in volume, the peculiar technicalities incident to installment basis tax computation operate to bring about a grossly disproportionate bearing of the tax load.

Situation parallels the excess profits tax problem relieved by Congress

The principles involved in the situation are known to the Congress and the joint committee staff and have been recognized as justification for providing the special relief provision in connection with the imposition of excess profits tax, which the Congress made available to installment basis taxpayers in section 455 of the Excess Profits Tax Act of 1950.

Need for correcting present tax situation was anticipated and called to attention of Congress

It will be recalled that last year, at the time of enactment of the excess profits tax, the possibility of the present situation in connection with an emergency normal tax rate was called to the attention of the joint committee and the congressional committees. It was stated then that if the Congress should find it expedient to enact an emergency increase in normal and surtax levies, there would be needed a provision to avoid inequity just as was required in the case of the excess profits tax.

Nature of relief and its temporary nature while emergency experience develops

The harsh impact of the situation on installment basis taxpayers would seem to warrant a permanent freeze at the preemergency rates on the income derived from sales in prior years.

Certain technical and administrative difficulties seem to preclude a request for the full relief warranted.

Therefore a certain measure of justified correction will be sacrificed in the interest of simplicity.

The principle on which the relief provision is proposed is twofold.

1. Relief is requested on a temporary basis for 2 years only, at which time the situation can be reappraised. If warranted by facts at that time consideration should be given to extending the relief period.

2. Relief will be available when income on the installment basis, that would have been taxed at pre-1951 rates if computed on the accrual basis, becomes taxable at 1951 and 1952 rates during the period during which relief is provided. Therefore, where relief is afforded, the installment basis taxpayer will pay the same amount of tax as the accrual basis taxpayer will pay on that portion of his installment income that is equivalent to his accrual income. On the difference he will pay additional tax at the rate applicable to his taxable year ending in 1950.

Question of the position of the installment basis taxpayer at end of relief period

This problem has been considered. It may arise through questioning of whether or not any equity status achieved, versus accrual basis taxpayers, during a relief period, might result in a benefit when the emergency situation reverses.

While it is not anticipated that tax rates will decline to a 42 percent rate by the end of the 2-year relief period (or some other length of time, if facts subsequently warrant extension), the situation that would obtain has been analyzed on the assumption of a 42 percent rate.

It is found by accounting study that complete equity to the Treasury would prevail.

That accounting proof is set forth in the appendix as exhibit II.

Conversion from installment basis to accrual basis a simple procedure

This subject was completely explored with the joint committee staff and Treasury representatives prior to the adoption by the Congress of the excess profits tax relief provision for installment basis taxpayers (sec. 455 of the Excess Profits Tax Act of 1950).

So that the record of administrative feasibility is complete the demonstration of the conversion technique is set forth in the appendix as exhibit III.

Suggested statutory provisions to accomplish proposed equity

(NOTE.—Exhibit IV (examples A, B, and C) in the appendix provide specific accounting examples of the varying conditions that might be experienced during the period of relief as proposed.)

"Section 44 (e)

"(1) Corporate taxpayers with taxable years ending in 1951 and 1952.

"If the net sum of the net incomes (before net operating loss deduction) of a corporate taxpayer for all taxable years ending in 1951 and 1952, computed under

subsection (a) of this section, is in excess of the net sum of the net incomes (before net operating loss deduction) for such years computed on the accrual basis, then the taxpayer shall, subject to regulations prescribed by the Commissioner with the approval of the Secretary, compute the tax on such excess at the rates imposed by sections 13, 14, and 15 with respect to such taxpayer's last taxable year ending in 1950, in lieu of the rates applicable to the taxable year.

"(2) Net operating loss for taxable years ending in 1951.

"If a corporate taxpayer has a net operating loss in a taxable year ending in 1951, computed under subsection (a) of this section, to the extent of such net operating loss reduced by the net operating loss, if any, for such taxable year computed on the accrual basis, the taxpayer may elect in its return for a taxable year ending in 1951 or 1952, subject to regulations prescribed by the Commissioner with the approval of the Secretary, to treat such net operating loss so reduced as a carry-over only and not as a carry-back."

Exhibit I

Comparisons of income taxes of installment basis taxpayers with and without relief and accrual basis taxpayers under same operating conditions with variations in installment income

[Combined normal and surtax rates on incomes over $25,000—42 percent for 1950 and 52 percent assumed for 1951 and 1952]

	Taxable income		Income taxes payable		
			Installment basis		Accrual basis
	Accrual basis	Installment basis	If no relief	If relief is granted	
A—1951	$70,000	$90,000	$41,300	$39,466 66	$30,900
1952	70,000	100,000	46,500	43,725.00	30,900
Total	140,000	190,000	87,800	83,191.66	61,800
B—1951	70,000	90,000	41,300	39,466.66	30,900
1952	70,000	55,000	23,100	24,475 01	30,900
Total	140,000	145,000	64,400	63,941.67	61,800
C—1951	7,0000	40,000	15,300	15,300.00	30,900
1952	70,000	150,000	72,500	67,750.00	30,900
Total	140,000	190,000	87,800	83,050.00	61,800

Exhibit II

Proof of equity to Treasury should income-tax rate decline to 42 percent at end of relief period

	A	B	C
1. Unrealized gross profit—Dec. 31, 1950	$210,000	$210,000	$210,000
2. Accrual profit for 1951 and 1952	140,000	140,000	140,000
3. Total taxable in 1951 and 1952 and/or unrealized Dec. 31, 1952	350,000	350,000	350,000
4. Amount taxed at 1951 and 1952 rates	140,000	140,000	140,000
5. Amount taxed at 1950 rates	50,000	5,000	50,000
6. Total taxed	190,000	145,000	190,000
7. Unrealized gross profit, Dec. 31, 1952 (line 3 minus line 6)	160,000	205,000	160,000
Unrealized gross profit, Dec. 31, 1950, which equitably should be taxed at 1950 rates	210,000	210,000	210,000
Amount taxed at 1950 rates in 1951 and 1952	50,000	5,000	50,000
Balance equitably taxable at 1950 rates—same as amount of unrealized gross profit, Dec. 31, 1952	160,000	205,000	160,000

EXHIBIT III

A simplified method of arriving at the reportable gross profit is used in installment accounting. It involves the concept of "unrealized gross profit," a term signifying the amount of gross profit applicable to the installment accounts receivable. The gross profit contained in the year-end balance of the installment accounts receivable comprises the amount of unrealized gross profit to be deferred for tax purposes under code section 44 (a).

As a proof that the determination of gross profit on the installment basis by means of (1) the difference in unrealized gross profit at the beginning and end of the taxable year, arrives at exactly the same result as would be obtained by (2) a determination of the gross profit realized on cash collections, etc., there are presented sample computations of the determination of "installment basis" net income by both methods.

Basis for computations

	Net sales	Gross profit		Installment accounts receivable at end of year	Bad debts
		Amount	Percent		
1945			40	$90,000	
1946	$430,000	$176,300	41	145,000	$2,000
1947	505,000	212,100	42	195,000	4,000
1948	535,000	224,700	42	250,000	4,000
1949	490,000	205,800	42	295,000	10,000

SUMMARY OF INSTALLMENT ACCOUNTS RECEIVABLE LEDGER

	1946	1947	1948	1949
January 1, balance	$90,000	$145,000	$195,000	$250,000
Add: Net sales	430,000	505,000	535,000	490,000
Total	520,000	650,000	730,000	740,000
Deduct:				
Cash receipts:				
1945	88,000			
1946	285,000	141,000		
1947		310,000	191,000	
1948			285,000	240,000
1949				195,000
Bad debts:				
1945	2,000			
1946		4,000		
1947			4,000	
1948				10,000
Total	375,000	455,000	480,000	445,000
December 31, balance	145,000	195,000	250,000	295,000

NOTE.—It is assumed that all receivables from prior years are fully liquidated in each year, so that balance at end of year is all from that year's sales. Therefore, unrealized gross profit account at end of each year is as follows:

	1945	1946	1947	1948	1949
Accounts receivable	$90,000	$145,000	$195,000	$250,000	$295,000
Gross profit, percent	40	41	42	42	42
Unrealized gross profit	$36,000	$59,450	$81,900	$105,000	$123,900

METHOD (1).—*Determination of realized gross profit on cash receipts, etc.*

1946	Gross profit on cash receipts, year of sale			Loss on bad debts	
	1945	1946	Total		1945
Cash	$88,000	$285,000	$373,000	Bad debts	$2,000
Percent gross profit	40	41		Percent cost	60
Realized gross profit	$35,200	$116,850	$152,050	Loss	$1,200
1947	1946	1947	Total		1946
Cash	$141,000	$310,000	$451,000	Bad debts	$4,000
Percent gross profit	41	42		Percent cost	59
Ralized gross profit	$57,810	$130,200	$188,010	Loss	$2,360
1948	1947	1948	Total		1947
Cash	$191,000	$285,000	$476,000	Bad debts	$4,000
Percent gross profit	42	42		Percent cost	58
Realized gross profit	$80,220	$119,700	$199,920	Loss	$2,320
1949	1948	1949	Total		1948
Cash	$240,000	$195,000	$435,000	Bad debts	$10,000
Percent gross profit	42	42		Percent cost	58
Realized gross profits	$100,800	$81,900	$182,700	Loss	$5,800

SUMMARY

	1946	1947	1948	1949
Gross profit realized on cash receipts	$150,050	$188,010	$199,920	$182,700
Less: Cost element in bad debts	1,200	2,360	2,320	5,800
Net realized gross profit on collection of receivables	148,850	185,650	197,600	176,900

METHOD (2).—*Accrual method, adjusted by difference in unrealized gross profit account*

	1946	1947	1948	1949
Gross profit on sales	$176,300	$212,100	$224,700	$205,800
Less: Bad debts	2,000	4,000	4,000	10,000
Total	174,300	208,100	220,700	195,800
Add: Unrealized gross profit at beginning of taxable year	36,000	59,450	81,900	105,000
Total	210,300	267,550	302,600	300,800
Deduct: Unrealized gross profit at end of taxable year	59,450	81,900	105,000	123,900
Net realized gross profit on collection of receivables	150,850	185,650	197,600	176,900

EXHIBIT IV

Example A

Taxable year ending—	Unrealized gross profit at end of year	Taxable income		Combined normal and surtax rates on income over $25,000
		Accrual basis	Installment basis	
				Percent
Dec. 31, 1950	$210,000			42
Dec. 31, 1951	190,000	$70,000	$90,000	[1] 52
Dec. 31, 1952	160,000	70,000	100,000	[1] 52

[1] Assumed.

EXHIBIT IV—Continued

TAX COMPUTATIONS

YEAR ENDING DEC. 31, 1951

1. Tentative tax on installment-basis income at rates applicable to year ending Dec. 31, 1950:

$90,000, at 23 percent	$20,700.00
$65,000, at 19 percent	12,350.00
Total	33,050.00

2. Tentative tax on installment-basis income at rates applicable to year ending Dec. 31, 1951:

$90,000, at 30 percent	27,000.00
$65,000, at 22 percent	14,300.00
Total	41,300.00

3. Actual tax:

20,000/90,000 of $33,050	7,344.44
70,000/90,000 of $41,300	32,122.22
Total tax	39,466.66

YEAR ENDING DEC. 31, 1952

1. Tentative tax on installment-basis income at rates applicable to year ending Dec. 31, 1950:

$100,000, at 23 percent	$23,000
$75,000, at 19 percent	14,250
Total	37,250

2. Tentative tax on installment-basis income at rates applicable to year ending Dec. 31, 1952:

$100,000, at 30 percent	30,000
$75,000, at 22 percent	16,500
Total	46,500

3. Actual tax:

30,000/100,000 of $37,250	11,175
70,000/100,000 of $46,500	32,550
Total tax	43,725

Example B

Taxable year ending—	Unrealized gross profit at end of year	Taxable income		Combined normal and surtax rates on income over $25,000
		Accrual basis	Installment basis	
				Percent
Dec. 31, 1950	$210,000			42
Dec. 31, 1951	190,000	$70,000	$90,000	[1] 52
Dec. 31, 1952	205,000	70,000	55,000	[1] 52

[1] Assumed.

TAX COMPUTATIONS

YEAR ENDING DEC. 31, 1951

Total tax (see computation on exhibit IV, example A, for this taxable year)	$39,466.66

YEAR ENDING DEC. 31, 1952

1. Actual tax on installment-basis income at rates applicable to year ending Dec. 31, 1952:

$55,000 at 30 percent	$16,500
$30,000 at 22 percent	6,600
Total tax	23,100

NOTE.—No relief, as installment-basis income does not exceed accrual-basis income.

2. Since unrealized gross profit at Dec. 31, 1952, exceeds unrealized gross profit at Dec. 31, 1951, amount of such excess must be used to reduce the amount of income with respect to which relief was granted for year ending Dec. 31, 1951. The tax for the latter year is to be recomputed as follows (refer to computation on exhibit IV, example A, for year ending Dec. 31, 1951):

5,000/90,000 of $33,050	$1,836.11
85,000/90,000 of $41,300	39,005.56
Total tax for year ending Dec. 31, 1951:	
As recomputed	40,841.67
As originally computed	39,466.66
Additional tax due from taxpayer	1,375.01

EXHIBIT IV—Continued

Example C

Taxable year ending	Unrealized gross profit at end of year	Taxable income		Combined normal and surtax rates on income over $25,000
		Accrual basis	Installment basis	
				Percent
Dec. 31, 1950	$210,000			42
Dec. 31, 1951	240,000	$70,000	$40,000	[1] 52
Dec. 31, 1952	160,000	70,000	150,000	[1] 52

[1] Assumed.

TAX COMPUTATIONS

YEAR ENDING DEC. 31, 1951

Actual tax on installment-basis income at rates applicable to year ending Dec. 31, 1951:

$40,000 at 30 percent	$12,000
$15,000 at 22 percent	3,300
Total tax	15,300

NOTE.—No relief, as installment-basis income does not exceed accrual basis income.

YEAR ENDING DEC. 31, 1952

1. Tentative tax on installment-basis income at rates applicable to year ending Dec. 31, 1950:	
$150,000 at 23 percent	$34,500.00
$125,000 at 19 percent	23,750.00
Total	58,250.00
2. Tentative tax on installment-basis income at rates applicable to year ending Dec. 31, 1952:	
$150,000 at 30 percent	45,000.00
$125,000 at 22 percent	27,500.00
Total	72,500.00
3. Actual tax:	
$\frac{50,000}{150,000}$ of $58,250	19,416.67
$\frac{100,000}{150,000}$ of $72,500	48,333.33
Total	67,750.00

NOTE.—Relief is limited to amount by which unrealized gross profit at Dec. 31, 1950, exceeds unrealized gross profit at Dec. 31, 1952.

STATEMENT OF ANGUS McDONALD, ASSISTANT LEGISLATIVE REPRESENTATIVE, NATIONAL FARMERS UNION

Mr. McDONALD. Mr. Chairman, unfortunately Mr. Patton is unable to be here. I have a statement of his that I would like to read, if it please the committee.

The CHAIRMAN. How long is the statement.

Mr. McDONALD. About 15 minutes.

The CHAIRMAN. Well, sir, you may be seated. Can you summarize it?

Mr. McDONALD. I think I can, Mr. Chairman.

Senator CONNALLY. Put it all in the record.

The CHAIRMAN. We will put the entire statement in the record; but, if you can summarize it, you will greatly assist us this morning, particularly since you would not be able to answer questions, possibly, that the committee members would ask you.

You may proceed. Please identify yourself for the record.

Mr. McDONALD. Mr. Chairman and members of the committee, our position——

The CHAIRMAN. Please identify yourself for the record. You are speaking for Mr. Patton, but what is your name?

Mr. McDONALD. My name is Angus McDonald. I am assistant legislative representative of the National Farmers Union in Washington, D. C. I live here in Washington.

The CHAIRMAN. All right, Mr. McDonald.

Mr. McDONALD. Mr. Chairman and members of the committee, in regard to the need for additional revenues at this time, our organization is in agreement. The national-defense emergency, the pending current deficit, and other reasons, accentuate the need for these hearings, and for additional legislation to bring in additional revenue.

However, we do not feel that the fundamental tax policies of the Congress should be changed, except, perhaps, in regard to various exemptions to industry which are now in effect.

In regard to taxation of cooperatives, we favor the retention of section 101 (12) of the Internal Revenue Act. We do not believe that the deletion of this part of the tax law would bring in any substantial additional revenue.

Various estimates have been made, some of them as high as $25 million, were this exemption repealed.

When you would deduct the cost of collecting these taxes, it seems that you would get very little additional money.

There are other reasons, we feel, for retaining this socalled exemption for farmer cooperatives. The farmer has often been called the economic backbone of the Nation.

The farmer is unique because he alone satisfies the appetite of all mankind. The farmer has over the years faced monopolistic conditions in the market place, and the reason that we have various laws that the Congress has enacted is because the Congress took cognizance of this situation and tried to give the farmer a little relief in the market place, so that his bargaining power would be equal to those from whom he bought. Hence you have these various sections in the law regarding farmer cooperatives.

Senator TAFT. But you do not include that among the tax loopholes you deal with on page 3 of your statement. You do not regard that as one of the tax loopholes.

Mr. McDONALD. As I said, Senator Taft, the farmer is unique in two ways: He is the one indispensable element in our society, and he is the one segment of the population that has been discriminated against generally competitively, and we feel the Congress has been wise in making it possible for the farmer cooperative, providing it meets certain conditions, to be relieved from the payment of taxation on income.

Senator TAFT. But you think we should, on page 3, take away the depletion allowances from the other industries, take away the certificates of necessity, reducing the depreciation rates, and those things; you think those things ought to be canceled?

Mr. McDONALD. I believe we agreed to the President's recommendation that the depletion allowance be reduced to 15 percent. As I recall now, it is 27½ percent. We think that is too high.

In regard to certificates of necessity, we feel that there have been grave abuses in the administration of this part of the defense program. We recognize that in certain instances certificates of necessity were necessary to build plants for additional war production.

Senator WILLIAMS. How about charitable organizations? Do you recommend plugging any loopholes in relation to those?

Mr. McDONALD. Well, I am not——

Senator WILLIAMS. Certain types of, as I say, educational and charitable organizations have been set up, foundations, and so forth.

Mr. McDONALD. Senator, I am not authorized, and that question has not been discussed, at least recently, within my organization. I might give you my own personal interpretation——

Senator WILLIAMS. Yes.

Mr. McDONALD (continuing). And trust that it would coincide with the policy as laid down by the organization.

I do not feel that charitable organizations should be taxed.

Senator WILLIAMS. You do not think there is any violation——

Mr. McDONALD. I do not think that any nonprofit organization should be taxed in the way that ordinary corporations are.

Senator WILLIAMS. What percentage of your earnings do you distribute in patronage dividends that are not cash?

Mr. McDONALD. I am afraid I am unable to answer that question.

Senator WILLIAMS. I mean, do you have a rough estimate of that?

Mr. McDONALD. No, sir; I know that at least two of our cooperatives in St. Paul distributed around 3 percent last year.

Senator WILLIAMS. That is 3 percent on the volume of business?

Mr. McDONALD. On the volume, total operation.

Senator WILLIAMS. What was your margin of profit then? Did that represent all of your profit or did you distribute part of it in cash?

Mr. McDONALD. Well, there is no profit, according to my interpretation, in a farmer cooperative.

Senator WILLIAMS. We will not go into that.

You distributed 3 percent on your sales in patronage dividends; how much cash did you distribute back?

Mr. McDONALD. I might say, I am just speaking from memory——

Senator WILLIAMS. What percentage?

Mr. McDONALD (continuing). I think that is what was distributed.

Senator WILLIAMS. You did not distribute anything in cash, so far as you remember?

Mr. McDONALD. So far as I know, it was all distributed in cash; I just do not know.

Senator WILLIAMS. I was speaking of scrip for patronage dividends instead of cash, patronage dividends, is what I was referring to.

Mr. McDONALD. I am afraid I would not know, but it would not make any difference, according to my interpretation, how it was distributed, because we feel that certificates, stock, cash, merchandise, anything which is returned to the members of the cooperative is theirs.

Senator WILLIAMS. Well, for the time being, we will not debate that point, but I was just wondering whether that 3 percent did represent your stock certificates and scrip, so to speak, and was taxable to the farmer.

Mr. McDONALD. I would hazard a guess that it did not. If a large part of it was distributed in cash, and perhaps all of it, for all I know

——

Senator WILLIAMS. You do not know whether the Farmers Union distributed earnings, their refunds, in cash or patronage dividends last year?

Senator TAFT. Are you a cooperative yourself?

Senator WILLIAMS. You are a cooperative; the Farmers Union is a cooperative.

Mr. McDONALD. Let me make the distinction clear between the organization that I represent and the cooperatives. I am not here representing any cooperative. The Farmers Union sponsors Farmers Union cooperatives, but there is no governing connection between the two. They have their separate governing bodies.

I am an employee in the national office here of the National Farmers Union, which is completely autonomous, and we have nothing to do with the operation of any cooperative whatsoever.

Senator WILLIAMS. Well, you are presenting Mr. Patton's statement, and he is the president of the National Farmers Union, which is a cooperative; is that not correct?

Mr. McDONALD. No, sir.

Senator WILLIAMS. Is he not connected with the Farmers Union Cooperative—Mr. Patton?

Mr. McDONALD. I do not think he holds——

Senator WILLIAMS. Is he not connected with any farmers' cooperative?

Mr. McDONALD (continuing). He does not hold any position whatsoever in any farmers' cooperative. He is merely the president of the National Farmers Union, a farm organization, similar to the National Grange and Farm Bureau Federation, so he——

Senator WILLIAMS. He is not connected with any farmer cooperatives?

Mr. McDONALD. No, sir; only in the sense that I mentioned.

Senator WILLIAMS. It is your position that these patronage dividends should be exempt from taxes, even though in scrip or stock, whatever they might be, and nonredeemable form?

Mr. McDONALD. Yes, sir; I think it is immaterial.

Senator WILLIAMS. They should be taxable to the farmers only?

Mr. McDONALD. They should be taxable to the farmer's income, his personal income.

Senator WILLIAMS. What is your opinion on this: We will say, for instance, as has happened a few times, a certain cooperative will refund these earnings or profits or whatever you might call them in patronage dividends, scrip, nonredeemable to the farmer over a period, we will say, of five years or 10 years, and the cooperative retains the money, but they allocate it to the farmer. The farmer is subject to an income tax on it, and then the cooperative fails.

Now, what position do you take—how do you feel that the farmer can be protected under that set-up, because they cannot go back and claim refunds under the law. He has paid his income taxes.

Mr. McDONALD. The farmer cooperative, being the employee of the group of farmers, must account regularly——

Senator WILLIAMS. That is right.

Mr. McDONALD (continuing). As to the funds and their disposition, and so on, and there is nothing to prevent any farmer of any cooperative from taking out, if there are patronage refunds, those refunds, from taking them out or leaving them in.

Senator WILLIAMS. I disagree with you. A good many of those patronage refunds are refunded to the farmer in nonredeemable scrip, which can only be redeemed at the option of the directors.

Mr. McDONALD. That is not my information.

Senator WILLIAMS. Well, that is the fact. I mean, there is no dispute about that.

Mr. McDONALD. I have been trying for some years now—at least I have been talking to people and discussing this matter of a member not being able to get his money out of the cooperative—and I just have not run into that kind of situation.

I recall, if you will permit me to give an example, a few years ago, when Mr. Fulton Lewis, Jr., came before a committee and said that he could not get his money out of the cooperative, or he could not buy feed there, or so on. Well, two of his neighbors came down here, as I recall, and took the stand and said that any member of the cooperative to which the gentleman belonged could go in and get his money out of it at any time.

Now, it seems to me if there were any sizable number of farmers who had money tied up there, patronage refunds that they could not get, that we would have heard of it. I have not heard of any such instance.

Senator WILLIAMS. Well, assuming that that is true—and if it is not true, why, it does not make any difference, but assuming that is true—then, you would agree with me that if any cooperative is distributing a portion of its earnings in a nonredeemable scrip that they should be taxable to the cooperative that would resort to that practice; is that correct? I mean, you do not endorse the principle that a cooperative should be allowed to retain in their corporation any earnings, and allocate it to the farmer upon which it has to pay taxes—

Mr. McDONALD. Well, I think if the cooperative is violating the law, it is the job of the Bureau of Internal Revenue to see that they hew to the line in these restrictions.

Senator WILLIAMS. I am not speaking of a violation of the law. It seems to be that that is approved by the Treasury Department; but, assuming that the law would endorse that, you would go along with me that the law should be changed, so that if a cooperative retains into its treasury a certain portion of its earnings upon which the farmer has no call, cannot call for a redemption in his stock, only at the discretion, voluntary discretion, that it should be taxable to the cooperative? In other words, the cooperative should be forced either to pay a tax on the earnings or else give it to the farmer in cash or in something that could be turned into cash in 24 hours, without asking any questions.

Mr. McDONALD. I do not think at the present time, as far as the Bureau of Internal Revenue can know, that any cooperative which is not acting as a true cooperative is entitled to this exemption.

Senator WILLIAMS. We will not go into that. But I mean you say you do not think——

Mr. McDONALD. If they are by deceit or some other way getting by, then I am in favor of cracking down on them, but not in the manner you have suggested.

Senator WILLIAMS. What is your understanding of the manner that I suggested? Maybe that is where we are mixed up. There is not much difference to it if we understand each other.

Mr. McDONALD. Well, you have suggested, Mr. Senator, if the cooperative retained these patronage refunds against the will of the members that the Government should go in and subject the cooperative to taxation.

Senator WILLIAMS. Well, is that not what you just said?

Mr. McDONALD. I am saying from a cooperative standpoint that the retention of such funds is illegal. It is a violation; it is no longer a true cooperative.

Senator WILLIAMS. That is the point.

Mr. McDONALD. When that patronage refund is handled in that manner; I just cannot imagine when each member has a vote how the cooperative management could get by with such a situation.

Senator WILLIAMS. If I understand correctly, we are pretty much in agreement, I believe, and you have practically endorsed what my proposal is, because that is what I said: that either it was illegal or else it should be illegal for any cooperative to withhold a portion of the earnings from a farmer against his wishes, and merely allocate to him a tax liability, and on a piece of paper something that he cannot redeem.

I say that the man who keeps the money pays the tax. If the cooperative wants to relieve itself of 100-percent tax liability under my proposal, they can do it by allocating to the farmer the earnings and distributing them to him; or, if the cooperative wants to withhold those earnings in there against the wishes of the farmer or just arbitrarily hold them in there, I say that they should pay the tax on them instead of the farmer.

I do not think that any cooperative—and you have just said that you think it is illegal—I thought it was illegal until I found out that it was not, and apparently we have to correct the law to make it illegal.

Mr. McDONALD. Could I say a word, please?

Senator WILLIAMS. Sure.

Mr. McDONALD. I think the remedy is not here in the Congress for such a situation.

The members of the cooperative enter into a contract with the cooperative management under which the managers of the cooperative must, after expenses, return to the members what they had.

If the management of the cooperative violates that contract, then there is a remedy in a court of law, it seems to me.

Senator WILLIAMS. In the event that there is not a remedy in a court of law, you will agree with me that Congress should make it possible so that there would be a remedy in a court of law.

Mr. McDONALD. Well, I feel very strongly that there is a remedy, because when a contract is violated——

Senator WILLIAMS. Well, we are advised——

Mr. McDONALD (continuing). You certainly can go to court about.

Senator WILLIAMS. We are advised under the existing interpretations that the cooperatives are permitted to retain these earnings and not pay the tax on them, but can merely relieve themselves of the tax liability by allocating the earnings to the members.

Mr. McDONALD. I have already discussed that. I just do not know about it, and I cannot imagine a situation like that being widespread.

Senator WILLIAMS. I would not say how widespread it was.

Mr. McDONALD. And certainly 51 percent of the members could go in and fire the whole cooperative management if money was being withheld against the members' wishes.

Senator WILLIAMS. You will agree with me then that, in the event a cooperative does withhold a portion of the earnings or all of the

earnings, it is only fair that they pay the tax themselves on what they withhold and not make the farmer pay the tax on the withheld earnings——

Mr. McDONALD. Outside of reasonable reserves.

Senator WILLIAMS (continuing). If it is being done.

Mr. McDONALD. I think I have in my statement here that that is provided by State law in most instances.

Senator WILLIAMS. Well, the reasonable reserves would be——

Mr. McDONALD. I explain here that reasonable rserves are necessary at all times because farm prices, and prices of things farmers buy, go up and down; so, you need a reserve in order to take care of that situation. I am not in favor, Senator, of cracking down on the whole cooperative movement, if you manage——

Senator WILLIAMS. I agree with you on that.

Mr. McDONALD (continuing). To dig up these few people who are withholding money illegally that the members want.

Senator WILLIAMS. I agree with you on the cracking down on the whole cooperative movement. I do not think that has been suggested. If there are loopholes before they become too widespread, it has to be corrected, because I know of instances where farmers have paid tax on allocated earnings of cooperatives which later went bankrupt, and they are just stuck. They never had their earnings, they never had been in a position where they could have called for the redemption of that stock, and they cannot get a refund on their taxes because it has gone too long, and I think you will agree with me that should not be permitted to continue, and that is merely what we are proposing to do under this proposal and under this amendment.

This amendment that I offered would not place a single penny in tax on any cooperative that did, and conducted itself in the manner that you say a cooperative should, and in a manner in which I agree that one should, because a cooperative, if it is a true cooperative, is a nonprofit organization, and a nonprofit organization distributes its money back, and that is the reason it makes no money, and I propose to exempt 100 percent of all allocations that are back to the farmers in cash, but I do not propose to exempt those cases which you did not think existed, but which do exist in certain cases, where the cooperatives merely allocate to the farmer a tax obligation and no money.

The CHAIRMAN. Senator, we will have several cooperatives before us during the course of these hearings, and this particular witness himself is not a representative of a cooperative; he is a representative of the Farmers Union.

Senator WILLIAMS. Of course, that is true. But the reason I was directing these questions to him was because the entire statement of Mr. Patton is titled "Cooperative Taxation," and was directed to the subject, and that is the reason I was directing the questions to him. Yes, Mr. Chairman, I recognize that.

The CHAIRMAN. We have several witnesses scheduled for that.

Mr. McDONALD. To make the record perfectly complete and honest, the Farmers Union cooperatives, in most instances, are composed of Farmers Union members who pay dues. Part of their dues are derived indirectly from what they get out of the cooperative, and they are savings, so we do get a portion, the national office gets a small portion, of the dues which these members of the cooperatives pay, so that is an indirect interest. But, as I say, there is no organizational tie-up directly.

Senator WILLIAMS. I merely wanted to point out to you that I do not think that what I am proposing to do is any different from what you say should be done, and I think we are pretty much in agreement, and if you agree to that analysis, I almost can interpet your statement as an endorsement of it. I am glad to know that we are not so far apart.

Mr. McDONALD. We are in entire disagreement in regard to the remedy here. I feel that if there is an irregularity in the way a cooperative conducts its business that a court of law should be resorted to to correct that, to force the cooperative management to carry out its contracts.

Senator WILLIAMS. You would agree with me, though, that a cooperative should carry out its contract.

Mr. McDONALD. Yes, sir.

Senator WILLIAMS. If necessary, and if it is not being done, and if the laws are not adequate to enforce that to be done, you will agree with me that correction in the laws must be made whereby it can force one to carry out its contracts.

Mr. McDONALD. I do not agree with your assumptions. I do not believe that there are not adequate remedies in courts of law.

Senator WILLIAMS. Well, assuming there are no violations, if you are correct, and I hope you are, then there would be no harm done in the proposal to correct a situation which might not exist, but which, in the event as you say all of them were living up to the strict letter of the contract and were distributing dividends and earnings back, then the net effect of passing this amendment would be negligible.

Mr. McDONALD. I did not come here prepared to analyze or discuss the amendment. I am afraid I have not studied it sufficiently, but I do recall one provision, aside from the cash provision, which could be very damaging, the 60-day provision, in which everything has to be returned in cash.

Well, as you must know, livestock operations, farmers' business generally, are not necessarily conducted on a seasonal or yearly basis at all.

Senator WILLIAMS. Well, I think that——

Mr. McDONALD. We are just opposed to all of these restrictions set up. We think the present law is fine, and we think the Congress has been wise in encouraging cooperatives and, frankly, Senator, we just look with suspicion, and I say this with all respect to you, on any proposal to change the laws respecting cooperatives.

Senator WILLIAMS. Well, I can understand that, and I think that that is something, perhaps, that has clouded your vision somewhat, because really basically there is not much difference in what we are each trying to achieve.

As far as the 60-day provision, I made the statement, if you will read it, that I was not holding strictly to the 60 days. You had to put a figure on it. The main thing I was holding to was that it had to be a definite period, whether it is 30, 60, or 90 days, or whatever the time was.

The CHAIRMAN. All right.

Senator TAFT. I can see reasons for the exemption, but I do not think that it is quite fair for you to go after everybody else who has asked for some special treatment, on page 3, and wipe them all off the board, because Congress in each case has done it with respect to

some special situation because they thought the general law and the general application was unfair. That is what I would suggest would be some inconsistencies at the end of your statement.

Mr. McDONALD. I discussed that point about certificates of necessity, and the depletion of exemption a moment ago. I would just like to add that we feel, perhaps, the committee should provide for some provision by which these awards of certificates of necessity could be reviewed.

Now, I saw a pamphlet the other day, the result of an investigation, I believe, by the Small Business Committee of this body, and it was a scandalous document, because in one instance, an $8 million certificate of necessity had been granted, when the three individuals proposing to build the plant only had $600 in capital, and an abandoned race track.

Senator TAFT. Well, you object to the administration of that provision rather than the principle.

Mr. McDONALD. Yes, Mr. Taft. I think, perhaps—if the RFC turned this application down, it seems to me that the administration, the Iron and Steel Division, I believe, of NPA, when they awarded the certificate, then I think there was grave doubt about whether it should have been awarded or not.

Senator TAFT. I understand.

Senator FREAR. Mr. Chairman, may I ask just two questions?

The CHAIRMAN. Yes.

Senator FREAR. I believe they can be answered very briefly and very definitely by the witness.

What is the National Farmers Union?

Mr. McDONALD. I beg your pardon? What is it?

Senator FREAR. What is the National Farmers Union?

Mr. McDONALD. It is an organization of farmers. We have about 500,000 members, possibly around 200,000 farm families. Membership is centered mainly in the Wheat Belt, extending over into Wisconsin, the dairy section, and west to the livestock section to Montana, south to Colorado, and over into Oklahoma.

We are first as an organization in only two States or one State, North Dakota, where about three-fourths of the farmers are in our organization. In Oklahoma we are second to the Farm Bureau.

Senator FREAR. What are the requirements of membership?

Mr. McDONALD. The requirements of membership are that the member must be a farmer. Exceptions are made in regard to country physicians and ministers. No other person may belong to the Farmers Union.

Senator FREAR. What are the privileges? What are the privileges of membership in the National Farmers Union?

Mr. McDONALD. Well, the membership entitles you to participate in any of the cooperatives; it entitles you to receive literature, of course, which is published—to participate in local, county, State, and National conventions. It provides a method of articulation of the needs of the farmer.

Senator FREAR. Can a person, a farmer, be a member of the National Farmers Union without being a member of a cooperative?

Mr. McDONALD. Yes, sir..

Senator FREAR. Does his membership in the National Farmers Union permit him to buy from a cooperative on a cooperative basis?

Mr. McDONALD. Yes, sir.

Senator FREAR. I think that satisfies that.

I would like your definition on what is a true cooperative.

Mr. McDONALD. One in which only one member has one vote, and in which the bulk of the business which is transacted by the group is farmer business or business that concerns the group. We are in accord with——

Senator TAFT. You mean member business or farmer business?

Mr. McDONALD. Member business.

Senator TAFT. The bulk of it is member business. That is what you said.

Mr. McDONALD. Yes.

Senator FREAR. Your definition of a true cooperative, I assume, has nothing to do with the distribution of cash dividends or patronage dividends in any manner?

Mr. McDONALD. We feel that should be based on the amount of service or business that the individual members——

Senator FREAR. But a true cooperative is one in which a member has a vote?

Mr. McDONALD. And he may determine policies of the group.

Senator FREAR. Through his authority or privilege to vote for the officers?

Mr. McDONALD. Yes, sir.

Senator FREAR. Thank you.

Senator WILLIAMS. Could I ask one further question? In the event that these cooperatives—and I do not know if that applies to your organization or not, but there is a pyramided ownership—you have a series of small cooperatives, and then another cooperative of which these smaller cooperatives are members, and they pyramid them up to the top, and you say that each member has a vote. How do you attribute the power to the management? How does the management at the top get the power to call the shots?

Mr. McDONALD. Well, they determine their power just as they do in our organization.

Senator WILLIAMS. That is what I was getting at. How do they do it?

Mr. McDONALD. We have small meetings at which they elect delegates, and then large meetings of a State nature, let us say, State-wide or region-wide; and then the regions finally come together in a national convention, which includes delegates from every segment of the group.

Senator WILLIAMS. Do you have such a pyramided organization, that is, the Farmers Union? I am not familiar with the set-up at all. That is, do you have a smaller cooperative in the field, and then larger cooperatives composed mostly of just the members of the cooperatives themselves? Do you pyramid them up to the top?

Mr. McDONALD. I do not understand, Senator, what you mean by pyramiding. I would say that every part, as far as I know, of our cooperatives from the local down to the largest group is completely democratic, and the delegates, as I recall at the convention in St. Paul, which I did not attend, but I read about it last year, one of the cooperatives, I believe, had about 5,000 delegates. I am just speaking from memory. Maybe it was 3,000, but there were thousands of

people there from every area who had been duly elected by the members from that area, and from their area.

Senator WILLIAMS. That is all.

The CHAIRMAN. Well, thank you very much. The full statement of Mr. Patton will go in the record.

Mr. MCDONALD. Thank you, Senator.

(The prepared statement of James G. Patton is as follows:)

STATEMENT OF JAMES G. PATTON, PRESIDENT, NATIONAL FARMERS UNION

The magnitude of the Federal debt, recent estimates of the pending current deficit, and the continued necessity for building up our military strength necessitate the imposition of additional Federal taxes. Receipts will not be adequate to meet the obligations of the Federal Government unless additional revenues are forthcoming.

There is no doubt in our minds, therefore, of the need for general tax revision. We do not feel, however, that there is any necessity for a revision in tax policy unless it is in regard to eliminating various tax privileges and exemptions which the business community enjoys. I am referring to the depletion allowance exemptions and to the very liberal exemptions which business has been receiving in the form of certificates of necessity. In regard to taxation of cooperatives, we do not feel that there is any reason whatsoever that present laws should be revised.

I. COOPERATIVE TAXATION

Authorities in the tax field do not seriously contend that changing or eliminating the tax statutes which apply to farmer cooperatives will result in any large amount of additional revenue. It was estimated by the Secretary of the Treasury in a study released in 1947 that elimination of section 101 (12) of the Internal Revenue Code would bring in only about $10 to $20 million annually. Since that time authorities have suggested that this sum might be raised to around $25 million. It is seen when allowance is made for collection of this money that the Government has little to gain from eliminating the so-called cooperative tax exemption.

There are additional reasons why tax laws relating to cooperatives should not be changed or weakened. The family-type farmer is entitled to market his crops and purchase his supplies in a way which is comparable to the large operator and to normal business operations. Farmers for many years have grouped themselves together in order to buy and sell in large quantities. By using the cooperative device the farmer has eliminated in part the middleman who previously took a large part of the fruits of the farmer's labor thus preventing the farmer from receiving a fair price in the market place. The consumer has also been penalized because of the numerous middlemen who exacted their profit at various points between farm and grocery store. Farmer cooperatives have not only enabled the farmer to secure a more equitable share of the retail price, but they have given the consumer a better product at less cost by more efficient marketing.

There are various proposals before the Congress which would qualify or set up barriers around farmer cooperative activity. In order to realize the seriousness of these proposals, it is necessary to consider the way a cooperative operates. The cooperative manager is an employee who necessarily must return to the members of the cooperative all funds which he receives when commodities are marketed, less necessary expenses. None of the savings or patronage refunds belong to the cooperative. They belong to its individual members.

Farmers have found in the operation of a cooperative that it is necessary to earmark a certain part of their patronage refunds whether they are issued as cash, stock or certificates so that they will remain in the cooperative to expand and carry on operations. It is plain that if no part of the patronage refunds which accrues to the farmer member was put back into the operation, that a cooperative could not grow or expand. Retention of funds in the cooperative which belong to the members is absolutely necessary to the efficiency and even the life of the various cooperatives.

We feel that the requirements laid down by the Bureau of Internal Revenue in regard to the administration of section 101 (12) are equitable and fair. It seems necessary to us if the cooperative qualifies under the exemption statute that all profits must be returned to the farmer members less expenses, that a majority of the business must be carried on by members, that a 15-percent limit be placed on nonfarmer business and that the cooperative limit its reserves to the

amount called for by State laws. These reserves, it must be emphasized, are necessary for the sound conduct of cooperative operations. Cooperatives must have a certain amount of reserve funds if they are to protect the interest of their members and ride up and down the tides of changing prices.

There is probably a greater need now than ever before for farmer cooperatives. Farmers face in the market place larger combinations of business, both on the marketing and the buying side, than they have ever faced before. At a time when increases in production are called for, when price spreads are widening, when we are faced with the prospect of higher and higher marketing charges, the Congress should not reverse its historic policy of encouraging farmer cooperatives.

II. GENERAL TAX REVISION

In regard to general tax revision, we urge raising the tax rate of corporations and higher-bracket individual incomes. Corporations today are making the largest profits in all history. According to recent reports, corporate profits for the first quarter of 1951 were 75 percent higher than for the comparable period last year (Economic Indicators, Council of Economic Advisers, June 1951, p. 23). Using 1947 as a base, corporate profits are 66 percent higher. Corporations for some years, if World War II experience is to be used as a criterion, have not been paying their fair share. In 1942–43 corporations paid 44.1 percent of all Federal taxes. In 1950 corporations were paying only 29.9 percent of total Federal taxes paid.

Workers and farmers have not increased their earnings to the extent that corporations have. Average weekly earnings of factory workers only increased 13 percent during the first quarter of this year as compared to the first quarter of last year. While farmers increased their cash receipts by 20 percent during the first 6 months of 1951, as compared to the first 6 months in 1950, most of this increase was absorbed by increased costs. Prices paid by farmers both for production and family living increased 13 percent. This meant roughly an increase of 7 percent for farmers.

We do not believe that those in the lower brackets, whether on the farm or in the city, should constitute the principal source of additional revenue. A look at figures published by the Joint Committee on the Economic Report in The Economic and Political Hazards of an Inflationary Defense Economy, February 1951, seems to indicate that there are already glaring inequities in regard to the proportion of taxes contributed by those in the lower brackets. On page 14 of this report, it is indicated that breadwinners earning under $1,000 actually paid 23.6 percent of their income in State and Federal taxes. They actually paid during the year 1948 a larger percentage of their income than did those making from $1,000 to $7,500. Here are the figures which indicate that State and Federal Governments have been following soak-the-poor tax policies: Those making $1,000 to $2,000 paid 20.3 percent of their income in taxes; those making $2,000 to $3,000 paid 21.6 percent, etc. The tax structure as revealed in this report indicates great inequity in the tax structure for all those earning below $7,500.

We do not believe that the Congress can hope to extract much more in taxes from the 17 million who are earning less than $2,000 a year or even the 50 percent who are making $3,000 or less. This 50 percent actually is responsible for only three-tenths of all expenditures for consumer goods. It is obvious that the Congress must look for taxes in those groups who are receiving more income.

We believe that corporation excess-profits taxes should be greatly increased. We also believe that taxes should be increased on those in the upper brackets, starting, say, at $3,500, and making the percentage increase rise as annual income increases.

We would like to emphasize that tax rates on those in the lower brackets who are already suffering from the pinch of inflation would not only result in great hardship and suffering but would actually undermine the strength of the Nation and destroy national morale. Wage earners will not look with favor on an increase in their tax rates at a time when business profits have ascended into the economic stratosphere. The people generally expect to pay their share. They realize that they have a stake in this national emergency. They are willing, we feel, to sacrifice. But they also feel that business should not be allowed to profit from the Korean episode or from the defense program.

III. TAX LOOPHOLES

We suggest that this committee, in considering tax revision, take a look at the vast sum which is slipping through the fingers of the tax collector in the form of certificates of necessity, depletion allowances, and other special-interest devices. We fail to see the logic of allowing the oil industry huge subsidies in the form of depletion allowances when farmers receive nothing for the depletion of their resources. Neither do we feel that other industries are entitled to special tax-exemptions. If subsidies are necessary to the carrying out of the defense program, then they should be given openly and only in instances where it is absolutely necessary to build a plant or increase production.

We are apparently repeating a system of double rewards, or subsidies, for big corporations involved in production of military goods which the Truman committee exposed during the last war. At that time, the Government built war plants and gave the operators an option to buy, or we gave them accelerated amortization. The Truman committee noted that in negotiating contracts for war procurement the manufacturers included in their cost of production the accelerated amortization on which the Government was already allowing them the tax benefit. We thus had the spectacle of concerns getting a special concession from the Government using the concession to jack up their prices to the Government. Today we are repeating the same double rewards. One reward or subsidy to big business for building plants which they should have built long ago is questionable. A double reward is special privilege carried to a scandalous degree.

We also suggest that some provision should be included into the tax bill which would limit inclusion as tax deductions items such as lush expense accounts for employees engaged in Government contracts; unwise and unnecessary frills on real property and expansion of nonessential plant capacity; and the placing on company payrolls of personnel used primarily for private service to corporation officials such as landscape workmen, chauffeurs, and personal maids shown as factory employees.

We hope that the committee will comb our tax laws thoroughly to eliminate loopholes, including special treatment of utilities, railroads, and airlines.

If there are to be any favors, they should go to small and new business enterprises which will reestablish a measure of competition in the American economy.

The CHAIRMAN. Mr. Seidman. Mr. Seidman, will you please identify yourself for the record.

STATEMENT OF M. L. SEIDMAN, CHAIRMAN, TAX COMMITTEE, NEW YORK BOARD OF TRADE

Mr. SEIDMAN. I am M. L. Seidman. I am chairman of the tax committee of the New York Board of Trade.

Gentlemen, this bill, H. R. 4473, has the distinction of proposing to collect the largest amount of taxes ever imposed by any of its famous predecessors. I am sure you will agree that is quite a distinction. Yet the fact remains that after superimposing this huge additional sum upon the largest revenue take in our history, inherited from the long string of earlier revenue acts, we will still fail by many billions to meet the President's budget. As you gentlemen know, the Ways and Means Committee of the House of Representatives devoted itself intensely for a period of more than 5 months to seeking out sources of additional revenue and it came up with this bill as its final answer.

Since there is general agreement that we must meet our civil and military costs out of current revenue or further aggravate the monster of inflation, a primary conclusion becomes immediately obvious. Government spending must be tailored to stay within Government revenue. In other words, we must live within our means. Civil expenses must be cut to the bone and nonessentials, whether civil or military, must be completely eliminated. There is still plenty of open-handed spending. Proof of that can be found in the studies

and reports made by Senator Harry F. Byrd and others. These show ample room for cutting many billions of dollars out of our budget without harm to our defense or other essential Government functions.

I might say in this respect that the Senate has already done a commendable job in cutting down many budget requests. Its fine work in that direction has the full-hearted support of every clear-thinking citizen. Now, as always, our real strength is our economic strength. This we must preserve as a prerequisite to the maintenance of our way of life.

But a balanced budget, by itself, is not enough if it is to be attained at the cost of weakening our system of private enterprise. One of the most important factors in a sound economy is a well-balanced tax system. Far from being well balanced, ours is a completely lopsided one; and this proposed revenue bill will throw it still further out of kilter.

A striking fact about our tax system is the extent to which it depends upon direct taxes on income. Taken together, such taxes would, under the proposed program for 1952, constitute 83 percent of net budgeted receipts compared with 78 percent last year and 50 percent in 1939. What this means in income-tax rates can be seen from the rate schedule after giving effect to the proposed 12½-percent increase in individual taxes. The marginal tax rate at $10,000 is 43 percent; at $20,000, 63 percent; at $40,000, 78 percent; at $50,000, 84 percent; and a $80,000, the maximum rate of 94½ percent.

The way in which the press handled the proposed 12½-percent increase in individual taxes gave the impression, in some instances, that the increase stopped at the $80,000 income point. Actually, the increase applies all along the line; however, one cannot increase taxes by 12½ percent on income already paying a 91-percent tax rate. That would make the top tax rate 102.4 percent or 2.4 percent beyond complete confiscation. The surtax schedule was itself therefore changed so that the top rate under this bill would be 94½ percent. Viewing this increase in terms of a percentage of take-home pay, or what is left of income after present taxes, the effect becomes startlingly clear. It means a reduction of only 1.1 percent in take-home pay to the man now paying a 20-percent tax, but more than a 30-percent reduction in take-home pay or in retained income to the man whose top tax rate is already 91 percent.

Under this new Fair Deal, therefore, a man reaches the zenith of his financial success in life when he can retain $23,502.50 out of $80,000 of income. After that he can keep a nickel out of every dollar. If you should be looking for that unaccounted-for half penny, I must point out that many States collect income taxes, too, and on the selfsame income. Their tax rates range up to 15 percent. Except for the fact that the State tax is deductible from income for Federal tax purposes, the combined top rate of tax on the same income would be 9½ percent more than 100 percent. That could well be the result anyway, where a taxpayer has no income in the following year from which to deduct his State tax when he pays it.

You may recall in F. D. R. days, and purely, I suppose, as a war measure, it was suggested that retained personal income be limited to $25,000. This brought on such unfavorable repercussions, even from so-called liberal sources, that the idea was quickly dropped. Yet the practical effect of the 12½-percent tax increase in this bill is to very

nearly limit personal incomes to $25,000. In the case of the few individuals who are lucky enough—or shall I say unlucky enough—to have incomes ranging up to $1 million and beyond, they will be permitted to keep a dime instead of a nickel out of every dollar; that is, providing their over-all tax is 90 percent of their total income. In their case the tax is not a graduated one but a flat 90-percent tax on every dollar of income.

Now, I ask you gentlemen, in all sincerity, can anyone reasonably be expected to put much enthusiasm into his efforts to produce and preserve income only to have it almost entirely taken away from him? Experience has shown otherwise. Extreme and unconscionable tax rates do not supply revenue for very long. They tend to force liquidation of income-producing properties. They promote tax avoidance and in the end they destroy the very sources of Government revenue.

Not only are the sources of income destroyed but our national way of life is itself destroyed. The net effect of extreme and unconscionable tax rates is to annihilate the middle and upper classes of society. Then, of course, there is only one class left to pay the taxes. That is exactly what has happened in England. That is socialism. We all profess we want no part of that here, but we are assuredly heading swiftly in that direction.

What I am defending here is capitalism, with all of its defects, against socialism and communism, with all of their idealisms. No tears need be shed for the rich man who can live comfortably even after he pays these taxes. It is the wage earner who is the real victim of this confiscatory tax policy. It is he for whom higher wages must depend upon more and more capital going into tools of production. Confiscatory taxes leave little or nothing for capital formation upon which, in the long run, the worker's progress largely depends.

In this bill it is also proposed to increase normal and surtax rates on corporations to 52 percent. In addition, it is proposed to manipulate the excess-profits-tax thermometer in such a way as to produce the illusion that more "excess" profit exists than is actually there. That is just another way of saying that the tax rates on normal income will be substantially more than 52 percent. Also, the combined corporate rates would total 82 percent, with an over-all rate of 70 percent.

Here again, the big corporations to whom capital markets are open even after paying out most of their earnings in taxes and dividends can stand up much better against extreme taxes than can the little companies. It is the small business which must depend upon capital accumulations from its own earnings for growth and competition with big business. Capital markets are not open to the small unlisted companies which, however, make up the great majority of our corporate businesses.

We profess to be particularly solicitous of small business, so it is worthy of note that there is a provision in this bill section 123, which, in numerous cases, will have the effect of greatly increasing taxes of small family companies, entirely aside from the proposed tax increases. This would come as a result of limiting "related corporations" to a single surtax exemption and a single excess-profits-tax credit.

As long as there is a full exemption or credit extended to each corporation there is frequently an advantage for a business to operate through more than one unit. That is what the proposed change in the law seeks to eliminate. However, the remedy is very much like

cutting off a man's foot to cure his corns. It is a radical one to say the least. There are any number of related businesses that are nevertheless separate and distinct enterprises, and entitled to be treated as such.

Thus, a man may be in the shoe business and his wife may operate a little dress shop of her own. Or, a man may put his son into business, retaining, however, a controlling interest. Or, an individual may be in one business and acquire another completely separate and unrelated business. There would seem to be no good reason why any of these situations should not be entitled to separate corporate treatment. This proposal, however, through several extremely complicated and involved provisions would deny them individuality and would limit so-called controlled corporations to a single surtax exemption and a single excess-profits-tax credit.

The Bureau of Internal Revenue, under existing administrative procedure, has ample powers to treat with corporations whose separate existence is influenced chiefly by tax considerations. I submit that this proposal can do a lot more harm to small business than may be warranted by any possible revenue.

In an obvious attempt to treat calendar-year and fiscal-year taxpayers alike as regards the effective date of tax increases, this bill makes careful provision for fiscal year individual taxpayers. However, it overlooks the fact that few individuals report on a fiscal-year basis but that a great many partnerships, estates, and trusts from whom individuals receive income do report on a fiscal-year basis. This bill, however, makes no provision for allocating such partnership or fiduciary income as between the 2 years involved. Instead, it treats as 1951 income all of an individual's share of income from a fiscal-year partnership or fiduciary whose year ends within the individual's calendar year. Thus, for instance, in the case of a partnership having a year ending on January 31, 1951, the individual's share of the partnership income from February 1, 1950, to January 31, 1951, will all be taxed to him at 1951 rates in his 1951 calendar-year return. The same situation was true when tax rates were hiked in 1950 with respect to 1949 income. In the light of the sharp increases in rates, this discrimination between taxpayers should be corrected.

In pointing up some of our tax weaknesses, let me remind you of some of our forgotten men—forgotten, not by the tax collector but by Uncle Sam as security dispenser. I am referring to self-employed professional men—lawyers, doctors, engineers, architects, accountants, et cetera. To this group also might be added individuals in business for themselves or in partnership with others.

Under our present high taxes and high cost of living it is practically impossible for anybody, in or out of these groups, to provide amply for his own old age and for his family's future security. In recognition of this obvious truth, employers are given tax incentives to set up pension plans, stock bonus, and profit-sharing plans for the benefit of their employees. They are permitted a deduction from taxable income up to 25 percent of an employee's annual earnings if the amounts so deducted are set aside for the employees' future benefit. The employer thus gets an immediate tax advantage while the employee is not taxed on his benefits until he himself or his beneficiary receives what has been set aside for him.

In all fairness it would seem that the very least we should do is to make similar security provisions for the professional man and the self-employed businessman. Various plans have been suggested to accomplish this purpose. One of the simplest is to allow these individuals an annual deduction up to 15 percent of their taxable income, if the amount so deducted is invested in a specially designated series of United States Government bonds. These bonds would not be redeemable except under certain conditions approximating those now applying to approved pension plans or stock bonus or profit-sharing plans, and would constitute taxable income when redeemed.

In revamping our tax structure, we must face up to the fact that substantial additional revenues, if needed, can only come from the average man of average income and average wealth. The President's own Council of Economic Advisors said recently:

> By far the largest part of the additional revenue must come from the middle and low tax brackets. These are the brackets in which the bulk of the income is located. Of the net income on all taxable returns, 86 percent of the amount remaining after Federal income taxes is estimated to be received by taxpayers with net income of less than $10,000. To hold down consumption, which is vital to the control of inflation, the bulk of consumers must be affected directly by tax increases.

It must be perfectly clear to all of us by now that we cannot get the money by simply soaking the rich. Even if we were to tax away all income over $25,000 a year the yield would be less than $1 billion over and above present taxes the first year, and certainly much less thereafter. Nor can we do much better by soaking the corporation—popular a pastime as that may be. There is a limit to what corporations can be made to pay without loss of incentive and without promoting waste and extravagance.

From the standpoint of the entire national economy this is the time when we should be discouraging consumer spending and doing everything we possibly can to promote savings. This is a time also when we are trying to induce and accelerate production. As an obvious corollary, therefore, this is no time to substantially increase individual or corporation income taxes but it is a particularly good time to impose further taxes on consumption.

Few of us would regard consumers' taxes, taken by themselves, as an equitable method of taxation, but they can and should play a much more important part in our tax system than they do today. The usual objection to sales taxes, namely, that they fall too heavily on the lower income groups, is not valid today because of the steeply aggressive income taxes paid by other groups who in addition would, of course, also have to pay the sales taxes. It is the lower-income groups, by and large, who have benefited most from the general rise in income over the past decade.

Finally, in consumer taxes the individual at least has some choice whether to spend or not to spend, hence whether to pay or not to pay the taxes. Food and other basic necessities are in any event usually exempt from such taxes.

And now, having been critical of some of the major provisions of this bill, I want to say that it is also has some excellent features in it which I hope you gentlemen will see fit to retain. For instance, the provision recognizing the head of a household as being entitled to special treatment; the provision with respect to gain from the sale

or exchange of a taxpayer's residence; the recognition that some family partnerships have been mistreated; and the encouragement given to venture-capital companies, are all excellent provisions, to mention only a few of them. They go to emphasize the fact that even under extreme revenue needs the Ways and Means Committee was ready to sacrifice revenue in order to promote equity in aggravated situations.

Summarizing the point of viewing in the New York Board of Trade on some of the major items, It is:

(1) First and foremost, civil-government spending must be cut to the bone and all nonessentials, civil or military, must be completely eliminated from our budget.

(2) Personal income taxes are already entirely too high, particularly in the middle and upper brackets. But, if additional revenue must be raised from this source, it can be more equitably distributed among taxpayers if treated as a percentage of retained income rather than as a percentage of the present tax.

(3) The combined total of a corporation's normal and surtaxes should not exceed 50 percent of its income.

(4) Excess-profits taxes should be imposed only on the true excess over normal profits. Base-period income, once arrived at, should not be reduced by any arbitrary percentage, as at present or otherwise.

(5) Substantial additional tax collections can only come from the average man of average income and average means. The best taxes under present circumstances are those that would discourage consumption and induce savings. Whether such taxes are imposed on retail sales, with carefully worked-out exemption provisions, or whether they be imposed at the last point of manufacture, or confined simply to a broader field of selective excise taxes, is not as important as it is that the taxes be imposed at the point of spending rather than at the point of receiving or saving income.

(6) No retroactive taxes of any kind should be imposed.

And, finally, gentlemen, perhaps we can learn something from our northern neighbor. Canada has had a balanced budget for every 1 of the 5 years since 1945. In each of these years also it reduced its national debt substantially. It has no excess-profits tax. Its individual tax rates are considerably lower than ours. It does, however, have an over-all retail sales tax of 10 percent in addition to special excise taxes on luxury goods.

Canada's economy is of course materially affected by our own. Last year, especially, there was an inflow of speculative capital from the United States that reached flood proportions and provided a sharp inflationary stimulus. In April Mr. D. C. Abbott, the Canadian Minister of Finance, presented the nation with a unique budget. It is a budget designed to finance the defense program on a pay-as-you-go basis and to control inflation. Permit me to quote just a few pertinent remarks from the Minister's speech in presenting this budget. He said:

> The field of the corporation income tax is a difficult one, and one which I have to approach with a particularly keen sense of responsibility for the real national interest, because the general public does not, I am afraid, fully understand the implication of these taxes. It would be only too easy to take a superficially popular line and increase these taxes to a point which while yielding large immediate revenues would do grave damage in the longer run to the economy as a whole.

Then he went on to say:

> A part of what I said about the excess-profits tax, namely, that it blunts the goal to efficiency and that it invites waste, applies also to high rates of corporation income taxes. It is, of course, a question of degree. I say quite frankly, however, that I am not happy about corporation tax rates when they go over 50 percent. I think it is bad psychology to permit people to say that more than half of any income earned, or any savings made, will go to the Government.

It looks to me, gentlemen, like they grow some real statesmen up there in Canada.

Thank you.

The CHAIRMAN. Yes, sir.

Any questions, Senator Connally?

Senator CONNALLY. No questions.

The CHAIRMAN. Thank you for your appearance here.

Mr. SEIDMAN. Thank you for permitting me to appear.

The CHAIRMAN. The committee will recess until 2:30.

If any of the witnesses who are scheduled this morning wish to file a brief for the record in lieu of their appearance, they may do so. Otherwise we will hear you sometime in the afternoon.

Mr. YOUNG. My statement is going to take about 5 minutes, and it is very short. As a matter of fact, if I could be taken out of order it will take me a few minutes to get it into the record.

The CHAIRMAN. Mr. Young, I will be perfectly willing to remain here for you to make your statement and let it go in the record if you wish at this time.

STATEMENT OF MILTON YOUNG, ATTORNEY AT LAW

Mr. YOUNG. That is very kind of you, Senator.

The CHAIRMAN. Yes, sir. Have a seat.

Mr. YOUNG. Yes, sir. My name is Milton Young.

The CHAIRMAN. For whom are you appearing?

Mr. YOUNG. I am an attorney at law, and a member of the faculty of New York University Graduate School of Law.

The CHAIRMAN. Yes, sir.

Mr. YOUNG. My remarks are addressed to section 123 of the pending revenue bill of 1951.

It costs about $50 to form a corporation in New York State. It may cost as high as $13,000 each year, if section 123 of the revenue bill of 1951 should be enacted in its present form.

THE PRESENT PRACTICE

One corporation may both manufacture and sell its product. If the net income of the corporation is $40,000, its combined normal and surtax liability under the proposed rates will be $15,300 and its excess-profits tax liability will be $4,500 for a total tax of $19,800. If a selling corporation were to be formed by the same stockholders, the tax liability of each corporation, assuming the $20,000 income was equally divided between them would be $6,000 each with no surtax or excess-profits-tax liability by reason of the $25,000 exemption and minimum excess-profit credit. The total tax would be $12,000 for a savings of $7,800. It may well be that in a given flagrant case the Commissioner may overcome the tax advantage by invoking either section 45 or section 129 of the Internal Revenue Code with no need for additional legislation.

The new section would limit the $25,000 surtax exemption and the $25,000 minimum excess-profit credit to a single exemption and credit where two or more corporations are controlled by the same stockholder or small group of stockholders. The section was designed to prevent the—

deliberate splitting up of corporations for the purpose of realizing the unusual tax advantages which present law permits in a period of high corporate tax rates.

While there may be no quarrel with the objectives of the amendment, there is serious opposition to the sweeping language of the new section and the hardship it will work upon many small-business men who are innocent of any deliberate attempt to split up a business activity.

It is clear from the report of the House Ways and Means Committee that the tax advantage sought to be eliminated is one arising from the use of multiple corporations to carry on various phases of a common business activity.

Section 123 (a) (3) (B) of the revenue bill of 1951 defines a controlled group as "any group of two or more corporations" which meet the statutory stock ownership test. All corporations falling within the classification would be permitted to share but one surtax exemption and one minimum excess-profits credit. This limitation will apply solely by reason of the identity of stock ownership and would be operative even though the activities of the corporations are unrelated. It will apply to corporations which may have been in existence for many years and which conduct completely isolated business functions. It will affect only small business because where stock ownership is divided among groups consisting of more than five persons, the new section will not apply.

How the proposed rule will work by way of example: Messrs. Jones and Smith may own all the stock of a corporation engaged in the operation of, say, a dairy farm, which enjoys a net income of $50,000 a year. The corporation's total normal tax, surtax and excess-profit-tax liability (assuming no variations in normal tax net income and excess-profits income) would be $28,000.

Jones and Smith decide to buy all the outstanding shares of O. B., Inc., which operates an office building in a neighboring city. O. B., Inc., has a net income of, say, $20,000 a year. If Messrs. Jones and Smith were to buy the shares in the same proportion as the stock held in the dairy farm corporation, as would be natural, the penalty imposed on O. B., Inc., by reason of the identity of stock ownership would be $8,000 a year computed as follows:

Tax before purchase of shares (income $20,000):	
Normal tax on $20,000	$6,000
Surtax ($25,000 exemption)	0
Excess-profit tax ($25,000 minimum excess-profit credit)	0
Total	6,000
Tax by reason of operation of proposed sec. 123:	
Normal tax (30 percent)	6,000
Surtax (22 percent) ($25,000 exemption unavailable)	4,400
Excess-profit tax (30 percent) ($25,000 minimum excess-profits credit unavailable) $6,000, but by reason of 70 percent limitation	3,600
Total tax	14,000
O. B., Inc., tax liability before acquisition of stock of Jones and Smith	6,000
Additional annual tax	8,000

This result follows despite the absence of any relationship between the operation of the dairy farm and the office building. If O. B., Inc.'s income were greater, the additional tax, solely by reason of the identity of stock owners, might be as high as $13,000 annually.

The pattern may vary, but additional tax may result whenever five or less persons, who happen to be stockholders of a corporation, attempt to enter another corporate business activity jointly. In effect, the new rule would say that you may be the shareholders of only one small corporation, but no more, unless you wish to subject the corporations to a prohibitive corporate income tax.

SUGGESTIONS TO OVERCOME THE INEQUITY OF THE PROPOSED LAW

(*a*) The language of the section should be amended so as to limit its applicability to corporations which are related not only through stock ownership but through a common business activity.

(*b*) Amend section 45 of the Internal Revenue Code (which authorizes the Commissioner to allocate gross income, deductions, credits, or allowances between related taxpayers) by adding a subsection authorizing the Commissioner to limit the surtax exemption and the minimum excess profit credit in cases of related corporations controlled by the same stockholders which deal with each other through the purchase or sale of products, rental of property or the use of the services.

(*c*) Amend section 129 of the Internal Revenue Code (which deals with acquisitions to avoid income or excess profit tax and provides for the disallowance of deductions, credits, or allowances), by adding a subsection which would provide that duplication of stock ownership, as defined in proposed section 123, will cause a limitation of the surtax exemption of the minimum excess profit credit, unless the taxpayers establish the absence of a business relationship between the entities.

(*d*) If it is impractical to create the statutory distinction suggested then section 123 should not be enacted. The Commissioner may still rely on sections 45 and 129 in cases where excessive tax advantages are obtained.

The House committee report states that an anticipated revenue of $55,000,000 yearly may result from the enactment of section 123. The depressive impact of the proposed section on new corporate business activities may be more injurious than the loss of the anticipated revenue, particularly when one realizes that all of the new tax will come from that much abused but important group known as small business.

The CHAIRMAN. Yes, sir: I have been very much interested in that particular provision in the House bill, and undoubtedly it is a very drastic one, and I have already discussed the matter with the joint staff.

If you, in effect, are going to require consolidations, then certainly these corporations should be given the advantages that come from consolidation, or something to offset it. I have not worked it out in my own mind, and I am very glad to have your views on it.

Mr. YOUNG. Thank you, sir.

The CHAIRMAN. Thank you, sir, very much.

(Discussion off the record.)

The CHAIRMAN. Mr. Lang, if you wish to file your statement, I will be very glad to have you do so.

(The prepared statement of John G. Lang referred to, is as follows:)

STATEMENT OF JOHN G. LANG, TREASURER, CUBAN TOBACCO CO., INC.

The matter which I am bringing before the committee concerns the dividends received credit provided for in section 26 (b), which is not allowed at the present time with respect to dividends received from a resident foreign corporation which derives the greater portion of its income from sources within the United States and, of course, pays the United States income tax on such income.

With certain exceptions the statute at the present time allows a credit of 85 percent of dividends received from all domestic corporations which are subject to taxation under chapter 1 of the Internal Revenue Code, such credit being subject to a limitation of 85 percent of adjusted net income of the recipient corporation. The exceptions referred to are that no such credit is allowed with respect to dividends received from China Trade Act corporations and corporations entitled to the benefits of section 251, and a special credit of 59 percent is crurently allowed with respect to dividends received on the preferred stock of a public utility. However, the statute makes no provision for the 85 percent credit with respect to the dividends received from a resident foreign corporation even though such a corporation is subjected to United States tax on its income received from United States sources in the same manner and at the same rates as a domestic corporation.

Obviously, the principal reason for the allowance of this credit with respect to dividends received from domestic corporations is to prevent, to a great extent, the repeated taxation of the same corporate income as it passes, in the form of dividends, from a subsidiary corporation to its parent corporation. For example, under existing law a corporation is subject to an income tax of 47 percent of its net income. When its net income remaining after the payment of such 47 percent tax is distributed to its parent corporation in the form of a dividend, and if the dividend received credit was not allowed, it would result in the imposition of another 47 percent tax on the parent corporation on the dividend received thus subjecting the subsidiary corporation's original income to an effective income tax rate of approximately 72 percent as a result of the double taxation. If the corporate income tax rate is increased further to 52 percent as proposed in the bill passed by the House the double tax burden would be approximately 77 percent in such a case.

Such double taxation of income of a subsidiary corporation is effected equally in the case of a resident foreign subsidiary which derives income from United States sources, as it does in the case of a domestic subsidiary, and therefore, the statute should be amended so as to eliminate such double taxation by allowing a dividends received credit in the case of dividends received from such a resident foreign subsidiary.

In 1947 the House Ways and Means Committee held public hearings in connection with a tax revision bill which was being considered at that time and I appeared as a witness before the committee on July 7, 1947. My testimony, which was comparable to that now being presented, called that committee's attention to the tax inequity which exists in section 26 (b). On May 26, 1948, the tax revision bill H. R. 6712 was introduced in the House of Representatives and was cited as the "Revenue Revision Act of 1948." The bill was subsequently passed by the House but was never enacted into law because the Eightieth Congress adjourned before the Senate was able to take any action. Section 120 of that bill was an amendment to section 26 (b) of the code and would have corrected the tax inequity referred to.

Ever since February 1946, which was prior to the introduction in the House of H. R. 6712 and prior to my appearance before that committee as a witness, I have had conferences at regular intervals with representatives of the Treasury Department and the chief of staff of the Joint Committee on Internal Revenue Taxation in order to keep this tax inequity before them. At no time did I encounter any opposition to my proposal that the inequity be corrected by legislation. As a matter of fact at the time H. R. 6712 was being prepared the then Under Secretary of the Treasury, Mr. A. L. M. Wiggins, wrote a letter to the House Ways and Means Committee in which he recommended numerous changes to the code, one of which was an amendment to section 26 (b) so as to allow the credit with respect to dividends received from resident foreign corporations. Also, the American Bar Association at its annual meeting in St. Louis in September 1949

adopted a recommendation made by its committee on taxation of corporations that this inequity be remedied by legislation.

This tax inequity has a decidedly unfavorable impact upon the Cuban Tobacco Co., Inc., which I represent and which is a domestic corporation having two resident foreign subsidiaries which earn the greater part of their income from sources within the United States and pay the United States tax on such income. The dividends received from these subsidiary corporations are taxable to the parent corporation in full despite the fact that the greater part of such dividends represents a distribution of income which the subsidiaries derived from sources within the United States, and which income has already been taxed by the United States.

Cuban Tobacco Co., Inc. (hereinafter referred to as "Cuban Tobacco"), is a domestic corporation and its two resident foreign subsidiaries are Henry Clay and Bock & Co. Ltd. (hereinafter referred to as "Henry Clay"), and the Havana Cigar & Tobacco Factories, Ltd. (hereinafter referred to as "Havana Cigar") which are British corporations and resident foreign corporations for United States tax purposes.

The tax effect of this set-up is as follows:

First, Havana Cigar and Henry Clay pay a United States income tax on their income from sources within the United States. For the year 1950, for example, they paid an aggregate United States income tax of approximately $208,000 on an aggregate income from United States sources of approximately $519,000.

Second, Cuban Tobacco in 1950 received dividends from Havana Cigar and Henry Clay in the approximate aggregate amount of $266,000. In the year 1950 approximately 86 percent of the aggregate gross income of Havana Cigar and Henry Clay was derived from United States sources and, therefore, to the extent that such dividends were paid from income subjected to United States income tax the amount thereof was taxable twice at the full corporate income tax rate.

Thus, the double taxation involved and described above resulted in an effective income tax rate of 66 percent for the year 1950 but for the year 1951 such effective income tax rate would be 72 percent predicated on an actual income tax rate of 47 percent which at present the statute imposes. However, such effective rate will be approximately 77 percent if corporate income taxes are further increased to 52 percent as provided in the bill passed by the House.

The effective United States income tax rates imposed on the United States income of a resident foreign subsidiary in terms of $1 are determined as follows:

	Actual income tax rate of—		
	42 percent	47 percent	52 percent
Income earned by subsidiary within, and taxed by, the United States	1.00	1.00	1.00
United States income tax paid by subsidiary	.42	.47	.52
Balance distributed to domestic parent corporation as a dividend	.58	.53	.48
United States income tax paid by parent corporation on dividend	.2436	.2491	.2496
Total United States income tax paid	.6636	.7191	.7696
Approximate effective United States income tax rate (percent)	66	72	77

I have drafted a proposed amendment to section 26 (b) (1) of the Internal Revenue Code which achieves the result of granting a corresponding dividend received credit with respect to dividends received from resident foreign corporations as that presently granted in the case of dividends received from domestic corporations and attach same hereto as exhibit A. The amendment divides section 26 (b) (1) into two subparagraphs, the first dealing with dividends received from domestic corporations and the second dealing with dividends received from resident foreign corporations. The first subparagraph is exactly the same as section 26 (b) (1) as it now exists and the second subparagraph is added as an amendment.

As to the second subparagraph which accomplishes the result of granting a credit with respect to dividends received from resident foreign corporations, this is worded in language parallel to the present section 26 (b) (1) except that it is necessary therein to limit the credit to the proportion of the dividends received which are paid from income derived by the payor corporation from sources within

the United States. This limitation in the credit is accomplished by using the same ratio for the total dividends paid during the year as the gross income of the payor corporation for the 3-year period ending with the close of its taxable year preceding the declaration of such dividends (or for such part of such period as the corporation has been in existence) derived from sources within the United States bears to its gross income from all sources during the said period. This is similar to the method used in the Internal Revenue Code in section 119 (a) (2) (B) which deals with the amount of the dividends received from a foreign corporation which is to be considered as derived from United States sources. By this wording of the provision it is intended that the 85 percent dividend received credit would be allowed only with respect to the portion of the dividend which represents a distribution of income earned by the payor corporation from sources within, and taxed by, the United States. No dividend received credit would be allowed with respect to the portion of dividends derived from non-United States sources as that portion of the income would not previously have been subjected to United States tax.

It is proposed to allow the credit only in those cases where the income of the payor corporation for the preceding 3 years was derived to the extent of at least 20 percent from sources within the United States. This cut-off is designed for administrative purposes and is parallel to the 20 percent provision contained in section 119 (a) (2) (A) relating to the source of dividends paid by domestic corporations.

As to the effective date of the amendment, it is proposed that it be made applicable to the taxable years beginning after December 31, 1945, which, for the Cuban Tobacco Co., Inc., would mean beginning with the calendar year 1946. The reason for choosing this particular year is because as previously mentioned it was in February 1946 that I brought the section 26 (b) tax inequity to the attention of representatives of the Treasury Department and the chief of staff of the Joint Committee on Internal Revenue Taxation and also because it is in the year 1946 that this tax inequity materially affected the tax liability of the Cuban Tobacco Co., Inc. for the first time. Prior to 1946 the company had little or no net income but in 1946 because of increased dividends from its two resident foreign subsidiaries the company's tax liability was approximately $31,000 whereas it would have been $2,700 if a credit had been allowed with respect to dividends received from its resident foreign subsidiaries. In 1947, 1948, and 1949, the comparable tax liabilities are approximately as follows: In 1947, $28,600 whereas it would have been $2,500; in 1948, $8,500 whereas it would have been $1,000; in 1949, $2,000 whereas it would have been $300.

In no case is there a large amount of revenue involved insofar as the United States Treasury is concerned but nevertheless the amounts are large for a small company like Cuban Tobacco Co., Inc., which is in poor financial condition. The ratio between the two comparative amounts in each year is extremely large and emphasizes the inequity. As a result of the afore-mentioned conferences with Treasury Department representatives and the chief of staff of the joint committee it appears that retroactivity to 1946 would have a very negligible effect upon United States Government revenues because there is no knowledge of any other taxpayer suffering from this inequity. It seems obvious that if any other taxpayers were materially affected by this inequity they also would have made efforts to remedy it.

Exhibit A

Proposed Amendment to Section 26 (b) (1) of the Internal Revenue Code

Sec. 000. Technical Amendment Relating to Dividends Received Credit

(a) In general. Section 26 (b) (1) (relating to dividends received credit allowed in the case of a corporation) is amended to read as follows:

"(1) In general.—

"(A) From domestic corporations.—85 per centum of the amount received as dividends (other than dividends received in taxable years described in paragraph (2) on the preferred stock of a public utility) from a domestic corporation which is subject to taxation under this chapter and

"(B) From resident foreign corporations.—85 per centum of the amount received as dividends from a resident foreign corporation which is subject to taxation under this chapter unless less than 20 per centum of the gross income of such resident foreign corporation for the 3-year period ending with the close of its taxable year preceding the declaration of such dividends (or for such part of such period as the corporation has been in existence) was derived from sources within the United States as determined under the

provisions of section 119 but only 85 per centum of an amount which bears the same ratio to such dividends as the gross income of the corporation for such period derived from sources within the United States bears to its gross income from all sources and"

(b) EFFECTIVE DATE OF AMENDMENT.—The amendment made by subsection (a) shall be applicable so taxable years beginning after December 31, 1945.

The CHAIRMAN. We will recess until two-thirty.

(Whereupon, at 1 p. m., the committee recessed, to reconvene at 2:30 p. m., the same afternoon.)

AFTERNOON SESSION

The CHAIRMAN. Let us come to order.

We have finished with all the witnesses except two. Mr. Herrmann is here, and we will hear him now.

Mr. HERRMANN. I will endeavor to make it as brief as possible.

The CHAIRMAN. That is all right.

Will you identify yourself for the record?

STATEMENT OF DAVID W. HERRMANN, CHAIRMAN, TAX COMMITTEE, NATIONAL ASSOCIATION OF SHOE CHAIN STORES

Mr. HERMANN. Mr. Chairman, my name is David W. Herrmann. I am vice president and secretary of Miles Shoes, Inc., of New York, N. Y., operators of 145 stores in the Mid-Atlantic area. I am here representing the National Association of Shoe Chain Stores as chairman of its tax committee.

The policies expressed are known to be those of the shoe chain store industry generally, although some individual companies may not share the same viewpoint.

The National Association of Shoe Chain Stores represents 50 companies, with more than 5,000 stores in every State, retailing popular-price shoes, and selling approximately 25 percent of all of the shoes worn in this country. Of these companies, 23 operate 30 or less stores. A list of members of the association is attached to the statement, which I will file with the committee.

The chain-store organizations of the retail shoe industry are strongly opposed to section 123 of the proposed Revenue Act of 1951, which seeks to limit related corporations to a single minimum excess-profits-tax credit of $25,000 for the entire group, and permits only one surtax exemption for a group of related corporations.

While a hypothetical $55 million in increased revenue is estimated by the Treasury, if such legislation is enacted, we believe that the resultant inequities would greatly exceed any increased revenue, the realization of which, we believe, is highly improbable.

Although section 123 of the proposed Revenue Act, according to the Ways and Means Committee report, is directed primarily at big business, it will also hurt small business, individual merchants, and our whole economic system which, traditionally, provides unlimited opportunities for merchants to expand, develop, and to grow.

Under this provision, despite an increased tax burden, big business will remain big business, but small business will remain small business. This provision will harm small business, will arrest its growth and impede our economy, which we believe is superior to any other in the world, both in respect to the opportunities provided for all individ-

uals, and in respect to its efficiency and resourcefulness in times of emergency.

Section 123, in effect, states to every individual and corporation in this country, "If you have been making big profits in the past, you may continue to do so; if you have not, you may not do so." Furthermore, we may assume, in the light of world conditions, that the excess-profits tax will be in effect for some time.

The operator of one or two shoe stores, one or two gasoline stations, one or two drug stores, making a profit of approximately $25,000 per year, will not, under the proposed legislation, have the incentive of opening additional establishments. Any additional profits will be largely taxed away, as a result of being subject to the normal, surtax, and excess-profits tax provisions of the proposed new tax law.

Many businesses were operating on a related corporation basis long before high corporate taxes and excess-profits taxes were enacted. Obviously, such companies did not create this type of corporate structure for Federal tax advantage. Even since income and excess-profits taxes have assumed substantial proportions, numerous companies have established a related corporate structure for sound business reasons, other than tax saving. These companies were required to demonstrate to the satisfaction of the Commissioner of Internal Revenue that the corporations involved were neither sham nor fictitious, and were not conducted on an artificial basis, and that the corporate structure was not created primarily for the purpose of reducing, or evading, the payment of taxes.

Many of these corporate structures met the requirements and obtained the approval of the Bureau of Internal Revenue, and were permitted to calculate their tax obligations in accordance with the profit of the separate corporations, just as though such separate corporations were not related.

Among those reasons which have been accepted as valid in winning the approval of the Treasury Department are:

1. The limitation of liability on leases, contracts, and tort claims.
2. Closer identification of a separate business with the local community.
3. Possible immunity from the trend toward local chain store taxation, predicated on the number of stores operated by any one corporation.
4. The ability to operate an employee profit-sharing plan based on the earnings of a single business establishment.
5. The ability to obtain local advertising rates, representing an advantage in comparison with national rates in various communities.
6. The maintenance of exclusive franchises for merchandise from particular manufacturers, which would not be granted were all stores of a group merged under single corporate ownership.

The enactment of proposed section 123 would prevent management from exercising its proper function by imposing a prohibitive penalty upon the effectuation of any of the programs listed above.

Senator TAFT. Why prohibitive? Why is it any different from any of the big companies? Is your objective that you want the exemption for small corporations in every place, even though there are a hundred stores all owned by one company? The alternative, if they do go through with the House bill, would be simply to make you pay the same taxes as any big corporation.

Mr. HERRMANN. That is true, except for the fact——

Senator TAFT. Why is it prohibitive on you more than the others that are taxed at the same rate? It is a terrible tax; it is a destructive tax. But why is it different in your case?

Mr. HERRMANN. It would not be possible to work out certain of these arrangements in the event that these corporations, which are largely small-business enterprises, in their own community, were to have to pay prohibitive taxes.

Senator TAFT. Yes. But here is a big corporation owning 100 stores, with a large capital. Why are they treated differently from a department store that has the number of sales, say? Why is it any more prohibitive?

Mr. HERRMANN. There is a very definite reason, Senator Taft. All of these businesses are actually small businesses under one control in competition with all of the small businesses in their various local communities. And if it were necessary to measure their particular tax advantage as against those corporations which did not have a multiple set-up, obviously those corporations which did not have a multiple set-up elected to remain as one corporation despite the fact that they might have various establishments, because in evaluating the tax situation they felt it was to their advantage to do so.

Evidently the Treasury Department, in reviewing that situation, felt that consolidated returns to a very great extent might represent an advantage, and for that particular privilege——

Senator TAFT. We are considering here an exemption, an exemption given to small business. What is that? The first $25,000?

Mr. HERRMANN. The first $25,000 would be exempt from these excess-profits tax and surtax.

Senator TAFT. And why does a big business with 100 stores get 100 times that exemption? Is it a small business or a big business? You must have a common purchasing department. You must have certain other common features of operation in those stores. There must be some advantage in having 100 stores instead of having 1 store.

Senator JOHNSON. How many tax returns do you send in? One for each store, or do you send in for all stores in one?

Mr. HERRMANN. We are not permitted, unless we pay a penalty for doing so, to file a consolidated return. That penalty would be 2 percent above the regular tax rate.

Senator JOHNSON. If one store takes a loss and the other takes a profit, can you charge one against the other?

Mr. HERRMANN. If one store takes a loss and the other makes a profit, we are not permitted to charge the loss against the profit. We believe that in electing to file on a separate basis, we assume a certain amount of risks; we do not have the advantage of shifting capital between corporations. In the event that there is any protracted period of loss where we would be precluded from taking advantage of the carry-back or carry-forward provisions of the income tax on such losses, those losses would never be recovered.

Senator TAFT. On the other hand, if you want to, you can file a consolidated return and take the 2-percent penalty? If that enables you to take this loss, you would probably consolidate this return and pay the 2-percent penalty?

Mr. HERRMANN. I doubt whether we could switch in midstream.

Senator TAFT. Can you switch?

Mr. HERRMANN. I do not think we can, sir. I think we would have to get the approval of the Commissioner of Internal Revenue——

Senator TAFT. Mr. Stam, can you switch back and forth between filing consolidated returns and not filing them, by paying the penalty, or, once you file them, do you have to go on filing them that way?

Mr. STAM. The general rule is that unless there has been a general change in the law, you are held to your election.

Senator TAFT. Indefinitely?

Mr. STAM. Indefinitely, unless Congress changes the law so substantially that there has been a substantial change. Now, in the last few years where Congress has been changing the law and changing the corporate rate and structure, if we do that, that gives them an election. But if you just kept the same law on for a long period of time, they would be bound by their first election.

Mr. HERRMANN. Senator, it is also my understanding that in the event that you made a new election to file consolidated returns, as against separate returns, the Commissioner can invoke the provisions of sections 45 and 129, which would prevent the shifting of income in order to reduce taxes, and that is also a protection that the Bureau of Internal Revenue would invoke against the change. You would have to get the approval of the Commissioner to do it, and he would review the matter very closely before I believe he would permit it for the purpose of absorbing losses.

Senator WILLIAMS. Is your stock all owned by one parent organization?

Mr. HERRMANN. I am representing a number of organizations here through the national association. Our particular set-up, of Miles Shoes, consists of wholly owned subsidiaries where all of the stock of the subsidiary corporation is held by one corporation; yes, sir.

Senator WILLIAMS. And then you distribute your earnings into the parent organization?

Mr. HERRMANN. When we distribute earnings to the parent organization, which earnings are over and above the normal business requirements of the subsidiary corporations, we shift them through the medium of a dividend, and consequently we pay a tax thereon, on 15 percent of the shift, which under the present rates would come to somewhere around 7½ to 8 percent.

Senator WILLIAMS. How are your salaries for executive officers computed? On the basis of each corporation, whether they make or lose money? Or can you pay it from the ones who make profits?

Mr. HERRMANN. No. That is definitely prescribed by the Commissioner of Internal Revenue, who has reviewed and approved our situation, and all local salaries and expenses that are not incurred directly by the corporations are allocated in accordance with the sales and with the size of the various subsidiaries on a preset formula. We do not have the opportunity to change that in any way from the previous year or the way we elected to do it originally.

Senator TAFT. How do people like A & P and Kroger and those people work? Do they run separate corporations? Not for every store, I presume, but do they run separate corporations for every town?

Mr. HERRMANN. Senator Taft, I do not believe that A & P operate on the basis of separate corporations. I understand that they believe it is a distinct advantage to operate under one set-up, due to the fact that they can shift capital, due to the fact that they will not be saddled with a tax on intercorporate dividends, and in many, many cases, the savings which might be effected would be more than offset if these stores made large individual profits by shifting the funds from one to the other through dividends which were taxed when they were declared to the parent corporation.

Senator WILLIAMS. If we kept this provision in that the House has, could the solution be arrived at by having a more graduated change-over, instead of just roughly leaving the $25,000 and jumping over into a higher bracket, if that could be extended over to $100,000 or $150,000, working up to that point?

Mr. HERRMANN. It is my particular opinion, Senator Williams, that the statute should remain as it is. I think that when I finish this, you will see a number of substantial reasons. I do not think that any graduated basis would be a solution, because the graduated basis undoubtedly would affect the corporations up to a certain point, and then beyond that point you probably would find it uneconomical to open up additional businesses due to the fact that practically all of their profits would be taxed away in the form of normal surtax and excess-profits taxes, because those taxes——

Senator TAFT. Of course, exactly the same principle applies against the expansion of any corporation under these tremendous taxes, not only to retail corporations, but to any corporation. That is the objection to the whole tax structure. I do not know why it is an argument particularly for this.

Mr. HERRMANN. That excess-profits tax will prevent expansion and prevent growth.

Senator TAFT. That is the basis of the whole objection to the excess-profits tax, and all.

Mr. HERRMANN. The smaller merchant will suffer a great deal more, for the simple reason that he will be prevented from expanding at all, whereas a great many of the large companies have reached a point of expansion beyond which they do not aspire any further, perhaps.

Senator TAFT. Hardly that, I hope.

The CHAIRMAN. You have a situation that does arise where just a small family group of not more than five people has to incorporate separately in different States. Now, you might not be familiar with that, but that is true, and that happens to be true within my knowledge down in my section of the country where a passenger bus service is required to take a separate State charter into each State in which it operates.

Mr. HERRMANN. Yes.

The CHAIRMAN. And, actually, I know a gentleman down there in Atlanta who with his family owns the one bus organization, the one bus company, but they have seven, eight, or nine different corporations, because they operate in that many States, and they are required by the law of some of these States to take out a separate charter there.

Now, this is a pretty harsh rule on this sort of organization, is it not? They would have to go out of business if they are limited to one surtax reduction and one excess-profits credit.

Mr. HERRMANN. They might have, if they are saddled with separate State taxes and franchises in various States. It occurs to me that they have to have some tax advantage in order to offset that, some Federal tax advantage.

However, it also occurs to me that if any such company did not have a justifiable business reason for the separate incorporation and for the purpose of getting five individual minimum credits, the Commissioner of Internal Revenue undoubtedly would consolidate their tax returns for the purpose of making them file their taxes as one corporation.

The CHAIRMAN. The House bill says that even where you are consolidated for tax purposes, you are not consolidated for the purpose of taking a loss against a gain in another corporation.

There is some inequity in the thing, and it is a very harsh sort of rule. I do not know whether it is going to get a lot of net revenue or not.

Mr. HERRMANN. I think, sir, that it will not get the revenue that is estimated, and I also think that it is liable, as I am going to indicate further in my brief, to result in a net loss of revenue to the Treasury Department.

The CHAIRMAN. You go ahead and read your statement.

Mr. HERRMANN. Yes, sir.

The CHAIRMAN. I just wondered about it because it seems to me that it leaves out some essentials of equity in those cases where the Government is making these people consolidate, because they could consolidate and file consolidated returns, but they do not do it. And yet they are denied a very valuable privilege at times when one has a loss and the other has a gain, one of these separate organizations.

Mr. HERRMANN. That is right.

Section 45 of the Internal Revenue Code authorizes the Commissioner—

> to distribute, apportion, or allocate gross income, deductions, credits, or allowances, between or among corporations owned or controlled directly or indirectly by the same interests.

Section 129 of the code provides similar language in the case of new incorporations. These are adequate safeguards upon which the Bureau of Internal Revenue can rely, to prevent the creation of related corporations mainly for the purpose of reducing Federal taxes.

Corporations have been operating for many years, relying on the provisions of existing laws which have upheld their corporate structure. They now find themselves confronted with the possibility of having these provisions eliminated.

Stockholders who have invested their money, based on a reasonable continuity of corporate earnings, which will be seriously reduced if section 123 becomes law, are powerless to protect themselves. They will find themselves prejudiced because they have similarly relied on provisions of existing law.

A corporation, singly or as part of a group, if formed for a sound business purpose, should be regarded as a separate entity, treated as such for tax and other purposes and should enjoy all the legal rights heretofore established by our corporate and tax laws.

The effects of the legislation contained in section 123 will be severe and, in some cases, disastrous to related corporations with outstanding

mortgages and loans. Since the contractual amortization of such credit is invariably predicated on dollars remaining after taxes, lending institutions would be confronted with borrowers rendered unable to meet the original terms of such loans. Extensions, foreclosures, and even liquidations might result.

The effect of section 123 is to impose a harsh excess-profits tax, by discarding the minimum credit heretofore granted to related corporations, and setting up an arbitrary minimum. If this is enacted, most related corporations will be compelled to pay an excess-profits tax on substantially all the earnings not heretofore subject to such tax.

As an example, we herewith cite a tax situation of a business consisting of 10 shoe stores, all part of a group of related corporations.

These stores made a net profit before taxes of $15,000 each, and under the 1950 Revenue Act would pay a total Federal tax of $37,500. As a result of the increase in the normal-tax rate in the 1951 Revenue Act—that is, from 25 percent to 30 percent—these corporations would pay a total tax of $45,000, representing an increase of 20 percent, the increase imposed on all similar corporations individually owned and unrelated.

If section 123 is enacted, these same 10 corporations, in addition, would pay a surtax of $33,000, and assuming that each corporation made an average of $10,000 during their base period years, would pay an excess-profits tax of $22,500. The total tax bill of these 10 related corporations would then be $100,500. This is an increase of 168 percent over the tax under the 1950 Revenue Act, and an increase of 123 percent over the tax paid by 10 corporations making the same profit and not part of a related group.

The above computations are based on rates being effective for the full year in all instances.

It should be remembered that corporations constituting a group of related corporations in the retail industry consist of nothing more than a group of small businesses in competition with similar small businesses in their respective communities. They have the same requirements for economic survival, and should be accorded the same tax treatment as the businesses with which they are forced to compete.

The Treasury has estimated additional revenue of $55 million, when section 123 of the proposed tax bill becomes fully effective. This estimate seems to ignore effects of this legislation which may, and we believe will, result in a decrease in revenue rather than the contemplated increase.

As a result of the increased tax burden imposed on related corporations, dividends will be drastically reduced, and will result in a considerable loss of revenue from individual taxpayers, many of whom are in the higher brackets.

Corporations confronted with the necessity of retaining earnings for good business reasons, such as expanding inventories, higher construction costs, and the maintenance of adequate reserves, may reduce dividends considerably in excess of the additional tax they will be compelled to pay as a result of section 123. There will be, in addition, a considerable loss of revenue, because of the fact that many small businesses and many other businesses will be prevented from opening new establishments.

A reappraisal of this situation might lead to the conclusion that section 123 immediately, and especially over a period, will result in lower revenue and close up avenues of additional revenue.

We have concentrated our attention on section 123 because we believe this to be a most inequitable provision and one that should be eliminated in its entirety.

Even if the Treasury Department's estimate of $55 million were to be realized by enacting section 123, we believe that the detrimental effects of section 123 on our economy and on the American way of permitting small business to grow far outweigh this insignificant amount of revenue.

The CHAIRMAN. Are there any questions, gentlemen?

Senator BUTLER. Mr. Chairman, I do not have any questions, but I might say that I have had more protests from Nebraska on this particular provision than any other one phase of the House bill.

One illustration is the publisher of a daily newspaper. He has been publishing it for over 50 years, and sometime back about 40 years ago he divided his business. One corporation publishes the paper and another corporation handles the supplies, or something of that sort. It is two different businesses.

That was done not to avoid any tax payments, it was done for some particular reason at the time; and it has been in operation for 40 years with those two corporations.

Now, under the law he must run it under the one set-up, and the gentleman who wrote me the letter said that it is going to affect their business very disastrously.

Mr. HERRMANN. It undoubtedly will.

The CHAIRMAN. I have had a good many letters about it, but it worried me because it does not seem to me to carry out complete equity even on the Treasury's theory. I have been worried about this other situation. In your small towns, you have many concerns that were established by, say, corporation A. It may be, say, a ladies' ready-to-wear dressmaking establishment in New York. Corporation A opens up a business in a little town—that town does not have one—in which we presume corporation A retains at least 95 percent of the stock of that separate corporation. But they sell a portion of it to a capable young man and his wife, who become the managers of the concern, and they go into business.

Now, that would be a related corporation, would it not, if they opened up in a half-dozen towns?

Mr. HERRMANN. According to the section, it would.

The CHAIRMAN. According to this section?

Mr. HERRMANN. Yes, sir.

The CHAIRMAN. I do not know whether they would be stopping that kind of business or not.

Mr. HERRMANN. I think you will find, Senators, that a great many firms that have resident profit-sharing plans——

The CHAIRMAN. That is what I mean.

Mr. HERRMANN. For managers of the local business will be in a position where there just will be no profits to distribute based on past performance, and I think it will seriously affect a great many local people who are so-called resident managers and resident owners and who have a certain percentage of the profits at stake.

Now, they may not necessarily own any part of the stock, with the result that it might even be a wholly owned subsidiary. But as a result of the tax structure, the wholly owned subsidiary might be able to make a normal amount of profit based on the profit made by every other individual merchant in the community, and there just would not

be any profits to distribute. And a great many chain stores are conducted on that basis.

Senator BUTLER. Have you heard of any movement among firms that would be affected by this proviso to dispose of fixed percent of their stock?

Mr. HERRMANN. I obviously, Senator Butler, have been in contact with a number of people who would be affected. A great many people are worried about it; a great many people are talking of disposing of 6 percent or more of their stock to so-called charitable foundations or to their employees or to any unrelated owners or stockholders that might enable them to comply with the law and still retain their former status.

I did not want to include anything about that in my brief, because I think that any law that creates evasion, any law that makes evasion too easy, is not sound, to begin with, and it puts a premium on the matter of an individual or a corporation that is going to do something for evasion and a penalty on those people that are going to conduct their business legitimately and not find loopholes.

I think that this particular law, honestly speaking, this particular section, if enacted will create all kinds of schemes for evasion based on what I have heard; and, very frankly, it is the kind of thing that creates a terrific incentive for that type of evasion and that type of reorganization.

The CHAIRMAN. We thank you, sir, very much for your appearance.

Mr. HERRMANN. Thank you, sir.

(The membership list of the National Association of Shoe Chain Stores, submitted by Mr. Herrmann, is as follows:)

MEMBERSHIP LIST, NATIONAL ASSOCIATION OF SHOE CHAIN STORES

A. S. Beck Shoe Corp., New York, N. Y.
The Berland Shoe Stores, Inc., St. Louis, Mo.
Block's Shoe Stores, Seattle, Wash.
Books Shoe Stores, Pittsburgh, Pa.
Brasley-Cole Shoe Co., Ltd., Los Angeles, Calif.
Butler's, Inc., Atlanta, Ga.
The Dan Cohen Co., Cincinnati, Ohio.
Cutter-Karcher Shoe Co., St. Louis, Mo.
Dial Shoe Co., Inc., Philadelphia, Pa.
Edison Bros. Stores, Inc., St. Louis, Mo.
Endicott-Johnson Corp., Endicott, N. Y.
Entroth Shoe Co., Toledo, Ohio.
Epko Shoes, Inc., Toledo, Ohio.
Eppenberger Shoe Co., St. Louis, Mo.
The Fashion Bootery, Inc., Seattle, Wash.
Fashion Thimble Shoe Co., St. Louis, Mo.
Robert Feilich Shoe Co., Inc., St. Louis, Mo.
The Felsway Shoe Corp., New York, N. Y.
Gallenkamp's Stores Co., Los Angeles, Calif.
General Retail Corp., Nashville, Tenn.
Karl's Shoe Stores, Ltd., Los Angeles, Calif.
Keystone Shoe Stores, Pittsburgh, Pa.
G. R. Kinney Co., Inc., New York, N. Y.
Kitty Kelly Shoe Corp., New York N. Y.
Krohngold Shoe Co., Cleveland, Ohio.
Lee's Shoe Stores, Inc., St. Louis, Mo.
Maling Bros., Inc., Chicago, Ill.
Melville Shoe Corp., New York, N. Y.
Miles Shoes, Inc., New York, N. Y.
Miller-Jones Co., Columbus, Ohio.
Niles, Inc., Chicago, Ill.
Morse Shoe Stores, Boston, Mass.
Morton's Shoe Stores, New Bedford, Mass.
National Shoe Co., Ltd., Los Angeles, Calif.
National Shoes Inc., New York, N. Y.
The Nobil Shoe Co., Akron, Ohio.
The Louis Ostrov Shoe Co., Akron, Ohio.
Roe Bros. Stores, Inc., Beverly Hills, Calif.
Sears, Roebuck & Co., Chicago, Ill.
Shoe Corp. of America, Columbus, Ohio.
The D. M. Siff Shoe Co., Akron, Ohio.
I. Simon Co., New York, N. Y.
S. & J. Simowitz, Augusta, Ga.
Spencer Shoe Corp., Boston, Mass.
Stanley Shoe Stores, St. Louis, Mo.
Tradehome Shoe Stores, Inc., St. Paul, Minn.
Thrift Shoe Stores, Wilkes-Barre, Pa.
Triangle Shoe Co., Inc., Wilkes-Barre, Pa.
Uncle Sam's Shoes, Inc., Paterson, N. J.
Wilkerson Shoe Co., St. Louis, Mo.

The CHAIRMAN. There is one other witness, I believe, who has not been heard. Is he present?

Mr. GILBERT. My name is Gilbert, sir.

The CHAIRMAN. Yes, come around, Mr. Gilbert. We shall hear you before we go into executive session.

Mr. GILBERT. You mentioned the executive session. If it is not convenient, I can be heard later.

The CHAIRMAN. Your statement is not lengthy, is it?

Mr. GILBERT. No, sir.

The CHAIRMAN. Very well.

STATEMENT OF ROBERT A. GILBERT, COMMITTEE OF INVESTORS OF AMERICA, INC.

Mr. GILBERT. I do not have a brief. The wire I got did not specify one. I brought, if the attendant will distribute these, a picture of what I want to talk about, in summary of the principal point.

The CHAIRMAN. Will you identify yourself, Mr. Gilbert?

Mr. GILBERT. Yes, sir.

My name is Robert A. Gilbert. I appear at these hearings as an individual investor and as secretary to the Committee of Investors of America. I happen to be on the staff of the Investment Trust. The opinions expressed here today, however, are mostly my own and not necessarily those of the trust.

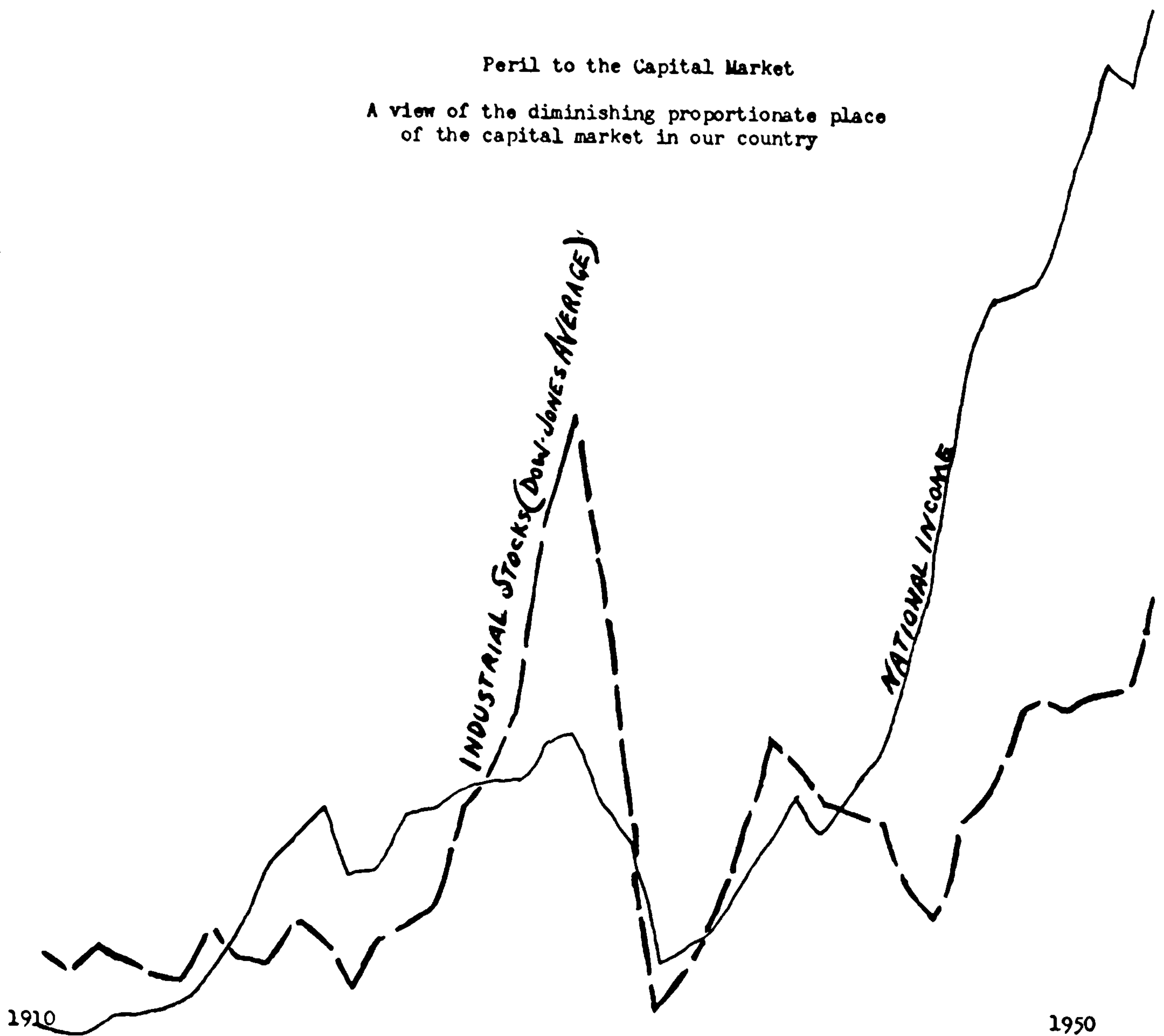
In the limited time at my disposal, I would like to call attention to some strained conditions in the 1952 tax policy.

Under any conditions we should, of course, be interested and undoubtedly are in a fiscal policy which encourages basic economic strength rather than the decay of the foundations of our productive system.

This is particularly so now when the economy, already struggling under a high tax load, must assume added burdens. It seems to me that the tax policy being followed and the incidence of certain specific levies proposed for the new fiscal year bear too heavily on the basic industry of the country. Our tax policy has been more favorable, to put it in perhaps a too spectacular phrase, to the production of champagne rather than freight cars. Yet there is no doubt, however, that strength in freight cars is far more important both to the present military situation and also to the continued growth of the standard of living here.

To give you a picture of the strained condition of the part of the economy about to be saddled with added burdens, let me submit in evidence a chart of the capital market. The market reflects, of course, many things, including the rate of operation of industry, its prospects and the possibilities of being able to finance basic industry, and so on. It is, in other words, a good index of the condition of industry.

(The chart referred to is as follows:)



The capital markets in this country are in much greater peril of extinction than is generally realized. This chart shows that at the end of the war industrial stocks were only 48 percent of a usual ratio to the rest of the economy, and that by 1950 the ratio had advanced to only 52 percent. This rate of gain on the average of only 1 percent per annum is a snail's pace which will require fully 48 years to bring the market to normal and thus insure it against the influences which will destroy it. Obviously the pace is too slow to avert such a disaster. In 1951 the tendency has been for the deteriorating disparity to increase.

The conditions of the utility and railroad capital markets are worse—appallingly so—because the ratios have actually declined instead of showing even a small advance. Utilities have declined proportionately from a postwar figure of 43 percent to about 30 percent, a precipitous drop. After the war the railroads were about 28 percent of probable normal, and in 1950 they were 27 percent.

There can be no capitalism without a capital market. Marx and Lenin are capturing us in economic Trojan horses.

Mr. GILBERT. If you will look at the chart, it shows that from 1910 to 1950, the period covered, a greater part of the time, in fact up to about 1941 or 1942, there was a tendency—not in exact correlation—but there was a tendency for national income and industrial stocks somewhat to go together.

Now, as I have written on the bottom of this statement——

Senator TAFT. Is that the capital value of industrial stocks?

Mr. GILBERT. That is their prices, sir, in Dow Jones industrial average.

Senator MILLIKIN. What was the answer to that question?

Mr. GILBERT. That is the price of industrial stocks.

Senator TAFT. Not the income?

Mr. GILBERT. No, sir. There are many other ways of measuring market, and they all seem to indicate the same trend. But this seems to be one way of bringing out the facts.

I have written a statement there that may seem a bit sweeping, and yet if you look at the market proportionately, as I have headed this, it shows a diminishing proportionate place of the capital market in the country.

Now, as I said at the bottom of the statement, the capital markets in this country are in much greater peril of extinction than is generally realized. This chart shows that at the end of the war industrial stocks were only 48 percent of a usual ratio to the rest of the economy, and that by 1950 the ratio had advanced to only 52 percent. This rate of gain on the average of one 1 percent per annum—and I have not written it down there, but that 1 percent was all accomplished last year. Other years they were more or less flat. And that makes a rate of return to normal in the capital market of 48 years. And against that rate, you have to consider the alternative of the capital market.

Now, obviously the pace is too slow to avert something approaching disaster, and in 1951 the tendency has been for the deteriorating disparity to increase, because the national income has been going up and the market has been rather hesitant for the last few days. I do not know that it is doing today.

The conditions of the utility and railroad and capital markets are worse, appalingly so because the ratios have declined, actually, instead of showing even a small advance. Utilities have declined proportionately from a postwar figure of 43 percent to about 30 percent in 1950, and that is a precipitous drop in terms of percentage. After the war the railroads were about 28 percent of probable normal, and in 1950 they were 27 percent.

I think that one could summarize the situation by saying that if there is no capital market, there is no capitalism. In other words, Marx and Lenin are capturing us in economic Trojan horses.

This is an amazing situation if these figures mean anything, and I do not think that they are 100 percent wrong by any means.

Senator MILLIKIN. You are comparing national income against capital value of stocks, are you not?

Mr. GILBERT. Yes, sir.

Senator MILLIKIN. What is the national capital?

Mr. GILBERT. I beg your pardon.

Senator MILLIKIN. What is the national capital?

Mr. GILBERT. Of all stocks?

Senator MILLIKIN. No. The whole capital, the whole national capital.

Senator TAFT. The value of all property.

Mr. GILBERT. Of all property in the country?

Senator MILLIKIN. Yes.

Mr. GILBERT. I have never seen such a figure. It has been estimated now and again. I think one figure I saw once published a year or so ago was somewhere around $400 billion. But this particular chart is just an index of industrial stocks and their relations to national income. I have other charts here which——

Senator MILLIKIN. I was thinking it might be interesting to have your industrial stocks compared, capitalwise, with your full national capital, whereas here you compare your industrial capital as valued by the stock market against the national income. I am not prepared, of course, to say that it is not a fair basis of comparison, but there would be a closer basis of comparison if you had it compared to the full national capital.

Mr. GILBERT. You mean, it would be more comparable, sir?

Well, it would be, except that those figures are difficult to obtain. The thing that interests me about this chart is that there is a correlation. They are two parts of our economy, not exactly the same parts. There was a correlation, but in recent years we have a disparity instead. There are many ways of measuring what the market is. You can take the yields on securities; you can take the price at which they sell in comparison to their current earnings. You can take the amount of capital invested in industry in every year, and even with our present large plant expansion, the amount of capital invested per capita each year in this country is still now below the previous long-term trend.

Senator TAFT. Your point is that the taxes on corporations and on individuals combined are such as to deprive people of any substantial return from industrial stocks; is that it? Is that the general conclusion that you are trying to put forth?

Mr. GILBERT. Yes.

Senator TAFT. I think that is generally admitted. I agree that it is so.

Mr. GILBERT. Yes; I think the question is also partly, perhaps, if I may say so, the rate at which the deterioration in the capital market is occurring. And this drop in utilities since the war compared to other parts of the economy indicates that that is a rather serious situation.

So far as the railroads are concerned, the editor of Railway Age which is a well-known publication, recently stated that he believed that socialization of the railroads in this country was very, very near. That was something you might expect if you have a stock on the capital market selling at 28 percent of its normal value, and after 4 years of national prosperity, instead of going up, it went down.

Senator MILLIKIN. What is your own theory of the cause?

Mr. GILBERT. Sir, I think that the capital is being confiscated in quite a number of ways. High taxes are among them, high labor costs. The market has taken those factors into account more than the country generally and reflects them in the prices of these securities. But I have some specific examples I was going to give in the course of events and a few other things that I would like to mention, if it will not take up too much time.

The CHAIRMAN. Very well.

Mr. GILBERT. Many of the taxes you are about to adopt will increase the disparity. So it is hoped that some changes will be made to avoid the loss of further capital.

I have covered part of what I was going to say in what I have just said. Of course, the markets are occasionally strong in terms of the prices quoted, but you have to consider the relative price. The value of the dollar is one thing, and also the place of the market compared to what is going on in the rest of the economy.

These charts show that we are hovering closer to socialism than we realize, because we are automatically extinguishing our capital market.

There have been some believers in some quarters that inflation could close the gap, but this is a dangerous fallacy, because it would destroy more capital than it could create. To the extent that we are now seeking the praiseworthy goal of a balanced budget, we are really helping to restore stocks to normal, but we should not balance the budget by taxes confiscatory of the very capital we are about to preserve.

Then, too, taxation that bears too heavily on basic industry will result in hesitation in important parts of the economy, and there will in the course of events be the old temptation of restoring economic activity only temporarily by another dose of inflation.

Neither inflation nor any other unsound policy can close the gap on the chart and thus restore basic economic strength. We are faced with the necessity of doing the right thing.

With reference to the taxes proposed in 1952 and their relation to our basic economic strength, the regulation corporation tax of 52 percent would bear too heavily upon segments of our economy already under great strain. It will bear most burdensomely on the railroads and on the utilities and will retard many industrials.

We have already seen the decided trend toward trouble in the railroad and utility capital markets. These industries are the very vitals of our productive system and they are headed for socialism.

You may ask, then, how could the funds needed this year be raised? The Government originally proposed $3 billion revenue from increased excises. Excises have much to recommend them this year. From a list of a dozen items or so, it was expected to produce $3 billion. It seems very likely that a thorough study of this field would yield enough items to raise almost twice as much. This is not necessarily to endorse the sales tax.

If we could find enough of the so-called sumptuary excises, we could perhaps avoid a sales tax this year and also avoid raising the regular corporation tax to the extent proposed. One advantage of the sumptuary tax is that it is optional with the consumer. Thus thrift could be encouraged to some degree, whereas proposed taxes tend to penalize thrift. Thrift, of course, is one bulwark against inflation.

I had a conference yesterday afternoon with Mr. Ecker-Racz, who I was informed by one of the departments of the Government is the expert in the Treasury Department who prepared the excise-tax increases. I was not going to make this part of my prepared testimony, but in the course of my conversation with him I developed so many points on this question that you might be interested in the supporting facts that were brought out.

Would there be any objection to my mentioning that now?

The CHAIRMAN. Proceed.

Mr. GILBERT. Mr. Ecker-Racz said that you had considered such other sources as soft drinks, candy, and furniture. He contested the chart by saying that the market does not necessarily have to follow national income. He asked whether I really thought the country was getting weaker, and to the latter I replied: "We have shown all the early symptoms of the disease of inflation, which has in its later stages been so disastrous in many foreign nations."

I said, "The test of having a disease come is the lack of ability to revert completely to formerly recognized sound policies. We do not go back. Moral weaknesses follow, and then the disease extends its progress.

"In 1952, we are about to penalize our basic economic strength again, and I think that that is a sign of moral weakness because we lack the courage to do otherwise."

Mr. Ecker-Racz said that the utilities had a good year in 1950. I explained to him that inflation had a double-edged effect on them and thus accounted for the great discounts of these facts from their normal price.

Inflation creates a demand for electricity that is partly paid for in synthetic money; yet it forces utilities to expand their plants at inflated costs. To finance the expansion, they must sell stocks, which requires dividend expansion and loots the earnings for dividend stockholders who find themselves in the position, in effect, of paying for the inflation.

For example, Pacific Gas & Electric stock was selling in 1940 for about 32. The other day it was selling at the same price, and in the interval their gross revenue has increased possibly four times. Their earnings in 1940 were about $2.50. Their earnings now are about $2.50. Their dividend in 1940 was $2, and their dividend now is $2.

It is one of the largest utilities in the country. They have had to do constant financing. They sell 1,000,000 shares of stock quite frequently, and they have been constantly in the courts with rate cases because of their costs and taxes.

Obviously in that case, Pacific Gas & Electric stockholders have paid for the advantage that the consumers in California have gotten.

There are other examples. The New York Central in the month of February lost $10 million, and I think that begins to compare with the statement of the editor of Railway Age who said that socialism for the railroads would be an easy possibility with much further increase in the cost of taxes and with any moderate recession in business.

I had a discussion with Mr. Ecker-Racz about additional excise taxes. He said that the sources could not be found, and he particularly disliked the idea of taxing luxury items of one class of goods without taxing all items. And he said it would not raise much revenue.

Then I pointed out to him that last year there were probably half a million Cadillacs, Lincolns, high-priced Buicks and other large cars made to sell for around $3,000. And of that $1,500,000,000, 10 percent would be $150,000,000. I asked Mr. Ecker-Racz if it would not be at all possible to make a study which would find perhaps 10 or 20 of these additional items which would give you as much as $2 billion or more, and thus take the pressure off the necessity for increasing corporation taxes at this time.

I appreciate the chance to appear here.

The CHAIRMAN. We thank you, sir, for your appearance.

I believe that finishes the witnesses for today. The committee will go into executive session.

(Whereupon, at 3:20 p. m., a recess was taken until 10 a. m., Monday, July 9, 1951, and the committee retired into executive session.)

REVENUE ACT OF 1951

MONDAY, JULY 9, 1951

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

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

Present: Senators George, Connally, Byrd, Hoey, Frear, Millikin, Taft, and Williams.

Also present: Elizabeth B. Springer, chief clerk; Colin F. Stam, chief of staff, Joint Committee on Internal Revenue Taxation.

The CHAIRMAN. The committee will come to order.

Mr. Magill, we will start, please. Other members of the committee should be on hand, and will be in shortly. We regret it is necessary to start before we have full attendance. You may have a seat there, and just identify yourself for the record.

STATEMENT OF ROSWELL MAGILL, CHAIRMAN, COMMITTEE ON FEDERAL TAX POLICY

Mr. MAGILL. My name is Roswell Magill, and my home is Westport, Conn. My business address is New York City.

The CHAIRMAN. You are chairman of the Committee on Federal Tax Policy.

Mr. MAGILL. Yes, sir.

The CHAIRMAN. How long is it since you were with the Treasury, Mr. Magill?

Mr. MAGILL. I served as Under Secretary of the Treasury in 1937 and 1938.

The CHAIRMAN. 1937 and 1938?

Mr. MAGILL. 1937 and 1938; yes, sir.

I appreciate very much your courtesy in permitting me to come here this morning.

I think anyone who appears here before your appears with humility and trepidation, because certainly you gentlemen have far greater responsibility and know a good deal more about the tax system than anyone else.

All of us particularly appreciate your permitting us to come, as indicating your own deep interest in getting all the information you can about tax measures which will work fairly and adequately in such difficult times as we now confront.

I am a member of the law firm of Cravath, Swaine & Moore, 15 Broad Street, New York City. I appear here on invitation as chairman of the Committee on Federal Tax Policy. That committee was

organized in 1944, to prepare and publish reports on Federal fiscal policy. It has published three such reports during the past 6 months: Financing Defense: Can Expenditures Be Reduced?; The Tax Program: Is an Excess Profits Tax the Solution?

The revenue bill before you, H. R. 4473, fails on two main counts to solve the fiscal problems the country currently confronts.

1. Unless proposed expenditures are cut much more deeply than seems likely, the bill will not produce enough money to cover the expected budget deficit for 1952. Worse still, it is implicit in Secretary Snider's statement to your committee that he will have to ask for still another tax bill in 1952, since still greater expenditures are expected for 1953, and all our taxes, present and proposed, will by no means pay that bill.

2. H. R. 4473 is designed to raise the money in the wrong ways. It will damage the economy and diminish individual and corporate incentives to work harder and produce more, at a time when we badly need all the production we can get. The bill will not retard inflation, as a properly drawn tax bill could do. On the other hand, H. R. 4473 is likely to promote inflation, since the severe increases in individual and corporate rates will discourage new investment and additional production; and at the same time will cause higher prices to the consumer, since a good part of the increased corporate taxes will have to be passed on. To the extent that corporations are unable to finance their expanded production programs out of retained earnings, they will have to resort to borrowing and to selling their holdings of Government securities. Both of these are inflationary.

The ends and aims of the Treasury and the Ways and Means Committee are, no doubt, about the same as ours. (1) We all agree that the Federal budget must be balanced in these times of extraordinarily high national production and individual incomes. If we can't pay as we go now, when can we ever hope to pay as we go? Again, we all know that borrowing to pay current governmental expenses inevitably brings about inflation and thus severe increases in prices, in the cost of defense, and in the cost of living. We know it does, for we have just seen it happen; and all of us who must live on more or less fixed incomes are feeling a pinch that becomes more severe day after day. (2) We all agree that we must have maximum production, for we are trying to take care of a $50 billion a year military program on top of a civilian consumption that is running at a very high figure. Here again there is grave danger of continuing increases in the cost of living, if civilian production should fall off, while money in hand for spending is available in greater volume.

Now how can a fiscal program achieve these two major aims that we agree on? If the Treasury is not to borrow money to pay the current costs of Government, there are only two ways to meet an excess of anticipated expenditures over receipts: to reduce the expenditures or to increase taxes. The President's January budget forecast $16.5 billion more of expenditures than estimated receipts. No one in the administration has ever told Congress how $16.5 billion additional taxes could be raised, on top of taxes already nearly at the peak of World War II. The reasons why no $16.5 billion program was ever presented may be either that the first drafts of that program showed that it was too drastic to be possible of adoption; or that the Secretary of the Treasury realized, even in January, that his experts had greatly overestimated expenditures and underestimated receipts.

The Treasury's latest estimates are that expenditures will be some $3 billion less than estimated in January ($68.4 billion); and that revenue will be some $3.5 billion more ($58.5 billion). The gap between expenditures and receipts is thus $10 billion; and Secretary Snyder has recommended a tax program to produce that much additional revenue. H. R. 4473, however, falls far short of bridging the gap between receipts and expenditures in 1952.

In any event, the better of the only two possible ways to balance, without more borrowing, a budget of the enormous size the President proposed is certainly to reduce expenditures to the essentials, particularly civilian expenditures. Only a few years ago, after World War II, fiscal experts thought they were being generous enough in forecasting budgets of $18 billion or $20 billion. True enough, the dollar has lost much of its value since then, and we are engaged in a half war and preparing to avert a full-scale war; but even so, a $70 billion Federal budget is at least $10 billion beyond the essentials, as Senator Byrd and other fiscal students have shown in detail. The present Congress has exhibited a real interest in economy; important cuts in unnecessary expenditures have been made; and we all hope for more.

Senator WILLIAMS. Mr. Magill, has your committee broken down and made any recommendations as to where such cuts should be made?

Mr. MAGILL. We have; yes, sir. One of these reports that I have here is on that subject, and I would like, if I may, Mr. Chairman, to put both of these documents in the record for such use as you may wish to make of them.

The CHAIRMAN. Yes, sir; you may do so, Mr. Magill.

Mr. MAGILL. Thank you, sir.

(The documents referred to follow:)

FINANCING DEFENSE: THE TAX PROGRAM

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ABOUT THE COMMITTEE ON FEDERAL TAX POLICY

The Committee on Postwar Tax Policy was organized in 1944. Its reports, entitled "A Tax Program for a Solvent America," were published in September 1945 and in February 1947.

By July 1950, nearly 5 years had elapsed since the close of the war, without any substantial overhaul of the Nation's tax structure. This led to a decision on the part of the committee to prepare a new report, outlining expenditure policies and suggesting revenue proposals which would be appropriate to the current needs of the Federal Government. The first part of this report, under the title "Financing Defense: Is an Excess Profits Tax the Solution?" was issued in December 1950. The second part, entitled "Financing Defense: Can Expenditures Be Reduced," was published in March 1951. This monograph is the third and final installment of the report.

Although the name of the committee has now been changed to Committee on Federal Tax Policy, its membership remains unchanged since 1947. As in the case of the earlier reports, Alfred Parker is secretary of the committee. This publication represents the cooperative effort and responsibility of each member of the committee and its secretary.

SUMMARY

1. For the third time in a generation the Nation has been forced to assume the burden of a huge military program. The dangers of deficit financing were impressively demonstrated during and after the First and Second World Wars. This time the cost of the defense program should be paid for currently by tax levies.

However, paying-as-we-go does not mean taxing ourselves to pay for unneeded and dispensable Government services and activities. The first step should be to reduce all Federal spending for nonmilitary services to the minimum of essential operation, and to scrutinize carefully even the plans and proposals for military spending.

2. Government expenditures today are so tremendous that it is no longer possible to single out any group of citizens or of corporations and expect it to bear all the costs. The burden must be distributed over the broadest possible base. At the same time, we must avoid levying additional taxes in ways that will unnecessarily intensify the adverse effects that taxation has on incentives to produce.

3. The great bulk of the Federal revenue comes from three sources: (*a*) the individual income tax, (*b*) the corporation income tax, and (*c*) the consumption excises or sales taxes.

(a) The only two practicable procedures for increasing the revenue from the individual income tax are (1) to increase the rates, and (2) to lower the exemptions. We believe that exemptions should not be lowered. Additional revenue should be obtained by a rate increase of general application. There is no longer any large amount of revenue to be obtained by tax rate increases applied only to the middle and upper income brackets.

(b) The problem with the corporation income tax is one of reconciling two goals: (1) to get increased revenue, and (2) to avoid impairment of the capacity and incentive to achieve maximum production. Corporation tax liabilities are already more than 50 percent of estimated corporate income. Increases would be likely to strike the smaller and less well-established corporations with greater force than the larger companies. We do not favor an increase in the corporate income tax rate (unless the excess profits tax is repealed), except as a last resort.

(c) We believe that excises should normally provide at least 25 percent of the national revenue. Their special advantages are: (1) their revenue yield is stable; (2) they help equalize the reduced supply of civilian goods and the undiminished volume of personal income which will prevail during the period of the heavy defense program; (3) they reach a broad base of personal income which is not subject to the income tax. By broadening the base of the whole Federal tax system through a greater reliance on excises, we can avoid the imposition of severely penalizing rates at any one point in the tax structure.

The present system of selective Federal excises is illogical, inequitable, and discriminatory. It should be replaced by a uniform excise tax across the board, and, in our judgment, the weight of the evidence favors a tax at the manufacturers' level.

4. In presenting some alternative methods of providing whatever additional revenue is required to balance the budget, we find that at the budget levels now proposed there is only a narrow restriction of choice.

(*a*) If the budget for 1952 is reduced by $10 billion, so that the revenue requirement will be $61.6 billion, a uniform manufacturers' excise at a rate of 7.5 percent (part of which will serve to replace all existing excise revenues other than liquor and tobacco) together with existing income taxes, will yield the necessary total. An increase of 3 percentage points in the individual income tax would reduce the needed excise rate to 5 percent.

(*b*) If only $5 billion is cut from the budget, and the total revenue requirement will be $66.6 billion, it is clear that the necessary taxes will weigh heavily on all the people. An increase in the individual income tax by 3 percentage points will not alone provide enough money. The Treasury would still need a manufacturers' excise tax at a 10 percent rate. If the individual income tax is increased by 3 percentage points, and the corporate normal and surtax rate is raised to 50 percent, a uniform excise must still be levied at the rate of 8½ percent.

(*c*) Finally, if no budget cuts are made for 1952, and the total revenue requirement is $71.6 billion, the choices are severely limited. A 3 percentage point increase in the individual income tax, an increase in the corporate normal and surtax rate to 53 percent (6 percent above the present rate, in addition to the excess profits tax), would still leave a revenue gap of $7.5 billion. A manufac-

turers' excise tax at 12 percent would be needed to close this gap and replace the revenue from present excises.

A less palatable alternative would be: a 4 percentage point increase in the individual income tax; a reduction of the individual exemptions from $600 to $500; an increase in the corporate normal and surtax rate to 55 percent; and a manufacturers' excise of 8 percent.

5. Even if the expenditures for 1952 are reduced by $10 billion, we should proceed without delay to set up the machinery for a broadly based Federal tax system. We cannot afford the fatal delay that might result from an overly optimistic view of current surpluses.

The rates of tax with which we are dealing here are drastically heavier than any that have ever been proposed in this country. Yet these burdens are preferable to deficit financing and inflation. The first basic requirement is that the Federal Government show that its expenditures are being managed with the same competence and prudence that we require of ourselves in our everyday affairs.

Financing Defense: The Tax Program

I. Introduction

EXPENDITURES MUST BE REDUCED

For the third time in a generation, the Nation has been forced to assume the burden of a huge military program. The evils and dangers of borrowing a substantial part of the cost were so impressively demonstrated during and after the First and Second World Wars as to require the conclusion that this time we must pay as we go. Paying as we go, however, does not require us to tax ourselves to pay for unneeded and dispensable Government services and activities. The first step, therefore, is to reduce all Federal spending for civilian or nonmilitary services to the minimum of essential operation, and to scrutinize carefully even the plans and proposals for military spending. Every dollar of unnecessary spending is so much excess baggage and, in the long-distance race upon which we have entered for the preservation of a free world, it will be the utmost folly to carry anything that will handicap us.

The budget for the fiscal year 1952 called for total expenditures of $71.6 billion. This total was immediately attacked as excessive by Members of Congress and many private groups. These attacks developed evidence from the budget itself to show numerous examples of unnecessary, even wasteful, spending. In our own report entitled "Financing Defense," issued March 5, 1951, we showed that the budget total could be cut at least $10 billion. Specifically, we made the following recommendations with respect to nonmilitary or civilian expenditures:

(*a*) Prompt withdrawal of the Federal Government from the lending field.

(*b*) A deep cut in the public works program and a suspension of all projects not contributing directly to some essential defense purpose.

(*c*) Drastic curtailment of Federal aid, grants, and subsidy and special services programs.

In recognition of the fact that much of this spending stems from a mass of previously enacted statutory authorizations, we recommended that the Congress, by an appropriate act or resolution, should suspend the operation of every law now in force requiring expenditures or appropriations, and start with a clean slate. In preparing this legislation the aid and counsel of the Budget Bureau should be utilized. At the same time, our recommendation provided, the Budget Bureau should be required to prepare a new budget for a total expenditure $10 billion less than the original total of $71.6 billion.

The current condition of the Federal finances is likely to obscure the necessity of the kind of drastic action that should be taken, with respect both to expenditure reduction and to tax revision. For some months receipts have exceeded expenditures, and the Secretary of the Treasury has recently announced (April 2, 1951) that for the fiscal year ending June 30, 1951, a surplus of some $3 billion is now anticipated, as against a deficit of $2.7 billion, forecast a few months earlier in the budget message. This reversal has been produced by a combination of a lower rate of actual spending and higher tax receipts than were projected in the budget estimates.

This situation is obviously only temporary. The lower rate of spending merely reflects the lag between the issuance of Government orders for military goods and the delivery of these goods. Secretary of the Treasury Snyder said, in the statement referred to, that much of the conversion and production cost was being met for the present out of the financial resources of business, which has made unnecessary prospective Government financing.

TAXES MUST BE INCREASED

But the bills are piling up, and all of them will presently be due and payable. The flood of orders and contracts, which has been running at from $3 billion to $5 billion a month, will lead to a parallel flood of payments as the deliveries are made. We dare not let this temporary budget surplus create the inference that the spending need not be cut wherever possible, or that preparation need not yet be made for a substantial increase in taxation. Unfortunately, Mr. Snyder's statement contributed to a sense of false security, for he indicated that action on tax increases beyond the $10 billion first requested could be postponed, even while he was warning that the spending was certain to increase greatly, not only in the fiscal year 1952, but also in the fiscal year 1953.

THE ALTERNATIVE TO PAY-AS-YOU-GO IS INFLATION

The cost of the defense program should be paid for currently by tax levies. The alternative to paying as we go is deficit financing. In view of the present size of the debt and the great difficulties that would be encountered in making a marked increase in the interest rate pattern that has been established for this debt, any new borrowing on a large scale would probably involve a further inflation of bank credit. Additional expansion of bank credit on the basis of Government loans would lead to a further inflation of prices, resulting in a heavier, more inequitably distributed burden than taxation. It would cause, moreover, a lasting depreciation of the currency and a permanent impairment of values expressed in terms of the dollar.

This means, for example, that, as measured in purchasing power for food, shelter, and other necessities, there would be another cut in the United States savings bonds when they come due, in pensions now in force or to be paid as retirement is reached, and in insurance policies.

Inflationary policies during the past 10 years have caused a loss of nearly 43 percent of the value of the dollar. The further erosion of value that would occur if a repetition of such financing methods were permitted would be disastrous here, as severe inflation and its resulting currency depreciation have always been everywhere.

There is still time to avert deficit financing. If unnecessary expenditures were eliminated, the load of taxation that must be imposed would thereby be diminished. Appropriate tax measures, promptly introduced, would produce adequate revenue by the time the large bills for the military program have to be paid. The purpose of this report is to indicate the steps that should be taken to provide whatever additional revenue may be required to balance the budget and keep us on a pay-as-we-go basis.

A BROAD TAX BASE IS REQUIRED

While there are many and varied forms of taxation, the fact is that all taxes are borne by the people. Another way of saying this is that all taxes come eventually out of income. The different kinds of taxes are merely different ways of determining where, when, and how much various citizens are to pay. Some taxes are based on the value of property; others on the amount of income received; others on the quantity of certain articles consumed, such as cigarettes, gasoline, liquor or cosmetics. Still others are levied on the net income or the gross receipts of business. Whatever their form or the manner of their imposition, it is still true that all taxes fall ultimately on the income of the people.

This basic fact requires particular emphasis at a time when the Government's need for revenue is as great as it now is. When the Federal budget was so small as to involve only a very moderate proportion of our total income, and there were no dangers ahead, it was possible to grant broad exemptions and reliefs, with a concentration of the cost of government upon limited groups or income classes. This is not possible today. The tremendous costs of government can be paid only by all citizens, for no single group can bear all the costs. Just as men from all income groups must serve in the Army, the tax levy must fall upon all incomes, not merely incomes above a certain amount.

THE DISTRIBUTION OF THE TAX LOAD

Since all taxes are borne by the people because they come out of income, it is proper to consider how the tax burden may be distributed so as to cause the least injury to our economy.

First, there will be least injury when the tax load is distributed over the broadest possible base. There is no single form of taxation, not even the tax on

net income, that is capable of producing all of the revenue that will be required without the levy of tax rates that would be seriously damaging to the economy. We must give up the notion that somewhere there is a tax that will be paid only by others and that will produce enough revenue to pay all of the bills. There is no such tax. Everybody must pay a share of war costs, whatever his income may be. This time it is not a question of some working in the sun while others sit in the shade.

Second, we must avoid, to whatever degree possible, the levy of additional taxes in a manner or to an extent that will intensify the adverse effect that taxation has on the incentives to produce. It is never wise to increase taxation to the point at which too many people work only part time and with halfhearted energy or stop working altogether.

THE FORMS OF FEDERAL TAXATION

Although the Federal Government has considerable latitude in the exercise of its taxing powers, the great bulk of its revenue is derived from three major taxes. These are (1) the individual income tax; (2) the corporation income tax; and (3) the consumption excises or sales taxes. The tax receipts from all sources in 1950, and as estimated for 1951 and 1952, will indicate the relative importance of these major sources. The data are given in table I.

TABLE I.—*Federal budget receipts, fiscal years 1950–52*

[Millions]

Source	1950 actual	Original budget estimates		1952 revised estimate
		1951	1952	
Individual income tax	$17,408	$21,599	$26,025	$27,528
Corporation income and excess profits taxes	10,854	13,560	20,000	21,500
Excise taxes	7,597	8,240	8,222	8,380
Other taxes [1] and miscellaneous receipts	3,345	3,448	3,594	3,785
Total receipts	39,204	46,847	57,841	61,193
Less refunds	2,160	2,336	2,703	2,703
Net budget receipts	37,045	44,512	55,138	58,490

[1] Includes estate and gift tax, net employment tax, and the customs.

Source: The Budget of the United States Government for the Fiscal Year 1952, Special Analysis C; Treasury Estimates of Apr. 2, 1951.

This table shows that the sources of Federal revenue other than the three major taxes provide only a small part of the total. For the fiscal year 1952 they are estimated to yield only 6.5 percent of budget receipts. Minor additions to the revenue might be secured by changes in these lesser taxes, but the chief reliance for the large revenue requirements must be upon the three major Federal taxes.

Unless proposed expenditures are cut much more drastically than now seems likely, each of our major taxes will have to be increased materially. The real choices lie in (1) the relative amounts to be secured from each, and (2) in the form of excise tax to be employed. Shall Congress seek to derive most of the additional revenue from the individual income tax; or shall it distribute the new load over both the individual income tax and the excises? Shall the corporate income tax be increased to the point where the Government takes more corporate profits than the corporation and its shareholders may retain for themselves? Shall the excise tax increases take the form of very heavy special levies on the sales of commodities in common use: Cigarettes, gasoline, automobiles, for example; or of a tax levied at a lower rate on nearly all sales?

These are the hard questions Congress must answer in the Revenue Act of 1951.

II. THE INDIVIDUAL INCOME TAX

INTRODUCTION

First among the great Federal taxes in point of yield is that imposed on the incomes of individuals, estates, and trusts. We have already examined the principal features of this tax in two previous reports.[1] The law imposing it has

[1] Committee on Postwar Tax Policy, A Tax Program for a Solvent America, 1945, and Supplement, 1947

been in operation since 1913, and over this period the law has been the subject of sufficiently serious concern on the part of the Congress, the Treasury, and the taxpayers to have produced significant improvements and corrections of evident defects. Notable among these improvements in recent years have been the current payment of tax as income is received; the withholding of tax on wages and salaries, a necessary step as the tax base was broadened through the reduction of personal exemptions and dependency credits; and the division of income between husband and wife.

The permission to split income between husband and wife, which was granted by the Revenue Act of 1948, has been attacked as a boon to taxpayers in the middle and upper brackets, and efforts are being made to have Congress reconsider its action. In our opinion a reversion to the system as it existed prior to the 1948 amendment would be very unfortunate. It will be recalled that under the old law citizens in community-property States were enabled to split their income with their spouses, whereas citizens in common-law States were not. During the period immediately preceding the 1948 amendment, many of the State legislatures in common-law States had either changed their property laws to accord with the community concept or were embarked on such a course. In other words, States were being forced to attempt to secure, through individual State action, the uniformity which was more efficiently provided by the Revenue Act of 1948. In addition, the 1948 amendment removed the inequity between taxpayers having earned and unearned incomes. Taxpayers with unearned incomes, by making gifts of capital, could split income between the spouses. Under the decision in *Lucas* v. *Earl*[2] a husband was not permitted by contract to split his earned income with his wife. The 1948 act, therefore, granted equitable relief for earned income. The result has been salutary and should not be disturbed.

LIMITED OPPORTUNITY FOR INCREASE FROM MIDDLE AND UPPER BRACKETS

The nature and source of the additional revenue potential in the tax on individual incomes are not fully understood. Some believe, for example, that a large amount of revenue can be obtained by substantial tax rate increases on the middle and upper income brackets.

This view is erroneous. The amount of taxable income in the middle and higher brackets, from which additional revenue could be squeezed, is shown in table II, on the basis of Treasury estimates of the distribution of incomes in taxable returns.

This table is arranged to show the distribution of total taxable income (surtax net income) by taxable income brackets. For example, each taxable income of $4,000 would have $2,000 in the first bracket, 0 to $2,000, and $2,000 in the next bracket, $2,000 to $4,000; a taxable income of $10,000 is distributed through the first five brackets, with $2,000 in each. The figures in column (2) show for each income bracket that portion of the aggregate income of all taxpayers that falls within that bracket. The normal and surtax column (4) shows the amount of tax estimated to be paid, at the respective tax bracket rates, on the aggregate of the incomes in each bracket. Column (5) shows the amount of income remaining in each bracket after the taxes at existing rates. The final column (6) shows the amount of additional tax that could be secured at any point by complete confiscation of all taxable income above that point remaining after present taxes.

The sum of the remaining income after present tax, for example, in the income tax brackets from $50,000 up, is $215.1 million. That is the limit to additional revenue which could be secured by a tax rate of 100 percent applicable at $50,000 and above. If the 100 percent rate were to begin at the $26,000 surtax net income level, the total additional revenue would be limited to $766.6 million. If everything were taken in tax from the $10,000 surtax net income level to the top, the limit would be $3.5 billion. If the 100 percent rate were applied from the level of $6,000 of surtax net income the limit would be some $6.5 billion.

These additions to the revenue would represent the final state of the income tax. All incentive to get income beyond the point at which 100 percent of it is taken in taxes is bound to disappear. A sheep can be sheared every year but it can be skinned only once.

Table II abundantly demonstrates that the additional taxes must come from persons of moderate or small income for that is where the bulk of the income is after present taxes. The upper middle and upper brackets no longer have the income to pay.

[2] 281 U. S. 111 (1930).

TABLE II.—*Estimated distribution of taxable income, tax yield, and additional yield derivable from confiscation of all taxable income above each bracket level, Revenue Act of 1950, calendar year 1951*

Surtax net income bracket	Surtax net income (millions)	Rate schedule (percent)	Normal and surtax (millions)	Surtax net income after tax (millions)	Additional revenue derivable from confiscation of all taxable income over levels indicated by lower limit of bracket (millions)
(1)	(2)	(3)	(4)	(5)	(6)
Under $2,000	$62, 698. 9	20	$12, 539. 8	$50, 159. 1	$68, 047. 1
$2,000 to $4,000	10, 471. 5	22	2, 303. 7	8, 167. 8	17, 888. 2
$4,000 to $6,000	4, 335. 5	26	1, 127. 2	3, 208. 3	9, 720. 4
$6,000 to $8,000	2, 668. 0	30	800. 4	1, 867. 6	6, 512. 1
$8,000 to $10,000	1, 779. 9	34	605. 2	1, 174. 7	4, 644. 5
$10,000 to $12.000	1, 273. 5	38	483. 9	789. 6	3, 469. 8
$12,000 to $14,000	966. 5	43	415. 6	550. 9	2, 680. 2
$14,000 to $16,000	755. 8	47	355. 2	400. 6	2, 129. 3
$16,000 to $18,000	609. 6	50	304. 8	304. 8	1, 728. 7
$18,000 to $20,000	488. 4	53	258. 8	229. 6	1, 423. 9
$20,000 to $22,000	396. 6	56	222. 1	174. 5	1, 194. 3
$22,000 to $26,000	617. 7	59	364. 5	253. 2	1, 019. 8
$26,000 to $32,000	633. 5	62	392. 8	240. 7	766. 6
$32,000 to $38,000	425. 9	65	276. 9	149. 0	525. 9
$38,000 to $44,000	302. 9	69	209. 0	93. 9	376. 9
$44,000 to $50,000	242. 5	72	174. 6	67. 9	283. 0
$50,000 to $60,000	266. 8	75	200. 1	66. 7	215. 1
$60,000 to $70,000	181. 3	78	141. 4	39. 9	148. 4
$70,000 to $80,000	129. 0	81	104. 5	24. 5	108. 5
$80,000 to $90,000	95. 2	84	79. 9	15. 3	84. 0
$90,000 to $100,000	80. 2	87	69. 7	10. 5	68. 7
$100,000 to $150,000	200. 0	89	178. 0	22. 0	58. 2
$150,000 to $200,000	96. 2	90	86. 6	9. 6	36. 2
Over $200,000	295. 0	91	268. 4	26. 6	26. 6
Total	90, 010. 1		21, 963. 0	68, 047. 1	

Source: Columns 2 and 4, Statement of Secretary Snyder Before the Committee on Ways and Means of the House of Representatives, Feb. 5, 1951, Table 13. Columns 5 and 6 derived respectively by subtraction and cumulation.

RAISING THE RATES

The only two practicable procedures for increasing the revenue from the individual income tax are (1) to increase the rates and (2) to lower the exemptions.

The Treasury has recommended an addition of 4 percentage points to each bracket rate in the present scale. The present scale starts at 20 percent on the first $2,000 and rises to 91 percent on taxable income above $200,000. Under the Treasury recommendation, the first rate would be 24 percent, and the top rate would be 95 percent.

While it might appear that the method of tax increase proposed by Secretary of the Treasury Snyder is no more than an advance of the basic or truly proportional part of the tax-rate scale, it intensifies the impact of the tax on the upper income brackets, as the following table shows.

The final column of this table shows the progressive inroad on remaining income that is made by a 4 percentage point increase throughout the rate scale.

TABLE III.—*Relationship between additional tax under Treasury proposal and income after present tax*

Taxable income	Tax at present rates	Income after tax	Additional tax from 4 percentage-point increase	Additional tax as percent of income after present tax law
$2,000	$400	$1, 600	$80	5. 00
$5,000	1, 100	3, 900	200	5. 13
$10,000	2, 640	7, 360	400	5. 43
$25,000	10, 150	14, 850	1, 000	6. 73
$50,000	26, 820	23, 180	2, 000	8. 63
$100,000	67, 320	32, 680	4, 000	12. 24
$200,000	156, 820	43, 180	8, 000	18. 53

REDUCING THE EXEMPTIONS

The second way of securing a larger return from the individual income tax is to reduce the exemptions. These were raised by the act of 1948 to $600 from the World War II level of $500. A double exemption was authorized for taxpayers and spouses over age 65 and for the blind, whether taxpayer or spouse, regardless of age.

A reduction of the exemption to $500 would bring several millions into the fold of income-tax payers, and add several billions to taxable income. The only official estimate available as a clue to these additions is that presented by the Senate Finance Committee in its report on the 1948 tax bill. At that time the data related to the decline in number of taxpayers and loss of revenue from the proposed increase from $500 to $600. At the personal income level of $208 billion then assumed, it was estimated that some 7,000,000 persons would be relieved of tax and that the revenue loss would be about $2 billion. A reversal of the process would probably add some 7,000,000 to 8,000,000 new taxpayers, and at present income levels might be expected to increase the revenue by some $2.5 billion. This revenue gain is to be compared with the $3.6 billion that would be realized from the 4 percentage point increase recommended by the Treasury.

A reduction of the exemption, in our judgment, is one of the less desirable methods of getting more revenue. In view of the price change that has occurred since World War II, the present exemption of $600 has a smaller purchasing power than $500 had in 1945. We recognize that the amount of personal exemption or dependency credit allowed is never determined solely, or even primarily, by reference to prices and cost of living. Nevertheless, the price inflation of recent years is a factor to be considered in this connection.

A further reason for keeping the exemptions at the present level is that through the uniform excise tax discussed later there would be some Federal tax contribution from everybody. In view of this prospect it is the more desirable to avoid a further increase of income tax through the method of a lowered exemption.

CAPITAL GAINS

In previous reports we recommended that no change be made in the rate of tax or the holding period for the determination of long-term gains. Secretary of the Treasury Snyder has recommended an increase of the tax rate on capital gains from 25 to 37.5 percent, and an extension of the holding period from 6 months to 1 year. He has estimated that these changes would increase the capital-gains tax paid by corporations by $110 million, and that paid by individuals by $330 million.

These estimates, if realized, would be a significant addition to the revenue. It should be pointed out, however, that the realization of capital gain is under the control of the taxpayer, and hence that the timing of the tax payment thereon is likewise under his control. These considerations suggest the probability that the higher rate and lengthened holding period might very well result in less, rather than more, tax revenue from long-term capital gains.

At the same time we recognize that the tax advantage resulting from the conversion of ordinary income into a capital gain is a matter that should be strictly controlled. The solution does not lie in a further increase of the tax rate on capital gains, for this would be an injury to the many who realize entirely legitimate gains. It is to be found, rather, in a more careful legislative definition of the concept, and in more effective administration of the law as it stands.

CONCLUSION

Some additional revenue doubtless will have to be obtained from the individual income tax, unless expenditures can be very greatly reduced. Little additional revenue can be obtained from "closing loopholes," for that job has been done pretty thoroughly in previous years. The revenue called for now can be obtained only by an increase of general application. For that purpose, the method proposed by Secretary Snyder is wiser than a reduction in exemptions. Accordingly we recommend that it be used to the extent required.

III. The Corporation Income Tax

INTRODUCTION

A Federal tax measured by corporation income, imposed in 1909, was upheld by the Supreme Court as a valid excise tax, even in the absence of any direct grant of power to Congress to levy an income tax. When the sixteenth amendment was

adopted in 1913, an income tax was imposed directly on corporate incomes, as it was on individual incomes. Individuals receiving corporate dividends were subjected to surtax thereon, but not to the normal tax. In other words, the theory was that the corporation had already paid the normal tax on behalf of the shareholders.

During the twenties, the corporate normal tax rate was somewhat higher than the individual (10 to 13.5 percent as compared with 2 to 8 percent); and the disparity increased in the thirties. The full exemption of dividends from normal tax persisted, however; and recognition was thus given in part, though not in full, to the proposition that the tax on the corporation amounted to a tax on the shareholders.

In 1936, as a part of the undistributed profits tax legislation, the credit to individuals on account of corporate dividends received was entirely eliminated. The credit has not since been restored, though the undistributed profits tax has been repealed; and there has been continuous agitation for the restoration of the credit. Thus the corporate tax has, in effect, been returned to its status as an excise tax levied for the privilege of doing business in the corporate form.

INCIDENCE

Determining the effect of the tax on corporation incomes presents a problem that is far from simple. A tax on the pure profits of business corporations would, of course, be borne only by those corporations that made profits. It could not affect the corporations that just broke even or suffered losses. As to its immediate effect, such a tax cannot be shifted.

But this is only the immediate effect. Other changes take place after the tax is enacted and its effects are taken into account by businessmen. The first effect of the tax is to reduce the general level of profits after tax to which investment and business have become accustomed; in other words, to reduce the opportunity to make industrial profits. But it is the chance of profit that invites investment of capital and induces businessmen to undertake the task of planning and guiding industrial enterprise and assuming its risks. A tax on profits reduces this incentive. It tends to diminish industrial investment and industrial enterprise. The supply of products is accordingly reduced, and their prices tend to rise. There is thus brought about a new equilibrium, in which the tax has been shifted, in part at least, to the consumers of the products of industry. This can result very promptly.

This is the general principle. Its operation in the case of the United States corporation income tax is somewhat modified by the fact that taxable income, as legally defined, is not precisely the same as pure profits.

How promptly or completely the given corporation can pass its tax burden on to the consumers depends in part upon competitive conditions and in part upon the strength of the demand for the particular corporation's product.

If a given tax system should remain in force for a considerable time, without serious changes in rates or other features, there would tend to be established an equilibrium in which the greater part of the tax would be reflected in prices and so passed on by the taxed corporations to the consumers. However, in a dynamic economy, in which there are frequent and substantial changes both in the tax and in general business conditions, there will be a lag in the approach to equilibrium, and some considerable part of the tax will remain as a burden on the taxpaying corporations.

If the corporation tax is, in large degree, transmitted as a cost to consumers, this tax becomes an indirect excise or sales tax, in effect not unlike a heavy manufacturers' sales tax. But viewed as such a tax, it is subject to serious disadvantages. It is not likely to be passed on uniformly by all corporations. Much will depend on the competitive situation in different industries.

Moreover, since the degree of ability to pass the tax on is not uniform throughout the economy, the plight of the little corporation is obvious in those cases in which the tax cannot be passed to the consumer. In such cases, increases in the corporate tax reduce its retained earnings or its dividend distributions. Thus the tax increases bear hardest upon those corporations that most need earnings after taxes in order to finance needed development and expansion.

We have recommended in our previous report [3] that the tax on corporations be properly integrated with the individual tax structure. This recommendation, we believe, should be followed at the earliest opportune moment when conditions permit.

[3] Committee on Postwar Tax Policy, A Tax Program for a Solvent America—1947 Supplement.

AVAILABLE MARGIN FOR ADDITIONAL REVENUE

The principal problem before the Congress and the Nation, in approaching the issue of a greater revenue from the corporation income tax, is that of reconciling the two goals or objectives mentioned earlier, namely, how to get increased revenue and at the same time avoid, in the greatest degree possible, impairment of the capacity and incentive to achieve the maximum production at the lowest cost.

(1) *The record of net income, 1946–50.*—The first step in seeking an answer to the question of whether tax revenue can be collected from corporations without impairing productive capacity and growth is to see what the margin is from which additional taxes can be paid. This can be shown only in the over-all; particular individual companies will usually not conform to the general pattern.

The following tables gives the record of net income and its disposition for all private corporations through the years 1946–50.

TABLE IV.—*Corporate profits before and after taxes, all private companies*

[Billions]

Calendar year	Corporation profits	Tax liability [1]	Profits after taxes	Disposition of profits after taxes	
				Dividends	Retained
1946	$23.5	$9.6	$13.9	$5.8	$8.1
1947	30.5	11.9	18.5	6.6	12.0
1948	33.9	13.0	20.9	7.5	13.4
1949	27.6	10.6	17.0	7.8	9.2
1950 [2]	40.2	18.3	21.9	8.9	13.0
Total	155.7	63.4	92.3	36.6	55.7
Percent	100	41	59	23	36

[1] Includes Federal and State income and excess profits taxes.
[2] Estimated.

Source: The Council of Economic Advisers, The Annual Economic Review, January 1951.

(2) *Actual disposition of corporate profits.*—The dollar increase in total profits does not, of itself, provide a satisfactory or adequate criterion of the proportion that can and should be taken in taxes. In table IV above, profits after taxes as levied ranged from $13.9 billion in 1946 to $21.9 billion in 1950. Superficially it might appear that a considerable additional slice could safely have been taken out of this remainder of profit after tax.

From the standpoint of net revenue advantage, a policy that would compel serious retrenchment of dividend payments would become partially self-defeating, for individual income tax receipts would decline if there were a substantial decrease of dividends received by individuals.

If the additional tax were paid out of the retained earnings rather than out of the funds to be distributed as dividends, many corporations would encounter the problem of maintaining production. By and large, corporations do not withhold earned profits from their stockholders except to further the purposes of the corporate business by reinvesting the retained earnings. This reinvestment is for three major purposes: (1) to replace worn-out or obsolete equipment; (2) to expand capacity by purchasing additional facilities; and (3) to increase inventories. The rising prices of recent years have increased costs of replacement and of expansion of facilities and inventories.

The record of the sources and uses of corporate funds in the years 1946–50 appears in the following table.

Table V shows that, while cash and Government securities increased over the period some $5.8 billion, the increase was more than offset by the increase of $6.1 billion in Federal income tax liability, which obviously had first call on the increased funds available.

More important, plant and equipment outlays totaling $77.2 billion were only $5.1 billion less than the sum of retained profits, depletion and depreciation allowances ($82.3 billion). Looking at the picture another way, the aggregate outlays of $102.4 billion for plant, equipment, and additional inventories were only $5.6 billion less than the aggregate of $108 billion derived from retained profits, depletion, depreciation, and new mortgage and stock capital. During the same period, taxes took approximately 41 percent of corporate profits (see table IV), 23 percent was returned to owners as dividends, and 36 percent was reinvested in productive and operating assets of corporate business.

TABLE V.—*Sources and uses of corporate funds,*[1] *calendar years 1946–50*

[Billions]

Sources and uses of funds	1946	1947	1948	1959	1950 [2]	1946–50
Uses:						
Plant and equipment outlays	$11.6	$15.0	$17.5	$16.1	$17.0	$77.2
Inventories (change in book value)	11.2	7.1	5.0	−4.6	6.5	25.2
Change in customer receivables	4.8	7.5	2.4	−.5	6.5	20.7
Cash and U. S. Government securities	−4.7	1.0		3.0	6.5	5.8
Other current assets	−.7	−.1	.5	−.2	.5	
Total uses	22.2	30.5	25.4	13.8	37.5	129.4
Sources:						
Internal:						
Retained profits and depletion allowances	7.6	11.6	12.8	8.6	12.5	53.1
Depreciation allowances	4.3	5.2	6.0	6.7	7.0	29.2
Total internal sources	11.9	16.8	18.8	15.3	19.5	82.3
External:						
Change in trade debt	4.0	4.4	.9	−2.2	3.5	10.6
Change in Federal income tax liability	−1.6	2.3	.8	−2.4	7.0	6.1
Other current liabilities	1.8	.4	(3)	−.1	1.0	3.1
Change in bank loans	3.3	2.6	1.1	−1.8	2.5	7.7
Change in mortgages	.6	.8	.6	.7	1.0	3.7
Net new issues	2.3	4.4	5.9	5.4	4.0	22.0
Total external sources	10.4	14.9	9.3	−.4	19.0	53.2
Total sources	22.3	31.7	28.1	15.0	38.0	135.1
Discrepancy (sources less uses)	+.1	+1.2	+2.7	+1.2	+.5	+5.7

[1] Excludes banks and insurance companies.
[2] Estimates based on incomplete data: by Council of Economic Advisers. Total sources and uses are derived from unrounded figures while the components have been rounded to the nearest $500 million.
[3] Less than $50 million.

Source: Department of Commerce estimates based on Securities and Exchange Commission and other financial data (except as noted).

(3) *Consequences of additional heavy taxes.*—What does this record show as to the safe possibilities of rearranging the three-way division of corporation profits among taxes, dividends, and reinvestment?

First, it shows that in the years 1946–50, if corporations were to develop through the reinvestment of their retained earnings after taxes, not much more could safely have been taken in taxes.

Second, the 1950 revenue acts have increased the total Federal tax liability to about 50 percent of estimated corporate income. State taxes add to the total burden. Compared with the 41 percent combined load in 1946–50, this represents an increase of about 10 percent of profits. Yet during that period the net distribution (if it is defined as dividends paid out less new capital paid in) was only about 6 percent of profits. If dividends are required to be curtailed at the same time that taxes on their receipt are increased, it will be even more difficult to obtain new capital.

No categorical answer can be given to the question· What is the safe limit of additional corporation taxation? That rates in excess of 50 percent are in the danger zone is generally admitted. In recommending the 55 percent rate of normal and surtax, Secretary Snyder said before the Ways and Means Committee on February 5:

"I am aware that a corporate rate of 55 percent would raise serious equity and incentive considerations in a normal and stable peacetime economy. However, corporation tax rates requested during the present emergency cannot be judged by normal standards."

The foregoing tables and discussion show that corporations as a whole today have the money to pay an additional impost. On the other hand, corporate taxes are already heavy. Increases would be likely to strike the smaller and less well-established corporations with greater force than the larger companies. As we have said above, a point will come, as the tax is increased, at which the effort to shift it will reduce the volume of consumption. Absorption of the tax will cut to the danger point the retained earnings corporations require to replace inventories and

machinery at currently increased prices, to meet the heavy demands both of a garrison state and its civilian economy, or the dividends required to sustain the flow of new equity capital.

For these reasons, we do not recommend that additional revenue be obtained from an increase in the corporate income tax, unless the excess profits tax is repealed, and unless revenue needs are extreme. In our judgment, the increases in revenue currently needed can more safely be obtained from the individual income tax and from a general excise tax.

TREASURY RECOMMENDATIONS OF FEBRUARY 1951

The Treasury recommendation to the Ways and Means Committee in February 1951, is to increase the normal tax rate by an additional 8 percentage points, thereby raising the total rate on all corporate income above $25,000 to 55 percent The total taxes of corporations in 1951, assuming adoption of the rates recommended by the Treasury, would be as follows:

TABLE VI.—*Estimated corporate tax liability under proposed Treasury rates, calendar year 1951*

	Millions
Estimated corporation net income, 1951	$40, 760. 0
Normal tax at 33 percent	13, 450 8
Surtax at 22 percent on $35,837 surtax net income [1]	7, 884. 1
Total income tax	21, 334. 9
Excess-profits-tax liability	2, 918. 0
Total income- and profits-tax liability	24, 252. 9

[1] (1) Corporations with net income up to $25,000 are not subject to surtax. The Treasury estimated their total income in 1951 at $1,953 million. (2) Corporations having net income above $25,000 have an exemption of this amount from surtax. The Treasury estimted that 118,800 corporations would receive this exemption, which would exclude $2,970 million from surtax. The total not subject to surtax would be $4,923 million, leaving $35,837 million taxable at the surtax rate of 22 percent.

An important issue is presented by the results shown in table VI. There it is found that the income tax alone, at the new rates proposed by the Treasury, would take, in the aggregate, $21,335 million in taxes, leaving $19,425 million for the two corporate purposes of dividends and reinvestment. The recommended taxes would thus take $955 million more than half of the total.

The situation is worse if the combination of the income-tax increase and the excess-profits tax is considered. The total of these taxes in 1951 (see table VI) would be $24,253 million, which would leave only $16,507 million for division between dividends and plow-back, unless the additional taxes are passed on to consumers. The average of profits after taxes for the 5 years 1946–50 was $18.5 billion. The deficiency for 1951, under the Treasury's latest program, would be almost $2 billion below this.

The prospect involves grave consequences for the whole economy, and these consequences should be most seriously considered before accepting the Treasury recommendation. This prospect is not improved by taking the optimistic view that total profits may actually be more in 1951 than the amount estimated by the Treasury. The arithmetic of the combination of excess-profits tax and the proposed income-tax rates would continue to exact substantially more than half of the larger total of profits.

TREASURY RATES PLUS EXCESS-PROFITS TAX EXCESSIVE

It follows that this combination of excess-profits tax and the latest Treasury proposals has gone so far that we confront one or the other of two unhappy alternatives: (1) There is likely to be impairment of the capacity of business to maintain the production level needed to supply the military requirements, to provide civilian goods on a reasonable scale, and to finance itself; or (2) consumers will be forced in effect to pay a heavy additional excise, as part of the prices of the goods they buy.

The matter can be summed up by saying that either the excess-profits tax should be repealed or the proposed increase of the income-tax rates should not be made. The former step would diminish corporate-tax liability by about $2,918 million in 1951, and the latter would mean less revenue of $3,261 million from the income tax in that year. We have already expressed the judgment that

no excess-profits tax should be imposed. We reaffirm this judgment here, which is supported by the many reasons set forth in our earlier study and in virtually all of the testimony submitted by business groups before congressional committees last autumn.

EXEMPT CORPORATIONS

Over the years generous Congresses have gradually enlarged the scope of the statutory provisions exempting stated varieties of corporations from paying any Federal taxes at all, until a very large number of corporations are now exempted. The legislative philosophy has been, no doubt, that to benefit corporation A, which is doing useful work in the community, by a tax exemption, is merely to award a badge of merit to A, an award which in no way harms B, C, or D, corporations that remain taxable.

When tax rates are low, such a philosophy, however dubious it may be, can be accepted by the community, particularly since it is obvious that some exempt organizations perform public service of a high order and in most cases have little, if any, taxable income. Now that tax rates must be very high, however, it is painfully evident that if $1,000 must be raised by taxes, and if A is exempted from a tax that B, C, and D must pay, then B, C, and D will each have to pay more dollars than if A also were liable. Hence, whether corporate tax rates are increased or not, the statutory exemption provisions should be carefully reexamined and restricted in scope, so that only those corporations performing essential community tasks, not for profit, are freed from the tax that the rest of us must pay. It is intolerable in these times that the taxes of individuals and corporations generally should be increased by the exemption of other corporations engaged in like business activities.

Accordingly we strongly recommend a painstaking and indeed drastic revision of section 101, the exempt corporation provisions. The Treasury should take the lead in the revision, for in its day-by-day administration of the law, its officers and employees are more familiar than anyone else with the loopholes and inequities of the present provisions. Substantial additional revenue could be obtained. More important, the taxpaying citizens of the community would receive the renewed assurance that all of us are contributing equally and fairly to its maintenance.

COOPERATIVES

Certain types of cooperatives enjoy exemption from the corporate tax, though they may do millions of dollars of business in direct competition with taxpaying corporations. The exemption should be repealed; but the root of the evil is not so much the exemption as the unduly favorable and discriminatory definition of income which the Treasury has long applied without any direct statutory sanction. Cooperatives are owned by their members for the purpose of economic gain just as ordinary commercial corporations are owned by their stockholders for the same purpose. The incomes of the two types of corporations should be similarly computed. While the basis of distribution employed by cooperatives differs from that used by corporations, the essential economic characteristic of both forms of enterprise is that both make profits and the distribution made in each case is out of profit. Whether the distribution is in cash or in the form of new certificates of interest, the paying corporation, cooperative or not, first had to earn the profit before it can pay it out. So long as corporations and stockholders are separately taxed, the cooperative should be taxed on its full profits.

Legislation is probably required to bring about equal taxation of cooperatives and their competitors, for the unduly favorable Treasury rulings are of long standing. We strongly recommend such legislation.

IV. The Excises

INTRODUCTION

The third major Federal tax, in point of revenue produced, is the large group of sales or excise taxes. For a century and a quarter, except for a few years during and after the Civil War, nine-tenths or more of the financial support of the Federal Government came from consumption taxes; namely, the customs and the excises. These taxes need overhauling—more than either of the income taxes. Neither in their development nor in the consideration of their proper place in the Federal revenues, have the excises had the attention that has been devoted to the income taxes.

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BASIC CHARACTERISTICS

Some basic fiscal facts in relation to excises are important to us today—of much greater importance than they could have been when the Federal budget was measured in millions rather than billions. Among these basic facts are the following:

(1) *Stability of yield.*—Excise revenues are much more stable than income-tax revenues. That is, they recede less during periods of business decline, and they advance more slowly in boom periods. By comparison, income taxes are highly volatile, falling off rapidly in depressed periods and rising extravagantly in boom periods. The extraordinary yield of the income taxes during periods of boom and inflation encourages lavishness in public spending. Less dependence on income taxes and a greater dependence on excise taxes introduces a more sober attitude toward the scale on which it is proper to establish Government spending programs.

(2) *Related to the spending of income.*—Nearly all taxes are, in the last analysis, paid out of income. Income taxes are levied on income as it is received or produced. Excise or consumption taxes are collected as income is spent.

The objective of a dynamic, prosperous economy is the maintenance of a high level of both production and consumption. Unless both of these aspects of economic life flourish, the economy will decay. The maximum contribution to the attainment of this fundamental goal will be made when the costs of Government, as expressed in the taxes levied, are reasonably distributed over both the receipt and the spending of income. Excises should be called upon to bear their share of the total tax load.

(3) *Equalizing consumers' goods and purchasing power.*—The enlarged defense spending program requires that greater emphasis be placed on taxes collected as income is spent. There will be a smaller supply of goods for civilian use, because of the large withdrawals of product for military use. Those who are employed in producing the military goods will be paid for their services. The consequence is that there will be an undiminished—possibly even increased—volume of personal income, with less than the customary supply of goods to be bought. An increase of income taxes will diminish personal income, but if this tax alone were relied upon, the rates would be so severe at all levels of income as to thwart the incentives to get income. Greater use of the excise or consumption taxes will contribute to the equalization of purchasing power and available goods without that deterrent.

The objective of this equalization is to check rising prices of consumer goods. If there is an extensive array of excise taxes, the consumer will pay more for each item, because of the tax, but the Treasury will receive the increase as a revenue. Without such consumption taxes, the competition of purchasing power for the reduced supply of goods will still compel consumers to pay more for each item, but the Treasury will not gain thereby to the same extent, and there will remain the need for larger tax revenues from other sources.

Price control can never be an adequate protection of consumers against the evils of the upward pressure of prices that is produced by an unbanance between purchasing power and consumer goods. Experience during World War II, and even thus far in the present defense program, demonstrates that, for political and other reasons, such controls are not likely to be strict and comprehensive. Moreover, black markets always develop, into which scarce goods are diverted in defiance of the controls and in successful evasion of official prices. Finally, price controls, even if they be effectively enforced, bring in their train collateral effects, such as shortages of essential goods and distortion of production, which are apt to be worse than the high prices that were to be corrected.

Siphoning off purchasing power through taxation will reduce this pressure. For this siphoning operation, the income tax is not an effective instrument. Liberal use of excise taxes is required.

(4) *Broad base.*—The statutory definition of taxable income is such that only a minor portion of the total of personal income is subject to income tax. The limited scope of the present income tax in relation to total income can be illustrated from data supplied by the Secretary of the Treasury in his testimony before the Ways and Means Committee on February 5, 1951. The Treasury has predicted that the Department of Commerce would show total personal income of $245 billion in the calendar year 1951. Mr. Snyder estimated that in 1951 adjusted gross income [4]

[4] The term "adjusted gross income," as defined in section 22 (n) of the Internal Revenue Code means: the gross income minus—(1) trade and business deductions; (2) expenses of travel and lodging in connection with employment; (3) reimbursed expenses in connection with employment; (4) deductions attributable to rents and royalties; (5) certain deductions of life tenants and beneficiaries of property; and (6) losses from sales or exchange of property.

of individuals would be $170,975 million, and that the taxable income of individuals would be $90,010 million. Granting that there are substantial differences of definition between the Commerce Department concept and the income-tax concept of personal income, it is clear that there will be a large amount of individual income available for consumption spending that is not touched by the present kind of income tax, regardless of the rates of tax that may be imposed.

It follows that some part of the defense tax burden should be placed on the spending of income. By thus broadening the base of the whole Federal tax system, it will be possible to get the necessary revenue without the imposition of severely penalizing rates of tax on either the receipt or the spending of income.

EXCISES SHOULD BEAR A GREATER SHARE OF THE TAX LOAD

In 1950 the Federal Government obtained approximately 42 percent of its revenue from the individual income tax, 28 percent from the corporation income tax, 20 percent from excises, and 10 percent from all other sources together. (Table I, page 10—calculated after allocation of refunds.) In the 1952 budget, only 14 percent of the total estimated revenue of $58.5 billion is from the excises.

We believe that this is too little reliance on the excises. Their special advantages are not being fully utilized. We believe that the excises should normally contribute at least 25 percent of the national revenue, as we suggested in a previous report of this committee issued in 1947.

WEAKNESS OF THE EXISTING FEDERAL EXCISE SYSTEM

If Congress accepts the premise that the contribution of the excises should be materially increased, the next question is the way to do it: whether (1) by expanding the present system of selective excises, by raising rates and adding to the list of taxed commodities and services; or (2) by levying a general excise tax upon the sale of nearly all commodities.

The present Federal excises cannot be defended as a system of any kind. Their development has not been carefully planned, and the selection of commodities to be taxed cannot be explained on any consistently rational basis. Excise taxes are not applied solely to so-called luxuries; indeed there is no generally acceptable definition of a luxury. (Are gasoline and cosmetics luxuries?) The commodities taxed were not selected, as some have said, with a view to curbing the use of essential materials. (Consider cigarettes.)

In short, there is no logical plan for the list of commodities taxed. Effective political pressure or the lack of it has often been a deciding factor, and often decisions are made on certain items or groups of items without any adequate comparable treatment on any standard basis of related or competing items. The rates are extremely variable; the discriminations among consumers and among producers have been flagrant. For example, lipstick is taxable, but nylon stockings are not. Fur coats are taxable, whether the material be the finest mink or silver fox, or merely rabbit, but woolen coats are not taxed, however fine the quality or high the price. Refrigerators and stoves are taxed, but washing machines and vacuum cleaners are exempt.

There has been some advocacy of high selective excise taxes to prevent the use in civilian production of materials needed for the military effort. This is not the right way to deal with that problem. We already have an agency with authority to allocate materials to military production. This agency will presumably exercise its authority in a way that will give ample protection to all anticipated military requirements.

Extension of the present selective system, by adding more and more kinds of goods to the taxable list, would, if carried to the limit, eventually cover all commodities. Such a piecemeal method of extension would be likely to result, however, in a variety of rates which would retain many of the discriminations now present. Our recent experience has demonstrated that it is the discriminations in the selection of goods to be taxed and in the rates imposed that has caused much of the complaint from both producers and consumers. A more sensible solution and one more likely to gain general support, would be to sweep away the present illogical, inequitable system and replace it with a uniform tax across the board.

TREATMENT OF LIQUORS AND TOBACCO

Alcoholic beverages and tobacco should continue to be taxed separately in accord with long historical precedent. These commodities have always been singled out for special and relatively heavy, taxation. One reason has been the

demonstrated insistence of demand, which has made it possible for them to carry increased tax exactions without a significant decline in consumption. Another has been a belief, still held in some quarters, that the high prices caused by heavy taxes in some degree restrict use.

The taxation of alcoholic beverages and tobacco occurs at State and even local levels, as well as at the Federal level. In the case of alcoholic beverages, even the present taxes provide a substantial incentive to illicit manufacture, and any further material increase would offer still greater inducement. We do not recommend increases above the present rates, which are still at the highest levels attained during World War II.

A BROAD, UNIFORM EXCISE SYSTEM

(1) *Scope.*—From the standpoint of strict logic, a broad excise system should apply to all consumer products. When account is taken of the fact that the revenue need will also require some increase of the individual income tax, a good case can be made for excluding foods and food products, as well as clothing, from the uniform excise tax. Rent, being a service rather than a commodity, would not be included. The result of these exclusions would be that the amount of excise tax to be paid by any one small-income recipient would not include tax on these essentials of food, clothing, and shelter. Such essentials are a larger proportion of total expenses for him than for those with larger incomes and would relieve him from what might reasonably be considered an undue burden.

(2) *The question of regression.*—Many persons have expressed opposition to a broad, flat-rate consumption tax on the ground that such taxation is regressive. By this is meant that a given amount of tax constitutes a larger proportion of a small than of a large income. Strictly speaking, this is not the scientific definition of a regressive tax—which is a tax whose rate decreases as the base increases. Strictly, the general excise or sales tax is not regressive, but proportional; since the amount of the tax is always proportional to the base—the necessary result of the uniform rate.

Waiving the technical point of definition, however, it should be observed that the criticism of regression, as popularly understood, applies with equal force to the entire system of market prices. The price of a given suit of clothes, automobile, or television set is a larger proportion of a small than of a large income. The implications of the regressivity argument are that there is something especially harsh or severe about a tax that is proportionate to market price that does not exist with respect to the price itself.

We have always had a market price system that is "regressive" in the sense that that term has been popularly applied to the sales tax. Under it all of us have lived, worked, and spent our income, and our standard of living is the highest in the world. There is no evidence that our price system has hampered national growth and propsperity. There is no evidence that a general excise tax would produce results different from what we have always known under the price system.

(3) *Some advantages.*—A broad uniform excise tax would contribute to that universal distribution of a portion of the increased cost of government which should be an important feature of any tax program now adopted. It should be understood that it would be a consumption tax, and that the purpose would be to permit merchandisers to retrieve the tax eventually from the final consumer.

The advantages of getting a reasonable portion of the Federal revenues over the long pull from a uniform rate applicable to all consumer spending, instead of from a limited list of arbitrarily selected consumption goods, are also great. There is no sound reason for making those who spend for certain goods, for whatever reason, pay a part of the long-run cost of government, while those who buy other goods pay nothing through their spending. With a broadly based general excise, the rate that would be required to supply from this tax a reasonable and proper share of the normal peacetime cost of the Government would be moderate, yet it would be productive of a substantial revenue because of the immense base of consumer spending in our highly productive, dynamic economy.

RETAIL SALES TAX OR MANUFACTURERS' EXCISE

One important problem remains to be considered. The point of levy of the general excise tax would be either at the retail sale or at the stage of final manufacture. Each of these methods has been favored by some groups and opposed by others. A summary statement of the advantages and disadvantages of each method is in order.

(*a*) *The case for the retail sales tax.*—In support of the tax levy at the time of retail sale the following points have been made:

(1) A tax collected from the purchaser when the sale is made will be out in the open, the consumer will be aware of the amount of the tax, and hence will be conscious of it as a burden on him. A tax collected originally from the final manufacturer and passed along to the consumer as an element of price may not be disclosed to him as a tax.

(2) There will be no possibility of pyramiding; that is, of adding something more than the amount of the tax because it will have been included in the cost base on which middleman mark-ups are computed. There is this possibility in the case of a tax at the point of final manufacture.

(3) In many States the people are already familiar with the retail sales tax, and there would be greater popular understanding of a Federal tax of this sort than there would be of a new and different tax such as a manufacturers' excise.

(4) If the tax were imposed at the retail level it would be easier to get rid of after the emergency is over than would be the case with the manufacturers' excise. The latter is more likely to become a permanent feature of Federal taxation.

(5) The retail sales tax can be distinguished and billed separately in the amount charged the purchaser. This might make it less likely to be used as ground for increased wage demands on the basis of advancing cost of living.

(*b*) *The case for the manufacturers' excise.*—The manufacturers' excise tax considered here is one imposed at the final stage of manufacture. There would be no tax on materials passing from one producer to another during the intermediate stages of fabrication or assembly. For example, a manufacturer of piston rings or crankshafts would deliver these articles to an automobile manufacturer without tax.

On the other hand, the sale of piston rings to a local garage for repair jobs would be taxable. Control of the tax levy could be accomplished by the same procedure as is now used for the manufacturers' excises. For example, the Bureau of Internal Revenue issues a certificate to anyone who can show that he uses taxable motor vehicle parts in a further process of manufacture. This certificate prevents collection of the tax on sales to the fabricator or assembler.

In support of the levy of the tax at the point of final manufacture, the following points have been made:

(1) A Federal manufacturers' excise would be vastly more simple and inexpensive to administer than a Federal retail sales tax. There are at least 3,000,000 retail outlets in the United States, ranging all the way from large department stores to little hole-in-the-wall operators. The number of final manufacturers with whom the Bureau of Internal Revenue would have to deal would probably not exceed 200,000. The expense and the manpower involved in administering a manufacturers' excise tax would be very much less than would be required for the retail sales tax.

(2) The fact that upward of 30 States now make use of the retail sales tax is a strong reason for avoiding this form of the tax at the Federal level. In the aggregate, these States now obtain upward of 40 percent of their total State revenue from the tax on retail sales. They could suffer serious loss from invasion of this field by the Federal Government.

(3) The Federal manufacturers' excise would not be a new tax. Included in the present Federal excises are some twenty-odd classes of commodities that are taxed in the basis of the final manufacturers' price. In the fiscal year 1950 this group of excises produced a Federal revenue of $1,827 million.

(4) While the procedure of collecting the tax from the final manufacturer and of transmitting it down through the distributive channels to the consumer does offer a possibility of pyramiding, consideration ot the character of the merchandising system in this country encourages the belief that there would be no serious or extensive addition to the tax by percentage mark-ups.

If a system of price control is in effect, even the sporadic initial attempts at pyramiding would be more or less checked.

(5) Tax would not be hidden. A single rate of tax, applicable to everything except foods and food products, would be widely known, even if it were levied at the stage of final manufacture. Its existence and its rate would not be concealed. That few persons know the rates of excise tax now levied on the various classes of goods is subject to tax is attributable to the varying rates of such taxes.

(6) The position that a Federal retail sales tax would be more likely to be removed when the emergency had passed than would a manufacturers' excise, if well taken, is not an objection but a further impressive reason for using the latter type of excise tax. In the earlier reports of this committee we urged that there should always be a substantial Federal revenue from the excises. We reassert this position and recommendation here.

CONCLUSION

Taking into account the pros and cons that have been here summarized, and in particular the direct Federal-State conflict, the greater ease and lower cost of administration, and the familiarity with the nature and operation of the manufacturers' excise that has been gained from years of experience with it, the balance of the argument lies, in our opinion, heavily on the side of the manufacturers' excise rather than the retail sales tax.

V. Résumé of Tax Potential

All the possible combinations of tax methods, tax rates, and budget totals are too numerous to be cataloged here. We do not know how much expenditures will be cut, nor how much additional revenue we have to raise. For illustrative purposes in order to demonstrate the feasibility of keeping the Federal budget in balance and thereby avoiding further debt increase, we suggest below some alternative combinations.

In the tables below, the yield of existing rates is shown first. These are based on the latest Treasury estimates and are shown net of refunds. The corporation tax figures include both the excess-profits tax and the normal and surtax. On the assumption that the proposed general excise would replace all other excises now levied with the exception of liquor and tobacco taxes, we show the latter separately. Current excise-tax receipts are estimated at $8.4 billion by the Treasury Department, liquor and tobacco taxes accounting for $4 billion of this amount. The estimated yield from the general excise therefore includes $4.4 billion of replacement revenue in each instance.

The second part of each table lists some alternative tax changes or increases to meet the revenue goal projected in the table.

(*a*) *Assuming a budget reduction of $10 billion*

The first set of alternatives (table VII) is premised on the assumption that the expenditures for 1952 can be reduced by $10 billion, as we have recommended earlier. This would leave an over-all revenue requirement of $61.6 billion for 1952.

Table VII.—*Alternative methods of providing revenue of $61.6 billion*

[Billions]

		Total
1. EXISTING RATES [1]		
(a) Individual income tax at existing rates	$25. 2	
(*b*) Liquor and tobacco	4. 0	
(*c*) Estate, gift, customs, net employment taxes and miscellaneous receipts	3. 8	
(*d*) Corporation taxes at existing rates	21. 1	
(*e*) Uniform manufacturers' excise (to replace present excises)	4. 4	
Subtotal	58. 5	
2. INCREASED LEVIES		
Alternative 1:		
(*a*) Uniform manufacturers' excise at 7½ percent (less $4.4 billion to replace present excises)	3. 0	
		$61. 5
Alternative 2:		
(*a*) 3 percentage point increase in individual income tax	2. 7	
(*b*) Uniform manufacturers' excise at 5 percent (less $4.4 billion to replace present excises)	. 5	
		61. 7
Alternative 3:		
(*a*) Increase in corporate normal and surtax rate to 50 percent	1. 3	
(*b*) Uniform manufacturers' excise at 6 percent (less $4.4 billion to replace present excises)	1. 5	
		61. 3

[1] Source: Budget of the U. S. Government for the fiscal year 1952, and Treasury Department estimates of Feb. 5, 1951, and Apr. 2, 1951, (net of refunds).

In calculating the yield of a uniform flat rate manufacturers' excise tax, we have assumed that the taxable base would exclude food and food products, medicines, and wearing apparel. Government purchases, sales to other manufacturers, and net exports of manufactured goods have also been excluded. However, the base includes the value of presently taxed services, since we assume that these would continue to be taxed, though at a uniform rate.

The first alternative shows that some $7.4 billion would be required from a uniform excise tax if the rates of income tax, both individual and corporate, were held at their present levels. This would involve an increase of some $3 billion above the $4.4 billion of current excise tax receipts other than the liquor and tobacco taxes.

The second alternative shows the effect of a 3 percentage point increase in the individual income tax with a corresponding reduction of the amount that it would be necessary to get from excise taxes. This would be little more than is now raised from excises other than liquor and tobacco.

The flat rate of manufacturers' excise tax on commodities and taxable services required to produce the revenue shown in the first alternative would be about 7.5 percent. In the second alternative this rate would be about 5 percent. In the third alternative it would be about 6 percent.

(*b*) *Assuming a budget cut of $5 billion*

We proceed next to the assumption that only $5 billion is to be cut out of the 1952 budget. This would leave a total revenue requirement of $66.6 billion. In table VIII two alternative methods of providing this revenue are illustrated.

TABLE VIII.—*Alternative methods of providing revenue of $66.6 billion*

[Billions]

		Total
1. EXISTING RATES[1]		
(*a*) Individual income tax at existing rates	$25.2	
(*b*) Liquor and tobacco	4.0	
(*c*) Estate, gift, customs, net employment taxes, and miscellaneous receipts	3.8	
(*d*) Corporation taxes at existing rates	21.1	
(*e*) Uniform manufacturers' excise (to replace present excises)	4.4	
Subtotal	58.5	
2. INCREASED RATES		
Alternative 1:		
(*a*) 3 percentage point increase in individual income tax	2.7	
(*b*) Uniform manufacturers' excise at 10 percent less $4.4 billion to replace present excises)	5.4	
		$66.6
Alternative 2:		
(*a*) 3 percentage point increases in individual income tax	2.7	
(*b*) Increase in corporate normal and surtax rate to 50 percent	1.3	
(*c*) Uniform manufacturers' excise at 8½ percent less $4.4 billion to replace present excises)	3.7	
		66.2

[1] Source: Budget of the U. S. Government for the fiscal year 1952, and Treasury Department estimates of Feb. 5, 1951 and Apr. 2, 1951, (net of refunds).

The individual income tax is shown at a 3 percentage point increase above the existing rates. The combined normal and surtax rates of the corporation income tax are shown at existing rates in the first alternative and at 50 percent in the second. (This is in addition to the excess profits tax.) It would be necessary to impose a 10 percent uniform excise rate under the first alternative and an 8.5 percent rate under the second.

In the light of our earlier discussion of the serious consequences for the economy that would follow from an increase of the total corporation tax load, it should be clear that the alternatives for raising $66.6 billion in revenue represents an onerous burden on all the people. But our choices are already severely limited, once we assume that $66.6 billion is the minimum revenue requirement.

(c) *Assuming no budget cuts for 1952*

Finally, we show alternative methods of providing a total revenue of $71.6 billion, on the assumption that there is to be no reduction of expenditures for 1952 below the budget estimate. These alternatives are given in table IX.

TABLE IX.—*Alternative methods of providing revenue of $71.6 billion*

[Billions]

		Total
I. EXISTING RATES [1]		
(*a*) Individual income tax at existing rates	$25.2	
(*b*) Liquor and tobacco	4.0	
(*c*) Estate, gift, customs, net employment taxes and miscellaneous receipts	3.8	
(*d*) Corporation taxes at existing rates	21.1	
(*e*) Uniform manufacturers' excise (to replace present excises)	4.4	
Subtotal	58.5	
II. INCREASED RATES		
Alternative 1:		
(*a*) 3 percentage point increase in individual income tax	2.7	
(*b*) Increase in corporate normal and surtax rate to 53 percent	2.7	
(*c*) Uniform manufacturers' excise at 12 percent (less $4.4 billion to replace present excises)	7.4	
		$71.3
Alternative 2:		
(*a*) 4 percentage point increase in individual income tax and reduction of exemptions from $600 to $500	6.1	
(*b*) Increase in corporate normal and surtax rate to 55 percent	3.6	
(*c*) Uniform manufacturers' excise at 8 percent (less $4.4 billion to replace present excises)	3.4	
		71.6

[1] Source: Budget of the U. S. Government for the fiscal year 1952, and Treasury Department estimates of Feb. 5, 1951 and Apr. 2, 1951 (net of refunds).

The choice that is presented in these alternatives is that between a 3 percentage point increase in the individual income tax with a corresponding rise in the excise tax yield, on one hand; and on the other, a 4 percentage point increase proposed by Secretary of the Treasury Snyder, plus a lowering of the exemption from $600 to $500 and a smaller excise tax yield. In the second case, the corporation normal and surtax rate is shown at 55 percent.

In the preceding tables VII, VIII, and IX, the first alternative provides, in each case, for a larger relative contribution from the excises than does the second. However, it is only in the final summary, table IX, that the proportion of all excises, including the liquor and tobacco taxes, approaches 25 percent of total revenues. We are impelled, therefore, to give first choice to the first alternative shown in this series of illustrative summaries of how and where the revenues required to balance the budget at successive assumed expenditure levels from $61.6 billion to $71.6 billion can be obtained. In our judgment, this degree of relative emphasis upon the excises will involve less injury to the economy and less hardship on all taxpayers, than any other combination of tax methods.

The most important lesson to be learned from table IX is the restriction of choice which we face when attempting to raise $71.6 billion in revenue. An increase in individual rates to peak wartime levels and in the corporate rate to a level beyond safe limits still requires an increase of $7.4 billion in excises (above the present yield) in order to balance the budget. Drastically heavier rates on individuals and corporations at levels which will certainly be seriously damaging to the economy (Alternative 2), cannot avoid the necessity of a 40-percent increase in the present excise yield.

TAX CHANGES NEEDED NOW

In this series of choices among different tax methods and tax rates for the purpose of covering various budget totals, we should warn against an excess of optimism that may lead to a fatal delay. A present combination of expenditure much below original estimates and revenue from present taxes in excess of original

estimates has temporarily lessened the urgency of immediate action on substantial tax increases. In view of the large volume of appropriations and contract authorizations already voted and the additional amounts that are in the process of legislative consideration, there can be no assurance that the original budget estimate of $71.6 billion for the fiscal year 1952 is a dependable one. Even if the Congress should eliminate $10 billion from the original expenditure estimates, there is always the possibility that new demands for military funds may offset part or all of the reduction. The requirements for the fiscal year 1953 will probably be even higher than those now projected for 1952.

We do not propose that there now be collected as much revenue as will be needed to cover the expenditures of the fiscal year 1953. But we do recommend that there be laid, now, the broad and secure foundations of a tax system that will be capable of producing in that year and for the duration of a garrison state economy, whatever amount of revenue will be required. If we wait until the peak of the defense spending has been reached, it will then be too late to make the necessary tax adjustments. The new taxes will require time for their full and smooth operation. We must proceed without delay to set up the machinery of a broadly based Federal tax system.

CONCLUSION

The rates of tax that we are dealing with here are much higher than any that have ever been imposed in this country. We are also dealing with budgets much higher than any ever before proposed except under conditions of all-out war. For the first time in our war or near-war experience, we are giving serious consideration to paying in full out of current income. The tax alternatives presented above show unmistakably the added burdens that must be borne by everybody as expenditures are increased.

To meet defense requirements, the Government already taxes until it hurts. Taxes may well go higher and stay higher. But the Federal Government cannot fairly ask citizens to pay very heavy additional taxes and to reduce their standards of living while it goes on spending as usual on nonessentials. Congress should subject the expenditure side of the Federal budget to the fundamental test: Must this expenditure be made, must this activity be performed by Government in a free economy? We are fighting abroad to preserve liberty and a free economy. We must not lose that battle at home.

High as these rates are, and heavy as their burden will be, they are endurable. They express, in money and income terms, the burden of deprivation and shortages caused by the enlarged Government diversion of product and manpower. This real burden cannot be evaded or postponed. Failure to match the diversion of goods and services by an equivalent diversion of purchasing power will force the Government into debt financing. Such financing will inevitably be inflationary. Hence the alternative to paying as we go now out of current income will be the infliction of the heavier burden of inflation.

Hard years lie ahead, in which we shall need all the genius of our economy, all the initiative and full effectiveness of our free enterprise system, working at capacity. We shall still be able to maintain a good living standard relative to other countries, but there will be less good things to enjoy. Our citizens must tighten their belts.

We can succeed in our high endeavor. We can build a strong defense force. We can give it the essential backing it needs in unmatched industrial production and economic strength. We need only use what we have actively, prudently, and intelligently. The first basic requirement is that our Government show that it has established firm control of our fiscal affairs; that the Federal Government and its espenditures are being managed with the same competence that we require of ourselves in our own everyday affairs.

FINANCING DEFENSE: CAN EXPENDITURES BE REDUCED?

(By the Committee on Federal Tax Policy: Fred R. Fairchild, Knox Professor of Economics, Yale University; Rowland R. Hughes, Comptroller, National City Bank of New York; Walter A. Cooper, Peat, Marwick, Mitchell & Co.; Thomas N. Tarleau, Wilkie, Owen, Farr, Gallagher and Walton; Roswell Magill, Chairman, Cravath, Swaine and Moore)

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About the Committee on Federal Tax Policy

The Committee on Postwar Tax Policy was organized in 1944 as a result of several meetings held in the spring of that year. Its reports, entitled "A Tax Program for a Solvent America," were published in September 1945 and in February 1947.

By July 1950, nearly 5 years had elapsed since the close of the war, without any substantial overhaul of the Nation's tax structure. This led to a decision on the part of the committee, following suggestions made to it, to prepare a new report, outlining tax policies and suggesting revenue proposals which would be appropriate to the current needs of the Federal Government. The first part of this report, under the title "Financing Defense: Is an Excess Profits Tax the Solution?", was issued in December 1950. This monograph is the second installment of the report.

Although the name of the committee has now been changed to "Committee on Federal Tax Policy," its membership remains unchanged since 1947. As in the case of the earlier reports, Alfred Parker is secretary of the committee. This publication represents the cooperative effort and responsibility of each member of the committee and its secretary.

Summary

1. America must arm for defense for the third time in 35 years. We can expect an extended period, possibly 10 years or more, of tensions abroad and huge budget demands at home. We start from very nearly the highest plateau of national debt, budget expenditure, and burden of taxation in our history. The fiscal devices with which we went through past wars will not meet our needs today. In choosing measures for today's defense effort we should keep in mind two basic requirements: (1) Maintain national production at a level higher than ever before; and (2) preserve the American free economy.

2. The immediate fiscal problem is the gap between expenditures and revenues of $16.5 billion in the 1952 budget. This gap can be bridged in only three ways: (1) Reduce expenditures; (2) increase taxes; (3) borrow. To borrow means deficit financing and more inflation. We believe with the President, that the only policy to choose is a pay-as-you-go policy. At the same time, excessively heavy or badly devised taxation may be dangerous; it could blunt our ability to produce, which is America's greatest weapon. To avoid inflation and its attendant evils we shall have to take both steps (1) reduce expenses, and (2) raise taxes. This study deals with the first requirement, reducing the expenditure side of the budget. A later study will deal with ways of increasing taxation.

3. To find the areas in the budget where reductions can be made, we have rearranged all civil expenditures (other than military and interest on the debt) into four categories: (*a*) Loans; (*b*) public works, commodity inventories and equipment; (*c*) aids and special services, both domestic and international; (*d*) current operating expenses. These major areas total $24.8 billion and represent the reducible areas in the budget.

4. With respect to nonmilitary or civilian expenditures, we have recommended:

(*a*) Prompt withdrawal of the Federal Government from the lending field.

(*b*) A deep cut in the public works program and a suspension of all projects not contributing directly to some essential defense purpose.

(*c*) Drastic curtailment of Federal aid, grants, subsidy, and special services programs.

(*d*) Discontinuance of commodity purchases under price-support programs and liquidation of the accumulated inventories of the Commodity Credit Corporation.

(*e*) Liquidation or sale of mortgages and loans held by the Government as far as there is a market for them.

(*f*) Elimination of waste and inefficiency in all operations of the Government.

We have indicated possible goals for each group with a total of $8¼ billion.

5. Our analysis has been far from exhaustive. For example, no attempt was made to determine how much could be saved from the $7 billion for international aid, nor have we attempted to estimate what savings could be accomplished by eliminating waste and extravagance in the military budget. Giving recognition to these two factors and to our necessarily limited survey of civil expenditures, we come to the conservative conclusion that a total reduction of at least $10 billion is possible, while still leaving intact all the government that our free Nation requires.

6. The drastic demands of the present situation require drastic action. As a practical program we suggest: (1) That Congress start with a clean slate by suspending for 3 years the operation of every provision requiring expenditures or appropriations (with the exception of direct military expenditures, international aid, and interest on the debt); (2) that Congress obtain from the Budget Bureau new proposals on this clean-slate basis for a total expenditure budget of $10 billion less than the present proposal; (3) the Congress would then proceed with the consideration of these revised proposals, with the goal of approving a final total of expenditures $10 billion below the present Budget; (4) this clean-slate policy will enable the Congress to obtain better continuing future control over expenditures. The practice of appropriating tremendous amounts, which are carried forward to be spent in subsequent years, has weakened this control.

7. To increase our present peak tax bill of $55.1 billion enough to cover expenditures of $71.6 billion is to strain our economy and heavily burden our whole people. To borrow the money to meet such a budget is to fan the flames of inflation. On the other hand, even if budget expenditures are cut substantially, very generous provision will still be made not only for all defense requirements, but for essential and reasonable nondefense activities. We can then tax ourselves enough to meet the total bill on a pay-as-we-go basis.

Financing Defense: Can Expenditures Be Reduced?

America must arm for defense for the third time in 35 years. When World Wars I and II began, we were on the sidelines, though we were not wholly disinterested spectators. Today we are in the forefront and must expect to remain so. America is the principal target of the forces of aggression, even though it is not the direct target of today's shooting.

We are embarking on a great, perhaps our greatest, crusade: to maintain our place as a nation still dedicated to liberty and free enterprise. We must look forward to an extended period, possibly 10 years or more, of tensions abroad and of huge budget demands at home. Enormous expenditures will be required both to preserve a free world, and to prevent or discourage World War III. A world war would be immeasurably more costly and destructive to all of us, whether victor or vanquished, then any preparedness program.

THE PROBLEMS WE FACE

The program starts from very nearly the highest plateau of national debt, budget expenditure, and burden of taxation in our history. Our present fiscal situation is quite different from what it was when we embarked upon previous war efforts. We faced World War I with a national debt of about a billion dollars and annual tax collections only a little over a billion. It was comparatively easy to increase tax rates, add some new excises, issue bonds, and finance the war.

By the time we entered World War II, the fiscal situation had deteriorated markedly. We had a public debt of $43 billion and tax collections had increased to $5 billion a year. We used the same fiscal devices that had served us before. We did not pay the full costs of World War II with current taxes. The Treasury relied on very heavy borrowing, and the result was severe inflation.

Today our fiscal system has had much of its elasticity stretched out. We no longer have the unused margin of safety we have had in our tremendous national resources and the unprecedented productive power of our industry. The rough and ready measures that served us before will not suffice today. The threat to national production and the free economy from confiscatory taxation and/or ruinous inflation is far more pressing. Merely copying, with minor amendments, the fiscal devices of past wars will not meet our needs today.

Whatever measures are adopted should meet two basic requirements: (1) Maintain national production at a level higher than ever before, and (2) preserve the American free economy. To lose our free economy to inimical forces developed within our borders will be as bad as to lose it to forces from without.

The ability of America to produce is its greatest weapon. Our industrial genius and the technological and producing skill of our people are as vital as our plant facilities. They must not be blunted by unsound fiscal or tax policies.

THE CHOICES

The immediate fiscal problem is presented by the 1952 budget. There is little prospect of a large deficit for 1951. We therefore have time to make wise plans to meet the spending increase in 1952. The 1952 budget shows a gap between

expenditures and revenues of $16.5 billion. There are only three ways to bridge this budgetary gap:

(1) Reduce expenditures
(2) Increase taxes
(3) Borrow

To borrow means deficit financing. The evils of deficit financing, the inflation it engenders, and the weakening of the economy and productive ability that results have been amply demonstrated within our time. We have seen the destructive effects of extreme inflation in foreign countries. More important, we are now suffering from some of the effects of 20 years of deficit financing—deliberate during the depression years, enforced during the war years—and the end is not yet in sight.

Inflation destroys material values, distorts the burdens that must be borne during a war, and leads to a financial and moral disintegration. The financing methods used during World Wars I and II were violently inflationary. Since 1939 the dollar has lost over 40 percent of its purchasing power. A very important question for every person in this country is—What will be the purchasing power of our dollar in 1960?

The answer to this question lies in the manner in which the public finances are managed over the next decade. If the whole cost of the military program, and all other costs of the Federal Government, are paid for out of current income, further progressive decline of the value of the dollar can be prevented. On the other hand, if the people and their leaders lack the courage and firmness to attain a pay-as-we-go basis, the alternative is deficit financing.

A PAY-AS-WE-GO POLICY

We wholeheartedly support the President's decision for a pay-as-we-go policy. Even at this new level of spending, we rule out borrowing. As the President's Economic Message states: "This cost cannot be put off into the future. It must be paid by the people now, one way or another, and it should be paid through taxation, in the manner consciously determined by the Congress and not by the uncontrolled and inequitable incidence of inflation."

At the same time, excessively heavy or badly devised taxation of industry, the people, or both, may be dangerous. That, too, can destroy the incentives to work and to produce, with equally damaging effects on our economy and, more important, on our production.

The effect of the new levies proposed would be far more severe because they would be added to those we already bear. We start with the heaviest peacetime tax burden ever carried. It is substantially equal in consumer purchasing power to the wartime tax burden borne by taxpayers in 1945, the previous peak year. Thus, in a period of partial mobilization and preparation for defense, we as a Nation are being asked to shoulder a much heavier tax load than during the peak effort of an all-out war, and we will have to do it for a much longer period.

An indication of what this means may be gleaned from the President's recent suggestions to close but $10 billion of the $16½ billion gap under the expenditures proposed.

These are:

(1) A 4-percentage-point increase in all individual income tax brackets, to the highest point ever reached;

(2) An 8-percentage-point increase in the basic corporate tax rates to 55 percent, the highest ever reached;

(3) An 85-percent top corporate rate including the excess-profits tax, practically equal to the World War II net rate of 85½ percent;

(4) Substantial increases in excise tax rates, to the highest levels ever reached.

To close the balance of the $16½ billion gap would mean much more—lower exemptions, still higher rates, and still more and heavier excises. Obviously, any such program would be severely damaging to our economy.

The time for Federal Government spending as usual is past. Drastic cuts in the expenditure budget are necessary. Undoubtedly we shall have to take both steps to avoid inflation and its attendant evils: (1) reduce expenses, and (2) raise taxes. How much we have to raise in taxes will depend upon how much expenditures can be reduced.

Therefore, this study deals with the expenditure side of the budget. A later study will deal with ways of increasing taxation.

THE FEDERAL EXPENDITURES

President Truman said on December 16 in his message to the Nation that he had "instructed the Director of the Budget to reduce the nonmilitary expenditures

in the new Federal budget to the minimum required to give effective support to the defense effort."

We can all accept that standard. But to believe that $71.6 billion is the irreducible minimum according to that standard is wholly unrealistic.

Analysis of the civil portion of the budget shows that it can be reduced by $10 billion without any injury whatever to national defense. In the succeeding pages we show in broad outline how it can be done. We describe some of the general areas and types of nondefense expenditure that offer opportunities for this substantial reduction. At the end of this study we recommend procedures to bring and to keep budgetary expenditures at a tolerable level in these times of severe strain on the economy.

Federal expenditure increase since 1915

Federal expenditures have risen in the 37 years since 1915 from $730 million to the total in the 1952 budget of $71.6 billion, a total nearly 100 times that of 37 years ago. This enormous increase is only partially accounted for by inflation. On the basis of a standard value dollar (i. e., adjusted to allow for changes in the dollar's purchasing power according to the BLS wholesale index), the total of projected expenditures for 1952 is over four times the depression spending period of pre-World War II level. It is 15 times the post-World War I figure and over 40 times the pre-World War I. These comparisons are after adjusting for the depreciation in the value of the dollar over the years.

These facts alone indicate the the present budget is ripe for reduction. It is not the budget of an athlete training for tough contests ahead.

Large sections of the later years' expenditures are for such outgrowths of war as pensions costs and veterans' benefits, or are required by new defense preparations for new wars. The vital question, however, is not how much of the expansion can be traced to war causes, but what expenditures are actually required under the pressure of today's events.

What areas or what items offer possibilities of reduction?

The summary of proposed expenditures as presented in the budget is in table I. There is no detail whatever in the budget for defense and little for international aid. These two together make up two-thirds of the total.

1. Military services

Military expenditures are particularly difficult to review from the outside; and at the present time, in the absence of detailed information, a real review is impossible.

The objective must to be require that such expenditures be made as efficiently and with as little waste as is possible. Huge defense programs tend to generate substantial wasteful and unproductive expenditures. Although we do not advocate setting up such limitations and restrictions on military spending authorities as may seriously hamper the defense effort, administrative officers, military as well as civil, must exercise great care lest in prodigal spending to preserve and defend our civilization, we lose what we are fighting for.

TABLE I.—*Federal budget expenditures by major functions, fiscal years 1950–52*

[In millions]

Function	Expenditures		
	1950 actual	1951 estimated	1952 estimated
Military services	$12,303	$20,994	$41,421
International security and foreign relations	1,803	4,726	7,461
Finance, commerce, and industry	227	368	1,524
Labor	263	212	215
Transportation and communication	1,752	1,970	1,685
Natural resources	1,554	2,117	2,519
Agriculture and agricultural resources	2,784	986	1,429
Housing and community development	261	409	[1] −102
Education and general research	114	143	483
Social security, welfare and health	2,213	2,520	2,625
Veterans' services and benefits	6,627	5,746	1,911
General government	1,108	1,252	1,351
Interest	5,817	5,722	5,897
Reserve for contingencies		45	175
Adjustment for daily Treasury statement	+330		
Total	40,156	47,210	71,594

[1] Excess of receipts over expenditures.

2. International Security

International aid is in a somewhat different category from military services It is listed as $7 billion, almost $3 billion more than is estimated for 1951. According to the Budget, it includes both military and economic assistance, but no separation is given. The President says "more than one-half . . . will be for procurement of military equipment to be shipped from this country to our allies" If there are substantial nonmilitary items in this total, a reduction should be possible when complete information is presented to Congress.

Civil Expenditures

In our discussion of the nonmilitary or civilian expenditures, we use a different grouping of the Government's operations than is customarily employed. It has the merit of focusing attention upon the character of these operations in a way that promotes a better judgment as to the wisdom and propriety of Government participation in the lines of activity described.

So rearranged, the major budget expenditures (other than military and interest) are:

	Billion
1. Loans (table III)	$2.1
2. Public works, commodity inventories and equipment (table IV)	3.7
3. Aids and special services for programs of State and local governments and others (table V):	
(*a*) Domestic	9.6
(*b*) International	7.0
4. Other current operating expenses (excluding interest on the debt) (table VII)	2.4
Total	24.8

Table II shows the budget in this form for fiscal years 1949–52, including an over-all figure for military services. Since the details of the military program for 1952 are not yet available, subsequent tables will refer only to nonmilitary items.

TABLE II.—*Federal Budget expenditures showing areas of reducible Government spending for 1952, fiscal years 1949-1952*

[In millions]

	1949 actual	1950 actual	1951 estimate	1952 estimate
Total	$40,057	$40,156	$47,210	$71,594
Reducible areas:				
Gross disbursements for loans, table III	2,065	2,071	2,577	2,077
Expenditures for civil public works, commodity inventories, and equipment, Table IV	2,994	3,016	1,744	3,751
Expenditures for aids, and special services for programs of States, local governments and others (civil) other than International, Table V	10,074	10,702	10,574	9,603
Other current operating expenses, table VII	1,836	1,896	2,076	2,446
International aid (no details in budget)	5,554	4,392	4,218	7,008
Total reducible areas, including international aid	22,523	22,077	21,189	24,885
Military services (no details in budget)	11,914	12,303	20,994	41,421
Other items:				
Interest payments	5,444	5,817	5,722	5,897
Noncost payments [1]	578	563	572	623
Receipts a/c loans	−673	−936	−1,314	−1,406
Total	5,349	5,444	4,980	5,114
Reserve for contingencies			45	175
Adjustment to Daily Treasury Statement basis	+272	+330		

[1] Noncost payments are mainly for the railroad retirement trust fund, for which reimbursement through special payroll taxes is included in revenues.

The principal items in each of the above expenditure groups are considered below. We briefly review the types of expenditures, the major items in each class, and suggest possible savings.

I. Loans ($2,077 million)

Table III shows disbursements by the Federal Government under its various lending programs on a gross basis, for that is the amount that must be reviewed in looking for possible reductions. The proposed level of Government lending of $1,796 million in 1952 for domestic-civil purposes is actually $711 million more than in 1949, an increase of 66 percent, though it is $360 million below the 1951 estimate.

TABLE III.—*Gross disbursements for loans by function, fiscal years 1949–52*

[In millions]

Function	1949 actual	1950 actual	1951 estimate	1952 estimate
Total	$2,065	$2,071	$2,577	$2,077
Housing and community development [1]	479	1,015	1,321	698
Agriculture and agricultural resources [2]	423	432	460	406
Finance, commerce, and industry	183	285	368	688
Natural resources		3	4	2
Transportation and communication		2	3	2
Total domestic-civil	1,085	1,737	2,156	1,796
International security and foreign relations [3]	980	333	420	281

[1] The purchase of insured and guaranteed mortgages by the Federal National Mortgage Association is grouped with housing and community development loans.
[2] The agricultural loan totals do not include the activities of the Commodity Credit Corporation (see table IV), or of agencies of the Farm Credit Administration, which are not reflected in budget expenditures.
[3] Loans of the Economic Cooperation Administration are combined with other ECA expenditures in the category on aids and special services. International loans are chiefly those of the Export-Import Bank.

We entirely agree with the conclusions of the Hoover Commission, that "direct lending should be absolutely avoided except for emergencies." The loan class of Federal spending is a prime example of a kind of activity in which the Federal Government should not be engaged at all. The Government has nothing of its own to lend. It can make loans only after having first taken the funds to be lent from the people in taxes, or having borrowed these funds from the banks or other private institutions or individuals. Where borrowers and lenders can agree on the interest rate, maturity, repayment, and underlying protection, loans can and will be made privately. Where there is no such agreement, Government in effect forces private citizens to submit to unacceptable terms by taxing away their funds and lending them on conditions not approved by private business judgment.

There is always a possibility of departures from good business standards or of improper favoritism and influence. Loan programs that are conducted without regard to such standards are peculiarly susceptible to the latter abuses. The recent disclosures about the management of the Reconstruction Finance Corporation are shocking, but not necessarily unique in the annals of Government lending.

Drastic reduction or elimination of Federal government loaning activities, important at all times, becomes imperative during the period of our defense effort. The various types of loan programs relate to either (*a*) "Producer" loans designed to aid the borrower to manufacture or produce something usually either in competition with existing facilities or which existing plants could be converted to produce or (*b*) "Consumer" loans to individuals of some group to buy goods which otherwise they would not be able to buy. "Producer" loans as usually employed menace the supply of men and materials that must be used in defense production. "Consumer" loans put more dollars in their hands to compete for a rapidly lessening quantity of goods available to consumers, and increase the pressure on prices of such goods.

In regard to housing activities, for example, the administration, seemingly aware of these dangers to the defense effort, took some steps soon after the start of the Korean War to slow down the lending program. Housing restrictions imposed by executive order are expected to cut last year's level of over 1,000,000 housing starts down to about 850,000. There is a reduction estimated for 1952 loans below 1951, but the total is still about $700 million, or 50 percent more than 1949. There is also a net reduction of over $500 million of the mortgages held by Federal National Mortgage Association. The modest start included in the 1952 proposals is not enough.

RECOMMENDED SAVINGS

An end should be put to Government lending as promptly as possible. This would mean the discontinuance of all new loans, and restriction of the existing loan agencies to servicing and collecting outstanding loans. For this purpose a considerable consolidation of agencies could be made, with substantial savings in administrative costs.

The net effect upon the budget of eliminating entirely for 1952 new Federal lending would be a saving of $2 billion. This would require repeal of some existing laws. It may not be possible to accomplish the full reduction in 1952 because of noncancellable commitments, but with determination it should be possible to cut out 75 percent. Therefore, we include an estimate of at least $1½ billion as possible saving.

II. Public works, commodity inventories, etc. ($3,751 million)

The sudden need largely to increase essential military assets, chiefly new military equipment, atomic energy plants, and strategic materials stockpiles, raises two important questions:

(1) Can the national economy tolerate an additional $3¾ billion civil program [1] of nonmilitary construction projects, plus an accumulation of vast commodity surpluses hoarded in caves and warehouses?

(2) Must defense production compete with this nonessential civil program for scarce manpower and materials?

A comparison of the public works planned for 1952 with those of recent years (table IV) shows an increase of over 60 percent above the level of 1949, even after taking out atomic energy, defense housing, and proposed dispersal of Government facilities. (These total together almost $1 billion.) Details of the last two should be examined thoroughly for possible reductions. There are some small reductions from 1951 in some categories of public works, but every one is up over 1949—some substantially.

No citizen has the materials to enable him to analyze each of these groups of expenditures in table IV in detail. We shall restrict ourselves to the more obvious excesses in a few of them.

TABLE IV.—*Federal expenditures for civil public works, commodity inventory, and equipment, fiscal years 1949–52*

[In millions]

	1949 actual	1950 actual	1951 estimate	1952 estimate
Total	$2,994	$3,016	$1,744	$3,751
Public works:				
Proposed defense housing and community facilities				100
Atomic Energy Commission	312	240	377	720
Proposed dispersal of Government facilities			6	164
Veterans' Administration hospitals and domiciliary facilities	142	160	213	155
Tennessee Valley Authority	47	51	244	266
Other public buildings	9	14	64	18
Department of Agriculture	18	104	66	40
Department of Commerce	20	55	64	74
Flood control	374	413	440	387
River and harbor works	74	127	124	157
Other Army civil functions	5	5	8	16
Bureau of Reclamation	212	272	314	231
Other Department of Interior	86	98	159	133
International information and education, radio stations			6	73
Other Department of State and other agencies	9	21	45	62
Total public works—sites and direct construction [1]	1,307	1,560	2,130	2,593
Major commodity inventories—net change	1,511	1,253	−748	342
Major equipment [2]		17	84	488
Other physical plant acquisition and improvement [3]	177	186	278	327

[1] Some of the Federal expenditures for public works are in loans and grants to State and local governments and are included in the totals of tables III and V. Including such items would make a total of public works as follows (in millions): 1949, $1,693; 1950, $2,053; 1951, $2,877; 1952, $3,353.

[2] 1952 includes $220 million for defense production equipment and $211 million for merchant ships.

[3] 1952 includes $310 million for Atomic Energy Commission and $129 million for miscellaneous agencies offset by net receipts of $112 million from disposal of public housing.

[1] $3,751 million less $720 million (Atomic Energy Commission), less $164 million (proposed dispersal of Government facilities), less $100 million (defense housing) equals $2,767 million. See table IV.

PUBLIC WORKS

1. "Pork barrel"

In the field of flood control, river and harbor works and Army civil functions, congressional critics of "pork barrel" legislation have demonstrated large areas of nonessential and wasteful expenditures in the construction of new public works.

The House Appropriations Committee has been particularly critical of the "profligacy" exhibited by the Army engineers in their planning of public works projects. The cost estimate for almost every project has increased substantially from year to year, far beyond the rise in construction costs.

The "incredible extravagance" of the public works program was cited last year by Governor Leslie A. Miller, Chairman of the Natural Resources Committee for the Hoover Commission. He pointed out that the total bill for projects now under construction or planned for the future is more than $52 billion, and that on the basis of past performance in estimating costs, the entire job "probably would cost more than double that figure." His criticism, like that of the Hoover Commission itself, was directed principally at the wasteful competition between the Army engineers and the Interior Department's Reclamation Bureau, which he labeled "The Battle That Squanders Billions." In carrying out that "extravagant and wholly senseless competition," for example, the Engineers and Reclamation Bureau have spent millions of dollars planning huge dams on the same stream within a few miles of each other. They have developed conflicting billion-dollar plans for the development of the Missouri Basin. They have engaged in a 7-year struggle for authority to run the Central Valley project in California.

The two agencies usually attempt to justify their expenditures, especially in wartime, by pointing to the public power provided as an incident to their construction activities. Governor Miller points out, however, that if all the plans of the two agencies were carried out, the Government would be in a position to provide more than three times the amount of hydroelectric power, both public and private, that exists in the United States today—an extravagant program for which there is no foreseeable need. Moreover, many witnesses before the various Appropriations Committees have shown that proposed public power lines frequently duplicate existing lines and that many dams will provide public power to people already adequately served by existing private plants.

The complete lack of logic in the construction of the "multiple purpose" river projects has frequently been pointed out. These multiple purposes usually include flood control, power, irrigation, and navigation. Efficient flood control requires an empty reservoir when the rainy season starts, while power requires a full reservoir at all times. Irrigation likewise requires a reservoir that can be drawn down during the growing crop season and replenished at other times.

Notwithstanding the inconsistency of combining all of these objectives, the Government continues to spend huge sums on the so-called multiple projects. For the fiscal year 1952 the Corps of Engineers has planned an expenditure of $200 million on multiple purpose projects which include power.

The practice of reducing the program of public works in periods of high military costs led the Government to limit its Army civil functions expenditures during one of the World War II years to $32 million and to an $80 million average for the 3 years 1943–45. Corresponding expenditures for 1952 are slated to be more than $540 million. Reduction at least to the World War II level is as necessary as it is prudent.

2. Tennessee Valley Authority

The invasion by the Federal Government of the power field has led to the adoption of a policy of constructing steam plants to supplement the generating capacity of hydroelectric plants. This policy stems from the contradictions inherent in the multiple-purpose dam projects. The TVA item of $266 million includes $172 million for steam plant construction. To thus add to Federal expenditures for subsidized Government competition with private taxpaying business is wrong, especially in view of present defense needs. Here certainly is an opportunity for effecting a saving.

3. Veterans' hospitals

Another area of public works expenditures that needs reduction is the program of veterans' hospital construction, scheduled to cost $155 million during fiscal 1952. Although medical care for veterans, now costing close to $1 billion a year, was originally intended only for veterans with disabilities incurred in the service,

only about 15 percent of the admissions in fiscal year 1949 were for service-connected disabilities. The Budget reports the status on June 15, 1950, as 25,312 veterans awaiting hospitalization, of whom only 28 had service-connected disabilities.

Under the law, veterans with injuries or diseases that have no connection with their military service may be admitted, after signing a "poverty" oath, only "if a bed is available in an existing facility." Despite this limitation in the law, the hospital construction program of recent years has been intended almost solely to provide new facilities for the ever-increasing number of non-service-connected cases.

In addition, the short supply of doctors and trained hospital personnel apparently will make the new construction unusable after completion unless existing facilities are closed. The program is in large part the result of legislation previously passed by Congress. It will require suspension or repeal of this legislation to effect real saving.

CONCLUSION

Even if the first three items on table IV are excluded—and some reductions are likely to be found there upon close review—a 50 percent reduction in all other public works should be possible and would save about three-quarter billion dollars. Our citizens, individually, will be required to curtail purchases of durable goods not essential to defense activities. Government can do no less.

COMMODITY INVENTORIES OF FARM PRICE-SUPPORT PROGRAMS

The Government should heed the advice of a group of State farm bureau leaders of the American Farm Bureau Federation, who, at their 1950 annual conference in Dallas, suggested that agriculture shelve Government-aid programs now in order to provide additional funds for defense. They want agriculture to take the lead in urging reduction of government nondefense spending by supporting the suspension of price support operations on farm products for the duration of the emergency.

The original purpose of the farm program was to raise farm prices and farm income from depressed levels. Today that translates into sustaining farm prices at high levels. Since inflation is the greatest internal threat faced by the Nation today, the current defense effort demands a suspension of this program. The reasons that caused its creation no longer exist. It has long outlived its usefulness, and has become a real menace.

As of December 31, 1950, the Commodity Credit Corporation had over $2.9 billion of the taxpayers' money invested in farm commodities, including nearly $2 billion in inventories and over $964 million in loans. Estimates for 1952 indicate a $98 million excess of repayments and collections over expenditures. It is estimated, however, that this "excess" is after about $1.2 billion is paid out for additions to commodity inventories and $1.6 billion in commodity loans, some direct and some by lending agencies with commodity credit guaranties. There are savings possible here but they can be more readily measured in connection with commodity inventories discussed in a later section. The estimate of possible saving is part of the item of "Sale of mortgages, loans and commodities."

The budget item on table IV is made up of the above $98 million credit and of a $440 million expenditure for defense production materials. A study of this item may show that it is not all essential and that savings are possible here also.

III. Aids and special services to State and local governments and others ($16,611 million)

This group (table V) includes domestic items of $9,603 million, and international aid of $7,008 million.

International aid is $3 billion more than is estimated for 1951, but full details for 1952 are not presented yet. There may be considerable amounts that are not for military supplies and aid. We make no estimate of savings at this time, but believe that when the details are presented, a dispassionate study should be made to eliminate any amounts unessential to today's main effort.

Domestic items include a variety of programs, but they all have one thing in common. They are grants or gifts, either in money or in services, from the Federal Government to State and local governments or to particular groups or individuals.

In the first group (items 1 to 4), the expenditures are shown according to the kind of gift. Some relate to property of State and local governments, or of individuals or

organizations, such as Federal programs assisting farmers in soil conservation. Some are for research and development carried on either by the Federal Government directly or by Federal grants to States. And some, either as grants-in-aid or direct Federal expenditures, are aimed at improving the health and education of citizens or at developing productive skills.

The expenditures in the second group (items 5 to 10) are shown according to the beneficiaries. They are classified in the budget as current expense and are primarily to benefit particular economic groups or individuals. They consist of transfer payments to individuals, grants to States for the benefit of individuals or economic groups, subsidies for various economic groups, payments for goods procured for aid programs, and expenses of performing special services. Also included are expenditures for operation and maintenance of those physical plants which provide aids or services to particular groups.

Substantial benefits also accrue to various economic groups and private individuals from Federal expenditures for loans, for physical assets, and for other developmental purposes such as education, and scientific research and development

TABLE V.—*Federal aids and special services to State and local governments and others, fiscal years 1949–52*

[In millions]

	1949 actual	1950 actual	1951 estimate	1952 estimate
Total	$15, 628	$15, 094	$14, 792	$16, 611
1. Physical plant:				
(*a*) State and local	459	478	507	687
(*b*) Private	248	401	551	482
2. Education, training and health	1, 186	1, 114	997	1, 064
3. Research and development [1]	210	311	375	391
4. Engineering and natural resource surveys	53	43	50	49
5. Agriculture	341	601	890	673
6. Business	773	789	876	412
7. Labor [2]	175	228	180	180
8. Home owners and tenants	−11	−111	−47	−52
9. Veterans	5, 549	5, 583	4, 765	4, 263
10. General aids	1, 091	1, 264	1, 429	1, 454
Total domestic	10, 074	10, 702	10, 574	9, 603
11. International (not yet itemized)	5, 554	4, 392	4, 218	7, 008

[1] The largest single item in 1952 is $218,000,000 for the Atomic Energy Commission.
[2] 1952 includes $159,000,000 for administration of unemployment compensation and employment services.

The area of Federal grants and subsidies, which constitutes a good part of the amount in table V, is another example of an activity in which the Federal Government should not be engaged. The underlying reason is the same as that given for opposition to Federal lending. The Government has nothing of its own to give away. All that it gives or grants to States, cities, or individuals it must first obtain from the citizens in taxes or loans. An insidious consequence is the degree to which the grant system has resulted in an extension of Federal control over, and interference with, the management by the States of their own affairs. This is a logical outgrowth of the fiscal dependency that the grant system creates and promotes.

Also as with loans, whatever opinions may be held regarding justification for some grants and subsidies, the necessity for retrenchment becomes imperative under today's defense demands on our revenues.

According to table V, the total of domestic Federal grants and subsidies, together with special services included therein, will be $9,603 million in 1952. The Government must collect an additional $9.6 billion in taxes in order to dispense that amount in grants to the States, cities, and private groups.

A sudden, complete elimination of every item in this table would hardly be possible. These programs, originated under conditions of economic stress and continued into an era of great prosperity, have become embedded in the financial structure of States and cities, and in the long-range plans of individuals. But there should be steady, insistent advance in that direction as each program permits. It is true that transfer to the States of certain services now supported, in whole or in part, by Federal grants would not immediately reduce the over-all tax load if the States were to increase their own tax revenues in amounts equal

to the lapsed Federal grants. But if the States were to assume full responsibility for these services and the full cost were brought closer home, it is possible that some of the schemes which they now carry on a fund-matching basis would not be retained.

Physical plant, non-Federal (item 1)

Grants for State and local government plants are set at $687 million, including $100 million labeled for civil defense. The balance is planned mostly to spur State and local governments in their civil construction programs, principally roads, hospitals, and civil airports. It is significant that these are precisely the types of construction programs which it is generally felt should be reduced on the Federal level. Similar considerations appear to be applicable to the civil construction programs of the State and local governments.

The Budget also contemplates the expenditure of $482 million for the construction and improvement of private physical assets. Almost three-fourths ($335 million) is for soil conservation and other agricultural purposes, the balance mostly for hospitals ($95 million) and merchant marine promotion ($37 million). This is certainly a field for reduction in any amounts not truly a direct need for the defense effort.

Education, training, and health (item 2)

About half of this $1,064 million item is for veterans' programs for tuition, supplies and equipment. (Commented on under item 9, Veterans.) The largest other item is $290 million for the program of proposed Federal aid to education, repeating the recommendation made in previous budgets and found unacceptable by the Congress. The basic arguments for its rejection apply even more strongly this year.

Agriculture (item 5)

The major part of Federal aid activities in agriculture, which total $546 million in direct Federal programs and $126 million in grants-in-aid, is an off-shoot of the multi-billion-dollar farm price-support program. Nearly half of the direct aids covers the estimate for 1952 anticipated losses and net operating expenses of the Commodity Credit Corporation. There is also included $115 million for the wheat agreement and $70 million for Sugar Act expenses. The bulk of the grants consists of the distribution of surplus farm commodities to State welfare agencies.

A substantial portion of the item could be eliminated as part of the program for discontinuing price-support purchases previously discussed in this report.

Business (item 6)

Direct Federal aids to business and special services intended to benefit business have been reduced somewhat from 1951 but will still cost an estimated $412 million in fiscal 1952. About half is for ship and air navigation aids. The item for "postal subsidy" is listed in the budget as $70 million, but only because the budget contemplated an increase of $361 million in postal rates—an increase which has not yet been voted.

The administration, the Hoover Commission, congressional leaders, and fiscal experts have all agreed that more business services can be made self-sustaining by charging their cost to the users rather than to the taxpayers.

Veterans (item 9)

Next to international aids, this is the most costly of the Federal-aid programs, totaling an estimated $4,263 million for fiscal 1952. It is made up of $2,223 million in compensation and pensions, $1,087 million for readjustment benefits, $641 million for hospital and medical care, and $313 million of miscellaneous items. There is also $498 million for veterans' tuition, etc., in item 2, making the combined total for veterans, $4,761 million.

So far as pensions are concerned, there is no desire among either legislators or taxpayers to interfere with the funds provided by a grateful Government to those veterans who were incapacitated or to the dependents of those who were killed in military service. But it is estimated that of the 3 million individuals and families receiving these payments, nearly 25 percent involve cases of disability incurred outside military service. Many others seem to be paid where there is no present disability at all. To correct instances where disability payments go to veterans who proved themselves capable of holding important and even strenuous jobs, the late Defense Secretary James Forrestal recommended to Congress that recipients of such payments undergo new medical examinations to qualify for the benefits they receive from the Government.

The abuses and excesses of the veterans readjustment program have been brought to the attention of Congress by the Budget Bureau, the Veterans' Administration, educational groups, and others, and some steps have been taken to limit expenditures for recreational courses, fly-by-night schools, fraudulent training courses, exorbitant tuition rates, and excessive subsistence payments. But the initial report of the special Teague committee indicates that many of the abuses have not been completely remedied. Congressional studies raise serious questions as to the other aspects of the "readjustment" program which 6 years after the end of the war and in a period of high employment, will still provide veterans with more than $1 billion a year, in addition to the $500 million spent for education and training.

Under today's conditions every expenditure must be justified—even those labeled "Veterans" cannot be passed as "sacred" without examination. The President in his budget message makes the interesting comment that "Before many years, nearly all the population may be veterans or the dependents of veterans," and he draws the conclusion that "Therefore, in legislation directed particularly to the problems of servicemen and their dependents, we should provide only for those special and unique needs which arise directly from military service." Benefits that meet that test of the President can be taken care of to the full extent now provided in the laws. This will still leave large areas of possible saving in correcting and adjusting the more flagrant excess benefits for other veterans and dependents. Senator Byrd and others also point out the possibility of savings through better operation of the agencies. It appears to us that between $500 million and $1 billion could be saved without touching the service-connected cases. Some revision of the laws may be required.

General aids (item 10)

The major item in this category of general aids is the $1,300 million estimated as the 1952 level of grants-in-aid for the public-assistance program. With the passage of H. R. 6000, liberalizing and expanding the old-age and survivors insurance program of social security, it was anticipated that substantial reductions would be made in Federal public assistance expenditures for 1951 and subsequent years. The start of the new military preparedness effort is an opportune time to reconsider the purposes of the assistance program, to relieve the Federal taxpayer of the huge burden implicit in the program, and to restore it to its proper realm of local responsibility.

FEDERAL AID TO STATE AND LOCAL GOVERNMENTS

Scattered throughout many of the budget categories previously discussed are various forms of Federal aid to State and local governments. These aid programs are brought together in table VI and show a total of $3,177 million. This is not an addition to the totals in the other tables, but a convenient summary of items from them.

TABLE VI.—*Grouping of Federal expenditures for aid to State and local governments, fiscal years 1949–52*

[In millions]

	1949 actual	1950 actual	1951 estimate	1952 estimate
Total	$1,803	$2,269	$2,771	$3,177
Federal loans	−73	15	230	138
Expenditures for other developmental purposes [1]	613	701	810	1,279
Current expenses for aids and special services [2]	1,226	1,506	1,690	1,696
Other current operating expenses	38	46	41	63

[1] Some of the principal items in this grouping are included in table V.
[2] The items in this grouping are included in table V.

Aid programs for State and local governments on a contributory basis

The full impact of the Federal nondefense aid program is even greater than is indicated in the tables, since in almost all cases the Federal contribution must be matched by dollars of the States and localities. There is a double threat in this spending program, since it generates pressure for increased spending at State and

local levels. The total of this intrusion by the Federal Government into areas of public activity that are the responsibility of the State and local governments has risen in the past 6 years from $900 million to the 1952 total of $3 billion.

CONCLUSION

In this tremendous field of Federal aids, grants, subsidies, and special services, there is no room either for blind and wholesale spending or for blind and wholesale reductions. Part of the aid programs could be construed as related to defense needs (e. g., primary roads useful for essential military purposes, grants necessary for the maintenance of an adequate merchant marine, veterans' benefits that help the morale of servicemen who know they or their dependents will be cared for if military service brings injury or death). Part of other aids must undoubtedly be kept at or near present spending levels (e. g., benefits for veterans disabled in service, such as pensions and insurance, based on a contractual relationship between the Government and the individuals, and some navigational aids that assure safety in air and water travel).

There remains a large area of Government spending in the category of special aids and services that is neither essential nor related to the defense effort, and which certainly cannot be justified under present conditions. In domestic programs other than veterans, we estimate a possible saving of 50 percent through cutting out nonessential items. This would be about $2½ billion. With the possible savings on veterans' programs of $½ billion minimum, there should be a total of $3 billion to be saved in this area.

IV. Operating expenditures—Other current expenses ($8,343 million)

These expenditures are chiefly for interest, repair, maintenance, and operation of physical assets, economic regulation, law enforcement, and general operating expenses. Expenditures for economic regulation include expansion due to the defense program.

TABLE VII.—*Other current operating expenses (civil) fiscal years 1949–52*

[In millions]

	1949 actual	1950 actual	1951 estimate	1952 estimate
Total	$7,280	$7,713	$7,798	$8,343
Repair, maintenance, and operation of physical plant	388	276	311	335
Regulation and control [1]	292	342	408	672
General operation and administration	1,155	1,278	1,357	1,440
Interest	5,444	5,817	5,722	5,897

[1] The regulation control grouping for fiscal 1952 includes $464 million for economic regulation and $208 million for other law enforcement.

Excluding interest, of $5.9 billion for 1952, there remains only $2.4 billion in nondefense current operations expense in this particular budget area. This figure, however, is only a part of the total in which savings can be made through greater efficiency and the elimination of waste and mismanagement. The same type of expenses are included in the total costs of all the Federal activities discussed thus far, and in military and foreign aid programs. This enlarges the field for this type of savings far beyond the $2.4 billion in table VII.

Dr. Robert L. Johnson, chairman of the Citizens Committee for the Hoover Report, stated recently that "at no time since the Hoover report was completed has there been a greater need for its enactment. Now, more than ever, the Nation's economy needs the four or more billions of dollars that can be saved annually by the report's implementation. The Nation's safety demands that we have an efficient, muscular government, stripped of traditional encumbrances and freed from all the excess baggage it has collected in a century and a half of haphazard expansion."

There is no need to labor the evils of inefficient government—high cost, unnecessarily high taxes, red tape, costly delays, low employee morale, and duplication of activities. The double danger of such inefficiency during the all-out military preparedness program is that the wasted billions constitute a financial drain on an already strained economy, while at the same time siphoning off scarce manpower that could more profitably be employed in essential production.

Reductions in Government overhead

Substantial reductions in Government overhead, principally in the nondefense area, appear to be possible in three ways.

1. The elimination of existing instances of waste and inefficiency in Government activities;
2. A reduction of personnel and administrative expenses as the activities of nondefense programs are cut; and
3. A realization by administrative supervisors, at all levels, of the vital part that the streamlining of Government can play in the defense effort.

Reductions in nondefense programs, in addition to the direct savings made, should result in substantial economies in personnel and administrative costs. Some of this is practically automatic, but a large part of the whole savings possible will depend upon the determination and effectiveness of administrative supervision and direction. Supervisors are notoriously reluctant to trim their staffs below the level they have achieved. This reluctance is encouraged by the demoralizing and wasteful practice of basing salaries on the number of persons directed or supervised. Even when there is an urgent demand for employees in the expansion of necessary defense activities, and no lack of opportunity for other work, there is often persistence in trying to hold on to the old familiar job all down the line. Moreover, any padding of Federal payrolls at this time under the guise of defense needs is really a form of manpower hoarding that cannot be too strongly condemned. What better way of inducing a cynical attitude toward the whole defense effort: "Everybody must sacrifice but the Government"? On the other hand efficient administration can show notable results because the opportunities for savings are so numerous and so readily discoverable.

Official documents have cited hundreds of "horrible examples" that typify the waste and inefficiency prevalent in Government operation, such as:

1. Taking into account annual leave, sick leave, "coffee time," and Government holidays, the civilian employees of the Federal Government work an average of 250 hours less each year than the 1,900 hours which is considered a very liberal standard in private industry. On this basis, they work 31 days, or over 6 weeks, less per year than employees in private business. Reducing Government annual leave to 20 days (4 weeks) a year and sick leave to 12 days a year would save an estimated $100 million annually. (Congressional Record, Senator Paul Douglas.)

2. The Federal Government owned 3.6 typewriters for every typist and stenographer on the payroll. (Appropriations Committee hearings.)

3. The Bureau of Standards spent $50,300 during a single year for the maintenance of 40.3 acres of lawn and landscaped areas and 10 acres of uncultivated wooded area, an average of approximately $1,000 per acre. (House Appropriations Committee report.)

4. The overlapping of personnel and activities involved in conservation and related services to farmers was pointed out. Elimination would mean economy to both the Government and the citizen and save expense of at least $44 million. For example, one Missouri farmer received from five different agencies varying advice on the application of fertilizer on his farm. (Hoover Commission.)

5. The United States Coast Guard headquarters, in the Treasury Department, is staffed by eight admirals, a good example of government "extravagance which prevails in obscure places." (Overstaffing Subcommittee.)

6. The average workload of the Veterans' Administration employees handling national service life insurance is about one-fourth of the workload of employees in private insurance companies. (Hoover Commission.)

7. It has been estimated that for each Federal dollar spent in the name of conservation, the United States has had a return of about 10 cents in actual reduction of soil and fertility losses. (Dr. Milton S. Eisenhower.)

8. Veterans' hospital service survey shows increasing emphasis on non-service-connected disabilities, inordinately long "patient stay" (e. g., 14.3 days for appendectomy compared with 7.8 days in voluntary general hospital), poor planning of hospital services, and overlapping of veterans' and other Federal hospitals. (Hoover Commission.)

9. Bureau of Entomology and Plant Quarantine paid $27,000 rental over a 2-week period for use of a plane which had been sold to the lessor by the Government for $6,600. (House Appropriations Committee.)

10. In another instance one plane was rented for $70 an hour and another only 75 percent as effective for $100 an hour. When the work subsided the $70 plane was released and the more expensive, less effective, retained. (House Appropriations Committee.)

SUMMARY

Some claim that effective reductions must be made in programs and others say the only way to cut nonessential expenditures is to cut personnel. The overriding demands of the defense effort require that both methods now be put into effect for the reduction of all reducible programs and operating expenses that do not contribute to the security of the Nation. All Government departments can make savings of this type which would aggregate at least 25 percent of the total estimated by Dr. Johnson previously quoted. This would be a reduction of at least $1 billion.

V. Sale of loans, mortgages, and commodities

The budget includes as expenditures the net amounts paid out during the year by the Commodity Credit Corporation, Federal National Mortgage Association and the Reconstruction Finance Corporation. In other words, money expended each year in making loans or in acquiring commodities or mortgages under these programs becomes an expenditure of the Government and appears in the total of expenditure for that year. Correspondingly, when commodities are sold or loans are paid, the receipts are netted against the expenditures and there is a reduction of expense for that year by the amount received.

Considerable liquidation of the loans and assets of these corporations is reflected in the 1952 budget. However, there will still remain a substantial total of such items as of June 30, 1952, which are not programed for sale. There are also, as outlined in previous sections, programs in operation under the law which will result in the making of additional loans or the acquisition of additional property during 1952 and in subsequent years.

The total amount of commodities and loans which the budget estimates will be held by the Government at the end of 1952 (and therefore are not included in the proposed sale programs prior to that date) are as follows:

As of June 30, 1952

Commodity Credit Corporation:		
Commodities		$1, 660
Loans		350
Federal National Mortgage Association Mortgages (includes Veterans' Administration loans $701)		748
Reconstruction Finance Corporation		941
Total		3, 699
Less estimated liabilities of corporations:		
Commodity Credit Corporation	$134	
Federal National Mortgage Association	10	
Reconstruction Finance Corporation	216	
		360
Total		3, 339

Here are $3,699 million of presumably salable assets. If they were sold, the liabilities of these corporations could be paid off out of the proceeds, and the balance, $3¼ billion, would be saved to the Treasury. If the loan programs were discontinued to the extent estimated in this report for operations in 1952 (items in table III), there would still be almost $3 billion available at the end of fiscal 1952.

It might well be unwise, or even impossible, to sell everything included in the above total. However, if the same policy were adopted as is proposed for the review of other nondefense areas in the budget, some further substantial realizations and therefore reductions in the 1952 expenditure can be effected, and $2 billion might be saved for the 1 year.

This review should cover both the sale of commodities and loans on hand and the adoption of policies, supported by legislation where necessary, to reduce or eliminate further acquisition of such holdings. The latter step would affect not only 1952 but subsequent years' budgets.

FUTURE COMMITMENTS AND UNEXPENDED APPROPRIATIONS

This survey of Federal expenditures is necessarily limited to 1952. No reference has been made to the fiscal problems which relate to expenditures of future years. Government programs are often of long term. Some future expenditures will

result from present commitments or appropriations, and some will be the natural result of policies or actions taken in prior years.

The loan expenditures listed in table III, and the Public Works expenditures listed in table IV are for 1952 only. Actually, under the various loan programs in force, the estimated, cumulative authority for loans, guarantees, and insurance will total $61.4 billion on June 30, 1952. Of this amount, $48.8 billion will be actual commitments and $12.6 billion will be uncommitted but authorized. Of this total, only $5.5 billion is rquested in the 1952 budget; the balance is authorized under laws which have already been enacted. Similarly, for the public works program, Governor Miller in a Hoover Commission report, has pointed out that the total bill for projects now actually under construction or planned for the future is more than $52 billion. He also points out that on the basis of past performance in estimating costs, the ultimate cost is likely to be more than double that figure.

These facts support the necessity for taking energetic steps to curtail expenditures in these areas both in 1952 and in future years, as we enter what may well be a 10-year period of heavy expenditure for defense.

Another facet of the inadequate control over expenditure under our present budget system is revealed by the current figures. There is a tremendous difference between the appropriations requested (both in total and in particular items) and the expenditures for the same year. Of the $71.6 billion expenditure proposed for 1952, almost half, or $34.5 billion, is out of appropriations of prior fiscal years. On the other hand the President asks for new appropriation enactments of $94.4 billion for 1952, of which it is planned to spend only $37.1 billion in that year. Under this procedure the total of unexpended appropritions at the end of fiscal 1952 (including those carried over from prior to 1952) will be the huge amount of $81.3 billion. The military item is $60 billion of this total.

At the end of the 1952 fiscal year then, a total greater than the 1952 expenditure will have been authorized by appropriations of the Congress and will remain unexpended. That, in other words, will be the starting point before considering 1953 appropriations. Unless the international tension is eased by developments in the meantime, it will not be easy to keep the 1953 budget down even to the total now proposed for 1952. When we start the new fiscal year with such a huge amount of unexpended appropriations, our budgetary practice encourages mounting expenditures beyond any effective control by the Congress.

Summary of Reducible Areas

The total of expense, including international aid, in the "reducible areas" which can be subjected to examination and reduction under present conditions is the substantial amount of $24.8 billion for 1952. Table II shows these totals have held remarkably steady over the past 4 years except for the bulge in international aid in 1952. There is no reduction shown for 1952 to help meet the great increase in military expenditure.

Not every item in the nondefense area of expenditure can be eliminated. However, under present day conditions and necessities, the burden of proof is not upon the citizen to demonstrate where reductions can be made. Rather, the burden of proof falls on the Government and its departments. Each item should be justified for retention only after a thorough review of its purposes without regard either to any previous approval of its programs or to legislation on the statute books.

With respect to the nonmilitary or civilian expenditures, we have recommended a prompt withdrawal of the Federal Government from the lending field, and a limitation of its future operations of this sort to servicing and collecting outstanding loans.

We have recommended a deep cut in the public works program and a suspension of all projects not contributing directly to some essential defense purpose.

We have also recommended drastic curtailment of Federal aid, grants, subsidy, and special services programs. Accomplishment of this goal involves making the States responsible for various services now supported, in part, by the Federal Government, and withdrawal of the Federal Government form such inflationary devices as farm price supports at levels which impose a double burden, first on the taxpayers and second on the pocketbooks of all consumers.

In addition to reductions possible in the areas reviewed, possibilities of cuts in both the defense budget and the international aid total will appear, once the Government becomes imbued with the purpose to be wisely economical. If any individual items are found which have been called "defense" or "military" that do not rightfully deserve that classification, they should not be considered sacred and untouchable because of the "defense" name given them.

The precise amounts in the budget total that can be eliminated by applying standards of prudent judgment will have to be carefully worked out by the Congress, with the aid of the administration and the alert and continuous active support of the public. In the various areas that were reviewed we have indicated possible goals for each group as follows:

	Billions
I. Loans (table III)	$1½
II. Civil public works, commodity acquisitions, and equipment (table IV)	¾
III. Aids and special services (table V)	3
IV. Sale of loans and commodities	2
V. Operating economies, eliminating waste, etc	1
	$8¼

This summary rests upon an analysis which is obviously far short of exhaustive. No nonofficial committee could possibly make the complete study of all the details of the Budget which would disclose every point at which nonessential expenditures could be cut.

We have, for example, made no attempt to determine how much could be saved from the $7 billion devoted to international aid; Senator Byrd estimates $3½ billion in this item alone. We have confined our examination to the civil functions of the Government, although it is certain that large savings could be accomplished by eliminating the waste and extravagance in the military budget. Even among the civil expenditures our survey has necessarily been limited.

Giving recognition to the very many additional opportunities for saving, it is conservative to conclude that a reduction of at least $10 billion is possible, while still leaving intact all the Government that a free nation requires.

The history of efforts to reduce expenditures is discouraging. The story of waste and extravagance in many Government operations and the continual growth of the total spent for the various special pressure groups has been spread forth on the record. Often when a new budget is presented at the beginning of the year, there are emphatic and undoubtedly sincere protestations of determination to accomplish positive economies. Time after time when the final record is in, it turns out that the reductions are not as big as was hoped for. Time after time, other unbudgeted items of expenditure have offset some or even all of the savings so laboriously accomplished.

There are many practical obstacles to effecting reductions. The President says he is powerless because of some law passed by Congress. The Congress has very little staff of its own for investigation; it says it is helpless because of noncooperation on the part of the Executive in carrying out cuts effectively. Both cite pressure from the public against the specific cuts proposed. Opposition is often instigated by various groups of one kind or another interested in and affected by the particular items, sometimes under the guidance and promotion of publicity staffs or other paid employees of the Government departments. Experience emphasizes that teamwork is needed in cutting through the various obstacles. It is impossible for either the President, the Congress, or the public to do a real job alone without the help of the others.

Since the individual citizen feels he can do very little to reduce these billions of dollars, he tends to become apathetic. He feels unprepared to pass on the reasons for the various expenditures, listed in millions or billions of dollars. These sums are too large to understand clearly. The real facts concerning the need for them are beyond his information and knowledge. Yet, a prerequisite for expenditure reduction is the realization on the part of people in all economic groups that unnecessary expense cannot be tolerated, even if it means giving up pet projects.

HOW CAN WE EFFECT THE NEEDED REDUCTIONS?

The drastic demands of the present situation require drastic action. Budget paring is essential. But no one believes that paring will do the whole job. A percentage cut across the board on all nondefense items, even if it could be made large enough, is an unsatisfactory bludgeoning process that hurts equally the useful items with the bad ones. It penalizes any executive department that has done good work in cutting waste and is operating efficiently just as severely as the inefficient and extravagant operation.

The need is to start with a clean slate, so that only expenditures that can be proved necessary under today's conditions will be authorized. With teamwork between the executive and legislative branches of the Government and the under-

standing and alert support of the public this can be done. The important need is a genuine determination. Then "red tape" entanglements can be disposed of.

We suggest the following program—not an easy one, and requiring subordination of all special interests.

1. A clean slate

Congress, with the help of information from the Budget Bureau or from the general accounting staff would, by law, suspend for 3 years the operation of every provision of the law now in force requiring expenditures or appropriations. There should be no exceptions except for direct (not indirect) military expenditures or international aid. These two categories show no details in the budget, and could not be included in this first review. All laws relating to interest on the public debt would be left undisturbed. Undoubtedly there are some authorization and expenditure laws that after examination even in the light of today's needs would be retained in force: e. g., pensions to disabled veterans would certainly be continued. Such exceptions should and could be restored promptly after examination and study, but to accomplish the results there would have to be an absolutely clean slate on nonmilitary expenditures to start with.

2. Revised budget recommendations

The Congress would at the same time, with the cooperation of the President, ask the Budget Bureau (which has recently been studying all expenses thoroughly for the 1952 budget) to prepare a new budget promptly on the basis of the clean slate, with no commitments to any program or group. This revised budget should be for a total expenditure of $10 billion less than the present proposal of $71.6 billion. These budget reductions could well include reductions in proposals for international aid for nonmilitary purposes.

3. Enactment

The Congress would then proceed with the consideration of these revised proposals also on a clean slate basis and using all its "paring" techniques. The aim would be to approve a final total of expenditures that would be $10 billion below the present proposed budget. The Congress should, to make the limit effective, permit no additional expenditure not proposed in the Budget Bureau program, unless a corresponding amount is cut from other Budget Bureau proposals.

4. Better future control over expenditures

Unspent appropriations under the budget will have accumulated to $81.3 billion at June 30, 1952. For some years the appropriations and expenditures have been getting further apart. The appropriations authorizations by the Congress therefore have less and less relation to the actual expenditures each year. If the clean slate policy is adopted, it will have the additional advantage of providing an opportunity to strengthen the appropriations procedure so that real control over the total allowed for each year's expenditure can be given to the Congress.

With a clean slate to start with, and real teamwork by all, the goal can be reached—a reduction in the proposed expenditure for 1952 by at least $10 billion.

Conclusion

To increase our present peak tax bill of $55.1 billion enough to cover expenditures of $71.6 billion is to strain our economy and heavily burden our whole people. To borrow the money to meet such a budget is to fan the flames of inflation. On the other hand, even if budget expenditures are cut substantially, very generous provision will still be made not only for all defense requirements but for essential and reasonable nondefense activities. We can then tax ourselves enough to meet the total bill.

Hard years lie ahead, in which we shall need all the genius of our economy, all the initiative and full effectiveness of our free enterprise system, working at capacity. We shall be able to maintain a good living standard relative to other countries but there will be less good things to enjoy. Our citizens must tighten their belts. They can fairly require the Government to show similar prudence in spending.

We can succeed in our high endeavor. We can build a strong defense force. We can give it the essential backing it needs in unmatched industrial production and economic strength. We need only use what we have actively, prudently, and intelligently. The first basic requirement is that our Government show that it has established firm control of our fiscal affairs; that the Federal Government and its expenditures are being managed with the same competence that we require of ourselves in our own everyday affairs.

The CHAIRMAN. You may continue, Mr. Magill.

Mr. MAGILL. It is evident, however, that Federal expenditures are going to run very high for an unknown number of years to come. Some day we may get back to moderate-sized budgets, but for the present we must each of us pay a huge tax bill year after year after year. The first requisite, then, is as sound and well organized a Federal tax structure as the wit of Congress can devise. There is no good way or pleasant way or even satisfactory way to raise $70 billion or $60 billion or the $80 billion we may have to raise next year. To divert such amounts in taxes from the productive economy is a severe strain on any country, even one so prosperous as ours. However, some taxes certainly damage productive effort and the economy less than others, and those we must try to pick.

Fortunately, events have given us a breathing space to devise now—this year—a tax structure that can produce greater revenue yields without destroying our economy. We may not soon again have the chance to lay the ground work for taxes that face up to the realities of defense and inflation.

The present Federal tax patchwork is not a sound or well-organized tax structure to raise the vast amounts of revenue the Treasury needs. The pending bill makes the whole dreary mess worse by increasing rates that are already too high; and by emphasizing the defects of the present revenue laws, rather than by moving to cure the defects, or to supplement the old taxes with better new ones.

There are three great Federal taxes, the individual income tax, the corporate income tax, and the collection of special sales taxes or excise taxes. The two greatest taxes that produce 85 percent of all the money are levied on incomes when they are received. Excise or sales taxes are levied on incomes when they are spent. Both kinds of taxes are paid out of income.

The honest man has no alternative to paying an income tax on what he has already earned; but he can choose not to earn so much or more next year. A man has a real alternative to paying a sales tax; he can choose not to buy any particular article. He can save his money if he wants to.

At the present time, we want men to work harder and to produce more. On the face of it, putting additional income taxes on individuals tends to defeat the very result we want to achieve. Such increased taxes certainly do not help accomplish our main objective.

On the other hand, we already have some scarcities of goods and we expect to have more. Therefore taxes that will somewhat reduce the demand for goods will assist our general program. Sales taxes serve that purpose; income taxes do not. Especially in times like these of heavy budgetary demands, we ought to be using excise or sales taxes much more than we are doing.

What kind of sales taxes? Certainly not discriminatory sales taxes levied at very high rates on a few commodities—as in the House bill—but taxes generally applied to all sales except such essentials as food, clothing, medicines, and shelter. Such taxes, if generally applied will produce the money we need at much lower rates than the House bill applies to the list of specialties it taxes. General sales taxes operate fairly; most of the States employ them. They have the particular advantage of giving the taxpayer the choice of whether he will buy the article and pay the tax, or will save his money.

If the individual income tax has to be raised, it ought not be raised in the manner the House bill provides, but in the way the Secretary of the Treasury originally proposed: Namely, a few points increase in the basic rate. Nearly all the taxpaying capacity has been taxed out of the middle and upper brackets. To levy a flat percentage tax increase on present tax liability is to try to squeeze more juice out of a lemon already squeezed dry; to tax a good many incomes more than 100 percent, as the Ways and Means Committee found out. The House bill levies the heaviest tolls on taxpayers already the hardest hit. Moreover those are the taxpayers whom we must count on to manage the enterprises that must produce the additional goods, to work the extra hours, and so on. What possible incentive have they to do so when they can keep only 5 cents or 10 cents out of any additional dollar earned?

Levying an increase of a flat percentage of the tax in the manner of the House bill increases harshly the already severe impact of highly progressive tax rates. This becomes evident when we look at the effect of the tax increases on incomes left after present taxes. For taxable incomes below $5,000, the additional tax is about 3 or 3½ percent of income after present taxes. In the case of a taxable income of $100,000, the additional tax is about 25 percent of the income remaining after present taxes.

Your committee will recall that in 1948, when a flat percentage reduction in tax was proposed, it was condemned as unfair and was ultimately modified. Yet, these arguments are forgotten now when a flat percentage increase in tax is proposed.

One further point concerning the individual income tax seems to have been forgotten. Thirty-one States and the District of Columbia levy personal income taxes. Twelve of these States and the District of Columbia do not permit the deduction of Federal income taxes. The maximum rates in these States—excluding New Hampshire and Tennessee which tax only interest and dividend income—vary from 2 to 5 percent in Maryland to 7 percent in New York and North Carolina. Thus the combined bracket rate on income over $80,000 for single returns and over $160,000 for joint returns in the case of residents of these States is between 96.5 percent and 101.5 percent. In six States the combined proposed Federal and State rate is over 100 percent. Only the fact that the Federal Government permits the deducting of State taxes prevents the taxpayer from having to pay a little more than he earns for the privilege of earning money.

Senator BYRD. Is that after making allowance from the State tax of the Federal tax?

Mr. MAGILL. Yes, sir. The States that I have named are States that do not allow a deduction for the Federal income tax.

Senator BYRD. I mean a deduction of State tax from Federal tax, that is——

Mr. MAGILL. Yes; that generally is allowed.

Senator BYRD. Allowed in the Federal law. I just wondered whether these computations included the credit that the man who pays a State tax could get from his Federal tax as an expense.

Mr. MAGILL. Yes; the Federal tax is computed on the net income left after the deduction of the State tax.

Senator BYRD. For instance, if you pay $5,000 to the State, and in your Federal tax that is based on 50 percent, of course, you save $2,500.

Mr. MAGILL. That is right.

As the Secretary of the Treasury has told you, the needed additional revenue from individuals should not be obtained in the way the House bill proposes. An additional tax of 2 or 3 or 4 percentage points on all net income is the preferable way, if individual income taxes must be increased.

Corporate taxes ought to be raised only as a last resort, but certainly all profit-making enterprises should be made equally subject to them. Why should corporations that compete with ordinary taxpaying business enterprises and make millions be exempt from ordinary corporate taxes? Surely calling them cooperatives does not entitle them to exemption on the profits they make and retain. Nor should the fact that they are owned by farmers or other worthy citizens free them from tax, any more than the ownership of a macaroni factory by a university should free the macaroni corporation from tax. The significant facts are that the cooperative is organized to make a profit and does so; and that, in these times, we cannot afford the luxury of exempting profit-making enterprises from the tax, however useful the work that they do. Our ordinary business companies perform useful, indeed indispensable, services; and are owned by worthy people, but we tax those corporations and their stockholders heavily.

Senator WILLIAMS. Mr. Magill——

Mr. MAGILL. Yes, sir.

Senator WILLIAMS. During your experience as Under Secretary of the Treasury was there any estimate made as to the amount of revenue that would be raised if we plugged these loopholes?

Mr. MAGILL. I am not sure that one was made in my day, Senator. Such estimates have been made more recently, and I think the variation in the estimates turns simply on how big a plug you put in the loophole; that is, how many such organizations and how much of their income you subject to the tax.

Senator WILLIAMS. Has the organization that you represent made any estimates?

Mr. MAGILL. Revenues of $250 million to $350 million would be produced by taxing cooperatives upon their incomes.

Senator WILLIAMS. That is just plugging one particular loophole, or all of them?

Mr. MAGILL. That is taxing cooperatives upon their incomes in the way that other corporations are taxed.

Senator WILLIAMS. That is, farm cooperatives, and so forth?

Mr. MAGILL. Yes, sir.

Senator WILLIAMS. That is $250 million or $350 million?

Mr. MAGILL. Yes, sir.

Senator WILLIAMS. You have an estimate on the amount obtained by plugging other loopholes?

Mr. MAGILL. I think so; I think I do, and if you will tell me what you have in mind, I will be glad to put it in.

Senator WILLIAMS. I was just wondering what recommendations—you mention here educational and religious institutions.

Mr. MAGILL. Well, perhaps I should make that clear. What I had in mind in my statement is the case of the ownership by a university or a church of business corporations.

Senator WILLIAMS. I understand it that way. Do you have an estimate as to the amount of revenue lost on that?

Mr. MAGILL. I don't think we have an estimate on that, because so far as I am aware no one knows how widespread the ownership by universities of business corporations has become.

Senator WILLIAMS. I do not think there has been—I understand that, but I have not seen any proposal to tax universities or religious institutions, excepting where they owned the business in the entirety.

Mr. MAGILL. That is right. The university and the church, it seems to me, stands on a wholly different footing because it is not trying to make a profit. The macaroni factory is trying to make a profit, as other such organizations are, and it ought to be taxed like other business enterprises, I think.

The CHAIRMAN. Your estimate, if you have the estimate, on cooperatives there is on the total earnings?

Mr. MAGILL. That is right.

The CHAIRMAN. Profits?

Mr. MAGILL. That is right.

The CHAIRMAN. Without deductions for moneys disbursed.

Mr. MAGILL. Yes, sir.

The CHAIRMAN. Or paid out.

Senator WILLIAMS. That is on a retained earnings basis of the cooperatives.

Mr. MAGILL. There are, of course, two estimates, sir, as you are aware: One would be based on taxing the entire income of the cooperative. The other would be on the basis of taxing simply that part of the income which is retained and reinvested.

Senator WILLIAMS. You do not know which way your estimate is?

Mr. MAGILL. I think it is on the total income, sir.

The CHAIRMAN. It would indicate that it was on the total income and without the deduction.

Mr. MAGILL. That is right.

Senator WILLIAMS. You do not have the breakdown as to the different——

Mr. MAGILL. I think I can give you a breakdown, but I do not believe that it appears in this pamphlet.

The CHAIRMAN. All right, Mr. Magill.

Mr. MAGILL. Thank you.

The excess profits tax is a new and severe levy. It is fundamentally a bad tax, because of the impossibility of framing a general definition of excess profits that will apply fairly to hundreds and thousands of different businesses. We know that the tax will make the financing of new business difficult or impossible. We therefore endorse Secretary Snyder's recommendation that the tax rate should not be increased until we have had more chance to see how the tax works. It would be better still to repeal the tax, and get the money elsewhere.

The Treasury is already taking nearly half, and in some cases more than half, of what corporations earn. We ought not move any closer to the socialistic goal of 100 percent ownership of enterprise by Government. Consequently, to increase the corporate rate so that the business and its owners can keep less than half of what it earns is bad policy. We must have active, vigorous business. We cannot expect to have it, if the Government is going to assert a claim to the lion's share of all earnings. The prospective corporate investor has too little to gain by risking his hard-won savings.

In its Summary of the Budget of the United Kingdon, the staff of the Joint Committee on Internal Revenue Taxation pointed out that in the calendar year 1950, the receipts of all levels of government in Great Britain were about 38 percent of the national income as compared with about 29 percent in the United States. Even if we assume a higher level of national income for 1951, we find that the United States' percentage becomes 32 percent, when we take into account the effect of the tax increases proposed in the House bill. We are certainly treading hard on the heels of Great Britain in driving incentives to produce out of the economy.

Senator MILLIKIN. Are you taking account there, Mr. Magill, of the local taxes?

Mr. MAGILL. Yes, sir. They are taken into account in both cases.

Senator MILLIKIN. In arriving at your figure of 32 percent?

Mr. MAGILL. Yes, sir.

In conclusion, first, budget expenditures must be cut to the real essentials. The test should be: Must this function or activity be performed by government in a free society? The $71.6 billion budget can be reduced by $10 billions.

Senator BYRD. Mr. Magill, I believe you issued a statement showing in a detailed way how that reduction can be achieved.

The CHAIRMAN. Yes, sir; that is in the record.

Mr. MAGILL. If I may put this report in the record, it discusses that subject.

Senator BYRD. Would you mind discussing some of the main features of this reduction?

Mr. MAGILL. Would you like me to do that now?

Senator BYRD. Mr. Chairman, is that in order?

The CHAIRMAN. Oh, yes.

Mr. MAGILL. In this booklet, this summary which, I believe, is what you are asking for——

Senator BYRD. Yes.

Mr. MAGILL (continuing). Is on pages 28 and 29, and the detail with respect to each of these suggested reductions appears on earlier pages, commencing at page 12.

We suggested that there be an elimination from the budget of one and a half billion dollars on account of loans.

In the second place, civil public works——

Senator TAFT. Do you mean loans to be made by the RFC and housing and that kind of thing?

Mr. MAGILL. Yes, sir.

That civil public works, commodity acquisitions and equipment might be reduced by three-quarters of a billion; that aids and special services might be reduced by $3 billions.

Senator TAFT. How is that?

Mr. MAGILL. Aids and special services.

Senator TAFT. What do you mean by that?

Senator BYRD. Does that mean grants to the States?

Mr. MAGILL. I will get my breakdown on that.

The full heading is "Aids and special services to State and local governments and others." That includes the item of international aids, the various types of subsidies to the States, subsidies to agriculture, business, and so forth.

Senator BYRD. What reduction do you have there?

Senator TAFT. I can see international aid, but how are you going to cut the other? The committee just had this question up of old-age assistance to the States, and they decided they could not cut it, and not only that, but had to increase it.

Mr. MAGILL. Of course, you run into that problem everywhere.

Senator BYRD. I was one of those who did not think they needed increases. I was against it, and I am against it now.

Senator TAFT. I do not know whether they should be increased, but it is an impossible proposal; it is an impossible economic thing to cut 2 million people out of the old-age assistance program or cut it in half. The States have not got the money, and the burden would be the same.

Mr. MAGILL. That we did not recommend. The total figure in this aids and special services category is some $16,611,000,000, as we have it listed here.

Senator TAFT. I do not know what that would be.

Senator MILLIKIN. What are the special services?

Mr. MAGILL. Well, the table that we have breaking that down is on page 19 of this document.

Senator TAFT. What is that document, Financing?

Mr. MAGILL. Can Expenditures Be Reduced?

Senator TAFT. I got your preliminary——

Mr. MAGILL. I think each of you have it.

Senator TAFT. What page is that on?

Mr. MAGILL. This is on page 19.

Senator BYRD. We have a copy of that? Hasn't the committee got a copy? I have it in my office, but not here.

The CHAIRMAN. They were not passed around, sir, but we will put them in the record.

Mr. MAGILL. I will put one in the record.

(See contents.)

Senator BYRD. You may continue.

Mr. MAGILL. Total taxes, Federal and State, are approaching dangerously close to the capacity of our citizens and enterprises to pay, if we are to maintain our free enterprise economy.

Senator BYRD. Will you finish your explanation of the reductions? That is a very important question. If we save enough, we might not have to have such a large tax bill.

The CHAIRMAN. Well, Senator, we do not save it in this committee. This is not the committee that has that direct responsibility.

Senator BYRD. This was the committee that on Friday increased the aid to the aged, and so forth. We did it in that case.

The CHAIRMAN. Oh, yes. There are a few things of that kind, but they do not amount to much.

Senator WILLIAMS. If we do not raise the money, we will not be able to spend it. [Laughter.]

Senator TAFT. Senator Williams suggested if we do not raise the money it is going to be harder for them to spend it anyway. [Laughter.]

Senator WILLIAMS. It has to come back here sooner or later.

The CHAIRMAN. All right. You may proceed with this breakdown.

Senator TAFT. I do not see this particular information in this pamphlet I have.

Mr. MAGILL. This is a different study. We brought out——

Senator TAFT. I see, Can Expenditures Be Reduced?

Mr. MAGILL. Unfortunately I do not have a dozen of them here.

The CHAIRMAN. Mr. Magill, you may proceed.

Senator MILLIKIN. What is our question before us, Mr. Chairman, at the present time?

The CHAIRMAN. Senator Byrd asked for a breakdown of the possible savings in expenditures, and that is what he was going into.

In the beginning of Mr. Magill's statement he pointed out that this organization, the Committee on Federal Tax Policy had issued the following: Financing Defense: Can Expenditures Be Reduced? The Tax Program; Is an Excess Profits Tax a Solution; and those were simply studies that were made and published, as I understand.

Mr. MAGILL. That is correct. The other possible areas for reduction, as shown in our study, are: Sale of loans, mortgages, and commodities, $2 billion; operating economies eliminating waste, and so forth, $1 billion; and savings in international aid and elimination of waste and extravagance in the military budget. All these add up to possible savings of $10 billion.

Senator MILLIKIN. How much do you believe the foreign defense and economic aid program could be reduced?

Mr. MAGILL. Well, I think that is one item in——

Senator MILLIKIN. That is where the big money is.

Mr. MAGILL (continuing). In this grouping; yes.

Senator MILLIKIN. How much do you think could be saved?

Mr. MAGILL. In that general group we thought that $3 billion could be squeezed out.

Any of these expenditure cuts, as you gentlemen know, far better than I, are extremely hard to make, and it is a severe problem to put any of them through.

Senator WILLIAMS. When you say $3 billion cut in foreign aid, you mean $3 billion cut in 1 year's expenditures, not over the proposed 2 years?

Mr. MAGILL. I was talking of the foreign aid which, I believe, is one of the various items which we had lumped together in a category totaling $16 billion plus, out of which we thought $3 billion could be squeezed.

Senator WILLIAMS. You mean $3 billion below that of last year's expenditures or this year's request?

Mr. MAGILL. This year's request.

The CHAIRMAN. This year's budget.

Senator MILLIKIN. Mr. Magill, can I ask that you break down your proposed economies so far as aid and services are concerned a little more than you have. It has been touched upon, but specifically what would you do in the way of old-age assistance; specifically what would you do in the way of contributions toward our highways, and so forth and so on?

Mr. MAGILL. Well, my recollection is that we broke those two down. We left old-age assistance where it was. I don't think we cut that down.

As far as highways are concerned, we thought that that general class of expenditures for increasing the capital assets of the community could well be reduced, and a good deal of it deferred to a time when we need means to promote employment to get the economy going

well. We believe that now is not the best time to make great capital expenditures.

Senator MILLIKIN. You have touched on foreign aid, military and general economic; you have touched on Federal aid to States. Where else is there a prospect for a sizable reduction? I am not disparaging the aggregate of a lot of savings, but give me some of the larger reductions that you think might be possible.

Mr. MAGILL. Well, I think the fact is that there is no one single place where you can save a great deal of money. It is impossible.

I had gotten down through this aids and special services category at 3 billion.

Senator BYRD. Could I make a suggestion at this point? If you could take page 12, that gives you reducible items in bulk, does it not?

Mr. MAGILL. Yes; that is true.

Senator TAFT. Do you suggest any cut in the military budget?

Mr. MAGILL. No; we did not propose any.

Senator TAFT. Why not? I mean, that is what I would like to know. Why do people say that is sacred? The House committee does not think so. They have just cut hundreds of millions off the military construction bill in the House.

Mr. MAGILL. The reason that we did not, was a practical one that this report came out a month or two ago, and the administration had not submitted the military budget in detail; it had submitted a general estimate of 40 billions or 41 billions.

Senator TAFT. That was the expenditures, but the appropriations were about 65.

Mr. MAGILL. Since we had nothing to work on, we felt we had to leave it alone. We strongly suspected that a good deal of savings could be made there, but we had no material to work with.

Senator TAFT. I think there is a possibility, it seems to me, without cutting the effectiveness of the Army or the size of the ultimate striking force at all.

Mr. MAGILL. I think so, too.

Senator TAFT. And it seems to me when it is two-thirds or three-fourths of the whole budget, some attention has to be paid to it if you are going to save any money.

Mr. MAGILL. I entirely agree with you.

Senator BYRD. As you say, the budget was not in until some months after you made the report?

Mr. MAGILL. That is right.

Senator BYRD. So, therefore, you could not touch it.

Mr. MAGILL. We could not touch it.

Senator BYRD. But you thought there could be a $10 billion saving independent of the military?

Mr. MAGILL. That is right; yes, sir.

Senator BYRD. Have you got a table ——

Senator TAFT. Independent of the American military. I take it you could save something in the foreign-aid figure.

Mr. MAGILL. That is right; yes. We thought there could be a saving on foreign aid.

Senator WILLIAMS. You were speaking a few minutes ago about the savings of a billion or two from Government loans. Could that be done very much without repealing some of the services, cutting

out some of them that have been authorized, and would you advocate their repeal?

Mr. MAGILL. We did; yes, sir. Of course, one great difficulty, as I am sure you know better than I, in cutting the budget is the authorizations. Not much can be done with the budget unless the authorizations themselves are cut down or eliminated.

Senator WILLIAMS. I think you mentioned about four or five hundred million savings in the Commodity Credit Corporation. Well, that cannot be done unless you repeal or revise your farm program. Did you advocate that?

Mr. MAGILL. That is true, and we had that in here.

One of our recommendations was the rather strong one that there would have to be what we called a "clean slate" approach, that you would have to do away, to begin with, with a great many existing authorizations, and then find out from the Budget Bureau how or what authorizations need to be eliminated which, I believe, Senator Byrd has done, and then set about preparing a budget at a lower figure.

But I agree with you, I do not think it can be started until you get rid of some of the existing authorizations.

Senator MILLIKIN. Take the military program: In the first place, I assume there is a legitimate field of congressional interest in the program itself.

Mr. MAGILL. Yes, sir.

Senator MILLIKIN. Let us assume that the Congress endorses the general program. What mechanics do you suggest for the elimination of waste in the military program?

Mr. MAGILL. Well, I do not know how you can eliminate waste in any of these programs, except by getting a great deal of detail from people who are familiar with it.

Now, I would suppose that two steps would be possible: First, to ask the military themselves what kind of a program they could set up on, let us say, $20 billions if you wanted to try to cut $10 billions, or $35 billions. If you wanted to cut five, then I think you and your staff will have to study in detail what the particular authorizations, the particular expenditures are.

Senator MILLIKIN. There you ran into what I think is the great difficulty of the whole business. That, of course, is a function of the Appropriations Committee. The Appropriations Committee is not staffed, and we have no staff to do that kind of a job. The Appropriations Committee has a competent staff, but it necessarily must do a picking job here, there, and the other place, and so far as making an over-all detailed study of the operation of any of these great departments, there just is not any staff available to do the job; and in the last analysis that means that you take the word of those justifying for the departments which, in the last analysis, means no savings.

Mr. MAGILL. That is right; I quite agree with you.

Senator TAFT. Somebody must decide. I noticed Mr. Finletter requested—I think we have maybe 200 airports, and he proposes to build 77 more for the Air Corps. I do not know that 77 are necessary.

Senator WILLIAMS. He is closing up 75, so he will not need 77.

Senator TAFT. Certainly there is a field of investigation in a matter of that kind.

Mr. MAGILL. Is it quite true, as both of you have said, how is a civilian to judge whether 77 more airports are essential or whether this

is just the normal expansion of the Air Force, which any administrator wants to bring about.

Senator TAFT. We had one case in Wichita where we wanted to build a new airport, very large airport, and the Secretary of War didn't even know there was an airport within 30 miles. I think it had been used during the war, and was entirely in mothballs, and was not being used at all. You have a suspicion, but we have no way of finding out.

Mr. MAGILL. I am sorry the Secretary of War had not visited Wichita.

Senator MILLIKIN. There ought to be some middle ground of Congress, against playing Napoleon, on the one hand, and on the other hand, taking 100 percent of anything that it is asked to do.

Mr. MAGILL. That is right.

Senator MILLIKIN. There should be some place in there where some of the objectives can be subjected to an objective analysis. To find that place, to find the mechanics for doing it, I do not believe we have succeeded yet.

Mr. MAGILL. I think that is true, and that is, of course, the extremely difficult problem.

Senator MILLIKIN. Yes.

Senator BYRD. You spoke of the authorizations. You spoke of having a clean slate, of repealing them. There is a large area for economies without repealing the present authorizations.

Mr. MAGILL. That is right.

Senator BYRD. You did not mean to give the impression that you had to repal the authorizations in order to effect savings?

Mr. MAGILL. Oh, no. I think you have shown that large economies can be effected without touching the authorizations.

Senator BYRD. On page 28 you have more or less of an account—not in detail—of where the reductions could be made, and you have tables which explain it in further detail.

Mr. MAGILL. That is right. Page 28 is a general table which, as you see, refers back to earlier, more detailed tables and discussions.

As you gentlemen know, the undertaking of either one of these tasks is an impossible job for a civilian committee. All we can do is to make suggestions and recommendations as to how we think the task could be approached, and what problems can be tackled.

Senator BYRD. What investigation did you make of this before you made the recommendations?

Mr. MAGILL. Well, we made all we could. This committee was financed by the Maurice and Laura Falk Foundation of Pittsburgh, and we employed a staff to make this kind of a study.

What we actually did was to get much of the information from Government people down here and to cooperate with them in getting up this material.

Senator MILLIKIN. There was no other place to get it.

Mr. MAGILL. There is no other place to get it.

Much of the material, for instance, in this tax report is based on cooperation between our staff and the joint committee staff which has done extremely good work in getting up its statistical information.

Senator MILLIKIN. Did you get any information from the Budget?

Mr. MAGILL. Not very much, I think. It is pretty hard to get it from them.

Senator MILLIKIN. They did not recommend any reductions, did they?

Mr. MAGILL. No; they did not recommend any reductions.

The CHAIRMAN. All right, Mr. Magill, finish your other statement.

Mr. MAGILL. I was practically through.

2. Total taxes, Federal and State, are approaching dangerously close to the capacity of our citizens and enterprises to pay, if we are to maintain our free-enterprise economy. If 100 percent of all earnings went to the Government we would certainly have a socialistic state. What do we have when over 50 percent of the earnings of many individuals and of many corporations go to the state?

3. We must pay governmental expenses as we go. We must stop further inflation. With expenditures what they are, we must employ all our tax resources, and spread the increases fairly over all our citizens. There is no easy, pleasant way to raise $60 or $70 billions in taxes, but the sensible way is:

(*a*) Levy a general manufacturers excise tax at a sufficient rate not only to balance the budget but to substitute for all our present special excise taxes except those on tobacco and liquor.

(*b*) If the income tax on individuals must be increased, apply a flat-rate percentage-point increase to all net incomes across the board.

(*c*) Do not increase corporate income taxes or excess-profits taxes.

(The tables referred to are as follows:)

TABLE 1.—*Relationship between additional tax under House bill and income after present law tax (single persons and married persons filing separate returns)*

Taxable income level	Tax under present law	Taxable income after present law tax	Additional tax under House bill	Additional tax as percent of income after present law tax
				Percent
$2,000	$400	$1,600	$50	3.12
$5,000	1,100	3,900	138	3.54
$10,000	2,640	7,360	330	4.48
$25,000	10,150	14,850	1,269	8.55
$50,000	26,820	23,180	3,352	14.46
$100,000	67,320	32,680	8,078	24.72
$200,000	156,820	43,180	13,078	30.29

TABLE 2.—*Portion of additional dollar of income retained by taxpayer, present law, House bill (H. R. 4473), and Treasury proposal (single persons and married persons filing separate returns)*

Selected taxable income level	1950 act [1]	House bill [2]	Treasury proposal
$4,000	$0.74	$0.707	$0.70
$6,000	.70	.662	.66
$10,000	.62	.572	.58
$20,000	.44	.370	.40
$50,000	.25	.156	.21
$100,000	.11	.055	.07

[1] Revenue Act of 1950, under rates applicable to 1951 incomes.
[2] A special rate schedule will apply to single persons who are heads of households for taxable years beginning after Aug. 31, 1951, designed to accord to such taxpayers 50 percent of the benefits of income splitting.

TABLE 3.—*Portion of additional dollar of income retained by taxpayer, present law House bill (H. R. 4473), and Treasury proposal (married persons filing joint returns)*

Selected taxable income level	1950 act [1]	House bill	Treasury proposal
$8,000	$0.74	$0.707	$0.70
$12,000	.70	.662	.66
$20,000	.62	.572	.58
$40,000	.44	.370	.40
$100,000	.25	.156	.21
$199,999	.11	.055	.07

[1] Revenue Act of 1950, under rates applicable to 1951 incomes.

TABLE 4.—*Confiscatory aspects of Federal and State individual income-tax rates, State tax rates as of May 31, 1951, and Federal rates under House bill*

[In percent]

State	Rates on taxable income of $80,000 (single return) or $160,000 (joint return) and over		
	State	Federal [1]	Combined State and Federal rates
Arkansas	5.000	94.5	99.500
California	6.000	94.5	100.500
Delaware	6.250	94.5	100.750
Mississippi	6.000	94.5	100.500
New York	[2] 7.000	94.5	101.500
North Carolina	7.000	94.5	101.500
South Carolina	5.000	94.5	99.500
Vermont	[3] 6.325	94.5	100.825
Virginia	[4] 5.000	94.5	99.500
District of Columbia	3.000	94.5	97.500

[1] Under the House bill, H. R. 4473.
[2] Capital gains are taxed at ½ of the regular rates. For fiscal years ending in 1950, both the income tax and the capital-gains tax were reduced 10 percent. Income from unincorporated business is taxed at 3 percent.
[3] Includes 15 percent surtax levied for 1951 and 1952.
[4] A credit of 10–20 percent of tax is allowed for the taxable year 1950 depending on specified amount of receipts into the State treasury during the fiscal year ending June 30, 1951.

Senator MILLIKIN. With reference to the sales-tax suggestion which you have made, have you worked out burden tables so far as the sales tax is concerned?

Mr. MAGILL. It is my understanding, and I am here, of course, reporting the work of our staff; I think such tables have been prepared. As I understand it, the experts, I think, of the joint committee have worked out that if you had a general sales tax, exempting food, clothing, and medicines, which, I think, everyone agrees should be exempt——

Senator MILLIKIN. Shelter, you have included.

Mr. MAGILL. Shelter, too; that you will obtain in revenue for each percentage point of a manufacturer's tax $980 million; you will get a little under a billion dollars for each percentage point. About $100 million of this would come from taxation of services that are now subject to tax.

Now, our recommendation here was that the special excise taxes, other than liquor and tobacco, should be repealed, and a general tax substituted for them.

Senator MILLIKIN. I am not now thinking so much of what we would get, I am thinking in terms of burden on those who would have to pay.

Mr. MAGILL. Well, we worked on that, too. I am not sure as I stand here this minute as to whether those tables are shown in the report, but we did work out tables to show how much of this tax would rest upon the different income levels.

Now, what it works out to be is that the tax so worked out is mildly progressive; it is not simply proportional. That is, expenditures do increase with income out of proportion to the increase in income, but, of course, it is by no means as progressive as an income tax.

Senator MILLIKIN. And a flat sales tax, for example, works the the other way, does it not? I mean from a proportionate standpoint people in the lower brackets pay more than people in the higher brackets?

Mr. MAGILL. I think not, sir.

Senator MILLIKIN. Are you sure of that?

Mr. MAGILL. I think I am. That was one thing that we were interested in because the charge is usually made that a sales tax is regressive; that is, that it rests more heavily on the lower incomes than the higher incomes.

Well now, a good part of that regressiveness, I think, lies in the food, clothing, medicine, and shelter area, and that is because we all have to have food and clothing.

Senator MILLIKIN. Is that in your report, may I ask?

Mr. MAGILL. Yes; that is in there, and if you eliminate those items by exemption, then, sofar as a sales tax on the other items is concerned, it will be pretty much proportional, but it is somewhat progressive; that is, the burden is a little heavier with the higher incomes.

Senator MILLIKIN. They, of course, would take care of, would account for, existing State sales taxes, would they not?

Mr. MAGILL. Yes, sir; they do.

Senator MILLIKIN. Do they account for all other State and local taxes? For instance, in my State, we have a municipal cigarette tax. Does it take account of all those taxes that a citizen pays?

Mr. MAGILL. I think so.

Senator MILLIKIN. Does it take account of the argument which we so often use for other purposes, of concealed taxes?

Mr. MAGILL. Any of these computations are extremely difficult to make, to take into account all of these variations. For example, in New York we have a city sales tax, but we do not have a State sales tax. Well, now, in Connecticut, where I live, we have a State tax and no city tax.

Senator MILLIKIN. Yes.

Let me illustrate. When we are trying to develop the burden of excessive taxation, we make a great fuss about concealed taxes. Many people do not think they are paying any taxes at all, when in fact they are paying a considerable tax by virtue of the so-called concealed tax.

Mr. MAGILL. Yes.

Senator MILLIKIN. Do those calculations include those concealed taxes?

Mr. MAGILL. Well, I think our calculations in here, as I recall them, are based on what the burden would be at different income

levels of a general sales tax levied by the Federal Government, and I do not think we have in here tables of the sort that I expect you have in mind, that seek to show the total tax burden on incomes at different levels. Those things can be made up, and, if you would like, I will be glad to submit such a table.

Senator MILLIKIN. If you can do that, I think it would be very useful.

Mr. MAGILL. I will be very glad to.

Senator MILLIKIN. Mr. Magill, in regard to percentages, I think you can badly mislead yourself, and we can badly mislead ourselves, when we speak of a percentage like 30 percent. That is an over-all average?

Mr. MAGILL. That is an over-all; yes.

Senator MILLIKIN. That may include completely confiscatory rates, such as the rates you have referred to in some cases and, of course, it has to be less than that in other cases. But while having an average, which you view comfortably as an average, you may at the same time be indulging in something that wipes out a considerable segment of your economy.

Mr. MAGILL. That is true and, of course, that is, I think, the difficulty with placing much reliance on any such computations as are in that paragraph you are looking at.

I do not think anyone can say, as I think some have tried to, that if the taxes get beyond such and such a percentage of the national income, why, then, people are going to quit work, because among other things the incentives which any of us have to work are not all financial incentives. We work for other reasons than in order to make a living.

Senator MILLIKIN. That is right.

Let me ask you, Do you think that with a levy of a general sales tax, with the exemptions of the type that you have mentioned, together with existing taxes, and probably making allowance for a tax bill to come during this session, that we could balance the budget on $85 billion—on an $85 billion basis?

Mr. MAGILL. I think the answer is "Yes," but it obviously is going to be a tremendously difficult job.

I think I would approach it, as I expect you would, from the other angle, that I do not see how we can balance an $85 billion budget; and therefore expenditures must be reduced.

Senator MILLIKIN. Well, of course, you can balance most any conceivable budget if you do not care how you do it.

Mr. MAGILL. Yes; that is right.

Senator MILLIKIN. And if you do not care about the effects that would follow the doing of it, but I am talking about a practical bearable effect.

Mr. MAGILL. What I was about to say was that if you are going to try to balance an $85 billion budget, I think you would just have to have a sales tax. I do not think it can be done with simply the existing Federal taxes.

Senator MILLIKIN. Secretary Snyder, I think, testified as much, in substance. We asked him what kind of a tax it would take and I think he said that it would take taxes which are not conventional at the present time, but he did not specify what they would be.

Mr. MAGILL. I thought that was implicit in his statement, too. I read his statement just before I prepared this one.

Senator BYRD. Have you made an estimate of the income from the sales tax in various States?

Mr. MAGILL. Yes, sir; we have. As I have said, on a general tax at the Federal level, the figures that I bear in mind are that if you have a general manufacturer's sales tax, it will yield at current levels of the income about $1 billion for each percentage point of the tax.

Senator MILLIKIN. May I pursue my questioning a little further?

Mr. MAGILL. Yes, sir.

Senator MILLIKIN. It is the administration's theory that if we pass the kind of tax bill they want this time, that it will balance the budget for fiscal 1952. Assume that to be true.

Mr. MAGILL. That is a large assumption.

Senator MILLIKIN. It is a very large assumption, but assume it to be true. Under administration figures there would probably be a $20 billion increase to hit the people in expenditures in the next fiscal year. Do you believe that a sales tax in and of itself without further general tax legislation by the Congress could balance the budget if we looked at fiscal 1953?

Mr. MAGILL. Well, it would be extremely difficult to do, Senator.

Senator MILLIKIN. It would be extremely burdensome, too.

Mr. MAGILL. Oh, terribly burdensome.

Senator BYRD. It would have to be a 20-percent increase.

Mr. MAGILL. It would have to be at a very high rate, and I do not think anyone can contemplate, certainly with any responsibility, imposing a tax, a general sales tax, at a heavy rate on top of the existing special taxes which we now have.

Senator MILLIKIN. That is why I am so curious about getting as dependable information as we can get of what will be the total burden when we get through with this bill, and, considering existing local taxes, what will be the total burden on the people in the lower income-tax brackets.

Mr. MAGILL. Why couldn't I try to get it to you? Shall I send it directly to you?

Senator MILLIKIN. Send it to the chairman, and put some copies in so that we can all get it.

Mr. MAGILL. Yes.

Senator MILLIKIN. Would that be all right, Mr. Chairman?

The CHAIRMAN. Yes, sir. We will be glad to get it and put it on the record.

Mr. MAGILL. I think it is a tough job, but I will be glad to try it.

(The document referred to is as follows:)

THE TAX BURDEN ON VARIOUS INCOME GROUPS

The problem of calculating the incidence of the tax burden on people in different income groups is a very difficult one. Half a dozen studies of this type have been made and all have been beset by major difficulties both in economic theory and in statistical facts.

The limitations on obtaining reliable statistical data are great. To arrive at any workable figures, important assumptions must be made, and adjustments must be applied to available figures. All of these introduce shortcomings which seriously affect the usefulness of the final data. Assumptions must also be made as to the shifting of corporation, excise, and other taxes, and economists differ widely in their ideas on this subject. The incidence of many taxes is strongly affected by the supply-and-demand situation, inflationary factors, and other factors.

Because of these shortcomings and difficulties, the greatest caution should be used in applying the results of the studies made to date as a basis for determining tax policies.

Bearing these difficulties in mind, we have turned to the two most recent studies in this field. The first was made by a group of economists headed by Prof. R. A. Musgrave, and the results were published in the March 1951 issue of the National Tax Journal. The second is an unpublished study by Dr. Rufus Tucker which will appear in the September issue of the National Tax Journal. This differs in certain important respects, both as to assumptions and statistical methods, from the Musgrave study and, in our opinion, represents a more realistic picture of the tax burden distribution. The table below gives the distribution of selected Federal, State, and local taxes, and the total tax burden by selected income groups. In each case the figures are shown as a percentage that taxes are of the gross income in each class.

Distribution of tax burden by selected income classes--income taxes, excise taxes, and all taxes combined

[Percent of income]

Type of tax	Spending unit income classes [1]					
	$1,000 to $1,999	$2,000 to $2,999	$4,000 to $4,999	$5,000 to $7,499	$7,500 to $9,999	$10,000 to $14,999
A. Musgrave estimates: [2]						
Federal personal income tax	3.4	5.3	8.4	11.1	(3)	(3)
Federal excises	5.2	4.8	4.2	4.0	(3)	(3)
State and local personal-income taxes		(4)	.1	.3	(3)	(3)
State and local excises	3.9	3.6	3.4	3.1	(3)	(3)
Other taxes	11.8	12.1	9.8	9.0	(3)	(3)
Total	24.3	25.9	26.0	27.6	(3)	(3)
B. Tucker estimates: [5]						
Federal personal-income tax	3.0	4.9	7.4	8.1	8.8	11.6
Federal excises	4.5	4.3	4.2	4.0	4.3	4.4
State and local personal-income taxes		.1	.2	.3	.5	.6
State and local excises	3.5	3.3	3.3	3.2	3.6	3.6
Other taxes	6.7	7.5	8.4	10.4	11.8	12.5
Total (excluding social insurance)	17.8	20.2	23.4	25.9	29.0	32.7

[1] A spending unit is defined as all persons living in the same dwelling and related by blood, marriage, or adoption, who pool their incomes for their major items of expense; these income classes differ, therefore, from the net income classes to which the effective rate of the Federal income tax is usually related. Because of the presence of more than one income recipient in the typical spending unit, the splitting of income between spouses, and other factors, the pattern of income-tax payments is less progressive when allocated by spending units than when allocated by taxpaying units.

[2] The Musgrave estimates were prepared at the University of Michigan by Prof. R. A. Musgrave, J. J. Carroll, L. D. Cook, L. Frane, and others. They are published in the National Tax Journal, vol. IV, No. 1, March 1951, where a full discussion of the concepts, assumptions, and data used can be found. The main sources of data were the 1948 Survey of Consumer Finances prepared by the Survey Research Center of the University of Michigan in conjunction with the Board of Governors of the Federal Reserve System; the Bureau of Labor Statistics postwar studies of consumer expenditures published in various issues of the Monthly Labor Review; and tax-collection data published by the Department of Commerce.

[3] Not included in the Musgrave study.

[4] Less than 0.1 of 1 percent.

[5] Tucker's estimates are from Rufus S. Tucker, Distribution of Tax Burdens in 1948, to be published in a forthcoming issue of the National Tax Journal. The sources used are also mainly data of the Survey Research Center, the Bureau of Labor Statistics, and the Department of Commerce. The chief differences between the two estimates are (1) Tucker includes income in kind, most of which is received by the lower-income groups; (2) Tucker extends the income classes beyond $7,500 up to $20,000; and (3) Tucker makes a different allocation of social-security contributions, corporation taxes, and property taxes with respect to their incidence.

Both the Musgrave and the Tucker figures indicate that the existing Federal excises (including those on liquor and tobacco) are mildly regressive at the lowest part of the scale and then roughly proportional for the brackets covered. State and local excises, which include a large amount of retail sales taxes, are somewhat regressive. This, of course, is due to the inclusion of food, clothing, liquor, and tobacco in the base for most of the State and local excises.

We may assume that the incidence of the proposed Federal manufacturers' excise tax would be more progressive than the pattern of present Federal, State, and local excises, since it excludes food, clothing, medicine, shelter, liquor, and tobacco. The effect of the exclusion of these items will be to decrease substantially the impact on the smaller income brackets. Thus the manufacturers' excise will most likely be proportional and perhaps even mildly progressive through the lower- and middle-income brackets.

However, the impact of one tax cannot be measured as a single entity. It must be considered as a part of the total tax structure. The personal income tax is the largest element in the tax structure, and it is highly progressive. A combination of the excises with income taxes will, therefore, still be a highly progressive tax structure.

The conclusion that a general manufacturers' sales levy which exempts food, clothing, and shelter is not regressive and, in fact, is highly progressive when considered in combination with the income tax, is borne out by the following excerpt from the latest budget message of the Canadian Government. This message discusses the burden distribution of the Canadian sales tax (which is quite similar to the proposed manufacturers' excise tax) and gives the results of family budget studies made by the Dominion Bureau of Statistics.

"Our present sales tax has a very long list of exemptions. About 95 percent of all foods are free of sales tax. All fuels and all building materials are exempt. I think it is safe to say that two-thirds of the average Canadian family's total spending is not touched by the sales tax. Contrary to the frequent assertion, the sales tax does not strike a higher proportion of the expenditures of the low-income group. Calculations based on recent family budget studies made by the Dominion Bureau of Statistics indicate that in the lowest income groups only about one-quarter of total income is spent on goods subject to sales tax; at the $3,000-a-year level about one-third of the family income is spent on goods subject to this tax. This 33 percent of income spent on taxed commodities extends to beyond the $6,000-a-year level. Only when incomes exceed $7,000 or $8,000 a year does the proportion of income spent on goods subject to sales tax start to decline, and this is just about the point where our income tax starts to become sharply progressive. To say that our sales tax is a harsh regressive tax simply is not true."

Senator BYRD. Could you estimate the income and revenue from the different kinds of taxes? You have only discussed a manufacturer's tax.

Mr. MAGILL. That is right; that is all we have got.

Senator BYRD. You have not discussed retail?

Mr. MAGILL. No, sir.

Senator BYRD. You say that would bring in—a manufacturer's sales tax—1 billion on each 1 percent?

Mr. MAGILL. Yes, sir.

Senator BYRD. Is that on everything, on all sales of food?

Mr. MAGILL. No; that is excluding—that figure is excluding food, clothing, medicine and shelter—rent. However it includes about $100 million revenue from taxation of services.

Senator TAFT. The NAM had a $900 million estimate; that was their estimate.

Mr. MAGILL. I think the figure is actually—I believe it has its origin in figures prepared by the joint committee. I think it is $980 million per percentage point, so that you can round it off at a billion.

Senator BYRD. For instance, if a wholesaler buys from a manufacturer, and then the wholesaler sells to the retailer is it pyramided then?

Mr. MAGILL. Well, that, of course, is the problem with the manufacturer's tax as against the retailer's tax, as to whether or not it will be pyramided as it passes down the line.

Senator MILLIKIN. Manufacturers say, "No;" I mean, the representatives of the NAM say, "No," but the following day the representatives of the retail organizations say, "Yes."

Mr. MAGILL. They say "Yes," very strongly.

Senator MILLIKIN. And they are in a position to know, I should think.

Mr. MAGILL. I have talked to the retail people, and I have been interested in their interest in a retail tax rather than a manufacturer's tax, and they seem to have——

Senator TAFT. That is an emergency.

Mr. MAGILL. Yes. It seemed to be clear on that. The pyramiding is a difficult point.

Senator BYRD. I say that there are some products that go through three or four hands to be purchased and resold.

Mr. MAGILL. Yes.

Senator BYRD. I am just wondering what allowance you have made, if any, in your estimate of that?

Mr. MAGILL. Well, what we get is much the same picture that I think you have gotten. We have economists, particularly, saying that they think a manufacturer's excise tax can be set up so that the tax will not be pyramided. Others say the contrary, that it is pretty likely to be pyramided.

Now, the actual illustrations that one knows of—I know there are some cases today of the manufacturers' tax which are now on the books, where the tax is listed separately when the manufacturer bills the goods to the retailer and then when the consumer buys it, and it is pretty evident that the tax is not pyramided.

Senator BYRD. Suppose you collected at the source only, as you do in the automobile tax, it would not bring in 1 billion for each 1 percent will it?

Mr. MAGILL. That is the figure I have been given; yes.

Senator BYRD. You mean if whoever produces the article first pays that tax, that ends it?

Mr. MAGILL. That is supposed to be the case.

Senator BYRD. What about parts, take an automobile. They buy their parts from a lot of other manufacturers. How would that be carried out?

Mr. MAGILL. The theory of the manufacturer's tax in that case is that if the parts are sold to someone who is going to incorporate them in a taxable article that there would not be a tax until they were put in the taxable article.

Senator BYRD. Have you worked out the mechanics to avoid the pyramiding of the tax? Has that been worked out?

Mr. MAGILL. Well, we have not worked it out in detail; no ,sir.

Senator TAFT. In your estimate of 9 or 10 billions of a 10 percent tax, you have to credit about 3 billion on existing excises, outside of liquor and tobacco.

Mr. MAGILL. That is right.

Senator TAFT. So, the next increase would be six or seven instead of nine.

Mr. MAGILL. I think we estimated the Federal excises——

Senator TAFT. Outside of liquor and tobacco.

Mr. MAGILL. As about $4½ billion. I think it is $4.4 billion of special taxes that should be repealed if you put on a general tax.

Senator MILLIKIN. Do you favor a manufacturer's tax as again retailer's tax?

Mr. MAGILL. That was our conclusion; yes, sir.

Now, as we point out in our report, there are a good many arguments which can be made either way. It is not a simple choice at all. I think the main thing that moved us toward the manufacturer's tax is, first, this appealed, for instance, to Tarleau, who was a member of our committee, and myself, as old Treasury administrators, that the administrative problem would be tremendously simplified if it was a manufacturer's tax rather than a retailer's.

Then, secondly, the State sales taxes are generally retail taxes, and I think the Federal Government is already treading on the toes of the States too much on tax sources. I would like to stay out of further conflicts if we can. The principal argument against the manufacturer's tax is that of pyramiding, and that is a very hard argument to meet.

Senator MILLIKIN. If a mark-up applies to the money which is involved, it is unrealistic, I suggest, to try to separate where you can and cannot put on your mark-up. If you go to the bank to borrow money, whether to pay taxes or whether to buy goods or whatever the purpose may be you have got the risk of that money, and it has to carry the mark-up unless you are in philanthropy.

Mr. MAGILL. I have heard that said very stongly in connection particularly with liquor, that the retailer is only concerned about how much he has to pay for a case of liquor. He is not concerned with how much of that money consists of tax and how much of it consists of the cost of the liquor itself.

Senator MILLIKIN. The mark-up, of course, is subject to competitive conditions.

Mr. MAGILL. That is right.

Senator MILLIKIN. And those competitive conditions can apply to the money that is in the tax as well as to the money in the lumber or the fixtures or anything else.

Mr. MAGILL. That is right. I think the competitive conditions, the supply and demand, probably will have a good deal to do with whether the tax is pyramided or not. My judgment, on hearing the arguments both ways, is that in some cases the tax will be pyramided, that is, the retailer will get his mark-up on the tax, and in some cases it will not.

The CHAIRMAN. Well, Mr. Magill, you furnished us with a table.

Mr. MAGILL. Yes, sir.

The CHAIRMAN. We will want to use them in the executive session.

Mr. MAGILL. Yes, sir.

The CHAIRMAN. Furnish it as soon as you can.

Mr. MAGILL. I will; yes, sir.

Senator WILLIAMS. I would like to ask you a question.

The CHAIRMAN. All right, Senator Williams.

Senator WILLIAMS. On page 6 you criticize the flat increase in the House, where you say:

> Levying an increase of a flat percentage of the tax in the manner of the House bill increases harshly the already severe impact of highly progressive tax rates.

Then, on page 10 in your conclusions you make this statement:

> If the income tax on individuals must be increased, apply a flat-rate percentage point increase to all net incomes across the board.

I am wondering if that does not contradict your statement?

Mr. MAGILL. I am glad to have you bring that out. It is hard to talk about these things and not create confusion, and you may think one is contradictory of the other, although I did not intend it.

What I meant the first time was the type of increase that the House bill contains, that is, a taxpayer will compute his tax liability and will then compute 12½ percent of that, and that will constitute the final tax which he will have to pay.

Senator WILLIAMS. The flat percentage increase?

Mr. MAGILL. That is right. Over here on page 10, what I had in mind there was the sort of recommendation that the Secretary of the Treasury originally made; that, in effect, the basic rate of the income tax should be increased.

Senator WILLIAMS. By points?

Mr. MAGILL. By so many points.

The CHAIRMAN. Yes, sir. All right, thank you very much, Mr. Magill.

Mr. MAGILL. Thank you very much.

The CHAIRMAN. Mr. Russ Nixon. You may have a seat, Mr. Nixon, sir, and identify yourself for the record.

STATEMENT OF RUSS NIXON, WASHINGTON REPRESENTATIVE, UE

Mr. NIXON. I am Russ Nixon, Washington representative of the United Electrical, Radio, Machine Workers, and I would like, Mr. Chairman, if it is agreeable, to put into the record the full text of my statement. Then I would like to summarize it for the committee if that procedure is satisfactory.

Senator TAFT. Would that be independent or the CIO?

Mr. NIXON. It is independent, sir.

The CHAIRMAN. Yes, sir; you may do that.

Mr. NIXON. Thank you.

The CHAIRMAN. Now you may summarize it.

Mr. NIXON. Mr. Chairman and members of the committee, the position on tax policy which I am to present reflects widespread discussion amongst our membership, and deliberation in many of our meetings over a long period of time.

I think in a sense that whereas Mr. Magill's principal concern had to do with the tax problems of large-income people, that the burden of our position has to do with the tax problems of the lower-income people, and I would at the outset like to indicate the basic principles that we want to present.

First is this: No taxes should be levied on American families whose income is not large enough to maintain living standards at minimum adequacy levels of health and efficiency.

In other words, as we will develop this point, we want to raise for your attention a basic minimum standard of living that has been somewhat scientifically determined by Government sources and by other research agencies. We feel that that minimum standard should be protected.

Secondly, we feel that the revenue loss by not taxing family incomes below a living wage can be replaced to the extent necessary, without causing hardship from other sources of income.

I am sure it must appear at once to the committee that the first question that has to be considered is what is a living wage, what is this minimum adequate living standard?

Fortunately, it is not necessary to purely guess at this proposition. The Treasury Department has already assembled the basic information on this question in a study which they call Individual Income Tax Exemptions. It was published in 1947, but unfortunately, we think, it has received little attention even by the Treasury Department itself.

This Treasury study indicated that American families need the following amount of income at April 1951 prices to provide what they call necessary minimum of goods and services for health and efficiency.

The chart here represents these data. According to the Treasury, single persons have to live on a $1,700 income to meet a minimum budget. A married couple at present prices has to live on a minimum income of $2,400, and a married couple with two children have to have an income of $3,700, and this is exclusive of Federal income tax.

Now, these estimates presented by the Treasury are based on the Bureau of Labor Statistics City Workers Family Budget. It has been adjusted by the Treasury itself for different sizes of family, and by us for changes in the Consumer Price Index.

Now, the question that can very rightfully be asked at once is——

Senator MILLIKIN. Is there a regional adjustment in your calculations?

Mr. NIXON. Yes, sir; there is. In the BLS data it covers 34 cities in the United States.

Senator MILLIKIN. Is there adjustment between small towns, and middling, and large towns?

Mr. NIXON. Yes, sir. It has a pretty good spread of cities, sir.

The first question that might come to your mind is, Is this an exaggerated luxury type of budget?

The evidence, of course, is that it certainly is not anything more than a bare minimum. It is not really what I think most of us would call a budget to cover the American standard of living. It is approximately $450 for a four-person family, less than the budget estimated by the Heller committee of research in social economics at the University of California.

In important respects it is even lower than average consumption, particularly in foods even during depression years.

On page 3 of my statement I indicate this, trying to show you how modest a budget this is. The budget that gives rise to the figures I have mentioned provides, for example, per capita consumption of only 116 pounds of meat, poultry, and fish. That contrasts with an average consumption in 1950 of 187 pounds.

It provides for 256 eggs per person, compared with 395 on a Nationwide 1950 basis, and so on down the chart, showing that it is a very modest budget on the question of food.

Senator HOEY. Is it your contention that there ought not to be any tax imposed until they have earned the amount you specify as a minimum for living?

Mr. NIXON. Yes, sir.

Senator HOEY. Then, your policy would say that a single person should have an exemption of $1,700.

Mr. NIXON. Yes, sir.

Senator HOEY. Married couples should have an exemption of $2,400.

Mr. NIXON. Yes, sir. I have developed that later on.

Senator HOEY. And so increase that proportionately?

Mr. NIXON. Yes, sir. Based upon the proposition that there is a certain minimum required for healthful, decent existence.

Senator HOEY. Have you any figures as to how much that would mean in a reduction of present revenue?

Mr. NIXON. Yes, sir.

Senator HOEY. How much?

Mr. NIXON. Excuse me, sir. That reduction that I have estimated, roughly, based on Secretary Snyder's material presented to this committee would reduce the total income by around $4 billion.

Senator MILLIKIN. Revenue?

Mr. NIXON. Yes, sir; total revenue.

Senator HOEY. Under the present law?

Mr. NIXON. Yes, sir; under the proposed law.

Senator MILLIKIN. That figure is at complete variance with other calculations we have had on this subject. As I recall it, an exemption of $100 amounts to over $2 billion.

Mr. NIXON. Perhaps the difference arises from this: The figure that I gave would involve a necessary adjustment above these exemptions to take care of the larger-income families. In other words, it would require a change in the rate to not reduce their tax burden. But if you just remove from taxation the families underneath these minimum levels, the figure will be roughly $4 billion. I would not want to quarrel a million dollars one way or the other, but it is roughly $4 billion.

Senator MILLIKIN. By increasing the exemption $100 in 1948, we removed over 7 million taxpayers from the Federal rolls.

Mr. NIXON. That is correct.

Senator MILLIKIN. And my memory is rather distinct that as of that time, a rough rule of thumb was that a hundred dollars exemption resulted in a loss of $2 billion of tax revenue.

Mr. NIXON. I think you spread that figure all through the taxpayers and the figure, I imagine, was based on spreading the benefits of that exemption throughout the income-tax structure.

Senator MILLIKIN. If you do not do that, then you would take the lost revenue there and put it up above, is that correct?

Mr. NIXON. That is right. Actually what we did was to take table 7 in Mr. Snyder's presentation—no, it is not 7, it is 6—which indicates the income in the various "gross income class" groups, and made rough calculations.

Senator WILLIAMS. Are you not proposing that these exemptions be given to all taxpayers?

Mr. NIXON. The exemptions be given to all taxpayers, but the benefit should come to those under these exemptions. In other words, as far as our total income tax is concerned you would make the necessary adjustment in the rate. It is an arithmetical question to decide how much do you have to adjust the rate in the upper brackets to not reduce their general tax burden, at the same time giving benefit to the low-income families of the proposed exemptions.

Senator WILLIAMS. But your proposal is that all married couples with four children get $4,700, for instance, no matter who they might be.

Mr. NIXON. $3,700, sir; a married couple and two children.

Senator WILLIAMS. I said four.

Mr. NIXON. Yes, sir.

Senator MILLIKIN. Up and down the line?

Mr. NIXON. All the way up and down the line. I think you will find that the estimate of the loss of revenue, which was the question we started on here, would be around $4 billion, provided that you made the necessary arithmetical adjustments above the minimum level.

Senator HOEY. If you made no adjustment at all it would be $10 or $15 billion.

Mr. NIXON. Yes, sir.

Senator HOEY. You change the exemption from $600 to $1,700, and then run it all the way along, and proportionately to married couples, and you would probably lose $15 billion.

Mr. NIXON. I have not made that calculation, Senator Hoey, but I merely propose that the rates be arithmetically adjusted above the exemptions for the moment, not proposing any changes there, sir, in the general tax burden that they face.

Senator TAFT. There must be some little difficulty about this. This looks as if two could live as cheaply as one. It would be something that would highly promote marriage. You save a thousand dollars a year by getting married apparently.

Mr. NIXON. I can answer that.

Senator TAFT. There are two single people, and at $1,700 each, if they live alone, it costs $3,400, but if they get married it costs $2,400.

Mr. NIXON. I do not know what your experience is, sir, but these do not challenge my experience.

Senator TAFT. I think your figure for the single person must have been a little high, if the married is $2,400.

Mr. NIXON. Senator, you must remember, this is not my figure. This is the figure of the United States Treasury Department and the Bureau of Labor Statistics.

Senator TAFT. You say that the Treasury Department has not paid much attention to it? Maybe they do not think it is quite right.

Mr. NIXON. No, I do not think they do not think it is quite right. Maybe they think it is quite right, and maybe that is why they have not emphasized it. The documents on this constitute a very complete study, and this, I want to emphasize, is the type of thing that deserves the very close attention of this committee, because it has to do with what people eat, whether they have enough food, and whether they have enough medicine and enough clothing at the minimum levels of existence.

I was just trying to make the point that this is not a dream budget. On the clothing front, it provides the man of the house can provide one overcoat every 6½ years and one topcoat every 10 years and buy five shirts a year and two pairs of shoes.

His wife can buy one cotton street dress a year, and her wool dress has to last for 5 years.

What I am trying to underline is that this is a modest evaluation of what an American family has to have if that family is going to meet a minimum standard of healthful existence.

As I say again, it is not my calculation; it is the calculation worked out by the Department of Labor in a rather extensive study based on 34 cities, which they revise from time to time, and an adaptation of it by the United States Treasury Department in material which they issued December 22, 1947.

That is the first point I wanted to make. The point is that according to careful Government studies, to maintain the minimum standard of living, including no money for Federal income tax, the following annual incomes at April, 1951 prices are needed:

Single person, $1,700; married couple, $2,400; and a married couple with two children, $3,700.

I want to run rather quickly over some economic data that have to do with the actual distribution of income amongst the families of the country.

First, how many American families enjoy this standard that I have described? The Joint Committee on the Economic Report, in a study they have recently issued, estimated that nearly three-quarters of the American population do not arrive at this minimum standard of living. There is a considerable amount of discussion as to what is a "middle income." I know the distinguished chairman has spoken frequently of the burdens of taxes on the middle incomes.

I think it is extremely important for us to be very clear and concise about what the middle income is. Fortunately, this is not a subject for debate. It is a statistical question which we can very precisely define.

The last figure that we had in 1950 for American spending units, according to Federal Reserve Board data, showed the middle income figure at $3,000. Their general practice is to divide family income groups into fifths.

Senator WILLIAMS. Do I understand that 75 percent of the people are below $3,000 now?

Mr. NIXON. No, sir; 50 percent are below. That is the middle income. When you use "middle income," and if you are really talking about middle income—and "middle" is an English word that has a precise meaning—the precise meaning is that 50 percent of the families, or spending units, in 1950 got less than $3,000 and 50 percent got more than $3,000.

Senator HOEY. Does that apply to the family or the individual?

Mr. NIXON. It is what the statisticians call an income spending unit, and it comprises both families and single individuals who maintain a single, separate household.

Senator TAFT. I cannot reconcile the figures. You have $3,000 a family on the average; you have 33,000,000 families, about, and that is $100 million. But the national income is from $225 billion to $250 billion.

Now, in individual incomes, I think that your figures are out of date. That is my conception.

Mr. NIXON. Sir, I have before me the very latest 1951 Survey of Consumer Finances, just issued by the Board of Governors of the Federal Reserve System.

On page 4, they have income groups of spending units, and for 1950, they have listed the median income, money income before taxes, and the median income for 1950 is $3,000. A median is a type of average which means that 50 percent are above and 50 percent are below.

Senator TAFT. You have this peculiar difficulty, too, in making family incomes. You have nearly 60 million people working with only 35 million families. In other words, you have more than two workers in more than half of the families. That means, of course,

that when you try to get at this basis, you have a tremendous difficulty of adjusting your taxes to meet the advantage enjoyed by family units which have two or three workers in a family, and if you try to raise your whole standard to a point where every family with only one worker gets enough, then the families with two workers get nearly twice as much, or at least 65 or 75 percent more.

In other words, you have all sorts of complications when you begin to try to figure family incomes and individual incomes and work it out on just exactly what each person should get and what is the living wage. What is the living wage for one family may not be a living wage for another family. It is according to where they are and how many workers they have in the family, and a lot of other circumstances.

Mr. Nixon. Sir, I can understand the difficulty with regard to these data, and I certainly would not want to oversimplify them. But it is wrong to go to the other extent and not realize the tremendous general impact of these data.

For example, you mentioned multiple-income families. That is reflected in the figures that I cited to you. That is not a single-income person. That is the spending unit. If the spending unit has three people earning in it, it would be reflected in here as a single family unit, and would find its place in the data very carefully prepared by the Federal Reserve Board.

Another way to look at it, for example, is that we know what the average factory wage is as of now. It is around $65 a week. That is the average. There is just no debate about it. If a man gets 52 weeks of work, which is frequently not the case, and is a single-income family, that man takes home around $3,300 a year.

Now, I realize that these figures are shocking, and they are difficult to adjust to. There are two ways to adjust to them. One is to say that this city worker's family budget which I have reflected in that chart is false, that it is exaggerated, that it is blown up, and that it has things in it that it should not have.

On that, I think it is really beyond debate, because it is a very scientifically prepared study, and we can talk in great detail, if you wish to, about the content of that budget.

No. 2 would be to say that the income data of the Federal Government, upon which we base all of our economic calculations, are false. Certainly there is room for some nice distinctions, and there is some room for some complexities, and they are complex. But the general impact of the data, it seems to me, is unavoidable, and that simply is that a vast proportion of American families are not getting the incomes which permit them to do anything more—and on the part of the large proportion, do less—than meet the minimum standard of existence.

Senator Taft. It follows, then, that we should not be giving money away to other nations who have a low standard of living, because we need it to raise our own, does it not?

Mr. Nixon. I would just like parenthetically at this point to say that while I feel strongly about the data that I am presenting, and I feel confident that it is carefully worked out, I would want even more to urge this committee to study it and be absolutely sure that when you put taxes upon a worker's family that is getting $3,300 a year, you know what you are doing to that worker.

Now, Mr. Magill's testimony had a great deal of emphasis on the psychological aspects of the impact of tax burden. I am talking about physiological aspects, the question of eating, the basic question of maintaining a healthful existence. And I would really want to urge you to look carefully into this, because I think that the data are very troubling when we get into it.

Senator WILLIAMS. I notice that in 1948 you list the middle income average as being $2,840, and in 1949, $2,700. Has that been declining since that time?

Mr. NIXON. No, sir. Now it is $3,000.

Senator WILLIAMS. Now it is $3,000.

Mr. NIXON. I have that table right before me.

Senator WILLIAMS. I do not see it completed on that statement.

Mr. NIXON. No. When I prepared this, the 1950 data were not available. It has come out since I completed the statement. But I do think that there is a lot of loose thinking about middle income. I know that when Secretary Snyder speaks about the lower end of the scale, he is talking about incomes of less than $5,000. That is rather unusual for the lower end of the scale, because according to his data, that covers 83 percent of all the taxpayers. And it is a very lopsided "tax level" that covers 83 percent of the taxpayers.

I know that President Truman in his address to Congress made reference to $10,000 as the lower end of the scale. If you do that, then you are talking of only about 3 percent of the American taxpayers as above the lower level.

So what I am trying to urge your attention to is this really minimum standard of living and the actual middle income.

Senator TAFT. How many automobiles are there on the road now in the United States?

Mr. NIXON. I do not remember that figure exactly. It seems to me it is 15 or 16 million.

Senator TAFT. It is 40,000,000.

Mr. NIXON. 40,000,000?

Senator TAFT. More than there are families in the United States.

Senator GEORGE. It is around 50 to 60 million, I think; 50,000,000, at least. Some families have two cars in the garage.

Mr. NIXON. There may be that many automobiles, but that does not obviate the basic point about the standard of living of the people.

Senator TAFT. I do not know that there is much we can do about the average question. I think that there is a very serious low-income problem, but I do not believe it affects anything like the percentage of families that you mentioned.

In other words, I think you will find that much more than half of the families feel themselves reasonably well off and satisfied, and that the problem extends to a much smaller group of low-income families. That is my suggestion. I say that I believe that you will find that something like 80 percent of the families in the United States have automobiles today.

Mr. NIXON. They may have an automobile, but in many cases it is necessary for work.

Senator TAFT. In some cases, but not many.

Mr. NIXON. And they have old automobiles.

Senator TAFT. But most workers in cities can reach their work by public conveyance. I am not talking about the average. I think,

though, that it is a very difficult problem to analyze statistically, and I am not satisfied with any of the analyses so far worked out.

Mr. NIXON. It seems to me that while there may be a lot of automobiles and a lot of people have automobiles——

Senator TAFT. There is not much that you can do about an average. That is a tremendous job. If you took away the income of everybody over $50,000 a year, you would not increase the average.

Mr. NIXON. That is true.

Senator TAFT. You might be able to help the low-income group some, but you certainly are up against a real economic problem when you try to increase the average. And the average is about two and one-half times what it is in Great Britain, according to my figures. It is twice, anyway.

Mr. NIXON. The problem is that we are now talking about additional tax burdens on a worker with a wife and two kids who is getting $3,300 or $3,200 a year. He is paying $120 in direct taxes now. He is paying over $700 total taxes, direct and indirect, as I will point out, and we are talking about increasing it. That man is already at a point where he cannot meet the minimum budget that we have defined. He is scratching and scraping, cutting corners, not buying enough food, going without the dentist when he needs him, and so on, and you are down to bed rock, in terms of existence.

These data are borne out by complementary data on the question of who has the savings. The Federal Reserve Survey of Consumer Finances shows that at the top, 5,300,000 families hold 65 percent of the total liquid savings. At the bottom, 26,500,000 hold 1 percent. To put it another way, roughly 65 percent of the families and households in early 1951 either had no liquid assets or had liquid assets of less than $500.

It has been brought to your attention, I know, the extensive cashing in of war bonds. There has been a tremendous amount of dis-saving as the families in the middle- and lower-income brackets have not only not been able to save, but have been spending beyond income to try to make ends meet.

According to this latest study, the top fifth, on the basis of income, alone accounted for 93 percent of net savings in 1948 and 131 percent in 1949, 131 percent because of dis-saving in the lower levels.

Senator WILLIAMS. You are familiar with Mr. Snyder's testimony, I presume, where he recommended to this committee to disregard the House proposals and put a greater percentage of this tax increase on the lower-income tax brackets?

Mr. NIXON. Yes, I am.

Senator WILLIAMS. What do you think of that statement?

Mr. NIXON. I think it is completely wrong; and I cannot understand how they can make that statement in the face of their own study of budget needs.

Senator WILLIAMS. He made that statement as a recommendation of the administration.

Mr. NIXON. Yes, sir. When we started to emphasize this, we talked with Treasury representatives and other administration people, and asked them, first, to present these data to you. We asked them to tell you about the city workers' family budget and to tell you about the minimum exemption levels that are required if you are going to put the Department of Labor minimum budget study to use.

We asked them just to present the data so that it could be used. Unfortunately, up to the present time, the data of the Government itself on these questions is not being presented to the Congress, and we are very disappointed about that, because we think that if they have made these studies—and they have, and they are serious and important studies—then the data ought to be given to you so that you can have a more precise basis for judging what you have to do when you consider increasing tax burdens on families in the low- and middle-income levels.

Senator WILLIAMS. Do you think it has been consistent with the policy of Mr. Snyder and administration representatives to place the income tax burden on the low-income levels?

Mr. NIXON. Speaking below these minimum levels that we have in mind, there can be no question about it, that their inclination has been steadily to increase the burden and not adequately to take into account the minimum income needs of the families. Actually, over in the House committee, it was a majority operation there which changed the impact of the income tax burden a little bit, so that it was a little less burdensome on the low-income levels. And yet when they come to present the position before you, they oppose that position.

On principle, it seems to me it is significant. It is not inconsistent with what we, at least, think they have been doing in the past.

Senator WILLIAMS. I remember particularly Mr. Snyder criticized the tax-reduction bill of the Eightieth Congress, and I think it was criticized somewhat by your organization, but that increased the exemptions for the low-income brackets and it increased the exemptions for those over 65 and the blind. And I remember particularly that the committee got a lot of criticism for placing such a large percentage of those benefits in the lower levels at that time, which is not at all consistent with the general policy.

I wonder if you agreed with me on that.

Mr. NIXON. We certainly would not criticize that, because I have been appearing before this committee for 10 years, and we have never been here but that we have talked about raising the exemptions for the incomes at the lower levels.

The CHAIRMAN. Proceed.

Mr. NIXON. I have already made the point that the average factory worker today gets around $3,300 a year if he works 52 weeks. That is including overtime. To achieve a minimum living standard required by the BLS budget, he needs $3,550. If you add to that the $120 tax burden, that means $3,670. His income is $370 short. This means that he and his family must now do without some food they need or some clothing or some medical care or some of all these items to meet daily expenses.

In 1939, the income exemptions here were in general accord with what was required for minimum budget standards. We have tried to present in a chart here, which I think you can barely see, the change in the income exemptions and the amount that would be necessary now in income exemptions to keep them at the 1939 level. You can notice that we have had to change the chart. We economized a little bit. That ought to please some of you. We economized and did not remake the chart. We just changed the chart that we gave to the House and brought it over here.

But in each case, you see, we had to add several dollars to the amount that would be necessary now to adjust to 1939 levels because of the rise in the cost of living since we testified over in the House.

There have been some very important studies, and I know Senator Taft is well acquainted with these, because they were presented to the Joint Committee on the Economic Report, showing the actual incidence of taxes—Federal, State, and local, direct and indirect—on income levels.

The average manufacturing worker with a wife and two children earning $3,300 a year today is paying a total tax burden now of more than $700. The Administration's proposal would increase this to nearly $800. H. R. 4473 would raise it to around $750.

In terms of the proportionate incidence, we have the benefit of very careful studies showing the proportion of income in various income groups that is going to all these taxes put together.

Under $1,000 in the income group is paying 23.6 percent of their income. Then it goes to 20.3 percent for $1,000 to $2,000, and so on, emphasizing the heavy burden that is already carried by low-income people.

Senator MILLIKIN. Pick out your own bracket so that we know what you are talking about. What would you call a low-income bracket?

Mr. NIXON. A low-income bracket?

Senator MILLIKIN. Yes. Pick it out, so that we do not get into this confusion that you speak of that comes from using the wrong word. So pick out a bracket.

Mr. NIXON. I think that my brackets are reflected in this chart, sir.

Senator MILLIKIN. You pick out any one of them.

Mr. NIXON. Four people?

Senator MILLIKIN. All right. Now take an income of $2,400.

Mr. NIXON. That is two people.

Senator MILLIKIN. How much concealed taxes would the $2,400-income bracket pay?

Mr. NIXON. Let me pick it out for you. For a man and wife and two children getting $3,200 a year, talking about the present time, his Federal income tax is $220, his social-security tax is $49.50, the estimated Federal——

Senator MILLIKIN. The social-security tax is, from one viewpoint, a form of savings.

Mr. NIXON. I agree with that, sir. But it is an income problem. He has no choice about it.

Senator MILLIKIN. It is a form of investment that he makes, but nevertheless he has to take it out of his pocket.

Mr. NIXON. Federal excise is $130, and other taxes—that includes State and local taxes—$420.

Senator MILLIKIN. How much concealed taxes?

Mr. NIXON. The excises are largely concealed.

Senator TAFT. He could not pay a lot of excise taxes unless he smoked and drank a lot?

Mr. NIXON. He might not drink, sir. He might smoke, or go to a movie, or buy gasoline, or buy some drugs, or ride on a streetcar; all of those things.

Senator MILLIKIN. Let us get the concealed taxes, now.

Mr. NIXON. Actually, the breakdown of this study is not exactly on a concealed and unconcealed basis.

Senator MILLIKIN. I know that. But that is what I am driving at, the concealed taxes.

Mr. NIXON. Out of the $719, on the basis of a rough calculation, at least $400 would be a concealed tax, at that income level.

Senator MILLIKIN. Your figure is not limited to direct payment of taxes?

Mr. NIXON. No, sir.

Senator BYRD. What is that $420 item you have in there?

Mr. NIXON. This is the estimated total tax burden, Federal, State, and local.

Senator BYRD. You have $420.

Mr. NIXON. That is for the calculation of other taxes. It includes State, city, and local taxes, and sales taxes.

Senator BYRD. Would that be on the property that the taxpayer owns, or what kind of tax?

Mr. NIXON. Sir, it would be. But at that level, it would not be a very important item, because we are now talking of a $3,300-income person.

Senator MILLIKIN. It includes local excise and sales taxes?

Mr. NIXON. Yes.

Senator MILLIKIN. Admission taxes?

Mr. NIXON. Right.

Senator MILLIKIN. And various forms of transaction taxes?

Mr. NIXON. Yes, sir.

Senator MILLIKIN. Those are direct, and easily measurable. Now I would like to get a clear answer as to whether your figures do or do not include all estimated indirect, or concealed, taxes.

Mr. NIXON. Yes; these figures do include that, sir.

Senator BYRD. I wonder if you have not got a breakdown of this item of $420.

Mr. NIXON. I think we can give you some more detail on that, Senator Byrd. You understand that this is not, again, my calculation. This is a calculation made by a group at the University of Michigan presented to the joint group on the Economic Report.

Senator MILLIKIN. Now, out of the whole group that you are presenting, how much is concealed taxes?

Mr. NIXON. As I say, that breakdown is not precise here. I think I can give you a good estimate of it. My off-the-cuff estimate would be around $400 out of this $719 is now concealed.

Senator MILLIKIN. Now, those concealed taxes come about through the imposition of taxes on higher brackets, do they not?

Mr. NIXON. No. They come about through taxes that are passed on in various sorts of ways by manufacturers and retailers.

Senator MILLIKIN. They reflect taxes like income taxes; they reflect the excise taxes of higher income brackets; they reflect corporation taxes. They reflect the whole line of taxes imposed on the higher brackets, which conceal themselves in increased rentals, increased professional fees, and increased charges of all kinds; is that not correct?

Mr. NIXON. They include all the taxes that it is estimated are passed on.

Senator MILLIKIN. So if you get rid of this burden in the lower brackets that you are talking about, you impose it on the higher brackets, which in turn come back as concealed taxes; is that not correct?

Mr. NIXON. I think that you cannot generally say that all taxes on higher brackets have the same capacity to be passed on as others.

Senator MILLIKIN. I would not contend that. Some do and some do not.

Mr. NIXON. Corporation profits taxes have a limited capacity to be passed on, and individual income taxes.

Senator MILLIKIN. But under your own figures, more than half are concealed taxes.

Mr. NIXON. Yes, sir, but——

Senator MILLIKIN. They must necessarily come, in the main part, from taxes imposed higher up the scale.

Mr. NIXON. Not exactly higher up the scale; at a different place in the scale. There are taxes imposed on the manufacturer, on the distributor, on the retailer, and on the transportation man, who somehow or other can pass them along.

Senator MILLIKIN. That is right.

Mr. NIXON. And it is possible to make an estimate of how much of this is actually passed along, and out of the income of $3,300 how much of it represents money paid for taxes.

Senator MILLIKIN. But you would not disagree with the general proposition that as you increase your taxes in the higher brackets, you increase the amount of concealed taxes that the lower-bracket people pay?

Mr. NIXON. I think that that is probably generally true, but I would want to emphasize that you certainly can increase taxes in higher brackets, corporate and individual income taxes, which cannot be passed on, or not very easily passed on.

Senator MILLIKIN. I would agree with you that generally, since we are talking generalities, some taxes pass on easily and some do not, or may take longer to pass on, than would occur on the first bounce.

Mr. NIXON. That is right.

Senator MILLIKIN. But generally speaking, I am suggesting that you agree with me that as you increase taxes other places in the scale, they ultimately come back as concealed taxes on people in the lower part of the scale.

Mr. NIXON. Many of them do.

Senator MILLIKIN.–That is right. Thank you.

Mr. NIXON. I just want very quickly, now, to summarize the conclusions and some ultimate proposals.

The first proposal is the obvious one, that the individual income-tax exemptions be increased to allow free of tax enough income for a minimum adequate living standard. The Treasury Department has made an argument for this, which I think bears reading:

> For the long run, it is regarded as essential to exempt amounts required to maintain the individual and his family in health and efficiency. Apart from humanitarian aspects, this view is based on certain practical social and economic considerations. Thus, it is held that taxing substandard living will result in lowered economic vitality in the community, lower revenues, and possibly result in higher Government expenditures for social repairs.

Our conclusion is very simple, that the sacrifices involved in cutting the family consumptions down from a Cadillac scale of living to a Buick scale or even to a Chevrolet scale are not to be compared with the sacrifice involved in giving up a quart of milk a day or new shoes for the children or a much-needed visit to the doctor. Yet this is exactly

the kind of sacrifice which is imposed daily on low-income families by the present tax burden and which would be aggravated by the proposals for additional taxation in the low incomes.

Senator TAFT. In that connection, it occurs to me that the logic of your conclusion would be that if you had to spend, say, half of the national income on taxes to pay for a great defense effort, you would get everybody down to the same level.

Mr. NIXON. I think that is right, Senator Taft, to the same income of not taking away the ability to have enough to eat for minimum health needs, and enough doctors' care——

Senator TAFT. But as a practical matter, the amount of national income over and above this figure that you fix here probably is about half the total national income. So if you had to tax half of the income to pay for a defense effort, you would get everybody down to the $3,000 flat. In other words, you reach the final socialistic goal of everybody's having exactly the same net income to live on; is that not it?

Mr. NIXON. We have made an estimate in our statement as to what this would cost. It would cost $7 billion to take off the excise taxes on these low-income people and the individual income taxes.

Senator TAFT. I think that is very low. I do not believe you can support that.

Mr. NIXON. I would be glad to go into it with you, because I worked it out. I have my work sheets. I just think that the data are pretty clear. If you want to say that it is $8 billion instead of $7 billion, that would not change the basic burden of the argument.

Senator MILLIKIN. Mr. Chairman, I would like to ask that the witness submit the demonstration to Mr. Stam, because we have been going on entirely different assumptions here.

I am interested in these burdens that taxes impose on the lower income brackets. I do not accept your arguments, all of them, with hostility. I do not accept what you seem to give as the conclusive character of some of your data. Those make for large question marks in my mind.

Mr. NIXON. You are speaking of the loss of revenue?

Senator MILLIKIN. I am speaking of that, and also this additional Treasury data and supporting material behind it. That has never been, so far as I know, subjected to a close and thorough congressional scrutiny. Perhaps the Congress is wrong in not having done it, but I am simply speaking of the ultimate facts so far as they are known to me. Those data have not received a careful ransacking by the Congress.

Mr. NIXON. I certainly think that it is constructive if you do look at it with a critical and careful view, as critical and careful as possible. I will submit a further memorandum on the loss of revenue estimated, which I want to make more clear to you.

Senator MILLIKIN. I wish you would.

Senator TAFT. I want to make it plain that it seems to me that the theory you adopt is wrong, because it assumes a complete leveling of income; it eliminates any possibility of graduation of income in accordance with the relative abilities of different people, beyond a certain point.

While I dislike the tremendous burden of taxes, nevertheless I do not see how you are going to help the situation. If you are going

to maintain some response to the relative abilities of people, I do not see how you are going to help by lowering everybody's income to the point where you want them to say, "This is absolutely sacred. Everything is to be paid down to here." And if that tax is big enough, then everybody is equal in income. And you have leveled income completely. You have abandoned our whole theory of incomes, that are supposed to be, at least under this system, graduated in accordance with ability and education instead of other things that have been taking place in other lights.

It seems to me that to adopt your theory necessarily involves the socialistic goal of absolute equality of incomes. So I question the underlying philosophy of your statement.

Mr. NIXON. Sir, I do not think that is where this would lead. I want to emphasize that the basis of it is to take something that can be studied and be said to be a minimum standard of living. Is there such a concept? Can you do it? The Government says you can. Does it have validity? Then if you do that, isn't that the last thing that you impinge upon, the amount of minimum food that a family has, the amourt to see a doctor if they need to?

Senator TAFT. There are no such absolute standards. You have hundreds of millions of people throughout the world, living far below the standard that you now regard as essential, and I think it is highly desirable as a goal. I agree that it ought to be there. But I think that you have certain limitations if you are going to keep the country going on the basis on which it has been going, which has produced a general average two or three times that of any other nation in the world, and I think that is partially due to this theory of graduated reward for increased or better effort or more ability. I do not think you can abandon that concept and keep up your average. That is the trouble with the socialist theory, it seems to me.

Mr. Nixon. I am not preaching the socialist theory.

Senator TAFT. I think your basic assumptions eventually lead to socialism. I do not see how you can get away from it. It leads to the theory of the equality ultimately of all income for all families or all individuals.

Mr. NIXON. The income data now show tremendous differences, and there is no way to get around it. If you want to go beyond the data as a jury might, you might come to a Mink Avenue and Cadillac Street in New York, and you will see what I mean. There are differences. When you are at the point of taking away food, clothing, shelter, and medical care for families, it seems to me that the burden of our argument is that that is the last thing you should get at.

As you say, sir, there should be from a public policy point of view a sacred level, and we think that this is important to the health of the country and the security and welfare of the country.

Leaving aside the question of the definition of it, just as a general proposition, we would urge that. It seems to me that this committee has to have pretty well defined as it goes into this area of taxation, which I know has bothered every member of the committee, exactly what that level is and how far you can go.

Senator TAFT. Is not the point of view of your union a Socialist point of view?

Mr. NIXON. No, it is not.

Senator TAFT. The CIO says it has been a Communist-dominated union for a good many years. I do not insist on that fact, but certainly its philosophy is the Socialist theory.

Mr. NIXON. No, that would not be right, because our position is a very clear one and a very limited one on these questions. If this tax testimony is Socialist, then that is all right. That is Socialist. But I do not think this is. I think it is quite a different thing to argue for a minimum level of existence that should not be impinged on by the tax burden.

The CHAIRMAN. Your whole statement, Mr. Nixon, will go in the record, and I see that you have covered practically all of these points. But there is additional information asked for. If you would bring it, we would be glad to have it.

Mr. NIXON. Very well, sir.

(The prepared statement of Mr. Nixon is as follows:)

STATEMENT OF RUSS NIXON, UE WASHINGTON REPRESENTATIVE, BEFORE SENATE FINANCE COMMITTEE, ON 1951 TAX PROPOSALS, JULY 9, 1951

This statement is presented on behalf of the 300,000 workers represented by the UERMWA in 1,000 electrical, radio and machine plants where UE is the bargaining agent. This UE position on tax policy reflects widespread discussion and deliberation amongst our members, in the annual UE national conventions, UE district conferences and UE local union meetings.

The basic UE tax principle is simply stated:

1. No taxes should be levied on American families whose income is not large enough to maintain living standards at minimum adequacy levels of health and efficiency. Existing taxes reducing incomes below such a level should be repealed. No taxes should be placed on family incomes already below a living wage.

2. The revenue lost by not taxing family incomes below living wage levels—estimated at $7 billion—can be replaced to the extent necessary, without causing real hardship, from sources of large income and wealth now escaping adequate taxation.

The UE realizes that our proposal is opposed by a major propaganda and pressure campaign of large industrial and financial interests to put the burden of increased taxes on low-income families and to minimize the burden of taxes on corporate profits, large individual incomes, and wealthy estates. This campaign, led by the Chamber of Commerce and the National Association of Manufacturers, is echoed in the press generally. It aims at a Federal sales tax, the lowering of individual exemptions, and further increases in income tax rates on low incomes. These proposals would aggravate existing poverty for the 45 percent of low-and middle-income families now receiving less than a living wage. They would drive millions of middle-income families now on the border line down into substandard existence.

I WHAT IS A LIVING WAGE?

In spelling out the UE proposal, the first consideration is: How much does a family need to have a minimum adequate living standard? Fortunately, Government sources furnish roughly adequate objective answers to this question.

The Treasury Department has assembled the basic information on this question in a study called "Individual Income Tax Exemptions." It was published in December 1947 but has received little attention and no emphasis by the Treasury Department itself. The Treasury study indicates that American families need the following amounts of income—at April 1951 prices—to provide a "necessary minimum" of goods and services for health and efficiency:

Single person	$1, 700
Married couple	2, 400
Married couple with 1 child	3, 100
Married couple with 2 children	3, 700
Married couple with 3 children	4, 200
Married couple with 4 children	4, 700

These estimates are based on the Bureau of Labor Statistics' City Workers' Family Budget, which was adjusted by the Treasury Department for different sizes of family, and which we have adjusted to April 1951 price levels by means of the BLS Consumers' Price Index.[1] The budget amounts estimated above do not include any allowance for Federal income tax.

The standard of living provided by these estimates based on the BLS budget is extremely modest. For a single person, for example, the estimate is $1,700, excluding Federal income tax. The Industrial Welfare Commission of California estimated that in October 1950, when prices were lower than now, a single working woman needed at least $1,750 per year excluding all direct taxes. That budget in April 1951 would cost $1,850. The New York State Department of Labor estimated that a working woman living with her family in September 1950 needed $1,900 excluding direct taxes. That would cost over $2,000 in April 1951.[2]

The BLS family budget is not a "luxury" budget. It is far below that we consider "the American standard of living." It is approximately $450 (for a four-person family) less than the budget estimated by the Heller Committee for Research in Social Economics, University of California, as necessary for a "healthful and reasonably comfortable living." In important respects, it is even lower than average consumption in depression years, especially of foods:

BLS food budget versus United States per capita consumption

	BLS budget allowance per person	Actual United States 1935-39	Consumption per capita [1]	
			1947	1950
Meat, poultry, fish .... pounds..	116	157	194	187
Eggs .... number..	256	298	379	395
Fluid milk and cream .... pounds..	320	340	398	385
Fresh vegetables .... do....	121	235	252	253
Sugar .... do....	45	97	91	97

[1] U. S. Department of Agriculture, National Food Situation, April-June 1951.

There is nothing luxurious about the clothing budget. The man of the house could buy one overcoat every 6½ years, one topcoat every 10 years. He could buy five shirts a year, and two pairs of shoes. His wife could buy one cotton street dress a year; her wool dress would have to last her 5 years.

In the medical care department, the family could each go three times a year to the doctor, and each could receive one visit from the doctor at home.

The family could buy one low-priced car every 15 or 16 years. In this car, they could drive to 19 movies during the year and to four baseball games (or other sports events, plays or concerts).

This family would be allowed one newspaper a day. It could buy a magazine once a week for 32 weeks of the year. For serious reading, it would have to go to the public library: the budget allows only one book per year! It would have to get along with the same radio for 9 years.

This family could not have a telephone in its home, but would be allowed to make three local phone calls a week. It could write one letter a week. It could have such standard appliances as a cook stove, refrigerator, washing machine, iron, sewing machine, vacuum cleaner, etc., if it could find a way to finance them on terms extending to 17 years for the stove, refrigerator and vacuum cleaner and up to 100 years for the iron and sewing machine. The alternative is to share such items with other families, where possible.

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[1] The BLS Consumers' Price Index has been used in this instance only to make the estimates for April 1951 comparable to the estimates in the Treasury Department study, which are for September 1947. It should be understood that the BLS Consumers' Price Index does not measure changes in workers' living costs, though it is commonly misused as a cost-of-living index. A thorough, carefully documented study made by the UE this year indicates that the BLS index reflected only 70 percent of the increase in workers' living costs from 1939 to January 1951. (See The Facts About High Living Costs, UE Publication 198, June 1951.)

[2] Source: Department of Labor, Facts on Women Workers, February 28 and March 31, 1951.

To repeat: according to careful Government studies, to maintain such a limited "necessary minimum" standard of living, including no money for Federal income tax, the following annual incomes at April 1951 prices are needed:

Single person	$1,700
Married couple	2,400
Married couple and 2 children	3,700

The UE says—no taxes should be levied to reduce families below such a minimum standard.

II. HOW MANY AMERICAN FAMILIES ENJOY A LIVING WAGE?

It is a shocking fact—and one we easily overlook because its implications are unpleasant—that the modest living standard just described is out of reach of nearly three-fourths of the United States population, according to the estimates of the staff of the Joint Committee on the Economic Report (S. Rept. No. 210, April 2, 1951, p. 48).

It is a monstrous misrepresentation to contend that workers and other low-income people have excess purchasing power, which must be drained off to prevent inflation. This false reference to labor's excess purchasing power is carefully propagated by the big industrial and financial interests and unfortunately parroted by too many Government spokesmen wanting to put the burden of new taxes on low incomes. There can be no excess purchasing power among people who are suffering substandard existence.

In 1948, considered to have been one of the most prosperous years in our history, 53 percent of American families got less than $3,000 (Joint Committee on the Economic Report, Materials on the Problem of Low-Income Families, November 9, 1949, p. 9). One-third of families got less than $2,000.

The staff of the Joint Committee on the Economic Report observed that the 1948 income data "indicate that a surprisingly large number of families fall short of full participation in American prosperity, even in years of full employment" (Joint Economic Report, S. Rept. 1843, June 16, 1950, p. 39). This is no less true today.

How can anyone, after studying these figures, seriously talk about "excess purchasing power" in the low-income brackets?

However, the argument of the big financial and industrial interests is supported by Government officials whose own statistics refute them. The Wage Stabilization Board, for example, has put forward the argument that workers have "excess purchasing power" as the main justification for both wage control and more taxes from low incomes. (See WSB Policy Statement, Dec. 18, 1950, Release ESA–GPR–18.)

The Secretary of the Treasury and the Council of Economic Advisers join industry and financial spokesmen in declaring that people in the middle and lower income brackets have the bulk of total income and therefore should pay the bulk of taxes. (See, for example, Secretary Snyder's statement before the House Ways and Means Committee, February 5, 1951, p. 11; January 1951 economic report of the President, p. 104.) But the Census Bureau data already cited, and the data from the annual Federal Reserve Survey of Consumer Finances which I am about to cite, show that people actually in the middle and lower brackets not only do not have enough to live on but do not have the bulk of income even when all their incomes are added together.

Clearly, to tax families at these low-income levels is not the way to stop inflation, but rather weakens our country by creating poverty conditions of life for millions of families.

III. WHO DOES GET THE INCOME?

In 1948 and 1949—latest years for which detailed Federal Reserve Board data are available—the three-fifths (60 percent) of families and households in the middle and lower income groups received only 32 percent of total personal income.

The middle income in 1948 was $2,840; in 1949, $2,700. In a relatively prosperous year, 1948, the lowest fifth of families and households had a typical income of $860. The next highest group had a typical income of $2,000. Incomes averaged even lower in 1949 due to the recession.

When incomes are divided into dollar brackets instead of into fifths, the result is essentially the same. Families and households with incomes under $3,000—more than 50 percent of all families and households—got about 25 percent of total

personal income in 1948. If the definition of middle incomes is stretched up to $4,000—which takes in 73 percent of all families and households in 1948—the total share of income received by middle and lower incomes in 1948 was 45 percent.

These estimates from the Federal Reserve Survey of Consumer Finances refute statements of the Chamber of Commerce, the National Association of Manufacturers, Secretary Snyder, the Council of Economic Advisers and others, that the bulk of taxable income, or any other kind of income, is "in the lower end of the scale" (Secretary Snyder's statement to House Ways and Means Committee, February 5, 1951, p. 11).

To prove his statement, Secretary Snyder stretches the definition of "lower end of the scale" to include incomes up to $5,000. By his own estimates, this definition puts in "the lower end of the scale" 83 percent of all taxpayers in 1951. If "lower end of the scale" is thus definited to include all but the highest 17 percent of incomes, there is no such thing as a middle income.

By more accurate definition of "lower end of the scale," Secretary Snyder's own data show that the 46 percent of Federal income taxpayers with incomes under $3,000 will have only 22 percent of estimated taxable personal income in 1951.

At the other end of the scale, the 17 percent of taxpayers with incomes above $5,000 will have an estimated 42 percent of that income.

IV. WHO HAS THE LIQUID ASSETS?

Another variation on the argument that low-income people have excess purchasing power is the claim that they have accumulated large savings and other liquid assets "which they are free to spend as they choose" (President's tax message, February 2, 1951). This argument, even for those who approach the anti-inflation fight on the basis of the simple purchasing power "demand pull" on prices, doesn't stand up when we look at the official estimates of who has the liquid assets—the wealth that can be spent.

The latest Federal Reserve Survey of Consumer Finances shows that "at the top, 5.3 million families hold 65 percent of total liquid savings. At the bottom, 26.5 million hold 1 percent. This, taken in conjunction witn survey figures on income, suggests that the big market for high-priced goods is concentrated in relatively few families" (U. S. News and World Report, June 29, 1951).

The 1951 Federal Reserve Survey of Consumer Finances reports that 28 percent of all consumer spending units had no liquid assets in early 1951. Another 30 percent of families and households had liquid assets of less than $500. Thus, roughly 60 percent of families and households in early 1951 either had no liquid assets or had liquid assets of less than $500 (Federal Reserve Bulletin, June 1951).

The amount of liquid assets held in early 1951 by an average family in the middle- and low-income brackets was very small, as the following tabulation shows:

Income bracket:	*Meridian liquid assets*
Under $1,000	0
$1,000 to $2,000	$30
$2,000 to $3,000	190
$3,000 to $4,000	250
$4,000 to $5,000	530

The lower half of families, by income, had only one-fourth of total liquid assets in early 1951.

The middle holding of liquid assets in early 1951, for families which had such assets, was $710—the lowest figure in any survey since World War II. For all families, the median was $300—the same as 1949, but well below 1947 and 1948. The decline reflects what happened during this period: living costs rose steadily; workers' families cashed bonds and drew on savings accounts, not from choice but simply to make ends meet. High living costs and medical expenses are cited as the most frequent cause for using up savings (Federal Reserve Bulletin, June 1951).

The staff of the Joint Committee on the Economic Report pointed out last year that 11 million families disposed of all the Government bonds they owned in the three relatively prosperous years from 1946 to 1949 (Joint Economic Report, S. Rept. 1843, June 1950, p. 42).

People have gone on cashing bonds right through 1950 and 1951 to date. At the start of 1950, 43.5 percent of E bonds issued since 1940 had been cashed; by March 31, 1951, despite strenuous Treasury efforts to increase sales, 47 percent

had been cashed (Treasury Department release, United States Savings bonds issued and redeemed). Sixteen percent of E bonds bought in 1950 were cashed that same year.

A letter in the Washington Post financial column, February 14, 1951, describes the situation in its essence:

"Sixty to seventy percent of the working families today have an overhead which is greater than their wages. The cost of living is so great that when trouble or sickness or accident occurs, there is no alternative but to cash bonds."

Federal Security Administrator Ewing has pointed out that only 1 out of 5 families can meet the cost of serious illness without outside help. For half the population, in families earning $3,000 a year or $60 a week or less, anything remotely approaching adequate medical care is out of the question.

In 1950, 51 percent of all families and households which cashed bonds or other liquid assets did so to meet medical expenses. One-third cashed them to buy food, clothing, and other cost-of-living essentials. Twenty-eight percent used them for such expenses as repairs to house and automobile, farm operating expenses, education and taxes (Federal Reserve Bulletin, June 1951).

For these reasons, families in the middle- and lower-income brackets have been able to save little or no money in recent years. In 1948 and 1949, the lower two-fifths spent, on balance, much more than they got in wages and other income. For the Nation as a whole, only the upper two-fifths saved appreciably. The top fifth alone accounted for 97 percent of net saving in 1948 and 131 percent in 1949. Much of this saving, it has been pointed out, has been in the form of corporate stocks and tax-exempt State and municipal bonds (January 1950 Economic Report of the President, p. 47).

Hereafter, in talking about "excess purchasing power," it would be well to recall this statement from the July 1950 Economic Report of the President (p. 75):

> "The distribution of liquid assets is highly concentrated in the upper income groups. The upper 20 percent of families, in terms of annual income, owned 54 percent of bank deposits and Government bonds in early 1949. * * * This concentration of liquid assets among higher income groups does not provide as accessible a reservoir of purchasing power as if they were more broadly distributed."

The surge of so-called scare buying since Korea has not come from low-income people, who could not indulge in such buying even if they wished. In the first place, they don't have the money. In the second place, the various Government measures to freeze wage rates, raise taxes, and curb installment buying have further diminished the already inadequate buying power of most people.

The 1951 Federal Reserve Survey of Consumer Finances confirms that this buying has been done by the relatively well-to-do who drew on savings for the purpose. The survey declares that the "widespread reduction in large holdings probably reflects the surge of buying and investment that took place following the outbreak of fighting in Korea" (Federal Reserve Bulletin, June 1951).

The bare or below living-wage income families have no rich store of savings to cushion their low incomes. They have no hidden excess purchasing power. Taxes on these levels can only compound poverty.

V. WHO DOES THE SPENDING?

A third variation on the argument that low-income people have excess purchasing power, which must be taxed away, is the assumption that workers and other low-income groups not only have too much money but that they also spend it. This leads a major spokesman of the industrial and financial community, W. Randolph Burgess, chairman of the executive committee of the National City Bank, to argue that we must "discourage spending—we should tax spending and not production" (address to New York State Chamber of Commerce, November 2, 1950). The same position is taken by the Wage Stabilization Board and is clearly implied throughout the January 1951 Economic Report of the President and his Council of Economic Advisers. This leads the Council to conclude that "by far the largest part of the additional revenue must come from the middle and lower tax brackets" (p. 104).

The FRB surveys demonstrate what we ought already to know; that the middle and low incomes, having the smaller share of income and savings, could not possibly do the major share of spending. In fact, the lower 60 percent families and households accounted for less than 40 percent of expenditures for all goods and services in 1948 and 1949.

Estimates presented to the Joint Committee on the Economic Report in January 1951 indicate that families and households with incomes under $3,000 accounted for only 30 percent of consumer expenditures in 1950. They accounted for about 31 percent of total retail sales, but only 26 percent of sales of durable goods (Joint Economic Report, S. Rept. 210, April 2, 1951, p. 52).

As already indicated, low-income families have no excess purchasing power. They spent their incomes up to the hilt for cost-of-living necessities, and then drew on savings and credit when their incomes ran out. The lower fifth spent 22 percent more than its income in 1948, and 39 percent more than its income in 1949, on items like food, clothing, housing, medical care, etc. The second fifth spent 90 percent of its income for these items.

In the light of these facts—which are set forth in appendix B of the January 1951 Economic Report of the President—it is fantastic to read the Council of Economic Advisers' statement that the American people as a whole must reduce their living standards and can easily do so. The Council says at page 82:

> "Economies have not been wrecked because the people decided to do with fewer new pleasure cars and elaborate mechanical amusements, or wear their topcoats for longer or get healthier by eating less * * * we must stop eating so much cake * * *."

But at page 223 in appendix B, the Council report admits:

> "There are still large numbers of families in the United States with small or inadequate incomes * * * allowing for Federal income taxes, the proportion of spending units below $3,000 is raised to 59 percent."

VI. WHO PAYS THE TAXES?

What I have demonstrated so far is that people with middle incomes are just barely able to keep their heads above water, in terms of maintaining a minimum adequate living standard; while some 45 percent of American families, of all sizes, are suffering a substandard existence because they cannot afford that minimum. They do not have the income; they have used up past savings; they therefore cannot spend as they should to maintain a living standard of health and efficiency.

Furthermore, the aggregate income, saving and spending of all families from the middle down, the lower three-fifths of families and households—account for only one-third of the Nation's income and saving and for less than 40 percent of total spending. Let me emphasize that the highest income in the middle group—the third fifth—was only $3,200 in 1949 (January 1951 economic report of the President, p. 149). We are not talking about people with incomes of $10,000, as the President did in his February 2, 1951, tax message. In 1947, 1948, and 1949, only 3 percent of American families and households enjoyed that much income, according to the FRB surveys.

Now we come to the heart of the problem, from the point of view of tax policy. These incomes are already inadequate to maintain a minimum adequate living standard, whose estimated cost does not include Federal income tax. When you add present Federal income taxes to the cost of the minimum adequate budget, those incomes are even more inadequate. And now you are faced with proposals to add even more Federal income taxes—and excise taxes and general sales taxes—on those low incomes.

Let us take a very representative case: a manufacturing worker with wife and two children, who is earning the average weekly wage of $64 (as of April 1951). His annual income at this rate is about $3,300—if he works 52 weeks. To achieve the minimum living standard provided by the BLS budget, however, he needs $3,550, as we have already seen. But this doesn't include his Federal income tax, which is now $120. So he actually needs a total income of $3,670 today. His income is $370 short. This means he and his family must now do without some food they need or some clothing or some medical care or some of all of these items.

The least you can do in such a situation is to relieve that family of paying $120 in Federal income taxes. Instead, the administration initially proposed to raise the Federal income tax for that family to $144, and to increase that family's living costs still further by higher excise taxes on common consumption items like beer, cigarettes, transportation, and recreation. This is the exact opposite of a constructive tax policy which must put first and foremost the health, efficiency and general welfare of the American people.

The NAM and the Chamber of Commerce propose to do much worse: to reduce that family's exemption from $2,400 to $2,000, to increase its tax rate, and to add a Federal sales tax to its cost of living.

H. R. 4473 is not as severe as the initial administration proposals, but its impact on this average manufacturing worker and his family will still be adverse. His Federal income tax will be raised from $120 to $135, and he will still have to pay more for beer and cigarettes, for running his car, and for household operation.

In the matter of Federal income-tax policy, we have moved backward instead of forward. In 1939, incomes under $5,000 paid less than 10 percent of Federal income taxes. In 1951, they will pay close to 40 percent (Secretary Snyder's statement, table 12). In 1939, the exemption from Federal income tax provided a family with sufficient income to maintain a decent living standard. For a family of four, the exemption amounted to $3,300. Today it would take $5,950 to provide the same exemption in terms of purchasing power:

Individual income-tax exemptions: 1939 and now

Size of family	Exemptions		Amount needed to restore purchasing power of 1939 exemptions (April 1951 prices)
	1939	Present	
Single person	$1,000	$600	$1,860
Married couple	2,500	1,200	4,650
Family of 4	3,300	2,400	6,150

Source: Treasury Department staff study, Individual Income Tax Exemptions, December 1947, chart 3 adjusted to April 1951 prices by BLS Consumers' Price Index (see p. 2).

Above all, present exemptions are grossly inadequate compared with the budget requirements we have cited, as the next table shows. Such exemptions mean lowering by taxation the standard of living of families already at or below minimum health and efficiency levels:

Present individual income-tax exemptions and minimum budget requirements

Size of family	Present gross exemptions	Cost of BLS and Heller family budgets: April 1951	
		Minimum adequate (BLS)	Health and decency (Heller)
Single person	$675	$1,700	$1,900
Married couple	1,325	2,400	2,700
Family of 4	2,675	3,700	4,150

Source: Treasury staff study cited above.

How much taxes does a worker pay? We have already included social security and all other taxes in the estimated cost of the BLS budget. But it is important to note the total burden of taxes—direct and indirect—on the average worker. For the average manufacturing worker with wife and two children, earning $3,300 a year, the estimated total tax burden today is more than $700. The administration's proposals would boost this to nearly $800. The proposals of the NAM and Chamber of Commerce would increase this tax load far beyond the administration's proposed increase. H. R. 4473 would raise it to around $750.

Estimate of total tax burden—Federal, State, local—on worker with wife and 2 children and $3,300 gross income

	Present [1]	Administration proposal [2]	H. R. 4473
Federal income tax	$120.00	$144.00	$135.00
Social-security tax	49.50	49.50	49.50
Federal excises	130.00	175.00	150.00
Other taxes	420.00	420.00	420.00
Total	719.50	788.50	754.50

[1] Based on estimates of R. A. Musgrave, economics department, University of Michigan, presented to Joint Committee on Economic Report round table on fiscal policy, Jan. 31, 1951.
[2] Based on proposals of Secretary Snyder to House Ways and Means Committee, Feb. 5, 1951.

The impact of all taxes, Federal, State, and local, direct and indirect, has been very carefully studied by several economists both before and since the war. On the basis of the latest and most careful estimates by Prof. Richard A. Musgrave, of the University of Michigan, as the table below illustrates, the proportion of income going for taxes at lowest income levels is very high, equals that for much higher incomes covering up to 95 percent of all taxpayers, and only in the top 5-percent class is there even a limited application of the ability-to-pay principle:

Impact of Federal, State, and local taxes on various income groups [1]

Income group	Tax payments as percent of income	
	1938-39	1948
Under $1,000	18.0	23.6
$1,000 to $2,000	17.5	20.3
$2,000 to $3,000	17.4	21.6
$3,000 to $4,000	17.7	21.8
$4,000 to $5,000	18.2	21.7
$5,000 to $7,500	18.7	23.1
$7,500 and up	32.7	31.7
All groups	20.2	24.7

[1] Source: 1938-39: TNEC Monograph No. 3, Who pays the taxes? (1940), revised figures cited in Fiscal Policies and the American Economy, editor, Kenyon E. Poole, Prentice-Hall (1951), p. 382. 1948: Estimates of R. A. Musgrave et al. in The Distribution of Tax Payments by Income Groups in 1948, to be published in the National Tax Journal, March 1951. Presented to Joint Committee on Economic Report round table on fiscal policy, Jan. 31, 1951.

These facts are startling in view of widespread propaganda to the contrary. They underline the urgency of applying the basic UE tax rpinciple: No taxes should be lievied on American families whose income is not large enough to maintain living standards at minimum adequacy levels of health and decency.

VII. UE Tax Proposals

UE's specific proposals are guides to eliminating Federal taxes which cut down the living standards of Americans whose income is not more than sufficient for a minimum adequate existence.

1. The first UE proposal is that individual income-tax exemptions be increased to allow, free of tax, enough income for a minimum adequate living standard. The argument for such a step is unanswerable from an economic, social, and humanitarian point of view. The Treasury Department study on Individual Income Tax Exemptions cites this argument:

> "For the long run, it is regarded as essential to exempt amounts required to maintain the individual and his family in health and efficiency. Apart from humanitarian aspects, this view is based on certain practical social and economic considerations. Thus, it is held that taxing substandard living

will result in lowered economic vitality in the community, lower revenues, and possibly result in higher Government expenditures for social repairs."

The study notes further:

"In this view, ability to pay does not commence until a point is reached in the income scale where the minimum means of life have been obtained."

Anticipating the argument that exemption of low incomes puts more taxes on the rich, and that this reduces incentive, the Treasury study notes that "the sacrifice involved in going without certain necessities is not susceptible of measurement or comparison." In other words, the sacrifice involved in cutting family consumption down from a Cadillac scale of living to a Buick scale, or even to a Chevrolet scale, is not to be compared with the sacrifice involved in giving up a quart of milk a day, or new shoes for the children, or a much-needed visit to the doctor. Yet that is precisely the kind of sacrifice which is imposed daily on low-income families by the present tax burden and which would be aggravated by the proposals for additional taxation on low incomes.

In line with the budget requirements we have noted, exemptions should be set as close as possible to the following amounts—put in round numbers for administrative convenience:

Single person	$1,700
Married couple	2,400
Dependent	650

This would provide an exemption of $3,700 for a family of four. Upward adjustments in the tax rates on incomes above these proposed exemption levels should be applied to compensate for the effect of the higher exemptions in lowering their tax liabilities. Also similar upward adjustments could be roughly calculated to compensate for tax savings in the higher brackets due to the removal of certain excise taxes to lift the tax burden on low incomes.

Adoption of the UE exemption schedule, it is estimated, would reduce Federal income-tax returns by roughly $3,250,000,000 under the present law and roughly $4,000,000,000 on the basis of the proposed H. R. 4473 rates. These estimates are based on data presented by Secretary Snyder to this committee showing the prospective revenue from each income class under present and proposed Federal income-tax rates for the calendar year 1951.

Estimated annual distribution of income for individual income-tax returns under present and H. R. 4473 rates, and estimated effect of such income of UE exemption proposals

[Millions of dollars]

Adjusted gross income class	Total tax revenue: Present law [1]	Total tax revenue: H. R. 4473	Total tax revenue: Under UE exemptions [2]	Estimated decrease in H. R. 4473 revenue with UE exemptions
Under $1,000	54	61		61
$1,000 to $2,000	842	947	47	900
$2,000 to $3,000	2,245	2,526	1,026	1,500
$3,000 to $4,000	2,871	3,229	1,729	1,500
$4,000 to $5,000	2,672	3,002	3,000	2
Total	8,684	9,765	5,802	3,963

[1] Data presented to House Ways and Means Committee by Secretary of Treasury Snyder, Feb. 5, 1951, table 12.

[2] Rates assumed to be adjusted upward to offset effect of higher exemptions on incomes above such exemptions.

To prevent income taxes from aggravating or creating substandard living conditions would reduce the tax revenue roughtly $4,000,000,000 below the Treasury proposals.

2. UE also urges you to remove Federal excise taxes on common consumption items like beer, cigarettes, transportation, and household appliances. Here again, the revenue loss, which UE estimates at roughly $3 billion, is small compared with the benefits to living standards. Above all no new sales taxes, general or specific, should be levied on common consumption items.

3. Close loopholes—tax profits and wealth: If $7 billion in revenue is given up by these two proposals, there are alternative sources of revenue which can be tapped without lowering living standards.

The UE does not know how much finally will be set as the amount to be raised by taxes in 1951. Our main emphasis is on what this committee should not do; i. e., it should not force families below minimum standards of living by taxes. The following suggestions of alternative sources of income are presented to demonstrate two points:

(i) Elimination of poverty creating taxes does not necessarily mean reducing actual tax revenue;

(ii) Any alternative source of tax revenue is more desirable than taxes which force American families not to eat enough, to be ill clad, and not to see the doctor when need be. Such are the real choices before this committee.

Profits

Corporations took in an estimated $41 billion in profits in 1950. After taxes, they had $23 billion, or double their profits in 1944 which was a bonanza profits year. Corporations could pay an additional $12 billion in taxes on 1950 profits, on top of the $18 billion they are now paying, and still enjoy profits after taxes equal to the lushest year of World War II.

In 1951, Secretary Snyder estimates, corporations will take in $45 billion in profits. Under the present law, according to Treasury estimates, they will have an estimated $21.5 billion after taxes, $4 billion more than the average for 1946–49 which Secretary Snyder has called "a period of unusual and sustained prosperity" (testimony to Senate Finance Committee, June 28, 1951, tables 13–14).

H. R. 4473 would raise corporate taxes by $3 billion. But by holding profits after taxes to the 1944 level, and additional $8 billion could be raised from corporation profits. Can you justify not taking additional taxes from such profits, when then alternative means taking food from children?

Income splitting, withholding tax on dividends

Or take wealthy married couples in the upper income brackets who split their incomes and thus pay substantially lower taxes. Secretary Snyder has pointed out that such couples will pay "substantially less" tax than they did during World War II, even after the administration's proposed 4-point increase in rates. At the $25,000 level, where, as he pointed out in earlier testimony, "income splitting gives about the largest relative advantage," the saving is now $3,400 under the World War II tax for a family of four, and would still be $2,500 with the new proposed rates.

Last year, stockholders failed to report some $1 billion in dividends. A withholding tax on dividends, similar to that on wages, would close this tax-escape route and increase revenue $250,000,000 a year. This step alone would raise more than four times the income that would be lost by ending all income taxes on incomes less than $1,000.

At least $2 billion more could be raised by eliminating income splitting and by rigid enforcement of the existing tax schedules. Here, again, the question must be asked: Can you justify such saving for those who are not in need, if it means keeping others in dire need?

Accelerated amortization for corporations

Or take the provision for accelerated amortization of defense facilities which was enacted in 1950. Certificates of necessity have already been granted for facilities valued at $6.7 billion (Defense Production Administration release 65, June 18, 1951). In 6 months, the total approved is almost equal to the $7.3 billion approved during 4 years of World War II. The House Committee on Expenditures in the Executive Departments calls the program "the biggest bonanza that ever came down the Government pipe," and declares its administration has been "unsound and detrimental to the public interest" (H. Rept. 504, May 28, 1951).

Interior Secretary Chapman has estimated that the short-term revenue loss to the Treasury could be as large as $13 billion, money which will be made up now by higher taxes on workers and other low-income groups. Even in the long run, after renegotiation, the program at its present stage will cost $6.5 billion to $9 billion by Secretary Chapman's estimates. That means roughly $1.3 billion to $1.8 billion per year, spread over the next 5 years.

The corporations which are getting this tremendous tax concession are by and large the same ones which will take in an estimated $43 billion in profits in 1951. How much are they to be allowed to get away with?

At least $1 billion a year increased revenue could be raised by eliminating unnecessary accelerated amortization allowances.

How can you justify allowing these companies to save up to $1 billion in taxes a year, and at the present rate of granting applications it will eventually be much more, when it means taking that $1 billion from the grocery baskets of American families?

Estate and gift taxes

In 1939 only the first $40,000 of an estate was exempt from taxation, now that exemption is $60,000 for a single person and $120,000 for a married couple's estate. Furthermore, estate tax rates have been reduced: In 1939 an estate of $1 million paid an 18 percent tax. By 1949 such an estate paid only 12 percent. Whereas in 1939 estates and gifts accounted for 7 percent of total personal taxes paid to the Federal Government, in 1949 they accounted for only 2 percent.

On the basis of the recommendations of the Secretary of the Treasury to the House Ways and Means Committee on February 3, 1950, with necessary rate adjustments estate and gift taxes can yield an additional $500 million.

Can one justify going easy on the estate and gift transfers of the well-to-do when the price of that consideration is heavy taxes on the ill-clad, the ill-fed, and the ill-housed?

Depletion allowances on mineral properties

One of the major tax loopholes is the provision allowing corporations to make excessive deductions from taxable income on the basis of depletion of mineral properties long after the original costs of the property plus development costs have been fully recovered. Oil companies, for instance, may deduct 27½ percent each year from the gross income of their oil-bearing properties.

Thus, in the case of 10 oil and gas companies studied by the United States Treasury, for the period 1943–47, out of net income of $62 million (after all deductions for operating expenses, depreciation, basis depletion, exploration costs, and losses on unsuccessful ventures) 77 percent was eliminated for tax purposes through special deductions.

H. R. 4473 would widen this loophole by increasing the percentage depletion allowance for coal and by adding new minerals and metals to the list now eligible for this kind of tax relief.

At least $500,000,000 added revenue can be gained by ending this annual raid on the Public Treasury by wealthy oil and mining companies.

Can anyone justify satisfying the lobbyists of these greedy special interests at the cost of taxes on decent American families living at or near poverty conditions?

Income tax rates

There can be no question but that income tax rates are heavy in all brackets. Ability to pay, however, can really only be considered for incomes above the levels required for a minimum health and efficiency living standard.

If additional income taxes from individuals are required in addition to closing loopholes and raising taxes on profits, they should be raised only from incomes above the proposed UE exemption levels which preserve "living wage" conditions.

After the H. R. 4473 proposed rates are applied, $35 billion could still be taken from incomes above $5,000, before these 7 million taxpayers would be reduced to the average income levels of the 35 million taxpayers under $5,000 income levels. The UE does not propose such a tax—the point is that a vast margin of potential income still exists above the minimum income levels dividing poverty from minimum healthy existence.

The alternative sources of tax revenue suggested above could raise from $15 to $25 billion above current Treasury proposals. Some of these sources should be taxed to end grossly unjust tax privileges of the greedy. All should be used to the utmost rather than to put taxes on family incomes below the proposed UE exemptions of $1,700 for a single person, $2,400 for a married couple, plus $650 for each dependent.

No taxes should be levied on American families whose income is not large enough to maintain living standards at minimum adequacy levels of health and efficiency.

No taxes should undercut a living wage.

[In pursuance of its proposals to eliminate taxes on bare living wage income families, the UE sent the following memorandum to the Secretary of Treasury, the Secretary of Labor, and the Council of Economic Advisers.]

FEBRUARY 2, 1951

MEMORANDUM

To: Mr. John Snyder, Secretary of Treasury.
From: Russ Nixon, UE Washington representative
Subject: (1) Proposals of United Electrical, Radio, and Machine Workers of America for administration activity against excessive tax burden on low-income families. (2) Suggestions for use of certain Government research studies on low-income groups in campaign against such regressive taxes.

During the past several days, representing the United Electrical, Radio, and Machine Workers of America, I have discussed with representatives of your Department certain UE proposals with regard to the big business special-interest campaign to impose heavy tax burdens on low-income families as an alternative to more taxes on large incomes and on profits. This opportunity was very much appreciated. This memorandum summarizes the UE proposals:

UE POSITION

The UE holds that no taxes should be levied on American families which would reduce their standard of living below a "necessary minimum" level for decent, healthy existence as defined by the Bureau of Labor Statistics' City Workers' Family Budget. To the extent that existing tax schedules reduce living standards below such minimum standards, adjustments should be made to eliminate those taxes. To the extent that increased tax revenue is required, it should be found exclusively from sources other than those whose incomes are below the minimum required for decent, healthy existence.

UE PROPOSAL TO THE ADMINISTRATION

The above-stated UE position is countered by a major propaganda and pressure campaign being carried on by large financial and industrial interests and their lobbies and press to put the burden of increased taxes on low-income families and to minimize the burden on corporate profits and large incomes and wealthy families. This campaign, carried on notably by the Chamber of Commerce, the NAM, the National Tax Equality Association, and the general press and other groups and forces representing business and financial interests, is aimed at a national sales tax, at lowering income tax exemptions and raising the existing taxes on low-income families. This campaign will cause a major contest in the Congress and the country in the coming weeks. A study of this subject, issued by the Treasury Department December 22, 1947 states:

> "Apart from humanitarian aspects, this view is based on certain practical social and economic considerations. Thus, it is held that taxing substandard living will result in lowered economic vitality in the community, lower revenues, and possibly result in higher Government expenditures for social repairs."

Consequently, the administration is urged to counter this reactionary-special interest campaign by taking action along the following lines:

1. The administration should put forth and fight for the position as outlined above by the UE and should wage an active and aggressive fight against all proposals to increase taxes on low-income families.

2. It is urged that the Treasury in its presentation to the Congress should strongly emphasize the case against increasing taxes on low incomes and should build its entire revenue proposals around the principle of avoiding such taxes. This should mean an effective presentation by the Secretary of Treasury on this question and supporting statements and efforts on behalf of such a position by all other administration spokesmen, both in Congress and in the administration itself.

3. The administration should use all its existing weapons against the regressive proposals, particularly those in the form of research studies already at hand, including:

   (*a*) BLS estimates of city workers' "necessary minimum" family budget; and studies of low-income consumption patterns.

   (*b*) Federal Reserve Board studies and Department of Commerce research on national income distribution, ownership of liquid assets, and purchasing patterns in the field of such products as consumer durable goods.

An excellent step toward dealing with this problem is made by the Treasury Department in its study Individual Income Tax Exemptions which was released to the press December 22, 1947. Up to date, however, this staff study has not been effectively utilized and made available as a weapon in the fight against regressive tax legislation.

4. It is particularly urged that the Department of Labor, through its Secretary and the BLS, become labor's champion on this issue and exert its full influence and voice its demands both in the utilization of research material and in the cabinet, administration, and congressional discussions and debates.

(The following letter was subsequently supplied for the record:)

UNITED ELECTRICAL, RADIO AND MACHINE WORKERS OF AMERICA,
Washington 1, D. C., July 13, 1951.

Hon. WALTER F. GEORGE,
Senate Finance Committee, Senate Office Building, Washington, D. C.

DEAR SENATOR GEORGE: Attached is a memorandum requested by the Senate Finance Committee members when I presented the statement of the United Electrical, Radio, and Machine Workers of America, on the Revenue Act of 1951 on Monday, July 9, 1951. It describes in more detail the basis for our estimate that approximately $7 billion in revenue would be lost through adoption of the UE individual income tax exemption schedule of $1,700 for a single person, $2,400 for a man and wife, and $650 for each added dependent.

I trust this will serve to clarify the questions raised at the hearing on this matter. I appreciate the courteous attention given by the committee to the statement I presented on behalf of my union.

Very sincerely yours,

RUSS NIXON,
Washington Representative.

MEMORANDUM

To: Senate Finance Committee,
From: Russ Nixon, Washington representative, United Electrical, Radio and Machine Workers of America.
Subject: Additional data supporting UE estimate of approximate $7 billion revenue loss through adoption of UE individual income tax exemption schedule of $1,700 (single person), $2,400 (man and wife), and $650 (each added dependent).

Several members of the Senate Finance Committee requested additional information concerning the estimate of the United Electrical, Radio, and Machine Workers of America (UE) in its testimony before the committee on Monday, July 9, 1951, to the effect that adoption of the UE schedule of individual income-tax exemptions of $1,700 for a single person, $2,400 for a married couple, and $650 for each additional dependent, together with elimination of excise taxes on items commonly purchased by low- and middle-income families, would reduce Federal tax revenue approximately $7 billion.

In evaluating this estimate it is important to keep in mind the basic UE tax position: The tax burden should be removed from individuals and families whose income is below the necessity level for minimum healthy existence as defined by Department of Labor, City Worker's Family Budget, estimates. It is not the UE proposal, in order to obtain these needed adjustments, to reduce the tax obligations of individuals and families above these minimum income levels.

Furthermore, in such an estimate it is impossible to be precise where so many variables are concerned. However, precision is not required to sustain the basic point being made by the UE. The $7 billion estimate of revenue loss would be somewhat smaller if compared with the yield of the present law; somewhat larger if the basis of comparison is either the increased yield of H. R. 4473, or the proposed administration bill. In any case the variations would not be so large as to change the quality of the UE argument.

In considering the UE estimate of $7 billion loss of revenue the following specific points need to be kept in mind:

(1) As the text of the UE statement to the Senate Finance Committee points out, it is assumed that upward adjustments in income tax rates above the minimum levels will be made to maintain the tax revenue from individuals and families at these relatively higher income levels. This is most important since it is frequently assumed, while calculating revenue loss from changes in income tax exemptions, that benefits are permitted to be reflected throughout the entire taxpaying structure.

(2) The elimination of excises should apply only to items now taxed which are commonly consumed by low and moderate income individuals and families. It is not as easy to make upward adjustments to reserve the tax reduction benefits solely for the low and middle income families in this instance, although necessary adjustments of excise taxes for the upper income pattern are possible. Also,

the excise tax revenue schedule is quite complicated and it is impossible to give here, anything more than a reasonable "rule of the thumb" estimate.

(3) The basis of the UE position protecting the minimum budget requirements, is the actual family unit. Therefore, adjustments would need to be made in the extensive utilization of split returns, to assure that the increased exemptions should not be permitted to continue or further aggravate the special advantage gained in this way.

In the individual income tax category it is estimated that adoption of the UE exemption with the above provisions, would decrease revenue by approximately $4 billion. This revenue loss would be 40 percent of the revenue expected under H. R. 4473 from adjusted gross income classes below $5,000. This rough estimate is based upon data available from the United States Treasury, showing the distribution by number of dependents of the tax returns for each income class for the year 1947. Even this does not give a precise guide but does provide a rough measure of the expected income loss.[1]

The following indicates the rough adjustment based on table 8, Report of Committee on Ways and Means, Revenue Act of 1951, page 12, which gives the "Estimated distribution of individual income tax returns, income exemptions and tax liabilities under present rates and under the committee bill when fully effective":

Adjusted gross income class	Estimated decrease in H. R. 4473 revenue, with UE exemptions		Remarks
	Millions of dollars	Percentage loss	
Under $1,000	61	100	No revenue from this class.
$1,000 to $2,000	900	95	No revenue from this class except from single individuals with incomes between $1,700 to $2,000.
$2,000 to $3,000	1,500	60	Revenue lost relative to H. R. 4473 from married couples with incomes $2,000 to $2,400; married couples and one dependent with incomes $2,000 to $3,000, and married couples and two dependents with incomes from $2,400 to $3,000.
$3,000 to $4,000	1,500	46	Revenue lost relative to H. R. 4473 from married couples and one dependent with incomes from $3,100 to $4,000, married couples with 2 or 3 dependents with incomes from $3,000 to $4,000 and married couples and 4 dependents with incomes $3,600 to $4,000.
Over $4,000	2	Negligible	Negligible revenue loss above this income level because only families of 5 or more would benefit from UE exemptions.
Total	3,963		

It is estimated that approximately $3 billion would be lost in excise income through the elimination of taxes on commonly purchased products. Less than $5 billion total revenue comes from the excise taxes on the following items: beer, cigarettes, gasoline, automobile parts, appliances, pens and pencils, radio and television, toilet preparations, transportation, tires and tubes. Since not all of these items need be excluded from excise taxes under the principle of safeguarding minimum family budget levels, and since certain compensatory excise increases in the higher brackets are possible, the probable loss of revenue under this heading may be reasonably assumed to be about $3 billion.

The central point is that, with proper care and with compensatory adjustments, the net loss in revenue through protecting America's families whose incomes are not more than sufficient to maintain the minimum standard budget, should be within the range of 6 to 10 billion dollars, depending on the assumptions made. This revenue loss is easily made up from alternate sources of revenue in which the personal sacrifice and the resulting damage to national welfare are minute compared to the poverty-creating effect of taxes on these low and marginal income levels.

The CHAIRMAN. The next witness is Mr. Kline.

Mr. Kline, will you identify yourself for the record, please?

[1] It must be kept in mind that the Treasury figures of dependency distribution by income class must be adjusted for the splitting of incomes which is very important, particularly in the single exemption category where 5 million out of 20 million tax returns were those of split income families.

STATEMENT OF ALLAN B. KLINE, PRESIDENT, THE AMERICAN FARM BUREAU FEDERATION

Mr. KLINE. I am Allan Kline, president of the American Farm Bureau Federation.

The CHAIRMAN. And you are representing the bureau here today?

Mr. KLINE. Yes, sir.

The CHAIRMAN. All right. We shall be glad to hear you.

Mr. KLINE. Mr. Chairman and members of the committee, I believe that I can save some little time by not reading the formal statement of the American Farm Bureau Federation which has been furnished to the members of the committee, and which I know will receive your careful consideration.

The CHAIRMAN. You may put the entire statement in the record, Mr. Kline.

Mr. KLINE. I would like to do so.

I would note that there is in this statement relatively little of the sort of detailed discussion of particular taxes and the incidence of those taxes, and relatively more of the reasoning back of the support of the American Farm Bureau Federation for a pay-as-we-go tax situation at this time.

I should like to spend a little time in an oral statement on the reasons for which we find it possible to be for the kind of taxes, in themselves most unsatisfactory, most burdensome which it takes to make a pay-as-you-go proposition effective at this time.

We are fully aware of the responsibility which devolves upon an organization of farmers at this time, the largest farmers' organization in the United States. We have a paid-up membership now of approximately 1,500,000, in good standing—farm families.

As citizens, we have responsibilities the same as we have as farmers. We are interested in maintaining a situation where the job of production can be carried forward. There is a lot of talk about standards of living, without fully appreciating that back of it there must be production. Standards of living do not come out of thin air. They come out of organization of the productive forces, out of progress in research, out of machines of production, hard work, and the application of energy and ability.

In this situation, I think anyone will make serious errors in logic who does not appreciate that regardless of the outcome of the thing in Korea, we are faced with a defense situation without definite terminal facilities. This is a situation in which we hope to avoid a third world war and in which we hope to keep the American way. We hope to evolve policies and programs which will make it possible to do both of these things. We do not have the terminal facilities we would have if we sought now a victory with the major enemy at the earliest possible time. We are rather concerned with a situation in which the emphasis is on doing the sort of things consistent with the maintenance of the peculiar productiveness of the American way. In this struggle for the survival of freedom I am myself convinced that there is no other thing so important, no other one thing so important any place, as the survival of the peculiar productiveness of the American way. We might lose it without ever getting into a third world war.

We are not unaware that basic freedoms can be destroyed with taxes. This is a matter of alternatives.

Government expenses which are incurred will be paid. The activities of the Federal Government are going to be paid for. They are going to be paid for either with taxes or inflation. Part of the inflation may be delayed by selling bonds to the public, to the individual members of the public. But this can only take place if there is a continuing confidence in the capacity of the United States to make the dollar good, and the foundation of that proposition in this enduring defense period is to pay the bill with taxes.

We have put considerable emphasis in this statement on getting the kind of bill that we can pay. I appreciate that this is not the particular prerogative of this committee. It is, however, the prerogative of Congress, and it must be done. There must be an approach to this thing based on the fact that if inflation is to be prevented, the bill must be paid.

The Government, to be sure, can pay the bill by unbalancing the budget and creating new money. The most obvious method is to sell bonds to cover the deficit, to commercial banks. But this also pays it, and this taxes everybody by decreasing the value of money, whether it be wages or whether it be savings or life insurance contracts or what not. In that case, we will inevitably undertake extraordinary interferences with the economy of the American way, in an effort to submerge or cover up the actual facts of inflation. It goes also in the direction of per-capita distribution of goods.

Under a combination of inflation and price control the movement in this direction is inevitable, and it is positive. If we decide not to use price to distribute goods, then we have decided to use rationing, whether we appreciate it or not. Whenever we get a controlled price materially below what the people are willing and able to pay for that commodity, then we have increased the demand. We obviously have depressed the production also, because we allow less incentive to producers and there is no choice left except to distribute with ration coupons.

Another result, of course, is wasted manpower. This is not only the manpower used in writing and revising regulations; this is manpower also at every level of business, and this is far more important, in trying to keep up with the regulations and do business under the regulations.

Then there are black markets involved. It does no good just to say there will not be any. Everyone knows there will be, and they again take some very able manpower and brains to operate the black markets and try to stay out of jail. But this is pure waste so far as production is concerned.

Then there is the matter of subsidies. I am rather astonished by people who say we do not intend to use subsidies. They are going that way, and they are going to use subsidies. They are inevitable if we go the control route, because of the production being depressed and prices being held, and the gradual rise in cost illustrated by the slow and gradual rise in wages and the cost of machinery and equipment, and all that sort of thing.

Then we see declining production in exactly the areas we wished production, and the proposal for subsidies is natural. It comes forward. Again, it is the people's money. It can come in one of two ways, either inflation or taxes, and it can be used to eliminate the functions of price.

We are convinced that the American way, with its peculiar adaptability, is a way which, on the record, has enabled one hundred fifty million-odd people in America to produce half the steel in the world, to produce with a very small proportion of our workers all the necessary food for our people, and to release thereby the people that make in America the record of which she is so proud. We think it simply cannot operate under this control system without all the automatic functions of price in the system.

It is for that reason that it is a matter of alternatives. We do not like taxes. We stress in the prepared statement that taxes undertaken ought to be for the mobilization period and ought to be terminated when it is over. But in the meantime, we believe that we will do a far better job of capitalizing on the capacity to produce, of keeping the American dollar good, if we force ourselves to do it by a pay-as-we-go program and a program that we can pay for.

In the statement itself, the first part of the statement is taken up with consideration of the items which I have just discussed. There are various quotations from the resolutions developed at our latest annual meeting. There is a discussion of the basic causes of inflation, of the psychology of inflation created by many of the things we have done that have convinced people that goods are going to get scarce and money is going to get cheap; the cheap money policies which we followed for several months after Korea resulting in an increase in the money supply for the last half of 1950 of $8 billion; the psychology itself, of course, resulting in people overspending, increasing installment purchasing, and increasing loans from the banks for all sorts of purposes.

Then on page 15 we have stressed the things which seem to us necessary to control inflation, and we end with the proposition that we have to pay the bill.

Now, as an agricultural organization, an organization of farmers, an organization as representative as it would be possible to make it, not an organization of people who have high incomes—actually, the average per capita income in agriculture is about half of that in manufacturing work—as this kind of group, we have approached this problem in the area where we do know what it is made up of. There is in the budget a proposal of $285 million for the ACP program. That is the Agricultural Conservation Payments program. This money is appropriated from the Federal Government and goes to our members. And after a long and hearty discussion, I might say, we decided to support a cut of $135 million in this particular item.

We think that the same kind of cuts have to be made by other groups in the areas in which public expenditures are made for their particular benefit; that we must exercise the utmost efficiency in government in the so-called domestic expenditures, and we are further convinced, and especially since this is not a short-run proposition, that we have to submit our expenditures in the military area to the same kind of scrutiny.

I know there are those who say that circumstances force the United States to do this, that, and the other. I do not believe that the attitude is appropriate to the United States. We are the most powerful nation in the world. We are a free nation. We, as a group of farmers, a million and a half families of us, are likewise free people.

We believe that on the basis of sound judgment we shall avoid the Third World War, are far more likely to avoid it if we make up our own minds about what makes sense in this situation, in the military on the one hand and domestically on the other, because I say to you that it is the confirmed opinion of our board of directors that there is no defense more important, no defense as important in the long run, in this defense period as the maintenance of the peculiar capacity of the American system to capitalize on the igenuity and ability of its citizens. And this we think is what we circumvent if we get a bill we cannot pay and we pay the bill with inflation and then we undertake all of these superimposed political controls in the economic field, which are far more like the system of those whom we are trying to defend against than they are like the basic features of the system of which we are all so proud and which is currently the best defense of freedom not only in this country but in every other country.

We have, then, made some specific suggestions with regard to taxes at the close of this presentation, in which we have indicated that we are willing to support an additional $4 billion of individual income tax, the addition to capital gains suggested by the House, an extension of 6 to 12 months for long-term gains. We have discussed our willingness to go along with a corporate income tax increase of 8 percent, and have indicated misgivings with regard to excess-profits taxes as in themselves highly inflationary because of the pressure they take off for effective operation after a certain level of income has been achieved.

We have discussed the tax on cooperatives but have not changed the position presented to this committee before. We have expressed opposition to a straight Federal sales taxes on two bases, first that it is a regressive tax, and second that we need to leave something to the States as a basis for taxes.

We have indicated that we would prefer to reduce exemptions from $600 to $500 rather than go to a sales tax.

With regard to excise taxes suggested, we recommend the long-term policy that they be limited to amusement goods, but at present we would support them otherwise, especially where the commodities indicated use strategic materials.

We have indicated briefly some other minor propositions.

The important thing in this statement is not a detailed analysis of particular taxes. It is the proposition that as a group of farmers and as an organization of citizens that happen to be farmers, we are prepared to support pay-as-you-go taxation, and we are prepared to work with this committee on that proposition, and we are prepared to work with the people of this country and with the other committees of this Congress in devising a program that we can pay for.

In conclusion, I should like to state again that we shall be short-sighted indeed if we fail to appreciate that there is something different about the American way. We are not the only people with resources. There are in Western Europe alone 275,000,000 people. They have resources. They have land, they have materials, they have factories, they have basic research. They have higher institutions of learning; they have skilled workmen. The only thing they do not have is production, comparative production. There is something fundamentally creative about the American way.

This we have got to protect. It is at least half of our defense. If we should build a military structure ever so powerful and if in the

building of it we destroy the basis for its support or the morale of the American people because we fail to capitalize on the creative capacities, basic to the American way, then we have lost the battle, and it is our firm conviction that the outlook is not as bad as many people think it is, that it would be folly to base our actions upon fear, that it is a far more appropriate attitude for us to have the self-reliance and the self-confidence that the record of America entitles us to, and to build on the proposition that we are going to win.

We believe that we can outline a program that makes sense and that we can pay the bill and are prepared to support programs to that end.

The CHAIRMAN. Thank you very much, Mr. Kline.

Are there any questions?

Senator WILLIAMS. Mr. Chairman, I was wondering whether you want to go into this cooperative tax bill. Would that come up now or later?

The CHAIRMAN. We shall donate a full 2 days on that, not this week but possibly next week.

If there are no further questions, we shall proceed.

(The prepared statement of Mr. Kline is as follows:)

STATEMENT OF ALLAN B. KLINE, PRESIDENT OF THE AMERICAN FARM BUREAU FEDERATION, BEFORE THE SENATE FINANCE COMMITTEE WITH REFERENCE TO TAX LEGISLATION

Mr. Chairman and members of the committee, the American Farm Bureau Federation, a voluntary general farm organization composed of over 1,440,000 farm families in 46 States and Puerto Rico, appreciates the opportunity to participate in these hearings on tax legislation.

The task of writing a tax program to support our national defense effort is one of the most important matters likely to come before this session of the Congress. The decisions reached at the conclusion of these hearings will do much to determine whether we are to maintain a strong, healthy economy at home, or whether we are to be weakened by a disastrous inflation. Indeed, the decision on how we are to finance Government expenditures for defense may well determine whether or not we can preserve our freedom, and what we have come to call our American way of life.

This is a time for clear thinking. The situation faced by the United States today is unparalleled in our history. Our military forces are engaged with an enemy, but we are not in an all-out war with the only nation that presently is capable of threatening our security. Without question, our national policy is still to avoid the outbreak of a third world war and to build up our national military and economic strength as rapidly as possible so that we will be able to win if such a war proves unavoidable. As long as we are not directly engaged with our real enemy, we do not have the timetable. We cannot estimate the probable duration of the present tension or calculate when we may face the greatest test of our strength. We must adopt policies which will not only meet our present needs but contribute to the rapid development of a much greater national strength. Therefore, we must consider this period of tension and mobilization as being of extended duration—perhaps 5, 10, 15 years, or longer. In the light of this fact, we must make sure that the policies adopted will not only meet our present needs, but will be policies under which the American system can operate over a long period of time.

We must decide how much of our resources we need to devote to defense, then carry the program forward on an enduring basis as long as the threat of war continues to exist. Our major task is to keep the Russians continuing to decide not to precipitate a third world war.

Above all, we must strive to increase the productive ability which appropriately has been called our most potent nonsecret weapon. In addition, a major aim is to preserve our American system of individual initiative and reward based on service rendered. These two aims are in no way inconsistent. It is the American free-choice system that has created our present ability to outproduce the rest of the world. It is only logical that we should build on the techniques that have

made it possible for the United States, with 6 percent of the world's people and 7 percent of the total land area, to produce one-half of the world's steel. We can outproduce the Russians, but it is doubtful that we could outcontrol them.

We could lose our freedom here at home without ever getting into a war. We could lose it by adopting wrong policies, by destroying the value of our money with inflation and by strangling the most productive economic system the world has ever known with unworkable controls in an effort to conceal the inflation. Fortunately, sound techniques for the control of inflation are available and well known. All we need is the courage to adopt them.

The American Farm Bureau Federation is thoroughly convinced that present conditions demand an increase in taxes sufficient—with the economies we hope the Congress will adopt—to at least keep the Federal budget balanced. Pay-as-we-go taxation is not a complete anti-inflation program, but it is an essential part of such a program. Unless we can convince people that we are going to balance the budget and that we are going to keep it balanced in the present situation, we have no real chance of combating successfully the psychology of inflation in the public mind.

Our position on this vital matter and the recommendations which we desire to present to you are based on resolutions adopted by the elected delegates of our member State Farm Bureaus at our annual meeting in Dallas, Tex., last December. On inflation, our voting delegates said in part:

"The inflationary pressures generated by our present national defense program make effective action to stabilize the purchasing power of the American dollar more urgent now than ever before.

"Inflation cannot be stopped by price, wage, and ration controls. Such measures deal with symptoms rather than fundamental causes. They interfere with production, impair the flexibility of our economy, reduce our capacity to expand output, require huge administrative staffs, and invite black markets. We face an emergency of indefinite duration. In such a situation the premature adoption of price, wage, and ration controls could strangle our economy to the point of impairing our ability to fight an all-out war should such a conflict prove unavoidable.

"American farmers have produced beyond belief in times of need and we pledge ourselves to ample production now. We believe that if we are given full information as to production desired, and if productive aids are made available to us, we can produce more food and fiber more efficiently if controls are held to an absolute minimum. We insist that we be given an opportunity to demonstrate our productive capacity without controls. If total war forces the application of price and wage ceilings, we will insist that they be applied on an across-the-board basis.

"The present situation calls for a bold attack on the fundamental cause of inflation, which cause is an increase in the supply of money in relation to the supplies of goods and services available to consumers.

"Most importantly, we must pay the bill. There is no possibility of controlling inflation without taxes high enough to get on a pay-as-we-go basis.

"We must strive to meet increased demand with increased production wherever possible. To do this we must enhance the opportunity of individuals to be productive, and increase the length of the workweek. Strict Government economy is a "must." Nonessential Government expenditures must be eliminated. Necessary Government borrowing must be planned so as to prevent an increase in the Government debt to the banks, because such an increase would both directly and indirectly increase the supply of money. To this end we urge that efforts to sell E bonds be intensified; that careful consideration be given to the desirability of offering additional inducement for holders to reinvest the proceeds of maturing E bonds in Government securities; and that steps be taken to prevent a further shift of nonbank-held negotiable bonds to the banking system.

"The national debt should be so handled as to make the maximum contribution to price and economic stability, rather than to finance the debt at a minimum cost.

"Monetary and credit policies carried on by the Federal Reserve System cannot alone achieve a stable level of prices. Yet they are an important factor and should be geared toward that objective. The Federal Reserve's authority to vary member bank reserve requirements should be increased. If the inflation threat continues, reserve requirements for banks should be raised, with appropriate adjustments in the bank holdings eligible to be counted as reserves.

"The Government's present policy of restricting the expansion of housing and installment credit should be continued in effect, with such adjustments as may be necessary from time to time to keep these restrictions consistent with the requirements of an effective program to control inflation."

On the need for Government economy and increased taxes, our delegates commented as follows:

"The expanded defense program made necessary by the current international situation is adding many billions to our Federal budget. As a fundamental step to prevent this program from touching off a run-away inflation, we insist that the legislative and executive branches of the Government take the necessary action to place Federal spending on a pay-as-we-go basis. Neither Government inefficiency nor the waste of manpower or material can be tolerated. Economy and efficiency must be achieved to minimize the additions which a pay-as-we-go program will make necessary in our already heavy tax burden. We insist that all nonessential Federal expenditures be eliminated; and that all expenditures be reduced to the minimum necessary for the national interest, essential world aid, and adequate national defense. No Government expenditure should be exempt from scrutiny by both Congress and the administration to determine whether it can be reduced or eliminated without impairing an essential governmental function. While the nature of military operations makes some waste inevitable, it is nonetheless urgent that every effort be made to get the most out of the money appropriated for defense.

"Costly new programs should be deferred except where immediate action is essential for the national defense. Now, during a period of high employment and scarcities of many essential materials, is not the time to add new services or construct works which can be deferred.

PAYING FOR DEFENSE

"Strict economy will reduce the total amount that must be raised by taxes, but increased taxes will still be necessary to balance the Federal budget. We stand ready to support necessary increases. We will insist, however, that the new taxes be levied on a fair and equitable basis and that they be consistent with the objective of preventing inflation.

"New taxes and increases in existing taxes should be tied to a definite termination date to emphasize their emergency character. A general Federal sales tax should be avoided. New excise taxes or increases in existing excise tax rates should be confined largely to items which are expected to be in short supply because of the defense program and should be reduced when such goods become more plentiful. This approach will help to keep supply and demand in balance.

"Income from all future issues of Federal, State, and local government bonds should be taxed as other income is taxed. New taxes on individuals and corporations should be carefully selected so as to preserve a maximum incentive for efficiency and production.

"We oppose the enactment of an excess-profits tax of the type imposed during World War II. Experience has demonstrated that a tax of this type is difficult to administer, is discriminatory, creates many inequities, and leads to excessive litigation over tax liabilities. Furthermore, such a tax has inflationary effects. It almost destroys the incentive for coprorations in the "excess" bracket to improve their efficiency and, in fact, encourages such corporations to hoard manpower and make extravagant expenditures during periods when both labor and materials are in short supply. We are convinced that the laudable objective of preventing profiteering on Government contracts can be achieved more effectively by the improvement of Government procurement practices, and that an effective anti-inflation policy will do much to prevent excessive profits on sales to civilians."

(The section of our resolutions which deals with long-range tax policies is attached to this statement as exhibit A.)

The basic causes of our inflation problem lie in (1) the fact that in World War II, and again in our present defense program, we have found it necessary to divert substantial proportions of our resources from production for consumption to production for defense, and (2) the fiscal and monetary policies we have been following. We created inflation during World War II when we threw our resources into the war effort, unbalanced the Federal budget, and paid a considerable part of the bill by selling bonds. The Federal debt rose from $43 billion at the end of the fiscal year 1940 to $257.4 billion at the end of fiscal 1950. Much of this increase was financed through the commercial banks—a process which not only adds to the money supply as directly as if new money were printed to pay the bill, but also provides a basis for the expansion of credit, since banks can obtain reserves by shifting Government bonds to the Federal Reserve System.

Heavy expenditures for war or defense create inflationary pressures by putting more dollars in the hands of the people without producing a corresponding increase in the things people can buy. As a result of the conditions which developed during World War II and the postwar period, our economy is particularly vulnerable to inflationary pressures at the present time. A very considerable inflation already had occurred before Korea. (In terms of its 1940 purchasing power at the retail level the dollar was worth only 59 cents in June 1950. On the same basis, today's dollar is worth only 54 cents. These computations are based on the Consumers Price Index published by the Bureau of Labor Statistics.) We had a huge Federal debt and a greatly expanded money supply; the economy was operating at a high level; there was little unemployment; some materials were relatively short; and prices were showing a tendency to rise. Furthermore, people's experience with inflation has been such as to encourage the kind of actions which aggravate the danger.

The inflationary rise in the general price level which has occurred since Korea was not brought about by a Federal deficit or a shortage of consumer goods. It was almost entirely the result of two factors:

1. "Inflation psychology"—which developed as a result of irresponsible statements from Washington and elsewhere on the magnitude and ultimate cost of the defense program, doubts that taxes would be raised sufficiently to pay the bill, controversy over the need for price and wage controls which suggested that prices were going to "run away," and the rumors which preceded the actual imposition of controls. Quite reasonably, many people became convinced that money was going to be cheap and goods scarce, so they rushed out to get things done while they could. New wage contracts were negotiated, because employees wanted to improve their position before the wage freeze and employers wanted to strengthen their ability to hold workers in the event a manpower shortage developed. Stocks of goods were built up all the way from the manufacturer to the consumer, as witness the following seasonally adjusted data:

[In billions of dollars]

	June 1950	February 1951
Monthly retail sales	11.7	13.0
Retail inventories	14.7	17.8
Manufacturers' inventories	30.0	35.6

Source: Survey of Current Business, U. S. Department of Commerce, April 1951.

2. "Cheap money policies": As a result of the Treasury's insistence that interest rates be kept low to keep down the cost of carrying the Government debt, the Federal Reserve System increased its holdings of Government bonds about $4.5 billion between May 1950 and the end of February 1951. This increased bank reserves and made it possible for the banks to increase their loans and deposits, with the result that the supply of money went up about $8 billion in the last half of 1950.

We stimulated demand by causing people to think that money was going to get cheap; then we increased the supply of money. Is it surprising that prices have gone up since Korea? The fact that inflation occurred while the Federal budget was balanced and production was high indicates the importance of fiscal and monetary policies in the control of inflation.

The declining purchasing power of money, which is the other side of rising prices, is a matter of vital concern to every American citizen. Inflation dilutes the value of every person's wages or other income. It works a particular hardship on persons who have fixed incomes or less than average opportunity to obtain higher cash incomes. As the inflation progresses, it whittles away the value of cash savings, bank deposits, loan investments, Government and corporate bonds, pension and annuity rights, and insurance policies. Inflation reduces the incentive to plan for one's own future security, and increases reliance upon Government to provide such security.

The value of the dollar is also of concern to every citizen, because the "free choice" system we have come to call "the American way" depends for its successful operation upon the use of money. Under this system, the individual sells his goods or services for money; he decides what to do with the money he receives, and he knows that he can expect to do better individually if he strives to make his efforts productive than if he does not. Money and free market prices are key

factors in determining the distribution of goods in a free choice system. If we allow inflation to destroy the value our money, we will have to use ration coupons and the decisions of Government administrators to determine what is to be produced and how it is to be distributed. Such a system leaves little freedom of choice to the individual. It reduces individual incentive, promotes the misuse of productive resources, and reduces our ability to produce goods and services. The substitution of ration coupons and political decisions for the automatic functioning of a free market inevitably moves in the direction of per capita distribution on the political basis of one vote, one share.

Price and wage controls are an ineffective and unworkable approach to the problem of preventing inflation. They are a clumsy and inefficient substitute for the automatic functioning of a free economy. They cannot possibly prevent inflation, because they strike at the symptoms of the problem and not at its real causes. As a matter of fact, if a government were to decide to deliberately create an inflation, it would want first to put on price controls so as to conceal from the people, as long as possible, the fact that the value of their money was being destroyed.

It is an obvious impossibility for any group of men to set millions of prices and keep them in a proper relationship with each other—a job which a free market does automatically.

By creating confusion, disrupting normal business procedures and price relationships, ceiling regulations make the job of getting production vastly more difficult. This situation grows steadily worse as the number of regulations multiplies. Each new order inevitably creates new problems and thereby forces the development of further regulations and still further problems. Each step down this road increases Government controls over the actions of the individual and brings us closer to the complete regimentation of our entire economy.

Continued price control will lead to a breakdown of respect for the law, and a consequent breakdown in public morality. Price controls create an opportunity for the unscrupulous to make money by violating price-ceiling regulations with only a slight possibility of getting caught. They establish a premium for dishonesty and violation of law. They create cynicism with respect to law. An economic base for the support of a new criminal group in our population is being created. The disrespect for law created by price controls and related measures inevitably will result in the deterioration of the moral stamina of all citizens. Price controls continued for any significant period of time thus break down those ideals and concepts which are basic to a Christian democracy.

Black markets and maldistribution are an inevitable consequence of price control. In the case of meat, this can mean the loss of valuable byproducts, including raw materials for leather and life-saving medicines. Also in the case of meat, controls can result in health hazards, due to the fact that black-market operators may follow unsanitary practices in uninspected operations. Although livestock production is currently at a high level and can be increased further if not restricted by unworkable controls, the continuation of price ceilings eventually will cause meat to be very scarce at regular meat counters.

Price and wage ceilings waste manpower, which is our scarcest resource. Millions of man-hours must be diverted from productive effort to the unproductive job of writing regulations and the impossible job of enforcing them. It is reported that OPS currently is planning to develop a staff of 35,000 employees. Far more important is the drain imposed on the time and ingenuity of the people at every level of business who must read, interpret, and try to carry out a multitude of unproductive regulations.

Shortages inevitably occur whenever price controllers succeed in depressing a price below the free-market level, because the lower price stimulates demand and discourages production. This leads to rationing, and forces housewives to stand in line for commodities which we have the ability to produce and distribute in a much better way.

If we go the price-control route, proposals for subsidies are inevitable because with controls in effect, special incentives become necessary to get needed production. Subsidies increase Government costs in a period when the Federal budget is already inflated. They conceal the true cost of an item and give the public an unrealistic idea of its worth. Costs become fixed at one level and prices at another and relatively lower level, with the result that it becomes very difficult to go back to a free market. Subsidies aggravate inflation by increasing the Government deficit if the Government is not balancing the budget and by increasing the purchasing power available to the public for the purchase of other items.

Price and wage controls can be endured for a limited period of all-out war when it is necessary that a nation exert a maximum effort to achieve victory, but we are not in an all-out war. The current discussions of a truce in Korea make it more clear than ever before that this is not world war III. Price and wage controls are not appropriate to a period of extended mobilization that may last 5, 10, or even 20 years. They are not measures which can be kept in effect indefinitely without reducing our national strength. Furthermore, the present period does not have the automatic terminal facilities for "emergency" controls that is provided by the achievement of victory in an all-out war.

For these reasons the American Farm Bureau Federation is opposed to the continuation of price and wage controls and for a positive program to control inflation by a bold attack on its real causes.

Regardless of the outcome of the current congressional consideration of legislation to extend price and wage controls, we will continue to exert every effort to bring about (1) the adoption of a sound anti-inflation program and (2) the termination of price and wage controls at the earliest possible moment.

If we really want to control inflation, and our national welfare demands that we do control it, we must do the following things:

1. Meet increased demand with increased production wherever possible. This will be much easier to do if we discontinue price and wage controls and thereby avoid strangling our economy with unworkable regulations.

2. Eliminate all nonessential Federal expenditures and institute real efficiency in all Government activities, including defense. The bill must be paid. We must make the hard decisions necessary to insure that we get a bill which we can pay.

One of the basic decisions that must be made concerns the proportion of our national production we need to devote to building a defense against a constant threat. Once that decision is made other decisions will become much easier. For example, we cannot devise a tax program to pay the bill unless we have some assurance as to what the bill is going to be.

Another basic decision relates to the extent we are going to practice economy in nondefense expenditures.

We believe that Congress can, and should, make a 20-percent reduction in the administrative expenses of the activities of Government, including those in the Department of Agriculture, not directly connected with the national defense. In the present situation, we not only must cut administrative expenses, but we must also cut nondefense program expenditures throughout the Federal budget. As an indication of our willingness to do this in agriculture, we have recommended that the authorization for a 1952 agricultural conservation program be reduced from the budget estimate of $285 million to $150 million.

3. Continue to emphasize measures to restrain credit. Selective credit controls, such as have been applied to installment buying and home financing, can help, but measures to restrain the over-all expansion of money and credit are more important.

4. Encourage increased private saving. This will be much easier to do if we adopt a realistic program to control inflation and thereby reassure our people as to the future value of present savings.

5. Continue to stress the sale of Government bonds to individuals and non-bank investors and take steps to prevent a further shift of non-bank-held negotiable bonds to the banking system. The establishment of confidence on the part of the people that inflation is going to be curbed is a prerequisite to an accelerated voluntary savings program. The average citizen wants to know—and has a right to know—that the purchasing power of his investment in bonds isn't going to be diluted so that a bond buys less at maturity than did the original amount invested. The people of America are looking to the Congress of the United States to take such action as will provide this assurance to them.

6. Manage the public debt so as to make a maximum contribution to price and economic stability instead of with the objective of keeping interest costs at a minimum. This means that the Federal Reserve System must discharge its statutory responsibilities by relating its purchases and sales of Government obligations to the Nation's need for money and credit instead of endeavoring to peg the market. Considerable progress has been made in this direction since the Treasury and the Federal Reserve Board reached their so-called accord on debt-management policies.

7. Finally, we must pay the bill through higher taxes. The Farm Bureau is fully aware of the threat of excessive taxes to a free system; however, we must choose between alternatives.

The real cost of war or a defense program occurs when labor and materials are diverted from civilian uses to the creation of military strength. As the Government spends the money, the bill must be paid, either by taxes or by inflation. We prefer to pay it by taxes.

If we adopt a pay-as-we-go tax program, people will know that they are paying for their defense, and we will have the opportunity to distribute the burden equitably on the basis of ability to pay. At the same time, we can reduce the inflation threat by bringing consumer purchasing power more nearly in line with the available supply of consumer goods. Inflation, on the other hand, is an insidious and inequitable way of paying for Government expenditures. If we inflate, there is a good chance that, even though we successfully avoid a third world war, we will substitute a vastly extended control system for our American way in the process.

In our resolutions on long-range tax policies we say that "tax sources should be selected, not only to bring about fair and equitable distribution of the tax burden, but also with due regard to their effects on the national economy." In the present instance, this means that we should strive to obtain necessary increases in revenue in such a manner as to make the greatest possible contribution to the control of inflation. Furthermore, since the need for an expanded defense program may continue for several years, we should attempt to develop a tax program which can continue in effect indefinitely without destroying the incentives that are basic to American productive capacity.

With these objectives in view, we have developed specific recommendations as follows:

PERSONAL INCOME TAXES

We recommend that personal income tax rates be increased sufficiently to raise at least $4,000,000,000 in new revenue. This recommendation is based on a section of our resolution on long-range tax policies which reads as follows:

"The personal income tax should be the major source of revenue for the Federal Government. Its base should be kept as broad as practicable through the retention of low exemptions. All self-supporting persons should make a direct contribution to the support of government"

It is generally agreed that personal income tax is more closely related to "ability to pay" than any other tax. Furthermore, a substantial increase in income taxes at this time would have an anti-inflationary effect by bringing consumer purchasing power more nearly into line with the prospective reduced supply of goods available for civilian consumption. If increases in personal income taxes are to make a maximum contribution to the control of inflation, they must be designed to drain off income that otherwise would be spent by the recipient. With Government taking a larger part of our total production we cannot stabilize the real value of our money without using taxes to reduce the amount of money that is seeking consumer goods

We also recommend a reduction from $1,000 to $500 in the maximum amount of the optional standard deduction which individual taxpayers are allowed to take as an alternative to itemizing their deductions. The present provision of law which permits taxpayers to deduct 10 percent of their gross income up to a maximum deduction of $1,000 without itemizing allowable deductions undoubtedly carries a considerably advantage to taxpayers with a gross income of $5,000 to $10,000, since many of these taxpayers would be unable to report deductible items equal to 10 percent of their gross income. The optional standard deduction is sound in principle, since it facilitates tax computations for many people; however, we feel that any person claiming deductions in excess of $500 should be required to list the deductible items.

CAPITAL GAINS

We favor the moderate increase in the capital gains rate, provided by H. R. 4473, as passed by the House. In addition we recommend an increase from 6 to 12 months in the length of time assets must be held before income from their sale can be reported as "capital gain." The idea of giving "capital gains" more favorable tax treatment than ordinary income is sound in principle, since it provides an incentive for savings and investment; however, 6 months does not appear to us to be a sufficient length of time to put a transaction in the category of a long-term investment. A longer holding requirement for "capital gains" treatment would appear to be particularly desirable in an inflationary period such as the present to reduce the incentive for speculation.

We favor the provision of the House bill which is intended to make it clear that sales of livestock held for dairy, breeding, or draft purposes are eligible

for treatment as "capital gains" under section 117 (j) of the Internal Revenue Code. The eighth circuit court in the Albright case and the fifth circuit court in the Bennett and other cases have held that section 117 (j) does apply to such sales of livestock; however, the Bureau of Internal Revenue has limited its application to certain classes of livestock and we believe it would be well to resolve the question with legislation.

COOPERATIVES AND OTHER CORPORATIONS

Our position on the taxation of cooperatives and other corporations is set forth in our resolutions as follows:

"Agricultural cooperatives are an integral part of the twentieth century farming business and have significantly aided the successful operation of the farm economy. They are a vital part of a free competitive enterprise system. Their basic aim is to enable the farmer to sell his products and to purchase his farm supplies under conditions which allow him to compete effectively in a mass production and distribution economy. Agricultural producers must continue to have the right to market their products, purchase farm supplies, and acquire needed services through their cooperatives. Bona fide agricultural cooperatives must be protected against certain vested interests who are using the term "cooperative" as a guise for selfish motives. We will defend, to the fullest extent of our ability, the right of farmers to form and operate cooperative associations.

"The attacks on cooperatives under the banner of tax equality by certain groups are deeply resented. Since genuine farmer cooperatives are owned and operated by the farmers who use their services, the cooperative has the alternative of reflecting savings to the patron either through patronage refunds or through price adjustments. We are convinced that it is in the best interests of our entire economy for the savings of cooperatives distributed as patronage refunds to be taxed only in the hands of the individual members.

"We will aggressively oppose any efforts to tax cooperatives on such savings returned as cash, or clearly shown on the books of the cooperative to be property of the patron. There is no sound basis for imposing on cooperatives an income tax on patronage earnings refunded in the form of cash refunds, certificates of stock, certificates of indebtedness, or revolving fund certificates where the obligation to the producer patron is certain.

"Savings in the form of unassigned surpluses of cooperatives should be taxed in the same manner as profits of other corporations.

"All corporations should be exempted from Federal income taxes on the portion of their annual earnings that is distributed to the stockholders as dividends, where such dividends are taxed in the hands of stockholders. A reasonable proportion of corporation earnings retained should be taxed at the rate used in the first income bracket of the personal income tax. The balance of any amount retained should be taxed at a rate sufficient to encourage, but not compel, the distribution of earnings.

"We oppose the application of a dividend withholding tax system to cooperatives and other corporations. In many instances patronage refunds or dividends are in such small amounts as to make the necessary bookkeeping transactions impractical. A withholding plan would not accomplish the desired results because recipients of refunds and dividends fall in all tax brackets. The withholding of tax on nontaxable refund items would complicate tax collection procedures."

We recognize that the Government's present need for increased revenue makes it impractical for the Congress to take immediate action on that part of our recommendation which would end the present double taxation of corporate dividends by exempting corporations from Federal income taxes on the portion of their earnings that is distributed to the stockholders as dividends. Nevertheless, we believe that this recommendation is sound from a long-range viewpoint and that it should be adopted as soon as conditions permit.

We are unalterably and aggressively opposed to any effort to tax farmer cooperatives on savings and earnings returned as cash or clearly shown on the books of the cooperative to be the property of the patron; however, we believe that savings in the form of unassigned surpluses of cooperatives should be taxed in the same manner as profits of other corporations. We will support legislation to implement this principle for farm cooperatives and to extend it on an equitable basis to other cooperatively owned businesses such as mutual savings banks, loan associations, etc.

For reasons stated in the resolution just quoted, we oppose the application of a dividend withholding tax system to cooperatives and other corporations.

CORPORATION TAX RATES

In the present situation, we are prepared to support an increase from 47 to 55 percent in the effective rate of the combined corporation normal and surtax rate.

In its present form H. R. 4473 raises the combined corporation normal and surtax rate to 52 percent of taxable income, and reduces excess profits credit from 85 to 75 percent of the corporation's base period net income.

We believe it would far better to leave the excess profits rate unchanged, and to raise the additional revenue needed from corporations entirely through adjustments in the regular corporate rates. For the reasons set forth in our resolution on taxation, the American Farm Bureau Federation is convinced that a high excess profits tax is basically unsound and inconsistent with our efforts to control inflation. Such a tax gives every corporation in the "excess" bracket a powerful incentive to reduce its tax liability by making expenditures it would hesitate to make if it were not for the fact that dollars subject to high excess profits taxes are "cheap dollars" to the taxpayer. A further increase in the regular corporate rate is far more consistent with our present need to promote economical business practices, preserve incentive and control inflation, than is an increase in the excess profits tax designed to raise the same amount of money.

FEDERAL SALES TAXES

We are opposed to a Federal sales tax. Such a tax is undesirable because it would be a drastic departure from the principle of basing Federal taxes on "ability to pay." Furthermore, we need to recognize the need for leaving some possible sources of revenue to the States—many of which already have sales taxes. As an alternative to a Federal sales tax, we would prefer to reduce personal income tax exemptions from $600 to $500.

EXCISE TAXES

As a long-time tax policy, excise taxes should be limited largely to levies on amusements and luxury goods; however, in the present situation, a broader application of excise taxes can be justified both to raise revenue and to assist in the fight against inflation by reducing the demand for scarce goods. We are prepared to support heavy excise taxes (for the duration of the emergency) on luxury goods and on goods which are made of materials of strategic importance or which are in short supply.

In the enactment of new or increased excise taxes, taxes which will increase business costs should be avoided insofar as may be practical, since the common business practice of using percentage markups pyramids the effects of such taxes.

We are opposed to excise taxes on replacement parts for automobiles, trucks, farm machinery and equipment. If we are going to have a period of short supply for equipment of this type, we should make a real effort to keep existing units in operation, and it just isn't sound to tax the fellow who is buying replacement parts to keep an old machine in operation. This recommendation does not apply to accessories, since such items are luxuries.

We are also opposed to any increase in the Federal tax on gasoline. This field of taxation should be left to the States for use as a source of highway funds.

In our testimony before the Ways and Means Committee, we recommended an amendment to section 3411 of the Internal Revenue Code to provide that the tax (3⅓ percent of the selling price) imposed on electrical energy for domestic or commercial consumption shall be collected from publicly owned electrical systems and those owned by cooperatives or nonprofit corporations to the extent that such systems sell electricity for domestic or commercial consumption.

Since this tax is ultimately paid by the consumers of electric energy, we can see no basis for discriminating among consumers on the basis of the source of their supply. We pointed out, however, that a tax on electric energy is undesirable from the standpoint of long-time tax policy; that electricity is a necessity rather than a luxury, and that a tax on its use increases the cost of doing business and may therefore cause a disproportionate increase in consumer prices.

The House committee ultimately decided that the best way to achieve equity between the consumers of electricity was to repeal the existing tax. Since our original recommendation was primarily directed toward providing equitable treatment for all consumers of electricity we are prepared to support the House committee's decision. If, however, this committee should decide to recommend that the tax on sales of electric energy be retained, we must insist that it be applied equitably to all users.

ESTATE AND GIFT TAXES

We recommend that there be no increase in estate and gift taxes.

INCOME FROM BONDS

We recommend the enactment of legislation to make the income from all future issues of Federal, State, and local bonds taxable on the same basis as other income.

DEPLETION ALLOWANCES

We recommend that the committee give careful study to the possibility of a reduction in depletion allowances and that it provide for the elimination of any such allowances which are found to be unjustified.

We recognize that depletion allowances are related to the matter of getting people to invest money in precarious enterprises, but it looks somewhat unreasonable to farmers to permit an enterprise to continue to claim depletion allowances after it has recovered its original investment in this fashion.

TERMINATION DATE

We recommend that all new taxes and increases in existing tax rates be tied to a definite termination date to emphasize their emergency character.

In conclusion, we want again to stress our conviction that a pay-as-we-go tax policy is absolutely essential to the control of inflation. If we are to preserve our freedom, we must be willing to pay, as well as fight, for it. We are not unaware that individual initiative and private enterprise can be destroyed by taxes, and we know that the tax burden required by a pay-as-we-go program will be heavy. We are convinced, however, that a pay-as-we-go program is within the capabilities of the American people. In the long run, we will be far better off if we pay the bill through taxes and take other steps necessary for the real control of inflation than if we take the seemingly easy path of deficit financing and inflation—with the latter concealed from the people through direct controls over prices and wages. Taxes can be reduced when the emergency has passed, but if we destroy the value of our money and tie up our economy with direct controls, we may never be able to return to the "free choice" system through which our unparalleled progress has been made possible.

Exhibit A. Text of 1951 Resolution Regarding Long-Range Tax Policies, Adopted at the Annual Convention of the American Farm Bureau Federation Held at Dallas, Tex., December 1950

LONG-RANGE TAX POLICIES

As a long-time tax policy, we favor the following principles and urge their adoption as rapidly as conditions will permit:

Long-range plans should be made for the gradual reduction of the national debt; however, debt retirement should be handled in such a manner as to promote a stable price level and a prosperous economy. This may necessitate adjusting both the amount of revenue and the volume of expenditures of the Federal Government with reference to the level of employment and national income.

A Federal tax policy should be adopted which will contribute to a more stable price level and to an expanding domestic economy. This means that tax revenues should rise relative to governmental expenditures in inflation, and fall in depression. The maintenance of a stable tax rate would partially accomplish this objective.

The personal income tax should be the major source of revenue for the Federal Government. Its base should be kept as broad as practicable through the retention of low exemptions. All self-supporting persons should make a direct contribution to the support of government.

Tax rates should be high enough to balance the budget under normal conditions and allow for gradual reduction of the national debt, and to make possible increased payments on the debt during periods of prosperity. Prompt but temporary reduction of the lower bracket personal income tax rate within certain limits should be made during periods of low business activity. We do not believe that it is a sound tax policy to increase taxes during periods of depression or lower them during periods of prosperity.

In fairness to taxpayers with widely fluctuating incomes, the administration of tax collections should be revised so as to permit the averaging of individual incomes over a period of years for tax purposes.

The CHAIRMAN. Mr. Eshner, you may identify yourself for the record, and give your name and address.

STATEMENT OF JULES ESHNER, VICE PRESIDENT, SMALLER BUSINESS OF AMERICA

Mr. ESHNER. My name is Jules Eshner, from Cleveland, Ohio, and I am a vice president of Smaller Business of America, and I speak, Senators, to the tax bill which was recently enacted, on behalf of most of the small corporations of the country, and in two respects.

In the first place, I urge that you change the present tax proposal of a point increase in the general corporation tax and instead adopt the House principle of a percentage of the increase on the tax dollar.

For example, a corporation which now earns $25,000 would pay a 30 percent tax on the basis of the House bill. That is a 5 percent average point increase. And that represents a 20 percent increase in its tax. But the larger corporation would only have a 5 point increase, and its percentage increase of its present tax would be only from 6 to 10 percent.

That discrimination falls on the small business concern which needs, Senators, to retain every dollar of profit in its coffers in order to provide the operating capital, because these profits are not expressed in the kind of cash out of which you can pay dividends; they are expressed in inventory at higher figures; they are expressed in additional machinery and equipment, in a larger amount of accounts receivable, and in the higher prices of labor and what they have to pay their engineers and clerical help, and so on.

In other words, you are aware of the fact that it costs a lot more money to do business. It costs a lot more money to develop business and to provide the tools with which business can keep going.

Now, fortunately or unfortunately, this tax statement from the Treasury was prepared with the idea of administration of a tax bill. It was based on having the smallest possible objection, I think, from the larger corporations of the country. You gentlemen are familiar with the fact that most of the big companies of the country had their best years in the four base years, 1946 through 1949.

The excess profits tax, for example, is not going to hit them very hard. But the great majority of small corporations, doing business with less invested capital—or they would not be small corporations, and therefore the invested capital base does not give them much help—those smaller corporations in the main give services. They have not had those good years. And there are four distinct classes of corporations on which the present excess profits tax law falls with a terrible burden, and on which I hope you gentlemen will make some changes.

Those are the smaller new corporations which have relatively small capital.

The second class of corporation is the corporations which have organized since the base period began.

The third class of corporation is those corporations which were organized not too long before the base period, and therefore which

were not able to attain their normal growth and their normal profit picture until just recently. Therefore, the base period is completely inadequate for them.

The fourth class is those companies who had consistent losses, for one reason or another, during the base period, and which the present 4 or 5 formula that the present law permits does not help at all.

Now, the fifth class of corporations is those companies which were newly organized, and for them there is absolutely no relief except the specific exemption.

I submit, gentlemen, that smaller business, which employs roughly half of the employees of the country, and which does 40 percent of the business that is done in the country and which is the thing that sparks that American ingenuity of which Mr. Kline just spoke to you, without which this country cannot progress, without which this country cannot produce the sinews of defense, without which this country will cease to be a great power, must not be forgotten. Unless there is some relief which permits small business to get by, the whole American economy will tend to stifle and die, because small business, Senators, is the channel through which that American ingenuity flows.

Do we want to wreck an economy or do we want to build it? Do we want to infuse new life into the veins and the arteries of American business, or do we want to inject embalming fluid?

Therefore, on behalf of small business, I urge you to apply the percentage of the tax dollar increase just as was done with individual incomes, in dealing with small business. And I urge you also to write into the tax law some relief—perhaps it would have to be in general terms, similar to the old section 722—which will give some relief to those five classes of smaller corporations of which I have spoken.

I think I have kept my word to get through in 10 minutes.

The CHAIRMAN. Thank you very much, Mr. Eshner.

The committee will not be able to sit this afternoon because of conditions in the Senate. If any of the witnesses listed here wishes to file a brief for the record, the committee will be glad to receive them. If not, you will go over until tomorrow and we will hope for better luck. That would be the best that we could do, to allow you to be added to the list of witnesses for tomorrow, because we shall have to be on the floor this afternoon.

The committee will recess until 10 o'clock tomorrow morning.

(Whereupon, at 12:35 p. m., the committee recessed; to reconvene at 10 a. m., Tuesday, July 10, 1951.)

REVENUE ACT OF 1951

TUESDAY, JULY 10, 1951

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

The committee met, pursuant to recess, at 10 a. m., in room 312, Senate Office Building, Senator Robert S. Kerr, presiding.

Present: Senators Kerr (presiding), Byrd, Hoey, Frear, Millikin, Taft, Butler (Nebraska), Williams, and Flanders.

Also present: Elizabeth B. Springer, chief clerk; Colin F. Stam, chief of staff, Joint Committee on Internal Revenue Taxation.

Senator KERR (presiding). Mr. William Jackman.

Mr. Jackman, what is the duration of your statement?

Mr. JACKMAN. Not over 15 minutes.

Senator KERR. We are in the position of having a number of witnesses brought over from yesterday, and we shall appreciate it if you will stay within the limitation of the time that was assigned you.

Mr. JACKMAN. Yes, sir.

Senator KERR. You may proceed.

STATEMENT OF WILLIAM JACKMAN, PRESIDENT, INVESTORS LEAGUE, INC.

Mr. JACKMAN. I am William Jackman, president of the Investors League, Inc., with headquarters at 175 Fifth Avenue, New York 10, N. Y. The league I represent is the oldest and most successful organization of investors, with thousands of members residing in every State of the Union. It is an organization of investors, both small and large, who make up the backbone of our private-enterprise system, which is in turn the backbone of our national economy.

I speak in the interest of millions of American men and women who have worked hard, sacrificed freely, and lived frugally to save and invest in "prosperity, American style."

Gentlemen, these are loyal citizens who can be counted upon to keep faith with the principles and practices which have made ours the greatest country in the world. These men and women stand ready to meet every national crisis, every threat to our civilization. These citizens stand ready to give of themselves to help meet every plan for social and material advancement of the people of this country and of the world.

The Investors League states with pride that the average investor is a splendid and upright American.

As one of the members of the House Ways and Means Committee stated in an article written for the Bulletin, the league's official publication, the tax bill prepared and passed by the House is an economic

monstrosity. He stated also that those members of the committee who approved the proposal had their tongues in their cheeks, believing that the Senate Finance Committee would rewrite the measure as it properly should be done and as it has done so many times in the past on tax bills.

Because prices are so high and the dangers so great, let us above all keep our taxes down to bare necessities. Let us eliminate all unnecessary cost of Government. It is reliably estimated that savings of $3½ billion can be effected if our nonmilitary Government expenses are cut to the bone. Let us not waste unnecessary money on even military expenses. Let us set up a proper agency to check into military expenditures to see that no funds are wasted.

As an illustration: How can we reconcile the President's statement of "tax until it hurts" when the Quartermaster's service last January bought 5 million pounds of oleomargarine at 25⅓ cents a pound, and at the same time the Department of Agriculture sold 5½ million pounds of surplus butter to Italy for 15 cents a pound? It is almost too fantastic to believe.

Regarding the withholding tax, the 1951 revenue bill (H. R. 4473) would place a 20-percent levy on all dividend and interest payments at the source. In other words, the payee would be obliged to deduct 20 percent of all dividend and interest payments.

As president of the Investors League, I feel it my duty to call to your attention the ill effects such legislation, if enacted, would have on the general economy of the country. I wish also to register with you the protests of these investors against such proposed legislation.

Over the years we have heard a great deal in certain quarters in Washington about the charge of discrimination. I say to you that no group of Americans should be discriminated against. I want to call your particular attention to the discrimination against American investors, which is so obvious in that provision of the tax measure which provides that 20 percent of all interest and dividends should be deducted at the source and paid directly into the Treasury.

This is not only discrimination; it is insulting. It is insulting to at least 10 million loyal Americans. It says to this group, in effect, I do not trust you to pay taxes on the income which you receive from dividends and interest payments. I believe you will chisel on Uncle Sam at this time when revenues are badly needed. In other words, I think you are a crook.

I know and you know that our upward of 10 million investors in the United States are not crooks. Why should the Government say to these people that they are not to be trusted, any more than it should be said to any other group of our law-abiding citizens that they are not to be trusted? In my estimation, this is a disgrace, and I am here as representing this group to protest vigorously.

The Investors League is in complete accord with the principle that taxes due should be paid and collected. Collection, at the source, of taxes on dividends will, however, include many cases in which no tax is due. More than 47 percent of stockholders have incomes of less than $5,000 per annum. The withholding of 20 percent of dividends will, in these cases, work hardships, severe in some instances. Even though refunds may, in time, be made, the stockholder will not have the use of this portion of his income until receipt of such refund as may be

due to him. This is, therefore, a vicious principle and, moreover, unduly burdensome on the low-income investors.

Furthermore, its actual benefit is doubtful. Both the withholding agent and the Government will undoubtedly be put in additional expense. When the withholding agent has reduced his tax liability by credit for the additional business expense, when the Government has deducted its expense plus refunds, the net will, it is believed, be far below estimates.

Such a provision as this withholding of dividends is equivalent to saying to the stockholder, "We will collect the tax and then give you the opportunity to prove you do not owe it." That is a police-state procedure. Furthermore, it is penalizing the majority for the few—even more a police-state method.

The league believes such a withholding procedure will prove a deterrent to the purchase or holding of stock and, therefore, will discourage the flow of capital to business and industry, from which more jobs and hence more tax revenue are created. The cycle is vicious and may result in its own dissipation.

On the national excise tax, the Investors League believes that the time has come when a national excise tax should be applied to all commodities, with the exception of food. It strongly recommends that this tax be 5 percent, which, it is estimated, would produce at least $5,000,000,000 annually in revenue.

The objection to a general sales tax of a reasonable amount—say 5 percent—is admittedly purely political. We suggest that this objection be met at its own level merely by changing the name of the tax from "sales" to "excise."

The present system of special sales taxes, for the most part based on no rational basis of either coverage or rates, is another example of the grossly unfair discrimination which characterizes the Internal Revenue Code and which demands a complete overhauling.

For example, at present a large number of sports articles are subject to a so-called manufacturers excise tax of 10 percent. Why sporting goods should be taxed while dancing shoes are exempt, is puzzling enough, for surely nothing is more essential to the health of the country than plenty of outdoor exercise. But it is now proposed to accentuate this bias by exempting one group of sports altogether, while increasing the sales tax on the rest to 15 percent, cricket, football, and hockey equipment would be tax-free; baseball, golf, and tennis further penalized. We are now to pay a 20 percent excise tax on mechanical pencils and fountain pens, while ordinary pencils, pens, and ink are exempt.

These senseless distinctions naturally cause confusion, and make the sales tax, which should be the simplest of all taxes to understand and enforce, a frequent subject of litigation in the Federal courts.

The so-called excess-profits tax is another example of misnomer, so gross in this case as to constitute actual fraud, which H. R. 4473 by lowering the false "average earnings" base still further to 75 percent of reality, would make more gross. The whole excess-profits statute is an unintelligible monstrosity, which serves only to confuse the taxpayers and the public, and which will create endless headaches and litigation unless promptly replaced by provisions for renegotiation of actual excessive war profits on Government contracts, with a readjustment of the flat corporate tax rate if more revenue is needed.

On double taxation, among the multitude of needless complexities, hypocrisies, and injustices found in the tax law, the most unfair to investors is the double taxation of dividends, which alone has taken from them many billions of dollars in the last 17 years, to which the House now proposes to add the 20 percent withholding tax. There is no doubt that the Government should remove grossly biased tax provisions which it has imposed. These provisions, some of them, such as the double dividend tax, agreed by both parties and also by the Treasury Department to be unfair, were bad enough when rates of tax were comparatively low. They are intolerable under present conditions.

The Investors League firmly believes that the Internal Revenue Code should be rewritten from one end to the other.

Year after year the need for a complete rewriting and simplification of the tax laws has been admitted on all sides. Three years ago the House, after lengthy study by the Ways and Means Committee, passed a bill, too late for Senate action, which corrected a large number of obvious minor injustices. The excuse for nonaction has been lack of time.

Gentlemen, with the present load of taxes under which our economy is staggering, we believe there is no more time for delay in removing complex confusion, iniquitous discrimination, and gross unfairness from the Internal Revenue Code. Accordingly, we earnestly recommend that a joint committee be appointed forthwith from the Senate Finance Committee and the House Ways and Means Committee, adequately staffed, to rewrite the Internal Revenue Code from one end to the other, as speedily as possible, to make it more simple and understandable in form and more equitable in substance; that H. R. 4473 be limited by amendment to the provisions passed by the House in 1948; and that a general excise tax of 5 percent be imposed on sales, to take the place of existing special sales taxes of all kinds except on liquor, tobacco, and high-priced luxuries. Such a tax would be immediately effective and would produce additional revenue of at least 5 billion a year—an amount which should be enough, with proper executive economies, to balance the budget for the current fiscal year.

On the capital-gains tax, the Investors League also favors a reduction in the holding period which applied to capital-gains taxes. We believe—in fact we are certain that if this holding period was reduced the Government would receive more in tax revenues and that investors at the same time would benefit.

As the taxes stand now a person who has purchased securities must wait for 6 months before he can resell them and still come within the provisions of the capital-gains tax. It frequently happens that the profits on the securities decline and may even disappear before that 6-month period has elapsed. This means that if a purchaser were to sell at the end of a 6-month period he would pay a smaller amount of taxes or perhaps no taxes at all.

It follows too that if a person were to come within the scope of the capital-gains tax provisions by holding for a 3-month period rather than a 6-month period, it is probable that his taxes would increase.

In the final analysis a capital-gains tax is in effect a levy on capital. In fact it has been held to be such a levy by our courts.

Many countries have no capital-gains tax whatsoever for that reason. Certainly the taxes levied in this country should not be designed to hamper the employment of capital.

We believe, therefore, that the holding period should be reduced to not more than 3 months.

The Investors League is aware of the possibility that such a reduction in the holding period might encourage greater speculation in corporation securities. We believe, however, that any such increase in speculation would not be detrimental to the Nation's economy, particularly in view of the very rigid credit restrictions now in force and also because of the careful scrutiny which the Securities and Exchange Commission exercises over our security markets. The same reasoning applies even more strongly against the proposed increase in the capital-gains tax return which certainly has the effect of reducing the tax received.

In conclusion, gentlemen, I ask you with all the sincerity at my command: Please, for God's sake and for the sake of God's children, humanity, do not dry up the wells of prosperity, American style.

Senator KERR. We thank you, Mr. Jackman. I take it for granted that you included all of us in that designation of God's children.

Mr. JACKMAN. That is right.

Senator KERR. Thank you for your appearance.

Senator KERR. Mr. Kruse.

Mr. KRUSE. Mr. Chairman, I will confine myself to the period of 15 minutes.

Senator KERR. We appreciate that.

STATEMENT OF EDWARD H. KRUSE, JR., THE WAYNE PUMP CO., FORT WAYNE, IND., ACCOMPANIED BY A. F. KALIKER, ASSISTANT SECRETARY, THE WAYNE PUMP CO.

Mr. KRUSE. Mr. Chairman and gentlemen of the committee, I have full appreciation and respect for the task confronting the committee at this time, and I shall endeavor to be as brief as I possibly can.

I appear before you at this time in connection with a proposed amendment to section 131 of the Internal Revenue Code. This section of the code relates to allowance of credit for income, war-profits, and excess-profits taxes paid to foreign countries and possessions of the United States. More particularly, the proposed amendment which we submit herewith relates to the treatment under section 131 of the taxes paid to a foreign country during a taxable year in which the taxpayer has a net operating loss, or would have had a net operating loss had the foreign dividends or income been excluded in computing gross income.

A complete discussion of this matter will be impossible at this time. I shall confine myself to a presentation of only the factors pertinent to the case.

I might say that I appear as counsel for and in behalf of the Wayne Pump Co., of Fort Wayne, Ind. The Wayne Pump Co. is engaged in the manufacture and sale of gasoline filling station equipment, hoists, air compressors, hose reels, airport equipment, and related items.

The company has been in existence since 1891, and at the present time has two active foreign subsidiaries, one active domestic sub-

sidiary, and one active foreign division. The subsidiary corporations are located in London, England, Rio de Janeiro, Brazil, and Cincinnati, Ohio; the division is located in Toronto, Canada. The Wayne Pump Co. is thus in position where it may receive income from sources both within and without the United States.

Senator TAFT. Is this activity outside the United States just selling, or does it include manufacturing?

Mr. KRUSE. Just selling and some assembling, Senator.

The company has been a very successful enterprise throughout the years; however, during the year 1948 the parent corporation suffered reverses and ended the year with an over-all net operating loss. In 1949 the company suffered a net loss on its United States operation. During both of these years the parent corporation received dividends from its foreign subsidiaries. During 1948 it realized net income from its Canadian division; in 1949 it suffered a loss from its Canadian division.

The problem is this: The officials of the company learned during this period of time that under the provisions of section 131 of the code that they were not permitted to utilize the credit for foreign taxes paid in a loss year; whereas, they are permitted under present law to utilize this credit against the tax in years of income. This peculiar situation is the crux of our problem; furthermore, it may be stated definitely that the situation is one in which a hardship is worked upon the company, or any other company in a similar position.

Senator TAFT. You cannot take the credit at all; is that the point?

Mr. KRUSE. That is correct, Senator.

Senator TAFT. The carry-over provision does not help you any?

Mr. KRUSE. That is correct. You see, in the case of a foreign subsidiary from which you receive dividends, there is only an allowance in the nature of a credit for the tax paid on these dividends. You cannot take it as a deduction. Now, the reason you cannot use it in the case where the domestic parent has an over-all operating loss is for the reason that there is no United States Federal income tax against which to apply the tax paid on the dividends abroad. In the case of a foreign division or branch which belongs to the parent organization, you can treat the tax paid for net income from the division or branch as either a deduction or as a credit, but you cannot take it as both. You have to make an election. But at least in the case of net income from a branch or a division, you do have the benefit of the tax paid. You can take it as a deduction or a credit. But in the case of a subsidiary, we can only utilize this credit in years of net income because that is the only time we have a Federal tax against which we can apply this credit.

Senator TAFT. You have to file a consolidated return to get the credit, do you not? With the subsidiary corporation, you have to file a consolidated return, or do you just pay on the dividends?

Mr. KRUSE. First of all, let me say this. The credit is subject to certain limitations. We compute the credit; then we figure out our over-all net income. Then we deduct this tax credit from the tax on our computed net income. Then the balance is the tax that we pay.

Senator TAFT. But I do not quite understand the situation. You are dealing with a question of a foreign subsidiary, are you?

Mr. KRUSE. Yes, sir.

Senator TAFT. Do you file a consolidated return or do you not?

Mr. KRUSE. At the present time, the law does not permit a foreign corporation to be included in a consolidated return. I am not the tax man for the company, Senator. He is not permitted under the law, as I understand it, to deduct a foreign loss in such a way as to reduce the tax he would owe on domestic profit.

Senator TAFT. It is not the foreign loss. That does not bother him. He wants the tax credit for taxes he has paid for the foreign company. I do not quite see why.

Mr. KRUSE. Permit me to make this further observation perhaps to clear up this situation.

First of all, a domestic corporation must own a majority of the voting stock of the foreign subsidiary corporation to be eligible for this credit. Then, secondly, there is a fiction in the present law which has created what I might say is an exception to the law in this, that for purposes of obtaining the credit, the domestic corporation is deemed to have paid the tax on the dividend received from the foreign subsidiary. It is a fiction, Senator, and it is an exception to the law.

Senator TAFT. I am afraid I do not understand. You will have to state it much more clearly.

Mr. KRUSE. May I depart from this and use the illustration?

Senator TAFT. Yes.

Senator KERR. I wonder if Mr. Stam could not state this problem for us.

Senator TAFT. Mr. Stam, could you do that?

Mr. STAM. He has an example.

Mr. KRUSE. Referring to exhibit E, these are three different cases. The amounts are rounded off, and are approximately accurate. We have rounded them off for purposes of illustration.

This is the actual case of the Wayne Pump Co. This is the year 1948; this is the year 1946. Now, let us just talk about this one case (A) alone for a minute.

In the year 1948, the Wayne Pump Co. had a net loss of $490,000. In 1946, they had net income in this amount [indicating].

Now, notice this. The dividends from our foreign subsidiary in England were includible in computing income. However, the credit for the tax paid on those dividends could not be taken because they were received in a loss year. We wound up with a loss with no Federal income tax; so we had no tax base against which to apply our foreign tax credit.

Senator TAFT. Why should you have such a tax base? After all, you had an over-all loss. The credit is only given to you so that you do not pay double taxes.

Mr. KRUSE. Yes, Senator; your point is very well taken. And if there were no such thing as a credit in the present law which we could take in years of income, I would agree with you 100 percent.

Senator TAFT. But these dividends from England must be after the subsidiaries paid their tax.

Mr. KRUSE. Yes, sir; that is correct.

Senator TAFT. You are not including the whole income from the foreign company, are you, but just what they pay you in dividends?

Mr. KRUSE. That is right. And what you mentioned would certainly be right and I would be in agreement with it, provided there was no provision at all in the present law ever to take this credit.

But we are permitted to utilize this credit in years of income when we would least need it, and in years of loss, such as occurred to Wayne Pump for one of the first times, when we needed it most, we discovered that we could not take it. And, of course, anyone in a similar situation is similarly affected.

Senator KERR. Do you think that we might remedy that by eliminating the credit that you are permitted to take in years of profit? Would that relieve the pain?

Mr. KRUSE. Senator, in that case, the argument would be that the Government must carry on all foreign investment abroad, and those of us in private business in this country who are willing to invest money abroad, would be further discouraged from doing so.

Senator KERR. You say that you would not be conscious of it if it were not for the fact that in the years you have a profit and pay a tax you get the credit for it.

Senator TAFT. I do not see why there should be a credit? If you included all the income from the foreign subsidiary, that will be all right. But you do not. All you do is include in your income the dividends actually received from abroad, which is after you paid the foreign taxes. I do not see why there should be a credit at all.

Mr. KRUSE. You mean, in either case, including a loss?

Senator TAFT. Yes; in either case. I do not see the purpose for the credit. If you are filing a consolidated return and putting all the income from your foreign company in, that would be another thing. But here all you are putting in is net dividends after you have paid the foreign tax.

Mr. KRUSE. Senator Taft, from our own research into this matter, we have brought it down to really two answers. In going into the books, we learn that the theory back of it originally was to encourage investment abroad and to prevent taxation of dividends which already have been taxed abroad.

Senator TAFT. They have not been taxed——

Mr. KRUSE. They have been taxed to the subsidiary abroad.

Senator TAFT. Not those dividends. What has been taxed is the earnings.

Mr. KRUSE. I mean, taxed as earnings.

Senator TAFT. The dividends are after earnings.

Mr. KRUSE. Yes, sir. What I meant was the earnings from which the dividends were paid. Now, may I take the second situation?

Senator KERR. Let us go down to here. You understand that if you have this $490,000 loss in 1948 in your American company, you can carry that forward into 1949, and any profit you paid is reduced by that amount before there is a tax assessed against you.

Mr. KRUSE. Yes. Well, that is true in any case, sir.

Senator KERR. I understand that.

Mr. KRUSE. Yes, Senator; I understand that.

Senator KERR. Does that not take care of the problem that you are talking about?

Mr. KRUSE. It does not permit us to utilize the credit in years of loss, and we are premitted to utilize it in years of income.

Senator KERR. You do not think that you should be paid a premium for taking a loss?

Mr. KRUSE. No, sir; I do not.

Senator KERR. If you show a loss in your bookkeeping, you would not want a situation where the Government would pay you a premium for that?

Mr. KRUSE. No, Senator. But we are allowed the credit. It has been in the present law for some time, and we can use it in years of income.

Senator KERR. It is a credit against profit, is it not?

Mr. KRUSE. It is a credit against the tax on profit.

Senator KERR. Then how would you fix it so that it would be a credit against loss?

Mr. Kruse. By permitting us to carry the credit back or forward to the last taxable year.

Senator KERR You are permitted to carry the loss forward.

Mr. KRUSE. To permit us to carry the credit back or forward.

Now, may I go forward to the next situation?

Senator KERR. Yes, sir.

Mr. KRUSE. Referring again to exhibit B, case (B), this is the year 1948, and this is the year 1946, again. Now, for purposes of illustration, we have divided the income into 2 years. The total net income for the 2 years, $1,508,000, is the same as in this situation (A). We had income in both years, but we pay less tax, $52,060 less tax in case (B).

These are subsidiaries. This is a subsidiary corporation.

Senator TAFT. What is this $490,000? How do you get that? Is that carried back?

Mr. KRUSE. Yes, Senator Taft; it is. That was our net loss, and we carried it back to our last taxable year, under the carry-back provisions of section 122 of the Internal Revenue Code.

Now, in this case (C) we received foreign income from a foreign branch or division, and in this case we were permitted to deduct the tax paid on the net income from the foreign branch. The amounts in case (A) and (B) you will notice here was $137,000 in dividends, and the same amount in case (C), but that represents net income, and not dividends. The tax we paid in the case of net income, you can either take it as a deduction or as a credit. Since we had a loss and thus no taxable base against which to apply the credit, we took it as a deduction, so that it increased our over-all deduction.

So here, in this case (C), we wind up paying $20,000 less tax than in case (A) where we had the same amount of money received in the way of dividends.

Those are the three situations. And yet all of them aggregate approximately the same amount of net income—see exhibit D for further explanation.

Senator TAFT. With respect to this business of foreign subsidiaries, of course, those are dividends.

Mr. KRUSE. Yes, sir.

Senator TAFT. Now, the income from the branch, that is gross income, I suppose, calculated right in Canada?

Mr. KRUSE. Yes, sir.

Senator TAFT. So that the two are not quite comparable. You may have a much larger income from your foreign subsidiary in England than $137,000 and still not have it as dividends.

Mr. KRUSE. Yes, sir.

May I say in conclusion, gentlemen, that I think the points you have raised are very well taken. Had there been no credit ever allowed under present law in the case of foreign income, our situation would never have arisen; we would not be aware of such a thing. But the fact is that the credit provision is in present law and the reason for it is to encourage investment abroad and prevent the double taxation of those dividends at home. We find we went along for years never having a net loss; we utilized it in years of income, and then in a year of loss, when we most need it we cannot take it. We feel that it would be as equitable or more so to have it in those years of loss, assuming that a credit is proper, and it must be so or it would never have been written into the law.

I guess I have exceeded my time, Senator. I apologize.

Senator KERR. That is all right. You have a very interesting matter.

Senator TAFT. Mr. Stam, what are your views on it?

Mr. STAM. I think what he is attempting to say is something like this, Senator, that the domestic corporation is entitled to carry its loss forward against its income for the following year, but the dividends received from the foreign company, when they come in, reduce that loss. Therefore, he has less loss to carry forward into the next year. But he is not entitled to offset that income for the next year by the foreign tax paid.

In other words, he is being handicapped to some extent by having his loss reduced by these dividends received, but he is not entitled to a credit for the foreign tax paid in connection with those dividends in the next year.

Is that not your point?

Mr. KRUSE. That is correct. You see, Senator, these amounts go really to reduce our loss. Now, if this were an income year, we could take the credit. But it was a loss year. So we could not take the credit. But still the dividend goes to reduce our loss.

Senator KERR. What would happen if you did not pay yourself that dividend in a loss year?

Mr. KRUSE. We have investigated that——

Senator KERR. And waited until you had a profitable year in which to take the credit?

Mr. KRUSE. As a general rule, it is not possible to control the receipt of those dividends when they are paid. It depends upon the particular foreign country. But, generally speaking, that is our experience. We cannot control the receipt of those dividends. If we could, we could avoid this situation.

Senator KERR. All right, Mr. Kruse.

You will want your entire statement placed in the record?

Mr. KRUSE. Yes, sir. I certainly do thank you for your time.

Senator KERR. We thank you for coming here. You have an interesting problem, and one that we will give the best attention to that we can.

Mr. KRUSE. Thank you very much.

(The prepared testimony of Mr. Kruse is as follows:)

EXHIBIT A

PETITION

The computation of a net operating loss deduction under section 122, Internal Revenue Code, is inequitable if a taxpayer has a net operating loss in a year

when dividends are received from a foreign subsidiary on which foreign taxes have been paid.

Section 131, Internal Revenue Code, allows a credit against United States income taxes for income, war profits, and excess-profits taxes paid or accrued during the taxable year to any foreign country or possession of the United States. Under section 131 (f) taxes paid by a foreign subsidiary are deemed to have been paid by the domestic parent.

Under the present law if the domestic parent has a net operating loss, it receives no benefit under section 131, Internal Revenue Code, for foreign taxes paid on earnings received from a foreign subsidiary in either the year the dividends are received or the year to which the net operating loss deduction is applied. Moreover, the parent's loss from operations is reduced by the amount of the foreign subsidiary dividend received which appears contrary to the idea of a "net operating loss" under section 122 (d), Internal Revenue Code.

The effect of the law is that under these conditions a taxpayer pays a 38 percent United States income tax on earnings previously taxed by a foreign country.

The Wayne Pump Co. for its fiscal year ended November 30, 1948, had a net operating loss which was carried back to its fiscal year ended November 30, 1946. The 1948 loss from operations of about $627,000 was reduced by approximately $137,000 of dividends received from a foreign subsidiary so that the net operating loss under the code was $490,000. The subsidiary paid taxes in England on these distributed earnings of more than the United States corporation tax of 38 percent. Under the present law the net operating loss of $490,000 was carried back to the year 1946, reducing the net income of that year from $1,998,000 to $1,508,000 on which the United States income tax was $573,040.[1] If Wayne Pump had the same aggregate net income of $1,508,000 for the years 1948 and 1946, but had net income instead of a loss in the year 1948, the aggregate United States income tax for both years would have been $520,980, or $52,060 less than the actual tax paid. It is apparent, therefore, that Wayne Pump has paid $52,060 more United States income tax than a comparable company having the same aggregate income in the 2 years with income from operations in both years. Exhibit B, case A, and case B, showing this situation in statement form, using round approximations of actual figures for the Wayne Pump Co. for its fiscal year ended November 30, 1948, year of operating loss, and its fiscal year ended November 30, 1946, year to which loss was carried back is attached.

Exhibit B, case C, also attached, shows the tax result using the same figures of income and deduction (plus, however, deduction for Canadian taxes), but the foreign income of $137,000 in case C is net income from a foreign branch or division (Canada) as contrasted to the $137,000 as dividends from a foreign subsidiary (England) in case A and case B. It will be noted case C has a loss in 1 year the same as case A, but the tax result is somewhat more favorable than case A, but still not as favorable as in case B, the company fortunate enough to have net income both years. It would seem the situation should be reversed, so that the company unfortunate enough to suffer a loss would have the better treatment.

For its following fiscal year ended November 30, 1949, a similar condition exists, involving a difference in tax of approximately $25,000 as compared to the $52,060 for the previous year.

At this time conditions are developing that this situation might again occur during its present fiscal year to end on November 30, 1951. This condition did not develop during its fiscal year ended November 30, 1950, however.

Congress certainly did not intend to discriminate against corporations suffering operating losses by depriving such loss companies of tax benefits available to companies operating at a profit. As the effect of the net operating loss provisions relative to foreign tax credit is contrary to the purpose of the net operating loss carry-back, it appears that Congress, possibly through oversight, failed to consider the above combination of circumstances which create an unintended hardship on some companies.

THE WAYNE PUMP CO.
A. F. KALIKER,
Assistant Secretary.

[1] This figure is before a foreign tax credit deduction of $60,310.52, with respect to foreign net income received in 1946. This was handled in this manner in order to eliminate unnecessary complications in the presentation of the problem in this exhibit A, and in exhibits B and D. This credit appears in proper form and sequence in the detailed technical computations in exhibits E and F. It will be seen the benefit under the bill, $52,060, as presented in exhibits B and D, is nevertheless approximately the amount of $52,216.24 shown in exhibit F.

EXHIBIT B

Situation in statement form

	Case A: The Wayne Pump Co.	Case B: Same aggregate net income as case A, but no loss in either year (see note)	Case C: Same as case A, but foreign income is from branch
Fiscal year ended Nov. 30, 1948:			
Dividends from foreign subsidiary (England)	$137,000	$137,000	
Net income from branch (Canada)			$137,000
Other gross income	2,749,000	3,749,000	2,749,000
Total	2,886,000	3,886,000	2,886,000
Deductions	3,376,000	3,376,000	[1] 3,428,000
Net income (loss)	490,000	510,000	542,000
Federal income tax (38 percent)	None	193,800	None
Less credit for foreign taxes paid ($137,000 × 38 percent)	None	52,060	None
Tax after foreign tax credit	None	141,740	None
Fiscal year ended Nov. 30, 1946:			
Net income	1,998,000	998,000	1,998,000
Net operating loss deduction (1948, above)	490,000	None	542,000
Net income after carry-back	1,508,000	998,000	1,456,000
Federal income tax (38 percent)	573,040	379,240	553,280
Comparisons:			
Aggregate net income 1946 and 1948	1,508,000	1,508,000	1,456,000
Aggregate Federal income tax 1946 and 1948	573,040	520,980	553,280
Less aggregate Federal income tax 1946 and 1948 (case B)	520,980		520,980
Additional Federal income taxes paid on the same amount of aggregate net income because of loss of credit for foreign taxes paid	52,060	None	32,300

[1] See the following:

Deductions (case A)	$3,376,000
Plus deduction for Canadian income taxes ($137,000×38 percent, approximately)	52,000
Total	3,428,000

NOTE.—The amounts are the same as those in case A except that, for comparative purposes, net income for the fiscal year ended Nov. 30, 1948, has been increased $1,000,000 and net income for the fiscal year ended Nov. 30, 1946, has been decreased $1,000,000. The aggregate net income for the 2 years in the same for both cases A and B.

EXHIBIT C

A BILL Relating to the treatment under section 131 of the Internal Revenue Code of taxes paid to a foreign country during a taxable year in which the taxpayer has a net operating loss

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That section 131 of the Internal Revenue Code (relating to taxes of foreign countries and possessions of the United States) is hereby amended by adding at the end thereof the following new subsection:

"(k) TAXES PAID IN YEAR OF NET OPERATING LOSS.—If income, war-profits, and excess-profits taxes imposed by a foreign country or a possession of the United States are paid or accrued during a taxable year for which the taxpayer has a net operating loss (as defined in section 122 (a)), or would have had a net

operating loss if the net income in respect of which such taxes were imposed by the foreign country or possession of the United States was excluded in determining the amount of the net operating loss under section 122 (a), then—

"(1) such taxes shall be considered, for the purposes of this section, as having been paid or accrued during the last taxable year of the taxpayer to which any amount of such net operating loss is carried back or carried over under the provisions of section 122 (b), or would have been carried back or carried over had a net operating loss resulted through the exclusion of the net foreign income in the actual year of receipt; and

"(2) for the purposes of applying subsection (b) of this section, the net income or normal-tax net income of such last taxable year shall be computed by including the net income in respect of which such taxes were imposed by the foreign country or possession of the United States."

SEC. 2. The amendment made by this Act shall be applicable in computing the credit allowed under section 131 for taxable years ending after December 31, 1945 (including any case where taxes paid or accrued in a taxable year beginning prior to such date are considered under the amendment as having been paid or accrued in a taxable year ending after such date). If the application of this amendment results in a credit or refund to the taxpayer, a claim for credit or refund will be timely filed if filed within the provision of section 322 (b) (6), or within one year from the enactment of this amendment, whichever is later.

EXHIBIT D

Situation in statement form (after bill)

	Case A—The Wayne Pump Co.	Case B—Same aggregate net income as case A, but no loss in either year	Case C—Same as case A, but foreign income is from branch
Fiscal year ended Nov. 30, 1948:			
Dividends from foreign subsidiary (England)	$137,000	$137,000	
Net income from branch (Canada)			$137,000
Other gross income	2,749,000	3,749,000	2,749,000
Total	2,886,000	3,886,000	2,886,000
Deductions	3,376,000	3,376,000	3,376,000
Net income (loss)	490,000	510,000	490,000
Federal income tax (38 percent)	None	193,800	None
Less credit for foreign taxes paid ($137,000×38 percent)	None	52,060	None
Tax after foreign tax credit	None	141,740	None
Fiscal year ended Nov. 30, 1946:			
Net income	1,998,000	998,000	1,998,000
Net operating loss deduction—1948 above	490,000		490,000
Net income after carry-back	1,508,000	998,000	1,508,000
Federal income tax (38 percent)	573,040	379,240	573,040
Less credit for foreign taxes paid ($137,000×38 percent)	52,060		52,060
Tax after foreign tax credit	520,980		520,980
Comparisons:			
Aggregate net income 1946 and 1948	1,508,000	1,508,000	1,508,000
Aggregate Federal income tax for 1946 and 1948	520,980	520,980	520,980

NOTE.—The same aggregate Federal income tax is now paid in all 3 cases on the same aggregate net income.

Exhibit E

Computation of decreases in normal tax and surtax for the year ended Nov. 30, 1946, resulting from carry back of net operating loss from the year ended Nov. 30, 1948 (actual computation filed with Form 1139, application for tentative carry-back adjustment)

	1946 law	1945 law
Net income per return filed	$1,998,134.80	$1,998,134.80
Less net operating loss for year ended Nov. 30, 1948	490,240.61	490,240.61
Adjusted net income	1,507,894.19	1,507,894.19
Less excess of net long-term capital gain over net short-term capital loss	7,762.33	7,762.33
Remainder	1,500,131.86	1,500,131.86
Normal tax and surtax:		
Tax on amounts excluding excess of net long-term capital gain over net short-term capital loss, 1946 basis, 38 percent; 1945 basis, 40 percent	570,050.11	600,052.74
Tax on excess of net long-term capital gain over short-term capital loss, 25 percent	1,940.58	1,940.58
Total	571,990.69	601,993.32
Number of days in fiscal year ended Nov. 30, 1946		365
Number of days prior to Jan. 1, 1946		31
Number of days after Dec. 31, 1945		334
Tax under 1946 law—334/365 of $571,990.69	523,410.66	
Tax under 1945 law—31/365 of $601,993.32	51,128.20	
Total	574,538.86	
Less credit for income taxes paid to foreign countries:		
Great Britain ($57,287.82/$1,507,894.19×$574,538.86)	21,827.84	
Brazil (as per tax return for the year ended Nov. 30, 1946)	3,484.81	
Canada ($91,852.95/$1,507,894.19×$574,538.86)	34,997.87	
Total	60,310.52	
Balance of income taxes	514,228.34	
Normal tax and surtax paid per return filed	701,327.70	
Decrease, due to carry back of net operating loss only	187,099.36	

EXHIBIT F

Technical application of bill to actual figures and facts, fiscal years of the company ended Nov. 30, 1946 and 1948

		1946 law	1945 law
Fiscal year ended Nov. 30, 1946, recomputation of credit for foreign taxes paid, under new sec. 131 (k) Internal Revenue Code:			
Net income per return filed		$1, 998, 134. 80	$1, 998, 134. 80
Less net operating loss for year ended Nov. 30, 1948		490, 240. 61	490, 240. 61
Total		1, 507, 894. 19	1, 507, 894. 19
Plus carry-back of 1948 foreign dividend income:			
Dividend from English subsidiary	$132, 907. 50		
Dividend from Brazilian subsidiary	4, 451. 61		
		137, 359. 11	137, 359. 11
Net income—corrected		1, 645, 253. 30	1, 645, 253. 30
Less excess of net long-term capital gain over net short-term capital loss		7, 762. 33	7, 762. 33
Remainder		1, 637, 490. 97	1, 637, 490. 97
Normal tax and surtax:			
Taxes on amounts excluding excess of net long-term capital gain over net short-term capital loss, 1946 basis, 38 percent; 1945 basis, 40 percent		622, 246. 57	654, 996. 39
Tax on excess of net long-term capital gain over net short-term capital loss, 25 percent		1, 940. 58	1, 940. 58
Total		624, 187. 15	656, 936. 97
Number of days in fiscal year ended Nov. 30, 1946		365	
Number of days prior to Jan. 1, 1946		31	
Number of days after Dec. 31, 1945		334	
Tax under 1946 law, 334/365 of $624,187.15			571, 173. 99
Tax under 1945 law, 31/365 of $656,936.97			55, 794. 65
Total			626, 968. 64
Credit for foreign taxes paid:			
Great Britain (tax rate is in excess of United States rate):			
Amount of dividend received in 1946	$57, 287. 82		
Amount of dividend received in 1948	132, 907. 50		
Total	190, 195. 32		
Limitation on credit: $190,195.32/$1,645,253.30×$626,968.64		72, 478. 83	
Brazil (tax rate is less than United States rate):			
Amount of dividend received in 1946	$9, 941. 46		
Amount of dividend received in 1948	4, 451. 61		
Total	14, 393. 07		
Limitation on credit: $14,393.07/$1,645,253.30× $626,968.64	5, 484. 72		
Amount of Brazilian taxes actually paid:			
For 1946	3, 484. 61		
For 1948	1, 560. 29		
Total	5, 044. 90		
Use lesser amount		5, 044. 90	
Canada (tax rate is in excess of United States rate; provincial income taxes are includible):			
Amount of net income from Canadian Division during 1946	$91, 852. 95		
Limitation on credit: $91,852.95/$1,645,253.30× $626,968.64		35, 003. 03	
Total credit for foreign taxes paid, recomputed			112, 526. 76
Income tax for 1946, prior to foreign tax credit, after operating loss carry-back prior to new sec. 131 (k) Internal Revenue Code			574, 538. 86
Less total credit for foreign taxes paid, recomputed under new sec. 131 (k) Internal Revenue Code			112, 526. 76
Balance of income taxes for 1946			462, 012. 10
Balance of income taxes for 1946, after foreign tax credit, after operating loss carry-back, prior to new sec. 131 (k) Internal Revenue Code			514, 228. 34
Decrease due to credit for foreign taxes paid, recomputed: New sec. 131 (k) Internal Revenue Code			52, 216. 24

EXHIBIT G

Technical application of bill to actual figures and facts fiscal years of the company ended Nov. 30, 1947 and 1949

Fiscal year ended Nov. 30, 1949, net operating loss:		
Net income per return filed		$110, 418. 03
Adjustments per sec. 122 (d) Internal Revenue Code exceptions, additions, and limitations		None
Less foreign dividend income: Dividend from English subsidiary		174, 793. 50
Net operating loss if net foreign income is excluded (not deductible but does entitle taxpayer to benefits of new sec. 131 (k) Internal Revenue Code)		64, 375. 47
For information—tax computation per return as filed:		
Net income		110, 418. 03
Normal tax and surtax (38 percent)		41, 958. 85
Less credit for income taxes paid to foreign countries:		
Great Britain (tax rate is in excess of United States rate):		
Amount of dividend received in 1949	$174, 793. 50	
Limitation on credit: $174,793.50/$110,418.03 ×$41,958.85		66, 421. 53
Amount of foreign tax credit lost (see note)		24, 462. 68
Fiscal year ended Nov. 30, 1947, recomputation of credit for foreign taxes paid, under new sec. 131 (k) Internal Revenue Code:		
Net income per return filed		2, 540, 008. 95
Less net operating loss for year ended Nov. 30, 1949 (none allowable)		None
Total		2, 540, 008. 95
Plus carry-back of 1949 foreign dividend income: Dividend from English subsidiary		174, 793. 50
Net income corrected		2, 714, 802. 45
Less—excess of net long-term capital gain over net short-term capital loss		2, 919. 75
Remainder		2, 711, 882. 70
Normal tax and surtax:		
Taxes on amounts excluding excess of net long-term capital gain over short-term capital loss (38 percent)		1, 030, 515. 43
Tax on excess of net long-term capital gain over short-term capital loss (25 percent)		729. 94
Total		1, 031, 245. 37
Credit for foreign taxes paid:		
Great Britain (tax rate is in excess of United States rate):		
Amount of dividend received in 1947	None	
Amount of dividend received in 1949	$174, 793. 50	
Total	174, 793. 50	
Limitation on credit: $174,793.50/$2,714,802.45×$1,031,245.37		66, 396. 73

Technical application of bill to actual figures and facts fiscal years of the company ended Nov. 30, 1947 and 1949—Continued

Credit for foreign taxes paid—Continued		
Brazil (tax rate is less than United States rate):		
Amount of dividend received in 1947	$21, 367. 52	
Amount of dividend received in 1949	None	
Total	21, 367. 52	
Limitation on credit: $21,367.52/$2,714,802.45×$1,031,245.37	8, 116. 93	
Amount of Brazilian taxes actually paid:		
For 1947	5, 061. 24	
For 1949	None	
Total	5, 061. 24	
Use lesser amount		$5, 061. 24
Canada (tax rate is in excess of United States rate; provincial income taxes are includible):		
Amount of net income from Canadian division during 1947	$116, 880. 91	
Limitation on credit: $116,880.91/$2,714,802.45×$1,031,245.37		44, 398. 21
Total credit for foreign taxes paid, recomputed		115, 856. 18

SUMMARY

Income tax for 1947, prior to foreign tax credit, prior to new sec. 131 (*k*) Internal Revenue Code	964, 423. 84
Less total credit for foreign taxes paid, recomputed under new sec. 131 (*k*) Internal Revenue Code	115, 856. 18
Balance of income taxes for 1947	848, 567. 66
Balance of income taxes for 1947, after foreign tax credit, prior to new sec. 131 (*k*) Internal Revenue Code	915, 365. 32
Decrease, 1947 taxes, due to credit for foreign taxes paid, recomputed, new sec. 131 (*k*) Internal Revenue Code	66, 797. 66
Less increase in 1949 taxes, due to disallowance of foreign tax credit for that year	41, 958. 85
Net decrease (see note)	24, 838. 81

NOTE.—In explanation of the small difference in these two figures, namely $24,462.68 and $24,838.81, it must be stated it arises because of various differences and ratios between the 2 years 1947 and 1949. In actual practice this occurs continually. If all extras are eliminated, and only the necessary facts in a simple illustration are used, the difference disappears.

STATEMENT OF EDWARD H. KRUSE, JR., IN BEHALF OF THE WAYNE PUMP CO. OF FORT WAYNE, IND., ASSISTED BY A. F. KALIKER, ASSISTANT SECRETARY, THE WAYNE PUMP CO.

INTRODUCTORY

Mr. Chairman and gentlemen of the committee, having full appreciation and respect for the task confronting the Senate Finance Committee at this time, I shall endeavor to be as brief and concise as possible.

STATEMENT OF CASE

I appear before you at this time in connection with a proposed amendment to section 131 of the Internal Revenue Code. This section of the code relates to allowance of credit for income, war-profits, and excess-profits taxes paid to foreign countries and possessions of the United States. More particularly, the proposed amendment, which I shall submit herewith, relates to the treatment under section 131 of the taxes paid to a foreign country during a taxable year in which the taxpayer has a net operating loss, or would have had a net operating loss had the foreign dividends or income been excluded in computing gross income.

It is recognized that a complete and thorough discussion of the problem would entail considerable time. In view of the time element, I shall confine myself to a presentation of those factors deemed pertinent to the problem at hand.

STATEMENT RE COMPANY

First of all, I wish to say that I appear as counsel for and in behalf of the Wayne Pump Co., of Fort Wayne, Ind. The Wayne Pump Co. is engaged in the manufacture and sale of gasoline filling-station equipment, hoists, air compressors, hose reels, airport equipment, and related items.

The company has been in existence since 1891, and at the present time has two active foreign subsidiaries, one active domestic subsidiary; and one active foreign division. The subsidiary corporations are located in London, England, Rio de Janeiro, Brazil, and Cincinnati, Ohio; the division is located in Toronto, Canada. The Wayne Pump Co. is thus in position where it may receive income from sources both within and without the United States.

OPERATIONAL HISTORY RE CASE

The company has been a very successful enterprise throughout the years; however, during the year 1948 the parent corporation suffered reverses and ended the year with an over-all net operating loss. In 1949 the company suffered a net loss on its United States operation. During both of these years the parent corporation received dividends from its foreign subsidiaries. During 1948 it realized net income from its Canadian division; in 1949 it suffered a loss from its Canadian division.

THE PROBLEM

The officials of the company learned during this period of time that under the provisions of section 131 of the code that they were not permitted to utilize the credit for foreign taxes paid in a loss year; whereas they are permitted under present law to utilize this credit against the tax in years of income. This peculiar situation is the crux of our problem; furthermore, it may be stated definitely that the situation is one in which a hardship is worked upon the company.

THE TAX CREDIT

As a general rule, citizens and domestic corporations are taxable on all of their income whether of domestic or foreign origin. In order to encourage investment abroad and to prevent double taxation of foreign income, there is allowed under present law a "credit" against the United States income tax for income, war-profits, or exess-profits taxes paid or accrued during the taxable year to any foreign country or possession of the United States. This credit is actually applied—or deducted—from the Federal income tax determined for the taxpayer involved.

As a prerequisite to the use of such credit, a domestic corporation must own a majority of the voting stock of a foreign corporation from which it receives dividends in a taxable year. For the purposes of the foreign tax credit, a domestic corporation thus receiving dividends is deemed to have paid the income, war-profits, or excess-profits taxes which have been paid by the foreign subsidiary—to the extent that they are allocable to the dividends received by the domestic parent.

CREDIT VERSUS DEDUCTION

For purposes of the problem at hand, and in order to help illustrate the peculiar inequity involved, it is necessary that we distinguish between the credit for foreign taxes and a deduction for foreign taxes.

As a deduction, the foreign taxes paid are deducted from gross income in determining the net income upon which the tax is to be computed; but, as a credit against the tax, the allocable amount of foreign taxes paid are deducted from the over-all income tax itself. It may be seen that the credit provision is in some respects more valuable than the provision for deduction. However, it should be carefully noted that a taxpayer is in no position to take the credit in years of loss for the reason that there is no Federal tax against which to apply the credit. Thus, a deduction, though less valuable, is certainly far more valuable than no credit at all. Furthermore, in years when the domestic parent receives dividends from a foreign subsidiary but has an over-all net operating loss, the credit for foreign taxes is lost altogether. A deduction may be carried back to a taxable year; a credit cannot be so treated.

Certain other provisions in present law relating to credits and deductions are necessarily of importance in any consideration of this problem. Earnings or income received from a foreign branch or division is received in the form of net income and not as dividends. In such a case the net income is taxable When earned. The tax on net income may be taken or treated as either a deduction or or a credit. Therefore, under present law this situation works out equitably regardless of whether or not the parent corporation has over-all net income or loss.

Earnings or income received from a foreign subsidiary corporation is received in the form of dividends and not as net income. In such a case the dividends are taxable when received by the parent corporation. A parent corporation cannot as a general rule control the receipt or payment of these dividends from a foreign subsidiary—so that instances may arise when the dividends are received, as in our case, in a year when the parent corporation has a net operating loss. However, in this case, as contrasted to the treatment available for net income, a credit may be taken for the tax paid only in years when the parent corporation has net income. In years of loss, the credit is lost; and, furthermore, the foreign taxes paid in such case may never be taken or treated as a deduction.

SITUATIONS: I. THE SUBSIDIARY

Let us now examine particular case situations wherein the principles in question may be well illustrated. In the case wherein the corporate structure includes a subsidiary from which dividends are received, the allocable amount of foreign taxes paid may be taken only as a credit. The foreign tax in this case may not under any circumstances be taken as a deduction. This works favorably when the domestic parent has net income, but unfavorably in years of loss—when most needed.

SITUATIONS: II. THE FOREIGN DIVISION

In the case wherein the corporate structure includes a foreign branch or division from which income is received, the allocable amount of foreign taxes paid may be taken or treated as either a deduction (from income) or as a credit (against the tax).

Under no circumstances, however, may the taxpayer, civilian or corporate, take or treat these foreign taxes in the taxable year as both a deduction and a credit.

SITUATIONS: III. SUBSIDIARY PLUS DIVISION (WAYNE PUMP)

In a case such as ours, wherein the corporate structure includes both a foreign subsidiary and a foreign branch or division, the domestic parent must elect for any taxable year whether to treat the foreign taxes paid as a deduction or as a credit. In view of present law, the company will naturally treat the taxes as a credit (against the tax) in years of net income; in years of net operating loss this credit will be lost completely, since there is no federal tax against which to apply the credit—and also because a foreign tax in this instance (i. e., tax on subsidiary dividends) cannot be treated as a deduction.

SUMMATION AND EXHIBITS

One further point in connection with this situation is the fact that any dividends received from a foreign subsidiary are includible in the computation of the domestic parent's gross income, thus increasing the taxable base in years of both income and loss. But, strangely enough, the credit for the tax on these same dividends may be taken only in years of income.

It appears to us that if a credit for foreign taxes paid by a subsidiary is proper and allowable in any instance—and apparently such is the case—then it would certainly appear that the credit should be granted in years of net operating loss when the parent corporation obviously needs it most. The parent corporation, under present law, is in effect penalized for suffering a loss year.

Certainly it was not the intent of Congress to extend less advantageous treatment on a related item to a corporation suffering losses than when it is learning taxable income. Such appears contrary to the very purpose of section 122: Net Operating Loss Deduction.

The situation may be illustrated in statement form as follows, Exhibit B:

EXHIBIT B

Situation in statement form

	Case A: The Wayne Pump Co.	Case B: Same aggregate net income as case A, but no loss in either year (see note)	Case C: Same as case A, but foreign income is from branch
Fiscal year ended Nov. 30, 1948:			
Dividends from foreign subsidiary (England)	$137,000	$137,000	
Net income from branch (Canada)			$137,000
Other gross income	2,749,000	3,749,000	2,749,000
Total	2,886,000	3,886,000	2,886,000
Deductions	3,376,000	3,376,000	[1] 3,428,000
Net income (loss)	490,000	510,000	542,000
Federal income tax (38 percent)	None	193,800	None
Less credit for foreign taxes paid ($137,000×38 percent)	None	52,060	None
Tax after foreign tax credit	None	141,740	None
Fiscal year ended Nov. 30, 1946:			
Net income	1,998,000	998,000	1,998,000
Net operating loss deduction, 1948 above	490,000	None	542,000
Net income after carry-back	1,508,000	998,000	1,456,000
Federal income tax (38 percent)	573,040	379,240	553,280
Comparisons			
Aggregate net income 1946 and 1948	1,508,000	1,508,000	1,456,000
Aggregate Federal income tax 1946 and 1948	573,040	520,980	553,280
Less aggregate Federal income tax 1946 and 1948—Case B	520,980		520,980
Additional Federal income taxes paid on the same amount of aggregate net income because of loss of credit for foreign taxes paid	52,060	None	32,300

[1] See the following:

Deductions case A	$3,376,000
Plus deduction for Canadian income taxes ($137,000×38 percent approximate)	52,000
Total	3,428,000

CASE B NOTE.—The amounts are the same as those in case A except that, for comparative purposes, net income for the fiscal year ended Nov. 30, 1948, has been increased $1,000,000 and net income for the fiscal year ended Nov. 30, 1946, has been decreased $1,000,000. The aggregate net income for the 2 years is the same for both cases A and B.

It is proposed that the present inequitable situation could be remedied by the following amendment, exhibit C:

EXHIBIT C

A BILL Relating to the treatment under section 131 of the Internal Revenue Code of taxes paid to a foreign country during a taxable year in which the taxpayer has a net operating loss

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That section 131 of the Internal Revenue Code (relating to taxes of foreign countries and possessions of the United States) is hereby amended by adding at the end thereof the following new subsection:

"(*k*) *Taxes paid in year of net operating loss.*—If income, war profits, and excess-profits taxes imposed by a foreign country or a possession of the United States are paid or accrued during a taxable year for which the taxpayer has a net operating loss (as defined in section 122 (a)), or would have had a net operating loss if the net income in respect of which such taxes were imposed by the foreign country or possession of the United States was excluded in determining the amount of the net operating loss under section 122 (a), then—

"(*l*) Such taxes shall be considered, for the purposes of this section, as having been paid or accrued during the last taxable year of the taxpayer to which any amount of such net operating loss is carried back or carried over under the provisions of section 122 (b), or would have been carried back or carried over had a net operating loss resulted through the exclusion of the net foreign income in the actual year of receipt; and

"(2) For the purposes of applying subsection (b) of this section, the net income or normal tax net income of such last taxable year shall be computed by including the net income in respect of which such taxes were imposed by the foreign country or possession of the United States."

SEC. 2. The amendment made by this act shall be applicable in computing the credit allowed under section 131 for taxable years ending after December 31, 1945 (including any case where taxes paid or accrued in a taxable year beginning prior to such date are considered under the amendment as having been paid or accrued in a taxable year ending after such date). If the application of this amendment results in a credit or refund to the taxpayer, a claim for credit or refund will be timely filed if filed within the provision of section 322 (b) (6), or within 1 year from the enactment of this amendment, whichever is later.

The effect of the proposed amendment would be to permit the taxpayer, in our case the domestic parent, to apply the credit to the last taxable year to which any amount of net operating loss is carried back or over under the provisions of section 122 (b). This may be illustrated as follows, exhibit D:

EXHIBIT D

Situation in statement form (after bill)

	Case A: The Wayne Pump Co.	Case B: Same aggregate net income as case A, but no loss in either year	Case C: Same as case A, but foreign income is from branch
Fiscal year ended Nov. 30, 1948:			
Dividends from foreign subsidiary (England)	$137,000	$137,000	
Net income from branch (Canada)			$137,000
Other gross income	2,749,000	3,749,000	2,749,000
Total	2,886,000	3,886,000	2,886,000
Deductions	3,376,000	3,376,000	3,376,000
Net income (loss)	490,000	510,000	490,000
Federal income tax (38 percent)	None	193,800	None
Less credit for foreign taxes paid ($137,000×38 percent)	None	52,060	None
Tax after foreign tax credit	None	141,740	None
Fiscal year ended Nov. 30, 1946:			
Net income	1,998,000	998,000	1,998,000
Net operating loss deduction, 1948 above	490,000		490,000
Net income after carry-back	1,508,000	998,000	1,508,000
Federal income tax (38 percent)	573,040	379,240	573,040
Less credit for foreign taxes paid ($137,000×38 percent)	52,060		52,060
Tax after foreign tax credit	520,980		520,980
Comparisons:			
Aggregate net income 1946 and 1948	1,508,000	1,508,000	1,508,000
Aggregate Federal income tax for 1946 and 1948	520,980	520,980	520,980

NOTE.—The same aggregate Federal income tax is now paid in all three cases on the same aggregate net income.

In conclusion, Mr. Chairman, I should like to thank you and the other members of the committee for your courteous attention during the presentation of our case.

Senator KERR. Mr. Ketcham, will you give your name and identification?

STATEMENT OF FRANK S. KETCHAM, THE TENANT-OWNED APARTMENT ASSOCIATION, INC.

Mr. KETCHAM. My name is Frank S. Ketcham. I am appearing on behalf of the Tenant-Owned Apartment Association, Inc., of New York.

Mr. Chairman, if I might have the complete statement filed in the record, I will take about 2 minutes of your time by reading just a portion.

Senator KERR. We will be glad to have the complete statement in the record.

Mr. KETCHAM. It is in support of section 303 of H. R. 4473 that I am appearing. Section 303, in substance, is a relief provision intended to eliminate a hardship under existing law which now provides that when a personal residence is sold at a gain the difference between its adjusted basis and the sale price is taxed as a capital gain even though the seller immediately purchases substantially identical property. Often such transactions are necessitated by a change in the taxpayer's place of employment or the size of his family. The taxpayer simply sells his old residence and buys a new one at the same time with the result that he does not receive any cash or liquid assets with which to pay the income tax. The transaction is essentially an involuntary conversion. Relief is needed particularly now during this period of mobilization when changes in the place of employment of many home owners are necessitated by our defense program.

Section 303 of H. R. 4473 does not propose to deal with this hardship by eliminating the tax altogether on capital gain from the sale of personal residences. Section 303 merely provides that whenever the new residence is bought within the year prior to or subsequent to the sale of the old residence, the capital gain will be recognized only to the extent that the selling price of the old residence exceeds the purchase price of the new residence. The adjusted basis of the new residence is reduced to the extent that capital gain on the sale of the old residence is not recognized, so that the basis for the new residence is the basis of the old residence plus the additional funds invested.

Senator TAFT. If you simply sell a residence and do not buy another one, then you pay the capital gains tax just as you did before?

Mr. KETCHAM. Yes, sir.

Senator TAFT. This applies only where you buy another home within the year?

Mr. KETCHAM. Within the year.

Generally speaking, the effect of this arrangement is that the entire capital gain will ultimately be recognized whenever the taxpayer sells his residence without purchasing a substitute residence. Usually that will be the first occasion on which the taxpayer will have funds available to pay the tax.

Under section 303, stock in a cooperative apartment corporation will be treated as the equivalent of ownership of a residence, provided the taxpayer occupied the apartment as his principal residence. Under the existing law, sale of a tenant's cooperative apartment stock by which he holds his personal residence is subject to capital-gains tax just as is the individual's personal residence. Consequently the cooperative tenant-stockholder is in need of relief just as is the individual homeowner.

Senator KERR. Does the law as it came over from the House recognize the stockholder in a cooperative arrangement?

Mr. KETCHAM. Yes, sir. In both the majority and the minority report, they favored the provision.

Senator KERR. Yes.

Mr. KETCHAM. That is all. Thank you, Mr. Chairman.

Senator KERR. We thank you for your appearance, Mr. Ketcham.

(The prepared statement of Mr. Ketcham is as follows:)

STATEMENT OF FRANK S. KETCHAM ON BEHALF OF TENANT-OWNED APARTMENT ASSOCIATION, INC., IN SUPPORT OF SECTION 303 OF H. R. 4473

I am a member of the bars of the State of New York and the District of Columbia and appear here on behalf of the Tenant-Owned Apartment Association, Inc. of New York City. The Tenant-Owned Apartment Association, Inc. is a business association which was formed in 1928 to enable New York real estate companies engaged in the organization, sale and management of cooperative apartment buildings to exchange information and to promote their mutual interests. The Association is the only organization wholly concerned with the welfare of cooperative housing projects. Its management members manage one hundred and twenty-odd buildings in New York City, containing about 4,800 apartments.

It is in support of section 303 of H. R. 4473 that I am appearing. Section 303, in substance, is a relief provision intended to eliminate a hardship under existing law which now provides that when a personal residence is sold at a gain the difference between its adjusted basis and the sale price is taxed as a capital gain even though the seller immediately purchases substantially identical property. Often such transactions are necessitated by a change in the taxpayer's place of employment or the size of his family. The taxpayer simply sells his old residence and buys a new one at the same time with the result that he does not receive any cash or liquid assets with which to pay the income tax. The transaction is essentially an involuntary conversion. Relief is needed particularly now during this period of mobilization when changes in the place of employment of many homeowners are necessitated by our defense program.

Section 303 of H. R. 4473 does not propose to deal with this hardship by eliminating the tax altogether on capital gain from the sale of personal residences. Section 303 merely provides that whenever the new residence is bought within the year prior to or subsequent to the sale of the old residence, the capital gain will be recognized only to the extent that the selling price of the old residence exceeds the purchase price of the new residence. The adjusted basis of the new residence is reduced to the extent that capital gain on the sale of the old residence is not recognized, so that the basis for the new residence is the basis of the old residence plus the additional funds invested. Generally speaking, the effect of this arrangement is that the entire capital gain will ultimately be recognized whenever the taxpayer sells his residence without purchasing a substitute residence. Usually that will be the first occasion on which the taxpayer will have funds available to pay the tax.

Under section 303, stock in a cooperative apartment corporation will be treated as the equivalent of ownership of a residence, provided the taxpayer occupied the apartment as his principal residence. Under the existing law, sale of a tenant's cooperative apartment stock by which he holds his personal residence is subject to capital gains tax just as is the individual's personal residence. Consequently the cooperative tenant-stockholder is in need of relief just as is the individual homeowner.

The similarity between the circumstances of the individual homeowner and the cooperative tenant-stockholder has been recognized by the Congress in the enactment of an important relief provision. Section 23 (z) of the Internal Revenue Code permits tenant-stockholders in cooperative apartments to deduct their portion of real estate taxes and interest on indebtedness incurred in connection with the land and buildings. Senate Report No. 1631, Seventy-seventh Congress, Second Session, page 51, explained that the purpose of section 23 (z) was to place tenant-stockholders in the same position as individual homeowners who were, of course, permitted the deductions under sections 23 (b) and (c), Internal Revenue Code.

The Tax Court also has recognized the similarity between the economic situation of the cooperative tenant-stockholder and the individual homeowner. U. S. Treasury Regulation 111, section 29.23 (e) (1) (1943), provides that a loss on the sale of the taxpayer's personal residence is not deductible. Similarly, the Tax Court has held that a loss sustained on the sale of cooperative apartment shares could not be deducted because it was neither incurred in a profit-making transaction, nor in a trade or business (*Cecil P. Stewart*, 5 CCH TC Mem. Dec. 229, 46,077 P-H Memo TC (1943)).

Therefore, cooperative apartment tenant-owners and individual homeowners are recognized by the Federal income tax law as being in substantially the same economic position in two important respects:

(1) deductions for interest and real property taxes; and (2) capital gain or loss on sale or exchange.

Section 303 of H. R. 4473 met with full approval in both the majority and minority reports of the House Ways and Means Committee. I respectfully request that this committee likewise approve this relief for residence-owners who suffer from extreme and often unavoidable hardship under the existing law.

Senator KERR. Mr. Cardwell, you may give your name and identification to the stenographer, please.

STATEMENT OF WALTER T. CARDWELL, COMMERCE AND INDUSTRY ASSOCIATION OF NEW YORK, INC.

Mr. CARDWELL. My name is Walter T. Cardwell, and I am here as a member of the tax committee of the Commerce and Industry Association of the city of New York, representing that association.

The Commerce and Industry Association of New York is the largest trade organization in the New York metropolitan area, representing over 3,500 New York City firms of every size and type of business.

Mr. Chairman, our statement is probably a little long, and I would like to conserve your time. With that in view, I would like to cover these pages rather rapidly.

Senator KERR. That will be fine. And your entire statement will be inserted in the record.

Mr. CARDWELL. Yes, sir.

Along with the rest of the country, we realize that we face many years of very high taxes. With that in view, we feel that it is absolutely essential that our tax bills be drawn in a way that will give us the needed revenue and will give maximum security to all classes of our people.

We have a feeling in our association that we are about to reach the end of the line in the raising of the income taxes. We heard the gentleman of the CIO yesterday speak of the heavy load of taxes on the low income class of people. We recognize that. It is very difficult for a man receiving $100 a week and having two or three children to be faced with the proposal that he pay high income taxes. We do not see how he can, in our present economy.

On the other hand, less than 4 percent of our taxpayers are paying about 42 percent of the total income taxes today. We do not see how you can increase the income taxes on those people safely. I know it is common to the experience of Senators that executives today of their own acquaintance are retiring and saying it is not worth the effort. I meet them every day, and I know you do.

There comes to mind the only source of revenue other than income taxes and corporate taxes, and that is the excise tax. Our association in its tax committee has had many discussions. We realize that your committee has expressed opposition to a sales tax which is pyramided and passed in the price of goods on to the consumers.

While a general retail sales tax might tend to avoid that, and in the larger sales establishments, merchandising or trade, or whatever it may be, it would be easily enforced, when you reach the little hole-in-the-wall establishment, than your enforcement breaks down, unless you have an army of enforcement officers.

A disregard of the tax, of course, ultimately breeds contempt for all law, and your whole tax system breaks down.

For that reason, our association favors a manufacturers' excise tax in that it would fall upon a smaller number of establishments, some 300,000, probably.

Now, we feel that it is possible for the Congress to establish such safeguards around such a tax as would avoid the pyramiding of that tax to the ultimate consumer. We have all kinds of controls that are established by the Congress today to protect the public. We do not believe that it is impossible to create such controls in a manufacturers' excise tax. We think it could be done. We feel that the tax should be on everything, with the possible exception of food and one or two other items. We are willing to exclude the liquor and tobacco taxes, simply as a practical, realistic approach, but beyond that, we think that all the excise taxes should be across-the-board.

We believe that we should strive more and more to return to taxation for revenue and less for other purposes.

We believe that the people of the country should have the choice of how they spend their money, and it is up to them to save it. We do not believe that one industry should be taxed 20 percent or 25 percent and another go free, and another be taxed 5 percent or another 2 percent.

We feel that the Congress should reexamine the budgetary needs of our country and should make every effort to cut the appropriations. In our statement here we have even gone so far as to suggest a law to suspend the present appropriations. That probably goes too far. I do not know.

Now, we feel that if we used about a 7½-percent tax rate in lieu of our present selected excise taxes, we would in that way gain about $3 billion out of this proposed revenue. If we remember that for each point of excise tax, as was pointed out yesterday—and our studies show the same thing, that each point in the excise tax would give us about $1 billion of revenue, we feel that the excise taxes as proposed in the bill could be sharply reduced and should be.

With respect to the personal income tax, we believe that they can be added to at the rate of a point increase in each rate rather than a 12½ percent as proposed by the House.

We favor a lower rate of increase and such as would probably produce something in excess of $1 billion of additional revenue from the individuals. We are told that next year we will have to produce more taxes, more revenue. We are facing a defense program in the country, but we do feel that ultimately the books must be closed, we cannot go on in a Ponzi-like plan of government much longer.

We feel that the proposed taxes on corporations are excessive. The proposed increase of 5 percent added to the increases last year, when they fully become effective, would more than double the tax on corporations, and the tax on corporations would rise from $10,800 million on the 1949 income to over $21 billion on 1951 income

It is our proposal that the proposed rate not exceed 3 percent, which would be a combined rate of 50 percent, which, as again pointed out in our statement, is higher than the highest rate in World War II.

We oppose this becoming effective at the beginning of the year. We think it should be effective at the end of the year and would meet the Government's demands adequately.

We are opposed to a reduction in the excess-profits-tax credit. We see no reason for it. We might just as well allow the full credit and increase the rate if that be necessary.

This association, when the excess-profits tax of 1950 was under consideration, opposed the excess-profits-tax bill and suggested in lieu of it a flat percentage as a defense tax. We understand that Canada has done just exactly that.

We did so for this reason. It now takes 6 printed pages to determine the excess-profits-tax credit of corporations under the present bill and the tax computations that go with it. This association would have added one line to the corporation income tax blank, the Form 1120, and would simply have taken a flat percentage of the normal and surtax, meaning that if a corporation made $1, it contributed a percentage of it to the defense tax.

We say under the Excise Profits Tax Act that does not occur. The corporations that are best able to pay the tax are the ones who pay the least, and the corporations that had poor experience in the base period--some did—will have to pay the most.

One other provision in the bill, section 123, proposes to limit an affiliated or related group of corporations to only one surtax exemption and one minimum credit of $25,000 under the excess profits tax. The House estimates that that will produce $55,000,000 of revenue.

The bill as drawn makes it so easy to avoid it in one way. For parent of a subsidiary affiliation, the bill states that if the parent owns 95 percent directly of the subsidiary, and through that, a chain of corporations, it shall receive but one surtax exemption and one minimum credit of $25,000 under the excess profits tax. All that parent need to do to break the the chain is to sell one percent of the stock and own 94 percent.

When it comes to common control, I think that every Senator here must in his own experience have knowledge of this. I doubt if there is a town or a city in this country, a small city, that does not have in it one or more individuals who either by inheritance or over the years have accumulated some small capital. They may want to open up an electrical supply business, a plumbing shop, or a lumber yard. If that man now sets up three corporations for that, he is to receive only one surtax credit and one $25,000 exemption.

Now, for more than a decade and a half, the Congress realizes that, as rates become higher and higher, it is important for the small business of this country to grant them some kind of favored treatment to permit growth. To that end, we had lower rates on corporations under $50,000. Last year that was knocked out and there was substituted the $25,000 surtax exemption.

Now, the present bill in many of these situations will take that away. The House estimates $55 million. We say that, instead of collecting $55 million, this bill will cost the Government in revenue and will absolutely put to an end all of these efforts of small men all over this country to start new businesses.

How can you start a business when you estimate that you may make $5,000, $10,000, or $15,000, and your surtax is going to be at the present rates? Under the old days, you could not have had it, and the Congress realized that. We say that this bill will put a stop to expansion and growth.

The Treasury has expressed violent opposition to so-called multiple corporate set-ups in this country, and has attacked those set-ups in the courts. The Congress itself has expressed some opposition to split-up businesses. Now, there are certain large enterprises that it is not possible to split up into corporations. They do not lend themselves to such a division. But you can take an expanding chain operation in this country, opening up merchandising operations, retail stores throughout the country. Those locations, those outlets, are subject to all the competitive hazards of all similar operations in those communities. Oftentimes they rent a store across the street from a man who has a similar business. They employ local help. They finally end up with a local citizen who becomes a manager, often, of that store.

Now, we say that those are natural divisions of enterprise, and there should be no reason whatsoever for the Congress to deny that corporation its $25,000 surtax exemption, nor should it deny to it a similar amount for excess-profits tax credit.

We think that the Treasury will simply confuse and aggravate the business of the country without obtaining the revenue. We see no reason why it should.

Where there have been split-ups, if they serve no purpose whatsoever than to avoid tax, then we have in section 129 and section 45 in the code today ample weapons for the Treasury to use. Where they fail in their efforts to apply those, then they should fail. And so far in most instances they have.

Other provisions in the bill have already been covered by others who have appeared. One is the withholding of dividends. We agree with the other speakers. We think that the failure to report by the citizens of this country is exaggerated.

We feel this. How can you reduce the administrative force of Government when you pass laws that involve you in almost endless bookkeeping? These things cannot be done without human effort, and if you collect millions of dollars from hundreds of thousands of stockholders of corporations, some of whom do not owe the tax, then you must refund their money, and that means more employees on the payrolls to administer the tax.

We are opposed to the proposed change in short- and long-term capital gains and losses. We feel, like the others who have appeared here, that the present provision should be left alone, or even lightened.

On collapsible corporations, the House bill attempts to cure the use of abuses through collapsible corporations. That is another feature that we think should not be in the bill. The proper administration of existing laws will reach any sham transactions.

We think that the House bill has picked out a few isolated situations that occur at long intervals. We think they have no place in the revenue bill.

In that connection, the House bill proposes to disallow or to control the sale of property by stockholders of a corporation to that corporation. Now, what earthly difference should it make whether you own a building and sell it to a corporation or sell it to a complete stranger, or whether your corporation sells that or buys it from a complete stranger?

If the price is not fair and is excessive, then the excessive withdrawal of funds from a corporation would be treated as a dividend or as income

to the stockholders. We say that the opportunities to do these things do not occur with such frequency that they should be even challenged in the first place. Secondly, they should not be incorporated in a tax law.

In the second place, we see no reason why they should be questioned in any event. Computations will show that the present payment of a long-term gain tax will, in the case of depreciation deductions at the normal rates from a corporation over the life of a building, make it very much to the disadvantage of the owners of that building to engage in that transaction. The present worth of the dollar will show that the Treasury will not gain in revenue, but will lose by it.

We think that the House is to be commended for one provision in the bill which eliminates the capital-gains tax on the sale of a personal residence when a new residence is purchased. It eliminates inequity arising because of the inflation in the cost of residences. We think that the House is to be commended for saying to a man, "If you sell your house and take the proceeds to invest in another house, we will not tax you."

Senator KERR. You think that is welcome?

Mr. CARDWELL. Yes; I do.

Senator KERR. Very well, Mr. Cardwell. We thank you.

Mr. CARDWELL. Thank you, gentlemen.

(The prepared statement of Mr. Cardwell is as follows:)

STATEMENT BY MR. WALTER T. CARDWELL, MEMBER OF ASSOCIATION'S COMMITTEE ON TAXATION AND PUBLIC REVENUE AND MANAGER, TAX DEPARTMENT, S. D. LEIDESDORF & CO.

The economy and continued defense program threatened by excess spending

This country is embarking on a long-term rearmament program, vital to its very existence. The maximum rate of spending for this program has not been reached and, in fact, will not come until 1953. If the current high level of nondefense spending is imposed on top of the rearmament program, the public reaction to this increasingly heavy tax burden will generate such pressure on Congress that severe cut-backs will be required in the defense effort. The history of this country indicates that this will be particularly true of a long-range program, such as is now contemplated, which may last from 10 to 20 years. Complacency with regard to the defense effort and public opposition to heavy taxes can be averted only if the American taxpayer is convinced that he is paying for efficient Government with heavy unnecessary expenditures eliminated or deferred.

Unnecessarily high taxes, particularly if inequitably imposed, likewise can ruin our long-term rearmament effort by upsetting and hampering our whole economy. Survival of the free nations of the world depends on the continued maintenance of a healthy economy in this country, with sufficient war potential to discourage aggression and to meet it fully if and when it occurs. It cannot be stressed too strongly that a cease-fire in Korea will not assure world peace and that our rearmament must continue at a high level.

Congress is to be commended for its current attempt to cut the fat from President Truman's $71 billion budget. A good start has been made in cutting $1 billion in seven appropriation bills. Further cuts still can be made. We are convinced that a total of $7 billion to $10 billion can be eliminated from the present budget without affecting essential Government services.

In appearing before your committee, the Assistant Budget Director blamed his high spending on the continuing programs approved by Congress. This is indeed part of the story. To meet this problem effectively, we strongly urge a "clean slate" approach. This can be accomplished by a law suspending every expenditure or appropriation except for direct military- and international-aid items. Congress could then reexamine the suspended fiscal program and make new authorizations only for those that meet the test of being absolutely essential. This forced reexamination of current spending in no way would affect justified programs, as they could immediately be restored.

The other part of the expenditure story not admitted by the Bureau of the Budget is that there definitely is overlapping and duplication in the Federal Government. By cutting back on unnecessary Government personnel, by eliminating many loan and grants-in-aid programs, by deferring most public-works projects and instituting real efficiency in the Department of Defense, the estimated budget saving can be made.

New taxes levied to meet essential budget

We are strongly in favor of continuing the pay-as-you-go policy. In enacting new taxes, however, revenues should be sought to meet only an essential budget. The Senate Finance Committee therefore can point the way to further reductions in the present budget. It is estimated that a budget of $62 billion or $63 billion could be achieved. If revenues from current taxes will yield $58½ billion, it is clear that the present tax bill then need only bring in additional revenues of from $4 billion to $5 billion to balance the budget.

Further tax increases doubtless will be required next year as maximum defense spending is approached. This points up the importance of making the present tax measure a sound one. Chairman Doughton's statement that this will be the last tax bill surely cannot be taken seriously and, for that reason, we are urging drastic revisions in the current proposal.

General comments concerning the proposed Revenue Act of 1951

This bill is based on political expediency. It ignores economic reality in an attempt to convince the mass of American taxpayers and voters that someone else is paying for the defense effort. It blithely calls a number of tax provisions "loopholes" and adds taxes that will have serious effects on many segments of our economy.

Congress must face the stark reality that the majority of taxable incomes—in fact, 56 percent—lie under the $5,000 level and 78 percent are below the $10,000 level. Confiscation of high incomes and unreasonable corporation taxes will not produce needed revenues in the long pull. A tax program must be devised and sold to the American people which will make every citizen adequately support the Federal Government.

Broad excise tax strongly advocated

It is widely recognized that the only source of substantial revenues which has not been tapped in our present tax structure is through a broad excise. We strongly urge that such a tax be incorporated in this bill. With a current labor force exceeding 63 million, only 44 million pay income taxes. Thus, some 20 million people give only nominal indirect support to our Government. A broad excise at a reasonable rate would reach every citizen equitably and would avert the danger inherent in the present tax bill of overloading the burden on existing sources of revenue.

We favor a broad excise, as contrasted to the high rate selective excises now in effect or proposed in this bill, because—

1. Many current selective excises do not cover "luxuries" but fall on regular consumer goods. It is in inequitable both to the producer and the consumer to apply excises to certain consumer products while leaving comparable items untaxed. Selective excises may have a valuable function in controlling consumption of certain products, but we do not believe this should be the basic objective of a tax bill. Material controls and credit restrictions accomplish that result.

2. A broad excise on all goods except food would have a much more valuable effect in controlling inflation.

3. Revenues from many selective excises will fall off during the coming months as material shortages cause product cut-backs. A broad excise will give much more stable revenues.

As between a manufacturers' and a retailers' excise, we favor the manufacturers' levy for the following reasons:

1. A manufacturers' tax can be administered more easily and effectively. There would be only 300,000 manufacturers paying taxes compared with over 3,000,000 retailers.

2. A retail tax would enter a field historically delegated to cities and States. To impose a Federal retail tax, in addition to the many similar city and State taxes, would lead to numerous difficulties in administration.

3. The objection to hidden manufacturers' excise taxes is met if a broad tax is imposed. Once a uniform tax is applied to all goods purchased except food, all the people will comprehend fully the impact of the tax burden. This is not true under a program of complicated selective taxes.

4. The possible objection that a manufacturers' excise tax might pyramid is counteracted by the fact that in Canada, after a short "shake-down" period, wholesalers and retailers adjusted their mark-ups to eliminate pyramiding.

A broad excise could be levied in one of the following ways:

1. Remove all existing excises, except on liquor and tobacco, and apply the tax uniformly on all products except food. On that basis, a tax of 7½ percent would yield an estimated $7½ billion. Since present excises which would be eliminated account for $4½ billion, the net gain in revenues would be $3 billion.

2. Apply a uniform tax on all products, except food, but leave in effect existing excises that are at a higher rate. Since adequate revenues are the objective, the more feasible method would appear to be to follow this plan and not reduce any existing excises. In that event, a much lower tax of possibly 4 percent at the manufacturers' level would yield $3 billion in added revenues.

A broad excise yielding an additional $3 billion would be adequate at this time and would make possible reduction of the drastic increases now proposed in personal income and corporate returns.

Drastic increase in personal-income rates is unwarranted

The provision in the bill to raise personal income taxes by increasing the tax computed under the present law by 12½ percent is unwarranted. A moderate increase when other taxes are being increased would be equitable.

The rates for high income would be confiscatory under this proposal and, even more important, the increases in the middle-income classes would be so drastic as to reduce incentives. As was vividly pointed out in the minority Ways and Means report, confiscating all income over $25,000 would produce a mere $750 million.

A recent study by a Harvard University economist showed that the present tax levels have important effects among executives; there is a reluctance on their part to change positions or to accept promotions. Proper incentives have been the backbone of this country's economy and should be protected zealously.

To call the 12½ percent increase a temporary defense tax is misleading. When the rearmament effort is clearly a long-term project, "temporary" may be a period of years. Experience with temporary taxes in this country shows that they inevitably become frozen into the tax structure.

The attempt to raise substantial revenues by increasing personal rates demonstrates the need for a broad excise tax. Only by tapping new sources of revenue can the increase in personal rates be kept to a reasonable level which can be sustained safely.

With a broad excise tax imposed at reasonable rates, a 2- or 3-percentage point increase in individual rates would yield needed revenuse of $1.8 billion or $2.7 billion.

Increase in capital gains rates

The proposal to increase capital gains rates by 12½ percent is based on extraordinary reasoning by the House Ways and Means Committee. The committee states that this is necessary in line with the increase in personal rates, ignoring the basic factor that there is no connection between capital gains and ordinary income. Already the Government receives substantial revenues from capital gains which are nothing more than increased prices resulting from inflation. Any change in capital gains treatment is strongly opposed, as it will discourage investments at the very time the country's objective is to attain maximum investment in industrial expansion.

Increase in corporation normal tax excessive

The proposed increase of 5 percent in corporate normal tax is excessive. It should be recognized that corporations already have been saddled with the largest tax boost of all taxable categories through the 1950 Revenue Act, which upped corporate normal and surtaxes from 38 to 47 percent, with a 30 percent excess-profits tax added early in 1951. When these two increases become fully effective, the tax revenues from corporations will be doubled, rising from $10.8 billion on 1949 income to over $21 billion on 1951 income.

Corporations expect to bear a just share of the tax burden in time of emergency. Further drastic increases may defeat the very objective of maximum increased production. There is much loose talk about high corporation profits and little recognition of the following factors:

1. In the past 5 years, 60 percent of corporate profits after taxes have been retained for reinvestment purposes. Corporations today are relying to a great extent on these retained earnings to replace equipment and for expansion; this is

a direct result of the shortage of equity capital which is becoming even scarcer under our present tax structure. Siphoning too great a portion of coprorate profits will hamper industrial expansion or require greatly increased Government or private loans, both of which can lead to unsound corporate finance. In the case of Government loans, it means tax revenues would have to be diverted back to industry.

2. Corporate profits are highly overstated because of two factors. In the first place, depreciation based on the original cost of plant and equipment is far short of the amount that must be set aside to meet the replacement cost. It has been estimated in recent years that depreciation has failed by $2 billion to $3 billion to provide funds for replacing capital equipment. Secondly, the upward price trend means that corporations' inventory profits, resulting from the purchase of raw materials at lower prices and selling the finished product at a higher market price, are paper profits which amounted to approximately $4 billion in 1950. When these two factors are considered, profits in 1950 dropped from $22 billion to an actual profit of only $15½ billion.

3. Corporate profits are often stated in inflated dollars. When compared as a percentage of gross national income, profits are smaller than in many past periods.

We strongly urge that the increase in corporate normal tax be no higher than 3 percent, giving a combined normal and surtax rate of 50 percent which in itself would be 10 percent higher than the highest rate in World War II.

Any change in corporate rates certainly should not be made retroactive, as proposed. Since the increase in corporate rates imposed by the 1950 revenue bill did not become fully effective until July 1, 1951, it would be unrealistic to impose such a burden. To make the increase effective, the end of this year would meet the Government's revenue needs adequately.

Reduction in excess-profits-tax credit opposed

The provision that would decrease the base period excess-profits credit from 85 percent to 75 percent is unconscionable. This is nothing more than an ordinary income tax under the guise of an excess-profits tax. A realistic base period credit would be 100 percent of base period profits and in fact, to be equitable, possibly should be 110 percent because of the deflated value of the dollar.

The mobilization effort will benefit certain corporations through increased production. Many other companies, particularly small business, will find it impossible to maintain the past level of corporate profits because of cut-backs. To impose an excess-profits tax on ordinary income, as is the result when companies do not benefit from the rearmament program, is completely inequitable.

The danger is clearly pointed up by the increase in business failures. Latest figures show these failures to be up 7 percent.

This proposal should be completely eliminated from the bill.

Proposal to limit surtax exemptions and minimum excess-profits credits of related corporations strongly opposed

Section 123 of the bill would limit an affiliated or related group of corporations to only one surtax exemption and one minimum credit of $25,000 under the excess-profits tax. Enactment of this section would deal a severe blow to many corporations, would disrupt the established method of doing business of many firms, and, more important, virtually would halt the expansion of many small businesses.

The estimated revenue of $55 million that would be achieved by adoption of this proposal is insignificant in contrast to the $7 billion sought under the bill and its harmful effects on many businesses would far outweigh the nominal added revenues. In the long run, revenues actually would suffer because of the damper put on expansion. The majority of companies that would be affected are retailers with 2 to 10 stores, small real-estate owners controlling a few properties, and manufacturers with small subsidiaries making various products.

Were this proposed limitation to prevail, the tax increase on small companies would be disastrous, since the larger the profits the smaller the percentage of tax increases, so that a corporation with $500,000 profit would pay only an additional 2 percent compared to a 74-percent boost for companies with $5,000 to $25,000 of taxable income.

Sound business practices dictate the organization methods a businessman employs; taxes are only one of many important factors. Yet, under this proposal, the Government arbitrarily would heap severe tax penalties on companies which were not even considering taxes in establishing allied corporations. In attempting to group corporations together, the Government would violate one of the most

basic tenets of law; namely, that a corporation is a single entity and in effect would be dictating the method of organization, taking such discretion away from corporate management.

Among the many sound business reasons for separate units are incorporation of branches so that local managers may have stock ownership incentive for participation in profits; to retain local identity; to limit liability which might jeopardize the entire parent company; to increase borrowing power. Incorporation in separate States often is essential to overcome disadvantages that would apply to a foreign corporation. When a company handles competing products, separate corporations may be the only means of doing business.

All these legitimate reasons for setting up separate corporations would be ignored if this proposal were adopted, because existing laws and powers to control any use of multiple corporations for tax avoidance purposes have not been properly administered.

Multiple corporations already are subjected to tax penalties. The law permits only an 85 percent credit for dividends received from other domestic corporations. This results in double taxation to the extent of 15 percent of the effective rate at which the parent corporation is subject to normal tax plus surtax. Consequently, unless an existing $25,000 inclusion and minimum credit are continued, an enterprise consisting of several corporations would pay a total normal and surtax substantially higher than a single corporation with equal total income. The limitation of $25,000 minimum excess-profits credit would mean the removal in many cases of the only compensating factor for the partial double taxation of intercorporate dividends.

The proposed section 123 should be eliminated in its entirety from the bill.

STRUCTURAL CHANGES IN TAX LAW

Withholding on dividends

One unfair feature of the proposal to withhold all dividends, interest, and royalties is that taxpayers will have income withheld by the Government when actually there is no tax liability. Retired persons living on investment income will have to file a claim for refund and wait 6 months after the tax year ends to obtain income rightfully due. Another bad feature is that much of this type of income, which the Treasury Department claims is not reported, will not even be subject to withholding because of the practical difficulties of administration.

We doubt that the evasion is nearly as great as estimated by the Treasury Department. Nonreporting certainly will be greatly reduced by the new requirement on returns that dividend income be reported by source.

Offsetting short and long-term capital gains and losses

The Ways and Means Committee report states that this proposal will cure a defect in the law. This is not so if the important distinction between long- and short-term capital gains is recognized. We are opposed to this proposal because it is one more end road that will tend to destroy the capital gains provisions which are most important to encourage adequate investments. The estimated revenue of $28 million is so nominal in comparison to the revenue sought by the bill that this type of provision does not rightfully belong in a revenue-raising measure.

Collapsible corporations

The attempt to cure a few alleged abuses through the use of collapsible corporations is another feature that does not belong in this tax bill. Proper administration of existing laws will reach any sham transactions.

Sale of property to a controlled corporation

Again in an attempt to reach a few alleged abuses, the Treasury Department proposes that individuals be denied the privilege of selling property to a corporation owned by them. In effect, this proposal says that a sale direct from an individual to a controlled corporation is not legitimate, while the same effect can be achieved by selling the property to a third person and then to the corporation.

SALE OF PERSONAL RESIDENCES

The provision eliminating the capital gains tax on the sale of a personal residence when a new residence is purchased is highly desirable. It eliminates inequity arising because of the inflation in the cost of residences. The association wishes specifically to commend the provision of the bill that includes cooperative

apartments under this provision as a number of New York City residents own such apartments instead of individual houses, as is the usual situation in other cities.

CAPITAL GAINS TREATMENT OF E BONDS RECOMMENDED

A most constructive measure would be treat the income from E bonds as capital gains, rather than ordinary income. It certainly is inequitable for this interest to be treated as ordinary income after the bond has been held for 10 years, when an individual can obtain capital gains treatment by purchasing a corporate stock or bond and after 6 months obtain the lower capital gains rates.

The Treasury Department reports that nonreporting of E bond interest is widespread. Capital gains treatment would reduce nonreporting greatly and would assist the Treasury Department in marketing its bonds which is considered most important at the present time to siphon off excess consumer purchasing power.

Senator KERR. Mr. Hess.

STATEMENT OF H. OBER HESS, CHAIRMAN, TAXATION SECTION, PENNSYLVANIA BAR ASSOCIATION

Mr. HESS. Mr. Chairman, I am H. Ober Hess, chairman of the tax section of the Pennsylvania Bar Association.

I should like to submit a statement covering in some detail our position in connection with the five points in our Federal legislative program. In addition, I should like to refer briefly and orally to each.

Senator KERR. We will be glad to have you do that. Do you have a copy there?

Mr. HESS. I gave the stenographer a copy.

The first point in our Federal legislative program deals with the subject of the possibility of reverter in the Federal estate tax field, with which I think your committee has a considerable familiarity. It is our recommendation that the relief granted by the Technical Changes Act of 1949 be extended to a group of cases which were not covered by that legislation.

Indeed, it is our thought that the cases that are not covered are the ones that are the most meritorious.

I should mention that the Technical Changes Act granted relief only in the cases of decedents dying on or after February 10, 1939, which date has no relation to the subject matter, its only significance being that it was the date on which the Internal Revenue Code was first adopted.

The most meritorious group of cases, as we see it, are the cases of decedents who died between November 11, 1935, and January 29, 1940. Those dates do have some logical significance in this field. You will recall that it was on November 11, 1935, that the Supreme Court of the United States clearly decided in the St. Louis Trust Co. decisions that these possibility of reverter situations were not taxable in any measure.

Following these decisions, the Secretary of the Treasury, on the 19th of March 1937, promulgated regulations which flatly stated that these possibility of reverter cases were not taxable.

It was not until January 29, 1940, when the Supreme Court decided the Hallock case and said that at least some of these possibility of reverter cases are taxable, and expressly overruled the St. Louis Trust Co. cases.

So we are here in the interest of those decedents who died in that period, who created trusts, who maintained trusts, and died in reliance on the state of the law then in effect.

Senator TAFT. Does a man die in reliance on the state of the law?

Mr. HESS. Senator, persons with estates who are most seriously affected by the Federal estate tax are usually represented by counsel who are quite sensitive to the state of the law and who keep their clients closely posted, and I think the Senator well understands that. So I think it is not torturing English diction to say that people involved in these situations did die in reliance on a state of the law.

Senator KERR. They did die at a time that they were relying on the basis of common acceptance of the interpretation of the courts that said what that law was.

Mr. HESS. Yes. Perhaps to put it another way, and use less risible language, it is just like this. Were it possible for the Government to move in the day a man dies and settle his estate tax liability and take his executor's check on that day, these people would not have paid tax on the possibility of reverter cases during that period. That is, in the case of anybody dying between those dates, his estate tax, had it been completed immediately and not delayed, would have created no problem.

Senator TAFT. What is the situation in our case? We passed two or three laws.

Mr. HESS. Senator, the statute you passed, the relief statute, was the Technical Changes Act of 1949, which granted a measure of relief back to February 10, 1939. That is, it granted relief in the estates of decedents who died on or after February 10, 1939. It pretends to grant no relief at all—it expressly excludes them from relief—to the estates of decedents dying prior to that time.

Senator TAFT. What was the reason for choosing that date?

Mr. HESS. As I indicated, that date has no rational relation at all. It was the date on which the Internal Revenue Code was enacted. It was a slightly simpler matter of statutory draftsmanship to end the relief there, because by so doing it was necessary only to amend the code. Had the relief been carried back beyond that date, it would have been necessary to amend the antecedent revenue acts, just as a matter of mechanics.

Our reasons for supporting this recommendation are amplified somewhat in our statement, and I do not mean to belabor them at this point.

Senator KERR. Very well.

Mr. HESS. That is the situation in which we are interested.

The second point in our program also refers to a matter which was first given attention in the Revenue Act of 1950, which amended section 115 (g) of the code to provide that a closely held corporation might redeem a decedent's stock without any risk of the redemption of the stock being taxed as an ordinary dividend. That was subject to certain limitations, principally that the decedent's total estate must consist, at least to the extent of 50 percent, of stock in that corporation, and secondly, the redemption must occur within the period of the statute of limitations plus 90 days.

Our recommendation is that that is a very good so far as it goes, and that it ought to be carried a little bit farther. First, it should not

be required that the decedent's estate consist to the extent of 50 percent of stock of a single close corporation..

Senator TAFT. The Senate bill cut it down to 40 percent, did it not, Mr. Stam?

Mr. STAM. I think they cut it out entirely, and then in conference with the House put it back in at 50.

Senator TAFT. You mean we went all the way down? We had no limits at all? But then in conference with the House we put it back in at 50?

Mr. STAM. Yes.

Mr. HESS. We would be glad to have it back where the Senate had it in 1950.

In addition, we should like the period somewhat adjusted within which this redemption might be made. Instead of the normal Statute of Limitations plus 90 days, it would seem more reasonable that the period be whatever period—it would be stated in this fashion—the period elapsing prior to determination of estate tax liability plus 90 days to make an allowance for appeals, and all that.

The third point in our legislative program is a recommendation that a provision be included in the bill now before your committee providing for the nonrecognition of gain in the case of spin-off of corporate stock. We are recommending specifically exactly the provision that the Senate Finance Committee put into the revenue bill of 1950, but which was taken out in conference.

Senator TAFT. Was that "spin-off?"

Mr. HESS. Spin-off. It is a mild form of corporate reorganization which comes about in this way. An existing corporation transfers a part of its assets to a new corporation and then distributes the new corporation's stock to the stockholders of the existing corporation without the cancellation of any of the old stock.

We recommend that that type of transaction be added to the list of corporate transactions in which gain or loss is not recognized at that time.

Senator KERR. Until it is implemented?

Mr. HESS. That is right.

The fourth point in our program involves the change in the carry-back and carry-forward of the net operating loss. You will remember that in the Revenue Act of 1950 the law was rewritten so that now net operating losses may be carried back 1 year and forward 5, whereas prior thereto they could be carried back 2 years and forward 2.

The way the law was written, a considerable measure of inequity was done, no doubt unintentionally, to a limited group of corporations, and the inequity came about in this fashion. The new law was made applicable to all taxable years beginning after December 31, 1949. The Revenue Act of 1950 was not passed until September 23, 1950, and there are corporations who had already gone into liquidation during the early part of the year.

During the early part of the year they may have taken steps—and I think some indeed did take steps—calculating as a part of the cost of what they were doing that they would receive a refund of taxes previously paid by reason of the 2-year carry-back provisions. In other words, they were done out unintentionally of 1 year of the carry-back and the carry-forward in these liquidating situations. We recommend the correction of that limited inequity.

Our fifth point recommends a liberalization of the deduction of medical expenses in the manner indicated more fully in that statement.

Senator WILLIAMS. In changing that carry-forward and carry-back provision, would you recommend taking it off the year forward and putting it on the year back?

Mr. HESS. I think the result we would be looking for would be accomplished perfectly if the effective date of this provision in the Revenue Act of 1950 were simply changed so that it would not apply to any corporation which had committed itself to liquidation prior to September 23, 1950. In other words, allow the old law to apply to them.

Senator KERR. To eliminate the retroactive feature of the new law with reference to corporations which had within a certain period prior thereto liquidated, relying on the provisions of the old law?

Mr. HESS. That is it exactly.

Senator TAFT. What do you want to do about medical expenses?

Mr. HESS. We should like to see some liberalization of the limits of the deduction.

Senator TAFT. On what?

Mr. HESS. It is all a matter of figures. The bar association did not authorize me to recommend any specific new figure. Therefore, we shall have to leave the matter of figures to the discertion of the committee. However, one other feature——

Senator TAFT. Do you think it is not big enough, or do you think you have to have too many of them before you can deduct them, or what?

Mr. HESS. The 5-percent floor is thought to be too high.

Senator TAFT. There are no deductions until you get up to 5 percent?

Mr. HESS. At the present time, there are no deductions until your medical expenses exceed 5 percent of your adjusted gross income. It is our thought that that ought to be reduced. At the present time, there is a ceiling on the deduction for medical expenses of $2,500 for a single person——

Senator KERR. For joint returns, and $1,250 on individual returns.

Mr. HESS. Yes, that is the way it is, plus $1,250 for each dependent, I think, subject to an over-all maximum of $5,000. We think the ceiling ought to be lifted.

Also, you will note in our statement that we recommend that medical expenses which are incurred in connection with a decedent's last illness and which are therefore usually paid by his executor, ought to be deductible on his, the decedent's life period return. As the law now stands, they are not deductible at all, no matter how large an amount.

Thank you very much, sir.

Senator KERR. Very well, Mr. Hess. We thank you for your appearance.

Mr. HESS. Thank you.

(The prepared statement of Mr. Hess is as follows:)

STATEMENT OF H. OBER HESS, CHAIRMAN OF THE TAXATION SECTION OF THE PENNSYLVANIA BAR ASSOCIATION

The recommendations for change in certain provisions of the Internal Revenue Code which are discussed in this statement were approved for action by the general assembly of the Pennsylvania Bar Association at its midwinter meeting held in Pittsburgh on January 19, 1951. While general revenue revision appears not to be an objective of the pending H. R. 4473, it is suggested that the sharply increased tax burden, which that bill as now drawn proposes, makes this an ideal time to consider the correction of certain existing inequities.

ESTATE TAX—POSSIBILITY OF REVERTER

This recommendation is addressed to the need still existing for further remedial legislation in the possibility of reverter field. Perhaps the matter may best be approached by stating the general problem, the solution offered by Congress to date, the need for further congressional action.

The legal question which gives rise to the problem under consideration is one of statutory interpretation and may be simply stated. From the beginning the Federal estate tax statutes have taxed property which a decedent transferred in his lifetime if the transfer was "intended to take effect at death." That is, if the transfer was intended to take effect at death, the property was taxed as if the decedent had never transferred it. But what is the meaning of the words "intended to take effect at death"? If, for example, a man gives away property but provides that if he survives the transferee he shall get it back, has he made a transfer "intended to take effect at death"? There is a possibility until he dies that the property may revert to the donor, but does this so-called possibility of reverter mean that the transfer was "intended to take effect at death" as those words are used in the statute?

The Supreme Court decided in the negative in two cases handed down on November 11, 1935, and said the transfers were not taxable: *Helvering* v. *St. Louis Union Trust Company* (296 U. S. 39), and *Becker* v. *St. Louis Union Trust Company* (296 U. S. 48).

After these decisions came down the Treasury changed its regulations to take the same view expressed by the Supreme Court in the St. Louis cases. The change was effected by T. D. 4729, which was approved by the Secretary of the Treasury on March 18, 1937, and which said:

"If, as a result of the transfer, there remained in the decedent at the time of his death no title or interest in the transferred property, then no part of the property is to be included in the gross estate merely by reason of a provision in the instrument of transfer to the effect that the property was to revert to the decedent upon the predecease of some other person or persons or the happening of some other event."

So matters stood, and instruments of transfer were written and transferors died, in reliance on the Supreme Court's decisions and the Treasury regulations, until January 29, 1940. On that day the Court overruled its prior decisions and decided *Helvering* v. *Hallock* (309 U. S. 106). Contrary to its prior decisions, it now held that the existence of a possibility of reverter in the transferor did mean that the transfer was "intended to take effect at death" and that the transferred property was taxable.

In the Hallock case the decedent's reversionary interest or possibility of reverter was contingent only upon his surviving one other life, but in many later cases the same result was reached where the decedent would have had to survive all of many persons much younger than himself before his reversionary interest would vest. And many cases made it clear that there was no distinction between situations where the decedent had reserved expressly the reversionary interest and those where it existed by silent implication of the law. These trends of decision culminated in *Commissioner* v. *Estate of Spiegel* (335 U. S. 701 (1949)), where the decedent's reversionary interest was so remote that its actuarial valuation was placed at seven one-thousandths of 1 percent of the value of the transferred property. Nevertheless, the Court held the transfer was intended to take effect at death and held the transferred property taxable at 100 percent of its value.

Congress was not slow in correcting to some extent the harsh rule of the Spiegel case. The Technical Changes Act of 1949 (Public Law 378, 81st Cong.) was enacted on October 25, 1949, and insofar as relevant to the so-called possibility of reverter cases it divided them into the following three categories:

(1) Those where the decedent died prior to February 10, 1939.

(2) Those where the decedent died after February 10, 1939, having made a transfer prior to October 8, 1949, subject to a reversionary interest.

(3) Those where the decedent made a transfer after October 7, 1949, subject to a reversionary interest.

The Technical Changes Act made no change in the first group of cases. They remain taxable under the Hallock case. The third group are those current situations in which a well-advised transferor can take care of himself.

The second group were handled in this fashion. If the reversionary interest was not expressly reserved the transferred property is not includible in the taxable estate, no matter what the value of the interest in proportion to the total property transferred. If the reversionary interest was expressly reserved, and if the interest is worth less than 5 percent of the property transferred there is no tax. But if the interest is worth more than 5 percent the whole value of the transferred property is taxed.

Congress took the further step in this act of opening closed cases to give relief where these provisions would apply.

It is believed that Congress stopped short of granting relief in all deserving cases, and drew lines which are unnecessarily arbitrary. Two features of the Technical Changes Act are believed particularly subject to this criticism.

Why limit the relief to the estates of decedents dying after February 10, 1939? The only significance of that date is that the Internal Revenue Code became effective on that day. It marks nothing in the history of the possibility of reverter problem. If there must be a date, the logical date is November 11, 1935 when the St. Louis Union Trust Co. cases were decided. These cases flatly rejected the contention that a possibility of reverter subjected an inter vivos transfer to estate tax, and any relief from the stringencies of the later cases to the contrary should apply at least to decedents who died since November 11, 1935, and especially to those who died between that date and January 29, 1940, when the Hallock case changed the law.

Where the reversionary interest (or possibility of reverter, as popularly styled) was expressly reserved, why limit the relief to cases where the interest was worth less than 5 percent? Especially may this question be asked in the cases of decedents dying before January 29, 1940, when the Hallock case was decided. Prior to that date it was the law that no possibility of reverter made transferred property taxable. After that date everyone conversant with the subject knew that some possibilities of reverter would have that consequence but surely no one anticipated that such a remote one, as presented by the Spiegel case, would do so. Thus, from the standpoint of the informed decedent, it makes some sense to invoke the 5 percent rule where he died after the Hallock case, but none that is apparent where he died before.

It is, therefore, recommended that relief be included in the pending bill along the following lines:

(1) Extending the relief of the Technical Changes Act of 1949 to estates of decedents dying after November 11, 1935.

(2) Eliminating the 5 percent requirement at least in cases of decedents dying between November 11, 1935, and January 29, 1940.

INCOME TAX—REDEMPTION OF A DECEDENT'S STOCK

The Revenue Act of 1950 added paragraph (g) (3) to section 115 of the Internal Revenue Code with a view to affording income-tax relief in certain situations where it is necessary to redeem a decedent's stock in a close corporation to get cash to pay the Federal estate tax. In order to insure that the proceeds of such a redemption will not be taxed as a dividend to the estate, the following conditions must be met:

(1) The redemption distribution must be after the decedent's death and before expiration of the period of the normal statute of limitations, plus 90 days.

(2) The amount of the redemption distribution must not exceed the decedent's death taxes, plus interest.

(3) The total value of the stock of the redeeming corporation in the decedent's estate must be more than 50 percent of the net estate for Federal estate tax.

It is believed that these requirements are unnecessarily stringent. The time limitations of the first requirement may very well be too short in many cases. It may not be known what taxes have to be paid until long after the end of the period—as in the case of prolonged litigation. It is recommended that this time be extended to at least 90 days after the tax liability is finally determined.

The requirement that the stock in question be at least 50 percent of the decedent's estate may well operate unfairly, especially in cases where the close corporation business is actually done by more than one corporation. It is recommended that the provision be revised to extend the relief to any situation where stock is redeemed to pay death taxes, without regard to the size of the block of stock in proportion to the total estate.

INCOME TAX—EXTENSION OF CORPORATE REORGANIZATION PROVISIONS TO INCLUDE "SPIN OFFS"

A "spin off" occurs when M, an existing corporation, transfers part of its properties to N, a new corporation, in exchange for stock of N and the stock so received is distributed to stockholders of M without surrender or exchange of any part of their stock of M. If in such a transaction stockholders of M surrender part of their stock in exchange for N stock a "split off" occurs. The Internal Revenue Code does not presently provide for nonrecognition of gains in such transactions even though the transactions are supportable by sound business reasons. When the Senate Finance Committee reported H. R. 8920 (which became the Revenue Act of 1950) to the Senate, it added a section (No. 207) to the House bill to provide for nonrecognition of gain or loss in the case of spin offs. (It was silent as to split-offs.) The Finance Committee pointed out that the currently effective nonrecognition provisions of the code usually covered a split-up; i. e., when M corporation is replaced entirely by two or more new corporations and the stocks of the new corporations are distributed in liquidation to stockholders of M. The Finance Committee believed that corporate reorganizations which accomplish substantially the same effect should be given the same tax treatment. Moreover, the Senate committee considered it economically unsound to impede reorganizations which break business up into smaller units.

In order to prevent the proposed provision for nonrecognition of gain in spin-offs from being used as a device to permit corporate profits to be distributed in such a way that stockholders could avoid the normal and surtaxes applicable to dividends upon receipt of the spun-off stock and be subjected only to capital gains tax if and when the spun-off stock is sold the Senate Finance Committee limited the nonrecognition provisions to those cases where both corporations were intended to continue carrying on business after the reorganization and the reorganization did not represent merely a device for the distribution of earnings and profits of the existing corporation.

The Senate adopted these recommendations of its Finance Committee but in conference the Senate receded and thus these provisions were not in the bill which was enacted into law.

When there are sound business reasons for a spin-off or split-off a corporation should not be forced to the more cumbersome and expensive split-up procedure to immunize its shareholders from income tax upon the receipt of stock which does not change their proportional interest in the business enterprise.

The desirability of dividing corporate assets into two or more corporations is in many instances too obvious to require extended discussion and when supported by sound business reasons should be encouraged.

It is recommended that a provision similar to that which the Senate Finance Committee added to H. R. 8920 be now added to H. R. 4473.

INCOME TAX—CHANGE IN CARRY-BACK AND CARRY-OVER PROVISION

Section 215 (a) of the Revenue Act of 1950 amended section 122 (b) of the Internal Revenue Code (relating to the allowance of carry-backs and carry-overs) by providing for a 1-year carry-back and a 5-year carry-over instead of the previous 2-year carry-back and 2 year carry-over. This amendment is made applicable to taxable years beginning after December 31, 1949.

According to the House Ways and Means Committee report, this amendment was intended as remedial, particularly in aid of small and new businesses. Since the over-all period is extended from 5 to 7 years the committee considered it to be a concession to retain a carry-back for even 1 year, but did so "in order to provide relief in particular circumstances where the carry-forward cannot be used or is inappropriate."

As applied to those corporations which sold their assets and liquidated prior to enactment of the 1950 act on September 23, 1950, this amendment works a hardship. Typical of such cases is the small closely held corporation with inventory and depreciable assets actually worth less than book where the sale was made on the justifiable assumption that the loss could be carried back 2 years. It is also characteristic in such cases that the law in effect at the time unquestionably had a definite bearing on the selling price simply as one of the bargaining factors, and the effect was to reduce the selling price.

Corporations going out of business, frequently on a distressed-sale basis, should not be penalized in order to compensate the revenues for relief extended to continuing or new corporations.

It is recommended that the amendment effected by section 215 (a) of the Revenue Act of 1950 be made inapplicable to corporations completely liquidating, or which were in process of complete liquidation on September 23, 1950, if the liquidation is completed by the end of the second taxable year beginning after December 31, 1950.

INCOME TAX—REVISION OF PROVISION FOR DEDUCTION OF MEDICAL EXPENSES

The medical expense deduction first came into the code in 1942. The Senate Finance Committee at that time expressed its belief that a medical deduction should be allowed in determining the heavy burden of war taxes then being imposed because the committee thought it imperative to maintain a high level of public health and morale.

The medical deduction was originally allowable only to the extent that such expenses exceeded an arbitrary 5 percent of net income with a limitation of $2,500 on joint returns and $1,250 on individual returns.

Since 1948 the law has permitted an increased deduction to the extent of $1,250 for each additional dependent, with a maximum deduction limitation of $5,000 on joint returns and $2,500 on individual returns.

The cost of living including medical expenses during an inflationary period, such as this, has increased tremendously. It would seem that the maximum deduction should be increased commensurate with the increased cost of living and, more importantly, medical expenses should become allowable long before they reach 5 percent of net income.

In the case of last illness where the medical expenses are paid after death by the executor, as frequently happens, the medical expenses are lost as a deduction on the individual's last life period income-tax return.

It is recommended that more liberal provisions for medical expenses in this period of increasing individual taxes be enacted and that medical expenses paid after death be made deductible on the life period return of the decedent.

Senator KERR. Mr. Javits.

You may identify yourself to the reporter.

STATEMENT OF BENJAMIN A. JAVITS, INDEPENDENT INVESTORS, INC.

Mr. JAVITS. I am Benjamin A. Javits, president of the Independent Investors organization.

Senator KERR. What time do you need, Mr. Javits?

Mr. JAVITS. I would say about 10 minutes.

Senator KERR. That will be fine. We can put your entire statement in the record, and you may summarize it.

Mr. JAVITS. It is pretty well summarized in the statement.

Independent Investors, Inc., is an organization made up of small independent investors—stockholders, small-business men, policyholders, savings bank depositors, bondholders, property owners all over the United States. The organization is in no way tied up with management or banking groups. It is the only general organization of its kind that is not subsidized by publicly owned corporation treasuries.

All of its officers and directors are independent investors who are neither officers nor directors of any publicly owned corporation.

The principal purpose of Independent Investors, Inc., is to make the American people aware of the little fellow's stake in the American economic system and to make the investor an active constituent of American business. Our purpose is to balance out the political power of the American citizen with his economic power.

The organization is vitally interested in a close relationship with members of Congress and Government so it may convey to them the views of investors of whom there are more millions than any other group.

We realize that in this hour of stress the country needs all the revenue it can get and we want to be helpful, but we do have some views with respect to how the money should be raised. We are concerned with the Government's attitude, of course. We do not believe that the attitude of the Government at any time should be confiscation of capital no matter how it is dressed up, because confiscation of capital involves the question of the right to own private property without fear of Government confiscation. We all know the old adage: The power to tax is the power to destroy.

If tangible property is in danger of confiscation by Government then ownership of intangibles is also usually destroyed. In place likes Germany and Russia where confiscation of capital was, and is, the order of the day personal intangible property—freedom of religion, freedom of speech, freedom of assemblage were destroyed. This "private property" we now fight for.

(*a*) We are concerned with the capital-gains tax. We believe that it is, in principle, a confiscation of capital and is, therefore, wrong. We further believe that the present rate and the proposed increased rate, if it is going to be retained, will not produce the revenue the Government should get. A reduction in rate to 15 percent will bring in twice as much revenue as you receive now, or will receive with the proposed increase. The House Ways and Means Committee apparently observed one suggestion we made in the House tax bill already passed. In a statement made before them on February 21 of this year, I said:

> The workingman who has bought a house, or built one, 20 years ago for say, $6,000, cannot replace that house today for less than $15,000. Therefore, it seems unreasonable to penalize him $2,250 in taxes, when he sells the house.

The same holds true for securities and other property.

We further made what might be called a sporting proposition, to the House Ways and Means Committee, but which we believe is sound. We submitted the suggestion that the law applied to capital-gains tax should be revised to 15 percent and the holding period to 3 months; that the law should provide that this should be tried for a 6-month period; that if the capital-gains tax collected by the Government is not substantially greater during that period than the capital-gains tax presently collected under the 25-percent law, then all the capital-gains taxes collected during the trial period should be retroactively increased to 25 percent or even 28½ percent, which you now have in the bill.

We know the Government will get more revenue, and more revenue is the important and salient point.

(*b*) We are opposed to the 20-percent withholding tax on dividends. The loophole you seek to close here is so small that it will be more annoying than practical.

In the first place, 20 percent withheld on small holdings is unfair to the stockholder group. In too many cases—and I have letters from lots of our members to support this—this income must be used for necessary living expenses, and they do not owe any of it for taxes, especially the older people whose deductions are great. They get no interest while the money is withheld, and some of them complain about that.

Second, we are opposed to this tax because it will throw a terrific burden on the corporations and will add tremendously to their expenses. This is unfair and unreasonable. The corporations' expenses will shoot upward and these expenses are deductible, before the Government gets any taxes. So whatever loophole might be closed will be eaten up by a deductible expense—an additionally heavy one—to which corporations will be put.

Third, there are many listings on corporate books of brokers who have to split the stock among many holders, and that is equally true of trustees. This seems a further unfair burden to the body economic.

Senator MILLIKIN. I suppose it would be very difficult to estimate the figure. But has any estimate been made of what the cost would be at the corporation level of maintaining this system of withholding?

Mr. JAVITS. It would be the purest guess, but I have been told by one secretary of the corporation that he figures that it would add to the costs anywhere from $15,000 to $100,000 a year.

Senator MILLIKIN. Mr. Stam, are there any estimates on that?

Mr. STAM. I do not think there are. We had some meetings with a group of corporations, and they did not seem to feel under that automatic method that was suggested in the bill that the cost would be very great.

Senator MILLIKIN. I realize that it would be extremely difficult to make an accurate estimate.

Mr. STAM. It would not be very great.

Senator MILLIKIN. Thank you.

Mr. JAVITS. As I understand it, you are trying to collect at the most $350,000,000, which you think escapes you, as far as revenue that you are entitled to is concerned.

Senator MILLIKIN. I am inclined to believe that that figure is grossly exaggerated.

Mr. JAVITS. So do I. I was going to say that.

Senator MILLIKIN. I am not in the position to prove that it is grossly exaggerated.

Mr. JAVITS. That sounds like too much, because your total taxes would be on dividends of $7 billion, and you certainly do not collect all that. And if you do collect—I do not know how much you collect on dividends—the percentage is way out of line, in any event.

Should I go ahead?

Senator KERR. Go ahead.

Mr. JAVITS. Fourth, it goes against the grain of our American system because it is, in a way, a police-state method of collecting taxes from responsible members of society. I say "police-state" because it is not necessary, it simply is a display of power. Withholding on salary and wages is a totally different proposition.

(C) We believe that double taxation is unfair and confiscatory. This is a kind of tax penalty, and will come home to roost some day. Our citizens will pay fair and square taxes. They don't have to be fooled or coerced or put in "double jeopardy"—if I may use a little literary license. Your committee should correct that inequity.

Senator TAFT. Do you mean the inequity on stockholders of corporations?

Mr. JAVITS. Yes. I mean the double tax on dividends.

(D) We believe that professional people—scientists, doctors, lawyers, engineers, architects, et cetera—should be able to provide for their own future. As it stands now, they cannot put anything aside in spite of their heavy investment in getting somewhere in their profession. As you know, it takes at least 15 years for a professional man to get recognition and when he does, under the present tax laws, he cannot provide anything for his future.

Senator FREAR. What do you mean by that?

Mr. JAVITS. What is that?

Senator FREAR. What do you mean by that?

Senator KERR. He means that when he gets into the highly productive period, his income tax rate is so high that most of what he produces during that time that he has the greatest capability is paid off to the Government in taxes, and that he has little of it left.

Senator FREAR. From what I have read—it may not all be true—however, I put a lot of confidence in the press—many of these people that you have mentioned here have done pretty well for themselves in providing for the future. Is that just a small percentage?

Mr. JAVITS. No. As a matter of fact, I have not participated in this, but I understand that the bar association for lawyers and the professional people have suggested that in the preparation of the tax bill, provision be made that a certain percentage of the earnings, 10 percent to 15 percent, could be set aside and put into Government bonds, and when these are sold, for a person's old age or disability, he then pays a tax. In that way, to set up a fund for the professional man.

In my experience, I know a number of professional men who cannot possibly accumulate anything at the present time.

Senator FREAR. You also have in your acquaintance some who can, however.

Mr. JAVITS. Yes; some who can and some who have. And I think most of those people are the older people, the people who have been able to accumulate something during a time when it was easy to do. Now, of course, the differentiation is that a man in business can, by operating through a corporation—and most men do—accumulate something on a capital-gains basis. When he gets to the point where he wants to retire, he can sell, and he has something for his old age. The professional man does not have that. And that is particularly true of those who are just coming up now and who need some help to carry on.

Senator FREAR. Thank you.

As to our views on the tax problem generally, we should like to see the elimination of politics in this new tax program, or "its heavy content of political expediency" as the New York Times puts it. We think politics should be adjourned for the emergency. Dishonesty should not be encouraged by a tax structure. Confiscation, discrimination, or onerous paper work does just that.

Labor pays its share of taxes in any event; if not directly, then in the price of goods. The little fellow pays most of the taxes regardless of what you may do to the big fellow. The big fellow is a symbol of our civilization. We would like to see all the people big fellows—in other words, very well off. That is the key to our kind of successful world; at least the opportunity must be preserved or all is lost.

Wealth privately owned is just as much a sign of our liberty and independence, as the opportunity to be President, Congressman, or Senator. The Government must preserve the right to accumulate capital in the hands of private people. But 90 percent taxes of income that could be productive, is confiscation.

The American people should have constantly new vistas of opportunity opened up for them. The present tax structure, and the structure in principle for many years past, as you know, have made the chances smaller of going into business for oneself. Or, if it hasn't made them smaller, has made it more difficult to survive. Every American should have the opportunity to go into business for himself and to find the capital for it. This is the competitive pattern that gives our people the lowest prices and the best wages.

The New York Times, in its editorial of June 28, 1951, believes that a fresh start should be made on taxes and believes we can get substantial revenue without destroying the sources of private capital. We agree with that.

Also, according to an editorial in the current Life magazine (issue of July 9, 1951) there are 19 million people in America who pay no taxes. To us this means that there are 90 million more who should know they are also paying for their Government. Life magazine favors a universal sales tax. So do we.

As to an across-the-board sales tax, the American people are not afraid to face the truth and should know exactly what the cost of government is in terms of their labor. You gentlemen, great as is your service to the country, would be rendering a still greater service if there were no hidden taxes and the people could see clearly their share of the cost of government. It might help to get the people aroused so that the waste in government would be cut down tremendously.

A general sales tax, and a tax on expenditures, in this emergency period, are taxes which are constructive and will leave some money for private investment which should not interfere with the raising of revenue on a pay-as-you-go basis.

Senator MILLIKIN. How do you distinguish between a general sales tax and a tax on expenditures? Just what do you mean by that?

Mr. JAVITS. I mean a general sales tax, a tax on all those who get paid for goods or services. What I mean by a tax on expenditures, I mean if you are going to tax a man who, say, has a $200,000 income, very substantially, as you probably have to do in this emergency, you should leave him some money for investment purposes, in other words, you give him an opportunity to accumulate private capital.

But if he wants to live on a $60,000, $70,000, or $80,000 or $100,000 basis per year, then he should pay a little bit more to permit him to live on that scale, so that he does not take the money out of the productive processes. In other words——

Senator MILLIKIN. When he spends his $60,000, $70,000, $80,000 a year, does he not aid the productive processes?

Mr. JAVITS. Well, he may or may not. I think what you are trying to do, in time——

Senator MILLIKIN. How do you save money and not aid in carrying out the productive processes?

Mr. JAVITS. For instance, if you buy a luxurious yacht for personal purposes——

Senator MILLIKIN. That involves a payroll for those who build the yacht; that involves the material supplier——

Mr. JAVITS. I agree with you.

Senator MILLIKIN (continuing). It involves the buying of oil or whatever is involved to propel it; it involves a payroll to run the yacht.

Mr. JAVITS. Yes, sir. I want to put a penalty upon the fellow who is at the present time enjoying, and might enjoy some extra luxuries and, therefore, he ought to pay a little extra for that privilege.

Senator MILLIKIN. We are running a luxury economy in this country.

Mr. JAVITS. Well, yes. Of course, democracy is a luxury.

Senator MILLIKIN. If you discourage luxuries in our economy, then you will face an economic cataclysm.

Mr. JAVITS. Well, I personally go along with you. Here I am trying to be a little bit more practical, a practical politician, which I am not, of course.

Senator KERR. But you recommend that we do not do that.

Mr. JAVITS. What is that?

Senator KERR. Would you reserve to yourself the privilege as a private citizen that you would deny to us, who might not be here without some political activity? [Laughter.]

Senator TAFT. You suggest an interesting theory, I suppose, when you first suggest that if a man saves a certain amount every year he shall not be taxed on the savings.

Mr. JAVITS. That is right.

Senator TAFT. Now, you have a corresponding theory that if a man spends his capital for consumption purposes, you are going to put a tax on that. That is a new idea, but there are lots of people today spending their capital to keep themselves going.

Mr. JAVITS. That is true.

Senator TAFT. And you could tax them to the extent that they would spend their capital over and above their income, I suppose.

Mr. JAVITS. That is right.

Senator TAFT. It would be a little tough, I think.

Mr. JAVITS. Well, I simply do this because you may say that in this great period of stringency or emergency or possible outside danger, that a fellow who wants to indulge himself in any great luxury should pay a little extra burden for doing it. But——

Senator TAFT. On the other hand, there are lots of people who, perhaps, just save or spend their capital because they have some emergency which requires them to do so, and it is a little hard to tax them on that extra spending while they are digging into their own capital.

Mr. JAVITS. I agree with you. What I should have said there is luxury expenditures. I would like to amend it to that extent.

Senator MILLIKIN. It would be very interesting to know the proportion of our payroll involved in making goods for luxury expenditure, and I think if you could evolve some kind of a system to restrict that,

you would have a system to destroy our economy, and I suspect that would be the result.

Mr. JAVITS. Logically that would be the result.

Senator TAFT. If you were to cut off all luxuries tomorrow, you would have the biggest depression that the world ever saw.

Mr. JAVITS. I am sure about that, too.

Senator MILLIKIN. During the depression it was socially inadvisable for people to spend money. I suggest that, if we are not willing to let a man do as he pleases with his money, the social pressure should be on him to spend his money in times of depression, spend it for cars or to buy cologne; spend it for new houses, spend it for luxuries, if you please, but spend it. That is one good cure for a depression. But the social pressure was just the opposite. People who had the yachts that you are talking about tied their yachts up to the docks and discharged the workers who ran the yachts, discharged the fellows who supplied the yachts.

Well, when you multiply that all over the country, we were doing a very foolish thing.

Mr. JAVITS. May I add that I would like to see every American have a yacht. [Laughter.]

Senator KERR. Do you recommend a provision of that kind in this act? Or is that just an academic observation? [Laughter.]

Mr. JAVITS. Just an academic observation.

Senator KERR. All right. You may go ahead, Mr. Javits. You were at the third paragraph on page 5.

Mr. JAVITS. The American people don't want to be too rich and all-powerful. No—the American people don't want the Government to be too rich and all-powerful. I am trying to get through on a time limit here. [Laughter.]

The American people want to be rich themselves. The Government should be owned by the people—not the people owned by the Government.

We have no quarrel with substantial taxes on inheritance; we have no quarrel with substantial excise taxes which, in effect, are sales taxes; we believe excise taxes prove that a substantial sales tax is feasible.

We are ready to help formulate a constructive tax program, but it must be one that will build our economy to great heights of uninflated dollars so that the initiative of our people will give us a three-, four-, or five-hundred-billion-dollar economy—not an inflated economy. Private rights need not be destroyed by the need for public money. The people need not be fooled. Our working rich need not be soaked. And, with our capitalism dedicated to eliminating all poor people, we still can provide plenty of money for our Government and our defense.

Senator MILLIKIN. You mean eliminating their poorness.

Mr. JAVITS. What is that?

Senator MILLIKIN. You mean eliminating the poorness.

Senator FREAR. Not the people.

Mr. JAVITS. Poorness is correct. I quite agree with that.

We plead for the elimination of politics in the formulation of a just, even though it may be a heavy, tax program, and we are sure that even the people who now believe that they would be hurt by a general sales tax or a "spending" tax, or the exemption of investments for

productive purposes, will find that the United States will have a healthier, bigger, and greater income so that the people can afford the cost of whipping collectivism here and communism abroad.

The principles that Independent Investors, Inc., is trying to convey to you honorable gentlemen are:

(1) People should know directly what their cost of Government is.

(2) Capital should be permitted to accumulate in private hands for productive purposes. It must not be confiscated. We urge upon you not to get even close to the point where confiscation extends to capital and, therefore, freedom—except for the emergency. The American people would be better off with deficit financing, and Government loans, than to go beyond the 25 percent of the total income of this Nation for Government expenditures. They can stand that sort of thing for the period of the emergency only. The bill you now pass should be for the emergency and should say so.

(3) The bill you pass should be such, if possible, as to help to bring us to a $500 billion yearly economy of real dollars so that our taxes can be proportionately less. That can only happen with incentive capital in the hands of the people. The emergency may last for a long time, and the country may need $100 billion a year for military and other sound Government operations.

We wish at this time to take the opportunity of suggesting also that there should be no abatement in the defense-mobilization program. We feel that investors, generally, favor no abatement in the expeditious arming of our great Nation regardless of cost. We are interested in our dollars, and we want to accumulate them; but even in our hands, as with our lives, too, they are dedicated to the service of this country, and to the building of a nation which will be equally powerful in peace and in war. Only a productive nation possesses that power. Only a nation which has a private and a free economy—because that is the epitome of all freedoms which can create the zeal and moral fiber to stand up and win against any odds.

Senator KERR. All right, Mr. Javits. We thank you for your appearance.

Mr. JAVITS. Thank you for your courtesy.

Senator KERR. Mr. Rolla D. Campbell.

All right, Mr. Campbell. Will you identify yourself?

STATEMENT OF ROLLA D. CAMPBELL, PRESIDENT, NATIONAL COUNCIL OF COAL LESSORS, INC., ACCOMPANIED BY H. L. PARKER

Mr. CAMPBELL. Mr. Chairman, does the committee have copies of my statement?

Senator KERR. We have copies.

Mr. CAMPBELL. I have here a little illustration which I would like to have passed around to the committee members.

Senator KERR. All right, Mr. Campbell.

Mr. CAMPBELL. Mr. Chairman and gentlemen of the committee, I am Rolla D. Campbell of Huntington, W. Va. I appear here as president of National Council of Coal Lessors, Inc., which is an association composed of owners of coal lands which are leased, or which are available for lease, to operating companies. I am personally interested in coal lands, both as a stockholder in coal-land

companies and as a direct owner. I am an active lawyer, and my firm's clients are principally coal operators and coal-land owners.

My purpose in appearing here today is to urge this committee to give its approval of section 307 of H. R. 4473. This section may be found at page 91 of the bill. Material explanatory of this section may be found in the accompanying report of the Ways and Means Committee on pages 31–32, and on pages 117–118. Our presentation to the Ways and Means Committee may be found on pages 770–773 of the committee hearings. I shall also suggest some desirable changes in the text of the new material contained in section 307.

Incidentally, I have copies of the bill and of the report which might be helpful to the members of the committee if they would like to pass them around. The new material in section 307 is indicated by underscoring.

Senator KERR. On the new document you gave us?

Mr. CAMPBELL. Yes, the effective part.

The purpose of section 307 is to tax coal royalties in the same manner as timber royalties have been taxed for some years. This section, if enacted into law, will remove a tax discrimination against lessors which retards the leasing of coal lands.

Senator BUTLER. Mr. Campbell, do you care for some questions as you go along with your prepared talk?

Mr. CAMPBELL. Senator Butler, if you can have them wait until I finish, I would appreciate it very much. Then I will be glad to answer any questions.

Senator BUTLER. All right.

Mr. CAMPBELL. The inequity under existing laws has become worse with every increase in tax rates and with every decrease in the purchasing power of the dollar.

The essence of a coal lease is to effect, when the coal is mined, a sale of capital assets. The coal when mined becomes wholly the property of the lessee. The only purpose of the lease is to permit the lessee to mine and dispose of the coal. But the money paid to the lessor for the coal, usually called royalties, is not under existing law treated as proceeds of the sale of capital assets. Instead, the gain of the lessor from coal royalties is taxed as ordinary income.

If a landowner sells the surface of his land, the gain is properly treated taxwise as a capital gain and taxed as such. If he sells his coal for a lump sum or for a specified price per acre, the gain is properly treated taxwise as a capital gain and taxed as such.

If he sells his timber for a lump sum or at so much per acre, the gain is treated taxwise as a capital gain and taxed as such.

If he sells his timber on a stumpage basis at so much per thousand board feet, to be paid for as cut, the gain is properly treated taxwise as capital gain and taxed as such.

But, if he sells his coal on a tonnage basis to be paid for as mined, the gain is improperly treated as regular income and taxed at rates much higher than those applicable to capital gains.

It is our sincere belief that coal royalties should be treated taxwise as proceeds of the sale of capital assets. The benefits of such a change would extend to all coal lessors, whether corporation, trust, partnership, or individual, and regardless of the amount received.

Coal leases have some distinguishing characteristics. Generally, they are very long affairs and run for periods of 25 years and longer.

Most of them run for the life of the deposit leased. Usually a modern mine will not be installed unless reserves available will justify full operations for a term of 25 years or longer. Many leases in existence today were originally negotiated prior to World War I, and some may last for more than 100 years.

Another peculiarity of coal leases is that, in most cases, they provide for a royalty payment of a fixed amount per ton of coal produced. The rates generally were fixed by the older leases when coal prices were much lower. While royalty rates have risen somewhat in the last few years, the big production from the older leases carrying the lower fixed royalty rates acts as a definite brake on substantial rises in royalty levels.

Another peculiarity is that the total amount to be paid by the lessee is uncertain.

Another peculiarity of both coal and timber leases is that the interest of the lessor is not finally terminated until the timber is cut or the coal is mined.

Coal lessors have suffered severely under the combined effect of inflation which has cut by half or more the purchasing power of their royalties, of an increase in their expenses, likewise caused by inflation, and of discriminatory taxation which has taken a greater and greater share of the royalties. The result of this tax discrimination in many cases is virtual confiscation.

I can illustrate it by a simplified example. For example, assume a lease effective in 1929 carried a royalty rate of 10 cents.

The cost-depletion allowance, we will assume, will be 2 cents, leaving 8 cents after depletion. Expenses of operation would be approximately a cent, leaving a net before income taxes of 7 cents.

The income tax at that time would be approximately a cent; so that the lessor company could distribute 6 cents to its stockholders out of the 10 cents. The income tax to the stockholder would be another cent, approximately; so that the stockholder would have 5 cents out of the 10 cents which he could spend after taxes.

Now, take that same lease today. The royalty rate will be 10 cents; the depletion rate will be 2; the expenses would have doubled; so, that is 2 cents, and the net before income tax is 6. The income tax to the corporate lessor is approximately 3 cents, leaving 3 cents to be distributed; and then, when the 3 cents are distributed, it is subject to the individual-tax rates which, of course, will vary with the stockholder, but we will assume it will run anywhere from 30 to 50 percent, going in on the top brackets, which would leave anywhere from 1½ to 2 cents of spendable income to the stockholder which, taking account of inflation, now is only worth half that, or about 1 cent, a reduction of 80 percent in spenable income.

Senator TAFT. This "depletion rate," what is that?

Mr. CAMPBELL. That is a cost depletion which is allowed, based upon the original cost of the coal.

Senator TAFT. I mean, who gets the allowance, the stockholder or the company?

Mr. CAMPBELL. Well, the owner gets the allowance.

Senator TAFT. What do you mean when you say "they keep the 2 cents"?

Senator KERR. That is a depreciation factor.

Senator TAFT. I know. What do they do with the 2 cents?

Mr. CAMPBELL. Well, they usually keep it or they may distribute it.

Senator TAFT. If you take the whole thing as a capital gain, you wipe that out.

Mr. CAMPBELL. No; cost depletion is a return of capital. My point goes to the rate of tax to be applied to the gain over cost.

Senator TAFT. When you return capital, it is all a return of capital, and that is why I do not see the consistency in your point.

Mr. CAMPBELL. When you own a house, Senator, and you have paid $10,000 for it, and you sell it for $20,000, the profit on that house is $10,000, and that profit is subject to your capital-gains tax.

Senator TAFT. I understand that. I am just asking why. The theory of depletion is that the depletion covers the property, and that the rest is income.

Mr. CAMPBELL. That is correct.

Senator TAFT. Then, if you change to a capital gain, why is there any depletion? I do not see the whole thing then as it is.

Mr. CAMPBELL. Well, there might be a constitutional——

Senator TAFT. The depletion is a return of capital, but you are saying it is all a return of capital, and I would think then you would have to pay the capital gains on the whole royalty.

Senator KERR. I think his position is that the sale is a sale of capital, and that the income represents, first, a return of the initial cost, which he identifies as 2 cents.

Mr. CAMPBELL. That is correct.

Senator KERR. And that which he receives above that should be recognized as a capital gain. It is a part of the sale price that was received for the sale of capital, and then, when he gets it, he puts the money that it cost into the pocket that he took it out of when he bought it, and the rest of it he is taxed on as though it were a capital gain, arising from the sale of capital.

Mr. CAMPBELL. That is correct.

Senator TAFT. I do not see why. It would seem to me you would either have to go on one theory or the other; either it is income or capital. If it is all capital, then I suggest you would have to pay a capital gain on the whole thing after you deduct what you put in. It may be 5, 2, or 10 cents, whatever it is.

Mr. CAMPBELL. Senator, there is no question but what the gain over the return of capital is a profit, but so is a gain on the profit on the sale of a house a profit.

Senator KERR. I think he used the 2-cent figure as an arbitrary figure representing the return of the initial cost.

Mr. CAMPBELL. I did; that is correct.

Senator KERR. And, if it were different, then he would change that figure to conform to what the initial cost was.

Mr. CAMPBELL. I used that figure, Senator, because I think it is a representative figure.

Senator KERR. Yes. I do not think he meant that that was applicable to all, but he used it as an illustrative figure, as I understood him.

Senator FREAR. You cannot assess a price—I assume you can, but it is not usual that you do assess a price—to the coal mine like you do a house. You build a house for $10,000, and that is a capital

investment surely, but if you depreciate a loan you reduce it down to $5,000. If you sell it for $20,000 you get a capital gain of $15,000.

Mr. CAMPBELL. That is correct. It works exactly the same on coal properties.

Senator FREAR. It does? What is this 2 cents? Is that a return on capital?

Mr. CAMPBELL. We would call that depreciation if we were thinking of it in terms of a house; in other words, the accrued depletion which you have taken——

Senator FREAR. Yes.

Mr. CAMPBELL (continuing). Would be a reduction of the value of your property, the reduction of your base, and if you should then resell it, why, that reduction would go into your profit. There is no difference between them. Both have the same significance, a return of capital.

Senator MILLIKIN. There is a double aspect. If you have a corporation that is the lessor, assuming we did what you want us to do, the corporation would pay a capital-gains tax.

Mr. CAMPBELL. Yes.

Senator MILLIKIN. But in its distribution to the stockholders, the stockholder would pay an income tax.

Mr. CAMPBELL. That is correct. The capital-gains feature would not carry over——

Senator MILLIKIN. That is right.

Mr. CAMPBELL (continuing). In the distribution of dividends to the stockholders. They would continue to be taxed at the normal rates.

Senator TAFT. Except there are a good many individuals, are there not?

Mr. CAMPBELL. Yes; there are, and, of course, the difference to them will depend upon the rate which each one has. I would say that, as an ordinary rule, people who own coal lands do have some other income. Frequently they are very dead investments, and people who do not have some other income cannot afford to carry them for the length of time often necessary before they can be put to productive use.

Senator BUTLER. Can the increased costs to the coal land owners be passed on in any way to their lessees?

Mr. CAMPBELL. If is very difficult, Senator Butler, to do that. I would say a great part of the production of coal today comes from lands which are either owned by the operators or which are leased under the old leases carrying the low royalty rates.

Now, you all know from previous hearings with reference to the Coal Act that the coal business is a highly competitive one, and there frequently have been long periods when the industry will operate at a loss.

The result is that the coal operators are extremely loath to pay a higher royalty rate than their competitors, and if a company wants to put a new mine right next to one that is already developed, and has a low royalty rate, why, it naturally does not want to increase its cost for royalties 2 or 3 times what its competitor is paying. That big production at a low cost or a low royalty rate has a very definite brake on the ability of the landowner to get a higher royalty rate to overcome the effects of inflation.

Senator KERR. The royalty rate is as nearly inflexibly fixed upon a fellow getting ready to lease a piece of land that is not under lease, as it is on a fellow whose land is already leased, and the amount fixed by the old lease; is it not?

Mr. CAMPBELL. In practical effect, that is true, Senator.

Do you have any further questions?

Senator KERR. All right, Mr. Campbell.

Mr. CAMPBELL. We presented our case to the Ways and Means Committee and it found merit in it and adopted the substance of our proposal in section 307.

We proposed to the committee that the following sentence be added to section 117 (k) (2) of the Internal Revenue Code:

> The date of disposal of such timber or coal shall be deemed to be the date on which such timber is cut or such coal is mined—

But it was not added in H. R. 4473. We believe that this sentence would clarify and make certain the intention of the Senate when section 117 (k) (2) was added to the Internal Revenue Code in the Revenue Act of 1943. Under both timber leases and coal leases, final disposition from lessor to lessee does not occur until the timber is cut or the coal is mined. However, the Treasury took a different view and held that, with respect to the lessor, the disposition occurred when the lease was made, and its position has, apparently, been upheld by the Tax Court of the United States in Springfield Plywood Corp. (15 TC No. 91 (1950)). The peculiar facts in this case resulted in a ruling which certainly ought not to be given general application. Correction of this decision will require affirmative action by Congress.

The facts in that case indicated that it was really a present sale rather than a lease, but the court passed remarks which indicated that it would uphold the Treasury's construction.

It would seem obvious that a landowner cannot at the same time dispose of coal or timber and retain an economic interest therein. This remark is directed to the exact language of the section.

There are practical difficulties in applying the meaning that disposition occurs when the lease is made. Suppose that 30 years ago a landowner acquired a tract of coal or timber and held it for 7 months and leased it on a long-term lease. His neighbor acquired another tract of coal or timber and leased it within 5½ months of acquisition. Although each lease might run for a 50-year period, the first lessor would get capital gains treatment under section 307, as explained by the Ways and Means Committee report, while the second one would not. Such a result is highly inequitable and is unnecessary. The result could be obviated and the 6-month holding period retained by a simple statement that disposition shall be deemed to occur when the timber is cut or the coal is mined, and we urge that such a provision be added to section 307. Such a provision will be of great importance to individual owners, whose interests change hands more frequently than in the case of corporate owners.

The code has already expressly fixed the time of cutting as the time of sale or disposition by the operator when he computes his capital gains on his timber under section 117 (k) (1). The language is " * * * the cutting of timber * * * by the taxpayer * * * shall be considered as a sale or exchange of such

timber * * *." We ask that the same rule apply alike to lessor and lessee, namely, that sale or disposition occurs when the timber is cut or the coal mined.

Section 307 contains a sentence that the coal owner shall not be entitled to the allowance for percentage depletion provided for in section 114 (b) (4) with respect to such coal. We did not propose this sentence but we do not object to it. We thought it would be implied in any event. However, it should be noted that this reference to percentage depletion applies only to lessors. There is no intent in our proposal, nor language in section 307, to affect in any manner whatsoever the computation of the depletion allowances to which coal lessees or operators are entitled under the code.

Section 307 contains another sentence which we did not recommend. It reads:

In the case of coal, this paragraph shall not apply if such owner is personally obligated to pay a share of the cost of mining operations.

This language probably originated with a desire to exclude from the lessor-lessee relationship arrangements known in the oil and gas industry as working interests. Similar language appears elsewhere in H. R. 4473—for example, on page 40 in the definition of royalty in connection with withholding of taxes. But if such language were given literal effect, it would deny the benefit of section 307 to many transactions which are normal or standard in the leasing of coal.

For example, it is not an uncommon provision for a coal-mining lease to place on the lessee the obligation to pay property taxes which may be assessed against the coal or coal land subject to lease. Where these taxes are assessed against the lessor, under the laws of many States they become the personal obligations of the lessor. Yet such taxes constitute part of the operating cost of the lessee. In other instances, a lessor may share some of the expenses of driving through faulty coal to see if good coal can be found beyond, or may share in drilling expenses for the same purpose. In other cases, the lessor may reimburse the lessee for engineering expense in connection with mining surveys, or the lessee may reinburse the lessor for similar expense. It is our belief that the intent of the quoted sentence was to exclude cases which might be described as joint adventures or as partnerships, or cases where the lessor is a coprincipal in the mining enterprise. We do not believe that the sentence is necessary in section 307 for the reason that the Bureau and the courts are competent to determine when a lease arrangement exists and when a coadventure or copartnership exists. Undoubtedly this view has already been taken with respect to timber, because the sentence is not made applicable to timber. If, however, it is the belief of the committee that some such language should be left in the section, it is our sincere belief that the language should be changed. The sentence would be satisfactory if it read as follows:

In the case of coal, this paragraph shall not apply if such owner stands in the relation of coadventurer or copartner with respect to the lessee in carrying on the mining operations.

Or the sentence might read as follows:

In the case of coal, this paragraph shall not apply if such owner is personally obligated, by virtue of his agreement with the mining operator, to pay a fixed percentage of the cost of mining operations, rather than a part or all of certain specific items of expense.

In conclusion, we believe that a coal lease presents a classic case for the application of the capital-gains provisions, and we respectfully submit that this honorable committee should approve section 307, modified in accordance with our suggestions.

Senator MILLIKIN. Let me put a case to you, please.

Mr. CAMPBELL. Yes, Senator.

Senator MILLIKIN. John Doe leases Black Acre to Y for coal-production purposes. John Doe retains a royalty on the coal. He also engages in the mining operation. In that kind of a case, would you make an exception as to the capital-gain treatment of the royalty concerned?

Mr. CAMPBELL. If the lessor is an active participant in the mining enterprise, he would be excluded from the capital gains by the language of section 307.

Senator MILLIKIN. Why?

Senator KERR. Don't you think his income from royalties should be recognized, and if he were not an operator——

Mr. CAMPBELL. Yes; I do. I suggested that the sentence be deleted.

Senator KERR. Then his income that he receives as an operator should be handled on the basis as if he were only an operator.

Mr. CAMPBELL. That is correct. I know a specific instance of that sort, where a landowner leased an undivided interest in his oil and gas to an operator. The operator pays a royalty on that undivided interest, but the landowner shares in the expenses with respect to the remaining undivided interest.

Senator KERR. Don't you think if he establishes both identities, that he should be permitted to separate them with reference to his tax liability?

Mr. CAMPBELL. Yes; I do, Senator.

Senator KERR. That is the point.

Senator MILLIKIN. But I don't believe you said so.

Mr. CAMPBELL. I think you are correct in your criticism of my remarks, because what I was trying to do was to make certain that the language here would not have the effect of excluding from the benefits of section 307 a case where a lessor might for some reason or other contribute to a specific item of expense.

Senator MILLIKIN. I don't think that has the slightest relevancy to your point. The lessor's contribution to the working interest may be the thing that is necessary for him to get any royalty, and he has the most legitimate reason, and he may have the most legitimate reason, for contributing to the working interest, and I certainly do not think—if it is sound to tax coal royalties on a capital-gains basis, I cannot think of the slightest reason why he should not have that benefit.

At the same time, as Senator Kerr points out, he should bear whatever the normal-tax liability is on the operating interest. I see no conflict between the two. In fact, the economic usefulness of each status is complemented by the other.

Mr. CAMPBELL. I think your comments are entirely in order and proper. The purpose of my remarks was to see that the language in section 307 was not such as to exclude from the benefit of section 307 arrangements which are common in the coal industry.

Senator MILLIKIN. We have got to watch what we are doing here because pretty soon we are establishing precedents in other fields.

Senator Kerr is more familiar with the facts than I am, but it frequently happens that a man will make an oil lease on his property, retaining a conventional royalty.

Mr. CAMPBELL. That is right.

Senator MILLIKIN. But in order to get action so that he can get some of that conventional royalty, he will contribute to the working interest for the development and exploration of the property. I see no conflict whatever between the two, and I see no conflict in treating each according to its status.

Senator KERR. Nor is there any difficulty involved in doing so.

Senator MILLIKIN. Not the slightest difficulty.

Mr. CAMPBELL. I do not want to be misunderstood as saying that where there is a relationship of lessor and lessee that this benefit should not apply, to the extent that the relationship involves a dual relationship of a coprincipal and a lessor and lessee, then, the two should be treated separately.

Senator MILLIKIN. Tax each according to the nature of the interest.

Mr. CAMPBELL. Yes

Senator KERR. In other words, you would allocate to the royalty owner that which was his, and to the lessee that which was his.

Mr. CAMPBELL. That is right.

Senator KERR. All right.

Mr. CAMPBELL. Mr. Chairman, Mr. L. H. Parker is here, and I would like to ask your indulgence to permit him to say just a few words about this time of disposals.

Senator KERR. At this point we have a Mr. Black who has to catch a plane, and who is next in line, and it might be that it would be possible for the other gentleman to appear later after the other scheduled witnesses have been heard, Mr. Campbell.

Mr. CAMPBELL. I think he will only take 1 or 2 minutes.

Mr. PARKER. The only thing I had to say was that I was associated with the Forest Committee on Taxation, and cooperated in drafting the timber provision, and from my experience, section 117 (k) (2) was made retroactive way back to 1913 to establish what we thought was the original principle which had been upset by bureau ruling in 1940, and it is my distinct and firm recollection that in the old days the time of disposal of the timber was the date on which the timber was cut, not on which the contract was made.

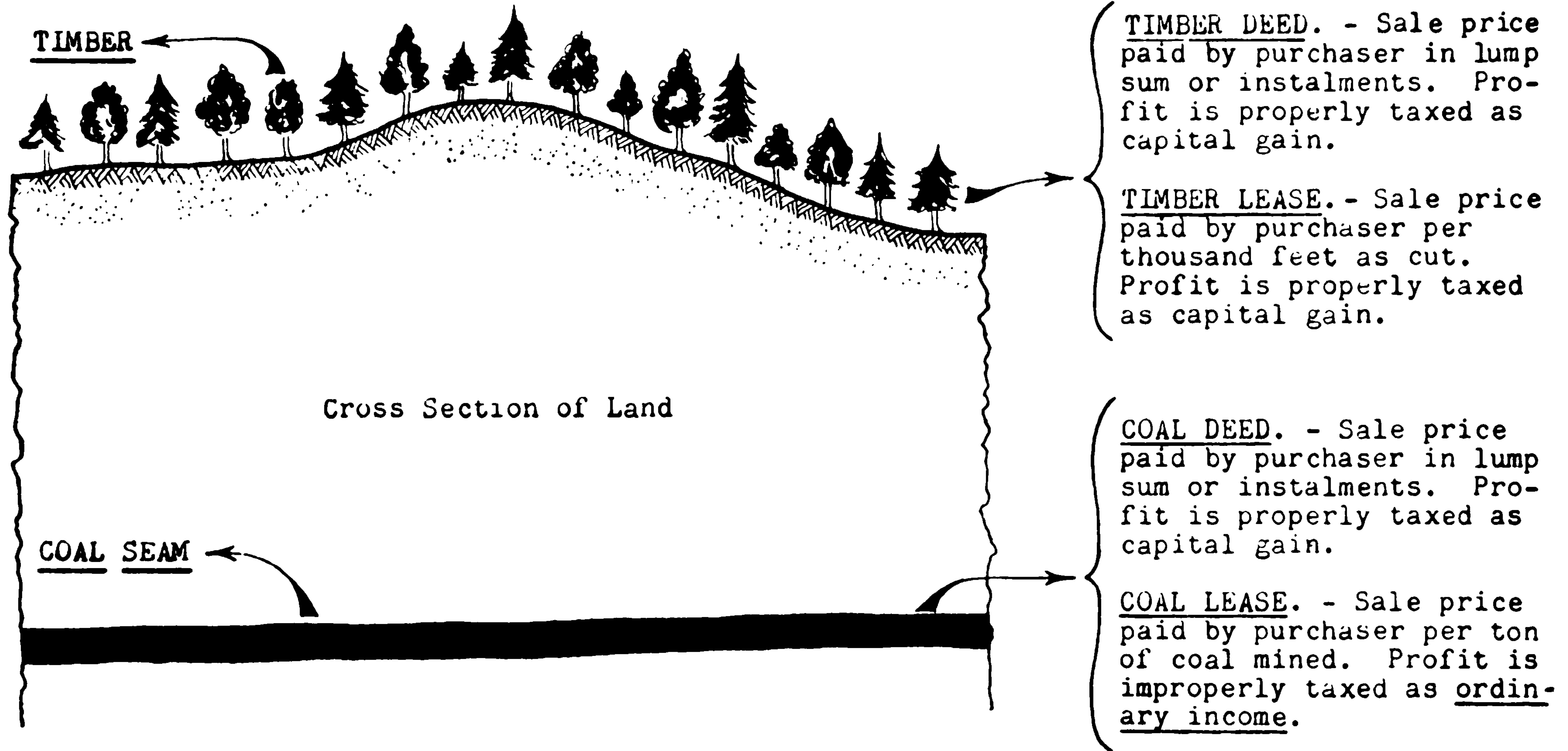
Senator KERR. The lease was made.

Mr. CAMPBELL. I thank you very much indeed for your indulgence.

Senator KERR. Your illustration will be placed in the record at this point.

(The illustration referred to follows:)

ILLUSTRATION OF THE PRESENT METHODS OF TAXING PROFITS FROM SALES OF TIMBER AND COAL IN PLACE, SHOWING DISCRIMINATION AGAINST COAL LESSORS



Since coal leases are sales of undeveloped real estate held for long-term investment, the same as coal deeds, timber deeds and timber leases, any profit from sale by coal leases should be treated as capital gain the same as the profits from sales by coal deeds, timber deeds and timber leases are treated.

Mr. CAMPBELL. I submit a revision of section 307, showing specifically the changes which I hope will be made by this committee:

SEC. 307. TAX TREATMENT OF COAL ROYALTIES.

(a) DEFINITION OF PROPERTY USED IN THE TRADE OR BUSINESS.—Section 117 (j) (1) (relating to the definition of property used in the trade or business) is hereby amended by adding after the word "timber" in the second sentence thereof the following: "or coal."

(b) GAIN OR LOSS UPON CERTAIN DISPOSALS OF TIMBER OR COAL.—Section 117 (k) (2) relating (to the disposal of timber) is hereby amended to read as follows:

"(2) In the case of the disposal of timber or coal (held for more than 6 months prior to such disposal) by the owner thereof under any form or type of contract by virtue of which the owner retains an economic interest in such timber or coal, the difference between the amount received for such timber or coal and the adjusted depletion basis thereof shall be considered as though it were a gain or loss, as the case may be, upon the sale of such timber or coal. Such owner shall not be entitled to the allowance for percentage depletion provided for in section 114 (b) (4) with respect to such coal. ~~(In the case of coal, this paragraph shall not apply if such owner is personally obligated to pay a share of the cost of mining operations.)~~ *The date of disposal of such timber shall be deemed to be the date on which such timber is cut or such coal is mined.*

(c) CLERICAL AMENDMENT.—The heading to section 117 (k) (relating to the gain or loss upon the cutting of timber) is hereby amended to read as follows: "(k) GAIN OR LOSS IN THE CASE OF TIMBER OR COAL.—"

(d) EFFECTIVE DATE.—The amendments made by this section shall be applicable only with respect to taxable years ending after December 31, 1950 (whether the contract was made on, before, or after such date), but shall apply only with respect to amounts received or accrued after such date.

Secretary HOEY (presiding). Mr. Black?

Mr. Black, give your name and connection.

STATEMENT OF JOHN W. BLACK, JR., PRESIDENT, DIXIE DRIVE-IT-YOURSELF SYSTEM, ACCOMPANIED BY WILLIAM A. WATSON

Mr. BLACK. John W. Black, Jr., of the Dixie Drive-It-Yourself System, of Birmingham, Ala.

Senator HOEY. All right, proceed with your statement.

Mr. BLACK. Mr. Chairman and members of this committee, we appreciate the time you have given us.

We are here in regard to what has already been mentioned briefly once, and that is section 123, which relates to affiliated or closely held corporations.

As you know, and as was incorporated in this bill, any group of two or more corporations which have at least 95 percent of the voting power of all classes of stock owned directly or indirectly by one or more individuals, and not more than five, must file a consolidated return with one surtax credit and one excess-profits-tax credit.

In the report of the House Ways and Means Committee on this bill, H. R. 4473, they state as follows:

> Evidence has been presented to this committee which indicates that a substantially smaller incentive led in some cases to the artificial splitting up of business enterprises into a large number of individual corporations during World War II.

We are not contending that is not so. What we are contending is that under the present regulation, as it stands, it will hurt not only small business in the future, but will certainly hurt small business corporations previously formed.

Our own corporations, of which there are nine, were formed in 1931, with no tax benefit in mind.

As we all know, the tax structure in 1931 was that the first $3,000 were completely exempt, and all over $3,000 we paid a flat 12-percent tax.

We have some figures here taken from our corporate statements and I would like to give these figures to this committee.

It was found that in our smaller corporations, when we report this income collectively, with just the single exemption, we found that the corporations making the smallest amount of money would pay the largest amount of tax. In fact, our smallest corporation, if this law goes through, will have a tax increase of approximately 60 percent.

Our largest corporation will have a tax increase of 26½ percent. In other words, it is a blow not only to our corporate structure as it has existed, but it is a blow against any type of small business.

Our company operates cars and trucks for daily rental and under long-term-lease contracts to various concerns, such as Sears, Roebuck and other national concerns including, of course, many local businesses.

A small business has only one source of actual capital growth or capital for growth, and that is through the retention of earnings. That is the only way our corporations have been able to grow and expand. We cannot go to the stock market for capital and cannot put out a bond issue to the general public.

If the law is passed, it will absolutely retard our growth, because of the greatly increased amount of taxes we will have.

There are tens of thousands of other small businesses opposed to this present law, but I want to make this point to the committee, and make it very pointedly, if I may: If this section 123 had been publicized properly—it was more or less a hidden provision—I believe that the Senate Finance Committee would have many thouands of protests with respect to this section.

There were a number of cases, and we know of them, where separate corporations have been set up for tax gain. Our nine corporations, scattered over seven States and in nine cities, were formed for legitimate reasons and, as I stated, without tax reduction in mind.

We were formed separately for four basic reasons back in 1931: First, for protection against excessive accident liability and damage suits. In our business this is a great hazard.

Second, the failure of one corporation or the bust of one corporation, could not pull upon the assets of the other, and we have had one of our corporations fail during the 20-year period we have been in operation. This corporation could not pull upon the others, which have been able to survive.

Third, we have nine vice presidents and managers, who participate in the profit of our corporations up to a maximum of 25 percent, and it would be very hard to penalize one manager for a good operation and give another manager a benefit or another vice president a benefit of what, we will say, is a poorer operation.

Fourth, and last, is that when we started in business we were very, very heavily indebted. We started out with a prayer and great hopes, with fear and trembling, and at that time we had to set up separate corporations simply because one of the corporations could very easily fail with the heavy obligations they had.

I would like to extend this point.

Senator HOEY. You spoke of the law requiring a consolidated return. You do not have to make a consolidated return under this, but you would be permitted only one exemption.

Mr. BLACK. Yes. We would spread the one between nine corporations; you are right about that.

I would like to make this point: We have been in business 20 years, and we have never split any of our corporations. They are and remain as they were formed. Yet now, if this new law goes through, we have to file a consolidated return.

This new law hits small businesses in other ways. First, the 5-percentage-point increase in the normal tax amounts to a 20-percent increase to one or any of our corporations, making $25,000 or less per annum.

Second, the forced division of the surtax exemption between related corporations will cost us anywhere from 20 to 60 percent more money in taxes this year, in addition to the increase in the normal tax, as advocated in the House bill.

Third, the spreading of the excess-profits-tax minimum credit will be an additional tax burden, but the amount will be unknown until our final calendar-year figures are available.

We know, and we believe, that the revenue bill of 1942 actually made the corporate split-up a profitable venture. It was that revenue bill that financed or began to finance World War II, and we started in with higher-notch provisions and with the various exemptions and, as I have said before, many corporations have split since 1942 for tax purposes only; we have not.

I would like to submit the following, and recommend the following, if I could be allowed to. We submit that this committee should take action along one of the following lines stated in order of preference: First, eliminate entirely from the law these changes that, in effect, force the consolidation of affiliated corporations, and further penalize small business.

Second, write into the law provisions that will give the Internal Revenue Department discretion in determining whether or not separate corporations have been organized and used primarily for the purpose of tax evasion.

Senator TAFT. I think that is impractical, Mr. Black. I mean, we were considering it, but I cannot see any merit to it. Gradually, if the tax advantage is one way or the other, corporations will drift into the place where they get the tax advantage, and they have some other reason for doing it, some other legitimate reason for doing it, and they drift into it sooner or later.

I do not see how we can base this distinction on the motives of the people who do it. There might be some distinction based on the separate enterprises being really separate enterprises, although I can see great difficulty in drawing that kind of a definition.

Mr. BLACK. Well, I can see the hard part of distinguishing this.

Senator TAFT. I cannot see how you can base it in the long run on motive. The motive disappears after——

Mr. BLACK. Well you could be right. If someone obtains a good tax lawyer it might be possible to find the motive.

Senator TAFT. Yes.

Mr. BLACK. We would like to make a third recommendation if this would be better; set a date and apply the changes only to those corporations organized since the date so set.

Senator TAFT. I have a good deal of—one thing that does seem to me perfectly clear—the other thing is pretty much confused—is that the tremendous increase, coming on top of the other increase that we are giving everybody, is a tremendous burden on these companies. If it is going to be done at all, it seems to me that that increase ought to be spread over 3 or 4 years, to let them get used to it.

But, on the other question, what worries me more is as to how you are going to distinguish these corporations.

Mr. BLACK. Could we possibly set a date? As I say, we have been in business 20 years. We established our corporations in 1931 when the tax made no difference to us at all, and in fact, for 3 or 4 years we had a hard time even keeping our head above water and staying in business. A date could be set, for example, 1942, when it actually started.

Senator Taft, in our own business, we could have set up separate corporations, because we have a truck rental and long-term-contract department, and a passenger-car rental and long-term-contract department, and they are in separate buildings in each instance. This could have been accomplished in 1946 and for 5 years we would have obtained a terrific benefit with these extra exemptions, if we had so desired. I think it is the intent and the purpose, and possibly the showing of good faith in this bill that would exclude such companies that have been in business, as separate set-ups for a protracted period of time.

Senator TAFT. Well, there are lots of other cases where the shouting is going to be just as loud. I do not think you are going to get people asking for this change here on any date.

Mr. BLACK. Well, you heard Mr. Cardwell, from New York, this morning. He brought it up from a different angle the instance of a man who has accumulated some cash and wanted to set up an electrical store or plumbing shop, and he owned it, or his wife owned it, and they had two businesses together, and they would have one exemption and file one return.

Our vice presidents or resident managers are interested in the net profits after taxes in each of our corporations to the extent of 25 percent and are, in effect, stockholders, even though they do not hold stock, and we believe that the law should be so written as to avoid penalizing these managers.

It is understood in the House bill as it is now written that everyone's tax will be increased 12½ percent. Mr. William A. Watson, who is the vice president and manager of our New Orleans corporation, is with me today. His tax will not be increased by merely 12½ percent and his income reduced accordingly because of the effects of section 123 and the fact that a great portion of his personal income is derived from the profits after taxes of his operation.

Senator Hoey, I would like at this time to ask Mr. Watson a few questions if we have the time.

Senator HOEY. You will have to make it very brief because we have a lot of witnesses who are waiting.

Mr. BLACK. Yes, sir.

Mr. Watson, you have been in this business for how long?

Mr. WATSON. I have been with this corporation for 20 years, about 20 years and a half.

Mr. BLACK. Would you explain just briefly to the committee how this would affect your income and your bracket of tax.

Mr. WATSON. I think that I am probably typical of a number, a great number, of employees who work for small corporations on a percentage-of-profits basis.

Of course, a lot of corporations would be affiliated under the definition of this section 123, but the earnings of a corporation determine my personal earnings.

Now, even if we go ahead on our small corporation in New Orleans, we are obliged to take only a portion of the exemption for surtax purposes, that immediately cuts back my earnings for the year.

Then, in addition to that, the tax on my personal income goes up, so I get reduced both ways under the proposed legislation.

I think section 123 almost takes the view that goes on the assumption that all corporations that are described under it were formed for the purpose of tax evasion, and I think that is a very erroneous assumption to work under.

Senator TAFT. No, that is not the principle, I do not think. The principle is that they are giving exemptions to small business. The question is when a fellow has got a hundred stores is he small business any more just because they are in separate towns. I mean, that is the argument for the proposal. I do not say it is a sound one. The answer seems to be that the distinction you are trying to make is that if that is a big business made up of a lot of little businesses, it is little business still.

Mr. WATSON. That is true, and we are explaining here, that the individual manager of each town and corporation is a de facto owner of stock, although he does not legally own the stock, see what I mean?

Senator TAFT. It was pointed out by one man that if you had a 10-percent interest in the stock, then this law would not apply.

Mr. WATSON. That is correct. But, Senator, we were organized in 1931. Had I had the capital at that time to have put in and bought the 25 percent of the stock then available we would not be here today because we would not be involved. But due to the fact that I had not the capital, I contributed to this corporation my experience, my ability, and my desire to work, and in return I obtained a contract calling for 25 percent of the net profit after taxes. It is not a stock interest, but it certainly works the same as a stock interest. But I am being penalized now because I did not have the capital 20 years ago.

Senator TAFT. But you see the distinction. Here you have one enterprise in one town doing the same business, we will say, as your whole nine companies. They get one exemption. You are doing that business, only you are doing it in nine towns and doing it in nine separate corporations, and you get nine exemptions. That is the thing that apparently the staff and the Treasury thought was unfair. In other words, you are just as big a business really as the fellow who has only one establishment and in one town, doing nine times the business. Even with this change, you do not get your rate up to—you do not get the rate any higher than every other corporation in the country is doing, you see. I mean this is a special exemption for small business. Now, shall it go nine times to a concern that is really

one concern? I think you have got to draw a distinction somehow about the character of the separate units that are in existence as a condition of their being allowed to be a small business. That is a hard line to draw, but I think that is the line to follow if you want to get relief, rather than some of the things suggested.

Mr. BLACK. I have many business associates who have split their corporations and this was done purely for tax purposes. These corporations differ from ours in that they are located in the same vicinity and in most instances operate out of the same building. In so far as our corporations are concerned they are widely scattered and are only separated to the extent of the cities in which we operate. It might be explained that we presently are operating in most major southern cities from New Orleans, La., to Cincinnati, Ohio, and there is a separate corporation in each of these cities.

Senator TAFT. Well, it certainly is having a very disastrous effect on a lot of people.

Mr. BLACK. Section 123 will reduce the return on our investment to approximately 1½ to 2 percent.

Mr. WATSON. You are hitting at a great number of men, Senator, who are not stockholders at all, that is the trouble.

Mr. BLACK. Senator, we appreciate your giving us the time.

Senator HOEY. Thank you very much.

I am advised that there are two witnesses whose testimony is short. and we will call them at this time.

First, is Mr. Clarence Schock. Will you give the reporter your name and connection.

STATEMENT OF CLARENCE SCHOCK

Mr. SCHOCK. My name is Clarence Schock. I am a citizen of Pennsylvania, and reside in Mount Joy, Lancaster County, Pa.

Senator HOEY. Have a seat if you like, Mr. Schock.

Mr. SCHOCK. Mr. Chairman, I am afraid I will be out of sight if I sit down. I am rather small in stature.

Senator HOEY. All right. Use your pleasure.

Mr. SCHOCK. Mr. Chairman and other members of the committee—I think I am about as blind as a bat, but they tell me that I am talking to Senator Hoey, Senator Millikin, and Senator Taft. I hope that you will find it possible to stay and not walk out on me before I get through. I will try to be as brief as possible.

I am appearing before you this morning on behalf of worthy 101 (6) corporations, organized and operated for the benefit of charity and education, the charters of which require that all net earnings must go to or be used fo· the benefit of educational institutions which have faculties to teach and a student body to be taught; which also require that even in case of dissolution, all assets must go to the same beneficiaries, and which also provide that the 101 (6) corporations may engage in business solely for the purpose of earning funds to be used exclusively for the benefit of charity and education.

Senator HOEY. These corporations, do they manufacture things wholly unrelated——

Mr. SCHOCK. I beg pardon?

Senator HOEY. Do these corporations manufacture goods and so forth wholly unrelated to the beneficiaries?

Mr. SCHOCK. They may do either. I am talking broadly, Senator. They may be manufacturing goods or they may be doing merchandising, but they go into these businesses—the kind I am talking about, that are permitted to go into any kind of business solely for the purpose of earning funds to be used solely for charity and education.

Senator HOEY. It is your position that they ought to be free from taxes, while engaged in business in competition with other folks?

Mr. SCHOCK. If you will let me finish I will tell you how it could be perfectly safe to let them do it. I am talking about the worthy ones. There have been plenty of evasions; there have been plenty of misuses, unethical use of the privilege of exemption, and I hope that you will punish those who dare to make unethical use of exemption, and I think you can do it.

Now, let me tell you, I am hoping that you Senators will persuade Congress to amend H. R. 4473 so that it will bring about the following results: First, impose penalties upon those who dare to make misuse of the privilege of exemption and second, give the Revenue Department power to compel an audit of an exempt corporation by a reputable auditing organization at the expense of the exempt corporation as often as the Revenue Department sees fit so to do, but not more frequently than once a year, in order that the operations of an exempt corporation may be an open book to the Revenue Department.

Third, I plead with you to grant exemption to the worthy 101 (6) corporations, to complete exemption, sir, provided you are assured that they are not guilty of unfair competition.

Senator MILLIKIN. Let us suppose—I am not taking a position one way or the other, but let us suppose a case, supposing that I have a dry goods store on Main Street in the town of Squeedunk. Supposing that Senator Hoey has one right next to me doing the same kind of business.

Mr. SCHOCK. Yes.

Senator MILLIKIN. Supposing that Senator Hoey is operating that dry goods store for the worthy purposes that you mention, and gets tax exemption.

Mr. SCHOCK. Yes.

Senator MILLIKIN. How are you going to equalize the situation so far as I am concerned, who is engaged in the business of competing with him?

Mr. SCHOCK. I am about to tell you that as I go on.

Senator MILLIKIN. I would like to know that.

Mr. SCHOCK. I think I can point out how it can be done. To me it is an easy thing to do.

Now, let me see, where was I at—about the Revenue Department having power to compel audit of exempt corporations.

Now, third—I have asked you to grant exemption, that was the third point.

The fourth point is if a 101 (6) corporation undertakes to go into business, as it is permitted to do under its charter, solely for the purpose that I have stated, and if such corporation engages in competition with nonexempt businesses, and if said exempt corporation shall have during any fiscal year from the profits of said fiscal year have given to charity and education no less than the same amount that it would have been compelled to pay as income tax to the Federal Treasury

if it were not exempt, then I say that such a 101 (6) corporation should be deemed to be worthy of exemption.

Senator MILLIKIN. How do you make good to me the competition which I am getting from Senator Hoey because of tax exemption for his worthy objective?

Mr. SCHOCK. I have told you that if he has got to pay the same amount of income tax, his revenue will be reduced just the same as the other fellow. He will not dare to do it. He will lose money. He will be in the same position if he has to pay the same amount of income tax.

Now let me add to the fourth provision that if an exempt competitor, such as Senator Millikin has described shall have been duly warned to desist from any unfair business practices and a Federal court shall have decided that such competitor shall have continued to be guilty of such unfair business practices, then such competitor should lose his exemption; and also, as previously stated, exemption will be lost if such competitor fails to pay to charity or education as much as his income tax would have been in case he were not exempt.

Senator TAFT. You are suggesting that he figure up his income tax and then be required to pay the full amount of that income tax to his charity?

Mr. SCHOCK. How is that?

Senator TAFT. Then you would have to go on further and require him to pay a distribution of dividends of some sort to the charity, too.

Mr. SCHOCK. To pay what?

Senator TAFT. He would have to pay some return besides—he could not keep all of his earnings. Then he would have to turn them over, too, as well as this tax.

Mr. SCHOCK. Senator, the earnings which are kept—they cannot be used for anything but for the benefit of the charity or education. They cannot pay them out to anybody. They must use them for that and nothing else.

Senator TAFT. I know, but they might reduce the price of the goods.

Mr. SCHOCK. What?

Senator TAFT. They might reduce the price of their goods. As I see it, if you want to do what you want to do, you would have to require that the corporation pay it, it seems to me, in that year—pay a sum equivalent to the income tax they would otherwise pay, plus some other sum, the return on the capital.

Mr. SCHOCK. You mean something to equal the amount of dividends that another corporation pays out?

Senator TAFT. That the private company would be paying.

Mr. SCHOCK. What?

Senator TAFT. Something to equal the amount of dividends the private company might be paying.

Mr. SCHOCK. Yes, you might claim to do that, I would admit that.

What I want you to do is to grant exemption to these people, but nail them down so that they behave themselves, and punish the ones that do not.

Now, there are some other things they must be kept from doing besides what we are talking about. My fifth condition is that the members and directors shall receive no remuneration whatever for their services, as such, and that officers and employees and managers receive nothing but salaries, and those salaries must be no greater

than the value of the services rendered to the corporation. That is also a qualification for exemption.

Next, sixth, I think is my number—you have got me a little mixed up—give the same consideration as to exemption to worthy 101 (6) corporations which Congress has seen fit for many years to give to municipal authorities, only there is no need for granting a deduction from taxable income for the benefit of the holders of bonds of such corporations.

Now then, here is the most important of all, No. 7: Make it a condition of the privilege of exemption that such a 101 (6) corporation must be able to prove to the Revenue Department that it has paid no more for fixed assets, including land, buildings, and equipment, than the true fair value of such assets, as of the time of the purchase of the same. That is something that has been very much abused; and in addition to that if said 101 (6) corporation has not already itself done so, let the Revenue Department have power to compel an appraisal of the fixed assets of such a corporation at the expense of the 101 (6) corporation, by a competent appraisal company, in order that the Revenue Department may know just what the actual value of the fixed assets was at the time they were purchased.

That is the most important of all, in my opinion, because from what I hear about things that have been done under this privilege of exemption, there have been some enormous violations, I would call them almost crimes willfully committed; of course, that kind of thing should be stopped, and you can stop it all right. It is only a matter of passing the right kind of laws, Senator Taft—I am addressing Senator Taft, am I not?

Senator TAFT. Yes.

Mr. SCHOCK. I am as blind as a bat; I cannot see you, but you might add the compelling of the payment to charity or education of a certain amount of dividends in addition to the amount of tax exemption.

Senator TAFT. A certain amount of the net earnings.

Mr. SCHOCK. But the corporation does not always have to pay dividends. You know sometimes they pass dividends so that you ought to be careful about how that would be imposed. But let me say if all these things are done, the exempt corporation must pay the same amount as income tax to charity or education that the nonexempt corporation must pay—the exempt corporation must pay the same amount of money to charity and education that the nonexempt one must pay into the Federal Treasury and if you follow the rates that are in H. R. 4473 now, that would be 52 percent of earnings in one case will go to charity and education, and in the other case it would go into the Federal Treasury.

Forty-eight percent is left, and they will be in precisely the same position under those circumstances. You could, as Senator Taft has suggested, compel them to pay income tax, or I mean an additional dividend to charity and education, equal to a moderate dividend on the value of the assets of the company.

Senator TAFT. Equal to some percentage of their net earnings, I would say.

Mr. SCHOCK. How is that?

Senator TAFT. Equal to some percentage of their net earnings.

Mr. SCHOCK. No; I would say——

Senator TAFT. For that year.

Mr. SCHOCK. I would suggest, Senator, that it be something equal to a certain percentage of their net worth. I think that would be fairer. Of course, I am pretty liberal on that question. I do not believe that any corporation should be allowed to pay more than 5 or 6 percent on the honest-to-goodness original paid-in capital; but that would be heresy under the present understanding of the American system of free enterprise.

I believe in private ownership of property and the operation of it privately, but I believe in strict regulation of it, and I think the power of money should be limited, and you cannot limit it unless you reduce and control the rate of interest that is paid even when it is invested in industry and commerce. There is no other way of doing it.

Senator HOEY. You had already passed the seventh point.

Mr. SCHOCK. I think I pointed out enough of this, and I say to you gentlemen that if you tax the corporation, such as I have spoken of, you will be taxing charity and education. If you grant exemption under the conditions that I have suggested, you will be helping to give more than double the amount of exemption to charity and education, and in normal times when taxes are more reasonable than today, why, that difference, that ratio might be even greater than that.

Now, let me tell you about one of these 101 (6) corporations which gives its all to public schools. It operates a mercantile business wholesale and retail. It has given to the public school district of the territory wherein it operates $330,743. Its members and directors receive nothing for their services as such. Its officers, managers and employees of all kinds receive nothing but salaries, and these are no greater than the value of the services rendered.

Beginning in 1951, because of the extreme shortage of teachers in the elementary grades of the public schools, this corporation obligated itself to give funds to four State teachers colleges to be used solely to provide scholarships of $1,000 each or $250 per year for dormitory students; and scholarships of $500 each or $125 per year for day students, to be used solely to help worthy young high-school graduates who are eager and able to become teachers in the elementary grades of the public schools, and who need financial assistance, to be able to pay the cost of elementary teacher education in a State teachers college. State teachers colleges have no funds for this purpose, except legacies and gifts.

They are immediately under the department of public instruction of the State in which they operate, and this 101 (6) corporation was compelled to enter into written agreements with each of these four State teachers colleges, and these agreements had to be approved before they became effective by the department of public instruction, and they had to have the signature of the superintendent of public instruction for that purpose, so that they might be able to carry out their plan.

Now, inasmuch as this 101 (6) corporation offered its services and its funds to an executive department of a sovereign State to be used solely to carry on a normal function of a division of an executive department of a sovereign state, and inasmuch as this executive department of a sovereign State approved this contribution and accepted it, and will use it to carry on the normal function of a division of an executive department of a sovereign State, gentlemen, I

claim that under those circumstances if Congress taxes corporations such as this 101 (6) corporation, it will be taxing the public schools of a sovereign State and it will be taxing a political division of a sovereign State; it will be taxing the department of public instruction of a sovereign State; it will be taxing an executive department of a sovereign State. It will, in effect, be taxing a sovereign State.

That, gentlemen, Congress has been reluctant, always been reluctant, to do, and I believe it has always been indisposed to impose a tax on any corporation which gave its all and devoted its whole attention to help to carry on a normal function of a political division of a State or a division of an executive department of a sovereign State.

Now, let me wind up in this manner. Let me offer two proposals for amendment to H. R. 4473, one of which is proposal (A) which, if enacted into law will grant exemption to such 101 (6) corporations which give their all to educational institutions which have faculties to teach and a student body to be taught; the other of which, proposal B if enacted into law will grant exemption to 101 (6) corporations which give their all to public schools.

I hope that Congress will see fit to grant an exemption to the larger and broader group, but if for any reason it cannot see its way clear so to do, I cannot see how Congress can consistently see fit to depart from its time-honored custom, and impose a tax on a 101 (6) corporation which gives its all to public schools, when such gift is approved and accepted by an executive department of a sovereign State and used to carry on a normal function of a division of an executive department of a sovereign State.

I desire to offer also herewith four statements by prominent educators of the public school system of Pennsylvania.

Senator HOEY. They may be included in the record.

Mr. SCHOCK. How is that?

Senator HOEY. They may be included in the record.

Mr. SCHOCK. That is the idea. I knew you would not give me time to read them.

Senator HOEY. No.

Mr. SCHOOK. I could not do it, Senator, because I am too blind. I would have to pass them on to someone else to do it.

You will let me tell you the names of the educators, won't you?

Senator HOEY. Yes, sir.

Mr. SCHOCK. One of these is by Dr. D. L. Biemesderfer, president of the State Teachers College of Millersville, Pa.; one is by Dr. Harry L. Kriner, president of the State Teachers College of Shippensburg, Pa., who is here in this room at this time, and who is here to take my place in case I should have failed to get here.

There is a copy of one which was sent directly to Senator George by Dr. Swope, president of the State Teachers College of West Chester, Pa.; and a copy of one which was sent by Dr. Rohrbach, president of the State Teachers College of Kutztown, Pa.; and one by Dr. Arthur P. Mylin, county superintendent of public schools for Lancaster County, Pa.

Senator HOEY. They will all be included in the report.

(The letters referred to follow:)

LANCASTER COUNTY PUBLIC SCHOOLS,
Lancaster, Pa., July 6, 1951.

Hon. WALTER F. GEORGE,
Chairman, Senate Finance Committee,
Senate Office Building, Washington, D. C.

DEAR SENATOR GEORGE: The need for trained elementary teachers in the public schools of our country is very great. A certain company, of which I am familiar, has turned all of its profits toward the preparation of teachers for this important field.

If H. R. 4473 is not amended to exempt corporations of this type, there would be a considerable reduction in the scholarships awarded by this company. Consequently, many young people would not be financially able to attend college to receive training in this important field of elementary education.

It would seem to me that the new revenue act could be drafted in such a manner so that corporations giving all of their profits to public education would be exempt from taxation.

Sincerely yours,

ARTHUR P. MYLIN,
Lancaster County, County,
Superintendent of Shcools.

COMMONWEALTH OF PENNSYLVANIA
DEPARTMENT OF PUBLIC INSTRUCTION,
STATE TEACHERS COLLEGE,
Kutztown, Pa., July 2, 1951.

Hon. WALTER F. GEORGE,
Chairman, Senate Finance Committee,
Washington, D. C.

MY DEAR SENATOR GEORGE: This letter represents a request for tax exemption for all 101 (6) corporations all of whose net income is donated for the benefit of public education.

This instution is the beneficiary of $1,000 from a 101 (6) corporation which provides all of its net income for scholarships in 195 1–52. This amount provides scholarships for five students who are preparing for elementary teaching.

All 101 (6) corporations should be required to be audited annually at their own expense by a reputable firm of accountants.

Such 101 (6) corporations should be required to contribute to public education at least as much as their Federal income tax amount would be if they were not in an exempt category. This requirement is necessary to control unfair competition.

All 101 (6) corporations must be controlled so that benefits accruing to directors, officers; employees, and stockholders shall represent only salaries with the amount no greater than the service rendered.

Sincerely yours,

A. W. ROHRBACK, *President.*

STATE TEACHERS COLLEGE,
West Chester, Pa., July 3, 1951.

Hon. WALTER F. GEORGE,
Chairman of the Senate Finance Committee,
United States Senate, Washington, D. C.

DEAR SIR: The West Chester State Teachers College is one of the beneficiaries of a 101 (6) corporation which, we understand, is organized and operated primarily for charitable and educational purposes. Other Pennsylvania teachers colleges which receive scholarship grants from this corporation are the Millersville State Teachers College, Shippensburg State Teachers College, and Kutztown State Teachers College.

Scholarships are given needy and worthy high-school graduates who wish to attend one of these colleges in pursuit of elementary education. These scholar-

ships are awarded in the amount of $1,000 each for a 4-year period. Three thousand dollars was assigned the West Chester State Teachers College which amount was given one resident and four day students.

I am informed that Congress is considering a tax measure which would not exempt a 101 (6) corporation from paying Federal income tax even though the company is incorporated as a nonprofit organization. It seems to us that a Federal tax imposed upon this and similar corporations is bound to handicap charitable and educational institutions which receive much needed assistance from such corporations. Trained teachers for the elementary grades presents one of the most serious problems in public school education today. Corporation 101 (6) has come to the assistance of the State Department of Public Instruction in Pennsylvania by making these scholarships in the colleges mentioned above available to deserving high-school students in order to prepare them to teach in the elementary schools of the Commonwealth.

If a Federal income tax is assessed against the earnings of a nonprofit corporation, I have no doubt it will seriously affect the operation of many private colleges State colleges, State teachers colleges, private schools and public schools which, in the past, have benefited from this source of income. It is for this reason that I am appealing to you and the members of your committee to consider and, if possible, to exempt from Federal tax all corporations which devote their earnings and assets to educational, charitable and cultural purposes.

Sincerely yours,

CHARLES S. SWOPE, *President.*

COMMONWEALTH OF PENNSYLVANIA,
DEPARTMENT OF PUBLIC INSTRUCTION,
STATE TEACHERS COLLEGE,
Shippensburg, Pa., July 4, 1951.

Hon. WALTER F. GEORGE,
Chairman, Senate Finance Committee,
Senate Office Building, Washington, D. C.

DEAR SENATOR GEORGE: During the coming college year 10 of our college students will receive scholarships given to them by a company whose charter compels it to give all profits to public education. These 10 students would not be able to attend college without these scholarships worth $1,000 each. Our college is only one of four in the State receiving these benefits from this nonprofit corporation.

If a new revenue act taxed 101 (6) corporations which are organized solely for education, the scholarships mentioned above would be substantially reduced, and the benefits now given to public education and benefits permitted for education and charity would suffer. I am informed by a Member of Congress that exemptions "of these nonprofit corporations would make it difficult to draw a line between the worthy and the unworthy." The very reason for the existence of government is to have an arbiter which can distinguish between the worthy and the unworthy. Surely the law can be drawn in such a way that the unworthy can be punished and the worthy can be given permission to continue their good work.

As I understand the situation, the original reason for exempting any group from taxation was to enable such group to perform services of such value to the public that they should not be called upon to contribute to the public treasury. These services include such things as would be necessary for the State to perform if they were not being performed by private organizations. I contend that the scholarships which enable students to prepare for the teaching profession are not only desirable but necessary.

As president of a college maintained by the State, and with students receiving aid from a nonprofit corporation, I urge you and your committee to draft the new revenue act in such fashion that corporations honestly giving its profits to education be permitted to continue in their worthy program without being penalized and without being classed with corporations unworthy of tax rexemptions.

Sincerely yours,

HARRY L. KRINER, President.

COMMONWEALTH OF PENNSYLVANIA,
DEPARTMENT OF PUBLIC INSTRUCTION,
STATE TEACHERS COLLEGE,
Millersville, Pa., July 6, 1951.

Hon. WALTER F. GEORGE,
Chairman, Senate Finance Committee,
Senate Office Building, Washington, D. C.

DEAR SENATOR GEORGE: As president of the State teachers college at Millersville, Pa., I have had first-hand knowledge of the benefits which accrue to young people of less than moderate means when they are enabled to come to college because of scholarship grants. About 20 of our 1951 freshmen, most of whom would not have been able to enroll in college at all, enjoy this opportunity because of a scholarship plan which was initiated by a small local corporation of the 101 (6) classification.

The plan is designed to assist competent but financially needy young men and women to prepare for service as teachers in elementary schools. There is, as you know, a great dearth of adequately prepared teachers in this field. Boarding students at this college, if by competitive examination and satisfactory recommendation entitled to a scholarship, may receive an award of $250 per year ($1,000 over a 4-year period) from this corporation. Day students may qualify for an award of $125 per year ($500 over a 4-year period).

The charter of the corporation which provides these scholarships to Millersville (and to three other Pennsylvania State teachers colleges) requires that all net earnings must be used for the benefit of charity or education. For years, net earnings have been used in this way. The Revenue Act of 1950 has withdrawn exemptions of income from corporations such as this, thereby reducing the amount of money available for scholarships for the kind of young people who come to a low-cost college like ours to prepare to teach children in the elementary schools.

It is the considered opinion of the writer that nonprofit corporations 101 (6) whose earnings, as revealed by competent audit and by charter statement of purpose, are used for charitable or educational services should be exempted from payment of income taxes provided it can be shown that all persons connected with the corporation as members, officers, directors, or employees receive nothing from the corporation, directly or indirectly, other than salaries in an amount which the nature and quality of the service rendered entitles them.

The common objection of unfair competition raised by nonexempt corporations may be justly met if the exempt corporation is required in each fiscal year to have paid out from the earnings in that year to charity, education, or to a political division of a State, an amount not less than the amount of Federal income tax which it would have been required to pay, had it not been exempt.

The fact that certain corporations or organizations have been guilty of flagrantly abusing the provisions of a former revenue act should not cause a new act to impose penalties upon corporations whose practices, both with respect to earning income and to its disposition when earned, have been conducive to the advancement of the best interests of healthy business life and to the furtherance of worthy charitable, educational, and community enterprises.

The writer is able to bear honest testimony to the unselfish purpose and able administration of the corporation whose charter and whose integrity makes possible a college education and entrance to an honored and socially vital profession, that of the teacher, for approximately 50 young people in 4 teachers' colleges in Pennsylvania. A good revenue act should not take away from these young people nor from society the opportunities now offered by this corporation any more than it should allow unscrupulous corporations or individuals to profit from evasions or malpractice under a loosely drawn act.

It is my earnest hope that the existing revenue act may be amended to enable 101 (6) corporations of the kind described in this letter to serve the worthy objectives, which alone, cause this letter to be written.

Sincerely yours,

D. L. BIEMESDERFER, *President.*

Mr. SCHOCK. Yes. Thank you for that. I hope you will give consideration to these. I thank you for granting me the privilege of appearing before you today.

Senator HOEY. We are very glad to have had you.

Mr. SCHOCK. I hope you will give some consideration to this subject because it is pretty deep down in my heart, and it seems to me

when people do something to help the public schools, it gives Congress an easy chance to help to support that kind of effort on the part of a community. I cannot see how if you administer the laws I have suggested, there is any chance of getting away with any crooked business.

Thank you very much.

Senator HOEY. The next witness is Mr. J. J. O'Malley. Give your name and address to the reporter.

STATEMENT OF JAMES J. O'MALLEY, PRESIDENT, FIRST FEDERAL SAVINGS & LOAN ASSOCIATION, WILKES-BARRE, PA.; ACCOMPANIED BY OSCAR R. KREUTZ, EXECUTIVE MANAGER, NATIONAL SAVINGS AND LOAN LEAGUE

Mr. O'MALLEY. Mr. Chairman and gentlemen of the committee, my name is James J. O'Malley, and I am president of the First Federal Savings & Loan Association of Wilkes-Barre, Pa. I appear here today in my capacity as chairman of the Federal legislation committee of the National Savings and Loan League.

With me, and available for questioning, is the executive manager of the National Savings and Loan League, Mr. Oscar R. Kreutz.

On behalf of the members of the National Savings and Loan League I wish to thank the committee for giving us this time. I should like to make it clear that we requested this opportunity to appear because of the nature of the attack which was made on savings and loan associations by a witness before the House Ways and Means Committee. This witness is scheduled to appear also before this committee.

I will be very brief. However, we will be very glad to answer any questions.

The question of changing the tax status of mutual financial institutions was considered in the House Ways and Means Committee where a decision was made not to recommend such a change. We hope that you will come to the same conclusion.

First may I emphasize the special character of savings and loan associations. One hundred and twenty years ago a group of people met in Frankford, Pa., and formed the Oxford Provident Building Association, the first of its kind in this country. The association had two main purposes: the pooling of the savings of its members and the use of those funds to finance homes. The essential character of building and loan, and savings and loan associations has not changed over the years. Today they are doing an increasingly important job in providing thrift facilities for the small saver and home financing facilities for the average family seeking its own home.

However, there is an important difference between the method of meeting losses in the early associations and the modern associations. The change in this respect is the result of experience, and the requirement of State and Federal laws.

In the original association, all of the net earnings each year were divided among all of the members pro rata according to their share holdings. When losses occurred, they were charged against all of the members' holdings on a pro rata basis.

In the modern association, a portion of the earnings are retained each year in a special fund for the purpose of absorbing losses. The portion of such earnings which is retained for the protection of all members is determined by statutory requirements and prudent management based upon the long experience of building and loan associations in general.

The purpose of this more modern arrangement for absorbing losses is to deal fairly and equitably with all the members of the association. Under the old arrangement, some members withdrew from an association before losses developed in loans on which they had received their pro rata share of earnings. In such cases the remaining members were forced to absorb an inequitable share of the losses.

Income received by a savings and loan association is entirely used for the payment of operating costs, allocation to necessary loss reserves, and dividends. Therefore, all earnings beyond those used for expenses and necessary reserves are taxable in the hands of the members who mutually own the association.

The effect of this is that the average building and loan, or saving and loan association, in 1949, produced approximately $5,000 of tax revenue for each million dollars of savings.

Senator TAFT. Do you mean to say that the earnings are tax able in the hands of the members even though they are distributed?

Mr. O'MALLEY. No, Senator. They are taxable in the hands of the members as they receive them.

Senator TAFT. Yes, that is what I meant.

Mr. O'MALLEY. That is what I meant, Senator.

Senator TAFT. That is what I thought.

Mr. O'MALLEY. That is right.

This was 50 percent more than the tax revenue produced by commercial banks. The basis for this statement is set forth in full detail in our supplementary statement which we would like permission to file for the record for use by the committee.

Senator HOEY. Yes.

(The document referred to is as follows:)

SUPPLEMENTARY STATEMENT SUBMITTED BY THE NATIONAL SAVINGS AND LOAN LEAGUE THROUGH ITS REPRESENTATIVE, JAMES J. O'MALLEY, CHAIRMAN OF ITS FEDERAL LEGISLATION COMMITTEE JULY 10, 1951

One hundred and twenty years ago a group of people met in Frankford, Pa. They formed the Oxford Provident Building Association, the first of its kind in America. From this small beginning the building and loan movement spread throughout Pennsylvania and into other States. Eventually many thousands of these thrift and home financing institutions were formed.

The public spirited citizens who organized these building and loan associations had no thought of personal profit. They were concerned with the need for building homes. They were impressed with the almost complete lack of facilities for financing the building of homes on reasonable terms. They recognized that the encouragement of thrift among small wage earners was the only way to make sure that people of small means could get homes.

The directors were elected by the members of these building and loan associations. Usually they served without pay of any kind. Frequently the secretaries whose job it was to keep the books and be responsible for the operating details served with very little or no pay. Just as frequently the organizers of these associations set out on their self-appointed undertakings with the zeal and fervor of religious crusaders.

Slightly more than a hundred years after the Oxford Provident Building Association was formed, home building activity throughout the Nation was suffering from a paralysis caused by the worst depression in our history. An analysis made by the Seventy-third Congress revealed the fact that about the only type of lending

institutions which were then making loans to finance homes were building and loan associations, but even these institutions were crippled by the general loss of confidence in all financial institutions. But the Seventy-third Congress found that building and loan associations were especially well fitted to finance homes of the low- and middle-income groups and so the Congress authorized, as a part of the Home Owners' Loan Act, the creation of Federal savings and loan associations. The Congress directed the Federal Home Loan Bank Board to give "primary consideration to the best practices of local mutual thrift and home financing institutions in the United States" in issuing charters for such associations. The Congress also provided substantial financial assistance to the development of these associations.

Today, building and loan associations, both State and federally chartered, number approximately 6,000. Their combined assets exceed $16 billion. Some $14 billion of savings in these associations are held by approximately 10½ million members, while 3½ million persons are borrowing members. Last year alone building and loan associations financed 900,000 homes for the people of America. Most of these home buyers were in the middle- or low-income groups.

As a further encouragement to the development of these associations, the Seventy-third Congress also provided for the insurance of their shares through an instrumentality of the United States, the Federal Savings and Loan Insurance Corporation. Thus the member of a building and loan association takes no risk as does the investor in an ordinary business corporation, but neither does he expect nor receive anything more than a very modest return on his savings.

BACKGROUND, DEVELOPMENT AND MUTUALITY OF BUILDING AND LOAN ASSOCIATIONS

There has been no change in the basic purpose of building and loan associations since their origin in this country in 1831, nor has there been any change in the functions which served as the basis for their exemption from Federal income taxes.

Under the original terminating plan, one group of members pooled their savings to provide funds to finance homes of other members. If losses resulted from such loans, they were equitably distributed among all the members on a pro rata basis by the simple device of recapturing the necessary portion of the earnings which had been divided among all members but retained by the association until the maturity of the shares.

The serial plan which later became popular was in effect merely a combination of several terminating groups of shareholdings within the same association. Here again losses as well as earnings were equitably distributed pro rata among the members of the association.

These plans of operation were cumbersome so they were generally abandoned in favor of the simpler type of operation as exemplified by the Federal Savings and Loan Association which represents a combination of the best practices of local thrift and home financing institutions as required by the Congress when it authorized their chartering.

However, the basic concept of the building and loan association has not changed. The association is still the facility through which people of small means pool their savings in order to provide for the financing of the homes of their fellow citizens. The benefit to the individual saver from this arrangement is that he obtains the safety and earnings available through a loan secured by a first mortgage on an American home. It is doubtful whether many of the members of building and loan associations would be able to obtain these advantages without pooling their savings with those of other people.

As in the case of the first association each member of the modern association is a cooperator with the other members in this undertaking for the mutual benefit of all members. As a part owner of the assets of the association he receives a pro rata share of the earnings in the association after the payment of operating expenses and provision for present or potential losses. In the event of dissolution—voluntary or involuntary—he receives his pro rata share in the distribution of assets. This relationship constitutes mutuality.

As we said in our main statement submitted to the committee, the modern arrangement for absorbing losses deals fairly and equitably with all the members of the association. There is no basic difference between assessing the members of a building and loan association for their pro rata share of losses after they occur and the retention of a portion of the members' earnings on their share accounts to meet losses before they occur.

For the information of the committee there is attached a letter of January 16, 1951, from the Federal Savings and Loan Insurance Corporation on the subject of the loss experience among building and loan associations. This letter clearly shows that building and loan associations are following a sound policy in building necessary loss reserves for their continued safe operation.

THERE ARE NO EARNINGS IN EXCESS OF DIVIDENDS

We are in a period of high prices and prosperity and have been for a number of years. Obviously these associations must build adequate loss reserves. The total amount in the reserve accounts of insured building and loan associations at the end of 1950 was 6.9 percent of their assets. It is apparent from this ratio that building and loan associations are not retaining an excessive portion of their earnings for loss reserves.

SAVINGS AND LOAN ASSOCIATIONS ALREADY PRODUCE 50 PERCENT MORE TAX REVENUE THAN INSURED COMMERCIAL BANKS

To support this fact outlined in our main statement to the committee, we herewith set forth the computation and the sources of the data.

The figures used to compute the tax revenue are taken from the Annual Report of the Combined Financial Statements of Members of the Federal Home Loan Bank System for the year 1949, published by the Home Loan Bank Board. On page 12, we find that the member institutions had a total of $11,396,091,000 in savings capital. On inquiry of the Home Loan Bank Board we found that these same institutions had, at the end of 1948, total savings of $9,964,865,000 or an average of $10,680,478,000 during the year 1949, when, according to page 51 of the report, they paid a total of $268,069,000 in dividends. This would amount to $25,099 in taxable income per million of average savings, and a 20-percent tax would produce $5,019.80 in tax revenue per million dollars of this savings capital.

In contrast let us look at insured commercial banks, and using official figures again, we find that these banks in 1949 provided approximately $3,300 in tax revenue to the Federal Government per million dollars of average deposits.

The total deposits of insured commercial banks are shown by the December 31, 1949, report (p. 136) of the Federal Deposit Insurance Corporation, as $143,137,715,000.

Total deposits of insured banks at the end of 1948 were shown by the 1948 report (p. 82) of the FDIC to be $140,641,975,000, making an average of $141,889,845,000 during 1949. On page 160 of the 1949 report total interest paid on deposits was shown to be $328,010,000. Figure a 20 percent on this and the amount is $65,602,000.

The insured commercial banks (p. 160) paid total Federal income tax (corporation tax) of $304,572,000. The same banks paid out in dividends on capital stock (p. 160) a total of $354,144,000. Assuming an average tax rate of 30 percent on these dividends the tax would be $106,243,200.

Total revenues produced by banks in 1949 would thus amount to $476,417,200. This is comprised of the 20 percent tax on the interest paid on deposits ($65,602,000); the 30 percent tax on dividends on capital stock ($106,243,200) and corporation tax of $304,572,000. Relate the total average deposits to the total tax and we find that the average insured commercial bank provided the Federal Government with $3,357 in tax revenue per million dollars of average deposits.

In other words, for every $1,000 of deposits in commercial banks the banking system, including its depositors and stockholders, pays approximately $3.30 in Federal income taxes, whereas for every $1,000 of savings in the building and loan movement there is paid approximately $5 in Federal income taxes.

UNFAVORABLE CONSEQUENCES ON BUILDING AND LOAN MOVEMENT OF A DIRECT FEDERAL INCOME TAX

1. A direct income tax would necessarily result in either a sharp reduction in dividends distributed to members, or a reduction in loss reserve ratios, or an end to growth, with a drying up of this source of thrift capital. Prudent management and supervisory authorities have long recognized the necessity of considering statutory reserve requirements as the barest minimum only.

2. Believing that prudent management would try as in the past to accumulate adequate reserves for the protection of the small saver, it would appear that the burden of a direct income tax would fall upon the small saver in the form of a sharply reduced dividend rate.

If, however, the burden of a direct Federal tax were to fall upon reserves, the result would be a direct weakening of the entire building and loan structure and an unwarranted increased financial risk to the Federal Savings and Loan Insurance Corporation.

3. The tax would inevitably restrict the sound growth of building and loan associations and they would be unable to maintain their position in the expanding economy and the expanding field of mortgage debt. The impairment to the operations of such associations would necessarily diminish in comparable degree their service in the promotion of thrift and home ownership.

ECONOMIC CONSEQUENCES OF A DIRECT FEDERAL INCOME TAX ON BUILDING AND LOAN ASSOCIATIONS

A tax upon gross income in excess of the immediate cost of operation and dividends distributed to members of building and loan associations either will or is likely to have the following broad effects upon the national economy:

1. The harm to the economy through distortion of home financing supply will exceed the value of the tax revenue.

2. Demands for direct Government financing, guaranteeing and aids to housing would be multiplied.

3. It would eventually result in the substitution of Government operation, subsidies and controls in lieu of privately operated institutions and private competition.

4. Until such substitution occurs, costs of housing and home ownership will rise despite the variety of legislation designed to bring down such costs.

5. Undue harm to thrift and savings' habits could result in contrast to present governmental encouragement.

Building and loan associations currently hold 31 percent of the total urban home mortgage debt as compared to 16 percent for the next highest institutional holders. They finance about 50 percent of the total amount of home mortgage loans in the United States which are not Government guaranteed or insured and which are made by financial institutions. They specialize in financing the homes of the middle- and lowest-income groups. For example, approximately 45 percent of the loans made by these associations in 1949 to finance home construction and home purchase were made to families with incomes of less than \$3,500; 25½ percent were made to families with incomes of from \$3,500 to \$4,500. By reason of their governing laws and methods of operation they are the only group of institutions which are equipped to make loans of this type on a practical basis throughout the entire country.

If the functioning of these institutions and their normal growth is curtailed, there will, of necessity, be a lessening of the supply of money for home financing, especially in the critical middle- and low-income field. Such curtailment or an operation of doubtful safety must result from a tax. Federal and State supervisory officials are constantly prodding these associations to increase their reserves more rapidly, i. e., at a higher rate.

It has been the long-standing policy of Congress to foster these institutions for the promotion of thrift and home ownership. To that end the Federal Home Loan Bank System was established, as was the country-wide system of Federal savings and loan associations and the Federal Savings and Loan Insurance Corporation. For the same purpose the Eighty-first Congress enacted H. R. 6743, which further strengthened the building and loan movement while providing for the early return to the Treasury of funds which had been advanced by it in the thirties to the Federal home loan banks and the Federal Savings and Loan Insurance Corporation.

Nearly all of the States have statutes recognizing the sound public policy served by these institutions.

APPENDIX A TO NATIONAL SAVINGS AND LOAN LEAGUE SUPPLEMENTARY STATEMENT

FEDERAL SAVINGS AND LOAN INSURANCE CORPORATION,
HOUSING AND HOME FINANCE AGENCY,
Washington 25, D. C., January 16, 1951.

Mr. OSCAR R. KREUTZ,
Executive Manager, National Savings and Loan League,
Washington 6, D. C.

DEAR MR. KREUTZ: We are glad to give you information bearing upon the subject of loss reserves which you raised in your letter of January 3, 1951. First, we may stress their importance and, second, we may give you the results of our studies on the question.

The history of all types of financial institutions has shown in no uncertain terms that adequate provision for possible future losses is vital to safe operation. Moreover, protection against losses must be anticipated in advance. To await their realization is too late. In institutions such as savings and loan associations, losses are mainly cyclical in character and may not make their appearance for a decade or more. This makes the problem more difficult to perceive and possibly more complex because of the deceptive successes of prosperity. Today loss reserves also take on more significance than at any previous time.

In turn, savings and loan associations occupy a large niche in the financial economy so that their operations play a vital part in the functioning of the national economy. The Federal Government itself is directly involved because of the insurance of savings through one of its instrumentalities. In giving recognition to this larger perspective, prudent management and business statesmanship must make adequate provision for loss reserves. It is not a little question; rather, the subject is of national importance.

Prior to the creation of the Home Loan Bank Board and the Federal Savings and Loan Insurance Corporation, cumulative and over-all records relating to losses of savings and loan associations were not maintained. As a result, it is necessary to appraise the problem on a sample or spot-check basis. The information that we can give you in response to your request may be summarized as follows:

Test No. 1. Analysis of the experience of 18 associations which became insured without write-down of their shares or segregation of their assets.

Test No. 2. Analysis of six cases with capital write-down so as to provide a cushion to absorb losses.

Test No. 3. Analysis of 35 associations where segregation of assets was necessary to qualify for insurance.

Test No. 4. Results of nine institutions liquidated by the Massachusetts Share Insurance Fund.

Test No. 1. Analysis of the experience of 18 associations which became insured without write-down of their shares of segregation of their assets.

In selecting the 18 associations in this category, it should be pointed out that we deliberately took institutions which had more than the usual amount of real estate. We did this for the very sound reason that in providing reserves to cover future contingencies safety is found in maximum rather than minimum coverage. Also, it gave us a more representative basis for the study of losses incurred on real estate owned. At the same time, it should be stressed that the conditions were not serious enough to warrant either a write-down of shares or a segregation of the assets.

As you will note in the enclosed table, the ratio of the gross losses on real estate to the average assets during the 9-year period of 1937–45 amounted to 8.7 percent for the entire period and averaged 1 percent per year. Obviously, if the period is extended through 1949, the respective ratios drop slightly.

Test No. 2. Analysis of six cases with capital write-down so as to provide a cushion to absorb losses.

In putting the insurance program into effect in the thirties, it was not uncommon to find that many institutions could not qualify for insurance without a write-down of the value of their shares in order to absorb recognized losses or to provide a reserve to meet contingent losses. Obviously, institutions in this

category would be in a weaker financial position than those mentioned in the previous category.

To test this type of condition, we made a study of six associations of scattered geographical location. Since the losses were recognized at the time insurance was granted, there is no way of measuring the actual losses which were realized from the liquidation of the real estate itself. Hence, we may simply advise you that the ratio of the write-down to the total assets of these institutions amounted to 19.0 percent.

Test No. 3. Analysis of 35 associations were segregation of assets was necessary to qualify for insurance.

Still another method used by the Insurance Corporation as a means of rehabilitating institutions in the thirties was that of segregating unsound assets into separate liquidating trusts or corporations. The shares issued by such institutions to cover the remaining good assets were then insured by us, while the shares against segregated assets realized only liquidating dividends to the extent made possible by the proceeds received from the liquidation of the segregated assets.

We know that there were at least 177 associations subjected to this treatment, but once again complete records were not always kept of the results. However, we do have fairly complete records showing the final losses in 35 cases. In order to apply our findings to the problem before us it seemed best to relate the losses to the total assets as of the date of segregation and not simply to the amount of segregated assets. The purpose of this is to bring the management problem into perspective, since the universally recognized measure of loss reserves for going institutions is the ratio of such reserves to the total assets. We found that in cases of this type the final losses of the 35 institutions, with total assets at the time of segregation of $25,917,550, amounted to $5,621,488, or 21.7 percent of total assets.

Test No. 4. Results of 9 institutions liquidated by the Massachusetts Share Insurance Fund.

Finally, there are the familiar cases where institutions were liquidated in entirety, and not in part as was true in Test No. 3. However, as stated before, the results of such liquidation are generally not available. Often savings and loan associations were liquidated voluntarily by the directors, and, in any event, the State authorities seldom kept comprehensive or uniform records. Fortunately, we have been able to obtain the results of the liquidation of 9 cooperative banks by the Massachusetts Share Insurance Fund.

In this instance, because of the existence of the insurance fund, a record of the losses which it suffered from the liquidation of its insured members was maintained. The assets of the 9 cooperative banks amounted to $8,700,000 at the time they were taken over and the net losses to the insurance fund amounted to $1,541,000, or 17.6 percent of the assets. For your information, these data were obtained from a book entitled "Three Score and Ten Years" by Oreb M. Tucker, which is a history of the cooperative banks in the State of Massachusetts.

We hope that this limited information will be helpful to you, and we will be glad to answer any inquiries that you may wish to make about the study.

Best wishes.

Sincerely yours,

WILLIAM H. HUSBAND,
General Manager.

Real estate loss experience of 18 insured savings and loan associations with large real estate holdings in late 1930's, 1937–49

[Amounts in thousands]

Year	Assets	Real estate owned		Operating income from real estate owned				Gross losses on real estate					Net losses on real estate				
									Percent to					Percent to			
											Net income					Net income	
		Amount	Percent to assets	Income	Expense	Net income	Percent net income to real estate owned [1]	Amount	Assets [1]	Real estate owned [1]	Before dividend	After dividend	Amount	Assets [1]	Real estate owned [1]	Before dividend	After dividend
1936	94,850	27,747	29.3	----	----	----	----										
1937	95,979	25,914	27.0	2,334	1,870	464	1.7	2,098	2.2	7.8	70.8	214.3	1,863	2.0	6.9	62.8	190.3
1938	94,961	25,588	26.9	2,339	1,866	473	1.8	652	0.7	2.5	23.1	96.6	524	0.5	2.0	18.6	77.6
1939	96,902	24,024	24.8	2,271	1,827	444	1.8	831	.9	3.3	28.2	103.0	623	.6	2.5	21.1	77.2
1940	98,307	20,854	21.2	1,927	1,606	321	1.4	1,064	1.1	4.7	40.8	212.0	830	.9	3.7	31.8	165.3
1941	101,458	17,484	17.2	1,675	1,425	250	1.3	1,090	1.1	5.7	35.7	99.5	895	.9	4.7	29.3	81.7
1942	101,055	13,902	13.8	1,397	1,242	155	1.0	951	.9	6.1	30.7	84.5	738	.7	4.7	23.8	65.5
1943	103,646	10,011	9.7	1,090	952	138	1.2	1,134	1.1	9.5	33.7	78.8	775	.8	6.5	23.0	53.9
1944	112,546	6,396	5.7	776	700	76	.9	690	.6	8.4	20.4	45.6	329	.3	4.0	9.7	21.7
1945	126,672	4,187	3.3	522	468	54	1.0	433	.4	8.2	12.6	29.4	250	.2	4.7	7.3	17.0
1946	137,920	1,542	1.1	307	274	33	1.2	32	(2)	1.1	.8	1.9	+114	----	----	----	----
1947	151,985	1,240	.8	139	111	28	2.0	94	.1	6.8	2.5	7.0	59	0	4.2	1.6	4.4
1948	162,193	740	.5	119	92	27	2.7	124	.1	12.5	3.1	9.5	113	.1	11.4	2.8	8.6
1949	171,015	507	.3	34	36	−2	----	68	(2)	10.9	1.5	4.5	60	0	9.6	1.4	3.9
1937–45																	
Total	----	----	----	14,331	11,956	2,375	----	8,943	8.7	50.8	32.3	93.1	6,827	6.7	38.8	24.7	71.1
Average	102,638	17,611	17.2	1,592	1,328	264	1.50	994	1.0	5.6	32.3	93.1	759	.7	4.3	24.7	71.1
1937–49.																	
Total	----	----	----	14,930	12,469	2,461	----	9,261	7.9	72.0	21.2	60.0	6,945	5.9	54.0	15.9	45.0
Average	117,821	12,867	10.9	1,148	959	189	1.47	712	.6	5.5	21.2	60.0	534	.5	4.2	15.9	45.0

[1] Percentages based on average assets and average real estate holdings during year, computed from year-end balance.

Senator TAFT. I do not understand your statement "produced approximately $5,000 of tax revenue for each million dollars of saving." Do they produce that through the payment by the stockholders, you mean, of the return that they got?

Mr. O'MALLEY. Senator, I would like permission to ask Mr. Kreutz to explain that. He has the figures.

Senator TAFT. Is that what you mean?

Mr. KREUTZ. Yes, that is correct. I could go into detail if you want, that is correct.

Senator TAFT. That is what you mean?

Mr. O'MALLEY. And the supplemental statement will explain it, Senator.

The sources of the data used are official reports of Government agencies.

By and large, the average banker is a friend of the building and loan movement. Countless bankers have encouraged the organization of and now support savings and loan or building and loan associations in their communities in view of the special purpose of our associations. Generally speaking, a savings and loan association and a commercial bank are not competitive and we deplore the unfair and untrue statements which have been made about the building and loan movement by representatives of a small segment of the banking field.

Now a word about reserves for losses. These associations are not accumulating excessive loss reserves. At the end of 1949, the total loss reserves of all insured associations were 6.9 percent of their assets. Parenthetically I may say that the insured associations hold nearly 80 percent of the assets of all associations and, therefore, are a sound example to use. These legal reserves are a necessary provision for meeting future losses and while they may be called by various names, they are all loss reserves.

As the managing officer of such an association, I can assure you that a loss reserve is an absolutely necessary ingredient of sound operation. Our operations are of a long-term character. All of our mortgage loans are made for a long term of years. Based upon more than a century of experience we must expect long-term losses. We can only be prepared to meet these losses by making annual allocations out of income to loss reserves.

A direct tax would either result in the accumulation of inadequate loss reserves or a reduction in the rate of dividend distributed to the members of our associations.

Prudent management would, under a direct income tax, continue to make necessary allocations to reserves for losses. Consequently, a direct tax levied on these mutual thrift organizations would fall squarely and heavily upon the small saver through a reduction in his dividends.

For example, if we assume that such a tax was in effect in 1949, and that consistent with statutory requirements and prudent management policies, these associations had made the same transfers to reserves for losses as were actually made, and a 38-percent tax rate had been in effect on these associations, their weighted average dividend rate would have dropped from 2.52 percent to 1.75 percent. If the tax rate had been 47 percent, the weighted average dividend rate would have dropped from 2.52 percent to 1.41 percent. Obviously a direct Federal income tax on these associations would have come direct-

ly out of the pockets of the 10,500,000 small savers of the country who are members of building and loan associations, and would have resulted in taxing twice the already taxable earnings in the hands of the recipient.

At the time the House Ways and Means Committee was conducting hearings, the Washington Post on March 16, 1951, in a lead editorial emphasized this point which I have just made, namely, that such a tax would be a tax on thrift. This newspaper said, "A tax of this sort would reduce the interest paid to depositors, discourage the accumulation of new savings and lead to withdrawals for current spending." The newspaper went on to emphasize further the inflationary effects of a tax because it would discourage thrift. Many other newspapers have expressed similar editorial opinions, and I would like to leave with the committee an editorial from our paper, the Wilkes-Barre Time Leader, saying practically the same thing.

(The document referred to is as follows:)

WHY DISCOURAGE THRIFT?

The proposal before the House Ways and Means Committee to tax savings and loan associations is a matter that concerns this community and others throughout the country where these institutions operate. While the need for revenue is admitted, the Federal Government would do well to study the repercussions from such a move.

For some time, the administration has been endeavoring to induce Americans to be thrifty. They have been asked to save their money with a view of relieving inflationary pressures. The Government, among other things, has been urging investment in bonds, with attractive interest rates in the hope of luring surplus funds out of business channels.

Thousands of Americans have their money invested in savings and loan associations because of interest rates. If the associations are taxed, the interest rates will be inevitably reduced, thus putting a damper on the accumulation of new savings at a time when the Government is anxious to halt spending. Moreover, many depositors might be led to withdraw money already in these accounts, adding to the headaches of those who are endeavoring to control inflation.

This is a time to encourage thrift, not to discourage it.

Mr. O'MALLEY. Such a tax would be unfair because, as I previously pointed out, savings and loan associations already produce approximately 50 percent more tax revenue per million dollars of savings than do insured commercial banks. If an even heavier burden were to be placed upon the members of these associations, it would, in our opinion, be most unfair. Such a tax would discriminate against a type of traditional institution which has a special job to do of a mutual character. A direct tax would result in less money being available for private home financing. One of the consequences undoubtedly would be a demand for further direct Government financing and building of homes.

In concluding I want to summarize the other unfavorable consequences on the building and loan movement of a direct Federal income tax:

1. There would be either a sharp reduction in dividends distributed to members, or a sharp drop in loss reserve ratios, or an end to growth with a consequent drying up of this source of thrift capital.

2. Prudent management would try as in the past to accumulate adequate reserves, the dividend date would be sharply reduced, and the thrifty members of those associations would suffer.

If, however, the burden of a direct Federal tax were substantially to fall on reserves, the building and loan structure would be weakened

and there would be unwarranted increased financial risk to the Federal Savings and Loan Insurance Corporation.

Therefore, we urge that in the interest of the continued encouragement of thrift and individual home ownership, you permit the building and loan movement to retain its present tax status.

Senator HOEY. Any questions?

Thank you very much, Mr. O'Malley.

Mr. O'MALLEY. Thank you very much for the opportunity to be heard.

Senator HOEY. The committee will now take a recess until 3 o'clock.

(The following letter was subsequently supplied for the record:)

FIRST FEDERAL SAVINGS AND LOAN ASSOCIATION OF WILKES-BARRE,
Wilkes-Barre, Pa., July 12, 1951.

Senator WALTER F. GEORGE,
Chairman, Senate Finance Committee,
United States Senate, Washington 25, D. C.

MY DEAR SENATOR: On Tuesday, the 10th, it was my privilege to appear as chairman of the Committee on Federal Legislation of the National Savings and Loan League before the Senate Finance Committee to discuss the tax status of savings and loan associations. Later in the hearings the serious charge was made that savings and loan associations in general require borrowers and other members to sign proxies at the time they take out membership.

In my own institution, the First Federal Savings and Loan Association of Wilkes-Barre, we have never requested any person to give us a proxy at the time he becomes a member of the association. When we send out notices of our meetings we also send out proxies for the convenience of our members in case they cannot attend the meetings. Every proxy is, of course, revocable at the pleasure of the member.

From a quarter of a century of experience and observation of savings and loan practices throughout the country and from discussions with supervisory officials, it is my opinion that our method of obtaining proxies is consistent with the practice of most associations.

Any association's management which attempts to force members to give their proxies would soon get into trouble with supervisory authorities. I am satisfied, therefore, that in practically all cases associations' management do no more than invite their members to send in or give their proxies, and in all cases any proxies given by members are revocable at their pleasure.

Because of the importance which was attached to this point by certain witnesses, I would appreciate it very much if this letter could be made a part of the record of the current hearings before your committee.

Respectfully yours,

J. J. O'MALLEY, *President.*

(Whereupon, at 1 p. m., the committee recessed to reconvene at 3 p. m. the same day.)

AFTERNOON SESSION

Senator HOEY (presiding). The committee will come to order.

The first witness, Mr. Harris, will come forward.

Mr. Harris, will you give your name and connection to the reporter?

STATEMENT OF W. GIBSON HARRIS, SOUTHERN DEPARTMENT STORES, INC.

Mr. HARRIS. My name is W. Gibson Harris, of the law firm of Parker, Fairbank, Neal & Harris, of 411 Mutual Building, Richmond, Va.

I greatly appreciate the opportunity of being heard today on what is such an important matter to so many of our clients, including

particularly, but not exclusively, Southern Department Stores, Inc., of Richmond, Va.

As I understand it, this committee is endeavoring to determine the fairest and most equitable way to raise the funds that are necessary for the operation of our Government during the ensuing year. The House-approved bill which is now before you would, in general, provide such funds by an across-the-board increase of approximately 12½ percent on individual taxes and a general increase of the normal corporate income tax from 25 percent to 30 percent, which would amount to an increase in the total corporate income tax varying from about 10.6 percent for corporations with the highest net incomes to 20 percent for those with net incomes of $25,000 or less.

I am one of the witnesses who, despite the small amount of publicity this particular provision has received, would call your attention to one section of the bill which would have the effect of increasing the total taxes of a certain class of corporate taxpayer, not merely 12½ percent or 20 percent, but upward of 100 percent. If it is doubtful whether a general increase of from 10 to 20 percent can be justified for anyone, we believe that it is beyond question that no corporation can afford to have its already high tax bill more than doubled.

The provision to which we are referring is section 123 of the bill. Subsection (a) of that section in effect removes from all but one of a group of affiliated corporations the surtax exemption of $25,000. That means that all the income of such corporations would be subject to the surtax of 22 percent in addition to the normal tax, which the House bill would increase from 25 to 30 percent. Thus the first $25,000 of such a corporation's net income would be taxed at 52 percent instead of 25 percent, an increase in tax of $6,750 or 108 percent. This provision would have the unfair result of hitting smaller corporations the hardest, for section 123 (a) would not increase the tax on that portion of a corporation's income in excess of $25,000 and thus the larger the portion of the income over that figure, the smaller the percentage of tax increase. That is illustrated in detail by schedule A set out below, showing, for example, that in the case of a corporation with net profits before taxes of $1 million the percentage of increase in income taxes amounts only to 11.95 percent.

Subsection (c) of section 123 applies the same principle to the excess-profits tax by removing the minimum excess-profits credit of $25,000 from all but one of a group of affiliates. That means that an affiliated corporation would pay the excess-profits tax of 30 percent on its excess-profits tax net income in excess of its actual credit even though its actual credit is less than $25,000. Obviously this provision can increase a corporation's excess-profits tax only on that portion, or some part thereof, of its net income below $25,000 and like subsection (a), thereby serves to put the disproportionate burden upon the smaller corporations. It is not by accident that a representative of that size corporation is addressing you now, and that you have heard virtually no objections from groups of large affiliated corporations, to whom the increases of section 123 are relatively unimportant.

Why, then, in the light of these apparent inequities and incongruities, has the Treasury Department recommended the adoption of

section 123, which it realizes will bring in only a comparatively small amount of $55 million of additional revenue, $55 million compared with $7 billion which has been asked for?

Certain large corporations which have always operated as one corporate entity have recently seen the apparent tax advantages of splitting into a number of separate corporations purely to effect tax savings. We share the Treasury's view that in such a case the attempted split-up should be disregarded and the group of new corporations taxed as one entity. Moreover, the Commissioner of Internal Revenue already has the authority to take this action under section 129 of the Internal Revenue Code as well as under other provisions of law, including section 45 of the code. The Commissioner has frequently taken this position and so acted, and his present request for the enactment of section 123 into law stems from the fact that in a number of recent court cases he has been unsuccessful in showing that the taxpayer's dominant motive for the split-up was tax avoidance. This fact is reflected in the report of the House Ways and Means Committee, which says, and I quote from page 24:

> Evidence has been presented to this committee which indicates that a substantially smaller incentive led in some cases to the artificial splitting up of business enterprises into a large number of individual corporations during World War II.

Perhaps in view of these decisions the Commissioner's hands should be strengthened to prevent this type of tax dodging by creating a statutory presumption that the split-up of an existing corporate organization after, say, January 1, 1951, or any other date you decide upon, was for tax-avoidance purposes, and therefore should be disregarded unless the taxpayer can prove by a preponderance of the evidence that his real reason was purely a business one unrelated to taxes. Or, if you would go even further, you could make that presumption not merely rebuttable but conclusive.

That would certainly stop the practice about which the Commissioner is rightly concerned, and at the same time not affect the very different situation of a group of affiliated corporations which for years have been separate entities for good bona fide business reasons unrelated to tax avoidance or advantage. Our law firm in Richmond is only an average-sized one and our clients are local individuals and local corporations, but virtually every corporate client of our office has one or more small corporations affiliated with it in such a way as to bring the group within the definition of "controlled groups" and make the penalty of section 123 applicable. These so-called groups were not created with any thought of tax avoidance: There were and are good business reasons for their existence. Often, in fact, they operate entirely different types of business.

I would like now to describe to you in more detail the history, growth, and organization of one of those clients of ours who would be most adversely affected by this particular provision.

Southern Department Stores, Inc., is a Virginia corporation created in 1928 to provide top-level management for small department stores. Over the years it has acquired varying stock interests in 27 separate corporations throughout Virginia, West Virginia, North Carolina, and

South Carolina, each operating one department store or junior department store. The percentage of interest in each of those separate corporations which is owned by Southern varies from a low of 32.9 percent to a high of 100 percent. Thus in the case of some of these corporations Southern does not own even a controlling interest, but nonetheless it provides the management for all of them on exactly the same basis.

These corporations have always been separate corporate entities. The biggest reason for this is that, like Topsy, they just grew that way. Historically, many of them were existing corporations before Southern bought an interest. It was only natural for them to continue as they were, and there were many valid business reasons for preserving their separate identities. The 27 stores in question are, for the most part, located in the smaller towns and villages where there is a great deal of local pride and feeling against outsiders. Everything possible has been done to preserve the local nature of the individual store and to identify it with its community. Each store is different and adapted to the needs of the particular locality which it serves. Some are large, some are small, but all are different.

The name of each separate corporation is likewise different, each carrying a local name, as for example, Halifax Department Store, Inc., in Halifax, Va.; Anderton's Inc., in Tappahannock, Va.; and Grayson's, Inc., in Warrenton, Va. The Anderton family owned Anderton's for years before Southern bought an interest, and it kept that same name, and the same is true of Grayson's, and many others of the stores.

When Southern acquires an interest in a new store, an effort is made to keep the former local owners in the picture. For example, when Timberlake's, Inc., in Staunton, Va., was purchased last December, the former local owners retained as large an investment in preferred stock as Southern made in common stock. That store, known as Timberlake's, had been operated there for years, and it is still being operated the same way.

Southern believes it good business for the manager of the local store to have the incentive of a stock interest in the local corporation, and is helping and has helped many of its managers to acquire such an interest. Also, as was brought out in the case of another group of affiliated corporations this morning, the compensation of those managers, some with stock interest and some without, is usually based upon the corporation's net profits.

Further, the local character of each corporation has enabled it to do its current borrowing from the local banks on a personal and highly satisfactory basis.

An additional very important reason exists in the principle of limitation of legal liability. The operation of each store, including par-

ticularly the long-term leases that they are being called upon to enter into, involves considerable risk and as long as there are separate corporations each store is in effect insulated from any misfortune or liability of the others. Also, as we have said, the 27 stores here under discussion are located across four States, and I am sure the members of this committee are all familiar with the business as well as legal reasons for conducting business in a particular State as a native corporation rather than being subject to the less favorable treatment so often accorded foreigners.

In every sense of the word, the local corporation is a small business It stands on its own feet. For example, each store's lease is with that particular local corporation.

It is thus apparent that the loosely knit group of corporations affiliated with Southern Department Stores is a very different animal from any large corporation which now for tax reasons attempts to split into a number of different entities. Let us consider how the tax increases contained in section 123 would affect these corporations. Of the 27 stores in the Southern group, nine of them are at the present time owned in excess of 95 percent by Southern and would therefore come within the provisions of section 123 if that percentage of stock ownership should still obtain on December 31. The figures for those nine corporations, as prepared by Ernst & Ernst, certified public accountants, are set out on schedule B set out below. That schedule shows that the House bill would increase the income tax of those nine corporations on their last year's net income an average of 94.7 percent, and would increase the total of their income and excess-profits taxes an average of 122 percent.

The total increase in the case of one of the corporations is 174 percent, and in another it is even 191 percent. The only reason that the average is not higher than 122 percent is the fact that two of the corporations had net profits considerably in excess of $25,000.

We wish to point out another respect in which section 123 seems inequitable. When Southern opens a new store in a new location, as it is planning to do, for example, this September in Covington, Va., it expects that new corporation to show a loss for the first several years before it gains steady customer acceptance, just as schedule B shows that the Halifax Department Store, opened a few years ago, is still operating at a loss. The loss of any one of the affiliated corporations connot be offset against the profit of the others unless the entire affiliated group files a consolidated return and pays the penalty of an additional 2 percent tax. But section 123, which in effect taxes as one corporation all affiliated corporations with a net profit for the year, still does not allow the loss of another to be offset. That is, it doesn't unless a formal consolidated return is filed and the additional 2 percent tax is paid.

There is no question, gentlemen, in our minds but that section 123 would have a drastic effect upon limiting and virtually curtailing the expansion of a group of corporations such as this. The reasons for this were explained in detail this morning by another witness.

Also, we wish to emphasize the ease with which this particular section could be avoided. A group of affiliated corporations subject to section 123 could avoid every penny of the additional taxes imposed thereby by merely disposing in a bona fide way of sufficient stock to reduce its stock holdings below 95 percent. And the additional taxes are so substantial that virtually no small group could afford not to do so. Yet there is certainly no national policy favoring such an enforced disposal of stock.

Thus, in summary, we believe that section 123 is a far wider and more drastic provision than is needed to close the loophole the Treasury has in mind and to cure the evil of corporate splitting for tax purposes. It seems distinctly unfair to small corporations in general, and there appears no reason whatsoever for more than doubling the tax burden of established groups of affiliated corporations continuing business exactly as they always have, with never a split-up and with no thought of tax avoidance. No corporation can stand having its taxes doubled, and we submit that no law-abiding one with a proper purpose and a proper organization should be asked to.

I appreciate very much the opportunity of appearing here today.

Senator HOEY. Thank you very much.

(Schedule A and schedule B referred to are as follows:)

SCHEDULE A

Net profit before taxes	Federal income taxes, 1950 rates	Federal income taxes, proposed rates, $25,000 surtax exemption	Federal income taxes, proposed rates, no surtax exemption (sec. 123)	Difference between 1 and 3	Percent of increase
(1)	(2)	(3)	(4)	(5)	(6)
$25,000	$6,250	$7,500	$13,000	$6,750	108.00
$50,000	18,000	20,500	26,000	8,000	44.44
$100,000	41,500	46,500	52,000	10,500	25.30
$200,000	88,500	99,500	104,000	15,500	17.85
$500,000	229,500	254,700	260,000	30,500	13.29
$1,000,000	464,500	514,500	520,000	55,500	11.95
$2,000,000	934,500	1,034,500	1,040,000	105,500	11.29
$5,000,000	2,344,500	2,594,500	2,600,000	255,500	10.90
$10,000,000	4,694,500	5,194,500	5,200,000	505,500	10.77

SCHEDULE B

Comparison of tax with 1950 rates and proposed rates for 1951 on stores owned in excess of 95 percent by Southern Department Stores, Inc.

Corporation and location	1950 net profits before taxes	1950 Federal income taxes	1951 House-proposed Federal income taxes (52 percent)	Percent of proposed increase of Federal income taxes	1950 excess-profits tax	1951 House proposed excess-profits tax (estimated)	Percent of proposed increase of excess-profits tax	Total amount of proposed income and excess-profits tax increases	Percent of total proposed income and excess-profits tax increases
				Percent			*Percent*		*Percent*
Andertons Department Store, Tappahannock, Va	$26,169.41	$6,487.82	$13,608.09	109.7	60.49	$3,139.76	5,091.0	$10,199.54	157.2
Davidson's, Inc., Farmville, Va	19,611.69	4,700.63	10,198.08	117.0		0		5,497.45	117.0
Economy Shop, Inc., Front Royal, Va	6,580.62	1,549.98	3,421.92	120.7		1,088.81		2,960.75	191.0
Grayson's, Inc., Warrenton, Va	11,380.08	2,710.38	5,917.64	118.3		1,522.53		4,729.79	174.5
Halifax Department Store, Halifax, Va	(911.29)	0	0			0		0	
Johnson's Department Store, Danville, Va	59,354.57	22,056.89	30,864.38	39.9		0		8,807.49	39.9
Rucker-Rosenstock, Inc., Petersburg, Va	98,940.22	38,731.67	51,148.91	32.8		0		12,717.24	32.8
Timberlake's, Inc., Staunton, Va	6,062.10	1,424.61	3,152.29	121.3	524.11	1,091.18	108.2	2,294.75	161.1
Weaver's, Inc., Front Royal, Va	27,407.50	7,207.04	14,251.90	97.7		464.49		7,509.35	104.2
Average percent of increase				94.7					122.0

Senator HOEY. Mr. Sidney Stahl.

Mr. Stahl, will you give your name and connection to the reporter?

STATEMENT OF SIDNEY STAHL, NEW YORK STATE CREDIT UNION LEAGUE, INC.

Mr. STAHL. My name is Sidney Stahl, and I represent the New York State Credit Union League, which is a voluntary association of credit unions operating in the State of New York.

Mr. Chairman and members of the committee, when I originally asked——

Senator HOEY. Do you have a prepared statement?

Mr. STAHL. No; I do not have a prepared statement, I am sorry.

Senator HOEY. Go ahead.

Mr. STAHL. This is my first experience in testifying.

Senator HOEY. Go right ahead.

Mr. STAHL. When I originally wrote to Senator George requesting an opportunity to testify, the House Ways and Means Committee was considering their bill, and we were concerned about the provision with regard to requiring credit unions to withhold the tax on dividends at the source.

However, H. R. 4473, section 1202, presently exempts credit unions from this particular requirement. I hope that this committee will see its way clear in maintaining that status.

Senator TAFT. I think the less said about it the better, on the whole, from your standpoint.

I do not think that we are likely to disturb the House provision.

Mr. STAHL. I would, however, like to take this opportunity to read to you some facts about the credit unions.

Credit unions have been brought into being for the purpose of eliminating usury. They are chartered either by the State or Federal Government and there are at present approximately 11,000 credit unions operating in the United States.

Each credit union is examined annually, either by the State or Federal Government. Credit unions operating under Federal law have been given recognition by Congress as associations organized for the purpose of promoting thrift and creating a source of credit for providential or productive purposes.

Numerous acts by various State legislatures have also given express legislative recognition to credit unions as serving a proper and useful purpose.

In recognition of their useful and beneficial nature, as instruments to eliminate the evils of usury, both State and Federal credit unions have been exempt from the requirements of paying any Federal income tax. The essence of the successful operation of a credit union is a low overhead and low cost of operation.

Credit union treasurers are usually part-time employees who are paid very small salaries and frequently they are volunteer workers who receive no compensation at all. The latest available figures, as of April 30, 1951, indicate that there are now a little over 11,000 credit unions. To place on the unpaid or low paid treasurers of the vast majority of these credit unions the job of reporting, computing and accounting for a withholding tax on the members' dividends

would be to place a serious burden no the credit union movement and would be a step in the wrong direction.

Senator HOEY. Do you have objections to the bill?

Mr. STAHL. No, no objection.

Senator MILLIKIN. He is anticipating trouble.

Senator HOEY. I think that is about it.

Mr. STAHL. No, Senator Millikin, I am not anticipating trouble, but I felt that somewhere in the record of this committee our case should be stated. I do not know who is to follow. In New York, for example, I made a test of 37 credit unions that paid dividends at the close of 1949.

These 37 credit unions had 16,000 members, a little over 16,000 and 3,584 of the 16,000 received a dividend of over $4.

I just want to illustrate to you that the dividends in credit unions are nominal, that the cost to the Government in checking up the tax that would be of record would be burdensome to the Government as well.

Senator TAFT. What do you invest in? Loans to members?

Mr. STAHL. Yes, sir.

Senator TAFT. Just members?

Mr. STAHL. Just to members of the credit union.

Senator TAFT. You cannot loan to anyone else?

Mr. STAHL. That is correct.

Senator TAFT. Thank you.

Mr. STAHL. So, gentlemen, I appreciate the opportunity. As I say, I have no prepared statement. I did not anticipate any difficulty here. I am very grateful.

As I mentioned to you, this is my first experience in testifying before a legislative committee, and I thank you very much.

(A prepared statement, subsequently submitted, follows:)

STATEMENT OF SIDNEY STAHL ON BEHALF OF THE NEW YORK STATE CREDIT UNION LEAGUE, INC.

My name is Sidney Stahl, and I represent the New York State Credit Union League, which is a voluntary association of credit unions operating in the State of New York. When I originally wrote to Senator George requesting an opportunity to testify, the House Ways and Means Committee was considering their bill and we were concerned about the provision with regard to requiring credit unions to withhold the tax on dividends at the source.

However, H. R. 4473, section 1202, presently exempts credit unions from this particular requirement. I hope that this committee will see its way clear in maintaining that status.

I would, however, like to take this opportunity to read to you some facts about the credit unions.

Credit unions have been brought into being for the purpose of eliminating usury. They are chartered either by the State or Federal Government and there are at present approximately 11,000 such credit unions operating in the United States. Each credit union is examined annually either by the State or Federal Government. Credit unions operating under Federal law have been given recognition by Congress as associations organized for the purpose of promoting thrift and creating a source of credit for provident or productive purposes. Numerous acts by various State legislatures have also given express legislative recognition to credit unions as serving a proper and useful purpose.

In recognition of their useful and beneficial nature as instruments to eliminate the evils of usury, both State and Federal credit unions have been exempt from the requirements of paying any Federal income tax (section 101 (4) of the Internal Revenue Code and Treasury Regulation III, section 29.101 (4) 1).

The essence of the successful operation of a credit union is a low overhead and low cost of operation. Credit union treasurers are usually part-time employees

who are paid very small salaries and frequently they are volunteer workers who receive no compensation at all. The latest available figures (as of April 30, 1951) indicate that there are now 11,000 credit unions in the United States. To place on the unpaid or low-paid treasurers of the vast majority of these credit unions the job of reporting and computing and accounting for a withholding tax on members' dividends would be to place a serious burden on the credit-union movement and would be a step in the wrong direction.

Credit unions are not set up for the purpose of making substantial profits and the total amount of dividends paid out by them is relatively small and would have no appreciable effect on the national economy.

All credit unions are under governmental supervision and receive periodic State or Federal governmental examinations. This insures that such sums as should be paid out in dividends are actually paid out to the members and such payments are already taxable under existing law in the hands of the members.

Careful analysis will show that the vast majority of credit-union members are conscientious and stable elements of the population who give full recognition to their tax obligations. In view of this circumstance and the small amount of dividends involved per credit-union member, it would appear probable that the added cost to the Government of bookkeeping and record filing under the proposed legislation, as applied to credit unions, would more than offset any additional tax revenue that could possibly be derived from credit-union members.

In New York, as an illustration, I made a test of 37 credit unions that paid dividends at the close of 1949. These 37 credit unions had 16,000 members; 3,584 members received dividends of over $4, 1,951 of these members received dividends of over $10. In other words, there were 10,689 members who received a dividend of less than $4.

The Municipal Credit Union in New York State which was organized 36 years ago, at the close of 1949 had 38,028 members, 29,400 received dividends of less than $5 per annum for the past few years; 24,260 of their members received dividends of less than $1. All dividends in excess of $100 are reported to the Government as required by law. None have exceeded $150.

In view of the foregoing, I sincerely hope that the credit unions may be exempt from any requirement that the personal income tax on dividends be withheld at the source.

This is my first experience in appearing before the lawmakers of our country, and I am grateful to you for the opportunity.

Senator HOEY. Thank you, sir.

Mr. Taylor.

Mr. Taylor, will you identify yourself for the reporter, please?

STATEMENT OF HARTWELL F. TAYLOR, CONSUMER BANKERS ASSOCIATION

Mr. TAYLOR. Mr. Chairman and gentlemen of the committee, my name is Hartwell F. Taylor. I am executive director of the Consumer Bankers Association, an organization with a membership of 85 banks and 22 branches, located in 32 States. Combined assets of the members of this association total nearly $2½ billion, a large percentage of which is represented by time deposits and savings accounts of several hundred thousand American citizens.

The member banks of this association have, for many years, had a great interest in the so-called little man, the average citizen of our Nation, and have been recognized throughout our country as leaders and pioneers in making banking available to the average man, both in the field of savings and in financing the credit needs of individuals and business firms. Most of our members specialize in financing the purchase of automobiles, household appliances, medical expenses, educational expenses, and many other credit needs of the citizens of America.

By and large, the members of this group have been leaders in paying depositors a higher rate of interest on savings deposits than the larger, strictly commercial banks.

Our members are vitally interested in the future of this great Nation and in the welfare of its citizens. They are particularly interested in a stable economy and a balanced budget. They fully realize the emergency in which this country finds itself today and the struggle which is taking place between the ideologies of communism, on the one hand, and our great free-enterprise system, on the other hand, which has done so much to build the high standard of living enjoyed by our citizens today. They are in full accord with the efforts of our Government to build a defense program that will insure a lasting peace for tomorrow and the years to come.

We believe in a tax program that will permit us to pay our own way and not continue to pile up a heavy and staggering debt which will burden us and our economy for years to come. However, we believe in a program of taxation that will see every American citizen and business firm contribute an equal share rather than for the larger share to be borne by some and a lesser share borne by others. We believe that every citizen and firm has an obligation to help finance our defense program and the operation of our Government on an equal basis, with partiality shown to no single person or group.

In this connection, we have viewed with increasing concern the freedom from taxation which has been enjoyed for years and is presently enjoyed by a larger number of business concerns, mutual savings banks, credit unions, cooperatives, building and loan associations, and savings and loan associations, who claim to be mutual organizations but, who in the true sense, are not mutuals at all, and operate for profit just as much as any other business firm or corporation.

Senator TAFT. What is a consumer bank? It is a regular stock-owned bank with stockholders?

Mr. TAYLOR. Yes. It is the old Morris Plan Bankers Association, Senator.

Senator TAFT. The Morris Plan Bank?

Mr. TAYLOR. Yes. We have broadened our membership now to include many other banks.

Senator TAFT. The Morris Plan Bank.

Mr. TAYLOR. Your Ohio National Bank in Columbus is a member. Clyde Shively is a member of our group.

Senator TAFT. I was not too sure.

Mr. TAYLOR. Most of these self-styled mutuals are unfairly competing with other organizations which are carrying a heavy tax burden along with serving the needs of their customers.

In America today there are approximately 531 mutual savings banks, 6,000 savings and loan associations, 10,000 credit unions, 503 production credit associations, and 1,200 farm loan associations, with total resources running into billions of dollars. In 1949 the total earnings of these organizations amounted to nearly $1 billion. It is reasonable to assume that 1950 earnings exceeded this figure or were at least as great.

Not one cent of tax was paid to our Government by these organizations on these earnings. If they had borne their fair and equal share of the tax burden, at the same rate as other firms with which they

are competing, our Government would have received several hundred million dollars in additional revenue last year.

These mutual associations enjoy an exemption from taxation today, which is based on a principle that has long ceased to exist. There is no logical reason why the profits of these concerns should not be taxed at this time. Other institutions, already taxed beyond their rightful share, are more heavily taxed, while these associations remain untaxed. The tax bill of every citizen and business is heavier because they do not pay any part of the tax bill.

These mutual and cooperative financial institutions attempt to justify their tax-free status upon the ground that they are small local thrift organizations which provide safe depositories for small savings and that they have no income to tax because they are nonprofit organizations operating on a mutual basis. These arguments fail to recognize the basic changes which have taken place in these institutions in the last 10 to 20 years.

Congress originally exempted these associations from taxation because as they were originally constituted, their sole purpose was to accept small savings funds in a local community and finance the purchase of homes for people with small incomes. The manner in which they formerly operated kept them from offering any substantial competition to fully taxed organizations. In addition the corporate income-tax rate at that time was not large enough to be of competitive significance.

Today building and loan associations, savings and loan associations, cooperatives, and mutuals are operating on a much more aggressive and enlarged scale and competing strongly with our chartered banks for the savings of the public. In effect they constitute a third banking system in the United States. They spend large sums of money each year advertising for the savings funds of the people and creating the impression in the public mind that they are banks in every sense of the word in spite of the fact that they are expressly forbidden to do this by an act of Congress.

They have strayed from their original purpose of financing homes and accepting small sums for deposit from thrifty persons who purchased shares in their organizations and who exercised complete control over the management of these firms. Today even their signature cards accepted from shareholders at the time shares are originally purchased, incorporate a printed proxy turning over to the officers of these associations the power to vote and run the business as they see fit, without consultation with members.

Because they enjoy a tax-free status they are able to compete with taxpaying banks by offering a higher rate of return on funds left with them and are attracting deposits from our banks because of this unfair advantage.

In 1949 the average size of a savings and loan association was approximately $2 million. Today there are less than 15,000 banks in the United States with an additional 4,000 branches, serving the needs of the American public. Most of these banks are making loans to individuals for the purchase of homes and in many instances the rate of interest charges on such loans is less than the rate charged by savings and loan associations. I might add that of the 15,000 banks, 11,200 of them have total resources of 7½ million and less. All of these banks are paying a Federal income tax on their earnings and

helping to support our Government finances, and, at the same time, offering services to the people at nominal cost. Why, then, should we permit a total of 18,234 mutuals and cooperatives, a number almost equal to the total of all banks and branches in this country, to continue to offer their services, which are in direct competition with the taxpaying banks, free of any share of the tax obligation?

There are numerous examples which could be pointed out to you at this time to prove the fairness of imposing a tax on these organizations, but I would be presuming on your time today if I did so since I have learned that a more complete and detailed presentation of these facts will be made to you tomorrow by a representative of another banking organization.

Every member of our association wants to do its part in helping to support the cost of operating our Government and building our defense program. Our testimony here today is not based on any desire to cut the tax bill below what you gentlemen shall decide is needed, but we are here to raise our voice in protest against a continuation of an unequal distribution of the tax obligation.

We have no desire to see mutuals, cooperatives, and savings and loan associations taxed on any other basis than are our banks and business firms, but we urge this committee to give serious consideration to imposing the same tax on them that is now imposed on other business firms.

Thank you, Mr. Chairman.

Senator HOEY. Thank you very much.

Senator HOEY. Mr. Schwulst, will you give your name and connection to the reporter?

STATEMENT OF EARL B. SCHWULST, PRESIDENT, THE BOWERY SAVINGS BANK OF NEW YORK CITY

Mr. SCHWULST. Mr. Chairman and gentlemen of the committee, my name is Earl B. Schwulst. I am president of the Bowery Savings Bank of New York City. I speak for the National Association of Mutual Savings Banks, which represents the 529 mutual saving banks of this country.

May I say, Mr. Chairman, that I have with me a supplemental statement that, with the permission of the committee, I should like to file after I have finished reading my summary statement.

Senator HOEY. That may be filed and put in the record.

Mr. SCHWULST. The median-size savings bank has assets of $14 million; more than half the banks have assets of less than $15 million.

The first two mutual banks in this country were established in Boston and Philadelphia about 1816 by public-spirited citizens to provide a place where thrifty people of small means could place their savings for safekeeping and investment. From that day to this, mutual savings banks have been operated without profit to anyone except for interest paid to their depositors, the small-wage earners.

The savings-bank movement spread throughout the eastern section of the country. The mutual savings banks are mostly in New England, New York, New Jersey, Maryland, Pennsylvania, and Delaware and a few in the States of Ohio, Indiana, Minnesota, Washington, and Oregon.

At the end of 1950, mutual savings banks had total deposits of $20,025,117,118, representing 19,263,695 accounts, with an average account of only $1,039.53. The average interest paid in 1950 was 2 percent. Of these accounts 10 percent, or 1,942,387, were held by school children with an average deposit of about $23 per account. The savings banks have long attempted to inculcate thrift by encouraging school children to open savings accounts, even with dimes or any small amount they can spare. Surely our Government would not want to tax the penny savings of school children.

The savings banks are operated by trustees under strict State control and supervision entirely for the benefit of the depositors. These trustees usually serve without compensation or at most receive nominal compensation for attending meetings. They can have absolutely no pecuniary interest in any transaction in which the bank is involved.

These banks are mutual institutions without capital stock or stockholders, established for the sole purpose of promoting thrift by small-salary and wage earners. All the earnings which can properly be distributed are taxable to the depositors themselves, the remaining earnings being added to reserves for the protection of depositors as authorized by State statutes and often to meet the specific requirements of State and Federal supervisory authorities.

These banks, ever since there has been a corporate income tax, have been exempt from it. This long-standing exemption is based on the social purpose they serve, that is, the encouragement of thrift by wage earners, thus preventing destitution and public help as far as possible.

This social purpose is equally as important as the social purpose of other exempt organizations, such as unions and employees' trusts.

Senator MILLIKIN. May I interrupt to ask you a question, please? The preceding witness in referring to building and loan associations and savings and loan associations, and cooperatives and mutuals, said that—

> Even their signature cards accepted from shareholders at the time shares were originally purchased incorporate a printed proxy turning over to the officers of these associations the power to vote and run the business as they see fit, without consultation with members.

What do you know about that?

Mr. SCHWULST. He was speaking, I think. of the savings and loan associations. In the case of the mutual savings banks, the depositors are creditors of the institutions. There is no vote. These banks are run by trustees under the supervision of the banking department.

Senator MILLIKIN. You are saying that that is not applicable to mutual savings banks?

Mr. SCHWULST. It is not applicable to mutual savings banks.

Senator MILLIKIN. It is not applicable to the particular type of institution you have in mind?

Mr. SCHWULST. That is right.

Senator MILLIKIN. And you are not attempting to testify as to the other types of institutions?

Mr. SCHWULST. I am not testifying as to savings and loans at all. I am testifying solely with respect to mutual savings banks.

Senator TAFT. Mr. Schwulst, you say here:

> This long-standing exemption is based on the social purpose they serve, that is, the encouragement of thrift by wage earners, thus preventing destitution and public help as far as possible.

Does not the Morris Plan Bank in Cincinnati and every other savings bank attached to a larger bank perform the same social service in encouraging thrift? I do not think that that is a basis for exemption. You have to rely on the mutual character of the thing rather than its purpose. I do not see any justification for exemption for that purpose, because you would encourage other people to do the same thing.

Mr. SCHWULST. Of course, Senator, there are many stock institutions and many commercial banks that are engaged in the thrift promotion business.

But I think the difference between a stockholding type of thrift institution and an institution engaged in the promotion of thrift, such as the mutual savings bank, is that that is the sole purpose for the existence of the mutual savings bank, whereas the stockholding type of thrift institution is, I should think, since it is a stockholding type of institution, to earn a profit for the stockholders.

We have no stockholders, sir.

Senator TAFT. It is to earn a return on the money that the stockholders put in, which is capital. But as far as the general purpose of the bank is concerned, I do not see much difference.

Mr. SCHWULST. They earn that profit, Senator, principally from the employment of other people's money.

That is not the case with the mutual savings banks. The funds employed are the depositors' money. The trustees have no interests. There is no equity position in these banks at all.

Senator TAFT. My point is, I do not think that the purpose of it has anything to do with it. It seems to me that you have to rely on the mutual character of the organization rather than on the purpose.

Mr. SCHWULST. It is a mutual organization. But I just wanted to emphasize the purpose for which these institutions were started. They are run by these public-spirited trustees who can have no financial interest in the organization.

In fact, we can see no difference taxwise between such trust funds and the voluntary deposits made by wage earners in the mutual savings bank of their choice.

It has been suggested by some that the banks might be taxed on that portion of the annual earnings not distributed to the depositors but held as a reserve for the protection of the depositors.

The trustees desire to pay out to the depositors as much of the bank's earnings as possible, but they cannot prudently pay out all the earnings.

These trustees have an obligation to maintain the bank in a position at all times to pay off the depositors at par whenever demand is made and, consequently, must retain a portion of the earnings for the protection of the depositors' funds.

Since there are no stockholders and since the trustees can have no financial interest in the operations of a savings bank, they could have no possible motive for retaining earnings for any purpose other than that of protecting the small depositor.

Reserves must be set aside for inevitable losses in existing assets. Even with the most prudent management long-term investments are subject to depreciation and loss. Equally important, new deposits must be protected by adequate reserves if these banks are to function to encourage savings as a curb on inflation.

Since a mutual savings bank has no capital stock to absorb losses and no stockholders on whom it can call for additional funds, its earnings are the only funds available for reserve purposes.

All of the States in which mutual savings banks are located, except one State with only one bank, have statutory reserve requirements for depositor protection.

The retention of a portion of the earnings is required by law and indispensable to the survival of a mutual savings bank. It is submitted that the Federal Government should not undertake to tax these reserves, which are set up in accordance with State law, and which are required by sound business judgment for the protection of the life savings of so many millions of depositors.

The record of the last 30 years shows that there has been no excessive retention of earnings. During the predepression period, 1920 to 1930, mutual savings banks paid out to depositors 80.40 percent of their net operating income.

In 1930 their average ratio of general reserve to deposits was 11.65 percent. This ratio proved to be inadequate. Depression losses from 1931 to 1944, after all profits and recoveries, were so large that they would have wiped out 90 percent of the banks' reserves accumulated up to that time. In order to restore their reserves, the banks were compelled to cut drastically interest payments to their depositors. At the end of 1950, the ratio of general reserves to deposit was 11.4 percent, which is less than the ratio of 1930.

You can understand our concern at the prospect of any legislation which might run counter to a sound reserve policy or interfere with the independent and prudent supervision of these banks by the States.

Even though a tax were imposed upon these retained earnings, sufficient earnings would still have to be retained by the trustees for the protection of the depositors. Any such tax levied on the banks would have to be paid out of earnings that otherwise would be distributed to these small depositors because the reserves must be built up and maintained, not only on existing deposits but on new deposits, and the State authorities and the FDIC would require that this be done—tax or no tax.

Thus, the earnings paid over to the Government in the form of a corporate tax would in effect represent a tax imposed on these small depositors at a much higher rate than they would have paid on those earnings had the banks been able to pay those earnings out to the depositors instead of having to withhold them and pay them over to the Government as a corporate tax.

This would be a tax imposed on earnings not received by the depositors and without regard to their ability to pay.

Senator TAFT. That is true of every corporation tax, is it not?

That statement is just as true, that it would be a tax imposed on earnings that are not received. We have a double taxation system. It is very unjust. It is a proper criticism, but I do not see that it applies there any more than it does to any other corporation.

Mr. SCHWULST. Again, Senator, I would point out that experience shows that all of the earnings from the investment of these depositors' funds are paid out to them as dividends, except what must be kept to protect the principal of those deposits from loss. There is no stockholder interest which is making any profit out of the use of these funds.

Senator TAFT. I think the profit made by stockholders in banks is comparatively insignificant. It is not much more than a return on the money that they put in to provide this reserve.

Mr. SCHWULST. But the profit made by the stockholders of a commercial bank is made from the use of depositors' money, primarily and not from use of their own capital.

Senator TAFT. I think that is a distinction you cannot bear out. I do not see that at all. They invest their own money and get a return on their stock.

Mr. SCHWULST. Are not the bulk of the funds that are invested by commercial banks——

Senator TAFT. My point is this, that you say that they would get smaller dividends if you taxed the reserves. Also, every bank depositor in a savings bank gets a smaller return of interest because the bank has to pay taxes, so that they cannot pay so much interest. That is true of every bank, every savings bank in the United States.

That particular argument does not seem to me to be sound.

Mr. SCHWULST. Could we consider for a moment the difference between the status of the savings depositor in a commercial bank and a savings bank?

The tax that is paid on the earnings made from the use of the savings deposits in a commercial bank is on the profits from the use of that money.

Now, it is the tax on those profits which holds down the dividend that is paid to the stockholders. It does not hold down the interest that is paid to the depositors of the commercial bank.

Senator TAFT. Why not?

Mr. SCHWULST. Because the interest that is paid to the depositors of the commercial bank is exempt from taxes, so far as the commercial bank is concerned.

It is a deductible item.

Senator TAFT. I know. But if the bank did not have to pay so much taxes, they could pay more interest on their savings, and they might or might not do it. It is the same thing. You are not subject to double taxation. They are. Is you interest rate higher than the ordinary commercial bank's savings department?

Mr. SCHWULST. Yes, it is, but it is not due to the fact that the commercial bank pays a tax.

Senator TAFT. That is one of the reasons. Obviously it is.

Mr. SCHWULST. I disagree with you, Senator, because it is the profit which the stockholders are withholding from the earnings that they make.

Senator TAFT. The stockholders do not withhold more than just a 6-percent return on their own money as a rule, and otherwise, whatever comes in goes into the reserve just as you keep a reserve.

Mr. SCHWULST. But the reserve belongs to the stockholders, and it would be reflected in the book value of the stock, because there is an equity position in these commercial banks and there is no such position in the case of the savings bank.

Senator TAFT. I still maintain that since they have to pay taxes, they are not likely to pay so much interest, and it is reflected in the interest to the people who deposit in those banks. As you say, they pay less than your savings banks pay.

Mr. SCHWULST. If the commercial bank did not pay taxes on the profits made from the investment of depositors' money, it does not follow that they would necessarily pay a higher rate of interest to the depositor, because that tax saving would belong to the stockholders.

Senator TAFT. No, not at all. They pay only 1 percent because that is all they can afford to pay, with the money that they make on their loans. They have one charge, the payment on capital, that they have to pay, but that is just a return on the money that they are using, their stockholders' money.

I cannot see the argument that the tax here would take away some of the depositors' interest. In a commercial bank it certainly takes away the interest. They used to pay 2 percent. Why did they cut it down to 1 percent? Because the expense of running banks has gone up.

Mr. SCHWULST. The savings banks used to pay 4 percent and used to pay 3½ percent.

Senator TAFT. Surely, but the returns on their loans are less. The returns on their investments are less. The returns on Government bonds are less and consequently, they have to pay less interest because they cannot make so much money.

And their taxes are much higher than they were, which is another reason why they cannot pay more than 1 percent, or whatever it is that they pay.

Mr. SCHWULST. The point that I am trying to make with respect to the mutual savings bank is that all of the earnings that are made from the investment in these deposits are paid out to the depositor himself, except what must be kept back by disinterested trustees to protect those deposits.

Senator TAFT. Kept back for reserves.

Mr. SCHWULST. That is not the case with respect to the commercial bank.

Senator TAFT. It is in substance the same with the commercial bank. They pay the stockholders 6 percent and the rest goes into reserves.

Mr. SCHWULST. All right.

But a part of the earnings that are not paid out to the savings banks' depositors of a commercial bank go as profit to the stockholders, and the corporation is taxed on that, whether it is distributed to the stockholder or not.

Our reserves do not belong to anyone except the bank. They are held there as a loss reserve, and history shows that they will be used for that purpose.

Senator TAFT. If they liquidate, they will go to the depositors?

Mr. SCHWULST. If there are any left, But if they liquidate, it would be an involuntary liquidation, and the chances are that there would be no reserve at all. I know in my own bank we had a depreciation in the Government bond account alone of $15 millions, and if we did not have some reserve and our depositors came in for their money, I do not know how we would meet the demand, because once those deposits became impaired through the inadequacy of the reserve to take care of losses in assets, the banks are insolvent.

We have no capital stock, no net worth. We cannot call on outsiders to put up funds to protect these deposits. We must keep back earnings for that purpose.

Senator TAFT. Neither has any other bank got anyone they can call on today.

Mr. SCHWULST. They do not.

May I proceed?

Senator HOEY. Go ahead.

Mr. SCHWULST. We do not believe that this committee would seriously consider applying a corporate rate of tax to the interest otherwise payable to these small depositors, nearly 50 percent of whom make less than $3,000 a year, and nearly 77 percent of whom make less than $5,000 per year, and who would pay taxes on this interest, if distributed to them in the low brackets or in some cases not at all. To pay a tax on retained earnings, the banks would have to reduce the interest to the depositors. This reduction would in turn increase the bank's income subject to tax and would result in a tax on the tax itself.

If the mutual savings banks had been subject to the regular corporate tax over the last 5 years it would have been necessary to reduce the interest paid to depositors by about 33½ percent.

At 1948 and 1949 tax rates, a depositor, married with two children, would have had to have an income of $25,000 to have incurred such a tax on the interest, if it had been paid to him. Even at the higher rates now imposed for 1951, he would have to have an income of more than $20,000 to justify such a tax on his personal income.

The statement is sometimes made that the tax exemption of mutual savings banks enables them to compete unfairly with commercial banks. Savings banks are not in the commercial bank business, do not have checking accounts, do not engage in general commercial bank activities but confine their operations entirely to accepting deposits from small savers and investing them for their benefit. Actually, savings banks are not, properly speaking, banks at all. They are really mutual societies or institutions for the encouragement and promotion of thrift among poor people.

Commercial banks do not generally pay as high interest as mutual savings banks on thrift deposits but this is not due to the so-called tax advantage.

There are three principal reasons for this difference:

(1) The yield of commercial banks on investments is less than savings banks;

(2) The expense of operation is greater, almost twice that of savings banks; and

(3) A substantial part of the earnings from thrift accounts is paid to or accumulated for the stockholders as profits on their stock investment.

As stated, a tax on mutual savings banks would reduce dollar for dollar the interest which the banks would have paid to the depositors. Since this interest is normally left on deposit as additions to savings, the tax on the bank would cut down savings, not spending. Thus, a tax on mutual savings banks would not serve to curb but would increase inflationary pressures.

The savings bank tax would reduce substantially the interest paid to the depositors; such cuts in interest payments would discourage the accumulation of new savings and encourage withdrawals for current spending.

In both ways, the tax would contribute to inflation. See Secretary Snyder's statement on necessity for encouragement of savings to combat inflation.

Now summarizing: A tax on savings banks would (1) be a tax on thrift;

(2) Indirectly tax the small depositor at several times the rate applicable to his bracket;

(3) Reduce interest paid to the small depositor; and

(4) Discourage savings and contribute to inflation.

Thank you very much, Mr. Chairman.

Senator HOEY. Thank you for your testimony.

(The supplemental statement of Mr. Schwultz is as follows:)

SUPPLEMENTAL STATEMENT OF EARL B. SCHWULST ON BEHALF OF THE NATIONAL ASSOCIATION OF MUTUAL SAVINGS BANKS

NATURE OF MUTUAL SAVINGS BANKS

Mutual savings banks were not created for profit or for commercial purposes in the ordinary sense of the term. They were formed to promote thrift among poor people. Today they are operated by boards of trustees solely for the purpose of encouraging thrift and providing safe depositaries for small savings accounts.

The savings bank has no capital stock represented by shares; it has neither stockholders nor directors. It is operated by a board of public-spirited trustees who appoint its officers and manage its funds.

The mutual savings banks are subject to constant supervision and regulation by State authorities and by the Federal Deposit Insurance Corporation. Their banking activities and investments are restricted by State law. The State authorities even have power to change the management of a mutual savings bank if they consider that step necessary for the protection of the depositors.

The mutual savings banks make annual reports. Their books are audited by State examiners. Their reserves and write-offs may be dictated by State banking authorities.

MUTUAL SAVINGS BANKS NOT COMPARABLE TO COMMERCIAL BANKS

There is a misunderstanding about mutual savings banks because the word "bank" in many instances is part of the title. They are thrift institutions and perform no commercial banking operations. They have no checking accounts. They make no commercial loans. They do not engage in the trust business, etc.

The field in which a mutual savings bank may operate is specified by statute. This type of bank is usually restricted to the receipt and repayment of savings deposits, the investment of its funds, the declaration of dividends, and the exercise of powers incidental to the conduct of the business of a savings institution.

Mutual savings banks, operating in only 17 States, are limited by State law in 16 States and by common law in 1 State as to types of investments. For example, in New York, which may be taken as typical, the savings banks are restricted to the following four general categories: (1) Government obligations including State and municipal bonds; (2) bonds and mortgages secured by real estate; (3) selected obligations of railroads and public utilities; and (4) miscellaneous obligations, such as those of the Port of New York Authority and housing authorities.

A commercial bank is owned by stockholders and can secure further capital funds through the issuance of additional stock. It primarily engages in a commercial banking business with checking accounts and commercial loans without limitation other than the credit of the borrower, except certain minor limitations as to the amount of the loan. A commercial bank can make loans in practically every field of endeavor including loans to individuals, unsecured as well as collateral loans.

SIZE OF BANKS

The savings banks are, on the whole, relatively small institutions. The median size savings bank has assets of $14,100,000. As shown in the following table, more than half of the 529 mutual savings banks have assets of less than $15,000,000:

Assets in millions	Number of banks	Cumulative total	Assets in millions	Number of banks	Cumulative total
0 to $4.9	93	93	$40 to $49.9	22	430
$5 to $9.9	110	203	$50 to $74.9	25	455
$10 to $14.9	69	272	$75 to $99.9	24	479
$15 to $19.9	52	324	$100 to $149.9	14	493
$20 to $24.9	33	357	$150 to $199.9	13	506
$25 to $29.9	26	383	Over	23	529
$30 to $39.9	25	408			

AGE OF BANKS

Most of the mutual savings banks are old institutions, many of them over 100 years old. Only a few are less than 30 years old.

Number of banks:	*Dates founded*	Number of banks—Con.	*Dates founded*
10	1816–1820	33	1881–1890
21	1821–1830	30	1891–1900
26	1831–1840	16	1901–1910
47	1841–1850	9	1911–1920
116	1851–1860	4	1921–1930
129	1861–1870	5	1931–1940
81	1871–1880	2	1941 to date

SIZE OF ACCOUNTS

Mutual savings banks are depositaries for small savers whose principal interest is the repayment of their deposits in full. The average savings bank account on December 31, 1950, was $1,039.53. On that date the average accounts by States were as follows:

	Average amount		*Average amount*
Connecticut	$887. 12	New York	$1, 231. 06
Delaware	814. 93	Ohio	914. 61
Indiana	1, 167, 00	Oregon	1, 586. 39
Maine	667. 13	Pennsylvania	853. 58
Maryland	726. 85	Rhode Island	779. 17
Massachusetts	892. 88	Vermont	788. 73
Minnesota	868. 06	Washington	1, 004. 68
New Hampshire	827. 92	Wisconsin	452 13
New Jersey	769. 99	Total United States	1, 039. 53

OCCUPATION OF DEPOSITORS

Wage and salary earners constitute the largest group of savers in mutual savings banks. A 1949 study of the New York State savings banks showed the following breakdown of depositors by occupations:

Occupation	Percent of total number of accounts	Percent of deposit liability
Mechanic, laborer, etc	17. 0	17. 1
Housewife	15. 9	14. 0
Clerk, civil service, etc	14. 2	10. 7
Salesmen, etc	7. 9	8. 9
Professional	6. 6	7. 9
Merchant	2. 6	3. 0
Domestic service	1. 7	1. 5
Executive	. 9	1. 5
Retired	. 7	1. 4
Miscellaneous or no answer	32. 5	34. 0
Total	100. 0	100. 0

The occupations of depositors who opened accounts with the Philadelphia Saving Fund Society of Philadelphia, Pa., during 1949, excluding Christmas Club accounts, were as follows:

Occupation:	Number of accounts
Wage earners and wives	16,473
Salaried employees and wives	12,430
Business	1,430
Professional	1,138
Domestic employees	425
Agriculturists	64
No occupation	5,666
Minors	19,028
Total	56,654

Many parents and other relatives open small savings accounts for minors. The mutual savings banks encourage these accounts and school savings accounts as a very important part of their program to promote thrift. A very substantial number of the depositors classified as "Miscellaneus" or "No answer" in the New York survey are minors. This is borne out by the experience of the Philadelphia Savings Fund Society. As shown above, 19,028 or about 33 percent of the 56,654 accounts of this institution were for minors.

INCOME OF DEPOSITORS

The mutual savings banks are institutions principally for people in the lower income brackets. According to a survey made in 1950 by the Federal Reserve Board, about 42 percent of savings depositors had incomes of less than $3 000 and about 77 percent have incomes of less than $5,000.

COMPOSITION OF ASSETS OF THE MUTUAL SAVINGS BANKS

The assets of the mutual savings banks of the country as of December 31, 1950, were as follows:

[In millions of dollars]

Assets:	
Cash	$792
U. S. Government securities	10,877
Other securities (railroads, utilities, etc.)	2,356
Mortgage loans	8,039
Other loans	127
Other assets	255
Total	22,446

NATURE AND SOURCE OF RESERVES

Reserves set aside by mutual savings banks are realistically not permanent earnings, but are in reality advance expenditures for the depositors to meet losses. They are part of the cost of staying in business.

To keep mutual savings institutions intact, and always in a position to pay 100 cents on the dollar to their depositors, they must set aside reserves from each year's earnings. Experience has proven that these reserves are not real profits, but over the years are consumed by losses and by shrinkages in asset value. The kind of long-term, low-yield investments, in which by force of State law and by dictates of prudence, savings banks must invest, are bound to show losses and shrinkage in value. Even United States Governments have shrunk in market value within the last few months. In the 1920's $100 Government bonds dropped to a market value as low as $80. In a word, even for the safest type of investments, reserves must be accumulated against shrinkage in market value in order to maintain an asset level equal to the deposit liability.

Over the years reserves have not been more than sufficient to offset shrinkages and losses. Reserves are like depreciation allowed for manufacturing concerns—a recognized part of the cost of doing business. These reserves are in reality operating costs as much as depreciation of buildings and equipment.

It is not sufficient to allow savings banks to deduct for losses on the proposed 20-year formula applicable to short-term loans of commercial banks. This formula does not take into account the necessity for providing for losses on long-

term investments before they come. It does not take into account possible shrinkage in market value, which mutual savings banks in order to remain solvent must offset by building up from net income a cushion of extra assets—a surplus or reserve—which can come from no other source, as they have no capital stock. These institutions must always possess assets greater than their deposit liability, so that when the market value of the assets falls below their cost, as is a frequent experience, there exists a margin of safety to take up the shrinkage.

Furthermore, in an era like the present, when new depositors come fast as a result of inflation and of the thrift preaching by these institutions, the funds cannot be put to work instantly and earnings from former deposits must be set aside in order to margin the increases in deposits in order to maintain a safe ratio of assets to increasing deposit liability.

The average surplus ratio for each of the States in which mutual savings banks operate and for the United States as a whole is as follows, as of December 31, 1950:

	Percent		Percent
Connecticut	12.5	New York	10.8
Delaware	17.4	Ohio	6.4
Indiana	10.4	Oregon	4.3
Maine	14.7	Pennsylvania	13.1
Maryland	11.8	Rhode Island	10.1
Massachusetts	12.7	Vermont	11.8
Minnesota	8.2	Washington	7.9
New Hampshire	14.0	Wisconsin	9.1
New Jersey	11.7	United States	11.4

All except one State (with only one savings bank) provide by statute the minimum surplus and the maximum. Although there is a wide range of State requirements on this subject, the minimum requirement in New York and Massachusetts (the two States having the largest savings deposits) is 10 percent and 7½ percent, respectively, of deposits. In most of the States, the maximum permissible surplus is 25 percent of deposits and in Massachusetts 15 percent. Thus the States do not set a specific standard for reserves other than the minimum and the maximum, leaving it to the trustees to determine, based on their judgment as to the needs of the particular bank, the aggregate amount of surplus or reserves required. The surplus within this permissible range is determined by trustees having no financial interest in the operation of the bank and motivated entirely by the desire to pay out as much as they safely can to the depositors.

DISTRIBUTION OF NET INCOME OF SAVINGS BANKS

During the predepression period, 1920–30, the banks on an average distributed about 80 percent of their current net income by way of interest to the depositors and retained about 20 percent of current earnings to add to reserves. This amount proved to be inadequate to provide for losses during the period 1931–44, during which period such losses aggregated 90 percent of the reserves at the beginning of the period. The banks were able to restore their reserves by drastic reductions in interest payment at a time when the depositors needed funds. In 1949, the total net income of the savings banks for the United States, after expenses, aggregated about $158,000,000. Of this amount, they were forced to retain about $113,000,000 for additions to general reserves. These additions to reserves were required by the fact that deposits increased and additional reserves were required to provide the needed margin of safety for the additional deposits. The complete 1950 statistics have not yet been compiled.

THE WELFARE OF THESE SAVINGS INSTITUTIONS IS IMPORTANT TO THE FEDERAL GOVERNMENT

The interest of the Federal Government has always been identical with the interest of the trustees. The Federal Government has refrained from imposing income tax on these institutions because it recognized their essential merit, believed in the value of their encouragement of thrift, and welcomed their extensive purchases of Government bonds. FDIC has never considered that its insurance is a substitute for the safety secured by the reserves these banks built up, but on the contrary has encouraged and even insisted upon a policy of adequate reserves. No institutions in the country, not even the others freely granted exemption under section 101, have done more to teach the citizenry self-reliance, to foster a belief in self-help, in sacrificing today so as not to become a

Government charge tomorrow. These institutions perform an inestimable social function far more valuable to the Federal economy than would be the returns from a Federal tax.

ALLEGED COMPETITION WITH COMMERCIAL BANKS

The allegation is made that the tax exemption of mutual savings banks enables them to compete unfairly with commercial banks. As before stated, savings banks are not in the commercial-bank business, accept no checking accounts, do not engage in general commercial banking activities but confine their operations entirely to accepting deposits from small savers and investing them for their benefit. Savings banks are restricted in the amount of deposits they may receive from one depositor. In the more important savings-bank States the maximum is $10,000. Commercial banks are not restricted as to the amount they may accept in their thrift accounts.

Depositors in mutual savings banks cannot be compared with stockholders of an ordinary taxable corporation, such as a commercial bank. The stockholder invests in stock for the purpose of making profits and also for any appreciation in the value of the assets, including the growth of the surplus. He can usually realize on his stock in increases in surplus by the sale of his stock. The depositor of a savings bank never realizes on surplus as such, except perhaps in the unlikely case of liquidation and even then the chances are that the surplus or reserve would be required to cover losses from forced liquidation.

Commercial banks have a great advantage in their wider lending powers and the greater range of their deposits. Commercial banks also derive collateral benefits from their thrift deposits because the depositors are likely to use other facilities and services of the bank for their needs. Normally they may have a great number of offices, whereas mutual savings banks are limited as to branches.

Commercial banks do not generally pay as high interest as mutual savings banks on thrift deposits. But this is not due to the so-called tax advantage. There are three principal reasons for this difference: (1) The yield of commercial banks on investments is less than savings banks; (2) the expense of operating commercial banks is greater, almost twice that of savings banks, and (3) a part of the earnings from thrift accounts is siphoned to the stockholders as profits on their stock investment.

EFFECT OF THE CORPORATE TAX APPLIED TO SAVINGS BANKS

The trustees of mutual savings banks are deeply concerned over the suggestion that the corporate tax exemption of mutual savings banks be removed. These trustees have no personal stake in the outcome. They are not stockholders. These institutions have no stockholders. They are concerned solely because of the effect on their depositors of small means resulting from the imposition of a tax at the corporate rate on that part of the earnings which must be set aside as a reserve, as a protection for their depositors, as an inherent cost of doing business in the safe, sound, thrifty, conservative mutual savings bank way.

The average deposit in a mutual savings bank is about $1,000. The fact is that the proposal to tax part of the earnings of these average $1,000 depositors would mean that individuals who are actually poor or minors or thrifty persons of moderate means would be taxed at the corporate rates on the income from their small earnings.

Trustees have no personal motive or reason to set aside unneeded reserves and no reason at all to hold down the interest paid to depositors. Their sole interest is to encourage savings against the adversities of ill health, old age and the like and for self-improvement, for children's education, etc., by thrifty individuals whose means are too small for them to undertake their own investing and who require absolute security for each dollar saved.

Prudent trustees retain a portion of the earnings for reserves. To the extent that these earnings are retained, a tax paid thereon must be deducted from the amount distributed as interest to the small savers. Thus the tax would be borne by the individual depositor and is a tax on thrift.

The proposed tax would be, in effect, a tax at corporate rates on sums that are retained as a part of the cost of doing business.

It is hoped that the Congress will not now reverse its long standing policy toward these institutions, will not cripple them, will not tax any part of the earnings of these average $1,000 deposits of thrifty, small individuals at the rate usually applied to corporate entities.

Senator HOEY. Mr. Thomson, will you be good enough to give your name and connection to the reporter, please.

STATEMENT OF J. CAMERON THOMSON, PRESIDENT, THE NORTHWEST BANCORPORATION, ACCOMPANIED BY HERBERT STEIN, ASSOCIATE RESEARCH DIRECTOR, COMMITTEE FOR ECONOMIC DEVELOPMENT

Mr. THOMSON. My name is J. Cameron Thomson. I am president of the Northwest Bancorporation, Minneapolis, Minn., and Chairman of the Committee on Money, Fiscal and Debt Policy of the Committee for Economic Development.

There is a list of the members of the committee on the last two pages of this report.

Senator, I want to save your time, and I appreciate how many people you have heard. This is a long report here, and I am going to hit the high spots in this report and read some pertinent sections, and you can interrupt me any time, but I will try to save your time.

Senator HOEY. We can include the whole report in the record, if you would like.

Mr. THOMSON. I would like to have you do that, if you will, and I hope some of you will get a chance to take the time to read it.

We start with the House bill. I will refer to the pages of my statement that I am talking about. We raise questions as to whether the House bill raises the amount of money that is needed or even too much, and whether it raises the money in the right way in order to encourage production and to control inflation and to distribute the burden of the defense equitably.

As to the principle in determining the amount that should be raised, CED stresses the cash budget rather than the administrative budget as the basis for measuring the impact of the Government's fiscal program on the economy.

In our committee, there is a minority that feels that you should not attempt to get a surplus over balancing the budget in 1952, but the majority ot our committee, and a large majority, feels that as to 1952, you should balance the budget on a cash basis and you should have a moderate of surplus.

Now, the reason for that is that, anticipating further inflationary pressure and anticipating that expenditures for the defense program are going to continue to rise, we think it is well to press for not only balancing the budget, but to have a surplus this year.

Of course, we think that the whole approach to this problem this year should be from the standpoint of not only balancing the budget, but from the standpoint of preventing inflation, and we think the House bill falls very short in that respect.

Senator MILLIKIN. Do you believe that the surplus should be used for current expenditures or for retirement of debt?

Mr. THOMSON. Of course, if you had a surplus, it would operate, Senator, to reduce the debt. That is what happened this year, and that is what automatically would happen if you had a surplus.

Senator MILLIKIN. In all events?

There is no choice?

Mr. THOMSON. Of course, you can still reduce taxes, but as a practical matter——

Senator MILLIKIN. No; I am talking about the Treasury's choice, as to how it would handle the surplus.

Does it not have the choice of reducing the debt or of carrying the surplus over for expenditure?

Mr. THOMSON. I think that by all means its policy has been and should be to reduce the debt.

Senator MILLIKIN. No. I am talking about the choice, and not as to what to do with the choice.

Does not the Treasury have the choice of reducing the debt, or carrying forward the surplus for use?

Mr. THOMSON. That is correct. Of course, they can increase their cash balances.

Senator MILLIKIN. Is it the thought of your organization that the surplus should be used for current expenditures?

Mr. THOMSON. No; the surplus should be used to reduce debt or increase the cash balance. If there is a deficit in a later year it would be necessary to increase the debt or reduce the cash balance.

Senator TAFT. I notice today that they have a cash balance of about $2,000,000,000 more than they had a year ago.

Instead of applying it to the debt, they held it for a larger cash balance.

Mr. THOMSON. This surplus is to make sure that you do not get caught short, to reduce the debt or increase the cash balance, partly in order to prepare for higher expenditures in later fiscal years.

Senator MILLIKIN. How about the taxpayer getting caught short?

Mr. THOMSON. We think he is.

Senator HOEY. He is always short.

Mr. THOMSON. Now the first five pages of this report deal with the principle of balancing the budget and having a surplus. We indicated that this question of balancing the budget should apply at this time. There may be circumstances when we should get off the pay-as-you-go program, but we have definitely indicated that as to fiscal 1952, we think you can see your way clear, and you should stay on that program.

Senator HOEY. Yes.

Senator MILLIKIN. Have you formed any opinion as to 1953?

Mr. THOMSON. The very fact that we are putting in here the fact that in 1952 you should do it, but that you should not do it indefinitely indicates that we will take another look at it in 1953.

Senator MILLIKIN. It has been indicated that we shall have an expenditure of $80,000,000,000 in fiscal 1953.

That, obviously, is a very different problem from balancing the budget in 1952, which presumably would have an expenditure level of probably $20,000,000,000 less or something like that.

Mr. THOMSON. The import of our report is that in the House bill you have gone beyond what you should do in taxing middle- and upper-bracket individuals and corporations. That would have a bearing on what you say about trying to continue the pay-as-you-go if you get $20,000,000,000 more in expenditures next year.

Now we come out with a figure that is required to balance the budget.

And this is based on the best estimate that we could make. I am not going into detail but we emphasize in here that we do not know today how much we are going to cut the expenditures. We hope that you are going to cut more than they have already been cut. We are glad they have been cut as much as they have.

But we come out with a figure of $5,400,000,000 to balance the budget and to produce a surplus of $3,000,000,000 on a cash basis in fiscal 1952, and anticipating that——

Senator MILLIKIN. Would you mind repeating that? I did not quite get that.

Senator TAFT. That is at page 5.

Mr. THOMSON. It is at page 5, at the top of the page.

It would take you $5.4 billion to balance the budget and produce a surplus in fiscal 1952, based on our analysis, that cash expenditures might reach $68 billion and receipts might reach $65.6 billion.

Senator MILLIKIN. Making allowance for a new tax bill?

Mr. THOMSON. Tbe $65.6 billion is from existing taxes. This is preparatory to getting to the amount that you have to raise this year.

Senator MILLIKIN. And of the type that you are going to propose?

Mr. THOMSON. That is true.

Senator MILLIKIN. Thank you.

Mr. THOMSON. Now, the $5,400,000,000 that is needed on the basis that I have outlined to balance the budget and produce a surplus this year really means that if you make your tax effective, say, October 1, from $7,000,000,000 to $7,500,000,000——

Senator HOEY. What is the committee's view of the effect on corporations?

Mr. THOMSON. We have specified October 1 without indicating that there was either merit or demerit to that. We have been opposed to retroactive taxation, but we have assumed that at this point, an October 1 date, if you are not going to have retroactive taxation, was about as good a guess as you could make. That means that our studies indicate that the House bill, as to the dollar amount, assuming you do not cut the expenditures further, is probably about right, but it is in the way that the House bill raises the money that we find the greatest objections to.

Taking the individual tax rate first—and here I am going to turn to the top of page 7, just a short paragraph, and over on page 8, particularly—we feel that the House bill in its 12½ percent of present taxes across the board, raising the tax rates in the upper middle income group and among the group of business executives, owners of medium-sized businesses, has gone too far.

On page 8 there is a table that indicates that under the House bill, for an additional $100 of income, for a man who gets $50,000 income after taxes, under the present law, you have reduced the amount that he is going to retain out of that additional $100 from 25 to 15.6 percent, or a reduction of 37.5 percent in the so-called marginal take-home pay after taxes of a man who gets $50,000 after his income tax.

We think that is too much, and we think that as to its effect on incentives it is too great a rate increase.

Raising the rates that are now above 50 percent only produces $400,000,000 of revenue, which is equivalent to the amount that you are going to get in on the gambling tax, if that is put into the bill finally. This amount of revenue does not warrant taking away the incentive from the people in those brackets.

Carrying that still further, on page 9 we point out that in our judgment, reducing the take-home pay after taxes of the people who are in the management group and the upper middle income group, who

presumably would save rather than spend money, is not helping an anti-inflationary program.

We think that the House bill is unfair in the raise in the taxes across the board, and that if the full import of that situation were brought home to people, they would realize that it was unfair, and that it impaired incentive and that it was not anti-inflatioanry.

Senator FLANDERS. Mr. Thomson, would you explain again why this taxation is not anti-inflationary?

That is, in these upper middle income brackets? I have lost the point.

Mr. THOMSON. On page 9, in the paragraph at the top there, I will read the sentence:

> But these large increases in the tax rates that are already highest will do relatively little to restrain demands, because they bear on incomes that are largely not spent for consumption goods but are invested. At the same time, they will interfere with the incentives for increasing growth of production. Thus they will make little if any net contribution to the control of inflation.

Senator FLANDERS. There is involved in that a question which has been troubling me, and that is whether the taxation in itself is anti-inflationary.

I can see that it is anti-inflationary to the extent that it makes it unnecessary to do deficit financing by bank borrowing

To that extent, certainly the taxation is anti-inflationary. But I question whether it is anti-inflationary to the extent that it reduces personal spending. It still goes into the market through the Government for scarce goods and services, and there is no reduction in the funds seeking goods. It just simply goes to another purchaser, to wit, the Government, instead of to the private purchaser.

So it is really not anti-inflationary in that sense.

Mr. THOMSON. Our program is predicated, Senator, and our recommendations all the way through on assuming that you would go forward with this tax program.

I should have read this sentence at the bottom of page one, that we are predicating our whole proposal on two factors: First, that the expenditures should be held to the lowest level possible in the present emergency.

That refers to the fact of Government spending, as you pointed out, rather than individual spending.

The second is that the additional taxes should be of kinds that will be useful in controlling inflation with the least damage to production.

In other words, we are saying that the Congress has a duty to make sure that you do not have the Government instead of an individual putting the pressure on the economy and creating inflation.

But fundamentally, as we see it, those people are not going to increase their expenses for consumption. They are savers, and they are the people who will invest and invest for production, and they will have more incentive, and it will be far fairer if you do not take the money away from them to the extent that that bill provides.

Senator FLANDERS. It is still not clear to me that the taxation as taxation tends toward restricting inflation. Taxation as reducing savings would seem to have a contrary effect.

Mr. THOMSON. That is right.

Senator FLANDERS. And taxation is turning funds over to the Government which would seem to have a neutral effect.

So I am not at all sure that taxation per se reduces inflation.

Mr. THOMSON. I think the basic thing that it does is the question you posed yourself, and that is that it prevents deficit financing.

Senator FLANDERS. Yes; that is it.

Mr. THOMSON. That much, speaking of taxation now, in toto. It would prevent inflation by reducing the necessity for deficit financing.

Senator FLANDERS. Then you do not controvert my proposition officially and definitely?

Mr. THOMSON. No.

I think that if you and I would take time, we would come to pretty close agreement on this.

Senator MILLIKIN. I suggest that there is some question of degree now in there.

Mr. THOMSON. Yes; it is a matter of degree.

Senator MILLIKIN. It depends on the dynamism of the particular products for which the Government spends its money.

Mr. THOMSON. Yes.

Senator MILLIKIN. If you plow back the money down at the consumer level, which has the greatest dynamic spending power of all, you may be doing a highly inflationary thing.

Mr. THOMSON. That is right.

Senator MILLIKIN. You can plow the money back into other brackets where the dynamics have been reduced, and to that extent you would reduce the inflation somewhat.

Mr. THOMSON. You have stated it much better than I did, Senator.

Senator MILLIKIN. But what I suggest is on the first bounce.

Mr. THOMSON. Yes, sir.

Senator MILLIKIN. If the Government builds a post office, for example, the post office as representing an expenditure is not as dynamic as perhaps a productive and successful factory would be, but it is still spending money for stone, which in turn supports the payroll of the quarry and all the transportation and the masons' labor, which in turn is spent for these dynamic things that we are talking about.

So in one aspect of it, in building a post office, you are doing something which, from that aspect of it, is not as violently inflationary as other expenditures might be, but nevertheless the money that the postal carrier gets and that the employees get and that received by all the construction processes, that money bounces right back into your general consumer market.

I do not see very much how they would reduce inflation.

Senator FLANDERS. Mr. Chairman, is it allowable for Senators to question each other?

Senator HOEY. I think I will just listen.

Senator FLANDERS. I was just thinking about this first bounce that Senator Millikin speaks of.

That first bounce may be heading for scarce labor; that first bounce may be bidding for scarce materials.

Senator MILLIKIN. I agree.

Senator FLANDERS. That is all.

Mr. THOMSON. I think you have to analyze each thing on the basis of degree.

But there is one paragraph which I did not read in here which bears on this question of the kind of income which you have to soak up.

That is the report of the Economic Advisers for 1951 on page 10, in which they said:

> Income tax increases should be imposed at all levels, emphasizing the progressive character of the tax structure; but by far the largest part of the additional revenue must come from the middle and lower tax brackets. These are the brackets in which the great bulk of the income is located. Of the total net income shown on all taxable returns, 86 percent of the amount remaining after Federal income taxes is estimated to be received by taxpayers with net incomes of less than $10,000. To hold down consumption, which is vital to the control of inflation, the bulk of consumers must be affected directly by the tax increases.

Senator FLANDERS. Mr. Chairman, I had a conversation this afternoon with a man in the tax bracket between $7,000 and $12,000, and he suggested that if he had been taxed more heavily, he would not have bought an electric refrigerator, which he had just done.

He was using that as an example of the usefulness of taxing his particular tax bracket.

He is a very objective sort of fellow.

Senator TAFT. That is very noble of him.

Mr. THOMSON. The considerations that we have outlined on which we base our proposal for the treatment of individual taxes are brought out at the bottom of page 10.

Senator MILLIKIN. Before you get to that, may I question you a little bit about the savings potentialities of the upper middle brackets?

The evidence in past hearings has been rather conclusive to me that that is the great source of savings.

But I am wondering, with the increased cost of living under the inflationary conditions under which we live, whether that theory has all of its old validity, in other words, these junior executives that get an increase in pay and who under your tables really have little left.

Definitely, does not that little that is left go to offsetting the loss in the standard of living to a greater degree than it used to?

Mr. THOMSON. Yes, I think that is true.

But the basic point as I see it, Senator, is this. It is far more important for the fellow in the lower brackets that you control inflation than that you hold down his taxes to the extent that the bill contemplates.

Now in my own case, with a higher income, it is the taxes more than the inflation that has hurt.

In the House bill, speaking perfectly frankly, the House bill will wipe out any possible savings that I can make. That is just what it does to a man who has always prided himself on saving some money every year he lived by adjusting his expenses to his income.

The House bill means that I cannot save any money.

Senator MILLIKIN. I think it can also be pointed out that savings as such do not completely insulate that money from inflation.

Mr. THOMSON. Oh, no.

Senator MILLIKIN. I put my money in a bank to save it, or I can put it in a bond or in something else, but anyhow let us say that I put it in a bank.

That money does not become sterilized so far as its economic activity is concerned.

The bank in turn loans it to some fellow who is building a store or a race track, or for any of the objectives acceptable to the bank, and the objective may be highly inflationary.

Mr. THOMSON. Except that from a banking standpoint, Senator, your controls are working and preventing consumers in the aggregate from going into debt.

Those controls are working, and as to housing, the controls are working both from the limitations on use of materials and on borrowing, and the banks themselves are discriminating so that it does not follow as it would have 2 years ago that money put in the bank——

Senator MILLIKIN. I recognize that savings represent a slowing-up process, but there is quite a misconception that if you put money in savings, you have destroyed the inflationary influence of the money. That is only relatively true compared to more explosive types of spending.

Mr. THOMSON. But it seems, too, that money left in the bank is not actually inflationary; it is potentially inflationary.

Senator MILLIKIN. I buy a bond from the municipality of Squedunk. That does not kill the inflationary aspects of that investment.

Mr. THOMSON. That is right.

Senator MILLIKIN. Because the municipality of Squedunk in turn has a sewage project, or some other building construction program which uses the money and causes it to be spent in ways which may have many inflationary aspects.

It is those things that I refer to as the bounces, Senator.

Mr. THOMSON. Another sentence I left out here in trying to shorten this, was the fact that taxation is only one part of this whole inflationary program.

You have to have a savings program and it has to be savings.

You have to have these controls that you have in the indirect field. To some extent, we say price controls. But the whole thing has got to tie together.

But the principles that we have set down here as the basis for our recommendations are:

That as to individuals, the amount of additional tax should be related to the income left after the present tax; the additional tax should be a larger percentage of larger net after-tax incomes; and marginal tax rates should not be sharply raised where they are already highest.

We have proposed a flat equal percentage tax on the net income minus the present exemptions and the present tax.

On page 11 we have spelled that out on the basis of a flat 5 percent rate, and what it would do. I will read that there:

> The rate of the additional tax would, of course, depend upon the amount of revenue to be raised from the individual income tax.
>
> A 4-percent rate would yield slightly more than the House proposal.
>
> However, we believe that if a $7,000,000,000 to $7,500,000,000 tax program is needed, the rate of the additional tax should be 5 percent.

When you get down below, you will see in column 3 our proposal of a 5-percent flat rate, and you get a gradually increasing cut in the income after tax, and you see the percentage of reduction.

But it is no such progression as is contemplated in the House bill, where they have raised it a flat 12½ percent of the present tax across the board.

That is our basic recommendation as to the individual tax, and we think it is the fairest recommendation you can make under all the conditions that we are faced with.

Senator TAFT. What is that?

Since it raises more than the House bill, presumably the rate on the lower-income brackets is considerably more than an increase of 3 percentage points.

You have not interpreted this in terms of the rise in percentage points.

Mr. THOMSON. Mr. Stein, can you tell me what that would be in regard to the House bill on the lower-income groups?

Mr. STEIN. Our recommendation is the equivalent of raising the first bracket rate from 20 to 24 percent, by 4 points.

Senator TAFT. Four points on the $3,000 man here?

Mr. STEIN. And by declining points from that point. That is, the number of points we add would be 5 percent of the difference between the present rate and 100 percent.

If a man was at the rate of 50 percent, where the rate is now 50 percent, we would be adding two and a half points.

Senator MILLIKIN. It is a progressive tax in reverse?

Mr. STEIN. No; it is a proportional tax on the income after the present tax.

Senator MILLIKIN. It is not a flat proportion, is it?

Mr. STEIN. Yes; it is a flat proportion.

Mr. THOMSON. It is a flat proportion on what is left after present taxes, and exemptions.

Senator TAFT. But to get that result, you have to have a sliding scale in your actual tax bill at the beginning. You come out higher than four, and running down at the top you get it down to practically nothing.

Mr. STEIN. Yes; where the present rate would be 80, it runs down to 1, which is 5 percent of 20.

But it would not be necessary to change the rate in the law since this would be superimposed.

It would merely provide an additional tax equal to 5 percent of what is left after you compute your present tax.

Senator MILLIKIN. You have to have that progression, as I call it, in reverse, in order to achieve a fairly exact proportion on this all the way across the board. Is that right?

Mr. STEIN. Yes, sir.

Senator TAFT. It seems to me you pose a very difficult problem, though, to draft that 5 percent of what is left. I do not believe that you could do that, and impose a tax of this 5 percent on what is left.

After all, what is left?

After you pay your tax, you take it out of your net income and deduct your contributions and all that.

Mr. STEIN. It would be 5 percent of the difference between your surtax net income as presently defined and the present tax as presently defined.

Mr. THOMSON. It is very simple. If I may read at the bottom of page 10:

> We propose a flat equal percentage tax on net income minus present exemptions and the present tax. Computation of the additional tax would be simple and would require no change in the present rate schedules or tables. The taxpayer would compute his taxable net income and subtract his exemptions just as he does under present law. He would compute his tax under present law just as he does now. He would subtract——

Senator TAFT. It would not be simple, now. I can see six more brackets you would have to have to figure it out.

Mr. THOMSON. We did not think that you would have but one more bracket.

Mr. STEIN. I think that there is one more multiplication, Senator.

Senator TAFT. You would have to have at least four places to write it down.

Then you would have to add it to the old tax, it would have to be added to the old tax.

Senator FLANDERS. Mr. Thomson, it seems very simple to me. A fellow has gone to the tax office and he has been taxed, and he starts for home, and the tax fellow comes back and says, "Come back here. I am going to take 5 percent more."

That is all.

Mr. THOMSON. That is all.

Senator TAFT. Five percent of what you have in your pocket.

Senator FLANDERS. Five percent of what you have in your pocket.

Mr. THOMSON. Would Mr. Stam like to make a comment? I suppose he knows whether it is simple or not.

Mr. STAM. I think that the plan is very simple, because you just compute the tax under the existing law and find out what that was and deduct that from the surtax net income, and whatever you have left, you would apply this 5-percent rate to it, it seems to me, from what you said.

Mr. THOMSON. Yes; that is it. We thought it was very simple.

As to corporation taxes, we are opposed to the excess-profits tax. We think that the corporate tax rate running at 77 percent and leaving 23 cents on the dollar does lead to inefficiency and puts a premium on inertia and playing it safe. We think that when you go further to reduce that to 18 cents, you have not accomplished what you want to accomplish in the way of increasing productivity at this time. We think you have reduced the incentive too much. We are definitely opposed to the idea of reducing the base percentage from 85 percent to 75 percent. It seems to us that when you say that normal profits were 85 percent of what they were in a certain period, and you now say that they are 75 percent at that period, that you rather discredit the basis for determining normal profits in the first place. Also, we think it is inconsistent with the facts which indicate that production is greater and wages and salaries are greater now than they were in the base period.

So we think that the excess-profits tax is not a good tax. It promotes inefficiency. And this intensification is wrong, and will further tend both to keep corporations from running at their maximum efficiency and keep them from having the funds to go ahead with the necessary plant expansion to take care of the defense effort.

We also think—and here I am turning to page 14—that there is a misunderstanding of these corporate profits. I do not find that the banking business is going to make more money this year than last year. I do know that the best information that we can get is that—well, take the Economic Advisers' Report, I believe they indicated that profits in 1950 after taxes and after taking out the inventory profits, were actually less than 1949 for corporations. And you certainly did not make as much in the first quarter, the corporations did not, this year, as they did in the third and fourth quarters last year, and there are losts of inventory profits in those reports, and corporate profits are on the decline now.

We call attention to the fact that you have raised in the last year corporate taxes 40 percent and individual taxes 17 percent and excise taxes 1 percent. Our recommendation is that you should not change the corporate taxes at the present time.

As further evidence why you should not change them, we indicate on page 15 what you are doing to the combined rate of taxes on a stockholder of the corporation, because when you stop and put the corporate tax in the range that is contemplated what you are doing as to the individuals is just reducing the amounts, and you are reducing the stockholders in the lower bracket. You are reducing too much the incentive and discriminating against the corporate form of business.

So our recommendation is that you leave the corporate tax as is, and that, in any event, you leave the excess-profits tax as is, and you should not raise the normal and surtax beyond 50 percent.

Then we come up with this individual——

Senator TAFT. Does that mean an increase from 47 to 50?

Mr. THOMSON. That is right.

Senator TAFT. And that is what you propose?

Mr. THOMSON. If the revenue is needed.

Senator TAFT. That would be about $1 billion if the excess-profits tax goes up the same percent.

Mr. THOMSON. Let me just read this:

> If the total revenue required is approximately the amount provided in the House bill, there should be no increase in corporate taxes.
>
> In any case, the present combined tax of 77 percent on excess profits should not be increased and the excess-profits credit should not be reduced. The present combined normal and surtax rates of 47 percent should not be increased beyond 50 percent.

And if you can do it with less than that, we would not raise them at all, Senator.

Now, we feel very strongly that, in this kind of emergency, you ought to go to an excise tax, and you ought to go to a retail excise tax. I have been interested in noticing that the retailers used to be opposed to retail excise taxes, but testified in favor of retail excise taxes the other day.

We think that that is one of the best ways to reduce the pressure on consumption goods and yet not reduce the amount of real consumption. We would exempt food and drugs, applying a flat tax at retail on the goods that are not now taxed, and specifically applying to clothing and furnishings.

Senator MILLIKIN. Would you apply your tax to services?

Mr. THOMSON. Services? No.

Is that not right, Mr. Stein?

Mr. STEIN. In general, no. And housing would be excluded.

Senator MILLIKIN. Housing would be excluded; shelter?

Mr. THOMSON. Yes.

We think that that tax, raising $2,750,000,000, is a strong anti-inflationary tax. In a time such as we are in, it is a sound tax, and it will be in the interest of the low-income groups, and will not hurt them unduly if food and drugs are exempted.

Senator MILLIKIN. How much would you raise with that tax?

Mr. THOMSON. $2,750,000,000, on a 5-percent retail excise tax exempting food and drugs and applying to those items that are not now taxed on an excise basis.

Senator MILLIKIN. How far do you think you could ultimately go with that tax?

Mr. THOMSON. You mean, in dollar amount or in precentage?

Senator MILLIKIN. I mean in percentage. We will figure the dollars later. I have in mind a potential deficit of $20 billion to $30 billion in fiscal 1953, and the question before this committee is, can it be covered, and if so, how? How far could you go with a sales tax?

Mr. THOMSON. We have not considered that, and I think we would have to consider that in the light of the equities involved and the anti-inflationary aspects. I think we would have to consider the whole thing before we could give an answer to that. And I hope that you do not have to get to that $20 billion additional expenditures in 1953.

Senator MILLIKIN. There is no way to avoid it unless we cut down the military program.

Mr. THOMSON. We feel definitely that the military as well as the ordinary expenditures should be reviewed and there should be cuts made.

Senator MILLIKIN. I think that almost everyone will agree with you, that you can cut the waste. I think that almost everyone will disagree with you if you mean that you would cut what might be determined to be an essential part of military preparedness.

Mr. THOMSON. When you come to the military side of it, we do not have the information to discriminate; and we would agree with you 100 percent on the essential military program. Nevertheless, when you are spending that amount of money and doing it under pressure and probably without the reviews that you should have on expenditures in that large amount, we feel certain that you could save some money there, and without impairing the essential part of the military program.

Of course, the retail tax, we feel, would enable you to keep from having the excise tax at retail reflected in the cost-of-living index. We think it is a thoroughly sound proposal.

On page 20 is a summary of the revenue to be raised. We have not dealt with some structural change in the tax bill, but page 20 spells out the effect of the recommendations we have made. We think that, taking the whole program together, it is a sound tax program from the revenue standpoint and that it is the best program that we know how to put up that will help to control inflation, which we think is the primary essential of a tax bill this year.

Senator HOEY. We thank you very much, Mr. Thomson. We appreciate your helping us to get through with this, and we thank you for your testimony.

(The prepared statement of Mr. Thomson is as follows:)

STATEMENT OF J. CAMERON THOMSON, CHAIRMAN, COMMITTEE ON MONEY, FISCAL AND DEBT POLICY, COMMITTEE FOR ECONOMIC DEVELOPMENT

My name is J. Cameron Thomson. I am president of the Northwest Bancorporation, Minneapolis, Minn. and chairman of the committee on money, fiscal, and debt policy of the Committee for Economic Development.[1] I appear today to present the views of the research and policy committee of CED on the difficult

[1] The Committee for Economic Development is an organization of businessmen formed to study and report on the problems of achieving and maintaining a high level of employment and production within a free economy. Its research and policy committee issues from time to time statements of national policy containing recommendations for action which, in the committee's judgment, will contribute to maintaining productive employment and a rising standard of living. A list of the members of the CED research and policy committee is attached

tax problems with which the Finance Committee and the Nation are now confronted.

The Finance Committee has before it a tax bill passed by the House of Representatives which would yield $7.2 billion in a full year of operation.

There are two questions about this tax bill.

First, does it raise the amount of money needed?

Second, does it raise the money in the right way from the standpoint of the need to encourage production, to control inflation, and to distribute the burden of defense equitably?

These two questions are tied together. How much taxes we need and can stand depends upon the kind of taxes. The kind of taxes is as important as the amount, and can be more important.

How much additional taxation do we now need? Under present circumstances the basic objective should be sufficient taxes to cover the necessary expenses of Government and yield a moderate surplus in fiscal 1952 (ending June 30, 1952). We recognize that this rule would not apply in all circumstances. For example, necessary expenditures might be so large that it would be impossible to run a surplus or even balance the budget, at least without taxes so repressive as to be undesirable. Expenditures in fiscal 1952 will be very large. There is some question whether in view of the high level of taxes that will be required it is wise to attempt to create a surplus. Some members of our committee feel that we should not raise taxes to provide a surplus in fiscal 1952. But the opinion of the large majority of our committee is that we should do more than just balance the budget in fiscal 1952, provided two conditions are met. The first requirement is that expenditures should be held to the lowest level possible in the present emergency. The second requirement is that the additional taxes should be of kinds that will be useful in controlling inflation with least damage to production.

We believe that a budget surplus achieved in the right way is an essential part of an effective anti-inflation program for fiscal 1952. A budget surplus is, of course, only a part and not the whole program needed. An effective program should also include measures to restrain credit expansion and promote savings. It should be emphasized that the existence of direct price-wage controls does not reduce the need for fiscal, monetary, and savings policies to restrain the demand for goods and services. If demand is not restrained, the direct price-wage controls will not work while they are in force and it will be difficult ever to remove them without a great surge of inflation, such as we had in 1946 when controls were removed after years of deficits and monetary expansion.

Because its effects are indirect there is some tendency to underestimate the importance of budget policy in the control of inflation. There is a tendency to identify inflation control with the obvious and dramatic action of price and wage controls. Tax policy is regarded as a matter of bookkeeping, a necessity of which we are unpleasantly reminded by subtractions from our weekly pay checks. This is a mistaken and dangerous viewpoint. The overwhelming interest of the American people in preventing disastrous inflation is an overwhelming interest in sound budget and tax policy. As Defense Mobilizer Wilson put the point:

"It has been correctly said that direct price and wage controls treat only the symptoms of inflation rather than its basic cause, which can be simply stated as an excess of demand over supply. A more direct form of attack, therefore, is to drain off excess purchasing power by higher taxes."

The rule that we should achieve a moderate surplus over necessary expenditures in fiscal 1952 does not tell us how much additional taxation is needed. So far as public information goes, there is an unusual degree of uncertainty about the budget outlook for fiscal 1952.

First, the amount of expenditure involved in existing or proposed programs of Government is uncertain. In testimony before this committee the Budget Bureau has reduced the 1952 estimates about $3 billion below the budget estimates issued in January. The actual month-by-month course of expenditures suggests the possibility that even this revision may overstate the expenditures that will actually be made under the administration's program. Moreover, there has been no estimate of the possible effects of a Korean truce on expenditures. In addition, the expenditure figures are subject to unpredictable changes as a result of possible price changes.

Second, the amount which Congress will cut out of existing or proposed programs is uncertain. Congress has completed action on only a small fraction of the total appropriation requests. The action so far suggests that the savings, although possibly not as large as they should be, will be substantial. But no one, or at least no one outside the Appropriations Committees, is in a position to estimate what the final figures will be.

Third, the yield of the existing taxes in fiscal 1952 is uncertain. The Treasury has increased its January revenue estimates for fiscal 1952 by $3.4 billion. The estimate of the staff of the Joint Committee on Internal Revenue Taxation is $2.4 billion above the revised estimate of the Treasury. The difference of estimate between the Treasury and the joint committee staff has not been reconciled, and both estimates are already 3 months old.

Thus, there is a range of uncertainty amounting to several billion dollars in the basic figures needed to determine the proper size of the tax program for fiscal 1952. The Finance Committee has access, through the Budget Bureau, the Treasury, the Congressional Appropriations Committees, and its own staff, to the best information available anywhere on the budget outlook for fiscal 1952. It is very important that this information should be collected and made public. Without it there cannot be adequately informed discussion of tax policy. In fact, without it there cannot be adequately informed discussion of any aspect of economi policy, for the whole economic outlook is dominated to an unusual degree by the budget outlook.

In order to discuss concretely the kinds of taxes that are appropriate for fiscal 1952 I shall base the rest of my remarks upon a tentative estimate of the revenue requirements, always remembering that a final decision should rest upon information not now generally available. I shall be referring throughout to the cash-consolidated budget, which is the most useful way of looking at Federal finances to determine revenue requirements. This budget differs from the administrative budget chiefly by virtue of the inclusion of trust fund receipts and expenditures in the cash budget.

The President's budget message last January estimated that cash expenditures in fiscal 1952 would be $74 billion. We believe it is reasonable to base tax policy on the expectation that actual expenditures can and will be held to $68 billion, or $6 billion below the budget. In a policy statement issued in March our committee recommended a $6 billion cut in the budget, and presented supporting evidence to show that such a cut was both feasible and urgently necessary. At that time we regarded the $6 billion cut as a goal which could definitely be achieved, but only with the greatest effort by all parties concerned. And while we were hopeful we were not overly confident that a reduction of this size would actually be achieved, in view of the inevitable political and administrative obstacles to economy. We are now much more confident than we were in March that 1952 expenditures not only can but also will be held down to around $68 billion. This confidence is based on two developments. First, the Budget Bureau has now recognized a $3.2 billion reduction in its original expenditure estimates. Second, Congress and its committees are being more rigorous than usual in reviewing and cutting the expenditure requests.

On the other side of the budget, the original estimate was that cash receipts under existing law in fiscal 1952 would be $61 billion. The Treasury has increased this estimate by $3.4 billion and the joint committee staff estimate is $2.4 billion higher still. I shall not attempt to choose between these estimates or to introduce a third competing estimate. Rather for my present purpose I shall use a figure midway between the two estimates, or $65.6 billion.

Cash expenditures of $68 billion and receipts of $65.6 billion would leave a deficit of $2.4 billion. Provided these estimates are approximately correct, we would regard a $3 billion cash budget surplus as a reasonable and desirable goal for fiscal 1952. This would be less than half the surplus actually realized in fiscal 1951. In terms of the administrative budget this would mean approximate balance at about $65 billion of receipts and expenditures.

To achieve a $3 billion surplus in fiscal 1952 would require $5.4 billion of additional revenue. But since any bill enacted now would be in effect for only part of the fiscal year, it will require a tax bill larger than $5.4 billion to yield that much revenue in the fiscal year. If all tax increases take effect on October 1, 1951, a tax increase of $7 to $7.5 billion would yield approximately the amount required in fiscal 1952.

The yield of the tax increase would be larger in calendar 1952 than in fiscal 1952. But, unless present plans are radically changed expenditures would also be larger. It appears that a $7 to $7.5 billion tax increase, together with the increased yields that may be expected from the existing tax system, will approximately balance the cash budget in calendar 1952. This would allow us to decide next year whether it is necessary to raise tax rates further to meet the planned peak expenditures of calendar 1953 or whether it would be wiser to run a temporary deficit during the peak expenditure period.

As already noted, these figures are exceedingly tentative. They should be checked by the later and better information available to your committee. How-

ever, these calculations suggest that the tax bill enacted by the House is of approximately the right size.

It is when we turn to consider the particular kinds of taxes proposed that the dangers and defects of the House bill become glaringly evident. We recognize that this is an emergency bill, and presumably temporary. But it is surely no justification for a bad tax bill to say that it would be so much worse if it were permanent. The emergency may require certain departures from normal standards of sound taxation. But there, departures should be in a direction that helps to meet the special problems of the emergency, and not in the opposite direction.

Moreover, it is unrealistic to regard any tax bill as purely temporary. Our tax law bears traces of almost every tax bill ever enacted. In addition, every tax bill creates precedents and leaves its mark in public opinion about what is an acceptable tax structure. Even in considering a temporary emergency tax program we must keep one eye on the longer run.

The present defense emergency creates two acute problems: To prevent inflation and to increase production. These are problems for all Americans—whether their incomes are low or high. An emergency tax bill should be designed to have the maximum effect in restraining inflation and the least effect in retarding production. The House bill does exactly the opposite; it will seriously retard the growth of production and have relatively little effect in restraining inflation.

I should like to turn first to the individual income tax rates contained in the bill before you. These rates must be considered in a certain historical perspective. Fifty-six years ago the distinguished lawyer Joseph Choate argued vigorously before the Supreme Court that a 2 percent Federal income tax was communistic and confiscatory. Mr. Choate was wrong. The American capitalist economy has survived and prospered under income tax rates much higher than Mr. Choate ever dreamt of. Today we are in danger of accepting the opposite and equally erroneous view that there is no limit short of 100 percent to the rates of income tax under which a free society can thrive. The House bill has gone dangerously beyond the point at which excessive tax rates undermine the forces that make the economy strong and dynamic. It has done this by drastically reducing the share of an additional dollar of earnings that many taxpayers retain after payment of tax.

To be more specific, let us consider the case of a married man with $50,000 of net income after present Federal income taxes. This man is well off. We are not now concerned with him as a person or with his standard of living. But we are concerned with his functions in the economy, and with the motives that make him perform his functions well and to the benefit of the whole society.

Who is this man? He is the owner and operator of a moderate sized business. He is a policy-making executive of a fairly large corporation. He is an investor with enough assets to be willing to take risks in a new venture. He is a successful engineer. He is in short, a person whose decisions are crucial to the vitality and progress of the economy. There are not many such persons. But their importance is out of all proportion to their numbers. Saying this does not belittle the contribution of other groups to the operation of the American economy. It merely points out the objective fact that this group of enterpreneurs, managers, risk-takers and innovators has an irreplaceable function in the whole process.

What makes this group of persons function? In other civilizations leading classes have been content to continue doing what they and their ancestors had always done, to invest their wealth in palaces and jewels, to spend their time in luxurious pleasures. What makes people in our society willing to risk their wealth in productive ventures and devote their energy to the search for better ways of making better products? A complete answer to this question would list a great many factors. But certainly an important part of the explanation is that there are opportunities in this economy to make money by taking risks and working effectively.

Under present law, a person with $50,000 of after-tax income would pay in Federal income tax 75 cents out of any additional dollar he earned. He would keep 25 cents out of each dollar. This 25 cents is the important aspect of the Federal income tax for his motivations to take investment risks and to work energetically in increasing production. Twenty-five cents is little enough—too little in my opinion—for the continued vitality of the American economy. But consider what the House bill would do to this 25 cents. The 25 cents would be cut to less than 16 cents. What is generally regarded as a 12½ percent tax increase will make a 37½ percent cut in this taxpayer's marginal take home pay—his real income incentive.

This $50,000 man is, of course, only an example, but not an extreme one. The table below shows, for various income levels, the percentage of an additional dollar's earnings left after the present Federal income tax, the percentage that would be left under the House bill, and the percentage cut made by the House bill.

Percent of an additional dollar earning retained after Federal income tax

Income after tax (present law)	Married person (2 dependents)		Reduction
	Present law	House bill	
	Percent	*Percent*	*Percent*
$2,000	100	100.0	0
$3,000	80	77.5	3.125
$5,000	80	77.5	3.125
$10,000	74	70.75	4.39
$25,000	50	43.75	12.5
$50,000	25	15.625	37.5
$100,000	9	5.5	38.9

This bill, as can be seen, systematically cuts the incentives the most where the existing tax is already most burdensome.

It is appropriate to ask why we do this. For what purpose do we impose this burden upon the development of our economy?

Is revenue the object and justification of these tax rates? The whole rate increase imposed in the brackets where rate sare already 50 percent or higher would yield about $400 million a year. This is the amount expected to be raised from the tax on gambling. It is slightly more than one-half of 1 percent of the 1952 budget. So small an amount of revenue cannot justify so radical an increase in rates.

Moreover, we should not now be interested in revenue only for its own sake. Our main object in additional tax collections is to assist in preventing inflation. We need additional taxes in order to restrain the demand for goods and help prevent total demand from exceeding the supply of goods. But these large increases in the tax rates that are already highest will do relatively little to restrain demand, because they bear on incomes that are largely not spent for consumption goods but are invested. At the same time, they will interfere with the incentives for increasing growth of production. Thus they will make little if any net contribution to the control of inflation.

Is the tax increase formula proposed by the House justified on grounds of fairness? This is a consideration of great weight. Any tax program must be tested by conformity to nationally accepted standards of fairness. We do not believe that the House formula would be regarded as fair by the great majority of Americans if its meaning were understood. The House formula achieves the superficial appearance of fairness by the deceptively equal process of raising everyone's tax 12½ percent. The crucial question, however, is 12½ percent of what? The real test of fairness is what the tax does to the incomes people have left after paying the tax. This is what people live by and what they have available for paying additional taxes. The table below shows what the House proposal would do to taxpayers at several income levels.

Effect of House proposal on income after tax (married couple, 2 dependents)

Income after rax (present law)	House proposal	
	Additional tax	Percent cut in income after tax
$3,000	$18.75	0.6
$5,000	81.25	1.6
$10,000	266.25	2.7
$25,000	1,425.00	5.7
$50,000	7,170.00	14.3
$100,000	30,526.00	30.5

We believe it is fair not only that persons with higher incomes should pay more additional tax than persons with lower incomes but also that the additional tax should be a larger percentage of the larger incomes. But we do not believe, and we do not think the American people would believe, that fairness either demands or justifies so wide a spread as this table reveals.

The House proposal completely neglects the real necessities of our current situation, which are well expressed in the following paragraph from the January 1951 report of the Council of Economic Advisers:

"Income tax increases should be imposed at all levels, emphasizing the progressive character of the tax structure; but by far the largest part of the additional revenue must come from the middle and lower tax brackets. These are the brackets in which the great bulk of the income is located. Of the total net income shown on all taxable returns, 86 percent of the amount remaining after Federal income taxes is estimated to be received by taxpayers with net incomes of less than $10,000. To hold down consumption, which is vital to the control of inflation, the bulk of consumers must be affected directly by the tax increases."

The Committee for Economic Development has proposed several times and recommends to your attention a method for increasing income taxes that would avoid the numerous defects of the House formula. The CED plan is based on the following principles:

1. The amount of additional tax should be related to the income left after the present tax.
2. The additional tax should be a larger percentage of larger net after-tax incomes.
3. Marginal tax rates should not be sharply raised where they already are highest.

To meet these principles we propose a flat equal percentage tax on net income minus present exemptions and the present tax. Computation of the additional tax would be simple and would require no change in the present rate schedules or tables. The taxpayer would compute his taxable net income and subt act his exemptions just as he does under present law. He would compute his tax under present law just as he now does. He would subtract his present-law tax from his taxable net income after exemptions. The additional tax would be the specified percentage—say 4 or 5 percent—of the difference.

The rate of the additional tax would of course depend upon the amount of revenue to be raised from the individual income tax. A 4-percent rate would yield slightly more than the House proposal. However, we believe that if a $7 to $7.5 billion tax program is needed the rate of the additional tax should be 5 percent. The table below shows the effects of the CED plan with a 5-percent rate. In comparing this table with the effects of the House proposal it should be remembered that the CED plan would yield about one-fourth more revenue.

Effect of CED tax plan with 5-percent rate (married couple, 2 dependents)

Income after tax (present law)	Additional tax CED plan	Cut in income after tax	Marginal rate of income after tax		
			Present law	CED plan	Cut
		Percent	Percent	Percent	Percent
$2,000	0	0	100	100	0
$3,000	$30	1.00	80	76	5
$5,000	130	2.60	80	76	5
$10,000	380	3.80	74	70.3	5
$25,000	1,130	4.52	50	47.5	5
$50,000	2,380	4.76	25	23.75	5
$100,000	4,880	4.88	9	8.55	5

I should like to turn now to the corporation tax changes passed by the House.

The corporate tax provisions of the House bill suffer from the same defects as the individual tax provisions.

First, they would contribute little if anything to controlling inflation by restraining demand. In fact, the results in this respect may be negative.

Second, they would seriously interfere with one of our main national objectives, the rapid increase of production.

Third, they violate accepted standards of equitable taxation.

Even if it were raised in the best possible way the amount of additional revenue the House proposes to raise from corporations would have these results. But the House bill not only would raise corporate taxes too much but also would raise them in the worst possible way.

The main defect in the present corporate tax system, from the standpoint purely of production and inflation, is the marginal tax rate of 77 percent imposed under the excess-profits tax. The evils of such a rate were explained at great length by the CED and others before the congressional tax committees last December. It was explained that the tax would reduce the value of efficiency and initiative to 23 cents on the dollar and at the same time reduce the cost of inertia and playing it safe to 23 cents on the dollar. It was explained that the main source of funds for expansion of new and growing businesses would be cut off. These points were made by businesses of all sizes and types, by economists, and by lawyers. They were made in general terms and in specific terms. Proponents of the excess-profits tax did not meet, let alone answer, this overwhelming weight of argument. But Congress, for symbolic and emotional reasons, had committed itself to enact an excess-profits tax. And Congress did enact an excess-profits tax.

Now it is proposed to compound this error, without even the justification of the emotional atmosphere that prevailed last fall and winter. The 23-cent dollar would be cut by more than 20 percent to an 18-cent dollar. The number of corporations exposed to this rate would be increased by a cut in the excess-profits tax credit and by an increase in the combined maximum rate.

The proposal to cut the excess-profits tax credit from 85 percent to 75 percent of base-period earnings reveals the complete absence of logic in the excess-profits idea. The excess-profits tax had a certain degree of popular support as a means of taxing profits attributable to the defense program. In order to measure profits attributable to the defense program Congress defined 85 percent of the earnings in the best 3 years of the period 1946–49 as "normal" and anything above that as "excess" and subject to a penalty tax. This was an arbitrary definition but Congress made it. Now we are asked to believe that what appeared normal to Congress last December was not normal but excess. We are asked to believe that not 15 percent but 25 percent of the earnings in the 1946–49 period was attributable to defense. The character of the period 1946–49 has not changed in the past 6 months. The redefinition of the base after the fact surely removes the last pretense that this tax applies to profits that are excess by any relevant standard.

The value of national production is now not 25 percent below the best 3 years of the base period but 25 percent above, the value of total production excluding defense production is 22 percent above, and wages and salaries are 25 percent above the best 3 years of the base period.

The report of the Ways and Means Committee supports its corporate profits tax recommendations by one statement only, the statement that corporate profits are very large. In a sense this statement is correct, but it is fundamentally misleading and irrelevant. This is a large country and a growing country. Of all the statistics that depict our economic life, there is hardly a handful that is not bigger today than in the base period of the excess-profits tax. But corporate profits after taxes and after allowance for the increased cost of replacing an unchanged amount of inventory are smaller today than in the base period.

Many of the loose statements currently made about corporate profits reflect failure to recognize three basic facts:

1. A large part of the increase in corporate profits in the past year results from the general increase in production and prices, in which all kinds of incomes have shared.

2. A large part of recent profits as recorded for statistical and tax purposes has been paper profits, resulting from charging off inventories at less than the cost of replacing them. One-fifth of the estimated profits of the first quarter of 1951 were of this character. These profits will disappear and are already disappearing as prices level out.

3. Existing profits taxes already take over one-half of all corporate profits, including the paper profits. Corporate taxes have been increased 40 percent in the past year, whereas individual income taxes have been increased 17 percent and excise taxes 1 percent.

In the absence of meaningful standards of comparison we should turn our attention not to the metaphysical question about whether profits are large but to the practical question before us. The question is whether the attempt to reduce these profits by further tax increases, on top of the 40-percent increase in profits

taxes enacted in the past year, will have harmful or beneficial effects upon the economy. On this point the answer is clear. The effects would be harmful.

The Ways and Means Committee recognized that its corporate-tax proposal would have adverse effects on incentives. However, it is maintained that these effects "will be reduced substantially by the fact that the additional collections will be made in a period of mobilization." Here we have the curious argument that a bad tax is justified in a period of emergency because its effects would be so much worse at some other time. As a matter of fact, this argument ignores the special need for maximum incentives to the emergency and the special risks attendant upon production in this period.

The full effects of the House proposal, in terms of incentives and fairness, can only be seen when the corporate profits tax and the individual income tax are considered together. Not only are corporate profits subject to very steep corporate taxes but also the remainder, when distributed as dividends, is subject to steep individual income-tax rates. For example, suppose a corporation with no more income than it earned in the base period now increases its earnings by $100. Of this, under the House bill, $82 would go in tax. Suppose the remaining $18 goes to a stockholder who has a $25,000-after-tax income. He then pays $10.13 of it in individual income tax and keeps $7.87 as the whole amount left after tax out of the $100 earned.

The table below shows the combined effects of the proposed corporate and individual taxes at various income levels, and compares the results with the tax on other kinds of income:

Amount retained out of an additional $100 earned under House bill

Income after tax (present law)	Corporate profits, distributed	Other personal incomes
$2,000	$18.00	$100.000
$3,000	13.95	77.500
$5,000	13.95	77.500
$10,000	12.74	70.750
$25,000	7.88	43.750
$50,000	2.81	15.625
$100,000	.99	5.500

This table reveals three things:

1. The incentive for individuals to invest in the stock of corporate enterprise would be very low.
2. The discrimination against corporate earnings as compared with other kinds of earnings would be tremendous.
3. The discrimination would be greater for low-income stockholders than for others.

With respect to corporate taxes we make the following recommendations:

1. If the total revenue required is approximately the amount provided in the House bill there should be no increase in corporate taxes.
2. In any case, the present combined tax of 77 percent on excess profits should not be increased and the excess-profits credit should not be reduced. The present combined normal and surtax rates of 47 percent should not be increased beyond 50 percent.

In view of the high rates of taxes now in effect and in prospect we urge that consideration be given to the relative taxation of cooperatives and their members as compared with the taxation of corporations and their stockholders.

I should also like to call your attention to the inconsistency between the provisions of the House bill and existing law with respect to the taxation of affiliated corporations. The House provision limiting to one the number of surtax exemptions and excess-profits minimum credits taken by a group of related corporations implies that the members of the group are really one corporation for tax purposes. But the existing provisions for taxation of intercorporate dividends and for a penalty tax on consolidated returns implies that the related corporations are not really one corporation.

The House bill provides about one and one-fourth billion of additional revenue from excise taxes. This figure includes the yield of the gambling tax, which I assume has largely nonfiscal objectives, and the net yield of scattered reductions and increases which are presumably in the nature of equalizing adjustments.

Increased excise taxation is now the most fruitful potential source of genuinely anti-inflationary revenue without a seriously depressing effect upon production. This is especially true in view of the limits already reached or approached by other forms of taxation. It should be noted that since hostilities began in Korea, Corporate taxes have been increased 40 percent, individual income taxes 17 percent and excises about 1 percent.

We recommend, therefore, assuming revenue needs of the approximate size tentatively used here, that about $2.75 billion of additional revenue should be raised from excises in addition to the gambling tax and the equalizing adjustments.

In imposing additional excises it will be important to avoid placing undue burdens upon families with very low incomes. This can be done by a judicious selection of rates and objects of taxation. Certainly the amount suggests, $2.75 billion—which is only about 1½ percent of total consumers' expenditure, can be raised without violating this standard. There are a great many families, touched only insignificantly if at all by the personal income tax, who can in the aggregate make an important additional contribution to the financing of the defense program and the prevention of inflation. In fact, their contribution is essential because they constitute so large a part of the demand for consumer goods.

It should be recognized that the purpose of additional excise taxation is not to cut the real amount of goods and services consumed. Consumption will be cut, if at all, by the requirements of the defense program. The purpose of additional excise taxation, as of other kinds of taxation, is to reduce the demand for consumption goods to the supply that is available. The effect of higher excises will not be to reduce the amount of consumers' goods purchased. The effect will be to clamp down the inflationary spiral by taking part of the price for the Treasury rather than leaving it in the private income stream where it can continue to bid up prices.

There are two main methods that may be followed in raising excise taxes. One is to raise the rates on items already subject to tax. The other is to broaden the coverage of excise taxes by applying them to commodities not now taxed.

Last spring when revenue needs appeared much larger than they now do, we recommended use of both of these methods. We suggested that $5 billion of additional revenue be raised from excises, evenly divided between new taxes and higher rates on old taxes. Now that, in our opinion, we need only about $2.75 billion from excises we would recommend raising this amount primarily by broadening coverage of the excise system.

There are two main reasons for preferring a broadening of the system rather than an increase in existing rates at this time.

1. To extend the coverage would be less discriminating against the industries and consumers already taxed than to raise the existing rates without extending coverage.

2. Last spring it appeared that the excess of demand would be especially large and especially concentrated on a category of items already subject to tax—namely automobiles and other consumers' durables. Under these conditions higher taxation of these goods was recommended as a means of reducing this concentrated excess of demand. Now for a number of reasons the prospective excess of demand in these lines appears smaller and less certain. Therefore we would not now recommend the singling out of these items for special treatment.

Federal excises are now levied on items that account for about 25 percent of consumers' expenditures, at rates ranging from 4 to 40 percent in terms of retail price. Another 50 percent of consumers' expenditures consist of items, such as food and housing, that should not now be taxed in order to safeguard the very lowest incomes or items that are difficult to handle administratively. This leaves about 25 percent of expenditures not now taxed and potentially eligible for new Federal taxation—the main items being clothing and household furnishings.

We suggest a tax on the eligible items not now taxed—which would cover mainly items in the following categories: clothing, housefurnishings, personal care and items of transportation and recreation not now taxed. In addition to sales of new items the tax would apply to sales of second-hand items in the same categories and to second-hand sales of items already subject to Federal excises—such as automobiles. A tax rate of 5 percent of the retail price would raise about $2.75 billion. We suggest imposition of the tax at retail so that it will be uniform in its effect and clearly visible to the taxpayer. However, if there should be strong administrative reason for imposing the tax on any of these items at the manufacturers' level this could be done, with appropriate adjustment of the rate.

It is, of course, fundamental to tax policy and stabilization policy that the new or increased excises should be excluded from the measurement of the cost of

living in any controls that link permitted wage increases to the cost of living. The purpose of linking permitted wage increases to the cost of living is to permit achievement of equitable relations between wages and other private shares in the national income. It is not to enable anyone to escape the share of the defense burden that congressional tax legislation would impose upon him. Similarly, increased corporate profits and income taxes should be excluded in any consideration of allowable price increases.

In recommending reliance primarily upon a new broad-based excise tax we do not want to rule out, of course, such adjustments in the existing rates as the Congress may find desirable for the sake of equalization and equity. However, we are doubtful whether in general a series of isolated ad hoc adjustments made in the heat and rush of a general revenue bill corrects more discriminations than it creates. Therefore, we recommend that after this bill is passed the Joint Committee on Internal Revenue Taxation initiate a study of Federal excises with a view to rationalizing the structure at the earliest appropriate time.

I have not discussed here a number of provisions of the House bill classified by the Ways and Means Committee as "structural changes." Most of these have not been studied by CED. We have, however, considered the proposed withholding of income tax on dividends and approve it as a logical way of improving the operation of the income-tax system, provided that it can be handled without excessive cost for the collection of small amounts of revenue. In adding up the yield of our suggestions we shall include the structural changes adopted by the House, without endorsing them on behalf of CED.

CED tax program (assuming revenue need approximately equal to House bill)

	Full year yield (millions)
Recommended by CED:	
5 percent additional tax on disposable personal income	$3,650
5-percent retail excise [1]	2,750
Withholding on dividends	323
House provisions included without endorsement:	
Other structural changes	−78
Gambling tax	400
"Equalizing" excise tax adjustments	203
Total	7,248

[1] Excludes food, housing, items already subject to tax, and certain other items.

In developing these tax recommendations the CED has tried to face the facts of our current national situation and to formulate a program that will serve the paramount interests of all the American people in controlling inflation and stimulating production. Only by sticking to this line is it possible to avoid the twin evils of demagoguery and special pleading and arrive at a policy that truly advances the common welfare.

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Senator HOEY. The committee will recess until 10 o'clock tomorrow morning.

(Thereupon, at 4:45 p. m., the committee recessed, to reconvene at 10 a. m., Wednesday, July 11, 1951.)

REVENUE ACT OF 1951

WEDNESDAY, JULY 11, 1951

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

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

Present: Senators George (chairman), Hoey, Kerr, Frear, Millikin, Taft, Butler (Nebraska), Williams, and Flanders.

Also present: Elizabeth B. Springer, chief clerk. Colin F. Stam, chief of staff, Joint Committee on Internal Revenue Taxation.

The CHAIRMAN. The committee will come tó order.

Mr. Elder, you may have a seat if you wish, sir, please.

Mr. ELDER. Thank you, sir.

The CHAIRMAN. Identify yourself for the record.

STATEMENT OF ARTHUR A. ELDER, TAX CONSULTANT, AMERICAN FEDERATION OF LABOR

Mr. ELDER. My name is Elder, Arthur A. Elder. I am tax consultant for the American Federation of Labor.

I appreciate this opportunity, Mr. Chairman, to place the views of the American Federation of Labor before the members of your committee.

On February 16 the views of the American Federation of Labor regarding the proposals for revenue increases then under consideration were presented to the House Ways and Means Committee. At that time the President and Secretary Snyder joined in recommending that action be taken at once. They urged that revenue be increased immediately by $10 billion yearly, with the possibility that an additional $6 billion might be required as soon as total expenditure needs were definitely known.

H. R. 4473 which is estimated to yield $6.83 billion in additional revenue is now before your committee for consideration. Secretary Snyder has testified that H. R. 4473 is deficient in that it provides for $3.92 billion less than is needed to keep the Federal budget in balance.

Specifically, the Secretary of the Treasury challenged the wisdom of the House action in cutting the recommended increases in excise taxes and personal income taxes. He questioned both the timeliness and equity of the tax reduction proposals embodied in the House bill. Finally, he urged that any tax revenue increase approved be made effective as speedily as posisble. These several matters will be discussed in detail.

We would like, first, to address ourselves to the proposed excise tax increases.

Neither the Secretary of the Treasury nor anyone else to our knowledge has justified the proposal to raise any substantial amount of the needed revenue increase from excise taxes. The American Federation of Labor was unequivocally opposed to the Secretary's initial proposal that $3.25 billion in additional excise taxes be levied; we wish at this time to record our opposition to the provision of the House bill that would increase revenue from excise taxes by approximately $1 billion.

Since the need for checking inflation has been termed the first objective of any sound tax increase measure at this time, we fail to see how that objective will be achieved by taxes that will increase the price of goods to consumers, that will inevitably be reflected in increased living costs, higher mark-ups, profits, and demands for wage raises. No reputable economist can deny that a very important contributory factor in the inflationary tendencies that have gathered momentum since 1945 is the fact that taxes on consumers have risen approximately $5 billion yearly at all levels of government.

Moreover, the record would seem to indicate that those who advocate additional excise taxes, manufacturers taxes, and sales taxes as a means of discouraging consumption do so either with tongue in cheek or out of ignorance. Experience has shown that in times of high employment and production excise taxes levied with a view to raising revenue have not appreciably discouraged consumption of commodities and/or services. Naturally, in combination with high prices, such taxes will operate to further depress the living standards of more than half of the American families with incomes of less than $3,000 a year.

Senator MILLIKIN. Mr. Chairman, may I ask a question, please? I noticed you say that experience has shown that in times of high employment and production excise taxes levied with a view to raising revenue have not appreciably discouraged consumption of commodities and/or services.

Mr. ELDER. Yes.

Senator MILLIKIN. You also said that naturally, in combination with high prices, such taxes will operate to further depress the living standards of more than half of the American families with incomes of less than $3,000 a year.

If they do not appreciably discourage consumption, how do they depress the living standards?

Mr. ELDER. I think I will come to that later, Senator. I think, in the next paragraph, as a matter of fact, I touch on that.

Senator MILLIKIN. All right.

Mr. ELDER. The 40 percent of the spending units in the income groups above $3,200 bought approximately 70 percent of all durable goods, 64 percent of the food, 73 percent of all liquor, and 66⅔ percent of the tobacco, and still managed to accumulate 80 percent of all savings in 1949. These figures are from Report No. 210 of the Congressional Joint Committee on the Economic Report.

Now that, it seems to me, Senator, if I may say, ties into your question.

Senator MILLIKIN. Give me an answer to this, if you can.

Mr. ELDER. Yes.

Senator MILLIKIN. Tell me the percentage of purchases by the income brackets from $3,200 to $5,000.

Mr. ELDER. I could not. I do not know that there are any breakdowns. I suppose breakdowns could be made. I do not have it.

Senator MILLIKIN. If you happen to run across a breakdown, will you mail it in?

Mr. ELDER. I certainly will, Senator.

It should be obvious, therefore, that while increased excise taxes may operate to depress the standard of living and curtail consumption of those in the lower income groups, they will have little or no effect on the spending of those in the upper income groups who do the bulk of the spending for durable goods and commodities in short supply. It would seem much more logical to assume that excessive spending by this group could be much more easily controlled by more effective personel income tax rates than have yet been proposed.

We sincerely trust that the members of your committee will oppose any increase in present excise tax rates or the enactment of any new excise taxes and that in the consideration of any future tax reduction measure first priority will be given to the elimination of war emergency imposed excise taxes.

Senator MILLIKIN. When you refer to excise taxes, are you referring also to sales taxes?

Mr. ELDER. Yes.

I would like next to address myself to a discussion of the personal income taxes, if I may, Mr. Chairman.

The CHAIRMAN. Yes, sir.

Mr. ELDER. The Secretary of the Treasury has pointed out that the House bill in adding 12½ percent ot tax liability under the present personal income tax law would fall $905 million short of the yield estimated from the 4 percentage point increase as recommended by him.

Under the existing rate schedule it is obvious that the percentage increase in tax liability approved by the House would be preferable to the 4 percentage point increase in the rate schedule, as recommended by the Treasury. Those in the first income bracket, for example, would have a 20 percent increase under the Treasury proposal. This is certainly excessive, bearing in mind the current abnormally high living costs and the general recognition that those in the income groups below $3,000 are already paying a disproportionate share of the total tax bill. We would urge that those with net taxable income up to $1,000 be given a tax credit equal to the amount of any proposed increase and that any increase on net income between $1,000 and $2,000 be limited to the 12½ percent provided in the House bill.

I would like, if I may, in this connection, to point out to the members of this committee that we are not proposing any tax reduction at this time. We are merely proposing that the first $1,000 of net taxable income be given a tax credit equal to the amount ofwhat ever increase is proposed. If it is a percentage increase of 12½ percent, we suggest that that percentage of tax credit be allowed to these people in this income group.

Senator MILLIKIN. On that assumption, how much revenue would be involved?

Mr. ELDER. Very little. I think the Treasury figures show that that first group up to $1,000—something in the neighborhood of about

$45 million are being collected now, and we are proposing, of course, that this tax credit be applied only to the increase, not to the present taxes.

Senator MILLIKIN. Let me ask you, what percentage of the income of the country is in the bracket from $3,000 down?

Mr. ELDER. Well, approximately half, I should say, about half.

Senator MILLIKIN. Are they paying half of the income taxes?

Mr. ELDER. No, they are not. But on a proportional basis, I think, as my paper develops, that we will show that they are paying much more than is reasonable that they should be expected to pay.

Senator MILLIKIN. I will be glad to hear what you have to say on that.

Mr. ELDER. Yes.

Senator MILLIKIN. But it seems to me that—well, you have said that you have referred to income groups below $3,000.

Mr. ELDER. That is right.

Senator MILLIKIN. And you have stated that they are already paying a disproportional share of the total tax burden.

Mr. ELDER. That is right.

Senator MILLIKIN. You mean disproportional in the sense of the justice of the situation?

Mr. ELDER. That is right, in terms of equity.

Senator MILLIKIN. All right.

Mr. ELDER. On net incomes of from $2,000 to $3,000, the 1 percentage point increase suggested by the Secretary we believe should be supplemented by the 12½ percent increase proposed in the House bill. I think the members of the committee will remember that the Secretary proposed a general 1 percentage point increase to apply over the entire rate schedule, plus the addition of the 12½ percent proposed by the Treasury.

We are suggesting here that a 1 percentage point increase be applied to the net income of between $2,000 and $3,000.

Then, our further suggestion is that a 2 percentage point increase for net income in all brackets above $3,000 supplemented by the 12½ percent proposed by the House bill within the over-all—there is a mistake there. It should be 90 percent instead of 20 percent—within the over-all 90 percent limits approved by the House and the Treasury would probably yield revenue considerably in excess of that originally requested by Secretary Snyder. This increased yield, however, would offset deficiencies that might result from the decision not to levy additional excise taxes. The 2 percentage point increase would apply to those income groups which are responsible for the bulk of the inflationary spending and thus would be more effective as well as more equitable than any excise tax that might be proposed.

We would like to address ourselves to the problem that has been occasioned to the Treasury as well as to the Congress in the matter of framing legislation to provide adequate revenue because of the operation of the split income provision.

Examination of the data submitted regarding the effective individual income-tax rates on a single person with one dependent, a head of a household with one dependent, and on a married couple filing a joint return, under H. R. 4473 shows that on net income before exemption the percentage of income paid in income tax by the three taxpayers will be identical on incomes up to $3,000. Above that income level,

the tax advantage of the head of the household and the married couple filing joint returns will increase until at $8,000 income level the single person will pay $1,800 in tax, the head of a household will pay $1,696, and the married couple will pay $1,592. At $50,000 income, the single person will pay $29,200, the head of a household $25,600, and the married couple $22,050. At the $100,000 income level, the single person will pay $14,900 more in income tax than the married couple filing the joint return.

The members of our organization can find neither logic nor equity in a tax measure which intrenches more firmly the policy of limiting exemptions of married couples with incomes below $3,600 and single persons at all levels of income to their dependency and personal exemptions, while allowing married couples in the income brackets from $5,000 to $100,000 to pay as much as 25 percent less in taxes than they should pay.

Senator MILLIKIN. When you say what they should pay——

Mr. ELDER. That is right.

Senator MILLIKIN. That is on the assumption that the present or some past level is the correct level?

Mr. ELDER. That is right.

Senator MILLIKIN. Yes.

Mr. ELDER. It is our considered opinion that the members of your committee should consider no tax increase on either single persons or married couples in the income groups below $3,600 until and unless the present differential favoring married couples filing joint returns is eliminated. Its elimination would remove the pretext for extending similar concessions to other taxpayers at a prospective loss in revenue of $45 million, as proposed in the House bill.

If I may refer to this point, it happens that several years ago, in connection with the committee that was set up by the House under the chairmanship of Representative Knutson who at that time was chairman of the House Ways and Means Committee, I had the privilege of representing the American Federation of Labor and of filing on behalf of the American Federation of Labor a minority report.

Now, during the discussions of that committee, a very large proportion of the time was given to discussing this business of the joint returns, and the contention of those members of the committee who very strongly advocated the adoption of the split income provision, was not that they wished to cut the revenue of the Federal Government. Their contention rather was that they were interested in equity as between the members of one certain group of taxpayers.

Well now it would seem to me with that equity having been achieved, when we are considering tax measures that involve the total economy, we should recognize that that particular group is enjoying, because of that action that was taken by Congress at that time, tax advantage that bears unduly on the other taxpayers in the economy who do not share the benefit of that particular provision.

Senator MILLIKIN. Take the paragraph that you have just finished reading; take the married couple with $8,000 in income level, they pay $1,592 in taxes.

Mr. ELDER. That is right.

Senator MILLIKIN. That is about 22 percent——

Mr. ELDER. That is right.

Senator MILLIKIN (continuing). Of the income.

Now, go up to the $50,000 bracket. The head of the household pays $25,000.

Mr. ELDER. That is under the House bill, Senator.

Senator MILLIKIN. Yes.

Mr. ELDER. Yes.

Senator MILLIKIN. He pays $25,600.

Mr. ELDER. Yes.

Senator MILLIKIN. That is 50 percent. What will it be after $100,000?

Mr. ELDER. After $100,000, the single person will pay approximately $15,000 more than the——

Senator MILLIKIN. What would the married couple pay?

Mr. ELDER. The exact amount?

Senator MILLIKIN. Yes.

Mr. ELDER. Well, that is in the Treasury table.

Senator MILLIKIN. What is it? You have the rest of the figures, but when you come to the $100,000, you do not say what they are paying.

Mr. ELDER. I can check up on that very quickly.

At $100,000, the single person will pay an effective tax rate of $74,300; the head of the household will pay $66,800, and the married couple filing the joint return will pay $59,400.

Senator MILLIKIN. Right. So you have got a tax that graduates from 22 percent of the total——

Mr. ELDER. Yes.

Senator MILLIKIN (continuing). Up to 59 percent of the total. Isn't that enough progression to suit you?

Mr. ELDER. Well, of course, it depends on where you start, Senator. It seems to me that if you are thinking of—you speak of 22 percent, but——

Senator MILLIKIN. I mean, you are talking about the basic equities.

Mr. ELDER. Yes.

Senator MILLIKIN. I mean if we are going to talk about the basic equities, if you are talking about the basic equities, does not a tax that graduates from 22 percent of the whole up to 59 percent in the range of figures that you have mentioned, satisfy your sense of equity?

Mr. ELDER. Senator, I am not discussing the schedule. I am discussing the inconsistencies between the schedule or the injustices within the schedule.

Senator KERR. Are you a married man?

Mr. ELDER. What is that?

Senator KERR. Are you a married man?

Mr. ELDER. Yes.

Senator KERR. Well, do you subscribe to the theory that two can live as cheaply as one?

Mr. ELDER. Two people can usually live more cheaply in one household than the same two people could in separate establishments. As a matter of fact, I have had an experience—I have had the experience under these several different categories that I referred to.

Senator KERR. You have not been married but once, have you?

Mr. ELDER. I have been a single person with dependents; I have been the head of the household with dependents, and I also have been married, and if you are talking in terms of expenses, I can tell you that my expenses as a single person with dependents, maintaining

people in a separate locality, in a different locality, my experiences with respect to expense in that category was that the expenses were higher than my expenses now are as a married person; and I think if you check up with people you will find that generally that is so, because people with separate dependents usually are put to expenses of maintaining separate establishments, and the maintaining of separate establishments is a costly business.

I think any of you who have been put to that expense recognize that that is a fact, and it is on that basis that I am saying that within this category—and this is entirely apart, Senator, from the question of the equity of the over-all progression—but within that particular category or any category there is definite discrimination against the single person under the proposal of the——

Senator MILLIKIN. I am not quarreling with that contention.

Mr. ELDER. Yes. The elimination of the preferential treatment enjoyed by married taxpayers in the upper income group would result in an additional revenue of from $1.9 to $2.5 billion.

Senator MILLIKIN. Senator Kerr directed the question to you.

Mr. ELDER. Pardon me, Senator. Did I take care of that?

Senator KERR. You had begun to describe yourself as a single man with dependents.

Mr. ELDER. That is right.

Senator KERR. And a single man as the head of a household, and you either got me confused or embarrassed at your statement, and I thought probably the cross-examination should go no further, and that is all right. Don't tell anything that you do not want to. [Laughter].

Mr. ELDER. You are wondering about the separate establishments?

Senator KERR. No, not at all. [Laughter.] It just illustrates how easy a man can get into trouble by asking another man personal questions.

Mr. ELDER. I do not care how far you go, Senator.

Senator KERR. No, no. [Laughter.] I do not blame you for hesitating, and I would not probe at all. It is certainly none of my business.

Senator MILLIKIN. I imagine a single man with several establishments would find himself in difficulty. [Laughter.]

Senator KERR. I had often been told that the more establishments a single man had the more expensive it was.

Mr. ELDER. Naturally.

Senator KERR. Yes. [Laughter.]

Mr. ELDER. I was not thinking of plural beyond two. I can conceive of situations, of course, in which you may run this up.

Senator KERR. You put whatever limitation on your remarks you want to. [Laughter.]

Mr. ELDER. You will notice that it just happens that I choose the single person with one dependent. I might have, in line with the discussion, chosen the single person with five dependents.

Senator KERR. You know how the split income provision came to be passed, do you not?

Mr. ELDER. Oh, yes, I have an idea about the pressures, and so on.

Senator KERR. You know it was brought about by reason of the fact that many of the States had community property laws and where they did have the practical result of the community property law

was to give the citizens in that State the benefit of a split income return.

Mr. ELDER. I recognize, Senator, that that was the story, but I also know that there were a number——

Senator KERR. Did you recognize it as a fact?

Mr. ELDER. Well, it was a fact that could have been taken care of in different ways, in my opinion. There is a difference of opinion on that.

The elimination of the preferential treatment enjoyed by married taxpayers in the upper income groups would result in an additional revenue of from $1.9 to $2.5 billion; and when I say this, Senator, I contend that this could be done without violence to that principle, which was the justification for the split income, in the first place.

This amount added to increased revenue that would result from a 1 and 2 percent increase in scheduled rates, combined with the 12½ percent increase proposed in the House bill, would result in increasing the revenue from the personal income tax by $6.4 to $7 billion, rather than the $3.8 billion initially proposed by the Treasury or the $2.9 billion contemplated in the House bill.

I would next wish to address myself to the revenue-losing provisions as incorporated in the House bill.

Our sorry experience with revenue losses and resulting inequities in the income and estate tax field through the adoption of legislation granting special concession to certain taxpayers would argue against hasty consideration and/or adoption of revenue-losing provisions proposed in the House bill. Some of these proposals, such as the increased percentage depletion allowances, application of low rate capital gain rates to coal royalties, and the validation of family partnerships we condemn and oppose as opening up further loopholes which should be eliminated.

We have already indicated opposition to the proposal that benefits conferred by the personal income tax to married couples should be extended to heads of households. In the interest of expediting the enactment of needed legislation increasing revenue, we would urge that all revenue-losing provisions that do not involve manifest and unquestioned injustices be deferred for consideration in connection with future legislation.

We would next like to comment on the corporation tax provision. In view of current estimates that corporate profits before taxes will reach $45 billion, exceeding the 1950 revenue by $4 billion, there would seem to be no reason for proposing a reduction of $570 million in the revenue requested by the Treasury. Neither dividends nor undistributed profits would be substantially curtailed if the revenue requested were approved.

We endorsed the Treasury proposal for an increase in the alternative capital gains rate of from 25 to 37½ percent in our appearance before the House committee, and at this time would urge your committee to amend the House bill in line with the Treasury recommendation so that some $360 million in additional revenue may be realized.

There are some general considerations with regard to H. R. 4473 which we would like to bring to the attention of the members of the committee.

The $6.4 to $7 billion increase from personal taxes, the $3.2 billion in increased corporate taxes, and the $440 million increase from capital gains tax on corporations and individuals which we have referred to

previously, would provide the amount of revenue required. With personal income running at an annual rate of close to $245 billion, there is every argument for concentrating tax increases on personal and corporate income at this time.

Additional revenue of from $1 billion to $1.5 billion yearly could be secured through integration of estate and gift tax rates and some changes in exemption and rate schedules. Because of the fact that in a period of mounting tax rates in virtually every other tax category income from estate and gift taxes has shown a consistent decline relative to the yield from other taxes, we urge your committee to give earnest consideration to amendments necessary to reestablish tax revenue from estates and gifts on a substantial basis.

Senator KERR. How much do you think we would be justified in increasing the mortality rate?

Mr. ELDER. The mortality rate?

Senator KERR. Yes.

Mr. ELDER. I would not want to hurry that up at all.

Senator KERR. That would be a very effective way to accelerate the collection of inheritance taxes. [Laughter.]

Mr. ELDER. It depends on how it worked out. [Laughter.]

Senator KERR. How would you do it?

Mr. ELDER. Well, Senator, I was told that I was limited to 20 minutes, that I would be limited in my presentation. I would have spelled all of these proposals out, and I am prepared to present written proposals with regard to any and all of these.

Senator KERR. Would you do that?

Mr. ELDER. I certainly will.

(The information referred to, subsequently submitted, is as follows:)

Tentative estimated possible increase in revenue from estate and gift tax

	Estimated revenue increase
Reduce exemption from $60,000 to $30,000	$150, 000, 000
Increase rates from 3 to 7 percent on first $10,000 net to 16 percent	450, 000, 000
Increase rates on $30,000 to $40,000 from 18 to 24 percent	
Increase rates on $300,000 to $400,000 from 32 to 45 percent	
Increase rates on $1 million to $2½ million from 39 to 63 percent	
Increase rates on $2½ million and over to 77 percent	
Recapture revenue lost through marital deduction through rate revision	375, 000, 000
Integration of estate and gift tax schedules	(?)
Closing various loopholes involving trusts, etc	75, 000, 000
	[1] $1, 050, 000, 000

[1] Above estimate might prove conservative if amendments were adopted and present levels of income continued.

Senator KERR. You did not expect to give a 35-minute paper in 20 minutes, did you?

Mr. ELDER. I could read it, I think, in 20 minutes. I timed myself, as a matter of fact, in working on these things.

The House bill, in our opinion, does not adequately recognize the present situation which finds low-income taxpayers paying a disproportionately large share of the tax load at a time when living costs have reached excessive heights. Several provisions in the House bill would still further increase this tax burden without providing the

necessary revenue. In our opinion, the principle on which the revenue bill now under consideration should be built was indicated on page 7 of the Report No. 210—the Report of the Joint Congressional Committee on the Economic Report, issued on April 2 of the present year in the following statement:

> Thus, for example, Whatever tax proposals are advanced for consideration should take cognizance of the fact that the people in the lower income brackets, that is to say, the people with incomes of $3,000 a year or less, are already overburdened, as is spelled out in the staff materials attached hereto, by the increased cost of living and the present level of taxes. The Government cannot look to them for any substantial new revenue. The new tax bill must be directed to absorb surplus purchasing power where it exists. In addition to closing loopholes we need a tax system that seeks to eliminate all profiteering and to make impossible that this defense effort produce a new crop of war profiteers.

We submit to the members of this committee that the House bill now before you for consideration will further burden the low-income taxpayers your congressional committee has declared are already overburdened; and further, that it will not in its present form operate either to absorb surplus purchasing power, close loopholes, or eliminate profiteering to any effective degree.

Elsewhere in the congressional committee report referred to above, staff studies show that those in the income groups below $3000 pay a greater proportion of their income in taxes for the support of local and State governments than those in the income groups above $3,000. I should qualify that—up to $7,500.

Senator MILLIKIN. Where do you put that?

Mr. ELDER. Specifically, the study shows——

Senator MILLIKIN. Where do you say that?

Mr. ELDER. That is the third paragraph, Senator, the short paragraph beginning with "Elsewhere in the congressional committee report"——

Senator MILLIKIN. It should be up to $7,500?

Mr. ELDER. Up to $7,500, yes.

Specifically, the study shows that in 1948, spending units with under $1,000 income paid 9.7 percent of that income in State and local taxes, 13.9 percent in Federal taxes—a total of 23.6 percent of their income going to the support of government——

Senator MILLIKIN. That includes concealed taxes?

Mr. ELDER. Concealed taxes, yes.

Senator MILLIKIN. There were some figures here the other day, as I recall it, that showed about 60 percent of the taxes that are paid by those in this lower-income bracket that you are referring to were concealed taxes.

Mr. ELDER. That is right. That is true particularly at State and local levels, where that is so.

Senator MILLIKIN. Those would result from the taxes imposed on the higher levels.

Mr. ELDER. Moreover—I skipped a sentence. Let me go back.

Specifically, the study shows that in 1948, spending units with under $1,000 income paid 9.7 percent of that income in State and local taxes, 13.9 percent in Federal taxes—a total of 23.6 percent of their income going to the support of government—a higher proportion of their income going to taxes than for any group of the population except those getting $7,500 or over. Moreover, the same study showed that those in the income groups below $3,000 paid on the aver-

age, approximately as great a percentage of their income in local, State, and Federal taxes as those in the income group between $3,000 and $7,500.

These studies, in our opinion, are important, because of the indiscriminate and ill-founded statements that have been made regarding the need for heavier taxation on those in the lower-income groups. For tax purposes at this particular time, we believe that the 52.8 percent American families with incomes below $3,000 who in 1948 received 23.7 percent of the income are definitely in that lower income category, while the 47.2 percent of the families with incomes of more than $3,000 who receive 76.3 percent of the total income might be termed in the middle and upper income groups.

Now, I know, Senator, on that point there is some tendency on the part of people who are breaking down these income figures to talk in terms of the income groups below $5,000, and the income groups above $5,000.

It does not seem to me that is fair because I think that we would generally concede that while many income payers in the income between $3,000 and $5,000 may have some difficulty in getting along at the present level of prices and the cost of living, that generally speaking their problems do not compare with the problems of a good half of the American people who are at the income level below $3,000.

Moreover, since 1948 it should be realized that higher taxes——

Senator MILLIKIN. Just a moment, please.

Mr. ELDER. Yes.

Senator MILLIKIN. Mr. Stam, have you the figures available of the income of people between $3,000 and $5,000, and the percentage of tax that they pay? Do you have that available?

Mr. STAM. I do not think we have it. We have the breakdown on $5,000 and over. We can get that for you, sir.

Senator MILLIKIN. I should think since you are establishing your own break-off points of $3,000, and since we have customarily used the $5,000, I think it would be important, as I suggested before, that we have statistics on what happens between $3,000 and $5,000.

Mr. ELDER. I agree to that, Senator.

Senator MILLIKIN. Yes.

Mr. ELDER. Moreover, since 1948 it should be realized that higher taxes—local, State, and national—combined with a 10-point increase in the cost of living, have placed those in the lower income categories at a still further disadvantage in their efforts to make ends meet.

We have a section on tax policy for the defense emergency and beyond. Secretary Snyder has stated that the fiscal policies of State and local governments——

Senator MILLIKIN. May I ask you a question?

Mr. ELDER. Yes, sir.

Senator MILLIKIN. I think every member of the committee is concerned with fiscal 1953 which starts in less than a year from now, where I think all of the testimony supports the theory of a deficit of from 20 to 30 billion bollars under present rates and under the rates proposed by the House bill giving effectiveness to the rates proposed by the House bill.

How would you meet that 20 to 30 billion dollar deficit, taxwise?

Mr. ELDER. For next year or——

Senator MILLIKIN. For the next fiscal year.

Mr. ELDER. For the next fiscal year? Well, Senator, I have my opinion. A good many other people have their opinion. I would not be prepared to talk in terms of billions precisely.

I would say this, however, to the fullest extent possible we should try to raise every dollar of additional expenditures that are made on a current basis, as nearly a current basis as possible.

Senator MILLIKIN. I think most everyone would agree with you, short of injuring our economy.

Mr. ELDER. That is true.

Senator MILLIKIN. That still leaves unanswered how are we going to meet the deficit of 20 to 30 billion in 1953.

Mr. ELDER. Of course, on that, Senator, I think that we recognize that events move very quickly, and in the light of events, the needs that seem to be looming up in 1953 at the present time may be either more or less.

Senator MILLIKIN. That is right.

Mr. ELDER. Now, back in January, I think we will remember, the Secretary of the Treasury and the Budget Bureau presented a budget which showed that we would need approximately $72 billion.

In the light of subsequent spending, plus the fact that the tax revenue was more than had been anticipated under the present schedules, it is not necessary to think in terms of 72 billion—at least we are told that it is not.

Senator MILLIKIN. The latest estimates by the same people——

Mr. ELDER. Is about 68 billion.

Senator MILLIKIN (continuing). Consider that for fiscal 1953 they give us figures which indicate a deficit of from 20 to 30 billion.

Mr. ELDER. Yes.

Senator MILLIKIN. Now, they may be wrong on that.

Mr. ELDER. That is true.

Senator MILLIKIN. I hope they are wrong.

Mr. ELDER. I certainly do, too.

Senator MILLIKIN. But they assure us at the same time that they are going to adhere to the programs that will produce that deficit. Maybe they will not, maybe they will exceed that, but we have got to operate on the most stable factors that you can find, and the question still remains how shall be meet, in your opinin, that 20 or 30 billion deficit, assuming that it will occur.

Mr. ELDER. Well, Senator, I also understand that along with those estimates are further estimates that in the year beyond we will be working at a lower level of expenditures.

Senator MILLIKIN. We will be working at approximately the present level.

Mr. ELDER. That is right; and beyond that, further, that we will be working at still a lower level.

Senator MILLIKIN. They will not go beyond that further. They bring us to a plateau that will run on more or less indefinitely at a rate of taxes under revenue estimates that will be equal to those that we get by the present revenue measures, plus the proposed revenue measures.

Mr. ELDER. Then, in the light of the information you give me here, I would say that with regard to that peak, the 1953 peak, that to

plan tax adjustments for the 1 year that might really be crippling, would not be good business.

Senator MILLIKIN. Yes.

Mr. ELDER. And that it would be advisable to think in terms of taking a portion of what we do not feel can be absorbed by the economy and spread that over this period of the plateau, if you will.

Senator MILLIKIN. Which would mean adding——

Mr. ELDER. Adding that——

Senator MILLIKIN (continuing). To the estimates of the present bill.

Mr. ELDER. That is right.

Secretary Snyder has stated that the fiscal policies of State and local governments can give effective support to the Federal Government's programs. The American Federation of Labor agrees that unnecessary and postponable expenditures at all levels of government must be avoided at this time.

However, we have reason to know that State and local units of government have been confronted with rising costs for services, minimum replacement needs, and absolutely unavoidable capital costs. Schools, hospitals, police and fire protection, welfare, sanitation, maintenance of highways and bridges are close to the lives of our American people. Total taxes necessary for their support have increased from $9.6 billion in 1942 to approximately $17.0 billion in 1950, an increase of 77 percent. The bulk of State and local revenue comes from the more regressive taxes. We need not be surprised, therefore, when we learn that the study referred to earlier showed the following percentage of income going to the support of local and State government at various levels of income.

Senator MILLIKIN. Let me ask you a question, please.

Do you not believe that, roughly during this emergency or war or whatever you want to call it, that the States will duplicate the experience which they had during World War II where they were piling up very large surpluses, for the simple reason that they will not be able to get the material and labor on which to spend the revenue?

Mr. ELDER. Well, Senator, I would agree with that if we had controls that were effective.

Defective as those World War II controls were, they were so far—in my opinion again—superior to anything that we have at the present time that it is not funny.

Senator MILLIKIN. Well I am not laughing. [Laughter.]

Mr. ELDER. So, I would say that that depends. I think with controls as they are, that you will find that States that are committed to hospital programs, as long as they get their materials, are going ahead with those hospital programs.

Senator MILLIKIN. I happen to know of a considerable recession in spending plans in some of the States.

Mr. ELDER. I know that is true.

Senator MILLIKIN. They may not develop the same magnitude of surpluses of World War II until we have tighter controls——

Mr. ELDER. That is right.

Senator MILLIKIN (continuing). But I believe that, roughly speaking, some of that World War II experience will be duplicated, and

that States will wind up with unexpendable money and, therefore, it will be a surplus.

Mr. ELDER. Well, I hope you are right. I have not seen enough of it to make me feel that will work out that way in an over-all fashion.

Then, Senator, there is this table, which shows the percentage of income at various levels that is going to support the local and State governments.

1948 tax payments as percent of income

Spending unit income bracket:	*Percent of income to State and local government taxes*
Under $1,000	9.7
$1,000 to $1,999	6.8
$2,000 to $2,999	6.1
$3,000 to $3,999	6.0
$4,000 to $4,999	5.6
$5,000 to $7,499	5.4
$7,500 and up	5.5

You will notice that in the income category of the spending units under $1,000, the estimate of the proportion of revenue going for State and local government is 9.7 percent, and then increasing as the income increases, you will note that the percentage of income going for the support of State and local government decreases, until when you get above $7,500, the percentage is 5.5 percent, as contrasted with the 9.7 percent shown for the first level of income.

Senator KERR. Do you have the percentage there of income of these income brackets that goes to Federal taxes?

Mr. ELDER. Yes, that is shown, Senator, in this Report No. 210 of the congressional document.

Senator KERR. I thought maybe I could just put it down here on this sheet of paper, if you have got it there.

Mr. ELDER. No, I do not have it in my testimony.

The above facts, in the opinion of our members, constitute compelling reasons why the Federal Government should avoid additional regressive taxation that would further burden low-income-group taxpayers.

Senator MILLIKIN. May I ask whether another short way of saying that would be that you oppose the further extension of excise taxes at the manufacturer's level, and you oppose sales taxes?

Mr. ELDER. That is right, as well as retail taxes.

Moreover, they would also seem to underscore the responsibility of the Federal Government for using its greater taxing power to enable States and local units to provide their services more adequately and with a greater degree of equity than they now are being provided. In our opinion there is real question as to whether the Federal Government has paid due regard to the revenue needs of the States and local governments in the shaping of its tax policy.

Our citizens recognize the necessity for wholehearted support of the defense program at home and abroad financed through the machinery of the Federal Government. The services at home financed through our local and State governments are not a whit less essential to that defense.

It is our sincere hope that your committee will take necessary action to provide increased revenue at the earliest possible date in the

amount and of the character demanded by the emergency now confronting us. Looking toward the future, we would urge that your committee in cooperation with the proper committee in the House initiate studies of a practical nature directed at eliminating existing competition among units of government and between the several levels of government in the tax field.

Senator MILLIKIN. Is not the general effect of what you are saying that if you want to increase the revenues at home available for expenditure at home and under home control, you have got to decrease the amount of Federal taxes siphoned from the States?

Mr. ELDER. Well, eventually it might mean that, Senator.

Senator MILLIKIN. Well, it could not mean any other way.

Mr. ELDER. No, that is true.

Senator MILLIKIN. Thank you.

Mr. ELDER. Mr. Chairman, I appreciate the time that your committee has accorded me.

The CHAIRMAN. Thank you, Mr. Elder, for your appearance.

Mr. ELDER. Thank you, sir.

The CHAIRMAN. Mr. Schram?

Mr. Schram, you may have a seat if you wish to.

STATEMENT OF EMIL SCHRAM, CONSULTANT TO THE NEW YORK STOCK EXCHANGE, ACCOMPANIED BY RICHARD M. CROOKS

Mr. SCHRAM. My name is Emil Schram. I have recently retired as president of the New York Stock Exchange, and I am now serving as the consultant, in a consulting capacity, to the exchange, and I live on my farm in Peru, Ind.

The gentleman with me at the table is Mr. Richard M. Crooks who, for many years, has been a governor of the New York Stock Exchange and is now the chairman of its board of governors.

He is a partner of a member firm of the exchange, and spent 23 years in the securities and commodities brokerage business.

I began appearing before congressional committees on matters of taxation in 1942. Then, as now, you were faced with the necessity of raising new and greater revenues. Because of my 10 years of service with the New York Stock Exchange, I have become intimately acquainted with the problems which surround the creation and flow of equity capital into productive enterprise. Each day we see the impact of taxation on this vital part of our free enterprise system. We in the securities industry recognize today, as we did when I first came before you in 1942, the need for more revenue. We want to carry our fair share of the tax burden. We do not take the position that additional revenue should be obtained from everyone but us. We believe—sincerely and after long study of all pertinent factors—that we can show you how more, not less, revenue may be raised from a capital gains tax.

Our essential task today is to make this Nation strong enough to preserve our liberties against any aggressor and to meet our international commitments as a guardian of democracy. At the same time, we must avoid crippling our efforts by excessive reduction in the output of consumer goods and services. The task is difficult, extraordinarily difficult. But our people have the power and the brains to accomplish it. The answer is production—more production.

Build new plants, new equipment; improve and modernize existing equipment. Provide labor with the tools to create new wealth.

The money to do this job must not come from Government—for Government's only source of income is taxation. Our production must be financed by private equity capital, the savings of the people. These savings can be transformed into risk capital—but not if the saver is penalized by too high a tax rate or too long a holding period.

There is another important factor to be considered. Capital investment is required to produce true income. The more capital that can be attracted into productive investment channels, the greater will be the real income which should and will be taxed under the income tax laws.

We have tried to approach this question of taxation with a view to bringing a higher revenue return to the Government with the least unfavorable effect on our economy in general and on the highly sensitive capital markets in particular.

Our association with the capital gains tax is an intimate one. It is a tax we live with day by day. It is our hope that out of this experience we can contribute constructively to your deliberations.

It is generally recognized that capital gains are not true income and that a tax on capital gains is in reality a capital levy. The Treasury does not seem to realize that a capital gains tax is a tax which is paid only if the taxpayer elects to realize a capital gain. To that extent it is a self-imposed tax, a tax which need not be paid unless the taxpayer elects to do so.

We are convinced that either an increase in the capital gains rate or a lengthening of the holding period will decrease revenues. We are certain that coupling a rate increase with a longer holding period will do so. When I testified before this committee in 1942 as a spokesman for the securities industry, I stated that if the holding period were shortened, revenues from the capital gains tax would be increased. We were right.

When the law provided a holding period of 18 months from 1938 to 1941, it is a matter of record that revenues from capital gains dropped from $12,000,000 in 1938 to the point that, in 1940 and 1941, capital losses offset capital gains.

In the tax bill of 1942, which was passed in October of that year, the holding period was reduced from 18 to 6 months. The full impact of the shortened period was not felt in that year, however, because the taxpaying public did not begin to thaw out their investments until the shorter period became law. Despite the limited time the shorter period was in effect, capital gains tax receipts expanded to $68,000,000 in 1942. In 1943 returns from the capital gains tax increased to $266,600,000, in 1944 to $354,000,000, and in 1945 to $720,000,000. In the latter year alone the revenues from the capital gains tax were more than 3½ times the net revenues from the capital gains tax for the 7-year period 1935 to 1941.

We are convinced that the retention of the present——

Senator MILLIKIN. Mr. Schram, in your last sentence you say the revenues from the capital gains tax were more than 3½ times the net revenues from the capital gains tax for the 7-year period 1935 to 1941. Do you mean the net revenues up above? By the revenues you mean the net revenues at that point?

Mr. SCHRAM. Yes, that was the tax paid, collected by the Treasury in 1945, which was $720,000,000, Senator.

Senator MILLIKIN. Yes.

Senator KERR. There is that much left from that source after deducting the capital loss?

Mr. SCHRAM. Yes. That is the return from the tax.

Senator MILLIKIN. May I repeat my question then: "In the latter" —I am quoting from your statement—"year alone the revenues"— at that point you mean the net revenues?

Mr. SCHRAM. The net revenues; that is right.

Senator MILLIKIN. Thank you very much.

Mr. SCHRAM. We are convinced that the retention of the present rate with a reduction in the holding period to 3 or 4 months will increase substantially the Government's revenue from the capital gains tax.

We are at a loss to understand why the Treasury estimates that increasing the capital gains rate by 50 percent and doubling the holding period would produce $440,000,000 in additional revenue. The record does not bear out their contention.

Though comparable figures for 1946 and later years are not available to us, it is known that capital gains revenues in 1946 exceeded 1945. It is also known that 1947 receipts were only slightly lower than 1946. We believe that the capital gains revenue for 1950 was the highest on record—and with a shorter holding period would have been still higher.

The theory has been advanced that if the rate of tax on income must be raised, the rate of tax on capital gains, in fairness, should also be raised. This concept, in our judgment, is open to serious question. A man owns a capital asset which has appreciated in value, a capital asset he is reluctant to sell because of the high tax penalty. He can escape the tax by continuing to hold the asset. But if, with a lower tax rate, he sells his capital asset, realizes his gain and thereby becomes a taxpayer who pays 25 percent of his gain to the Government has this man been favored? We think not. What we need is more taxpayers, not fewer.

A great deal is heard these days about helping the small-business man. Here is a solid way to help him. Many a small enterprise will die from financial malnutrition if tax legislation frightens away people who would be willing to risk their savings in an unseasoned business. Big business usually has easier access to the equity capital markets than does the small-business man who is frequently venturing into unchartered territory.

Let me summarize our position. We appreciate the difficult task which confronts you, the judgment it requires. We realize the needs of Government in this time of crisis and our own deep responsibilities.

We are firmly convinced that a shortening of the holding period will produce more revenue for the Government. The record confirms that position. We must always appreciate that the realization of a capital gain is under control of the taxpayer and the timing of the tax payment is also under his control; therefore, a higher tax rate and a lengthened holding period will result in less rather than more tax revenues from long-term capital gains.

That concludes my statement.

The CHAIRMAN. Are there any questions?

Senator MILLIKIN. I would like to ask Mr. Schram this question: Over in the House the other day someone proposed an experimental period for shortening the period and decreasing the rate on the theory which you propounded, that it would increase the revenues.

Would the next year provide a fair period for trying it out?

Mr. SCHRAM. Yes; I think so. That proposal, I think I heard yesterday here, Senator, was for a 6-month period, I believe. Now, I do not see how it would be possible to make the determination in 6 months' time because you do not get the returns—the Treasury, you know, is by force of circumstances naturally slow in getting out the figures, the net returns on capital gains.

Senator MILLIKIN. Suppose we tried it out for a period of a year?

Senator KERR. Two years.

Mr. SCHRAM. I think that would be very helpful.

Senator MILLIKIN. Two years, and give it a try, and put at rest these various contentions about capital gains.

Mr. SCHRAM. I think that would make a lot of sense to me.

Senator MILLIKIN. Thank you.

Mr. SCHRAM. You have a problem in the holding period of course, and this question of rate. Capital is being aged in a good many places, and people are reluctant to sell their property, which they would like to do in preparation, perhaps, of death; but if they do they have got to pay at the 25 percent rate, and then they take the chance on the estate tax, and it is prohibitive, so you have a lot of property that really should be disposed of, should be moved on to new and younger owners that really is frozen now.

A change, even the lowering of the rate, in fact, would produce more revenue because it would bring into the taxpaying category many positions where the capital gains tax, in my opinion, will never be paid.

Senator MILLIKIN. Let me ask you this, Mr. Schram: Supposing we shorten the time and, if you please, decrease the rate. I am asking you a purely experimental question. What would be the effect on inflation?

Mr. SCHRAM. Shortening the time?

Senator MILLIKIN. Shortening the time and, if you wish, decreasing the rate, in other words, giving your theory full play.

Mr. SCHRAM. It would be deflationary, in my opinion, rather than inflationary because, it would encourage—for example, in inflation we must assume that we would have rising prices in the values of stock, and it would encourage the sale, the taking of profits, which would have a deflationary effect. The longer the holding period, the more inflationary your movement of stocks—the influence is more inflationary.

Senator MILLIKIN. You would introduce an inflationary movement in the stock market?

Mr. SCHRAM. Yes, I think it would be, and in real estate or anything else, any capital asset.

Senator KERR. Let me see if I understand the answer you have given.

Senator MILLIKIN. I think there is a conflict in the answer.

Senator KERR. I either did not understand the Senator's question or your answer. I think he asked you whether it would be inflationary

or deflationary if the holding period were shortened, and the tax rate——

Senator MILLIKIN. Reduced.

Senator KERR (continuing). Reduced.

Mr. SCHRAM. My answer was that it would be deflationary.

Senator KERR. I thought you said it would be inflationary.

Mr. SCHRAM. The lengthening of the holding period would be inflationary, but the lowering of the rate and the shortening of the holding period would be deflationary.

Senator MILLIKIN. I focused attention on the effect on the stock market, whether that would have an inflationary or deflationary effect, and at that point I got thrown off.

Mr. SCHRAM. I meant to say that it would be deflationary, Senator, because, and I qualified my answer by saying. I explained my answer by saying, that it would cause the sale, it would encourage the sale, of securities which would have a tendency of holding the prices down.

Senator MILLIKIN. The moneys gained from, let us say, the sale of real estate and things other than stocks, would they find their way into the stock market?

Mr. SCHRAM. Not necessarily, no; oh, no; not unless they happen to be a corporation in which the stock was listed on the exchange, and we do not have many situations of that sort.

I think the real estate market, your farm market, your city real estate market, would be entirely separate from the stock market, but the effect would be the same on that market as it would be——

Senator MILLIKIN. Certainly in one aspect it would be deflationary.

Mr. SCHRAM. It would be deflationary.

Senator MILLIKIN. But if a lot of gains were realized from outside the stock market, and were poured into the stock market, you may have some inflationary effect, might you not?

Mr. SCHRAM. Well, you might have some additional purchasing, but I do not believe that would be of sufficient volume.

Senator, we have listed on the exchange today well over 2 billion shares which are more than twice that which we had in 1929, is that right, Mr. Crooks?

Mr. CROOKS. Correct.

Mr. SCHRAM. And our trading activity today——

Senator MILLIKIN. Twice what it was?

Mr. SCHRAM. Twice what was listed in 1929, and our trading activity is percentagewise way below what it was during that particular period.

Now, we always think of a boom and bust period as 1929, and we have never even closely approached 1929, since the 1929 period, and 1950 was one of the most active recent years we have had in the exchange.

Senator MILLIKIN. Taking the operation of those two forces, would it be a conservative judgment to say that one would neutralize the other? There would be a liberation of stock holdings which would tend to depress the market; there might be a liberation of purchasing power into the stock market which might tend to run it up, and in your judgment, the most conservative estimate would be that one would tend to offset the other?

Mr. SCHRAM. I am sure one would tend to offset the other, because a great many of these stocks—these estates that would be sold would

be in the nature of stocks, which would be supplying stocks into the market.

Now, perhaps, in the real estate field you might create some purchasing power, but I think one would offset the other.

Senator MILLIKIN. That is right.

Senator KERR. I understood you to say, in your opinion the release of this capital which now tends to be frozen would result in the starting of new businesses as much or more than in the investment in present businesses.

Mr. SCHRAM. It would put it in new hands. A lowering of a holding period, I think, would have more effect upon encouraging venture capital into new businesses, Senator.

Senator KERR. That is the way I understood it.

Mr. SCHRAM. That is right.

Senator KERR. And that would have neither a deflationary nor inflationary effect on the stock market.

Mr. SCHRAM. It would have a very healthy effect on our economy.

Senator KERR. Yes.

Senator MILLIKIN. Do you forsee any circumstances whereby the amount of revenue realized by possibly a reduction in the holding period, and by possibly the reduction of a percentage of tax would yield less revenue than we are getting at the present time?

Mr. SCHRAM. I do not. I am firmly convinced, and it has been our experience and our studies of this whole capital gains tax problem, and we have studied it closely for 10 years now, or more, and I am sure that it would raise more revenue. We are convinced of that, and the record proves that, sir; the record proves that.

Senator MILLIKIN. Thank you very much.

Mr. SCHRAM. Thank you very much.

The CHAIRMAN. Thank you, Mr. Schram.

Mr. SCHRAM. Thank you, Mr. Chairman.

The CHAIRMAN. Mr. John J. Magovern?

Mr. MAGOVERN. Yes, sir.

The CHAIRMAN. Mr. Magovern, will you please identify yourself for the record?

STATEMENT OF JOHN J. MAGOVERN, JR., COUNSEL, THE MUTUAL BENEFIT LIFE INSURANCE CO.

Mr. MAGOVERN. My name is John J. Magovern, Jr. I am counsel of the Mutual Benefit Life Insurance Co., of Newark, N. J.

I am appearing here today as chairman of the joint committee on withholding and information at source of the American Life Convention, and the Life Insurance Association of America. The combined membership of these organizations includes 233 legal reserve life insurance companies doing business in the United States and representing over 96 percent of the life insurance in force in such companies in this country.

My appearance here relates particularly to section 201 of H. R. 4473. This section would add a new chapter to the Internal Revenue Code which would provide for the collection of an income tax at the source on dividends, interest, and royalties.

The proposed law affects life insurance companies as payors and payees of interest and dividends, and affects policyholders and beneficiaries as payees of interest.

I would like to address myself first to life insurance companies as payors.

Under the bill there are two principal situations in which life-insurance companies are required to withhold 20 percent of interest: First, where interest is credited policyholders on dividends retained under the customary policy provision; second, where interest is due on policy proceeds retained under a policy provision or agreement to pay interest thereon.

The CHAIRMAN. Your first proposal is the ordinary case of where the dividends are simply permitted to reduce the annual premium?

Mr. MAGOVERN. No, Senator, that is where the dividends are retained by the company and not used in reduction of the premium.

The CHAIRMAN. I see.

Mr. MAGOVERN. The policyholder pays the gross premium, and he leaves the dividends with the company.

The CHAIRMAN. I see.

Senator MILLIKIN. Do those go into reserve?

Mr. MAGOVERN. No, that goes into a separate account called the accumulated-dividend account.

Senator MILLIKIN. What usually happens with it?

Mr. MAGOVERN. As you will see, I will explain in the next paragraph that what may happen to a dividend account is a variety of things, Senator.

Senator HOEY. There is no reduction of dividends, no withholding of the dividends, where you credit it on the premium?

Mr. MAGOVERN. No. I am addressing myself to the interest on the dividend fund which is retained.

Senator HOEY. Yes, sir.

The CHAIRMAN. Proceed.

Mr. MAGOVERN. The interest credited to policy dividends retained by a life-insurance company becomes an integral part of the accumulated-dividend fund subject to the contractual provisions of the policy. This is in response to your question, Senator.

This dividend fund may be used in a variety of ways under the terms of the policy contract: It may pay a premium due under the policy; it may shorten the period within which a policy may mature as an endowment; it may extend the term for which insurance coverage is provided after lapse; it may become a part of the policy proceeds at maturity with all the rights, options, and privileges applicable to policy proceeds.

To require a withholding of any portion of such funds would disrupt the operation of these policy provisions and result in hardship to insureds and beneficiaries alike. Confusion would arise because withholding of any part of the interest normally added to the dividend fund would reduce benefits. In fact, it could even destroy the benefits otherwise available under the policy provisions. It would be unfortunate indeed if the withholding of interest on the dividend fund resulted in the defeat of a beneficiary's claim. This could occur in the case of a lapsed policy where the withheld amounts so reduced the fund that it was insufficient to continue coverage to the date of death of the insured

Withholding on these dividend accounts would be burdensome to life-insurance companies. As an example of the scope of the problem, I can cite my own company, the Mutual Benefit Life Insurance

Co. We had approximately 390,000 policyholders at the end of 1950. The dividend-accumulation accounts numbered approximately 263,000, with an estimated average annual-interest credit in 1950 of $4.60. On the average, withholding would amount to 92 cents per policy.

These accounts are related to the anniversary dates of individual policies, the crediting of interest occurring on these dates. As a result the withholding would be a daily operation rather than at stated intervals as is the case with bank accounts. The increased volume of accounting which this would entail and the difficulties of many companies in adjusting their calculating- and recording-machine operations to meet such a demand would be costly.

I would next speak on the question of policy proceeds left under an agreement to pay interest.

These agreements, arising under the policy provisions, become effective at the maturity of a policy, usually by reason of the death of the insured. In most cases such interest payments are made on a monthly basis.

This interest, to a very large degree, is payable to widows and children and the aged who depend on its receipt to provide food and shelter. Many of them have relatively small incomes which are less than the exemptions available, so that no income tax is required on the payments they receive. Withholding 20 percent of the interest payable by life-insurance companies to these beneficiaries would create inconvenience and hardship. It does not seem fair to deprive these people of this income for an average period of 9 months and to force them to file claims to get it back. Moreover, the life-insurance companies would be called upon to furnish them with the details necessary to perfect their claims for refunds.

Our experience indicates that, faced with such a curtailment of income, these beneficiaries would seek revision of their settlement arrangements in an endeavor to overcome the deficiencies in their incomes.

Senator MILLIKIN. May I ask you, please, from your experience, what is the cost of a single mailing to a policyholder?

Mr. MAGOVERN. I do not have that figure, Senator, of the cost reduced to an individual policy.

I have some figures as to the effect of this, because it would require a completely new installation in some companies of operations, but I have not reduced it to the cost of actually processing a single payment.

Senator MILLIKIN. A person with a small dividend or a small interest claim would have to put in for a refund, and I am trying to think of just what the cost of that would be not only to the company but to the individual who asserts his claim for a refund. What does it cost to send a letter?

Mr. MAGOVERN. I am not sure——

Senator MILLIKIN. I mean, you have got an exchange of mail. I may be clear off base on this, but, as I recall it, political letters, by the time you have them addressed and multigraphed and put in the envelopes and sealed, and a stamp put on them, it costs them 10 or 15 cents.

Mr. MAGOVERN. I think it is even perhaps more so in this case, because here we would be dealing with a type of operation that could not be left to mimeographed notices, could not be left to just any——

Senator MILLIKIN. What I am getting at is, you are not only withholding a certain amount of the taxpayers' property, but you are, in effect, making another withholding by putting him to the expense of claiming his refund.

Mr. MAGOVERN. I have no doubt that the cost——

Senator MILLIKIN. I am trying to measure what that amounts to.

Mr. MAGOVERN. I am sorry, I do not have that. I could break it down and try to get it for you, Senator.

Senator MILLIKIN. I think it would be interesting if you would give us something on that.

Mr. MAGOVERN. I shall do that as soon as possible.

(The information referred to, later submitted, follows:)

THE MUTUAL BENEFIT LIFE INSURANCE CO.
Newark, N. J., July 23, 1951.

Hon. WALTER F. GEORGE,
Chairman, Senate Finance Committee,
Senate Office Building, Washington, D. C.

DEAR SENATOR GEORGE: At the hearing on H. R. 4473 before the Senate Finance Committee, Wednesday, July 11, Senator Millikin requested that I endeavor to determine the cost to a policyholder and a life insurance company of submitting a claim for the refund of tax withheld under the provisions of the bill from interest paid to a beneficiary.

Under the favorable circumstances and assumptions which I will outline, our study indicates that such a claim for refund would result in an approximate out-of-pocket cost to the beneficiary and the company of at least $5.77.

While the beneficiary may keep a record of the monthly payments made to her and by calculating 25 percent thereof determine the precise amount of interest withheld, our experience indicates that in the great majority of instances the company will be consulted for the precise figures. The company will thereupon examine its records and furnish in detail the amounts and dates of payment of the interest, the amounts and dates of withholding, the amounts and dates when the tax has been paid to the collector, the place of such payment, the character of the tax, the amount for which refund may be claimed and other details required for the completion of the customary refund form.

We do not anticipate that the company will prepare the refund claim but will probably be required to explain the legal basis upon which it may be made. We have also assumed that only normal and customary expenses will be incurred even though in many instances the payees will be minors with consequential guardian representation.

Assuming sufficient knowledge and acumen on the part of the beneficiary to transpose this information to the required form and to complete, execute and file it in proper fashion, the next operation involves action by the Government.

Since no details of the tax paid in respect to a given contract would be available to the collector of internal revenue from any other source, in order to form a basis for the correctness of the refund, he would perforce communicate with the life insurance company for confirmation of the tax withheld. Again, the life insurance company would be required to furnish the details in authentication of the refund claim. It is to be noted that we have made no estimate of the cost to the Treasury Department of processing such claims. It is a governmental expense in respect of which we assume cost estimates are available.

To what extent these claims would require an increase in the staff of a life insurance company is problematical at this time. We can be sure, however, that it would require the attention of competent clerks and could not be left to a mere routine procedure without adequate supervision.

The procedures herein outlined are minimum only and do not relate to any involved circumstances. Further, they assume that no misunderstanding or difficulties will ensue which would require additional correspondence either with the beneficiary or the collector's office.

I regret that this survey had not been completed at the time of my testimony but appreciate your willingness to permit me to add it to the record in this fashion.

Cordially and respectfully yours,

JOHN J. MAGOVERN, Jr.,
Counsel.

The CHAIRMAN. Now, the House did exempt interest paid by the savings banks and other banks, did it not?

Mr. MAGOVERN. Yes, sir.

The CHAIRMAN. The House bill also exempted interest on savings bonds collected by the banks.

Mr. MAGOVERN. Yes, sir.

The CHAIRMAN. Why is it not entirely logical and consistent that if the widow, in place of taking the full amount of insurance, simply goes up and says to the company, "I wish to take this in monthly payments." Would not that be the same principle there? Why, if the others are exempt, should not the exemption be extended to that other situation?

Mr. MAGOVERN. I am in hearty accord, Senator. I think the arguments for it are most persuasive.

The CHAIRMAN. It looks like it would be logical if you are going to relieve the other types of interest from the withholding.

Mr. MAGOVERN. Well, when we come to policy proceeds we are dealing in large measure with dependents of decedents—widows, and often their minor children.

Now, in the case of bank accounts, people are living, they are dealing with the bank. You do not have the complications that you have here.

The CHAIRMAN. You may go ahead. I do not know that you dealt with it, but it just occurred to me that the House action finally taken when they eliminated certain of these interests from the withholding provision, would logically apply in a case that you are now talking to us about, policy proceeds under an agreement to pay interest.

Mr. MAGOVERN. I will proceed, Senator.

The CHAIRMAN. Yes, sir.

Mr. MAGOVERN. In connection with the changing of the possibility of the terms of these agreements, we are convinced that there will be real disappointment and dissatisfaction on the part of the beneficiaries when they realize the difficulties in procedures that they would have to go through in order to clarify their records or claim a refund in given cases.

Under the terms of many of these agreements it would not be possible legally to increase the benefit payments. Disappointment and dissatisfaction on the part of these beneficiaries would be bound to result. And while H. R. 4473 does not contemplate accounting to each individual payee, withholding will require explanations to our policyholders and beneficiaries in thousands of instances.

It was undoubtedly some of these considerations which influenced the Ways and Means Committee to exempt interest paid by savings banks and other savings agencies from the withholding requirement. The same and additional considerations exist in the case of interest payments by life-insurance companies and we therefore believe that the reasons for a similar exemption for such payments are even more persuasive.

We have the other broad situation of life-insurance companies as payees.

The purpose of withholding of tax at source is to secure tax revenue from individuals which otherwise would escape collection. A withholding provision is not necessary to assure the collection of corporate taxes. This is recognized by the terms of the bill and the report of

the House Ways and Means Committee. Thus, where certain dividends and interests are paid to corporations only, the bill exempts them from withholding.

I suggest you see section 1202 of the bill, and it is to be found on pages 36 and 37.

In referring to these payments, the Ways and Means Committee reported that they are exempted because they are received entirely by corporations.

The proposed withholding from dividends and interest paid to corporations is premised upon the desire to avoid procedural difficulties and expense in the case of payers. While we are in sympathy with this purpose we suggest that consideration should also be given to the effect of the proposal on corporations such as life-insurance companies.

This bill in effect would require life-insurance companies to pay their income tax in advance of the March 15 due date, and also would destroy for them the privilege of paying their tax in quarterly installments following that due date. This discrimination arises because such a large amount of the taxable income of a life-insurance company would be subject to the 20-percent withholding.

Senator KERR. You refer to the taxable income of the life-insurance company. Is your company a corporation or a mutual company?

Mr. MAGOVERN. We are a mutual life-insurance company, sir.

Senator KERR. What income do you have that is taxable?

Mr. MAGOVERN. I have total—I have total income——

Senator KERR. Altogether.

Mr. MAGOVERN (continuing). Altogether of $41 million plus.

Senator KERR. Per year?

Mr. MAGOVERN. Yes, sir. There is a tax-exempt income which, taking that out, brings it down to $40 million.

Senator KERR. That means that a million of your 41 million is subject to tax?

Mr. MAGOVERN. No, sir. Getting down to the actual net interest, we take out the wholly exempt income payable to life-insurance companies, that is, interest on bonds, such as political subdivisions and the like, and that runs about a million, which leaves this balance of $40 million.

The point I make is that we must exclude by far the greater part of this because it is required by law to be added to the policyholder's reserves. Nevertheless, under this bill, 58 percent, 58.7, as a matter of fact, of the investment income of my company would be subject to withholding—that is gross.

Senator KERR. Of the tax of your company? Of the income——

Mr. MAGOVERN. Of the gross, I am sorry, sir——

Senator KERR. Of the total income.

Mr. MAGOVERN. Yes, sir.

Senator KERR. Let me see if I understand you. Your company has an income of $41 million a year?

Mr. MAGOVERN. That is gross.

Senator KERR. Do you have a break-down of that?

Mr. MAGOVERN. A break-down in what respect?

Senator KERR. I mean, is that your premium income?

Mr. MAGOVERN. No; that is investment income, sir.

Senator KERR. $41 million investment income. How much taxes do you pay on that?

Mr. MAGOVERN. It is estimated——

Senator KERR. No; at this time, now.

Mr. MAGOVERN. About $2 million, sir.

Senator KERR. About $2 million; and in what form tax is that?

Mr. MAGOVERN. That is the Federal income tax.

Senator KERR. You pay $2 million Federal income tax. What is your tax rate to the Federal Government?

Mr. MAGOVERN. The tax rate to the Federal Government, sir, on a life insurance company's taxable income as defined in the code is the same as applicable to other corporations.

Senator KERR. Well, what do you apply it to?

Mr. MAGOVERN. You apply it to the net taxable income. It is a complicated formula, and I cannot recall what the rates are at the moment.

Senator KERR. Well, now, whose money is that? Do you get $41 million of investment income, and pay $2 million in Federal taxes—do you pay any State taxes?

Mr. MAGOVERN. Yes, indeed, sir.

Senator KERR. How much?

Mr. MAGOVERN. We pay State taxes on the premium income.

Senator KERR. I am talking about this $41 million.

Mr. MAGOVERN. In some States we pay, but it is minor, it is small.

Senator KERR. Well, that leaves you about $31 million net after taxes—I should say $39 million net after taxes, is that approximately correct?

Mr. MAGOVERN. Approximately, that is correct. Actually a greater portion of that income must first be applied to the reserves that are required by contract.

Senator KERR. Do not get ahead of me; just go along with me.

Mr. MAGOVERN. I am sorry.

Senator KERR. That is net to you after taxes?

Mr. MAGOVERN. Yes, sir.

Senator KERR. Whose money is that?

Mr. MAGOVERN. That is the policyholders', sir.

Senator KERR. The policyholders'?

Mr. MAGOVERN. Yes, sir.

Senator KERR. How much of it does he get that year?

Mr. MAGOVERN. I do not have our figures on the amount that we must credit by law to the reserve, sir.

Senator KERR. How much does the policyholder get, approximately? Does he get 5 percent, 10 percent?

Mr. MAGOVERN. Oh, no. By far the greater portion of it, I would say, except for, perhaps—we might increase our surplus by a million or two million; the balance of it goes into various reserve accounts for the policyholders.

Senator KERR. Does it increase the amount of money that he gets under his policy?

Mr. MAGOVERN. It increases the reserve available in the event he should determine to surrender that; yes, sir. It is also reflected in dividends. It does not increase the face amount of his insurance.

Senator KERR. Here is what I am trying to do. Suggestions have been made that rural cooperatives should be taxed to the extent that

their earnings are not disbursed to the members who own it, and I was wondering if there was any possible similarity between a mutual life insurance company and a cooperative.

Mr. MAGOVERN. Well, I am not prepared to talk on the company income tax. There will be a hearing on that subject next week.

There is very definitely a distinction, sir. The life insurance industry and business is a long-range business to meet a contractual commitment at an unknown event, usually far distant. When you speak of disbursement and distribution, that distribution does not occur until some time in the future.

Senator KERR. Yes.

Mr. MAGOVERN. It is very difficult to relate——

Senator KERR. Did you understand the question I asked?

Mr. MAGOVERN. Perhaps I did not.

Senator KERR. If there was any degree of similarity between the reserves accumulated by a mutual life-insurance company, and the profits retained by rural cooperatives.

Mr. MAGOVERN. I do not know the arrangements under which the rural cooperatives operate, sir, but I would not think so. That is just my own personal opinion on that.

Senator KERR. A mutual life-insurance company continues to become stronger and stronger, does it not?

Mr. MAGOVERN. Its obligations increase with its assets, yes, sir.

Senator KERR. Do its assets increase as rapidly as its obligations?

Mr. MAGOVERN. We hope so, sir, and usually more so.

Senator KERR. And usually more so?

Mr. MAGOVERN. Yes, sir.

Senator KERR. Now, who owns that increment?

Mr. MAGOVERN. That increment is used in a variety of ways.

Senator KERR. I say, who owns it?

Mr. MAGOVERN. The policyholders. I am speaking now of the mutual life-insurance company.

Senator KERR. I am, too. Who owns that increment?

Mr. MAGOVERN. The policyholder.

Senator KERR. In what form does he get it, and when?

Mr. MAGOVERN. He gets it in a variety of ways, sir. He gets it currently by way of a return on his premium.

Senator KERR. Is that what you call a premium dividend?

Mr. MAGOVERN. That is a policy dividend.

Senator KERR. Do you maintain a steadily increasing rate of dividend, or a fairly steady rate of dividend?

Mr. MAGOVERN. Usually a fairly steady rate is the normal usage in a life-insurance policy.

Senator KERR. If the increment has increased, and the dividend return remains the same, that would leave the added increment undisturbed, would it not?

Mr. MAGOVERN. No. Perhaps when I said a normally steady return, I misled you. It varies as to age. But the formula is normally steady. But as the age of the insured advances, there is a normal increase in the amount, because of the mortality factor that goes into the dividend to the policyholder.

Senator KERR. But the over-all assets on a proportionate basis continue to grow at a faster rate than the over-all liabilities?

Mr. MAGOVERN. I think that is a factual statement, generally, Senator.

Senator KERR. Does the insurance company pay any tax currently on that annual increase?

Mr. MAGOVERN. That annual increase, as I say, is used——

Senator KERR. I thought you said it was owned by the policyholder?

Mr. MAGOVERN. Yes, sir, and it is used for him in a variety of ways.

Senator KERR. You keep it for his account, do you not?

Mr. MAGOVERN. Not necessarily.

Senator KERR. If he does not have it, you still have it, do you not?

Mr. MAGOVERN. Yes. One, it is used in a reduction of his premium. That is in effect cash to him, a return of his former premium.

Senator KERR. But in spite of the amount that you increase the premium dividend—and that is what you refer to when you say that increases the cash in the premium——

Mr. MAGOVERN. Yes, sir.

Senator KERR. In spite of that, your assets continue to increase proportionately at a greater rate than the liabilities?

Mr. MAGOVERN. Yes, sir. And we increase the surplus and the contingency funds.

Senator KERR. I asked you if you pay any taxes on that proportionate increase.

Mr. MAGOVERN. That is one of the bases of our Federal income tax, sir, that investment income over and above our statutory reserve requirements.

Senator KERR. What rate of Federal taxation do you pay on that increase?

Mr. MAGOVERN. I am sorry, I do not know.

Senator KERR. Is it the rate that is paid by a corporation that is not an insurance company?

Mr. MAGOVERN. The rate? I am not prepared to speak on the tax rates affecting life-insurance companies.

Senator KERR. You do not know what the rates are?

Mr. MAGOVERN. My recollection is that their rates are the same as for other corporations.

Senator KERR. Did the excess profits tax apply to you?

Mr. MAGOVERN. No life-insurance company incurs any tax, but they are subject to its provisions.

Senator KERR. Does the present combined surtax and normal tax of 47 percent apply to you?

Mr. MAGOVERN. I think so but I am not sure.

Senator KERR. I wonder if you would supply both of us with that information.

Mr. MAGOVERN. Yes, sir, I would be very happy to.

Senator KERR. Fine.

Mr. MAGOVERN. I can speak generally, but I am not prepared on figures here today for the company income tax.

Senator KERR. I do not know how you can give detailed information that consists of figures only, and do so generally.

The CHAIRMAN. Senator Kerr, we have the tax formula as applied to the insurance companies assigned especially for hearing before this committee on the 17th. We will go into this at that time.

Senator KERR. I understood, Mr. Chairman, that this gentleman was the chairman of the Joint Committee of the American Life Convention and the Life Insurance Associations of America.

The CHAIRMAN. Evidently he is, but he is talking on another point.

Mr. MAGOVERN. I have limited myself as chairman of the withholding committee dealing with the problem of this withholding on——

The CHAIRMAN. But we will have to go into this, because the tax formula applied to insurance companies is listed for particular consideration on the 17th.

Senator WILLIAMS. Mr. Chairman, to get the record straight, is it not a fact that the insurance companies are not paying any tax as of this time, unless we incorporate something in this bill?

The CHAIRMAN. Yes, they are paying tax.

Mr. MAGOVERN. Yes.

Senator WILLIAMS. Has that not expired?

Mr. MAGOVERN. The stop-gap legislation.

Senator MILLIKIN. There was a period of time, Senator Williams, when some of the companies did not pay any taxes by reason of the formula that Senator George is referring to.

The CHAIRMAN. Yes.

Senator MILLIKIN. And because of that fact, we are now reconsidering the formula, and to redress that situation, proposals were made that we tax insurance companies retroactively.

Senator WILLIAMS. But I say, that formula has to be revised in order to get them under at all, which would be the discussion on the 17th.

The CHAIRMAN. Yes. That goes out this year, I believe.

Senator MILLIKIN. Regardless of the theory of the subject, is there not a somewhat basic difference in operation between a mutual life insurance company and a cooperative? You have to operate according to a very complicated contract which you have in each case with a stockholder. You have to operate in accordance with very complicated formulas which are imposed upon you by the States in which you operate. Therefore, you have a smaller field of discretion as to how you will operate than perhaps a cooperative might have which does not have the same type of complicated contract with each of its members, the directors or trustees of which have greater leeway in how they would handle their business than an insurance company might have.

Could you conceive of that as a possible distinction between a mutual life-insurance company and a cooperative?

Mr. MAGOVERN. I think there is no doubt about it, Senator. The difference is, between a long-term contractual liability in the case of a life-insurance company, and the other is a cooperative enterprise for profit. We are bound by our contracts and our liabilities that we must meet, we just have to meet.

Senator MILLIKIN. A cooperative might have guides, and might in real substance not be an organization for profit, but certainly most cooperatives that I am familiar with would have a whole lot more leeway in how they want to conduct their business than a mutual life-insurance company has.

Mr. MAGOVERN. I think that is true, sir.

Senator MILLIKIN. I do not know of any cooperative that has a complicated contract that a mutual life-insurance company has with each of its policy holders, nor do I know of any cooperative that is subject to the State direction of its affairs, which is the case with a mutual life-insurance company. I think you can build up quite a few distinctions.

Mr. MAGOVERN. I think that is true. I had not anticipated that I would have to talk on the company income tax. The representatives of the industry will be here, I understand, next week, Senator.

The CHAIRMAN. They will be here.

Mr. MAGOVERN. And they will have all the figures and all that material available then.

The CHAIRMAN. Yes.

You may proceed.

Senator MILLIKIN. Mr. Chairman, I would like to make note of one fact that does not apply to cooperatives, but does apply to mutual life-insurance companies.

Under the State laws under which you operate, you are compelled to set up reserves, which is quite a different proposition from the leeway which I imagine is available to the manager of a cooperative.

Mr. MAGOVERN. Yes, sir.

One of the essential functions of the life-insurance business is the prompt investment and reinvestment of its funds as soon as received. Life-insurance companies are unlike most other corporations in that their income is derived entirely from the investment of policyholder funds. Withholding 20 percent on interest and dividends delays the reinvestment of a large part of their income. The delay in reinvesting these funds will average over 9 months and the resulting loss of income on policyholders' funds would be substantial. This loss would add to the cost of the policyholders' protection.

In view of these considerations, we submit that payments made or received by life-insurance companies should be exempted from the withholding provisions of H. R. 4473, and we respectfully urge that section 201 of the bill be amended in the following respects:

1. That paragraph (3) of the subsection (b) of the proposed new section 1200, lines 11 to 13 on page 34, be deleted.

2. That a new paragraph be added to the proposed new section 1202 at the foot of page 38, which would exempt amounts paid or credited by or to a life-insurance company.

The CHAIRMAN. Are there further questions?

Senator TAFT. If you are going to be exempt, why not others? Take the endowment fund of Yale University, which produces something like $3 million a year. I do not know how much comes from dividends or other sources. But if they are deprived of $600,000 a year, that makes a very substantial income to them, does it not?

Mr. MAGOVERN. I am in sympathy with their problem, Senator. I am appearing here for the life-insurance companies, though, and I do not feel free to speak for Yale University.

Senator TAFT. I only pointed to them as an example. But there are many other institutions in the same shape as the life-insurance companies in that respect If we are asked to make an exemption for one, I do not see any stronger argument for the life-insurance companies than for a good many other people.

The same principle applies to the individual, of course. To him it is a much smaller figure, but still——

Mr. MAGOVERN. I can only stress that we have, of course, the contractual responsibility of investing. If we cannot meet our contractual obligations, then we are in serious difficulties, and those are required investments. We have to get the return.

The CHAIRMAN. Thank you very much, Mr. Magovern.
Mr. MAGOVERN. Thank you very much.
The CHAIRMAN. Mr. Dougherty.
Will you identify yourself for the record?

STATEMENT OF CHARLES G. DOUGHERTY, SECOND VICE PRESIDENT, METROPOLITAN LIFE INSURANCE CO.

Mr. DOUGHERTY. Mr Chairman and gentlemen of the committee, my name is Charles G. Dougherty. I am the second vice president of the Metropolitan Life Insurance Co., and I am appearing as a representative of that company, a mutual corporation organized under the laws of the State of New York.

I should like to say, Mr Chairman, that I am not prepared to discuss the matter of the life-insurance company income taxes. Furthermore I understand that subject has been scheduled for next Tuesday.

I have asked for an opportunity to be heard because of the effect that the proposed withholding requirements, which would be added to the Internal Revenue Code by section 201 of H. R. 4473, would have upon the policyholders and beneficiaries, not only of Metropolitan, but those of all other life-insurance companies as well.

New section 1201 requires a 20 percent withholding in the case of certain dividend and interest payments. New section 1200 includes in the definition of interest, "interest on amounts held by an insurance company under an agreement to pay interest thereon." In addition to the effect these provisions would have upon payments to policyholders and beneficiaries, there is the added effect of withholding from interest and dividends paid to the companies. I should like to discuss these matters in that order.

The two major types of interest payments to policyholders and beneficiaries that would be affected are (1) interest on proceeds of life-insurance policies left with and held by the company after maturity under an agreement to pay interest thereon periodically, and (2) interest on policy dividends left with the company to accumulate to the credit of the policy. In the following discussion the figures I shall give will be those for Metropolitan ordinary policies only, and do not include payments under the smaller industrial life-insurance policies because the effect in that area is negligible.

I wish first to discuss interest on policy proceeds held under agreement to pay interest.

At the present time Metropolitan has outstanding in the United States approximately 135,000 such contracts which became effective upon maturity of life-insurance policies. The policyholder or beneficiary may elect to have such interest payments made either monthly, quarterly, semiannually, or annually. The total interest payments made each year under such contracts averages about $80 each. Thus the average amount withheld each year would be about $16.

Senator MILLIKIN. The policyholder also has the option, does he not, to take the full face value of his policy when it matures, rather than to go to the interest arrangement?

Mr. DOUGHERTY. Yes, sir. This is when he elects to leave the policy proceeds under an agreement by which we pay him or his beneficiary interest.

The CHAIRMAN. In effect, you simply become a savings bank for that account?

Mr. DOUGHERTY. There is a similarity, Senator.

The CHAIRMAN. There is much similarity, but it does not follow all the way through, of course.

Mr. DOUGHERTY. From these figures it is apparent that the average Metropolitan payee under such contracts is a person of very limited means. This, is further demonstrated by the fact that the average amount of insurance in force per ordinary policy was, at the end of 1950, $1,919. Many of these payees receiving the larger payments, who are principally widows, surviving children and aged persons, are dependent in part at least upon these periodic payments for their support and maintenance. To require the company to withhold one-fifth of each payment would create real hardship in a great number of cases. While there is no precise way of determining just how many of these people are free from income tax, I believe it is fair to say, based upon the foregoing figures, that many if not most of them are exempt. Withholding would not only mean that they would be deprived of funds withheld for periods ranging from a few months to more than a year, but also that in many cases they would lose this money completely because of their lack of familiarity with tax and refunding procedures.

Here, Mr. Chairman, I am coming to a point that you raised during Mr. Magovern's testimony.

It would seem that these people, who are recipients of such modest interest payments, should not be placed in any more disadvantageous position than those who have deposited their funds in banks. According to the public press, there was some thought originally that interest on bank deposits should also be subject to withholding. However, the House Ways and Means Committee very wisely excluded it before the bill was reported. I suggest that interest paid by life-insurance companies should be given the same treatment.

As a matter of fact, because of the difference between bank deposits and life-insurance funds, there are even stronger reasons for excluding the latter. For a large part, bank depositors are people who are accustomed to dealing with bank accounts and interest payments. With these life-insurance funds, however, the situation is different. As I have pointed out, many of the recipients of such interest payments are widows and children for whom some benefits have been provided by means of insurance. They are not accustomed to dealing with such matters, and not so well able to take care of themselves. Suppose that, by means of life insurance interest option, a man has left his widow, who has two minor children to look after, an income of $2,000 per year. This would mean a lot to her, and yet it would clearly be tax-exempt. If $400, that is, 20 percent, of this interest is withheld hardship would result. In many such cases there would be no way for the widow to supplement the income. The Government is continually being asked to appropriate funds to help support dependents who find themselves without any adequate means of support when the breadwinner dies. It would seem unwise to impose obstacles in the cases of those people who are at least trying to do something for themselves and their dependents.

It is submitted that interest on policy proceeds should not be subject to withholding.

The expense of administering the proposed program is not to be overlooked, but I shall undertake to cover that matter as a whole later in this statement.

The CHAIRMAN. The House toward the end of its work on this bill, did make an amendment such as you have described as having been reported in the press, and in the report on the bill they say:

The interest-withholding provisions do not apply to interest on Government bonds or to interest on bank deposits. The dividend-withholding provisions do not apply to the ordinary type of patronage dividends of cooperatives, or dividends or interest on deposits paid by mutual savings banks, building and loan associations, and credit unions.

Logically, I do not see why they do not exempt also the interest paid by insurance companies on the amount of the policy when it is left under the option, and take it in installment payments. It would seem that they would stand on the same footing in that respect, certainly.

Mr. DOUGHERTY. I am in 100-percent agreement with that, Senator George.

The CHAIRMAN. I do not know whether the other members of the committee will take that view of it. However, I am just making that suggestion. I cannot see any logical distinction between them.

You may proceed.

Mr. DOUGHERTY. Yes, sir.

With respect to interest on dividends left with the company, dividends are now being accumulated at interest on approximately 1,300,000 Metropolitan policies. The amount of interest credited each year averages about $1.90 per policy. If such interest is considered paid when credited, as indicated on page 84 of the Ways and Means Committee report, the average annual withholding thereon would be about 38 cents. Here again, just as in the case of withholding from interest paid on policy proceeds left with the company, to withhold would mean that many of these policyholders would lose this money entirely because of their lack of knowledge of refunding procedures. Also what has been said about the desirability of according equal treatment to those who save through insurance and those who have by means of bank deposits applies here with equal force.

Senator MILLIKIN. The cost of a single exchange of correspondence is almost equal to 38 cents.

Mr. DOUGHERTY. Senator Millikin, our estimate on that is that it would cost the company about 30 cents to deduct and pay to the Government 38 cents. That includes, of course, all of the clerical work, the calculations, and so forth.

Senator MILLIKIN. I am very glad to have that estimate.

Mr. DOUGHERTY. I might add, sir, that in a good many instances, I believe the cost would exceed the amount actually withheld, because here we are speaking of averages.

Senator MILLIKIN. You have the additional cost of the policyholder writing for refunds.

Mr. DOUGHERTY. Yes, sir; that is true.

There is another important consideration which should not be overlooked. These dividend accumulations, including the interest credited thereon, stand to the credit of the policy and can be used in a number of ways. They can be withdrawn in cash or used to pay premiums. If not so used, they will be added to the maturity benefit, or,

in the event of lapse, may have a very definite effect upon the nonforfeiture benefits available. Under most of our policies, if these accumulations are reduced by withholding, then, on lapse, the amount of paid-up insurance will be less, or the term of extended insurance will be shorter. In the latter case this may result in the complete loss of the death benefit which otherwise would be payable.

It is submitted that in the light of these practical considerations, interest credited to policy dividend accounts should be free from withholding.

I should next like to discuss the administration of the proposed program.

From the figures which I have quoted, it is obvious that the administration of the proposed withholding program with respect to interest payments by life-insurance companies would be expensive, both to the companies and to the Government. In Metropolitan alone, at least 1,435,000 small accounts, not including industrial policies, are involved In one category they involve annual interest payments of about $80, and in the other, average annual interest credits of about $1.90.

Many of the people involved do not pay income taxes because their incomes are comparatively small—less than their exemptions and deductions. In such cases, the Internal Revenue Bureau would be required to process many refund claims for small amounts.

Under the bill, it is true that an effort has been made to simplify the withholding and reporting procedures, and to hold the expense of the withholding agent to a minimum. Although this procedure simplifies the method of computing the amount to be withheld and paid over to the Government, it does not overcome the difficulties and misunderstandings which withholding would create as between the company and its policyholders and beneficiaries. These, generally speaking, are not people who are accustomed to dealing with stock dividends and bond interest. By and large, they are people of very moderate means. They will want to know, and should know, why their modest interest income, upon which so many of them are dependent, is not as much as they expected. Aside from the inescapable expense—and we estimate that for Metropolitan at $350,000 the first year and $125,000 annually thereafter on the present volume—of handling more than a million small accounts, this will inevitably lead to numerous inquiries and explanations, entailing a great amount of correspondence. There is no way to estimate, with any degree of accuracy, what the ultimate expense will be, but it will be considerable.

Senator MILLIKIN. You have a three-sided expenditure: You have your expense, the policyholder has his, and the Government has its.

Mr. DOUGHERTY. Exactly, sir.

Senator MILLIKIN. It would be very interesting to know what the total of all those would be in relation to all these small policies.

Mr. DOUGHERTY. I am inclined to believe, Senator, that there would be no way of estimating the ultimate total with any degree of accuracy, but I do feel that it would be great. The estimates that I have given in the statement, which are the only ones that I am in a position to give, is what I think it would cost the Metropolitan to install a system, and to operate that system.

Metropolitan being a mutual company, this added expense must of necessity be reflected in the cost of insurance to policyholders.

It is submitted that such additional expense to the Government and to the companies is not justified and is all out of proportion to the amounts involved.

Fourth, and last, I should like to discuss withholding at the source from the company's investment income.

Application of the withholding principle to payments made by others to life insurance companies would create further problems.

One of the functions of every life insurance company is to invest and reinvest its funds in order to produce income to maintain its policy reserves at an adequate level and to keep the cost of insurance to its policyholders as low as possible. Interest income from investments is promptly reinvested, and in turn earns interest. In 1950, Metropolitan received approximately $140,000,000 of interest on bonds and dividends on stock, exclusive of interest on Government bonds. On 20 percent of this amount, or $28,000,000, Metropolitan would lose interest for an average of at least 9 months each year. If interest on this amount is calculated at 3 percent, it would cost Metropolitan $630,000 a year.

Senator MILLIKIN. That is another way of saying that it would cost the policyholders that much.

Mr. DOUGHERTY. Yes, sir. This loss, of course, would be reflected in the ultimate cost of insurance to its policyholders.

The purpose of withholding at source is to prevent individual taxpayers from escaping legitimate tax liabilities. To attain this end it is hardly necessary to invoke such withholding requirements in the case of payments of dividends and interest to corporations. This is recognized in a number of instances in the report of the House Ways and Means Committee, where the reason for excluding certain types of dividends and interest from withholding is stated as, "because such dividends are received entirely by corporations," at page 19, and "since securities of this type are ordinarily held by corporations," at page 20. The apparent reason for requiring withholding from types of corporate income not specifically excluded is the belief that it eases the burden of the payor corporation in that it is not required to differentiate between payments to individuals and payments to corporations. While this reason undoubtedly has merit, nevertheless, in trying to simplify the procedure for the payor corporation, a burden has been imposed, perhaps unintentionally, upon others. It does not seem proper that the policyholders of Metropolitan should be so penalized to the extent of $630,000 a year.

Since the purpose of withholding is to prevent the loss of revenue in the case of individual taxpayers, there is a serious question as to whether it should be applied at all to income received by corporations. If, under the circumstances, the committee should decide to exclude corporate income from the withholding provisions, such action would take care of this phase of our problem. However, if this is not deemed feasible, we feel it is highly important that payments to life-insurance companies be excluded. This would be entirely justified because life-insurance companies are required to file annually detailed sworn statements which show all items of income and disbursements, and these statements are reviewed by public officials. Consequently, there is no need for withholding with respect to the income of such companies.

Senator MILLIKIN. With respect to municipal bonds that you have in your portfolio, do you think that they would have a legal right to

compel a municipality to maintain a withholding system for the benefit of the Federal Government?

Mr. DOUGHERTY. Senator, I would like to answer that question, but I honestly do not know the answer.

Senator MILLIKIN. It raises questions.

Mr. DOUGHERTY. It raises a very interesting question.

So, in conclusion, the picture we have is that in one company alone, based on present volume, the proposed withholding program would cost the policyholders almost $1 million the first year, and over $750,000 annually thereafter. This expense will grow as volume increases. It is submitted that neither this expense nor the expense to the Government would be justified.

The CHAIRMAN. Are there any questions?

Senator FLANDERS. Mr. Chairman?

The CHAIRMAN. Senator Flanders.

Senator FLANDERS. The thought has occurred to me, in remembering the testimony of the Treasury witnesses with regard to this, and the sampling program which they have on returns in general, whether it might not meet their purposes to some extent, at least, to find out what there is in this situation by asking from your company and others contributions to the sampling process, instead of withholding, not requiring you to report completely to them all these interest credits and the rest of it, but taking a small section of them, and reporting from time to time as they might ask, and then let them follow through with their own records.

I presume that your policies in general average smaller than some other companies do, do they not?

Mr. DOUGHERTY. That is true, Senator.

Senator FLANDERS. You specialize, I remember, in industrial insurance.

Mr. DOUGHERTY. Yes; we sell industrial life insurance.

Senator FLANDERS. Are those included?

Mr. DOUGHERTY. As I stated, I have excluded in the figures that I have given here, the industrial life-insurance policies. They are for smaller amounts.

Senator FLANDERS. Yes.

Mr. DOUGHERTY. The average amount of insurance in force at the end of last year, on our ordinary policies—they are the larger ones—was $1,919; and the average face amount of the ordinary policies issued was somewhere in the neighborhood of $2,700.

Senator FLANDERS. Can you see any possibility of cooperating with the Treasury on a sampling basis, in reporting, and not of withholding?

Mr. DOUGHERTY. I am not familiar with the sampling process which you refer to, but my company is always willing to cooperate in any reasonable way, and I am sure that we would make available whatever information would be required. As a matter of fact, we are now required, as I recall it, to report on items such as we have been discussing that exceed $600 per year. We do that now, sir.

Senator FLANDERS. Yes.

Mr. DOUGHERTY. If you would want to consider reducing that dividing line of $600 somewhat, we would be prepared to cooperate.

Senator FLANDERS. Based on the average size of your policies, it seems rather ridiculous to expect that they would turn up many unaccounted for taxable incomes through that process. I am rather astonished, frankly, at the small average size of your policies.

Mr. DOUGHERTY. Sir, we have so many policyholders who are vitally interested in this, and our figures appeared to be so surprising to many people that we felt that on behalf of those policyholders, we should make an independent statement and lay the facts and figures before you.

Senator MILLIKIN. Mr. Chairman, I should like to say to Senator Flanders that the suggestion of sampling has been made to the Treasury on several occasions, and they have never made the kind of approach to it that the distinguished Senator has in mind. So the cooperation has been, up to the present, an entirely one-sided cooperation.

The CHAIRMAN. In the House bill, you will find this provision. I am reading from the report:

> It is provided, therefore, that in lieu of such an exemption, these organizations will be permitted to use the amount withheld with respect to dividends, interest, and royalties received by them as a credit against the amount due from such organization under the income and payroll taxes. A claim for this credit will be made under regulations at the time of the filing of the returns for the purpose of these taxes. In addition, tax-exempt organizations may claim refunds quarterly for the excess of the amount withheld on dividends, interest, and royalties received over the amount of the income and payroll taxes due.

Even if life-insurance companies were given that privilege, it would be of considerable help, would it not?

Mr. DOUGHERTY. That would be of some help, Senator George.

The CHAIRMAN. It would save you from remitting to the Government.

Mr. DOUGHERTY. That would be of some help, sir, but it would not solve our problem.

The CHAIRMAN. No. I can see it would not, but it would be of some help, and it would save you some expense.

Are there any further questions?

If not, thank you very much.

Mr. DOUGHERTY. Mr. Chairman and gentlemen, thank you for your attention and consideration.

The CHAIRMAN. Thank you, sir; we were very glad to have you here.

Mr. DOUGHERTY. Thank you.

The CHAIRMAN. Mr. Satterthwaite, will you please identify yourself?

STATEMENT OF WILLIS H. SATTERTHWAITE, COUNSEL, THE PENN MUTUAL LIFE INSURANCE CO.

Mr. SATTERTHWAITE. I am Willis H. Satterthwaite, counsel for the Penn Mutual Life Insurance Co., of Philadelphia.

Mr. Chairman, since what my statement covers has been covered in the other two statements, I would be happy just to file this statement with you.

The CHAIRMAN. We shall be glad to have you do so, sir.

You are addressing yourself to the withholding provisions; is that right?

Mr. SATTERTHWAITE. To the withholding provisions, yes, Mr. Chairman.

I would like to point out that we have a particular interest in withholding as it affects dividend accumulations. Since our company has made an effort to encourage dividend accumulations, we have

588,000 such accounts. The average principal in those accounts is $144.

Senator KERR. Let me ask you this question. In most of these cases where you have these retained amounts, does not the owner of that have the right to take it out in cash at any time he wants to?

Mr. SATTERTHWAITE. He does.

Senator KERR. Then, if he finds himself in a situation where 20 percent of the interest that you paid is being withheld, and the savings bank across the street is in a different situation with respect to the depositors there, and it would not be withheld, might there be a decided persuation on that fellow to take it out of your custody and put it into that of another place where he could get better treatment?

Mr. SATTERTHWAITE. To answer that frankly, I would guess not, because of the fact that these dividend accumulations have very valuable rights attached to them. He is encouraged to use them, for example, to accelerate the maturity of his policy, as an endowment.

Senator KERR. I was speaking primarily with reference to the proceeds of a policy where the insured had died, and had left the account with the insurance company.

Mr. SATTERTHWAITE. Sir, I was talking about our dividend accumulation accounts. In the other case, it might well be so.

The CHAIRMAN. Your whole statement will go in the record.

Mr. SATTERTHWAITE. Thank you very much.

(The statement referred to is as follows:)

STATEMENT OF WILLIS H. SATTERTHWAITE, COUNSEL, THE PENN MUTUAL LIFE INSURANCE CO.

My name is Willis H. Satterthwaite. I am counsel of the Penn Mutual Life Insurance Co., Philadelphia, a wholly mutual company with approximately $2.9 billion of insurance in force and assets of approximately $1.3 billion.

We have asked for an opportunity to present to your committee our views on the withholding at source requirement which would be imposed by section 201 of H. R. 4473 because of our concern over the expense which this will involve, its effect on the rights of our policyholders under their policies, and the loss which will result to our company from imposition of the withholding requirement upon interest and dividend payments due the company.

WITHHOLDING ON AMOUNTS PAYABLE BY LIFE INSURANCE COMPANIES

The new sections 1200 and 1201, which the bill would add to the Internal Revenue Code, provide for the withholding of a tax equal to 20 percent of certain interest payments and make this requirement specifically applicable to "interest on amounts held by an insurance company under an agreement to pay interest thereon."

AFFECTS OVER 600,000 ACCOUNTS—MOSTLY FOR SMALL AMOUNTS

This is of great practical concern to our company because of the large number of interest-bearing accounts to which this would apply, as indicated by the fact that at the end of 1950 the Penn Mutual had approximately 604,000 such accounts, and the number is increasing. The great bulk of these, 588,000, were dividend accumulation accounts. The balance respresent policy proceeds held at interest.

DIVIDEND ACCUMULATIONS AS SAVINGS ACCOUNTS

With these large numbers of accounts (and accounts mean people) to consider, it can easily be seen that we have more than an academic interest in the effect which the adoption of this new withholding proposal would have. Our concern is heightened by the fact that the Penn Mutual has long followed a policy of encouragement to policyholders to increase the use of their life-insurance contracts as a medium for saving for the future by allowing the so-called dividends under their policies to remain with the company to accumulate at interest. These divi-

dends are in relatively small amounts. They may be received by the policyholder in cash or they may be applied under other dividend options—including a privilege to leave the dividend with the company to accumulate at interest until maturity or surrender of the policy. It is this privilege or a similar policy provision which has been responsibile for the very large number of interest-bearing accounts which would be subjected to the withholding provision.

Dividends which are left with the company to accumulate at interest are subject to withdrawal by the policyholder before maturity of the policy. If not so withdrawn, however, the dividend accumulations are, upon maturity of the policy, merged with the policy proceeds and paid to the beneficiary. They may be applied to accelerate maturity of the policy (under a policy provision to use the accumulations to mature the policy as an endowment), or they may be applied to relieve the policyholder of the responsibility for further premium payment. While the emphasis is upon the use of dividend accumulations for these purposes, these accounts are in effect savings accounts, although undoubtedly smaller than the average savings-bank account, and although the exercise of the privilege of withdrawal involves (as I will explain in a moment) the relinquishing of the right to restore the status which existed before the withdrawal—a right which does not have to be given up when a withdrawal is made from a savings account.

EXPENSE AND DIFFICULTY IN ADMINISTERING WITHHOLDING FOR LARGE NUMBERS OF ACCOUNTS FOR SMALL AMOUNTS

Despite the fact that the withholding provisions have been designed to keep to a minimum the expense which they entail for the payor of the interest, it is inevitable that a company with so many accounts as ours will be faced not only with the direct expense of the withholding transaction itself, but the not inconsiderable expense which is involved in the handling of correspondence and explanations with policyholders which follows any transaction affecting their policy contracts. At the same time only small amounts of tax will be involved. This is illustrated by the fact that an interest credit at the rate of 3 percent on a dividend accumulation of $144 (the average at the end of 1950) would be only $4.32 per year. The 20 percent withholding provision would require the withholding from this of a tax of only 86 cents.

The average account for policy proceeds held at interest is larger and the withholding would consequently be greater, but it should be remembered that these accounts represent the use of a policy option designed primarily for beneficiaries after maturity of the policy, and that many of these beneficiaries will probably be so situated that their exemptions will exceed their taxable income.

ADVERSE EFFECT ON POLICYHOLDERS' OR BENEFICIARIES' RIGHTS

From the policyholder's viewpoint, there is a further reason for such an exemption, and this is the effect which the withholding requirement could have upon the valuable dividend option privilege to which I have referred. As I have said, policyholders are encouraged to accumulate their dividends, and they have been given various rights with respect to their use.

It might seem that if in any event the policyholder will be subject to tax on the interest addition to his accumulations, it should make little difference if his tax is paid by withholding a portion of the interest, and that he is no worse off than in the case of a withholding from interest due him from any other source. This, however, is not the fact. The important difference is that the amount of his accumulations which otherwise would stand to his credit with the company will be reduced by the amount of tax withheld since this amount, being applied for taxes, of course, cannot be added to the accumulations.

This brake on the rate of increase of the policyholder's savings by means of his dividend accumulations can affect his rights under his policy in a number of ways—and it is this fact which makes the application of the withholding provisions to life-insurance company payments even less appropriate than to savings banks and other savings institutions. For example, it can delay the time when the policy will mature as an accelerated endowment through the operation of an accumulation provision of his policy. It can postpone the date when the accumulations will be adequate for the policyholder to eliminate the requirement for payment of further premiums, and it can reduce the amount which, through such accumulations, may be made payable under an income option of the policy upon its surrender before maturity.

EXPENSE AND DIFFICULTY OF ADMINISTRATION NOT JUSTIFIED

Withholding of the tax from interest which would otherwise be added to dividend accumulations would undoubtedly, in our judgment, result in confusion on the part of our policyholders as to its effect on these rights and administrative expense to the company, not to mention the expense to which the Government would also be subjected. We believe these considerations outweigh any benefit which it is supposed would inure to the Government from withholding on accounts of this type. Furthermore, withholding would affect adversely the rights of the policyholder under his policy provisions to make full use of the interest allowed him on his dividend accumulations.

INSURANCE COMPANIES ENTITLED TO SAME EXEMPTION AS SAVINGS INSTITUTIONS

Since life-insurance companies stand in essentially the same relationship with respect to amounts held by them at interest as do savings institutions as to their depositors, and for the reasons we have indicated, both fundamental and practical, we urge that life-insurance companies likewise be exempt from the requirement that they withhold the tax on interest on amounts held by them.

WITHHOLDING ON AMOUNTS PAYABLE TO LIFE-INSURANCE COMPANIES

We are concerned not only with the expense and difficulties which the application of the withholding provisions to us in our capacity as a debtor entails, but also with the loss which we will suffer as the result of the withholding from dividends and interest payable to the company under its investments.

The proposed extension of the withholding provision is designed as a means for assuring payment of personal income taxes as indicated in the report of the House Ways and Means Committee, which recognizes that there is no need for this to assure the payment of corporate taxes. Through the operation of the withholding provision our company will be called upon to make payment of its tax much sooner than other types of corporations which have little or no taxable income from this source.

We have estimated that over $2.4 million tax would be withheld from payments due our company in 1951 if such provision were now applicable. This would have the effect of depriving the company of the use of funds due it in substantial amounts for protracted periods, making it more difficlut for it to earn the required interest on its reserves and increasing the cost of insurance to its policyholders to the extent that such funds are unavailable for investments which could otherwise be made.

In view of these considerations and since the withholding technique is not required to assure the payment of the income tax by corporations, we urge that payments to life insurance corporations, which derive a much larger part of their income from sources which would be subject to the withholding provisions of this bill than corporations generally, should be exempt from such provisions.

The CHAIRMAN. Mr. Krug.

Will you identify yourself for the record?

STATEMENT OF CHARLES F. KRUG, SECRETARY AND TREASURER, MISSION CORP., ACCOMPANIED BY DAVID S. HECHT, COUNSEL, MISSION CORP.

Mr. KRUG. Mr. Chairman and members of the committee, my name is Charles F. Krug, and I am secretary and treasurer of the Mission Corp.

The gentleman who is accompanying me at the table is Mr. David S. Hecht, counsel for the corporation.

At the outset, I believe it should be stated that Mission Corp. does not object to the withholding tax as such, and any remarks that I shall make are limited to dividends paid in kind, or property dividends.

Mission Corp. at the present time owns about 1,510,036 shares of Skelly Oil Co., constituting approximately 59 percent of the outstanding stock of that company, and 2,414,962 shares of Mission Develop-

ment Co., constituting approximately 49 percent of the outstanding stock of that company.

Mission Development Co. owns about 40 percent of the stock of Tide Water Associated Oil Co. Skelly Oil Co. and Tide Water Associated Oil Co. are integrated operating oil companies.

It has been the practice of the Mission Corp., since the end of 1948, to pay dividends in the form of stock of Mission Development Co. Mission Development Co. was organized by Mission Corp. with the purpose and plan in mind of having Mission Corp. distribute its stock from time to time in the form of taxable dividends.

Senator TAFT. Now, wait a moment. Mission Corp. has individual stockholders?

Mr. KRUG. Yes, Senator. Mission Corp. has approximately 23,000 stockholders.

Senator TAFT. Twenty-three thousand stockholders. And it has been the practice of Mission Corp. to pay dividends to these stockholders in the form of stock of Mission Development Co. Is that gradually reducing their holdings in Mission Development Co.?

Mr. KRUG. That is right. At one time, we held 100 percent of the stock of Mission Development Co., when Mission Development Co. was organized in 1948. We are gradually getting rid of it.

Senator TAFT. So you are gradually getting rid of it, or transferring it to the stockholders of the Mission Corp.?

Mr. KRUG. That is right. There have been four dividends paid in Mission Development Co. stock since 1948.

Senator TAFT. I understand.

Mr. KRUG. Under section 102 of the Internal Revenue Code prohibiting the unlawful accumulation of surplus, it was deemed essential for Mission Corp. to pay substantial taxable dividends in each year. Mission Corp. required its cash earnings for business purposes, and it was therefore, in a position where, in order to meet the requirements of section 102, and pay taxable dividends, such dividends had to be paid in the form of property dividends or dividends in kind. In order to keep intact in one block the stock of Tide Water Associated Oil Co. then owned by Mission Corp. which constituted the basis for control of Tide Water Associated Co. instead of distributing the Tide Water stock directly, Mission Corp. caused Mission Development Co. to be organized and transferred all of the Tide Water Associated Oil Oil Co. stock then owned by Mission Corp. to Mission Development Co. in exchange for the capital stock of the latter corporation and adopted the policy and plan to distribute the shares of Mission Development Co. Thereafter, it transferred further shares of Tide Water Associated Oil Co. stock which it had acquired in the interim to Mission Development Co. for additional shares of Mission Development Co. stock.

When Mission Development Co. was organized, and prior to the initial transfer of shares of Tide Water by Mission Corp. to Mission Development Co. for Mission Development Co. stock, it was necessary to obtain the approval of the Securities and Exchange Commission to the transaction under the Investment Company Act of 1940, inasmuch as Mission Development Co. was a registered investment company within the definition of the mentioned statute and Mission Corp. was an affiliated company. At such time, Mission Corp. was required to state to the Securities and Exchange Commission, and

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did state, that it was its policy and purpose and plan to distribute the stock of Mission Development Co. to its stockholders from time to time. This policy, purpose, and plan was formally adopted at a meeting of the board of directors held in December of 1948. In pursuance of this policy and plan, as announced to the Securities and Exchange Commission, Mission Corp. has, since December of 1948, distributed all of its dividends in the form of taxable distributions of Mission Development Co. stock. It has paid no cash dividends. A summary of the distributions made is as follows:

On December 28, 1948, one-third of a share of Mission Development Co.

On May 2, 1949, one-half of a share of Mission Development Co.

These amounts, I might say, are the fractions of Mission Development Co. paid for each share of Mission Corp. outstanding at the dates recited.

On June 26, 1950, one-half of a share.

The most recent dividend was paid on April 9, 1951, of one-half of a share, being a total of 687,000 shares for the last dividend mentioned.

H. R. 4473 now being considered by your committee provides in section 1201 for the withholding of a tax equal to 20 percent of the amount of each taxable dividend paid by corporations after December 31, 1951. The exemption set forth in section 1202 does not include an exemption for dividends paid in the form of property or kind, such as the Mission Development Co. dividends which are distributed by Mission Corp. This, in the opinion of the corporation I represent, is a very serious deficiency in the proposed tax legislation. It would result in a very serious hardship to the corporation I represent and other corporations which may be in a similar position without any concomitant gain to the Government.

Senator TAFT. After they withheld 20 percent of its shares, would they then have to pay the Government in cash for the value of the shares?

Mr. KRUG. That is our problem, Senator.

Senator TAFT. What does the law provide? You could not pay it by giving the Government the shares.

Mr. KRUG. No. The Government would then be in the stock business, to the extent that it would receive shares.

Senator TAFT. They could not do that. So they would have to pay them in cash. But what amount of cash?

Mr. KRUG. That is another collateral problem.

Mr. HECHT. Senator, if I might answer that question, if there is no cash withheld, the corporation would have no cash to pay. All they would withhold is the stock. You could not very well pay in cash if you are withholding stock.

Senator TAFT. I was just asking what the provisions of the House bill are with respect to dealing with the situation.

Mr. HECHT. There were no provisions.

Mr. KRUG. There are no provisions to take care of the situation that we are talking about.

Mission Corp. presently owes approximately $12 million. This debt is in the form of debentures outstanding in the hands of the public. Substantially all of its cash income is required in order to service and reduce this indebtedness. This debt carries interest at the rate of 3¾ percent and the indenture securing the debt requires substantial

sinking-fund payments to be made semiannually. This debt was incurred in order to refund bank indebtedness incurred for corporate purposes prior to the consideration or passage by the House of Representatives of H. R. 4473. On the other hand, taxable dividends must be paid in order to avoid possible liability under section 102 of the Internal Revenue Code.

Senator TAFT. I should not think so. But you have a right to pay them.

Mr. KRUG. Since cash is required to service and reduce the outstanding debenture indebtedness, such taxable dividends can only be in the form of Mission Development Co. stock.

H. R. 4473 does not provide the mechanics for withholding in the case of dividends payable in property or kind. Nor does it appear to be feasible to provide any suitable mechanics for withholding taxes on distributions in property. The dividend paid by Mission Corp. in the form of Mission Development Co. stock is generally a fraction of a share for each outstanding share of stock held. When a stockholder is not entitled to a full share, he receives scrip which he can either sell or combine with other scrip and obtain a full share. It would not be feasible, nor would it be warranted, to withhold from a stockholder any portion of the stock he is entitled to receive. The stockholder should have the right of maintaining his stock interest in Mission Development Co. Inasmuch as the distribution is taxable, the recipient stockholder is obligated to include the value of the Mission Development Co. stock in his taxable income. The Government would lose no tax by eliminating these dividends in kind from the withholding provisions. The statute does not provide for any withholding of scrip or fractional shares. If it did so provide, it would not appear to be practicable. For example, if this provision was applicable, the question would arise as to whether or not the scrip should be turned over in kind to the Government or whether the stock representing the scrip should be turned over. If so, would the risk of a decline in value be upon the Government or upon the declaring corporation, or upon the stockholder? It is evident that any provision for the withholding of fractional shares of scrip would be very complicated and virtually impossible to administer. It would also disrupt the percentage holdings of stockholders, leading to a most disadvantageous result.

The suggestion might be made that the corporation should be compelled to declare a cash dividend equivalent to 20 percent of the value of the property being distributed. Such a provision would seem to be palpably unfair. It would require a corporation to pay a cash dividend when the corporation may not be in a position to do so. The purpose of paying the dividend in kind is that the corporation requires its cash income for other reasons. To compel the corporation to make a cash distribution at the same time might result in an unwarranted severe hardship on the corporation or might result in the inability of the corporation to pay any taxable dividends whatsoever. Furthermore, there are no mechanics provided for computing the value of the distribution in kind. At the present time, Mission Corp. follows the practice of obtaining a ruling from the Treasury Department as to the value of Mission Development Co. stock on the date of distribution. Such a ruling can be obtained only after the distribution has been made, which may be several months after the declaration date

and some time after the dividend has been actually paid. Any cash dividend declared for the purpose of paying the withholding tax would likewise be subject to further tax and further withholding, which would result in obvious complication.

The number of corporations which make distributions in kind is very small, of necessity. Such distributions are only feasible or practicable in very special situations. An examination of a booklet published by Commerce Clearing House, Inc., entitled "Stock Values and Yields for 1951 for State Tax Purposes," which purports to be "a comprehensive table showing values and yields of listed or legally quoted stocks for 1951, State and local property-tax purposes" indicates that, in addition to Mission Corp, there were in the year 1950 only eight other corporations whose securities are listed or regularly quoted which declared dividends in the form of stock in other corporations. The names of these corporations and the stocks distributed by them as dividends are as follows:

American International Corp., one twenty-fifth of a share of Adams Express.

American Turf Association, 1 share of Churchill Downs, Inc.

Consolidated Vultee Aircraft Corp., one-tenth of a share of Airfleets, Inc.

Electric Bond & Share Co., three and three-quarters shares Texas Utilities for each 100 shares held.

Newmont Mining Corp., one twenty-fifth of a share of Hudson Bay Mining & Smelting Co.

Oils & Industries, Inc., one-fortieth Inter-Coast Petroleum Corp.

Union Gas System, Inc., 10 shares of Midland Industries, Inc.

United Light & Railways Co. of Delaware, one-tenth of a share of St. Joseph Light & Power, one-half share of Iowa Power & Light, one twenty-fifth of a share of Eastern Kansas Utilities, and three-fifths of a share of Iowa, Illinois Gas & Electric Co.

this latter apparently being a liquidating dividend.

In addition, the New York Stock Exchange has advised that Standard Oil Co. of Indiana declared a dividend in December of 1950 payable in stock of Standard Oil Co. of New Jersey.

The number of instances in which dividends have been paid in the form of property is so small that it would not appear to be worth the involved mechanics which of necessity would have to be adopted, even if they could work, which does not appear to be probable, and the inconvenience and hardship which would be caused to corporations required to use the device of paying taxable dividends in the form of property distributions, merely in order to provide for a different method of collection from that which now obtains of a tax which is otherwise payable and otherwise collectible. It would not appear likely that the payment of property dividends in lieu of cash dividends would become more prevalent in the event of their exemption from the withholding tax. Of necessity, they can be used in only very limited situations. It is difficult to perceive how a corporation could avail itself of this device in order to avoid withholding under the proposed tax law. If the Senate committee, however, has any doubts about the matter, it could limit the exemption to those situations where the payment of dividends in property or kind has been availed of by a corporation in the past or where a corporation has previously

adopted a policy of making distributions in kind, such as in the case of Mission Corp.

In conclusion, it is the position of the corporation I represent that the withholding provisions of the tax bill now under consideration should contain a specific exemption for dividends paid in the form of property or kind and that the failure to contain such exemption will result in undue complications in administration and possible great hardships. If such exemption is not provided, the bill should be amended to provide mechanics for withholding as to property dividends which are not readily apparent to this taxpayer.

The CHAIRMAN. Are there further questions?

If not, we thank you, sir, for your statement.

We shall not be able to complete all of the witnesses on the list. I understand that Mr. Tark wishes to get away.

Mr. TARK. Yes, sir.

The CHAIRMAN. Mr. Tark, how long is your statement?

Mr. TARK. I would judge it to take about 14 or 15 minutes.

Mr. CHAIRMAN. I am afraid we shall not have time to do that. We have to go to the floor. I thought if it was a short statement, you could put it in the record. Is it in writing?

Mr. TARK. It is in writing; yes.

The CHAIRMAN. You could put it in the record, and tell us what the point is, if you wish. But we would not be able to take 15 minutes at this time.

Mr. TARK. I will do that, then.

The CHAIRMAN. Very well.

The other witnesses, starting with Mr. Bullock, will have to come back tomorrow, because I think we shall be on the floor pretty regularly this afternoon, and we would not be able to hear but this one witness now.

Mr. BULLOCK. May I return here tomorrow?

The CHAIRMAN. Yes, sir.

Mr. BULLOCK. Thank you, sir.

The CHAIRMAN. Mr. Tark, will you please identify yourself for the record?

STATEMENT OF L. SHIRLEY TARK, ILLINOIS BANKERS ASSOCIATION, ACCOMPANIED BY BEN H. RYAN, PRESIDENT, ILLINOIS BANKERS ASSOCIATION

Mr. TARK. My name is L. Shirley Tark. I am president of two of the small banks in Chicago, the Main State Bank and the Devon-North Town State Bank, located in the outlying parts of Chicago.

I would like to introduce Mr. Ben Ryan, who is president of the Illinois Bankers Association, and also president of a bank in East Moline, Ill., and mayor of East Moline. He has three titles.

I also want to state that I speak today for the Illinois Bankers Association, consisting of about 870 members, and also for the bankers associations of the States of Arizona, Arkansas, Colorado, Florida, Georgia, Indiana, Michigan, New Jersey, Nevada, Oklahoma, South Dakota, Texas, Utah, Washington, Wisconsin, and Wyoming, consisting of a total of 17 State bankers associations, and proxies from 3,800 independent banks of the United States.

I want to lay stress on that point, for the reason that it has been stated by other witnesses that I speak for a small clique of bankers from Chicago, who are trying to destroy the savings and loan association business. I think I can safely say that the sentiments that I express here represent the sentiments of fully 80 percent of the bankers of the United States.

I have telegrams and authority in writing from the various States that are listed.

There are three other State bankers associations whose views are identical with those I shall express, but who did not give me direct authorization to speak for them, as their views are already known to one of their Senators, who is on this committee.

On the first page of my presentation I state the points I am going to make, and I am going to skip it, because that will come up as we go along.

The first point I stress is the fact that the building and loan associations of today are not the original concept of a building and loan association that was granted tax-exemption. They are no longer the grouping together of a small local group of householders who pool their weekly and monthly savings in order to enable some member of theirs to acquire or build a home.

We charge today that these building and loan associations are a terrifically large business that advertise through brokers from coast to coast, who run these ads in newspapers from coast to coast—and I shall leave with you newspapers, for example, from New York, from California, and from Florida; and that these brokers receive a compensation from the savings and loan associations of 1 percent for the moneys that they bring into them.

I also have here copies of newspaper advertisements—I am hitting just the highlights—that were placed by savings and loan associations, showing that they no longer merely solicit moneys from the small fellow, as they claim they do, for the purpose of saving money, thrift accounts; that they are directing their advertising today at businesses and corporations and asking them to withdraw their excess funds or idle funds from the commercial departments of banks and to put them into their savings and loan associations. They are in direct competition with the banking system of America.

My presentation sets forth all of this.

I will leave with the committee the advertisements showing the direct appeal for corporate funds.

Much of the evidence I am presenting today is from Chicago, because I come from Chicago, and it is more accessible to me. But that which I am presenting as coming from Chicago is available in every other city.

I am also going to leave with the committee two brokers' brochures which contain many financial statements of savings and loan associations that are located from coast to coast, paying 3 and 3½ percent yield and in these brochures the solicitation in competition with banks is directly made.

I have here an advertisement of a broker who went so far as to state, "Not only will your money earn 3 percent, but because of its tax-exempt character, you will earn a better yield than 3½ percent."

He got it all confused, that even the dividend that is paid to the saver is tax exempt. But that is the way that he advertised.

To further demonstrate that they are in competition with banks, here is an advertisement that appeared in the newspapers of Chicago during the past week, by the Cook County Council of Insured Savings Associations, showing their growth, and stating that these savings and loan associations are the fastest growing saving institutions in America.

They say that in 1948, 1949, and 1950 they gained over 40 percent in savings, while type A institutions a little better than 10 percent; type B a little over 2 percent, and type C institutions lost more than 10 percent.

The reading of this is very important.

Senator MILLIKIN. What do you mean by the loss in type C?

Mr. TARK. Loss in deposits.

Senator MILLIKIN. But what is type C?

Mr. TARK. They do not disclose that. They say type A, type B, and type C. I do not know what they are. I do not know whether type A is life insurance, or what it might be.

But they disclose that their gain is over 40 percent, 'way ahead of everybody else.

But then this advertisement reads, showing a picture of a man, "It's time to change my thinking." And it reads as follows:

> Time was when folks thought of savings associations only as a place to save the down payment on a home, or as the source of a home loan.
>
> But times have changed.
>
> Whether your current savings goal is setting aside funds that can be called upon to meet emergencies * * * or the means of sending the kiddies through college, or the plan for the next year's vacation, savings and loan associations welcome your account—large or small. You'll find you're encouraged to save more by the higher-than-average earnings paid on your savings. Naturally, we still finance homes, too.

They admit that they do that.

What they are virtually saying is this: "We are no longer the savings and loan association whose primary purpose was to finance homes. That is incidental. We are in business today to accept all savings deposits for all purposes. We are, in fact, the fastest-growing savings institution in America."

In my written statement I say that that advertisement, more than any words I can speak, shows the nature of their institution today, and that they are in the banking business in competition with the banks on a grand scale.

I also present to you this extremely large number of ads that appeared on July 1, 1951, in one newspaper in Chicago. Please bear in mind that this appeared in one newspaper on one day. All the other papers carried similar ads.

The cost of these ads runs into many thousands of dollars. This has a bearing on the issue because it shows the profit nature of their business.

I also present this miscellaneous collection of ads that are run daily in the Chicago newspapers.

I now direct your attention to a four-color page ad that ran in the Chicago Tribune one day last week. This ad alone cost approximately $7,500, paid for by one savings and loan association that is tax-exempt.

Senator MILLIKIN. Is it more difficult to withdraw your savings account in that kind of association, than it is from a commercial bank?

Mr. TARK. No, sir, Senator. It is not, in a way. As a practical operation, while our economy is in strong condition they will honor the request to repurchase their shares upon demand.

The question arises in my mind—I do not know if you are interested in it—as to what might happen when the economy changes.

Senator MILLIKIN. Exactly.

Mr. TARK. When that economy changes, then they have the right under the law to state to their people who wish to withdraw moneys that they shall stand in line, receive numbers and wait their turn, and the law provides that they shall be paid $1,000 of the receipts as their number is reached, and go to the end of the line to wait for their next turn. During this period, the association is only allowed to make new loans up to, say, 20 percent of the moneys that come in.

Senator TAFT. That is the Illinois law?

Mr. TARK. That is the Federal law.

Then the savings and loan insurance law, if that is what you are thinking of, Senator Millikin, provides that in the event of a default of a savings and loan corporation, then the Federal Savings and Loan Insurance Corporation steps in and will pay out in cash.

However, the law under the FDIC reads:

> In the event of inability on the part of a bank to meet its depositors' demands then the FDIC pays out.

Now, the distinction between the two is not in the ultimate pay-out. The distinction is in the time of pay-out. If banks are unable to meet their depositors' withdrawals, FDIC steps in at once.

But the word "default" means when the association is insolvent, and not merely lacking in liquidity.

Senator MILLIKIN. These people propose a type of account where, if they are up against it, it might take a depositor quite a little while to get his money out.

Mr. TARK. That is what I am trying to convey.

Senator MILLIKIN. So at that point, the analogy falls down between the practices of a bank and of a building and loan association.

Mr. TARK. Correct.

Senator MILLIKIN. And that affects the competitive angle, I should think.

Senator FREAR. May I ask a question, Mr. Chairman?

The CHAIRMAN. Yes, Senator.

Senator FREAR. You stated that if a savings and loan association is going into bankruptcy or declared insolvent, the FSLIC can go in and pay out in cash?

Mr. TARK. Yes, sir.

Senator FREAR. Do they not have the privilege of taking first those shares into another solvent association?

Mr. TARK. That is right; either one or the other.

Senator FREAR. Does the depositor or the person who placed his funds there in investment, have his choice as to whether he gets it in cash or gets stock in another?

Mr. TARK. I do not think, under the new law passed in January that the stockholder has a choice.

Under the previous law he did have a choice. There was a different pay-out under the previous law. But the new law, I think, merely provides that it shall be paid in cash or by transfer to another solvent association, or something to that effect.

Senator FREAR. And the stockholder does not have the choice; is that it?

Mr. TARK. I do not think so, because it would be totally immaterial to him. He could get his money either way. The actual pay-out is identical between banks and savings and loan associations.

The distinction is the time of pay-out, namely, when he is entitled to get it from the FSLIC. The wording otherwise is identical.

Senator FREAR. Now, in your statement on page 8——

Senator TAFT. Banks have a right to impose a time limit on savings deposits?

Mr. TARK. Banks have a right to impose a restriction such as 30, 60, or even 90 days, a regulation that is required by Federal Reserve rules. It is not a rule that they impose. They have a right to impose that rule. In the savings and loan——

Senator TAFT. You are talking about savings deposits only?

Mr. TARK. Only savings.

And if you are interested in the counterpart in savings and loan associations, the law itself gives them that right of a 30-day delay prior to the time when they start paying out to their members who must wait in line.

Now on page 6, I set forth the recommendations of the United States Savings and Loan League for 1949, and in there you will observe that they say:

> A savings institution operates in a world where there is constantly increasing competition for all available dollars,

and it tells them that their advertising should be directed toward getting the public to use savings and loan facilities rather than those of competing savings institutions or commercial banks.

For example, what I wanted to bring out so quickly up to this point is the fact that they are in the banking business in competition with banks, and on a very big scale, too.

I want to leave with you another savings and loan association advertisement that advertises that money should be saved with it for home furnishings, for education for children, for down payment on a home, for funds for emergencies, or for retirement.

This is exactly a bank's savings operations. We do the same thing. We always have.

However—the original concept was that these associations were set up for the purpose of pooling small savings locally to enable homes to be financed, and not to engage in the general business of seeking savings from everywhere for every purpose, other than, or in addition to, financing a home.

Senator TAFT. Would you say for the record that with respect to the tax paid by banks, they figure their net income like other corporations?

Mr. TARK. Yes.

Senator TAFT. From that, are they entitled to deduct reserves, the setting aside of any of that for reserves?

Mr. TARK. No, sir.

A bank is entitled to set up—for the first time in recent years we were given the right to set up a loss reserve, upon the assumption that we may have losses, and set up that reserve as you go along, up to a certain point.

There is a formula. Now, all banks do not use it. For example, in my two banks I do not use it at all.

Senator TAFT. Is that in the law, or is that in the regulation?

Mr. TARK. I cannot answer that, whether it is in the law or the Commissioner's rule. I think it is in the law. However, beyond that one point, Senator, every dollar of income that the bank makes, except tax-exempt income is taxable at corporate rates. I want to be sure I have the record clear on that.

Senator TAFT. That exempts some bonds, which are a very large item, of course, in most banks.

Mr. TARK. Yes, sir. It is taxable income, every bit of it, whether it is retained earnings, transferred to undivided profits, to various reserves; it is all taxable, every bit of it before we pay dividends.

Our contention is that the same should apply to savings and loan associations.

Senator MILLIKIN. Your portfolio of tax-exempt securities is constantly decreasing?

Mr. TARK. Decreasing. And not only is it decreasing, Senator, because of a smaller supply outstanding, but in order to make expenses, we find it is desirable to have taxable bonds because of the greater yield we get on those.

In our bank, for example, our tax-exempt securities in both banks are almost nil, because we need the income.

Senator MILLIKIN. The availability of good tax-exempt securities is not nil, but their return is constantly decreasing in relation to what you get in return from your taxable bonds.

Mr. TARK. From your taxable bonds; that is right.

Senator TAFT. What percentage of Government bonds held by banks now are nontaxable?

Mr. TARK. Today I would say that there is a very small amount of Government bonds outstanding, which are partially tax-exempt, a very small amount. All those bonds are being paid off. I believe there are none that are totally tax-exempt.

Senator TAFT. Most of the tax-exempts are municipals?

Mr. TARK. That is correct.

Senator MILLIKIN. How about the old Liberty?

Mr. TARK. I think they are all out. They are gone.

Now then, I want to go on to this point, if you do not mind.

They have attempted to justify their tax exemption on the grounds that they are mutual institutions, not engaged in business for profit.

I ask, are they?

The member who is an investor, but not a borrower, receives dividends out of income from loaning to others the association funds.

To save time, I will skip that, because you will have that before you when you read the testimony being filed.

I want to lay stress on the more important things.

To give you an idea of the lack of mutuality, I have two photostatic copies of signature cards of two savings and loan associations, two big ones, in the Loop of Chicago.

At the time a man opens a savings account or, as they call it, a share account, he signs a signature card, and in those signature cards they have incorporated proxies, so that the members of those savings and loan associations do not enjoy the privilege of mutuality even in voting. They cannot vote.

Senator MILLIKIN. Are they required to sign the proxy?

Mr. TARK. It is handed to them, and the average person does not know the difference.

And in one of those signature cards it even provides that if the proxy is revoked, it shall only be considered as revoked for the meeting at which this takes place.

In other words, it reinstates itself automatically.

They have stated that their mutuality is proven by the fact that they distribute all of their profits——

Senator MILLIKIN. May I ask, is that a common practice?

Mr. TARK. I understand that that is a common practice, Senator.

We sent in and opened two accounts in two leading associations in the Loop of Chicago.

Those two signature cards were given to us and we had photostatic copies made of them.

Now they state that they are entitled to tax exemption because of mutuality based upon the theory that they distribute all of their profits.

I would like to ask this question? If there is a distribution of all of their profits, how does it always happen that the dividend that is paid to the investor is 2 percent or 2½ percent or 3 percent, if that is what they pay? How does it always happen that the income comes out so even as to come out to 2, 2½, or 3 percent?

The answer is: They do not distribute those profits. What they do is to put them over into reserves, undivided profits, and so on.

That member of the association who withdraws from the association only gets the money he puts into the association. He does not get any parts of those reserves or undivided profits, or the buildings that they own today, the big, and magnificent structures.

You gentlemen see them right here in Washington on a smaller scale. You also hear the associations on the radio with their advertising—things that banks cannot afford.

The only time a shareholder in a savings and loan would ever share in the accumulated reserves or assets that they own—as represented by reserves, undivided profits, surplus and what not—would be in the event the association were dissolved, and he happened to be a member at that particular time.

Now, gentlemen, you are interested in this. There are today approximately 6,000 associations in the United States. They have an income of $800,000,000. They have a net income of approximately $600,000,000. On the basis of the new rates, considering an effective rate to be 33 percent on an over-all picture, the revenue that would be produced for the United States Government would be $200,000,000. That is what is being lost to the savings and loan and being given to them so that they can expand, advertise, and compete unfairly and unduly with the rest of the banking system of the United States.

Their money is invested in real-estate mortgages overwhelmingly. According to their own figures, approximately 99.8 percent is invested in real-estate mortgages. That is, the share accounts are so invested.

Obviously, they can earn more and they do.

I understand that a statement was made in previous testimony to the effect that the savings and loan association system pays $5,000 of taxes for each $1,000,000 of share accounts, whereas the banking system pays $3,300 of revenue for each $1,000,000.

I want most emphatically to say this: Savings and loan associations, State or Federal, pay absolutely not one cent of taxes, not a cent. When they talk about a system, they are distorting something. They are taking the income that has been paid in the form of dividends to the individual saver, and have proceeded upon the theory that those dividends are assessed a 20 percent tax.

Then they have taken that figure and related it to the total savings shares in the associations.

We shall call those savings in the associations, debt. Then they make a comparison with banks by assuming that the savings depositors in banks pay a 20-percent tax on the interest paid to them, add on the taxes paid by the banks, plus a 30-percent tax on the dividends paid to the banks' stockholders, and come out with a figure of $3,300 per million dollars of deposit—but in making this comparison they include all of the deposits in the banking system which included only $35 billion of savings and $106 billion of commercial deposits.

What they have done is to relate their figures to savings, and ours they have related to commercial and savings deposits.

Gentlemen, if you relate our figures to savings only, it comes out to $14,000 for every $1,000,000 and not $3,300. The whole thing is nonsensical. The theory upon which they have tried to present their case is absolutely without sound reason whatsoever. You cannot relate collection of tax revenues in relationship to debt or assets, because it simply means this, that a corporation that has a large income and pays a large tax would be excessively taxed if it happened to have a small debt.

That is following out their reasoning to a logical conclusion.

I think I have hit the high lights. I have tried to rush it.

The CHAIRMAN. You may put in your full statement.

Mr. TARK. I have my full statement on file, and I would like permission to write you a letter, because my statement does not present these figures that I have given at the very end. I think the committee should have them.

The CHAIRMAN. You may do so. We shall be glad to put that in the record, too.

(The following letter was subsequently supplied for the record:)

MAIN STATE BANK,
Chicago 47, Ill., July 16, 1951.

Senator WALTER F. GEORGE,
Chairman, Senate Finance Committee,
Senate Office Building, Washington, D. C.

DEAR SENATOR GEORGE: This letter is written to supplement the last portion of my testimony which was given to your committee on the 11th day of July 1951. It refers to the presentation made by spokesmen for the savings and loan associations wherein they endeavored to show that more taxes are being produced (paid) by the savings and loan association systems than by the commercial banks. To keep the issue crystal clear, I want to state most emphatically that savings and loan associations do not pay any taxes at all—not 1 cent.

When they talk about a system, they are endeavoring to confuse the facts and to mislead. What they are attempting to do is to relate the assumed payment of taxes by their members on the dividends received by them, to the total share accounts outstanding in all savings and loan associations. They state that the share accounts outstanding in 1949 in all savings and loan associations averaged close to $11 billion, and the dividends paid by them to their members totaled $268 million. Then assuming that the recipients of these dividends were assessed income taxes on the basis of 20 percent, the revenue received is $53,600,000—and so they say the Government collects $5,000 for each $1,000,000 of share investments from the system. Then they assume that the depositors in savings

departments of commercial banks pay a tax of 20 percent on the interest that is paid to them, which comes to $65,600,000 in taxes, and assume that the stockholders of the banks pay a 30-percent tax on the dividends paid to them, which comes to $106,243,000 in taxes and then add to these figures, the taxes paid by the banks, namely, $325,148,000—making the total taxes paid by banks, stockholders, savings depositors, approximately $500 million. Then they divide this figure by the total deposits in all banks of $140 billion—including commercial as well as savings deposits—and come up with a figure of $3,300 per million-dollars of deposits. If they had confined this comparison to the savings deposits only, which were $35 billion, and had not included the commercial deposits, the resulting figure would show that the commercial savings banking system had paid over $14,000 per million of savings deposits. The commercial deposits, on their basis of calculating, should not enter into this equation.

However, let me state that their way of figuring the payment of taxes by a so-called savings and loan system, and my answer thereto, are specious and without any sound foundation and without common sense. What they are claiming is that savings and loan associations, as such, should not be taxed at all on their earnings because the shareholders pay a tax on their dividends (which is true in all corporations) and they relate the tax assumed to have been paid by these shareholders—not the association—to the total outstanding shares in all associations. They are virtually relating tax paid by shareholders to capital stock of corporations; and then relate tax paid by bank shareholders, bank depositors and the banks, to the total debt outstanding in the banking system, and by so doing, say that they pay more taxes than the banking system, when actually the savings and loan associations pay no taxes. Since when are income taxes figured either against resources or debt owing by taxpayer? Income taxes are based on taxpayer's income. If their reasoning were carried out to a logical conclusion, then businesses that make large profits and pay large taxes, would be paying excessive taxes, if the amount of their debt was low.

Let us not be misled. Savings and loan associations do not pay 1 cent of taxes, and we respectfully submit that simple justice and fairness requires that their net income, before dividends, be taxed on the same basis as banks are taxed.

May I take this opportunity to express my appreciation to the committee for having been given the privilege to appear before it. In an endeavor to get as much in as possible in a short time, I undoubtedly spoke too fast and a bit abruptly. My written testimony is much more detailed and I beg that the committee give it due consideration.

Very respectfully yours,

L. SHIRLEY TARK,
Representing Illinois Bankers Association et al.

Mr. TARK. May I leave these advertisements with the committee?

The CHAIRMAN. Yes, sir.

We will place these advertisements in the committee files.

(The prepared statement of Mr. Tark is as follows:)

TESTIMONY OF L. SHIRLEY TARK, OF CHICAGO, ILL.

My name is L. Shirley Tark. I am president of two small banks in Chicago, Ill.—the Main State Bank and the Devon-North Town State Bank—located in the outlying sections of the city. I represent the Illinois Bankers Association and have been asked to speak for the bankers associations of the States of Arizona, Arkansas, Colorado, Florida, Georgia, Indiana, Iowa, Michigan, New Jersey, Nevada, Oklahoma, South Dakota, Texas, Utah, Washington, Wisconsin, and Wyoming—18 State associations—and also approximately 3,800 independent banks throughout the United States.

Because time is limited, I shall endeavor to confine my remarks to the major points under discussion, and will file for the record a more complete presentation. The points I shall now make are—

1. Present-day savings and loan associations are not the associations that originally were granted tax exemption;
2. They are engaged in business for profit and are in competition with tax paying institutions;
3. They should not enjoy what is the equivalent of a governmental subsidy which permit them to compete unfairly and to the disadvantage of the commercial banks;

4. To tax them will not destroy them, nor impair their ability to render the service they were intended to render; and
5. The government needs the revenue and they should be taxed before taxes are increased on taxpaying banks, and other businesses and individuals.

PRESENT-DAY SAVINGS AND LOAN ASSOCIATIONS ARE NOT THE ASSOCIATIONS THAT ORIGINALLY WERE GRANTED TAX EXEMPTION

Savings and loan associations are no longer the banding together of a small group of local people, who agree to pool their respective weekly or monthly savings, for the purpose of enabling some of their group to build and acquire homes. Today, however, the institutions that bear these names are large financial institutions, occupying and owning large and imposing buildings. They no longer seek moneys exclusively from their own communities, but reach into nooks and corners of the United States that are as far away from their offices as from California to the New England States. New York City newspapers carry advertising from associations located in Los Angeles, Chicago, and vice versa. They also seek money from all over the country through the use of brokers, who receive their compensation of 1 percent from the associations for whom they secure these moneys.

These brokers run continuous advertisements and send their prospects expensive brochures, containing the financial statements of hundreds of these associations. Using newspapers, radio, and television, associations openly compete with the banks by urging that moneys be transferred from savings and commercial deposits. They actively seek funds from corporations and ask that excess commercial balances be transferred to them. I submit that this is commercial competitive enterprise for profit and should be taxed the same as banks.

SAVINGS AND LOAN ASSOCIATIONS ARE ENGAGED IN BUSINESS FOR PROFIT AND ARE IN COMPETITION WITH TAXPAYING FINANCIAL INSTITUTIONS

That they are in direct competition with banks is admitted by them in their own statements and advertising which I present herewith. I use evidence from Chicago because it is more accessible to me. I assure you, however, that the same material is available in every city in the United States. Here are two brochures issued by two brokerage houses in Chicago, containing financial statements of savings and loan associations located in States from coast to coast, and soliciting funds to be invested in these associations at a 3 percent dividend return. I shall quote only a few sentences:

"Federally insured savings and loan associations form an industry with assets of close to $15 billion, a real industry, an integral part of our American system of banking and finance."

"A federally insured savings and loan association operates very much the same as the savings department of a bank * * * When accepting these funds from the public it (association) offers two forms of 'evidence of deposit,' i. e. the savings pass-book which is almost identically the same as the savings pass book issued by the bank savings departments, and the certificate which is closely akin to the certificate of deposit which is issued by the bank savings departments."

"The Federal savings and loan association operates under a Federal charter similar to the Federal charter granted to national banks."

"We thus have the Federal savings and loan association, which is the counterpart of the national bank, and the mutual savings or building and loan association, which is the counterpart of the State chartered bank."

"Thus we have two parallel systems, the one a commercial banking system and the other a savings system * * *. Each is examined at regular intervals and each is requested to submit to Federal authorities a sworn report each month."

"These accounts, insured by Federal Government instrumentality similar to bank deposit insurance, are protected by insurance up to $10,000 in each association."

They have even gone so far as to advertise that these investments are exempt from taxation, and therefore, a "3 percent return becomes better than a 3½ percent investment with safety."

On July 1, 1951, the Cook County Council of Insured Savings Associations ran ads in Chicago newspapers which boasted that they are the fastest growing savings institutions in America. They showed that in 1948, 1949, and 1950 they grew over 40 percent, while type A financial institutions only grew a little over 10 percent, type B about 2 percent, and type C lost over 10 percent. Nationally, during the period of 1946 to 1949, their share accounts increased by 56

percent whereas the savings deposits in commercial banks increased only 5 percent. In 1949 alone their increase was 13.8 percent whereas the increase in commercial savings banks was only twenty-seven-one hundredths of 1 percent.

In their advertisement they state that it was "time to change one's thinking." I quote therefrom:

"Time was when folks thought of savings associations only as a place to save the down payment on a home, or as the source of a home loan. But times have changed.

"Whether your current savings goal is setting aside funds that can be called upon to meet emergencies * * * or the means of sending the kiddies through college, or the plan for the next year's vacation, savings and loan associations welcome your account—large or small. You'll find you're encouraged to save more by the higher-than-average earnings paid on your savings. Naturally, we still finance homes, too!"

What they are saying is this, "We are no longer the simple savings and loan associations whose prime purpose was to finance homes; that is incidental—we are in business today to accept all savings deposits for all purposes—in fact, we are the fastest growing savings institutions in America."

This advertisement more than anything I might say shows that they are not the local thrift institutions created to help local people acquire homes. They are in the banking business in competition with banks on a grand scale. Yet these people who admit that they are engaged in big business and in competition with banks, come before Congress, year after year and plead that their tax-exempt status should be continued because they are nonprofit mutual savings institutions, taking care of the small saver who wants to acquire a home, and distributing to him all of their earnings. Where is the resemblance between today's billion dollar savings institutions and the mutual building and loan associations of yesteryear?

The change in the character of these associations, and the scope and size of their operations, can be visualized by the amount of their advertising which appeared in one Chicago newspaper on one day a little over a week ago. Keep in mind that this is only one newspaper and only on one day. They run similar ads in all the other newspapers and they have been running these ads daily. On July 5 one association ran a full-page ad in four colors in a Chicago newspaper. The cost of this advertisement alone was approximately $7,500. In fact, these associations expend so much money for advertising that one of the banks which I head is having difficulty placing advertising in Chicago newspapers which contains statements of fact, on the alleged theory that these statements are controversial.

In the statement of policies of the United States Savings and Loan League for 1949 we find the following:

"A savings institution operates in a world where there is constantly increasing competition for all available dollars * * * (it) has a twofold job in its advertising if it is to secure funds to meet the continuing great loan demand: (1) to acquaint the public with its services; and (2) to get the public to use its facilities rather than those of competing savings institutions or commercial banks.

"It is recommended that each association spend more money on advertising. The minimum expenditures for the year 1949 are suggested below:

"Association size by assets:	*Recommended advertising expenditures*
$50,000,000	$120, 000
$35,000,000	85, 000
$20,000,000	50, 000
$15,000,000	37, 000
$10,000,000	25, 000
$5,000,000	15, 000
$2,000,000	8, 000"

This is big business for profit, and in direct competition with banks and other savings institutions.

SAVINGS AND LOAN ASSOCIATIONS SHOULD NOT ENJOY THE EQUIVALENT OF A GOVERNMENTAL SUBSIDY

Savings and loan associations have attempted to justify their favored position on the ground that they are mutual associations not engaged in business and have no profits to tax. Are they mutual associations today? Absolutely not—their savers are not their borrowers and their borrowers are not their savers. The member who is an investor, but not a borrower, receives dividends out of income

from loaning the association's funds to others. The borrower, who has only made a nominal investment in order to become a member technically, pays substantial interest to the association on his loan but receives an insignificant amount in dividends. Even their signature cards take away their members' right to vote at the very moment they open their investment account with them. I have brought with me photostatic copies of the signature cards of two of the leading associations in Chicago and you will note that each contains a proxy giving to an officer of the association the right to vote for the member—and one of them recites that if this power is revoked it shall apply only to the meeting for or at which the right to revoke shall be exercised.

By what stretch of imagination can one impute mutuality of benefits to the "withdrawing" investor who asks that his shares be repurchased? Does he get any part of the surplus, reserves, or the building that the association has acquired? Associations state that they distribute all their profits to their members. How does it always happen that the member only gets an even 2 or 3 percent? The earnings of these associations do not always come out that even. The answer is that the accumulated assets consisting of surplus, reserves, and buildings—and I stress buildings—will only inure to the benefit of those who are shareholders when and if the business is liquidated. There is no mutuality of benefits accruing to the thousands of investors or borrowers who withdraw before the ultimate dissolution of the association—an event which may never occur.

Authentic figures show that these associations, numbering approximately 6,000, have an annual income of over $800 million per year and a net operating profit of over $600 million. On the basis of comparing member's share accounts to bank deposits, they earn more than do the banks, and that is not surprising because they invest almost 100 percent of their share accounts in real estate mortgages and depend upon the Federal Home Loan Bank System for liquidity. Yet they are not taxed on this vast income. At proposed corporate rates the Government would collect over $300 million annually.

Because they are not taxed, they can and do expend many times more money for buildings than tax paying banks can. For example, for the year of 1950 Main State Bank, of which I am president, incurred an income-tax liability of over $200,000. Our bank has resources of approximately $33,000,000. The money which we pay as taxes is used by them to expand, to build, and to compete with us. Where is our inherent American sense of fairness? Why should they be subsidized at our expense and at the expense of every other American business and citizen? Why should only they be permitted to make building dollars out of tax dollars?

TAXING SAVINGS AND LOAN ASSOCIATIONS WILL NOT DESTROY THEM NOR IMPAIR THEIR OPERATIONS

It has been contended that taxing savings and loan associations would have the effect of destroying them or forcing them to reduce dividend payments to their investors or of impairing their ability to render the services they perform. Taxing commercial-savings banks has not destroyed them and likewise, taxing savings and loan associations will not destroy them. On the contrary, commercial-savings banks are more adversely affected by taxes than savings and loan associations.

Banks must maintain a large cash position to meet their daily requirements and to maintain required reserves at the Federal Reserve banks. They invest a large proportion of their deposits in Government securities which yield very little. Greatest income is realized when deposits are invested in real estate mortgages, and whereas commercial-savings banks have a relatively small proportion of their deposits so invested, the savings and loan associations have almost 100 percent of their shareholders' moneys invested in real estate loans.

For example, the net operating income of savings and loan associations for 1949 was 3 percent of their total assets, whereas the ratio of net operating income before income taxes of banks to total assets in the same year was eighty-seven one hundredths of 1 percent. After income taxes had been paid by banks, the ratio was fifty-five one hundredths of 1 percent. If, therefore, savings and loan associations were required to pay half of their income in Federal income taxes, they would still be earning at the ratio of 1.5 percent of total assets—which is about three times the earning ratio of the banks. Therefore, it must be obvious that to impose an income tax on savings and loan associations earnings, can under no circumstances work a hardship on them that is greater than the normal burden that any other business suffers that pays taxes.

If it is their intention to show that paying taxes would prevent them from paying extraordinarily high dividends, then the question arises, Why should they be given a tax subsidy at the expense of the Government in order to enable them to continue to do so, and thus enable them to destroy their competition? A study of their operations and figures, supplied by them, discloses that reasonable dividends could be paid their shareholders and reasonable appropriations be made to reserves and surplus, notwithstanding the payment of income taxes. Yes, it might reduce their ability to acquire the finest and most expensive skyscrapers in the loop of Chicago and the newest and most modern financial buildings in the outlying areas. It might also reduce their rate of expansion.

Are they entitled to tax subsidies to enable them to continue these activities? Is there some public policy, political, economic or social, that justified this favoritism to one segment of bug business, operated for profit, to the detriment of the banking system and the economy of the country? I do not think so. They operate just like other financial institutions—acquiring capital, advertising, loaning money, charging interest, paying dividends, and what they have left after deducting expenses is taxable net income.

THE GOVERNMENT NEEDS THE REVENUE, AND SAVINGS AND LOAN ASSOCIATIONS SHOULD BE TAXED BEFORE TAXES ARE INCREASED ON TAX PAYING BANKS

In conclusion, gentlemen, may I say that the banks of the United States are aroused and indignant, and becoming increasingly more so every day, by reason of the tax subsidy which is granted to these associations. They foresee the day when their activity in the savings field will be destroyed, and their checking accounts raided. They ask that savings and loan associations be taxed on exactly the same basis as are banks—on their net earnings, which includes retained earnings, before dividends. They do not ask that the shareholder member be taxed on the associations' retained earnings any more so than is the shareholder of a bank taxed on the bank's retained earnings. They ask that this Federal license to destroy competition be ended, and in the process of so doing, that our Treasury, with propriety, collect the tax that is so sorely needed.

The CHAIRMAN. The committee will recess now and resume tomorrow morning at 10 o'clock.

(Whereupon, at 12:50 p. m., the committee recessed; to reconvene at 10 a. m., Thursday, July 12, 1951.)

REVENUE ACT OF 1951

THURSDAY, JULY 12, 1951

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

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

Present: Senators George, Hoey, Kerr, Millikin, Taft, and Williams.

Also present: Elizabeth B. Springer, chief clerk; Colin F. Stam, chief of staff, Joint Committee on Internal Revenue Taxation.

The CHAIRMAN. The committee will please come to order.

Mr. BOMAR.

Will you identify yourself for the record?

STATMENT OF FLEMING BOMAR, GRANITEVILLE CO., AND COMMUNITY SERVICES, INC.

Mr. BOMAR. My name is Fleming Bomar. I am a Washington attorney who appears here in behalf of Graniteville Co., a South Carolina textile corporation, and Community Services, Inc., a South Carolina eleemosynary corporation.

My purpose in appearing here is to urge the committee to broaden the provisions of section 501 of H. R. 4473 in order to settle by legislation the pre-1951 tax status of all charitable organizations engaged in business.

Congress, in the Revenue Act of 1950, amended the provisions of the Internal Revenue Code relating to the tax-exempt status of charitable organizations. Among other changes the following new paragraph was added at the end of section 101 of the Internal Revenue Code, providing in part:

> An organization operated for the primary purpose of carrying on a trade or business for profit shall not be exempt under any paragraph of this section on the ground that all of its profits are payable to one or more organizations exempt under this section from taxation.

That amendment was made prospective in its application only. It applied to years after December 31, 1950. Four years prior to 1951, the question of tax status of such corporations was left open. That is, it was left up to the courts to determine whether such an organization did qualify under section 101.

Now, the House of Representatives, in section 501, has departed from the policy of leaving the question of the pre-1951 tax-exempt status of such an organization to the courts. Section 501 provides a tax-exempt status for a certain type of organization that this committee describes as a "feeder" organization. Section 501, as drafted,

however, is limited in its application to feeder organizations which distribute their net income to educational institutions having a faculty, curriculum, and student body.

No similar exemption is provided for years prior to 1951 where all the profits of a feeder organization are distributable to a hospital, a church, the American Red Cross, a crippled children's home, or any other equally worth while charitable or eleemosynary institution.

While the provisions of section 501 of H. R. 4473 are desirable there is no reason why that section should be limited in application to feeder organizations helping educational institutes. Instead, it should be broadened to cover "feeder organizations" helping any genuine religious, charitable, scientific, literary, or educational organization exempt under section 101 (6) of the Internal Revenue Code.

Let me give you an example of a type of feeder organization that is not covered by provisions of section 501 of the House bill.

On May 5, 1951, the fourth circuit court of appeals decided that Community Services, Inc., a South Carolina eleemosynary corporation which, by its charter, was required to distribute all of its net income to various educational and charitable organizations located in Aiken County, S. C., should not be exempt for years prior to 1951 because it derived income from the operation of concessions for the convenience of employees of Graniteville Co., a textile corporation. Graniteville Co. for many years prior to 1945 had operated as a division of its company a canteen refreshment service offering soft drinks, milk, candy, sandwiches and other similar items for sale to its 5,000 employees while at work. In other words, it was a type of company store.

The net income derived from such items had always been donated to the local churches, schools, and charities. To clarify this policy and to simplify bookkeeping, a South Carolina eleemosynary corporation known as Community Services, Inc., was incorporated in 1945, and authorized to operate the various concessions formerly operated by Graniteville Co. It has no stockholders. No member, officer, or director of Community Services, Inc., has ever received or can ever receive any income or other benefit from the operation of Community Services, Inc. By the terms of its charter, all of its net income has to be distributed not only to the schools but also to other worth-while educational and charitable organizations in Aiken County, S. C. Judge Timmerman, a South Carolina Federal judge, held that Community Services, Inc., enjoyed a tax-exempt status prior to 1951. The fourth circuit court of appeals, however, reversed, the reversal being based in large part upon inferences drawn from the provisions of the Revenue Act of 1950 and its legislative history, and the Senate Finance Committee report where it was stated in your report that it appears clear to your committee that such an organization is not itself carrying out an exempt purpose.

Simply because the income of that particular organization is distributed to other than an educational institution having a faculty, curriculum, and student body, it would not qualify for a tax-exempt status prior to 1951 under section 501 of the House bill.

In the interest of just, consistent, and nondiscriminatory tax policies, I urge your committee to broaden the provisions of section 501 of H. R. 4473 and settle by legislation the tax status of all so-called feeder organizations for years prior to the year 1951.

I have at the end of my statement here the suggested language which would serve to accomplish that purpose.

The CHAIRMAN. Yes, sir. The Mueller Macaroni case has been reversed also, has it not?

Mr. BOMAR. The Tax Court decided against the exemption. The third circuit court of appeals reversed the Tax Court and held for exemption.

The CHAIRMAN. And has it gotten to the Supreme Court?

Mr. BOMAR. It has not, and it will not go to the Supreme Court if section 501 is continued in the law. It will not need to.

The CHAIRMAN. You not only want to see this section made prospective, altogether, but you wish it broadened in a way that you have indicated, by taking in all feeder corporations?

Mr. BOMAR. Yes, sir. I do not care to make it prospective. I would like to broaden it simply insofar as its retroactive application is concerned. In other words, the provisions of section 501 now, by knocking the Mueller case out, probably decrease my chances of getting to the Supreme Court, because the importance of the issue is minimized.

The CHAIRMAN. Are there any questions, Senator Millikin?

Senator MILLIKIN. No questions.

The CHAIRMAN. Thank you very much, sir. We will be glad to give it consideration.

The following information was subsequently supplied for the record:

GRANITEVILLE CO.,
Augusta, Ga., July 16, 1951.

Senator WALTER F. GEORGE,
Senate Office Building, Washington, D. C.

DEAR SENATOR: On Thursday, July 12, 1951, Mr. Fleming Bomar, an attorney of Washington, D. C., who represents us appeared in our behalf before the Senate Finance Committee. Mr. Bomar advocated broadening the provisions of section 501 of H. R. 4473 "in order to settle by legislation the pre-1951 tax status of all charitable organizations engaged in business." Section 501 of H. R. 4473, as it now stands, exempts a "feeder" organized under Internal Revenue Code section 101 (6) only if the income flows to an educational institution.

We are deeply interested in this matter because of an organization in our community which receives income from a feeder business, but which must devote all of its income to religious, charitable, scientific, literary, and/or educational purposes. This organization is known as Community Services, Inc., and is incorporated under the eleemosynary statutes of South Carolina.

To broaden the provisions of section 501 of H. R. 4473, as Mr. Bomar advocates will, we believe, settle the pre-1951 tax status for us. We urge your serious consideration to this question.

Sincerely yours,

S. H. SWINT, *President.*

GRANITEVILLE CO.,
Augusta, Ga., July 16, 1951.

Senator WALTER F. GEORGE,
Senate Office Building, Washington, D. C.

DEAR SENATOR: The attached presents our position regarding valuations and taxation under the last-in, first-out method for inventories. We strongly favor and urge your serious consideration to amending section 22 (D) of the Internal Revenue Code as outlined in the accompanying suggestion.

Sincerely yours,

S. H. SWINT, *President.*

PRICE INFLATION PROVES SOUNDNESS OF "LIFO"

AMENDMENT NEEDED TO REMOVE OBSTACLE TO PRESENT ADOPTION

Soundness recognized in 1939

Last-in, first-out (LIFO) inventory pricing which keeps price increases out of the value of the continuous inventory investment needed in a business, was made available to all taxpayers by Congress in 1939—just before the beginning of an inflationary price trend which has continued to this date.

Interpretations too restrictive

The Commissioner of Internal Revenue's original interpretations (1939) were so narrow and restrictive that the tax regulations implied that the use of LIFO was to be limited to taxpayers having very simple inventories. Relatively few taxpayers adopted LIFO in the face of these adverse interpretations. Those regulations remained in effect until 1949—nearly 10 years.

Meanwhile inflation struck

The inflation spiral carried the Bureau of Labor Statistics "All Commodities" Index from 77.1 in 1939 to 155.0 in 1949. Many taxpayers who were so effectually discouraged by regulations from electing LIFO in 1939, 1940, or 1941, feared to adopt it because of the danger of "freezing" a high cost inventory. Reason: The LIFO tax law (then and now) prohibits writing down inventories computed thereunder to current cost or market if prices recede below the starting point.

Tax Court overrules interpretations

In January 1947 the Tax Court in *Hutzler Bros.* v. *Commissioner* (8 T. C. 14), upheld the application of LIFO to the diversified inventory of a large department store. However, not until November 1949 were the income-tax regulations broadened in harmony with the original intent of the law. But it was 10 years too late.

Inequities and confusion

Inequities exist today among taxpayers. Those who adopted it at low price levels, notwithstanding the implied restrictions in the tax regulations, are enjoying its benefits. Others (in far greater numbers) who could not prudently adopt LIFO at higher price levels because the law fails to recognize the possibility of price declines, are at great disadvantage.

Furthermore, in many industries, there are some companies wholly on LIFO, some for only part of their inventories, and still others (probably the greatest number) not as yet using LIFO at all. Financial reporting to stockholders, to Government agencies, and to the public is thus enormously confused.

Conditions growing worse

Even though price levels continue to rise (BLS Index in March 1951 was 183.6) many taxpayers continue to defer the adoption of LIFO because of the risks involved by being prohibited from recognizing price declines that might go below the beginning level at time of adoption. As a consequence, price inflation continues unabated in inventory valuations and profit determinations.

The remedy

A simple amendment to permit adjustment of LIFO cost base if future prices decline below the beginning level—a privilege tax laws have long granted to taxpayers using other acceptable methods of inventory pricing. Suggested wording for such an amendment is attached.

Available taxable income

Over the span of an upward and downward price cycle, the amount of available taxable income would not be affected. But the income determined annually under LIFO would be free from the fictitious increment of profit due to price inflation.

SUGGESTED REVISION IN INTERNAL REVENUE CODE

Section 22 (D) (1)

(1) A taxpayer may use the following method (whether or not such method has been prescribed under subsection (c) in inventorying goods specified in the application required under paragraph (2):

(A) (1) Inventory them at cost [1] *Or (2) at cost or market, whichever is lower. (Whichever basis is adopted shall be used in all subsequent taxable years unless a change in such basis is authorized by the Commissioner.)*

(B) Treat those remaining on hand at the close of the taxable year as being: First, those included in the opening inventory of the taxable year (in the order of acquisition) to the extent thereof, and second, those acquired in the taxable year; *and if the taxpayer has adopted the basis of valuation prescribed in subparagraph (A) (2) and the basis so determined is in excess of the most recent cost or market value at the close of the taxable year, such most recent cost or market value, whichever is lower, shall be the basis of valuation of inventory at the close of the taxable year and the opening of the next succeeding taxable year;* and

(C) Treat those included in the opening inventory of the taxable year in which such method is first used as having been acquired at the same time [2] ~~and determine their cost by the average cost method~~ [1] *and at the same aggregate value at which such goods are included in the closing inventory of the preceding taxable year.*

Section 22 (D) (2)

No change.

Section 22 (D) (3)

No change.

Section 22 (D) (4)

(4) [2] ~~In determining income for the taxable year preceding the taxable year for which such method is first used, the closing inventory of such preceding year of the goods specified in such application shall be at cost.~~

We will call the witnesses left over from yesterday. You gentlemen are operating under a time limit, and we hope that you will observe it.

Mr. Bullock.

Will you please identify yourself for the record to the reporter?

STATEMENT OF THOMAS M. BULLOCK, RICHMOND, VA.

Mr. Bullock. Mr. Chairman and gentlemen of the committee, my name is Thomas M. Bullock. I am an accountant and I reside in Richmond, Va. I am not appearing here today as a representative of any business entity. I am personally paying my expenses incurred in appearing here, without reimbursement from any source.

I wish to express my appreciation for having this privilege of appearing before you gentlemen. I feel that it is my duty as an American citizen to endeavor to cooperate with our Federal Government as far as my ability and knowledge will permit.

During this national defense program and at all other times for that matter, I think that the American taxpayers are willing to pay income taxes on their true earnings from year to year to support our Federal Government, though of necessity the tax rates on their incomes have to be increased during this year. Therefore, I feel that the Congress should assess Federal income taxes on sound accounting bases and formulas with equity to all taxpayers and special privilege to none.

In some cases some of the Federal income-tax laws are not accomplishing this equitable objective, that is, some taxpayers are paying more Federal income taxes than some other taxpayers on the same amount of their true earnings from business operations because of existing inequitable accounting bases and formulas under present Federal income-tax laws.

[1] Italic indicates revisions in statute.
[2] Linetype indicates elimination of present provision in statute.

Some taxpayers are permitted to deduct their entire losses on properties used in their trade or business, whereas some other taxpayers have incurred losses on properties which were acquired in carrying on their trade or business but are not permitted to deduct such losses because of the existing section 117 (j) (1), which said section reads as follows:

(j) GAINS AND LOSSES FROM INVOLUNTARY CONVERSION AND FROM THE SALE OR EXCHANGE OF CERTAIN PROPERTY USED IN THE TRADE OR BUSINESS.—

(1) DEFINITION OF PROPERTY USED IN THE TRADE OR BUSINESS.—For the purposes of this subsection, the term "property used in the trade or business" means property used in the trade or business, of a character which is subject to the allowance for depreciation provided in section 23 (1), held for more than 6 months, and real property used in the trade or business, held for more than 6 months, which is not (A) property of a kind which would properly be includible in the inventory of the taxpayer if on hand at the close of the taxable year, or (B) property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business, or (C) a copyright, a literary, musical, or artistic composition, or similar property, held by a taxpayer described in subsection (a) (1) (C). Such term also includes timber with respect to which subsection (k) (1) or (2) is applicable.

Existing section 117 (j) (2) reads as follows:

(2) GENERAL RULE.—If, during the taxable year, the recognized gains upon sales or exchanges of property used in the trade or business, plus the recognized gains from the compulsory or involuntary conversion (as a result of destruction in whole or in part, theft or seizure, or an exercise of the power of requisition ore condemnation or the threat or imminence thereof) of property used in the trade or business and capital assets held for more than 6 months into other property or money, exceed the recognized losses from such sales, exchanges, and conversions, such gains and losses shall be considered as gains and losses from sales or exchanges of capital assets held for more than 6 months. If such gains do not exceed such losses, such gains and losses shall not be considered as gains and losses from sale or exchanges of capital assets. For the purposes of this paragraph:

(A) In determining under this paragraph whether gains exceed losses, the gains and losses described therein shall be included only if and to the extent taken into account in computing net income, except that subsections (b) and (d) shall not apply.

(B) Losses upon the destruction, in whole or in part, theft or seizure, or requisition or condemnation of property used in the trade or business or capital assets held for more than 6 months shall be considered losses from a compulsory or involuntary conversion.

The proposed new section 117 (j) (1), which follows herein, would equalize all classes of individuals and corporate taxpayers with respect to the Federal income tax treatment of the sales or exchanges of their entire assets used in their respective trades or businesses, and would also equitably define the distinction between their assets held primarily for sale to customers in the ordinary course of their respective trades or businesses, and their depreciable or nondepreciable assets used in their respective trades or business which would not be property of a kind which would properly be included in their respective inventories if on hand at the close of the taxable year.

Proposed new section 117 (j) (1), to read as follows:

GAINS AND LOSSES FROM INVOLUNTARY CONVERSION AND FROM THE SALE OR EXCHANGE OF CERTAIN PROPERTY USED IN THE TRADE OR BUSINESS.—For the purposes of this subsection, the term "property used in the trade or business" means property used in the trade or business, or acquired in carrying on the trade or business, by purchase or otherwise, tangible or intangible, held for more than 6 months, which is not (A) property of a kind which would properly be includible in the inventory of a taxpayer if on hand at the close of the taxable year, or (B) property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business, or (C) a copyright, a literary, musical, or artistic

composition, or similar property, held by a taxpayer described in subsection (a) (1) (C). Such term also includes timber with respect to which subsection (k) (1) or (2) is applicable.

(Effective for taxable years beginning after December 31, 1947.)
Proposed new section 117 (j) (2), to read as follows:

GENERAL RULE.—If, during the taxable year, the recognized gains upon sales or exchanges of property used in the trade or business, or acquired in carrying on the trade or business, plus the recognized gains from the compulsory or involuntary conversion (as a result of destruction in whole or in part, theft or seizure, or an exercise of the power of requisition or condemnation or the threat or imminence thereof) or property used in the trade or business, or acquired in carrying on the trade or business and capital assets held for more than 6 months into other property or money, exceed the recognized losses from such sales, exchanges, and conversions, such gains and losses shall be considered as gains and losses from sales or exchanges of capital assets held for more than 6 months. If such gains do not exceed such losses, such gains and losses shall not be considered as gains and losses from sale or exchanges of capital assets. (Effective for taxable years beginning after December 31, 1947.) For the purpose of this paragraph:

(A) In determining under this paragraph whether gains exceed losses, the gains and losses described therein shall be included only if and to the extent taken into account in computing net income, except that subsections (b) and (d) shall not apply.

(B) Losses upon the destruction, in whole or in part, theft or seizure, or requisition or condemnation of property used in the trade or business, or acquired in carrying on the trade or business or capital assets held for more than 6 months shall be considered losses from a compulsory or involuntary conversion.

These proposed new sections 117 (j) (1) and 117 (j) (2) merely equalize in an equitable manner the classification of all assets held by all taxpayers and used in their business operations of their respective businesses. Such equalization of assets for all classes of businesses will provide equitable bases and formulas for determination of their true earnings from year to year on which the Federal income tax rates are to be applied.

These proposed new sections 117 (j) (1) and 117 (j) (2) further provide for the taxation of true income after the deduction of losses derived from the sales or exchanges of their entire assets from year to year.

These proposed new sections 117 (j) (1) and 117 (j) (2) further recognize the equitable fairness of taxing profits in 1 year and allowing losses in another year, as the case may be, thereby taxing the true earnings after profits and losses are reflected in the taxpayer's respective trades or businesses from year to year.

For Congress to tax the net profits from sales or exchanges of assets used in a trade or business or acquired in carrying on the trade or business, irrespective of what the Federal income tax rates may be, and to tax the net profits of one taxpayer and to not allow the net losses of another taxpayer who is holding the similar class of assets sold or exchanged, is certainly incongruous in the extreme.

The present Internal Revenue Code taxes income derived from income-producing assets used in the trade or business and acquired in carrying on the trade or business, that is, rents from real estate and personal property, interest from bonds and notes, dividends from stocks. Therefore, fairness to all classes of taxpayers should be granted by Congress in extending the equalization of their respective assets when they are sold or exchanged, to the effect that recognized gains and losses should be taken into account in determination of the taxpayer's true earnings from their trade or business, just as much as

the taxation of income from the same assets used in the trade or business and acquired in the trade or business.

Every taxpayer engaged in a trade or business should be entitled to the existing provisions in sections 117 (j) (1) and 117 (j) (2) in that all classes of taxpayers should be treated equitably alike. If Congress were to repeal the existing sections 117 (j) (1) and 117 (j) (2), I feel that such repeal would by far provide more equity between various classes of taxpayers than at the present time.

At the present time net gains from sales or exchanges of assets of life-insurance companies are not subject to the existing provisions of sections 117 (j) (1) and 117 (j) (2) or any other section of the Internal Revenue Tax Code. Such net gains are not taxed whatsoever. They are not part of gross income of life-insurance companies.

At the present time net losses from sales or exchanges of assets of life-insurance companies are not allowable deductions for Federal income-tax purposes.

Net gains or net losses from the sales or exchanges of assets of life insurance companies are not recognized in computing net earnings of life insurance companies for Federal income tax purposes, regardless of whether the life insurance company be a mutual or stock business entity. Moreover, such gains or losses are not recognized in computing for Federal income tax purposes the "reserve and other policy liability credit."

Sound and equitable accounting bases and formulas for all classes of taxpayers, be they individuals, banks, corporations, life insurance companies, et cetera, should be used for the determination of their respective true earnings from year to year from their respective trades or businesses.

The existing sections 117 (j) (1) and 117 (j) (2), or other appropriate sections of the Internal Revenue Code, should be amended now, to provide for taxation of net gains from the sales or exchanges of all assets used in the trade or business and acquired in carrying on the trade or business, regardless of whether the taxpayers are banks, corporations, individuals, or life insurance companies, and their respective net losses from the sales or exchanges of all assets should be allowable deductions in full against ordinary income for the determination of their true earnings from year to year.

During this national defense program, and at all other times for that matter, I think that the American taxpayers are willing to pay income taxes on their true earnings from year to year to support our Federal Government, though of necessity the tax rates on their income have to be increased during this year. Therefore, I feel that the Congress should assess Federal income taxes on sound accounting bases and formulas with equity to all taxpayers and special privilege to none.

I thank you.

The CHAIRMAN. Are there any questions?

If there are no questions, thank you very much, Mr. Bullock, for your appearance.

Mr. Tarleau.

Will you identify yourself for the record?

STATEMENT OF THOMAS N. TARLEAU, BUILDERS AND OWNERS COORDINATING COMMITTEE, INC.

Mr. TARLEAU. Mr. Chairman, my name is Thomas N. Tarleau. I appear here, Mr. Chairman, in opposition to section 123 on behalf of the Builders and Owners Coordinating Committee, Inc., which is a membership corporation. Its members are composed of buildings and real estate owners with interests in most of the Nation's largest cities, including Philadelphia, Chicago, and New York.

Section 123 of H. R. 4473 is evidently an attempt to provide in the statute a section which would prevent tax avoidance by allowing only one credit for surtax and excess profits tax purposes to a group of two or more corporations with substantially identical stock ownership, where in reality it is only one enterprise conducted by more than one corporation. The committee report accompanying H. R. 4473 states that to allow multiple exemptions where there is in reality a single business enterprise—

> confers an unwarranted tax advantage on businesses carried out by means of a series of corporations, rather than a single corporation, and sets up an incentive for the artificial splitting up of corporations.

However, the proposed section as contained in the House bill works automatically and denies the use of more than one credit to a group of corporations solely on the basis of stock ownership. Whatever the merits of section 123 may be as applied to corporations owned and controlled by the same interests, where there is in reality only one business, it is submitted that the section, as applied to a group of corporations, each engaged in its own business and not connected economically with the business of the others, is capricious and discriminatory.

The problem of controlling tax evasion and avoidance which may arise through the use of multiple corporations is not a new one. The Internal Revenue Code has several provisions which deal with the problem of tax avoidance through the manipulation of or the acquisition of corporations. For example, section 45 authorizes the Commissioner of Internal Revenue to distribute or apportion or allocate gross income, deductions, credit, or other allowances between or among trades or businesses controlled directly or indirectly by the same interests, if such allocation or apportionment is necessary to prevent tax evasion or avoidance or clearly to reflect net income.

Section 129 of the code disallows deductions, credits, or other allowances to persons acquiring corporations where such acquisition is for the purpose of tax evasion or avoidance. Recently the Bureau of Internal Revenue has tried several cases before the Tax Court with no marked success, in which it has sought to invoke section 45 and section 129. The circuit courts of appeal and the Supreme Court, however, have passed on few, if any, of such cases and consequently it is difficult to determine as yet the scope of the application of these provisions.

A striking example of the inequity of section 123 when applied to separate business enterprises may be found in the real estate field. Traditionally, each real estate operation is separately incorporated. This was the practice long before there were corporate income taxes, and is done for sound business reasons, the most obvious of which is personal protection against the bonds and the mortgages on the

property and other limitation of personal liability. Moreover, each real estate operation is a separate business project, with possibilities of success or failure not dependent upon that of any other project. For example, a corporation owning a walk-up apartment house in the Bronx may have the same stockholders as a corporation owning an industrial building in Boston or another corporation owning a store building in Houston is totally unaffected by such a fact. If this income is under $25,000, it has the same call for small corporation treatment as any other corporation and for precisely the same reasons.

The effect of proposed section 123 on small real estate corporations is not only inequitable but it would have extremely dangerous effects on the use of risk capital in the real estate building and investment field. Generally speaking, capital in the real estate field comes from four sources: (1) Insurance companies and tax-exempt institutions; (2) comparatively few large publicly financed companies; (3) a handful of wealthy individuals who form syndicates for the promotion of large ventures in real estate; and (4) small-business men who are the backbone of the real estate field. These small-business men are the men who built the apartment houses, store properties, and industrial buildings, which properties in 99 percent of the cases earn less than $25,000. Moreover, these are the properties which generally are unattractive to the three other types of investors, and if private investment were lacking, the properties would not be built.

Moreover, the yield on capital investment in the real estate field is generally small.

Last November Mr. McGoldrick, the State rent administrator of the State of New York, published a survey which showed that of a sampling of 1,698 buildings located in the five boroughs of the city of New York, 50.5 percent earned less than 6 percent on their assessed valuation, 37 percent earned from 6 to 8.9 percent and only 12½ percent earned more than 9 percent. Moreover, these earnings are before all fixed charges and before any Federal taxes. It should be pointed out that assessed valuations in the city of New York approximate 100 percent of the sales price of properties for the last several years.

The effect of section 123 in an actual case may more clearly show the problems involved. One of our members, together with a few other individuals, is in the real estate business. As a group they have bought the following properties, which I have described on page 5.

You will notice there are six of these properties, each of them separately incorporated, and they are the types I have indicated below.

The first project is a walk-up apartment house in the Bronx.

The second one is also a walk-up apartment house in the Bronx, built some years later.

The third is a commercial property in Manhattan.

The fourth is a business property in which a restaurant and a fur business are located.

The fifth is a gasoline station.

The sixth is a building containing a shoe store.

You will notice, Senator, how the yields on the investment in these properties depend on the risk that is involved, and how, by and large, they follow the pattern of Mr. McGoldrick's survey.

The average yield on all of these properties is about 6 percent.

Each of these projects is naturally separately incorporated. If a tax of 30 percent, as is proposed as a tax on small corporations under the House bill, is paid on the earnings of the corporate properties of these six small corporations, the corporations will be left with about $19,000 or in the neighborhood of 4 percent on the investment. It should be emphasized that this return of 4 percent on the investment is before any individual taxes. Under the application of section 123, these individuals are effectively precluded from any further investment in the real-estate field. For example, a further investment in a real-estate corporation which would yield 6 percent before taxes, which is the average of these six investments that I mentioned, would, after the application of a 52 percent rate, leave only 2.88 percent on the investment before any individual taxes. New York City tax-exempt housing bonds will earn far more than investment in New York City housing under such circumstances.

In the example we have discussed we have gone into the problem of existing apartment houses which have been built and financed before World War II. Imagine the result if these same stockholders decided to build a new store property in a suburban location. This is a typical operation in the real-estate field. The present high cost of construction, the governmental financing regulations, the difficulties of obtaining materials, all coupled with a 52 percent tax rate, plus excess-profits taxes, certainly deter risk taking by these small-business men. It is the employment of the risk capital, which in many instances represents the life savings of individuals, which has been the backbone of the expansion of the American economy. If these builders are discouraged from constructing supermarket-store properties in Leonia, N. J., or in Queens County, N. Y., or in Winnetka, Ill., in most cases such building will cease. Small-apartment-house construction of the nonluxury type without Government financing will stop completely.

It has always been difficult to obtain risk capital in the real-estate field, but if section 123 is passed, those investors who took risks in the past will have no incentive to continue to do so. It is obvious that a net return of 3 percent to 4 percent will not encourage risk taking.

Governmental regulations and controls have naturally had a discouraging effect. Descending upon real-property owners have been—

A. Federal, State, and local residential rent controls which have kept rentals at or near prewar levels despite an increase in the over-all price controls of over 100 percent.

B. At least in the State of New York, business-rent controls which affect all other classes of real property.

C. Credit regulations issued by the Federal Reserve System so seriously restricting the extension of credit for new construction as to make it, for practical purposes, uneconomic for the small man. A building can only borrow 50 percent of the value of new commercial property under these regulations.

D. Regulations in respect of new construction which overnight depreciate the value of land because of the present liability to improve the land freely.

E. Voluntary restraints upon mortgage credit imposed by banks and other institutional lenders pursuant to advisory action on the part of Government which have the effect of appreciably raising money rates

and almost eliminating a normal mortgage market. If it is impossible to obtain equity capital from outside sources and an over-all tax rate of 52 percent to 70 percent prohibits retention of earnings for reinvestment, the real-estate industry will suffer a tremendous blight.

The increase in the corporate taxes have during the last decade or more been generally passed on to the consumer by American corporations. It is only by considering the corporate taxes as a cost of doing business that the corporate investor can properly realize on his investment. An increase, however, from a 47 percent rate to a 52 percent rate is a problem even for the ordinary corporation. Where one is dealing with real estate corporations, which in the first place are not in position to pass on increases in corporate taxes to their tenants, and in the second place when the increase is from a 25 percent rate to a 52 percent rate, it shall be obvious that such legislation would be disastrous to the real estate small-business man.

Such legislation is effective only in increasing the dominance of the large and powerful money interests in the real estate field and in discouraging further investment by the small-business man. Insurance companies and colleges have invested billions of dollars in real estate on an average return of about 3½ percent plus amortization payments. The income taxes that they pay are negligible or nonexistent. It makes the competitive position of a small-business man in the real-estate field who would have to pay over-all corporate taxes as high as 70 percent as well as individual taxes impossible.

We urge your committee to disapprove section 123; or, failing that, to amend it by providing exemption from its operation to corporations whose incomes are from rents.

I would just like to make one more comment about the possibility of the amendment to section 123.

Naturally, persons engaged in the field of the organization which I represent see their own problems, and consequently notice the severity of the application of that provision to their own problems. There are other ways of amending the provision which might be preferable to the ones that we have suggested. But at any rate, if it is desired to eliminate these small real-estate corporations, the method for doing so is quite simple.

The CHAIRMAN. What is the estimated yield from this provision?

Mr. STAM. About $55 million.

The CHAIRMAN. About $55 million. That is squeezing them pretty hard, is it not?

Mr. TARLEAU. Senator, $55 million is the yield that is estimated. Estimates at best are guesses. It has been pointed out to this committee before that there will be many instances where this tax will be avoided, because a variance in stock ownership will continue the present tax rate. It has also been pointed out that this is an undesirable way of avoiding the tax.

There is some doubt, I take it, whether $55 million will be raised by section 123. But assuming that we can actually get an additional $55 million out of the application of section 123, it is estimated that in the first full year of operation, the rates on corporations proposed by the House bill raise in the neighborhood of $28 billion.

The CHAIRMAN. That is in the House bill?

Mr. TARLEAU. Yes; in the House bill.

Now, to get an additional $55 million out of the tax structure taxing corporations $28 billion, or increasing the yield from corporations two-tenths of 1 percent and at the same time risking destroying enterprises of the character that I have described, seems a very foolhardy way of getting some additional revenue.

In other words, the $55 million may result in much more economic harm to the economy than the $55 million warrants in revenue.

The CHAIRMAN. Obviously this section will have its main application on small corporations?

Mr. TARLEAU. Yes. You see, Senator, the small corporations, by having the rate increased from 25 percent to 30 percent, which is the way the 5-point increase has been provided, are already, under the House bill, facing an increase of 25 percent.

The CHAIRMAN. That is on the normal?

Mr. TARLEAU. On the normal tax. And those corporations whose earnings are small, and are consequently only subject to normal tax immediately have had their tax increased 25 percent, and there is no complaint about that. I am not complaining about it. But the fact is, nevertheless, that already the small corporation in this tax bill is asked to pay a substantial additional amount of tax, proportionately more than the larger corporation is asked to pay. And again, there is no complaint about that.

But if, in addition, corporations which were formed years ago that have accustomed themselves to and have worked under a tax system whereby, being separate enterprises, they are separately taxed, not only have their taxes increased by 25 percent in 1 year, but to have their taxes increased by over 100 percent by reason of the application of section 123, the damage may be crippling in some cases, and may actually completely wipe out the possibility of the further use of these small corporations.

The CHAIRMAN. Are there any questions?

Senator MILLIKIN. No questions.

The CHAIRMAN. Thank you very much, Mr. Tarleau.

Mr. TARLEAU. Thank you, sir.

The CHAIRMAN. Mr. Richard Carothers, and his brother, Harry Carothers.

Will you gentlemen identify yourselves for the record?

STATEMENT OF RICHARD BUTLER CAROTHERS, JR., AND HARRY SPINKS CAROTHERS, H. C. SPINKS CLAY CO., INC.

Mr. RICHARD CAROTHERS. My name is Richard Butler Carothers, Jr., and this is my brother, Harry Spinks Carothers.

The CHAIRMAN. Where are you from?

Mr. RICHARD CAROTHERS. We live in Henry County, Tenn. We are stockholders and directors of the H. C. Spinks Clay Co., Inc., which is engaged in the clay mining and livestock farming business in Henry and Weakley Counties, Tenn. We want to talk to you about our family partnership, which was succeeded by the corporation formed on January 1, 1949.

We desire to make this joint statement.

We want to thank you for the privilege of being permitted to appear here today and being allowed to testify in regard to family partnership legislation. This is a most important subject to us, and we certainly

hope that appropriate legislation will be passed to correct some of the injustice that now exists.

Gentlemen of the committee, we feel that we are being penalized taxwise by the Bureau of Internal Revenue because of two conditions in our partnership (1) we went into business with our parents rather than strangers, and (2) we volunteered for military service in World War II.

We certainly hope you will pass sections 313 and 191 of the House bill, H. R. 4473, affecting family partnerships and make it effective for the tax year 1941 and thereafter.

The CHAIRMAN. We passed such an act last year.

Mr. RICHARD CAROTHERS. That is right, sir.

The CHAIRMAN. But we were not able to get the House conferees to agree with us; so we had to eliminate it.

Mr. RICHARD CAROTHERS. We appreciate that.

Before September 4, 1941, our mother, father, and my brother and I formed a partnership. This partnership agreement, in our opinion, was a just, legal, and honest agreement that we were proud of and had talked freely about with many of our friends and associates. Before the formation of our partnership we discussed the matter with our banker, lawyer, customers, and friends. We were advised this was the best way to conduct our business. There were no strings attached to this agreement; it was stated very simply and clearly. Each partner had full responsibilities and unrestricted rights. The basis of the agreement was simply this. The partners were paid a salary only for the time they worked. Each partner at the end of the year was credited with 4 percent of his capital account. The remaining profits of the partnership were then divided, 35 percent to our mother, 35 percent to our father, 15 percent to my brother, and 15 percent to me It was also provided that losses would be shared on the same basis. In all of our business activities we were considered a partnership. Our banker loaned us money as a partnership just on our signatures. We had nothing to hide, and we still don't. We had no reason to believe that in the near future family partnerships would be looked upon as a means for tax evasion, nor did we anticipate World War II and the problems that would arise from it.

On April 1, 1942, I enlisted in the United States Marine Corps. My father enlisted in the United States Navy on December 9, 1942, and my brother also enlisted in the United States Marine Corps on February 24, 1943. While we were in the service, our mother, with the help of our outstanding employees and loyal customers, operated our business. When we came home from the service in the latter part of 1945 and the first part of 1946, one of the first things that we were confronted with was the Bureau of Internal Revenue claiming that we had organized our partnership only to evade taxes; that we had no legal partnership agreement at all; and, in fact, just about everything that we had done, they said, was against the law. Naturally, we were amazed and hurt, to say the least. All of the men in the family had volunteered for the service and had spent a great part of our time out of the country, and then to come home and be confronted with this situation seemed almost impossible.

Gentlemen, I hope you can appreciate the position that we are in. We understand there are many other partnerships in similar circumstances. We do not believe the law is meant to be interpreted in this

manner, and that is why we are so interested in the revenue bill, H. R. 4473, sections 313 and 191.

The history of our family partnership will show you why we so strongly oppose the position taken by the Bureau of Internal Revenue.

H. C. Spinks, of Newport, Ky., our grandfather, started in the ball clay mining business in Henry County, Tenn. in 1915. In 1922 our mother and father moved to Tennessee, and our father was in charge of the Tennessee operations. On March 3, 1926, our grandfather died and left a will which formed a trust estate under which the business was operated and carried on until March 3, 1941.

After the death of Grandfather Spinks in 1936 our grandmother, Laura Spinks, served under the terms of his will as trustee, and carried on the business with our father as the general manager. Grandmother Spinks died in 1933, leaving our mother and father as co-executors of her estate, and our father was appointed trustee of Grandfather Spinks' estate.

At the time of Grandfather Spinks death, and under his will, our mother, Harriet Carothers, inherited a one-sixth interest; that is, our grandmother took a one-half interest, and our mother, aunt, and uncle took the other half interest. After our grandmother's death, our mother owned an undivided one-third interest in this business. So you can see that my brother and I had a potential interest in the business at the time of the death of our grandfather and grandmother.

Our grandparents and our parents worked for this business for many years. My brother and I grew up in the clay and farming business. I started working for the company in 1936, and my brother in 1937. Naturally, some of this work was of small importance, such as being water boy, and that is how we both started to work; but we did work, and work hard. Later we drove trucks, became bulldozer operators, dragging line operators, loaded cars, prospected for new deposits of clay, branded, dehorned, cut, and sorted cattle. All during this time our business was very much a part of our family life.

At the time of the formation of the partnership we were well acquainted with the company's principal customers. Our education was planned to better fit us for this business. We both liked and enjoyed our work and wanted to stay in it, and we are still in this business.

During those early years, my brother and I saved our money and added this to the money our grandparents and parents had given us from time to time. In 1938 we bought 13 registered Hereford heifers and a Prince Dominio-bred bull from C. A. Iverson of Ames, Iowa. Later, we bought a carload of grade heifers and other cattle from W. T. Bonner of Gainesville, Tex. The cattle were grazed on land we rented from the company. In 1941, when the family partnership was formed, we owned 206 head of cattle which we put in the partnership, together with the money that we had saved, and a tract of land that we owned.

We knew that the trust created by the wills of our grandparents would terminate on March 3, 1941, and as I mentioned before, for a year or two before that time we had discussed forming a partnership and continuing in the clay and farming business. In fact, we discussed this with our attorney, bankers, friends, and customers, and they all encouraged us to form a partnership. The Tennessee prop-

erties of our grandparents' estate were sold by the chancery court in Weakley County, Tenn., on the 4th of September 1941, and we, with our father and mother, were the successful bidders. On the 29th day of October 1941, we signed a formal partnership agreement, effective as of the 5th of September 1941.

Now, gentlemen, to come back from the service and have the Bureau of Internal Revenue come to our office and say that we were defrauding the Government out of tax money was hard to take. No one else has ever so accused our family. You can see from our family history that we have been a family that had always been in business for ourselves, and it is our desire to continue that way. We were brought up to think in that manner, and it was only natural for us to put our efforts in that direction.

Another thing I would like to say at this time is, I have given shares of stock at various times to my son, who is only 7 years old.

Gentlemen, under the present law this is legal, as we understand it, to give shares of stock; yet it would not be so to give shares of a partnership.

I think of the time when he will have an active interest in the H. C. Spinks Clay Co., Inc. My brother and I are the third generation of our family in this business. Our business has grown and developed.

The position that you gentlemen have taken in the past on family partnerships has pleased us. We hope that our business history will encourage you to pass the family partnership legislation, sections 313 and 191, of the House bill, H. R. 4473, and amend these sections so as to make them effective to taxable years ending after December 31, 1940. This will protect us and other servicemen who were absent from their partnership businesses during the war.

We certainly believe in this just as firmly as we possibly can. We appreciate the fact that these boys in the situation today are getting this opportunity, and, even if we do not, we still think that they should have it.

My brother and I want to thank you again for the privilege and pleasure of appearing before you.

The CHAIRMAN. We appreciate your appearance.

Senator MILLIKIN. Your testimony has been very impressive.

Mr. RICHARD CAROTHERS. Thank you, sir.

Are there any questions?

Senator HOEY. Thank you very much.

The CHAIRMAN. I think that this committee believes in the family partnership provision which we inserted last year, which would fit your case.

Mr. HARRY CAROTHERS. Yes, sir.

Mr. RICHARD CAROTHERS. Yes, sir; I know that.

The CHAIRMAN. We regret that the House conferees were not willing to go along with us on it. But we hope now that they have taken the first step, and will agree to make it retroactive. Otherwise, it will not be worth very much.

Mr. HARRY CAROTHERS. We appreciate it, sir.

Mr. RICHARD CAROTHERS. Thank you.

The CHAIRMAN. We thank you for your appearance.

The CHAIRMAN. Mr. Francis Bravman.

Would you please identify yourself for the record?

STATEMENT OF M. FRANCIS BRAVMAN, NEW YORK CITY

Mr. BRAVMAN. My name is M. Francis Bravman. I am an attorney at law at 50 Broadway, New York City.

Mr. Chairman and gentlemen, I submitted to the House Ways and Means Committee a proposal to permit all individuals to average income for indefinite periods.

I should like now to present some supplemental information on what I call the tax-dividend plan.

Its title means just that. It is a plan to raise the necessary moneys required by the Government during the present emergency. Yet the bite on the average taxpayer is not too hard. The plan actually provides an incentive to work, to invest and reinvest capital, and to increase production. Also it eliminates the all too prevalent present-day custom of conferring with lawyers and accountants before risking an increase in profits or salaries which would lead to inclusion in a higher income-tax bracket. In addition, this tax-dividend plan looks into the future to guarantee manufacturers, businessmen, and workers alike security in later years.

Maybe this sounds like tax magic. But it is not magic at all. It is a sound and practical plan that merits your attention.

Under the tax law, as it would be amended by the revenue bill of 1951, passed by the House of Representatives, the share of the Government in additional income begins to exceed that of the taxpayer as soon as the income reaches $14,000 in the case of a single person and $28,000 in the case of a married person. This disparity in the shares increases until at $80,000 for a single person and $160,000 for a married person, the share of the Government is 94½ and that of the taxpayer 5½ percent. Despite these high personal taxes it has been said that American business executives are continuing to keep up all their regular daily activities but they tend to avoid moving from one business to another and sometimes turn down promotions. It may be assumed that these executives, like most other Americans, are going full blast, because in this time of emergency it is essential to maintain a high level of production of both military and civilian goods.

Meanwhile, there are other individuals who combine realism with their patriotism and by the use of various schemes are able to shift a portion of their income from a year of high earnings to one of low earnings or to spread their income over a number of years. Individuals with like incomes thus pay unlike taxes.

Such inequity in the tax burden is made possible by a number of provisions in the tax law, most of which are designed, strangely enough, to eliminate or mitigate these inequities in the tax. For example:

1. Individuals are permitted to spread over the period of service compensation received for personal services rendered over a period of 36 months or more. But individuals who receive lump-sum payments for personal services performed over a period of more than a year and less than 3 years cannot spread the compensation. If, however, they are able to procrastinate and thereby stretch the period of service to 36 months they effect a tax saving.

2. Individuals are permitted to carry back 1 year or to carry forward 5 years a net operating loss. Individuals who sustain a net

business loss are thus able to reduce their taxes but the amount of reduction will vary among taxpayers according to what the income happens to be in the particular year to which the loss deduction is carried, although for the period as a whole the net business results are the same for all of them.

3. Individuals are permitted to report income on an installment basis. Individuals who sell property to persons with good credit can so arrange the transaction that they pay a lower tax than individuals who sell like property at the same profit to persons with poor credit.

4. Individuals are permitted to exclude from their incomes amounts contributed by their employers pursuant to a pension plan for the benefit of the employees. Employed individuals who are beneficiaries of a pension fund thus are able to save taxes because a portion of their income is shifted from the year it is earned by them to the year or years it is paid to them after they retire. Other employed individuals whose employers do not contribute to a pension fund for their benefit and all self-employed individuals thus pay a higher tax than beneficiaries of pension funds who have a like amount of income in a particular year.

5. Individuals who receive back pay or recover bad debts, prior taxes, and delinquency amounts are permitted to restore all or part of such amounts to the year the back pay was earned or the bad debts, prior taxes, and delinquency amounts were deducted, but an individual who is required to return a portion of his income earned in a prior taxable year cannot go back and recompute the income of such year.

6. Individuals are permitted to report income on a cash or accrual basis of accounting. Tax results differ because of the use of one method rather than the other.

7. Individuals are permitted to report their income on a calendar or fiscal year basis. The use of the fiscal year permits some individuals to shift their income to a taxable period other than the one in which the income was earned.

8. Individuals are required to pay a tax based upon the taxable income computed for each year as though it stood by itself unrelated to other years. This affects adversely all individuals with widely fluctuating incomes. Those in the lowest brackets may lose the full benefit of their personal exemptions and allowable deductions by failure to have an income equal to them in a given year, and those in the higher brackets will be taxed at greatly varying rates. In either case, the result is that individuals with highly irregular incomes are required to pay substantially more Federal income tax over a period of years than those who receive an equal aggregate income ratably during the same period.

Here is a picture of unequal taxation of individuals who have the same income in a particular year or over the same period of time, a picture made worse by a constant rise in the amount of tax imposed upon them. If nothing is done to remove these inequities in the tax, individuals will continue to be under strong pressure to average out their income by whatever means are available to them. In addition to the methods already mentioned, other devices are used, such as deferred compensation contracts under which individuals are paid compensation over a period extending beyond the period of service, or tax loss sales entered into for the purpose of offsetting gains, and

so forth. If a device is not available the Congress is asked to provide one, such as the bills introduced in this Congress by Messrs. Coudert and Keogh, under which individuals would be permitted to exclude up to $10,000 or $7,500 of their earned net income if it is set aside in a manner specified by the Government for use after the individual attains 60 years of age. All such requests, if granted, merely add a number of provisions to an already highly complicated revenue law, make the taxpayer's activities more dependent on the tax law, and leave unsolved the basic problem which is the elimination of these inequities created by a tax imposed upon the annual net income.

The recommended solution is to change the tax base by permitting individuals to average their incomes for extended periods of time. Such a provision in the law would benefit everyone regardless of the time income is earned or received by him. Averaging of income would have the added advantage of simplifying the computation of income and of the tax since such a provision would eliminate existing provisions in the law designed to mitigate the effect of taxing income on an annual basis. It is not essential to the operation of the plan for averaging income that capital gains be included, but they may be.

The Congress now has an opportunity not only to equalize the tax burden among all individuals with the same income but to reward all who strive to attain their maximum earning capacity at a time when the need for revenue is great. Individuals required to pay the high taxes in effect today would be more willing to pay them when they know that their contribution at this time of national emergency would also benefit them when they themselves may be faced with misfortune. In other words, individuals would be more willing to earn additional income even if 94½ percent of it is going to the Government when they know that if at a future time their income declines a portion of the 94½ percent paid to the Government by them will be returned to them or credited against their then tax.

The Secretary of the Treasury at the hearings before the Committee on Ways and Means on revenue revision in the Eightieth Congress stated that "the adoption of averaging would result in a substantial loss of revenue." This would not be true under the proposed plan at least for the first year it is in effect. For example, under the proposed plan the revenue received by the Government would be equal to or higher than that collected under existing law. This is so because under the plan the income taxed the first year would be exactly the same as under existing law. The tax collected, however, may be higher under the proposal because there would be an incentive for the individual to earn more income. There would also be no advantage in establishing tax losses; and there would be no carry-back or carry-forward of net operating losses.

After the first year there would be no reduction in revenue unless there is a general decline in the incomes of individuals. But taking the country as a whole the question of loss of revenue may be more apparent than real. In any event comparing it with the loss under the existing system, there probably would be no difference between the amount of revenue collected by the Government under either system. Under existing law net business losses may be carried back 1 year and carried forward 5 years; net capital losses may be carried forward 5 years; long-term compensation may be spread over the period of service; and various other devices may be used to reduce

taxes. On the other hand, under the proposal individuals would be permitted to average their income earned during minority; from 21 through 30 years of age; from 30 through 55 years of age; and from 55 years of age to death. At any particular time there would be some who would be starting on an averaging period, some who would be ending an averaging period, and others who would be in various stages of an averaging period. Whatever loss there may be would not be concentrated in any particular year. Moreover, there would be no advantage under the plan for individuals to take losses; that is merely for tax purposes. On the contrary, there would be an incentive to earn more income or to accelerate its receipt so that, as a practical matter, the plan would favor increasing rather than decreasing current tax collections.

In other words, the plan for averaging income would reverse the existing procedure, where taxpayers determine when and in what form transactions should take place in order to produce the greatest tax advantage, and permit them to consummate transactions as and when dictated by business reasons and, at the same time, enable them to obtain the same advantage as if they had the privilege of reporting the income or deductions whenever they pleased within the averaging period.

The plan would give them the maximum tax advantage since, as a practical matter, there can be no lower tax than on the average income.

With the permission of the committee I should like to submit two exhibits, one which illustrates the computation of a tax or refund, and the other which describes the method of computing the tax or refund and the benefits to be derived from the tax-dividend plan.

If I have the time, Mr. Chairman, I could explain the operation of the plan and illustrate the computation of the tax.

Senator MILLIKIN. Do you have any age brackets at which the plan would cease to be effective?

Mr. BRAVMAN. No. The age brackets are merely for the purpose of permitting a taxpayer to begin or to terminate a particular averaging period. For example, say, at my age, I am under 55, but over 30, I could start averaging right now. But after I attain the age of 55, I would terminate this current averaging period, and then I would start a new one with age 56, and continue that until my death.

Senator MILLIKIN. Suppose a man were 70.

Mr. BRAVMAN. He would start with that year. It would be the last period. And he would continue averaging until he dies.

Senator MILLIKIN. What if his normal expectancy would not go to the end of the averaging period?

Mr. BRAVMAN. He would average out as long as he lived.

Senator MILLIKIN. But what I am getting at is, averaging age brackets, would not an elderly person have an advantage?

Mr. BRAVMAN. It is not the purpose of this plan to equalize the payment of taxes among all individuals. The purpose of the plan is to enable two people who earn the same money over the same period of time to pay the same tax. Of course, we cannot go backward. We cannot take this man at the age of 70 and reconstruct his income from the time he was born and equalize that with another person who may reach 70 years of age 20 or 30 years from now. But as far as that man is concerned, he will have at least this benefit, that no matter how much income he earns, he will not have to pay a higher tax be-

cause he worked harder and earned it in one year instead of spreading it over a period of two, three or more years.

Senator MILLIKIN. Assuming that he died in a few years, would he not have somewhat of a tax advantage? I am not talking against it. I am just trying to see what the effect would be. Would he not have a tax advantage over a fellow who starts to average, say, when he is 40?

Mr. BRAVMAN. No. There would be no tax advantage. If the man at 40 lived to be 70—let me see if I can state it this way. The purpose of the plan is to eliminate time as an element in determining income. If you eliminate time, then it does not matter when a man receives his income. He will not be penalized as he is today for working hard and concentrating his income in a single year. There is the chief purpose of this plan. It just happens that it also is consistent with the present necessity for increasing the revenue.

Assume that there is going to be no tax reduction, that either the existing tax rates will remain in effect, or there will be a tax increase. This plan has the added advantage in that it softens the impact of the present rate, or the increased rate. So a man would have an incentive to work harder and earn more in 1951 or 1952, and he will not feel that all that effort is going for the benefit of the Government.

Senator MILLIKIN. Let me put it to you this way. What is your averaging period? Over what period of time?

Mr. BRAVMAN. The averaging period that I recommended is during minority; a person can average all his income earned up through age 21. All this is prospective. You never go back. When a man decides to average, he says, "I now elect to average." And he starts with that year and goes forward. If he is under the age of 21, he goes up to 21. After he reaches 21, he can start another period and go up to 30. At age 31 he starts another period.

Senator MILLIKIN. That would be a 10-year averaging period?

Mr. BRAVMAN. That is right. That would be a 10-year averaging period.

Senator MILLIKIN. Maybe I have not made myself clear. Let me put the question to you this way. Does not a taxpayer who does not live long enough to average out for 10 years have an advantage over those who do?

Mr. BRAVMAN. No, sir. He just pays a tax on his average income during the period he is alive.

Senator MILLIKIN. But it is less than if he had paid it in a single year in which he had earned the income, and it is considerably less if you figure over the whole averaging period during which he does not live to average on.

Mr. BRAVMAN. It is not the purpose of this plan to produce——

Senator MILLIKIN. I understand the purpose. But I am just asking a simple question, whether that is not correct, regardless of the purpose or regardless of the fairness or unfairness of it. I am just trying to get the facts.

Mr. BRAVMAN. If a man happens to die before he must terminate an averaging period, he will have paid a tax on his average income for the portion of the period that he was alive.

Senator MILLIKIN. Let us say he pays it for 1 year out of 10, and dies the next year.

Mr. BRAVMAN. He has paid a tax on the average——

Senator MILLIKIN. The tax is less than he would have paid had he been taxed on a separate year, as we now do, is it not?

Mr. BRAVMAN. It may or may not be.

Senator MILLIKIN. Yes.

Mr. BRAVMAN. All right. We will say it is.

Senator MILLIKIN. Then, if your averaging period is over a 10-year period, the Treasury will suffer. If a man does not live the 10-year period, does he not have an advantage over those who do live 10 years?

Mr. BRAVMAN. I do not think so.

Let us illustrate it. Suppose a man earns $20,000 in one year and earns $10,000 the second year, and he dies. He pays a tax on the average income for the 2 years.

Senator MILLIKIN. Have I made my point clear?

Mr. BRAVMAN. I do not know whether I get your point, Senator.

Senator MILLIKIN. I cannot make it any clearer. So let us pass it.

Mr. BRAVMAN. I will say this. Naturally, a man who lives longer earns more. He will pay more tax than the man who dies at an earlier date.

Senator MILLIKIN. That does not necessarily hold true.

Mr. BRAVMAN. I do not see the connection between the two situations.

Senator MILLIKIN. Is this correct, that if a man lives throughout the averaging period, is it your theory that over that period he will have paid as much tax as he would have had we followed the present system?

Mr. BRAVMAN. No, sir. He will have paid the same tax that a man under the present system pays who earned the same amount of income ratably over that period. For example, take the second period, from 21 to 31. A man earns $20,000 every year, while another person earns fluctuating amounts, but over that 10-year period he earns $200,000. Under my plan both pay the same tax.

Senator MILLIKIN. In those two cases, you figure that the averaging process will be better for the taxpayers, and will also not hurt the Treasury is that not correct?

Mr. BRAVMAN. That is right.

Senator MILLIKIN. All right. Now let us take the other case. In either case that you were talking about, a man starts on this first 10 years, or any other 10 years, and then the first of the 10 years he has a very big income, in the second of the 10 years he dies. Does not the Treasury lose under your averaging plan?

Mr. BRAVMAN. No. The averaging period ends with his death. If he died during the second year of the period the income earned in the second year would be annualized. The tax or refund would be computed for the second year which would be the end of that period.

Senator WILLIAMS. Would not the effect of this be, though, assuming you have 4 or 5 years of relatively high prosperity and earnings, that when the country hits a recession, the Government would have no income whatever on the averaging process because a man could average downward, and he would not owe any taxes?

Mr. BRAVMAN. That does not necessarily follow.

Senator WILLIAMS. It could follow, could it not, if you had a major country-wide depression?

Mr. BRAVMAN. That is true under the present law.

Senator WILLIAMS. No, it is not true, because if a man was earning $30,000 a year, and he earned that for 5 years, and then you ran into

a couple of years' recession, he would not owe any tax because all of his tax on the averaging plan would have been paid. Is that not true?

Mr. BRAVMAN. That is partly true. You have offsetting items. In the first place, everybody's income is not going to drop.

Senator WILLIAMS. I am saying in those cases that are averaged.

Mr. BRAVMAN. All right. The income drops. Now, at the present time, if he were not averaging, he would be allowed to carry forward business losses.

Senator WILLIAMS. I am assuming that there are no losses, though. I am assuming that there is a profit each year, that the man has some income each year, and he would owe some tax under an existing rate each year, but he has 4 or 5 years—you have a 10-year program—suppose we say he has 7 years of relatively high earnings. In the last 3 years, we run into a major depression. On the averaging plan, he would not owe the Government any taxes, because he would take his previous tax payments, average them out, and he would owe nothing.

Mr. BRAVMAN. In the first place, taking the country as a whole——

Senator WILLIAMS. Is that not true, though?

Mr. BRAVMAN. I will have to answer that, sir, this way. Everybody will not be in the same stage of his averaging period. Some persons may be just starting. So that these persons will not be getting any refund. It is only that person who would be in between or ending a period who would get a refund.

Senator MILLIKIN. You figure that the averaging of the averaging would pull you out, whereas Senator Williams is talking about a single case.

Mr. BRAVMAN. That is right. And I have a further opinion on that. It may be a good thing to allow these refunds to people, as being antideflationary, and it may be a means of getting us back on a better basis than to have some form of relief, such as WPA or PWA projects.

Senator WILLIAMS. Without discussing the merits or demerits of it, the net effect would be that the Government would be making the refunds in a period of low income as far as the Government is concerned, thereby making for an extra reduction of our income at the time in the midst of a depression.

Mr. BRAVMAN. A man's income would have to drop very low before he would get a refund, and the longer the span of the averaging period, the less chance there is for the Government to return money. For example, if a man earned $100,000 the first year, and $10,000 the second year, then we have that decline, and, of course, the Government would lose money there. But I think it would be fair from the Government's viewpoint to return some money to that man after he earned $100,000 the first year, and then $10,000 the second year. I think taking the country as a whole, however, the loss in revenue will not be as great as it appears to be.

Senator MILLIKIN. So that I understand your plan better, do you average back 10 years?

Mr. BRAVMAN. You never go back.

Senator MILLIKIN. You never go back, always forward?

Mr. BRAVMAN. Yes, sir.

Senator MILLIKIN. Let us assume that a man had under the present system a taxable income of $100,000; what would he actually pay on it under your system?

Mr. BRAVMAN. He pays exactly the same amount.

Senator MILLIKIN. And the second year?

Mr. BRAVMAN. If he earned $100,000 the second year, he would still pay the same amount. If he earned, say $50,000 the second year, he would pay a tax on $75,000, which is the average income for the 2 years, less a refund on $25,000. In other words he earned $100,000 the first year, and $50,000 the second year. That is $150,000 for the 2 years, and the average income is $75,000. He pays a tax on $75,000, less a refund on $25,000, which brings him down to $50,000, the income for the second year. So he always pays a tax on the realized income of the particular year.

Senator MILLIKIN. Under the present system, would he pay the full tax on $100,000 for the 2 years?

Mr. BRAVMAN. No. Under the present system, he would pay a tax on $100,000 for the first year and $50,000 for the second year.

Senator MILLIKIN. I assume that you said he earned $100,000 the first year and $100,000 the second year.

Mr. BRAVMAN. That would be the same under both systems.

Senator MILLIKIN. If he earns $100,000 the first year, under the present system he pays a tax on $100,000.

Mr. BRAVMAN. Right.

Senator MILLIKIN. If he earns $50,000 the second year, he would pay a tax on the $50,000?

Mr. BRAVMAN. Yes, sir.

Senator MILLIKIN. Now, for those 2 years, what would be the basis of his tax for the 2 years?

Mr. BRAVMAN. Under my system?

Senator MILLIKIN. Yes.

Mr. BRAVMAN. He would pay a tax on $100,000 the first year, and in the second year he would pay a tax on $75,000, less a refund on $25,000.

Senator MILLIKIN. And the third year, what?

Mr. BRAVMAN. For the third year let us assume the income drops to $30,000, so that his income for the 3 years is $180,000. The average income is $60,000. Under my system, he would pay a tax on $100,000 the first year, he would pay a tax on $75,000 less a refund on $25,000 the second year, and in the third year he would pay a tax on $60,000 less a refund on $15,000 twice, that is $60,000 less $30,000.

Now, this may sound complicated, but that is because I am explaining the mathematics of the process.

Senator WILLIAMS. That is the point I was bringing out. If you hit a depression, and the income would have a drastic drop, you would have no tax on those whose income had dropped.

Mr. BRAVMAN. There would have to be a drastic drop in a particular case.

Senator WILLIAMS. I am figuring on a major depression.

Mr. BRAVMAN. I have that illustration here. A man's average income is $25,000 for 9 years. His income drops to $4,000 with the tenth year, and he gets a refund from the Government of $1,050.

If this refund is not allowed by the averaging process individuals will use other methods, as they are now doing, to accomplish the same result. For example, suppose a television star (married and with two children) is offered $300,000 for his services for 1 year. If he accepts the offer the Government gets $242,000 and he is left with less

than $58,000. But if he revises the offer so that he is paid $100,000 for each of 3 years but performs services for only 1 year and is subject to call for consultation for the last 2 years, the Government gets approximately $174,000 and the performer is left with $126,000, a tax saving to the individual or tax loss to the Government of almost $68,000.

The same may be said of the business executive who, instead of receiving $100,000 for each of 10 years, receives $50,000 for each of the 10 years and then $25,000 or more for life. Many other illustrations can be given where by the use of the methods outlined in my testimony the loss of revenue under the present system is enormous.

The purpose of the plan is to improve the operation of the tax structure and to eliminate manifest inequities in it. Since the tax burden is also heavier it is particularly important that like incomes should bear a like burden; that no taxpayer and no kind of income should be discriminated against. Moreover, the tax system should be adjusted so that it will interfere as little as possible with business; so that the economy will function actively and efficiently; and so that men will be encouraged to work and to produce.

Senator HOEY (presiding). Do you want to insert your two exhibits in the record?

Mr. BRAVMAN. Yes, sir.

Senator HOEY. Very well. You may do that.

(The exhibits referred to are as follows:)

EXHIBIT 1

EXPLANATION OF PLAN

The plan will provide a constant flow of revenue, allow payment of the tax when the individual is able to pay, and equalize the tax burden between individuals with fluctuating incomes and individuals with stable incomes. Under the plan individuals would be permitted to average their incomes earned during minority, from 21 through 30 years of age; from 30 to 55 years of age; and from 55 years of age to death.

The computation of the tax or refund is simple. The individual would compute the tax on the average income exactly as he does now on his net income. He would use the same rate schedule in computing the tax on the difference between the average income of the current and the preceding years (the equalizing factor) using the top rates (where the average income increased) or the next succeeding rates (where the average income decreased) used in computing the tax on the average income. To permit a "change in rates" the present scheme of a percentage increase or decrease in the amount of tax would be retained. This percentage would be accumulated during the averaging period and that percentage of the tax on the increase or decrease in average income would be added or subtracted to determine the tax or refund for the year.

COMPUTATION OF AVERAGE INCOME

The average income for any year of the averaging period would be computed in the return for that year. Reference to the records for all years of the averaging period would not be necessary, for the average income of the preceding year and the number of preceding years in the averaging period would be carried forward from the preceding return. The income for the current year would be added to the product of the two items carried forward and the sum divided by the number of years in the averaging period. The result is the average income for the taxable year.

COMPUTATION OF TAX OR REFUND

A simple schedule included as part of the tax return furnished by the Treasury Department would enable the individual to compute his tax or refund under the plan.

The following form would appear on the individual income tax return furnished by the Treasury Department. It also contains figures illustrating the operation of the proposed method of averaging income and computing tax.

In the example it is assumed the individual is married, has no dependents, and files a joint return; it is the tenth year of averaging with the average income for the preceding (ninth) year being $25,000 and the net income for the current (tenth) taxable year being $50,000. It is further assumed that since averaging was begun, the brackets of income and the basic rates were the same as in the present Internal Revenue Code, as amended by the revenue bill of 1951. There was, however, a 10 percent increase in the amount of tax for each of the first 4 years, a 40 percent reduction in the amount of tax for the sixth year, a 12 percent reduction for the seventh year, a 9 percent reduction for the eighth year, no reduction for the ninth year, and a 12 percent increase for the tenth year. The average income and the tax due from this individual for the tenth year of the averaging period would be computed as follows:

SCHEDULE L.—*Computation of average income and tax or refund* [1]

1. Number of preceding years in averaging period (line 6 of last year's return)	9	
2. Average income or loss in last year's return (line 7)	$25, 000. 00	
3. Product of lines 1 and 2	$225, 000. 00	
4. Net income or loss of current year	$50, 000. 00	
5. Total income or loss for averaging period	$275, 000. 00	
6. Number of years in averaging period (line 1 plus 1)	10	
7. Average income or loss (line 5 divided by line 6)	$27, 500. 00	
8. Increase in average income (line 7 minus line 2)	$2, 500. 00	
9. Decrease in average income (line 2 minus line 7)	$----------	
10. Tax on income reported in line 7		$7, 789. 00
11. Tax on amount in line 8 (at rates in highest applicable brackets)	$1, 065. 00	
12. Tax on amount in line 9 (at rates in next succeeding brackets)	$----------	
13. Tax on increase in average income (line 11 multiplied by line 1)		$9, 585. 00
14. Tax on decrease in average income (line 12 multiplied by line 1)		$----------
15. Total tax or credit (line 10 plus line 13 or minus line 14)		$17, 374. 00
16. Add (line 3, schedule N)		$----------
17. Subtract (line 6, schedule N)		$276. 90
18. Tax due		[2] $17, 650. 90
19. Tax refund		$----------

[1] For the first year of the averaging period the individual would be instructed to place a zero in lines 1, 2, and 3 of schedule L and line 1 of schedule M. Provision would be made on the return for the allowance of credit for partially exempt interest and for taxes paid to foreign countries and possessions of the United States. Internal Revenue Code, secs. 25 (a), 31.

[2] This tax plus the taxes paid and less the refunds received for the preceding 9 years equals the aggregate tax paid by an individual whose income was $27,500 in each of the 10 years.

SCHEDULE M.—*Computation of net cumulative percentage addition to or deduction from tax*

	Increase	Decrease
	Percent	*Percent*
1. Preceding year (net)	----------	[1] 26
2. Current year	[2] 12	----------
3. Net percent increase or decrease	----------	14

SCHEDULE N.—*Computation of addition to or deduction from tax*

	Amount	Line 1, schedule M		
		Increase	Decrease	
		Percent	*Percent*	
1. Line 11, schedule L				
2. Line 12, schedule L				
3. Amount carried to line 16, schedule L				
4. Line 11, schedule L	$1,065		26	$276.9
5. Line 12, schedule L				
6. Amount carried to line 17, schedule L				276.9

[1] This is the net cumulative percentage carried forward from line 3 of schedule M of the preceding return, representing in this case the 9 preceding years.
[2] This percentage for the current year would be printed on the form in the proper column.

The following illustration shows the computation of a refund. The basic facts are the same in both cases, except that the net income for the tenth year is $4,000 instead of $50,000:

Schedule L.—*Computation of average income and tax or refund* [1]

1. Number of preceding years in averaging period (line 6 of last year's return)	9	
2. Average income or loss in last year's return (line 7)	$25, 000. 00	
3. Product of lines 1 and 2	225, 000. 00	
4. Net income or loss of current year	4, 000. 00	
5. Total income or loss for averaging period	229, 000. 00	
6. Number of years in averaging period (line 1, plus 1)	10	
7. Average income or loss (line 5 divided by line 6)	$22, 900. 00	
8. Increase in average income (line 7 minus line 2)		
9. Decrease in average income (line 2 minus line 7)	2, 100. 00	
10. Tax on income reported in line 7		$5, 926. 00
11. Tax on amount in line 8 (at rates in highest applicable brackets)		
12. Tax on amount in line 9 (at rates in next succeeding brackets)	798. 00	
13. Tax on increase in average income (line 11 multiplied by line 1)		
14. Tax on decrease in average income (line 12 multiplied by line 1)		7, 182. 00
15. Total tax or credit (line 10 plus line 13 or minus line 14)		(1, 256. 00)
16. Add (line 3, schedule N)		207. 48
17. Subtract (line 6, schedule N)		
18. Tax due		
19. Tax refund		[2] 1, 048. 62

[1] For the first year of the averaging period the individual would be instructed to place a zero in lines 1, 2, and 3 of schedule L and line 1 of schedule M. Provision would be made on the return for the allowance of credit for partially exempt interest and for taxes paid to foreign countries and possessions of the United States. Internal Revenue Code, secs. 25 (a), 31.
[2] This refund, together with all payments and refunds for the preceding 9 years, equals the aggregate tax paid by an individual whose income was $22,900 in each of the 10 years.

SCHEDULE M.—*Computation of net cumulative percentage addition to or deduction from tax*

	Increase	Decrease
	Percent	*Percent*
1. Preceding year (net)		[1] 26
2. Current year	[2] 12	
3. Net percent increase or decrease		14

[1] This is the net cumulative percentage carried forward from line 3 of schedule M of the preceding return, representing in this case the 9 preceding years.
[2] This percentage for the current year would be printed on the form in the proper column.

SCHEDULE N.—*Computation of addition to or deduction from tax*

	Amount	Line 1, schedule M		
		Increase	Decrease	
		Percent	*Percent*	
1. Line 11, schedule L				
2. Line 12, schedule L	$798		26	$207 48
3. Amount carried to line 16, schedule L				207 48
4. Line 11, schedule L				
5. Line 12, schedule L				
6. Amount carried to line 17, schedule L				

EXHIBIT 2

A. Three figures determine the tax or refund for any year of the averaging period, namely:

1. The tax on the average income.
2. (a) Plus the product of—
   (1) the tax on the increase in the average income and
   (2) the number of preceding years in the averaging period, or
   (b) Minus the product of
   (1) the tax on the decrease in the average income and
   (2) the number of preceding years in the averaging period; and

(3) Plus or minus the net cumulative percentage (of the additions to, or reductions in, the amount of tax)—

(1) of the tax on the increase or decrease in the average income.

B. The "tax dividend plan" would have the following benefits:

1. It would enable an individual to strive to attain his maximum earning power, secure in the knowledge that he would not be penalized.
2. It would equalize the tax on all individuals having the same aggregate income over the same period of time.
3. It would extend to all individuals special benefits now enjoyed by some.
4. It would neutralize the effect of the income tax on the carrying on of business at one time or another.
5. It would simplify the computation of both income and tax and thus simplify the administration of the law.

Mr. BRAVMAN. I would just like to add this, that the computation of tax is essentially no different from the present computation of tax. The income is reported the same way, and the computation of the tax is a lot simpler than it sounds.

Senator HOEY. Thank you very much.

Mr. BRAVMAN. You are welcome.

Senator HOEY. Mr. W. F. Bronkie, West Pawlet, Vt.

Mr. Bronkie is being called out of order.

Mr. Bronkie, give your name and connection to the reporter, please.

STATEMENT OF W. F. BRONKIE, WEST PAWLET, VT.

Mr. BRONKIE. My name is W. F. Bronkie, representing the slate industry of the country, particularly the Vermont-New York Slate Association, the Pennsylvania Slate Association, and the slate producers of Maine and Virginia.

Senator HOEY. You may proceed, Mr. Bronkie.

Mr. BRONKIE. We have a very simple request to ask. The slate industry is a very small business. You have in past tax laws recog-

nized the percentage depletion factor as important to the mining and quarrying industry.

During all these years, slate has been overlooked.

It has been put into the House bill, but it has been tied to a lost-cost bulk product, stone, whereas slate is a specialized product, higher in value and quality, and should be given a separate identity, the same as any other competitive or comparative nonmetallic mineral product.

Senator MILLIKIN. What is its state in the earth, as distinguished from granite or marble? Does it present the same apprearances? Does it present the same mining problem?

Mr. BRONKIE. Exactly; the same mining problems as talc, feldspar, and other minerals that are already getting the percentage depletion in their own right.

Senator MILLIKIN. But does it have a higher value while it is still in the ground?

Mr. BRONKIE. Yes, sir. When you compare it to the bulk products which sell for dollars per ton, comparing it on a tonnage basis, which is wrong, because we do not do business on a tonnage basis—we do it on a——

Senator MILLIKIN. Is it a relatively rare deposit?

Mr. BRONKIE. It is relatively rare. It is only in these four districts that I have mentioned that it occurs commercially.

Senator MILLIKIN. But what I am getting at is, you find sand deposits in many, many places.

Mr. BRONKIE. That is right.

Senator MILLIKIN. And you find slate deposits that are suitable for commercial production with equal ease?

Mr. BRONKIE. No, sir. You have to hunt for them, spend a great deal of money and time in exploration and development, the same as you do on a gold mine or a copper mine or any other kind of mining operation that you are familiar with in Colorado.

Senator MILLIKIN. Where are your slate quarries located?

Mr. BRONKIE. In a very limited area in Vermont and New York. They run about 25 miles long and 2 or 3 miles wide.

Senator MILLIKIN. They do not occur generally over the United States?

Mr. BRONKIE. There is that one area in Vermont, as I mentioned. Another is in Virginia, around Buckingham and Arvonia.

Senator MILLIKIN. And does commercial production come only from those areas that you have mentioned?

Mr. BRONKIE. Yes, sir.

Senator MILLIKIN. What are the relative costs of producing the slate, as distinguished from reducing other quarry material to commercial form? What do you do with a block of slate at the quarry?

Mr. BRONKIE. We first have to quarry it, and get it out of the ground in a whole piece. It is the reverse of an ore mining operation that we try to keep our pieces as large as we can.

Senator MILLIKIN. Yes.

Mr. BRONKIE. And it is brought out and cut up either on a diamond saw or by cold cutting methods. It is put into a working group where it is split and trimmed and given its shape. There are further processes in surfacing, sandrubbing, fitting to setting diagrams for laying on the floor, or drilled for electrical switchboards.

Senator MILLIKIN. You have outlined quite a comprehensive and expensive process.

Senator TAFT. How does it come? In slices?

Mr. BRONKIE. In beds.

Senator TAFT. Yes. But is there something in between? Do you have a layer of slate and then a layer of something else and then a layer of slate?

Mr. BRONKIE. We have impurities in it from place to place.

Senator TAFT. How do you get a piece of slate, or a shingle?

Mr. BRONKIE. You get a large block out, and a man sits there with a hammer and a chisel and splits it.

Senator TAFT. He slices it to make it thin?

Mr. BRONKIE. He slices it. It has a natural cleavage in a natural slice. It is peculiar to slate. That is why not all slate has it. We think we have a quarry, but it does not have a good cleavage; so it is not a commercial slate quarry.

Senator TAFT. There is no machine that can just take a solid block of slate and make slices?

Mr. BRONKIE. There have been some patented, but none of them ever worked, unfortunately. One advantage that we have had in recent years is the diamond saw, which has given us a big lift.

Senator MILLIKIN. What would you like to see in this law?

Mr. BRONKIE. That slate be given a separate classification the same as granite, marble, talc, feldspar, vermiculite, and other competitive and comparative products.

Senator TAFT. It is not in the House bill?

Mr. BRONKIE. It is in the House bill, Senator, but it is tied to stone, and stone is a low cost, bulk product. Crushed stone you buy by the ton. Sand and gravel you buy by the ton at a very low figure. All it is is a question of having to go into a bank and dig it out with a steam shovel and put it on a truck. We have a very complicated and expensive development and exploration program to pay for, a big plant to carry. Our problem is exactly the same, on a smaller scale, of course, as the oil industry or the copper mining industry or any other mineral product.

Senator HOEY. You want this put over into the other classifications?

Mr. BRONKIE. No. We just want it to be given its own name.

Your law reads now:

> In the case of asbestos, sand, gravel, stone (including pumice, scoria and slate), brick and tile clay, shale, oyster shell, clam shell, granite, and marble, 5 percent.

Senator HOEY. What is it you want done? You mentioned slate in the last. Do you want it mentioned separately?

Mr. BRONKIE. We want it mentioned separately, the same as marble and granite. We do not want it included in stone, because it is not competitive with stone or comparative with it.

Senator TAFT. Do you want more than 5 percent? Is that the point?

Mr. BRONKIE. No. We would like more, of course.

Senator HOEY. I believe the House bill reads, "Stone, including slate."

Mr. BRONKIE. That is right.

Senator HOEY. And you want slate independent?

Mr. BRONKIE. That is right, because it is not a competitive product with stone.

Senator MILLIKIN. There is no such thing as a stone shingle, is there?

Mr. BRONKIE. No; there is a slate shingle.

Senator MILLIKIN. Do you use the slate for anything but shingles?

Mr. BRONKIE. Yes, sir; we use it for very many products. Electrical switchboards is a very important use of it at the present.

Senator MILLIKIN. Give me more instances of what you do with it.

Mr. BRONKIE. I think we have it in this statement here:

Uses.—Slate is used in a variety of products: namely, natural roofing, roofing granules, siding, electrical switchboards, paints, ceramics, structural slate products, blackboards and bulletin boards, school slates, expanded aggregates, billiard table tops, and has other numerous and miscellaneous uses important to the economy of the country, industrial and chemical.

Senator HOEY. Would you like to have this statement included in the record?

Mr. BRONKIE. Yes, sir.

Mr. HOEY. Mr. Chairman, I suggest that that be included in the record.

The CHAIRMAN. Yes. That will be included in the record.

(The statement referred to is as follows:)

STATEMENT IN SUPPORT OF PERCENTAGE DEPLETION ALLOWANCE FOR SLATE PRODUCERS BY INDEPENDENT CLASSIFICATION IN BILL

This statement is submitted in behalf of the slate producers in the Vermont-New York, Pennsylvania-Maryland, Maine and Virginia slate districts. The slate industry has been overlooked heretofore in the development of the application of the concept of percent depletion. The following facts are submitted for your consideration in support of our claim.

FACTS

1. *Small business.*—The slate industry is composed of approximately 80 relatively small companies operating on low-profit margins.

2. *Industry location.*—Slate is a nonmetallic mineral product manufactured in various grades and types and in various States; namely, Vermont, New York, Pennsylvania, Virginia, California, Arkansas, Georgia, Maine, Maryland. Annual total production is about 800,000 tons with a total value of about $12,000,000.

3. *Uses.*—Slate is used in a variety of products namely, natural roofing, roofing granules, siding, electrical switchboards, paints, ceramics, structural slate products, blackboards and bulletin boards, school slates, expanded aggregates, billiard table tops, and has other numerous and miscellaneous uses important to the economy of the country.

4. *Problems.*—The problems of exploration, development, production and processing of slate are the same as those involved in metallic and nonmetallic mineral products, both competitive and comparative, already granted depletion allowance. In addition, the slate industry is further handicapped by a limitation of 15 to 20 percent recovery of salable slate from a ton of raw material, the balance of 85 to 90 percent being waste material.

5. *Competitive position.*—Competitively, in addition to the depletion factor (wasting of capital assets without tax relief), slate has been at a disadvantage with competitive synthetic products because of greatly increased freight rates in recent years. Slate producers are located by nature and cannot place plants strategically as they see fit.

6. *Others receiving depletion.*—Competitive or comparative mineral industries already receiving depletion allowances are talc, ball and sagger clay, feldspar, china clay, trona, vermiculite, mica, beryl, flake graphite, and others. A workable slate deposit is depleted in the same manner as any of the above industrial minerals. Additional similar industries dealing with industrial minerals are

under consideration to be included in the present tax bill being considered by Congress.

7. *Quality product.*—Slate is a specialized nonmetallic mineral product currently having a market value ranging from $10 to $30 per ton. It should be classified independently as are marble, granite, quartzite, tripoli, etc. Definitely it should not be classified with low-cost bulk products such as stone, shale, sand and gravel that have values per ton only a fraction that of specialized slate products.

8. *Bureau of Mines recognition.*—The Bureau of Mines and United States Geological Survey have published many papers on the subject of slate by such eminent mining engineers and geologists as Oliver Bowles and T. Neslon Dale, and have long recognized our problems of survival to be the same as any other natural resource, be it oil sulfur, coal, or gilsonite.

9. *Discrimination.*—Any tax bill (or law) that allows percentage depletion to competitive products such as feldspar, talc, china clay, asbestos, granite, and marble and not to slate is discriminatory and will destroy the industry.

10. *Help needed.*—Depletion is loss sustained through the removal of natural resources from the earth. Once resources are used they cannot be replaced except by uncertain and costly exploration and development of new deposits. Depletion allowances to other industries with identical probelms assist their continued operation. Slate is fairly entitled to the same consideration.

CONCLUSION

Slate, because of its limited supply in quantities as well as areas, together with the necessity of expending substantial sums to provide adequate raw material, should be recognized as a separate and distinct item in the percentage depletion legislation now proposed, and should be included with competing items entitled to depletion under existing law.

For the reasons stated above and particularly because it is a quality product, slate is entitled to a specific listing separate and apart from the stone classification.

NOTE.—Supporting material is appended hereto as follows:

(*a*) Survey of slate industry.

(*b*) Statement of Winston L. Prouty, Member of Congress from Vermont, to Ways and Means Committee, March 8, 1951.

(*c*) Bibliography.

THE SLATE INDUSTRY—A SURVEY

INTRODUCTION

The production of slate is a small industry consisting of a small number of independent operators which has apparently been overlooked heretofore in the development of the application of the concept of percentage depletion as a means of encouraging the exploration and development of natural resources and providing an equitable method for recovery by the owner of the value of a wasting asset.

The Bureau of Mines Minerals Yearbook for the year 1949 shows that for that year the slate industry consisted of 80 operators who sold slate products having a total value of approximately $12,200,000.

Slate is a metamorphic deposit formed during earth disturbances of geologic time by the action of heat and pressure on shales and other finely divided sedimentary deposits. During this process secondary minerals were formed, principally mica, the crystals of which when properly orientated give to slate its outstanding characteristic of uniform cleavage. This unusual feature, which is fully developed only in limited deposits of slate within the major slate districts of the United States, makes it possible to cleave slate in slabs for processing in various commercial forms.

GEOGRAPHICAL DISTRIBUTION OF SLATE DEPOSITS

While the number of commercial slate deposits in the United States is limited, the slate industry is a part of the economy of a good many States.

PRODUCING LOCALITIES

Slate is known to occur in many localities but there are only five principal districts, all located in the eastern section of the United States, that contain deposits of commercial material. These districts are generally referred to as follows:

Maine: Monson, North Blanchard, and Brownsville districts.

New York-Vermont: Rutland County, Vt.; Washington County, N. Y.

Pennsylvania: Lehigh district—Chapman Quarries, Belfast-Edelman, and Pen-Argyl-Windgap areas.
Pennsylvania-Maryland: Peach Bottom district.
Virginia: Buckingham and Fluvanna Counties, Albermarle County.
Slate has also been produced on a small scale in Arkansas, California, Georgia, Michigan, Tennessee, Utah, and New Jersey.
The sale belts in all these districts are extensive—from 5 to 20 miles in length and from 1 to 3 miles in width. The commercial deposits within these belts, however, are extremely limited and individual quarries seldom extend for more than afew hundred feet in length and considerably less in width.

MODE OF OCCURRENCE

The commercial slate deposits are similar to all metallic and nonmetallic ore deposits in that they are generally lenticular in shape, limited in horizontal and vertical extent and contain a high percentage of material which must be discarded as waste. Like other metallic and nonmetallic deposits, the commercial slate deposits are wasting assets and have relatively short lives as compared to some of the great copper, lead, and zinc deposits of the Western States.

USES OF SLATE

Slate is well-suited to engineering uses because of its high strength, low absorption, resistance to weathering and chemical attack, low electrical conductivity, uniformity of composition, and permanent stability of dimension. Dimension slate or slab slate is used for roofing, electrical panels, architectual panels, laboratory fixtures, sanitary ware, blackboards and bulletin boards, flagstones, and miscellaneous uses. Slate granules are used chiefly in surfacing prepared roofing and siding. Slate flour is used as a filler in putty, wallboard, phonograph records, crayons, blotting paper, linoleum, insulation, facing pavements, building paper, wood filler, abrasives, pencils, plastics, metal polish, firebrick, tiles, ceramic ware, composition flooring, artificial stone, cement, dentifrices, roofiing compound, artificial leather, sweeping compound, explosives, paints, washing compound, and fiber.

INDUSTRY PROBLEMS

The production problems of the slate industry are described in Bulletin No. 47 issued in 1947 by the Mineral Industries Experiment Station of the School of Mineral Industries of Pennsylvania State College, at page 12, as follows:
"Slate tends to occur in narrow beds standing at high angles. Progressive development of quarries therefore produces very deep excavations in which recovery costs constantly increase. Marketable rock could be recovered only by skilled selection, careful handling, and the employment of hand labor. Because of the narrowness of the beds large tonnages of adjacent, noncommercial rock had to be moved. Imperfections in the slate causing rejection added to the tonnage of worthless material. In addition, the use of explosives in blasting and the employment of chenneling machines in cutting rock produce large quantities of shattered rock without value. It has been estimated that the quantity that had to be disposed of as waste varied from 70 to 90 percent in most quarries. This waste material was expensive to handle; its accumulation interfered with quarrying; and large quantities remain for which no use has been found."

COMPETITION

The general problem of competition is discussed in Bulletin 47 referred to above as follows at page 15:
"The magnitude of the entire industry and the drastic decline of the last 20 years are apparent. The decline has been caused almost entirely by the diminishing volume of construction during the depression and then during the war, plus the rise of competitive materials * * *. The slate industry, in common with other postwar industries, faces the problem of effecting every possible economy if it is to maintain its existence."
The problem of the producers of dimension or slab slate is discussed in Bulletin 47 as follows at page 16:
"Through hundreds of years slate has proved superior as a roofing material; but in the past 30 years the asphalt shingle has become the most common roofing on the average home, displacing slate in thousands of structures. The asphalt shingle can be applied with common labor; it comes in attractive colors; it has high

fire resistance and is reasonably permanent. To some extent this loss has been compensated for by the use of slate granules for surfacing the asphalt shingle.

"In the public-school market, the white "blackboard," a sheet of white or light green glass with a ground surface has displaced slate to an appreciable degree. Thus slate is encountering increasing competition not only in its most important markets, roofing and granules, but in one of its oldest uses—the blackboard as well."

The problem of the producers of slate granules is discussed in Bulletin 17 as follows at page 133:

"Business conditions in the industry are subject to change for a number of reasons. Granule technology has been developing rapidly. Almost yearly one or another of the producers offers new or improved products. There is an ever-present possibility that new patentable discoveries will make present practice obsolete. This technological pressure had led to the expenditure of large sums on research, and more highly trained men are required to control production. Quality demands of the consumers are becoming increasingly stringent."

Slate for roofing is by far the most important product derived from commercial slate. This industry has been active in the United States since the middle of the nineteenth century. Its competitive position, however, has been seriously invaded during the past 25 years by many types of roofing substitutes. The steadily increasing freight rates, almost 100 percent in the past 10 years, have placed a severe burden on the slate industry. Manufacturing plants producing substitute roofing media can be located close to the centers of major consumption. The slate deposits, however, fixed in locality by nature, must rely on long hauls by public carriers to reach the consumer. Steadily increasing State and Federal taxes which have been levied without regard to a great natural resource of our Eastern States, or recognition of the fact that slate quarrying is a wasting asset have done serious harm to the normal development of the industry. The combination of these factors has forced many large slate operations employing thousands of men to suspend operations entirely. The deposits of natural slate are not uniform in color or quality, with the result that in spite of core drilling it is almost impossible to determine the life of a quarry in that at any time off-color or an entirely different color slate, or intrusions may be encountered, with the result that either the entire quarry operation must be changed, or a new quarry site developed. It is costly to develop a new face in an existing quarry, but even more costly to abandon a quarry, locate a new deposit, and develop a new quarry location. Because of these many unknown factors it is necessary to constantly explore new deposit possibilities to assure a continuing source and supply of a satisfactory commercial slate.

NEED FOR TAX RELIEF

Mr. Oliver Bowles, associated with the Bureau of Mines for more than 25 years and recognized as the leading authority on the slate industry in the United States, has published many technical papers which definitely state that commercial slate is extremely limited in occurrence within the major slate districts. The hundreds of worked-out and abandoned quarries which can be seen in all the slate districts amply support this contention. Commercial slate must be explored, tested, and developed in a manner similar to all ore deposits and operating slate quarries should obviously be allowed to build up reserve funds to carry out such development work if the industry is to survive. The theory of percentage depletion is based on the assumption that a wasting asset, such as a mining or quarrying operation, can continue to explore, develop, and, if necessary, purchase new deposits to be operated when the old ones are exhausted, using funds which have been set aside, tax free, for this purpose. The soundness of this theory is proved by the healthy condition of the American mining industry which continues year after year to develop new natural resources. The slate industry has to date been denied the benefit of percentage depletion. This fact, combined with the steadily weakened competitive position of slate with its low margin of profit, has precluded the exploration and development of new slate deposits during the past 25 years of severe competition from substitute products. The attached list reflects that many competitive and comparable minerals enjoy depletion allowances which are denied the slate industry. Commercial slate in its original state was a clay which has been converted to its present form through the process of metamorphism. It naturally follows that slate should enjoy the depletion benefits which have been granted to the mining and quarrying industry in general including the products which are in direct competition with slate as well as those products which are analogous in form and character.

The slate industry endorses and supports the statement of Congressman Prouty, of Vermont, regarding the need for percentage depletion for the slate industry which was submitted to the Committee on Ways and Means of the House of Representatives at its hearing held on March 5, 1951.

Slate, because of its limited supply in quantities as well as areas, together with the necessity of expending substantial sums to provide adequate raw material, should be recognized as a separate and distinct item in the percentage depletion legislation now proposed and should be included with competing items entitled to depletion under existing law.

NOTE.—Bulletin 47 referred to above has been quoted extensively because it represents an unbiased objective study of the industry.

Mineral products which are now allowed percentage depletion

Product	Percent of gross income allowed for depletion	Date legislation was enacted	Product	Percent of gross income allowed for depletion	Date legislation was enacted
Oil and gas wells	27.5	1926	Talc	15.0	1943
All metal mines	15.0	1932	Lepidolite	15.0	1943
Coal	5.0	1932	Spodumene	15.0	1943
Sulfur	23.0	1932	Barite	15.0	1943
Fluorspar	15.0	1942	Potash	15.0	1943
Rock asphalt	15.0	1942	Bauxite	15.0	1947
Ball and sagger clay	15.0	1942	China clay	15.0	1947
Flake graphite	15.0	1943	Phosphate rock	15.0	1947
Vermiculite	15.0	1943	Trona	15.0	1947
Beryl	15.0	1943	Bentonite	15.0	1947
Feldspar	15.0	1943	Gilsonite	15.0	1947
Mica	15.0	1943	Thenardite	15.0	1947

STATEMENT OF WINSTON L. PROUTY, M. C., VERMONT, REGARDING THE NEED FOR PERCENTAGE DEPLETION FOR THE SLATE INDUSTRY

I would like to submit for the consideration of the committee a few reasons why I believe the slate industry should be given the benefit of percentage depletion.

As is quite commonly known the slate industry is made up primarily of small businesses. According to the Bureau of Mines there were 80 operators in 1949 doing a business of $12,200,000. This means about $150,000 apiece. The industry is located principally in Pennsylvania, Vermont, and New York State with scattered quarries in Arkansas, California, Maine, Georgia, Maryland, and Virginia. Recent years have seen the slate industry considerably weakened by the following features.

1. The steadily increasing freight rates, almost 100 percent in the past 10 years, has placed a severe burden on the slate industry.
2. Unlike the situation in the making of other roofing materials the use of mechanical appliances has not been completely feasible in the production of natural-slate products.
3. Steadily increasing State and Federal taxes have been levied with no consideration for the fact that slate quarrying is a wasting asset and consequently this lack of consideration has caused many slate operations to be suspended.

It seems only equitable that the slate industry should be given the same consideration as is given its competitors. Oliver Bowles, associated with the Bureau of Mines for over 25 years, has pointed out that slate quarries should be allowed to build up reserve funds to carry out development work if the industry is to survive.

As you well know the theory of percentage depletion is founded on the assumption that a wasting asset such as a mining operation can continue to explore if funds are set aside tax free for this purpose. Our mining experts from coast to coast have hailed this theory as being one of the chief causes of the fine development of the American mining industry. Mica is processed into roofing materials and it is significant to note the 15 percent depletion that this industry is allowed. Talc has a 15 percent depletion and feldspar has a 15 percent depletion. It would seem that all of these industries which are similar in nature should enjoy similar depletion privileges.

At a time when many of our people are beginning to feel that it is not worth while to attempt to make a go of a small business, I think it is important that we

make sure that industries like the slate industry made up primarily of small business concerns be allowed to grow and develop and also that they should be given an equal footing taxwise with their competitors.

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3. Slate in the United States, by T. Nelson Dale and others. United States Geological Survey Bulletin No. 586

The CHAIRMAN. Mr. James Haley. Will you identify yourself for the record, please?

STATEMENT OF JAMES W. HALEY, VICE-PRESIDENT, JEWELL RIDGE COAL CORP.

Mr. HALEY. Mr. Chairman and gentlemen of the committee, my name is James W. Haley. My business address is the Southern Building, Washington 5, D. C. I am vice president of Jewell Ridge Coal Corp., operating coal mines in the States of Virginia, West Virginia, and Kentucky and vice president of Virginia Smokeless Coal Co., which is engaged in the sale of bituminous coal in the eastern and midwestern markets and in the export trade.

I appear here today as a member of the special tax committee of the National Coal Association. The National Coal Association is the trade association of bituminous coal mine owners and operators throughout the United States and has in its membership coal producers in every major coal-producing State in the Nation. More than 75 percent of the commercial producers of bituminous coal in the United States are members of the National Coal Association.

The principal matter which we wish to bring to the special attention of the committee and the Senate is dealt with in section 304 of H. R. 4473. I refer to the proposal to raise the gross depletion rate for coal from 5 percent to 10 percent. We ask your honorable committee and the Senate to accept the well-considered action of the House in this matter.

Section 304 of H. R. 4473 appears at page 85 of the bill as it passed the House.

The Ways and Mean Committee carefully considered the matter of the depletion rate for coal. On the subject, the majority report states, at page 30:

> The testimony also indicated that the 5 percent rate allowed coal is of little practical value, and that the coal-mining industry is peculiarly in need of more favorable tax treatment because of the inroads which alternative sources of energy, particularly oil and gas, have made on the potential markets of coal. * * * Most of these changes would have been made under the House version of the bill which became the Revenue Act of 1950 but they were eliminated from the final legislation largely because of the revenue loss involved. It is apparent, however, that the need for equalization is substantially greater now because of the additional taxes imposed under the legislation of 1950 and under this bill.

The minority report states, at page 152:

> H. R. 4473 contains several commendable structural improvements and adjustments both in the excise and the income-tax field. These include * * * the addition to the depletion items which are now at a competitive disadvantage.

The Committee on Ways and Means also had the benefit of careful study of this situation in its consideration of the Revenue Act of 1950, and that bill, as it first passed the House, contained a provision raising the depletion for coal to 10 percent. However, due to the subsequent development of the military situation in Korea, the Senate Finance Committee, according to your report on the Revenue Act of 1950, decided to "postpone action" on the proposal, pending "more careful analysis of the problems involved."

We strongly urge that the serious and extensive defense program with attendant necessary very high tax rates is all the more reason why the depletion rate for coal should be raised to 10 percent.

We base our case on the dual grounds of coal's place in the picture today, and on a gross and aggravated inequity running against coal and in favor of coal's competitors.

No country in the world today can hope to put itself in a position to survive against even a potential external enemy without an adequate supply of coal.

Because there is so much coal in the ground, there is a tendency to overlook or minimize its essentiality. But we must be brought to realize that this country would be absolutely helpless without coal.

In 1929, in a time of peace, the late Thomas A. Edison said: "The first and best source of power is coal." Later, Winston Churchill, in time of war, said: "War is made of steel and steel is made of coal. Coal is the foundation, and to a very large extent, the measure of our whole war effort."

The statements just quoted indicate the importance of a healthy coal supply to the Nation, in peace and in war.

It is submitted that the best way, if not the only way, to assure a maximum supply of coal, or any other absolutely essential commodity, is to see that the essential commodity is equitably treated in laws of general application.

We state, in all earnestness, that the coal industry is not being equitably treated from the standpoint of the depletion deduction. This situation is forcibly demonstrated when we look at the impact of Federal taxation on coal and other natural resources.

Coal, easily the most important natural resource in the country, receives the lowest depletion rate. The depletion allowance inequity against coal was harsh under the old lower rates; it will be particularly severe under the new proposed much higher rates.

The difficulties of the coal industry in its competition with other fuels are a matter of common knowledge. Coal is in direct competition with oil and natural gas, and any tax disadvantage suffered by coal acts directly to the detriment of coal and to the further loss of coal markets to competitors.

It should be clearly understood that the bituminous coal-mining industry is making no allegation that the 27½ percent gross depletion rate allowed to oil and gas is excessive, in view of the necessity for increased oil and gas reserves in time of peace for use in case of war. It is my opinion, and I believe the opinion of many others in and out of the coal industry, that the United States was very fortunate during the last war in that the Congress had shown the wisdom and foresight to develop a tax structure which permitted this country to produce a supply of petroleum without which the war could not have been won.

This country needs a strong oil industry and a strong coal industry.

The folly of risking our Nation's existence on the assumption that foreign oil will be available in time of crisis is pointed up by the present situation in Iran.

In times of national emergency the coal industry is called upon to produce most of the additional fuel required to meet increased demands. It is the only really flexible source of fuel supply. In addition to taking care of the increased steel production and its normal markets, coal must take over markets which oil and natural gas are in wartime unable to supply.

This situation is demonstrated by the following figures showing the experience of the mineral fuel industries immediately preceding, during, and immediately following World War II:

Percent of energy contributed by mineral fuels

	Coal	Petroleum and natural gas
1936 through 1940	55.1	44.9
1941 through 1945	56.5	43.5
1946 through 1950	47.6	52.4

I call your attention to the little table appearing in the middle of page 5 of my prepared statement. This table shows the percentage of energy contributed by the several mineral fuels divided into three 5-year periods. You will note that in the 5-year period, 1936–40, immediately before the war, coal contributed 55.1 percent of the total supply of fuel by the mineral fuels; the petroleum and natural gas industry contributed 44.9 percent.

In the 5-year war period, 1941 through 1945, coal contributed 56.5 percent; petroleum and natural gas, 43.5 percent.

Then in the 5-year period subsequent to the war, 1946 through 1950, coal contributed only 47.6 percent; and petroleum and natural gas contributed 52.4 percent.

Senator KERR. I wonder if I might ask a question right there, Mr. Chairman.

The CHAIRMAN. Yes, Senator Kerr.

Senator KERR. I want to say to the witness that I am very much interested in his point of view.

While the percentage of the total market that the coal supplies is being reduced by those figures from approximately 56½ to 47½, what effect was felt with reference to the total output of coal? Can you give us the figures, for instance, for 1946, 1948, and 1950?

Mr. HALEY. The actual production of coal?

Senator KERR. Yes.

Mr. HALEY. The production of bituminous coal in 1946 was 534 million tons. In 1948, bituminous coal production was 599,500,000 tons; and in 1950, 512 million tons.

Senator KERR. Now, in the other kinds of coal, the production would probably be somewhat proportionately what the bituminous coal was?

Mr. HALEY. I believe so. I believe the anthracite production fell at a slightly more rapid rate than did the production of bituminous coal.

Senator KERR. Could you tell us what in your opinion the present rate of production is?

Mr. HALEY. The present rate of production, I believe, is at the rate of approximately 545 million tons.

Senator KERR. So that actually, while the percentage of the market which you have supplied has continued to decrease, the over-all production has remained somewhere near the same?

Mr. HALEY. Somewhere near the same.

Senator KERR. That does not in any way take from the effectiveness of what you say. I was just curious as to that point, because that illustrates how rapidly the economy is expanding and the demand for fuel is growing.

Mr. HALEY. Yes, sir.

Senator KERR. All right. Thank you, sir.

Mr. HALEY. In order that the coal industry of this Nation may maintain an economy sufficiently healthy to permit expansion to meet essential defense needs, the tax structure must permit adequate reserves for the procurement of new coal lands and for the opening of new mines. In order for capital to be available to an industry, either the rate of return must be reasonable or some return must be certain. In the coal industry there obviously is no certainty of a profit. Therefore, to allow this industry to remain in a position to meet the wartime needs of the Nation, the tax structure must be such as to permit a reasonable compensation for the increased use of its wasting asset—coal. A 5 percent depletion allowance is wholly inadequate.

For the 10-year period 1938 through 1947, the bituminous coal industry produced a total of 5,253,000,000 tons. For this the industry received a depletion allowance of only 6.6 cents per ton. Would anyone dare seriously suggest that under present conditions the 5,253,000,000 tons of coal would not be worth in the ground far in excess of the depletion allowed. Where can minable coal be leased or purchased at 6.6 cents per ton?

While the coal industry produced most of the Nation's energy during the 10-year period 1938 through 1947, the coal industry certainly did not receive a proportionate depletion allowance.

The following table computed from statistics of income compiled by the Bureau of Internal Revenue shows the distribution among the different natural resource industries of the total depletion allowances for the 10-year period 1938 through 1947.

I call your attention to the table appearing at the middle of page 6 of my prepared statement. From that table, you will see that the petroleum and natural gas industries received 60.4 percent of the total depletion, and the coal industry, bituminous and anthracite together, received only 6.5 percent of the total depletion.

Industry classification	*Percent*
Petroleum refining	42.3
Crude petroleum and natural gas products	18.1
Metal mining	10.9
Bituminous coal	5.3
Timber and lumber products	5.3
Lessors of real property	3.3
Public utilities	3.2
Nonmetals and quarrying	1.8
Chemical	1.5
Anthracite	1.2
All other industries	7.1
Total	100.0

Senator TAFT. This 6.6 cents per ton was based on cost depletion; is that right?

Mr. HALEY. No, sir. That is both cost and percentage.

Senator TAFT. The 5 percent has not been very long. This is for a period of 10 years.

Mr. HALEY. The 5 percent has been in effect since 1932, I believe.

Senator KERR. In other words, what he tells us that coal has sold at an average to the producer of about $1.12 a ton.

Mr. HALEY. Sold to the producer?

Senator KERR. Sold by the producer. The producer realizes about $1.12 a ton. That is what you are telling us.

Mr. HALEY. No, sir. The producer must realize more than that per ton.

Senator KERR. How much did you calculate mathematically that 20 times 6.6 is?

Mr. HALEY. Twenty times 6.6?

Senator KERR. It is $1.32, is it not?

Mr. HALEY. Yes, sir.

Senator KERR. If the depletion allowance got you 6.6 cents a ton and you figured it on the basis of 5 percent, does that not mean that the producer got about $1.32 a ton for it?

Mr. HALEY. It would mean so under those assumptions.

Senator KERR. It is not my assumption. I am just reading your figures.

Mr. HALEY. But the difficulty, Senator, is that the 5 percent gross depletion allowance is limited by the 50 percent of net. In the period, there were many producers who were not able to realize that 5 percent of gross or any percent of gross, because of the 50 percent limitation, and even during the war period, 40 percent of the coal companies operated at a loss. So the companies operating at a loss, unless they could have cost depletion, had no depletion whatsoever, and that was the rule rather than the exception.

Senator TAFT. What is the habit in the industry? Has it been to take cost depletion or has it been to take 5 percent?

Mr. HALEY. It varies from taxpayer to taxpayer.

Senator TAFT. They can take either?

Mr. HALEY. They can take either, yes, sir. Some take cost and some take percentage depletion.

Senator TAFT. Did we increase this to 10 percent?

Mr. HALEY. The House increased it to 10 percent.

Senator TAFT. Last year, a year ago?

Mr. HALEY. Yes, sir.

Senator KERR. I think a year ago we disregarded all of the increases and additional depletion allowances provided by the House, as I remember it.

Senator WILLIAMS. If the result has been that the 5 was not any good to you on account of the 50-percent limitation, what benefit would the 10 be to you?

Mr. HALEY. I did not mean to leave the inference that the 5 has not been of any value to some taxpayers. The 5 has been of real value to taxpayers who were able to make a profit, and the 10 percent will be of more value to such taxpayers and will encourage the development and operation of the efficient and low-cost mines, which is much to be desired.

The CHAIRMAN. Very well. Proceed.

Mr. HALEY. Raising the depletion rate for coal from 5 to 10 percent will be beneficial to the coal-producing industry in that it will afford to the industry an opportunity to acquire some reserve with which to maintain its physical properties. Certainly the value of coal, like the value of everything else, has increased in the last 10 years. Also, the acquisition of desirable coal properties has become in recent years increasingly difficult and expensive.

Raising the depletion rate for coal to 10 percent will not only remove a long standing and aggravated inequity; it will also help labor in that it will mean more running time and more employment.

Moreover, it will be beneficial to coal consumers. In the long run, it will enable the coal suppliers to offer coal to consumers at a relatively lower price. Due to the highly competitive nature of the coal-mining industry, this is certain to be the case.

It should always be remembered in the case of percentage depletion that the taxpayer never gets tax exemption or a subsidy free of taxation, because such depletion allowances are under the law limited to 50 percent of the net income from the property. It should also be remembered that the definition of property contained in the statute is limited to each separate tract or lease, and usually a mine operator has many such separate tracts or leases, only some of which may receive the allowance. Certainly it should very definitely be remembered that raising the depletion rate for coal from 5 percent to 10 percent will not mean doubling the amount of the depletion allowance.

According to official Treasury reports, the bituminous coal mining industry as a whole operated at a loss from the years 1925 through 1939, a period of 15 years. Since 1939 the industry has shown a small profit, although it should be remembered that even during the war years about 40 percent of the coal companies in America operated at a loss. In the 20-year period, 1929 through 1948, after paying Federal income taxes of 4.8 cents per ton, the bituminous coal-mining industry showed a profit of only 3.4 cents per ton.

The difficulties encountered by the coal industry in recent years are a matter of common knowledge. The industry is highly competitive within itself as well as being competitive with other fuels and sources of energy. In addition, indirect taxes, such as the social security tax, are unduly and discriminatorily oppressive on the coal industry. The social security tax, predicated as it is on payroll, is many times as oppressive on the coal industry as it is on practically all other major industries in the United States, due to the fact that approximately 60 percent of the total cost of producing coal goes for the payment of wages.

I should like to emphasize again that we are not in any way suggesting that the depletion rate for oil and natural gas be reduced. What we desperately need is an increase in our own rate. I feel that we have, without question, a most justifiable position, and express the hope that on examination and consideration your honorable committee will concur in the action of the Ways and Means Committee and the House in raising coal's depletion rate to 10 percent.

Other provisions of H. R. 4473 of special concern to the bituminous coal industry are dealt with in the supplement to this statement.

I thank the chairman and other members of the committee for the privilege of appearing here today.

The CHAIRMAN. You may put into the record the supplementary statement, because you deal with other things, I notice. You deal with section 123.

Mr. HALEY. Yes. Thank you.

(The supplementary statement referred to is as follows:)

SUPPLEMENT TO STATEMENT OF JAMES W. HALEY SPECIAL TAX COMMITTEE, NATIONAL COAL ASSOCIATION

The bituminous coal mining industry urges your honorable committee to take the following position on the indicated subjects dealt with in H. R. 4473, for the reasons stated:

I. RELATED CORPORATIONS

If section 123 is retained it should be substantially modified. From the statements on page 23 of the Ways and Means Committee report it appears that the section is designed to forestall tax losses resulting from artificial corporate split-ups of a business. No exception can be taken to such treatment where in fact the corporations in question are tax shams.

Two aspects of the proposal in its present form are open to serious question. First, it is not limited to corporate split-ups, but extends to all kinds of corporate common control situations regardless of when or why they came into being. Second, and most important, it takes mere prima facie, and often rebuttable, evidence pointing to possible tax evasion—that is, common ownership and control of stock—and makes such ownership a conclusive basis of a special penalizing tax treatment of the corporations in question.

In thus arbitrarily and conclusively piercing corporate veils solely on the basis of a pattern of stockholders' interests, the proposal in effect denies the very foundation of corporate income taxation—the independent corporate entity subject to the tax. The section, in effect, raises the doctrine of guilt by association to a new pinnacle. Corporations, regardless of their divergent histories, business purposes, and their entire separateness by every other known yardstick, are deemed guilty of tax evasion solely because of association of interest and voting power in their stockholders. It also penalizes, taxwise, exercise of the right of stockholders of any corporation to become similarly interested stockholders of another corporation. It does so regardless of the difference in risk and purpose of the two corporations, or even the legal necessity of their separateness. Common ownerships and voting power alone, regardless of all other considerations would attaint these corporations as shams created for tax evasion and deny them their normal tax treatment.

No administrative convenience which this proposal might afford the Treasury nor even the estimated $55 million in revenue, would warrant adoption of this radical departure from fundamental tax law. Moreover, there is no certainty that in practical operation the proposal would forestall evasion or collect the estimated revenues from the malefactors against which directed because the penalties of the proposal could be escaped by a small planned distribution of stock by deliberate evaders. But on the other hand, the proposal would impose a heavy and unwarranted tax penalty on many honest and long-established corporations.

For these reasons, if the section is retained, it should be so modified as to substitute for its arbitrary rule, a provision limiting its application to cases of actual tax evasion. Moreover, the section should be limited to suspect situations of recent split-ups marked by retention of common control—for example, those occurring after June 30 of this year.

II. MINING DEVELOPMENT EXPENDITURES

Section 302 provides for deduction, on a ratable basis as the mineral or ore is produced, of expenditures incurred in development of mines. The bituminous coal mining industry supports this provision, but suggests that it be revised as follows, to make clear that the expenditures to be deducted are the net expenditures in excess of receipts from minerals sold and to make certain that the deductions would begin after the development has been completed (suggested new language italicized).

SEC. 302. EXPENDITURES IN THE DEVELOPMENT OF MINES.

(a) DEDUCTION OF EXPENDITURES.—Section 23 (a) (1) (relating to deductions from gross income) is hereby amended by adding at the end thereof the following new subparagraph:

"(D) DEVELOPMENT OF MINES.—*Expenditures, in excess of net receipts from minerals* sold, paid, or incurred after December 31, 1950, in the development of a mine or other natural deposit (other than an oil or gas well), to the extent paid or incurred after the existence of ores or minerals in commercially marketable quantities has been disclosed, shall be deductible *after the development state is over*, on a ratable basis, as the units of produced ores or minerals benefited by such expenditures are sold. *In the case of a mine or other natural deposit on development at December 31, 1950, net receipts from minerals sold during the development period shall be applied in the following order:*

(1) *In reduction of development expenditures paid or incurred prior to December 31, 1950.*

(2) *In reduction of development expenditures paid or incurred after December 31, 1950.*

Such expenditures and the adjustments to basis provided in section 113 (b) (1) (J), shall not be taken into account in determining the adjusted basis of the property for the purpose of computing depletion under section 114. This subparagraph shall not apply to expenditures for the acquisition or improvement of property of a character which is subject to the allowance for depreciation provided in section 23 (l). For purposes of this subparagraph, allowances for depreciation shall be considered as expenditures.

III. CAPITAL GAINS

The capital-gains tax should not be increased as proposed in H. R. 4473.

The general theory of the "defense tax" is that it is a temporary tax imposed on defense period earnings. But, as indicated by the name, long-term capital gains represent gains which have accrued over an extended period. The fact that a gain becomes taxable by virtue of a sale in the defense period does not mean that the economic gain itself occurred during this period. Property held a long time may have reached its peak market value in 1949. The fact that it is sold in 1951 or 1952 does not mean that the gain occurred in those years. It is difficult to justify imposing a temporary tax on the gain.

The general theory of the capital gains tax is that it is imposed on economic income. So long as the value of the dollar when property was purchased was substantially the value of the dollar when the property was sold, the theory and practical application of the capital-gains tax were relatively consistent. But the capital-gains tax has become more and more a tax measured by the degree dollars have lost purchasing power, and less and less by true economic income which has been realized by the taxpayer.

In view of these facts, it would appear equitable to lower the effective rate of the capital gains tax. In any event, it would seem highly inequitable to subject property transactions to an added temporary defense tax.

IV. AVERAGE EARNINGS CREDIT

Lowering of the average earnings credit for excess profits tax purposes from 85 to 75 percent of base period earnings would be particularly harsh on the coal industry. The difficulties of the coal industry from an earnings standpoint are well known to all and need no elaboration here. Not only is the coal industry highly competitive within itself, but it must meet, as an industry, competition from other sources of energy. Moreover, the coal industry is subject to economic uncertainties and other conditions beyond its control. As applied to the coal industry, to class as "excess," earnings over 75 percent or even 85 percent, related to a prior period of years, is indeed a contradiction in terms.

V. EFFECTIVE DATE

It is not necessary to present further arguments concerning the difficulties inherent in increasing taxes retroactively. The Congress itself has publicly deplored such a procedure. To impose increased taxes on a retroactive basis seriously interferes with orderly planning of business in every field and imposes administrative as well as substantive problems on all corporations dealing with

the public and regulatory bodies. It is suggested that the new rates should not be made effective prior to the beginning of the calendar quarter in which the new tax measure becomes law.

The CHAIRMAN. Are there further questions?

Senator KERR. I would like to ask one further question.

At page 6, Mr. Haley, in your table there, in the classification and percent, I notice you said that petroleum refining received 42 percent of the total depletion allowed. I take it that you are there identifying an industry which, while it is defined primarily as being refining, also is the owner of crude oil production.

Mr. HALEY. Yes, sir.

Senator KERR. They do not receive this depletion on their refining operations?

Mr. HALEY. They do not.

Senator KERR. But with reference to the oil which they produce for themselves, you include them because they are primarily a refining unit?

Mr. HALEY. Yes, sir; I include them in that classification because that is the way they are classified at the Bureau, as I recall it.

Senator KERR. I believe unless the explanation is in the record to the effect that they may be classified as a refining industry, actually, any depletion that they receive is in connection with crude oil which they must produce on their own, even though they are a refining unit?

Mr. HALEY. I certainly concur in the observation of the Senator, that that explanation should be in the record.

The CHAIRMAN. Thank you, sir, for your appearance.

The CHAIRMAN. Mr. Jillson.

Will you identify yourself for the record?

STATEMENT OF JOHN D. JILLSON, SECRETARY, ANTHRACITE INSTITUTE, WILKES-BARRE, PA.

Mr. JILLSON. Mr. Chairman and gentlemen of the committee, my name is John D. Jillson. I am secretary of the Anthracite Institute, the principal office of which is located in Walkes-Barre, Pa., and which represents producers of more than 80 percent of the annual anthracite tonnage.

Mr. Chairman, our written statement would be too long to present to you in the time allotted for the oral presentation. So, with your permission, I will take certain passages of it.

The CHAIRMAN. Yes. And you may put your whole statement in the record.

Mr. JILLSON. Yes, sir.

In 1950, our industry produced slightly over 42,000,000 tons. The importance of the industry to the national economy is evident from the fact that 5 million homes, housing 20 million people, are dependent upon anthracite for their heating requirements. Approximately 75 percent of our production is used for this purpose, and the balance is used by public utilities, Army, Navy, and in commercial and industrial buildings.

We appear here to urge this committee to include in any bill reported by it, section 304 (a) of H. R. 4473 which would amend section 114 (b) (4) of the Internal Revenue Code by increasing the gross depletion rate for coal, applicable under section 23 (m), from 5 percent to 10 percent.

The factual justification for the increase is not unfamiliar to the appropriate committee of Congress. As stated by the House Ways and Means Committee in its report on H. R. 4473:

> The testimony also indicated that the 5 percent rate allowed coal is of little practical value, and that the coal mining industry is peculiarly in need of more favorable tax treatment because of the inroads which alternative sources of energy, particularly oil and gas, have made on the potential markets of coal.

Substantially the same finding was made by that committee in 1950.

Since this issue was last before this committee, the ever-increasing importance of coal to the Nation's welfare has been cast in bold relief. The Munitions Board has recognized the heavy increases that may be anticipated in fuel demand and the factors that limit particularly the availability of liquid and gaseous fuels to meet this demand. It has recognized that the Nation will have to look to the coal industries to supply not only their current load, but the deficiencies which cannot be met by the competitive fuels. Implicit in this recognition is the urgent necessity that the coal industry be in a position where it can readily undertake the expansion necessary to accommodate the increased demand for its product and that it maintain a health and flexibility that will enable it to serve the varying demands of the economy in peace and in wartime.

Coal is and must be the long-range fuel reliance of this Nation, whether in its present form, or as the source of synthetic oil production or through underground gasification for the generation of electric power or by some other technology not yet developed.

The financial status of the anthracite industry, for 20 years or more, has been chronically depressed.

Available information, covering over two-thirds of the anthracite industry shows that net operating income before taxes was about 17 cents per ton in 1950 and as low as 4.7 cents per ton in November of that year. This income for 1950 is about 2 percent of the average mine price.

The anthracite industry has been losing tonnage to oil and gas at a rate which, if sustained for many more years, would reduce the annual production of anthracite to a point where the Nation's anthracite resources for all practical purposes, would be of little importance. It is estimated that within the last 2 years, 4,300,000 tons have been lost to fuel oil alone.

During the same 2-year period, gas heating installations cost anthracite at least 500,000 tons.

We know the anthracite industry cannot remain strong and capable of expanding production if our mines and men are allowed to fall into a state of disuse. Unemployed or semiemployed miners will not stay with the anthracite industry, particularly with other industries looking for manpower, and accordingly will not be available to produce anthracite when the emergency, which authorities concede to be inevitable, arises.

It would be a mistake to assume that there is no direct relationship between the competitive losses suffered by the coal industry and the more favorable depletion treatment of its petroleum and gas competitors. This was recognized by the Ways and Means Committee, and it certainly is a fact that by the inadequate allowance accorded coal, as compared with the 27½ percent allowance given oil and gas,

the Internal Revenue Code is seriously penalizing the coal industry, although everyone recognizes that ultimately it is going to have to be the main source of fuel reliance. We suggest that the gap be narrowed, not by decreasing the depletion rate for oil and gas, but by increasing the depletion rate for coal from 5 to 10 percent.

There are considerations in the development, operation, and production of anthracite that are comparable to those involved in the discovery and development of oil and natural gas properties. Large coal tracts purchased by well-established coal companies in the anthracite region, which were supposed to be of great value, later proved, through exploration, to have no present-day worth, either because of the unmarketability of the coal contained therein or because of the physical conditions prohibiting economic extraction. This situation not only applies to entire tracts of coal lands but also exists in coal properties under active operation. It is an engineering fact that, in the process of mining coal, tremendous losses are often incurred through the occurrence of faulty seams, thinning or pinching out of the measures, bad roof and bottom conditions, squeezes, subterranean water, including disastrous floods, and mine fires.

These conditions amply document the need for adequate incentive recognition in the depletion rate.

The existing rates are inadequate to return the capital investment of the industry as a whole and to stimulate the exploration and development essential to our national requirements. The quantity of stimulus necessary must be appraised in the light of the fact that the industry is highly competitive within itself. Additionally, anthracite's competitive relationship with other fuels is very substantially affected not only by the direct impact of its relatively high labor cost of some 70 percent of its cost of production, but also by the added impact of payroll taxes including all social security taxes which fall so much more heavily upon anthracite than upon its competitors.

Because of the very close pricing of anthracite, it has not been possible to accumulate funds for the expansion which would be necessary in the event of war. Cash reserves are relatively small and the industry must look to its current operations for the necessary funds to meet the cost of expansions.

For the 7-year period, 1940 to 1946 inclusive, the depletion allowance per ton granted the anthracite industry was $0.106 as compared with an average royalty rate of about 40 cents per ton.

Considering all the circumstances, including the additional limiting factor because of the restriction to 50 percent of the net income, we feel that our request is conservative.

The anthracite producer's part in our economy is not a static one. He must continue to explore, develop and produce. Unlike the merchant or manufacturer, he cannot look to the market for replacement. When it is used, it is gone. Unlike the manufacturer, an anthracite producer cannot begin with a complete plant, expanding it only to accommodate greater volume. As a mine face recedes, he must follow it; he must constantly expand his plant, and the expanded plant can normally be expected to produce not more, but less, and at a greater cost per unit of production.

The mineral in place in the ground is the principal capital of any producer. An anthracite producer is actually engaged in liquidating

his capital and each and every ton of coal extracted constitutes a wasting away of an asset.

Senator TAFT. What are the reserves in anthracite?

Mr. JILLSON. They have been variously estimated at around 125 to 150 years.

Senator TAFT. At this rate of 40 or 50 million tons a year?

Mr. JILLSON. Yes, sir.

The United States Geological Survey at present is bringing out a new appraisal of all coal lands, and that is why I say that they have been variously estimated as between 125 and 150 years, depending on the depth of the beds and the overburden, and so forth.

Senator KERR. The reserves of the bituminous are far greater proportionately?

Mr. JILLSON. Much greater, sir.

We think that our request is justified and that the logic of the situation is clear. Coal must inevitably provide the long-range fuel reliance of this Nation. The existing depletion rates not only do not provide the stimulation for continuing vitality which percentage depletion was intended to accomplish but actually weaken the coal industry because of its inadequate allowance as compared to competitive fuels.

I greatly appreciate the privilege of having appeared before you. I have endeavored to make a strictly factual presentation and to gear my remarks to the seriousness and difficulty of your over-all task. I sincerely trust that, after deliberation, you will grant our request.

The CHAIRMAN. Thank you, sir, for your appearance.

Mr. JILLSON. Thank you.

(The prepared statement of Mr. Jillson is as follows:)

STATEMENT OF JOHN D. JILLSON, SECRETARY, ANTHRACITE INSTITUTE, WILKES-BARRE, PA.

My name is John D. Jillson. I am secretary of the Anthracite Institute, the principal office of which is located in Wilkes-Barre, Pa., and which represents producers of more than 80 percent of the annual anthracite tonnage.

In 1950, our industry produced slightly over 42,000,000 tons. The importance of the industry to the national economy is evident from the fact that 5 million homes, housing 20 million people, are dependent upon anthracite for their heating requirements. Approximately 75 percent of our production is used for this purpose, and the balance is used by public utilities, Army, Navy, and in commercial and industrial buildings.

We greatly appreciate the privilege of appearing before this committee. We are mindful of the revenue raising necessities of our Government to insure its continuing vitality in a global picture that is fraught with dangers and uncertainty. We are equally conscious of the extent to which that continuing vitality depends essentially on the enduring productive strength of our basic resource industries.

We appear here to urge this committee to include in any bill reported by it, section 304 (a) of H. R. 4473 which would amend section 114 (b) (4) of the Internal Revenue Code by increasing the gross depletion rate for coal, applicable under section 23 (m), from 5 to 10 percent.

For the reasons to be indicated, we believe that such an increase is a necessary step in the formulation of a constructive tax program designed to meet the revenue needs of the Nation and at the same time to protect the strength of its basic fuel industry.

The factual justification for the increase is not unfamiliar to the appropriate committees of Congress. As stated by the House Ways and Means Committee in its report on H. R. 4473:

"The testimony also indicated that the 5 percent rate allowed coal is of little practical value, and that the coal mining industry is peculiarly in need of more

favorable tax treatment because of the inroads which alternative sources of energy, particularly oil and gas, have made on the potential markets of coal."

Substantially the same finding was made by that committee in 1950.

We appreciate the considerations that led this committee in the summer of 1950, tragically jarred as we all were by the sudden developments in Korea, to "postpone action" on the recommended amendment pending "more careful analysis of the problems involved."

The intervening months have underscored the long-term nature of our preparedness obligation and have dramatized the essentiality of coal to the achievement of that responsibility. We very respectfully ask that this much needed relief no longer be deferred. The policy considerations and the materials for judgment are at hand and we hope that this committee, oppressed though it is with its many burdens, will meet the issue head on and recommend remedial action in this year's revenue bill.

Since this issue was last before this committee, the ever-increasing importance of coal to the Nation's welfare has been cast in bold relief. The Munitions Board has recognized the heavy increases that may be anticipated in fuel demand and the factors that limit particularly the availability of liquid and gaseous fuels to meet this demand. It has recognized that the Nation will have to look to the coal industries to supply not only their current load, but the deficiencies which cannot be met by the competitive fuels. Implicit in this recognition is the urgent necessity that the coal industry be in a position where it can readily undertake the expansion necessary to accommodate the increased demand for its product and that it maintain a health and flexibility that will enable it to serve the varying demands of the economy in peace and in wartime.

As stated by the Senate Committee on Labor and Public Welfare in Report No. 2042 on July 14, 1950.

"In this process, coal has played an essential role. Without coal, these adjustments could not have been made. Without coal, American production cannot continue at a high level.

"Coal is thus indispensible to the American economy. A healthy coal industry is of vital importance to the American people."

I have attached to my statement the memorandum issued by the Munitions Board on February 17, 1951, to the Secretary of the Army, the Secretary of the Navy and the Secretary of the Air Force. It directs that, because of the relatively more limited availability of other fuels, coal, as the Nation's largest fuel resource, should be used as far as practicable, in all military facilities in preference to other fuels.

Coal is and must be the long-range fuel reliance of this Nation, whether in its present form, or as the source of synthetic oil production or through underground gasification for the generation of electric power or by some other technology not yet developed. Even though during 1949 coal supplied only 39.8 percent of the Nation's energy while oil and natural gas supplied 55.3 percent, coal constitutes 83.06 percent of the Nation's total assured recoverable mineral fuel reserves and petroleum and natural gas together constitute but 3.82 percent.

There are several aspects of the national fuel picture that press for scrutiny and remedy over and above the one that is before you today. They have to do, among other things, with the risks inherent in any assumption that there are recoverable reserves of petroleum and gas in this country beyond the 14 and 29 years respectively of proved reserves; with the basic wisdom, in the light, for example, of the current Iranian situation, of building up a reliance on imported foreign oil which, while available, displaces domestic fuel production; and with the fairness of diverting millions of tons of badly needed steel for the building of gas pipelines and of petroleum facilities in displacement of domestic coal production.

These aspects must all be probed in appropriate forums, but over and above their resolution, the public interest demands an immediate increase in the gross depletion rate for coal.

The financial status of the anthracite industry, for 20 years or more, has been chronically depressed. In 1924 the commercial production of the industry amounted to 79,298,819 tons, but during the succeeding years, gradually declined until in 1938 it was only 43,170,457 net tons. A partial recovery occurred in 1939 and 1940, in each of which years the commercial production slightly exceeded 48 million tons.

World War II brought a fairly substantial increase in the demand for anthracite, culminating in 1944 in a commercial production of almost 60 million tons, brought about in part by increased demands for domestic fuels, but principally by the shortage of other domestic fuels, particularly oil. During 1944 the consumption

of anthracite reached 62.3 percent of the total consumption of domestic heating fuels in northeastern United States.

In the years immediately following the war, production was maintained at a level somewhat higher than before the war, the tonnages being:

	Net tons
1946	57, 310, 488
1947	54, 049, 581
1948	54, 228, 585

This was due to two conditions, first, a serious shortage of coal in Europe, which resulted in a heavy export movement, and second, a continuing shortage of fuel oil in the American market.

With the passage of these conditions, the anthracite market dropped back to prewar depression levels, the commercial production being only 40,653,304 tons in 1949 and 42,280,000 tons in 1950. This decline in anthracite production was due in some part to unusually warm weather in the heating seasons of 1948–49 and 1949–50, but the greatest factor undoubtedly was the tremendous increase in the installation of oil burners and the increased use of natural gas, brought about by the construction of new pipelines from the Southwest into the primary anthracite market area.

Available information, covering over two-thirds of the anthracite industry shows that net operating income before taxes was about 17 cents per ton in 1950 and as low as 4.7 cents per ton in November of that year. This income for 1950 is about 2 percent of the average mine price.

The anthracite industry has been losing tonnage to oil and gas at a rate, which, if sustained for many more years, would reduce the annual production of anthracite to a point where the Nation's anthracite resources for all practical purposes, would be of little importance. It is estimated that within the last 2 years, 4,300,000 tons have been lost to fuel oil alone.

During the same 2-year period, gas heating installations cost anthracite at least 500,000 tons and this form of competitive heating is just beginning to make a start in the anthracite marketing area. A large increase in the number of gas heating installations in northeastern United States is predicted for the next few years and the anthracite industry may therefore expect to suffer greater attrition from that source.

But, even assuming that the rate of attrition from oil and gas remains static, it is evident from simple arthmetic that an industry which produced 42,000,000 units in 1950 and is losing business at the rate of 2,500,000 units per year, or 6 percent of annual production the first year and progressively greater percentages in subsequent years, cannot continue indefinitely to preserve the health and ready expandability which the national interest requires.

We know the anthracite industry cannot remain strong and capable of expanding production if our mines and men are allowed to fall into a state of disuse. Unemployed or semiemployed miners will not stay with the anthracite industry, particularly with other industries looking for manpower, and accordingly will not be available to produce anthracite when the emergency, which authorities concede to be inevitable, arises.

It would be a mistake to assume that there is no direct relationship between the competitive losses suffered by the coal industry and the more favorable depletion treatment of its petroleum and gas competitors. This was recognized by the Ways and Means Committee and it certainly is a fact that by the inadequate allowance accorded coal, as compared with the 27½ percent allowance given oil and gas, the Internal Revenue Code is seriously penalizing the coal industry, although everyone recognizes that ultimately it is going to have to be the main source of fuel reliance. We suggest that the gap be narrowed, not by decreasing the depletion rate for oil and gas, but by increasing the depletion rate for coal from 5 to 10 percent.

There are considerations in the development, operation, and production of anthracite that are comparable to those involved in the discovery and development of oil and natural gas properties. Large coal tracts purchased by well-established coal companies in the anthracite region, which were supposed to be of great value, later proved, through exploration, to have no present-day worth, either because of the unmarketability of the coal contained therein or because of the physical conditions prohibiting economic extraction. This situation not only applies to entire tracts of coal lands but also exists in coal properties under active operation. It is an engineering fact that, in the process of mining coal, tremendous losses are often incurred through the occurrence of faulty seams, thin-

ning or pinching out of the measures, bad roof and bottom conditions, squeezes, subterranean water, including disastrous floods, and mine fires.

A goodly portion of the reserves and the current production of anthracite come from coal measures which have been partially exploited and then abandoned by former operators. In many instances in such areas the pillars of coal indicated only by old map records are nonexistent or are not recoverable due to conditions beyond the control of the present operator.

Many operating mines are faced with the possibility of inundation when an adjoining mine or mines are abandoned by exhaustion or suspension. This situation has been recognized by the Federal Government in the passage of House bill H. R. 4837, providing for the expenditure of large sums of money to make an engineering study of this problem and to prepare plans for handling this situation. Furthermore, there is a great expense involved in operating and maintaining extensive pumping facilities.

These conditions amply document the need for adequate incentive recognition in the depletion rate.

The increased rate requested will also serve a conservation objective in that it will enable the industry to mine a large quantity of coal now considered marginal, which is not being taken out because of the cost of mining.

The increase is in accord with and would more nearly accomplish the objective had in mind, in establishing the percentage depletion method for coal in 1932, oil and gas having had this privilege since 1926.

In describing that objective to the Ways and Means Committee last year, Secretary of the Treasury Snyder said:

"Since coal and nonmetallics, other than sulfur, had never enjoyed any significant amounts of discovery depletion, the percentage rates on gross income for those items were not based on special tax-depletion experience. Instead, rates were selected to afford tax relief and tax incentives which seemed to Congress reasonable at that time as compared to the treatment given oil, sulfur, and metals."

Subsequent events have demonstrated that the gross depletion rate for coal is not adequate to provide the "tax incentive" which Congress intended to effect in 1932 and which is now so necessary to meet the Nation's present and prospective requirements.

The existing rates are inadequate to return the capital investment of the industry as a whole and to stimulate the exploration and development essential to our national requirements. The quantity of stimulus necessary must be appraised in the light of the fact that the industry is highly competitive within itself. Additionally, anthracite's competitive relationship with other fuels is very substantially affected not only by the direct impact of its relatively high labor cost of some 70 percent of its cost of production, but also by the added impact of payroll taxes including all social-security taxes which fall so much more heavily upon anthracite than upon its competitors.

The granting of this relief is in no way intended to be inconsistent with the Congress adopting whatever over-all tax rates for the economy generally it deems necessary to achieve revenue raising necessities.

In World War II, anthracite was required to increase its production from 43,170,457 tons in 1938, to 59,888,928 tons in 1944, an increase of 39 percent. With a present production of only 42,000,000 tons, it can easily be seen that an even greater expansion would now be necessary.

Because of the very close pricing of anthracite, it has not been possible to accumulate funds for the expansion which would be necessary in the event of war. Cash reserves are relatively small and the industry must look to its current operations for the necessary funds to meet the cost of expansions.

The capital expenditures necessary for expansion would, no doubt, more than offset any tax savings from enacting our proposal and it does not follow that there would necessarily mean any increased return to the proprietary interests in the industry.

The increased rate would help labor in that it would tend to increase employment opportunities and the number of days of work. In the long run, it should tend to result in additional income taxes. Furthermore, it holds potential benefit to coal consumers since it carries with it the possible opportunity to offer coal at lower prices.

The present inequity as between competing industries is very apparent. The depletion allowance based on the gross income for the quantity of crude oil equivalent to 1 ton of anthracite is approximately $3.25, to be compared with a corresponding allowance for anthracite of about 50 cents, a difference of $2.75 or 550 percent in favor of oil.

For the 7-year period, 1940 to 1946, inclusive, the depletion allowance per ton granted the anthracite industry was $0.106 as compared with an average royalty rate of about 40 cents per ton.

Considering all the circumstances, including the additional limiting factor because of the restriction to 50 percent of the net income, we feel that our request is conservative.

The anthracite industry has operated at a loss, or a very small profit in each of the past 25 years. During the years 1940 through 1946, inclusive, operators of anthracite mines, having annual production of 50,000 net tons or more, had an average net income per ton before income taxes of approximately $0.163.

The anthracite producer's part in our economy is not a static one. He must continue to explore, develop, and produce. Unlike the merchant or manufacturer, he cannot look to the market for replacement. When it is used, it is gone. Unlike the manufacturer, an anthracite producer cannot begin with a complete plant, expanding it only to accommodate greater volume. As a mine face recedes, he must follow it; he must constantly expand his plant, and the expanded plant can normally be expected to produce not more, but less, and at a greater cost per unit of production.

The mineral in place in the ground is the principal capital of any producer. An anthracite producer is actually engaged in liquidating his capital and each and every ton of coal extracted constitutes a wasting away of an asset. This asset can then be replaced only by the acquisition of new coal deposits, requiring again a large capital expenditure for their development. In this respect, he is no different than a producer of oil and gas.

We think that our request is justified and that the logic of the situation is clear. Coal must inevitably provide the long-range fuel reliance of this Nation. The existing depletion rates not only do not provide the stimulation for continuing vitality which percentage depletion was intended to accomplish, but actually weaken the coal industry because of its inadequate allowance as compared to competitive fuels. Accordingly, that discriminatory treatment must be eliminated by increasing the depletion rate for coal.

I greatly appreciate the privilege of having appeared before you. I have endeavored to make a strictly factual presentation and to gear my remarks to the seriousness and difficulty of your over-all task. I sincerely trust that, after deliberation, you will grant our request.

MUNITIONS BOARD,
February 17, 1951.

Memorandum for the Secretary of the Army, through the Under Secretary of the Army.

Memorandum for the Secretary of the Navy, through the Assistant Secretary of the Navy.

Memorandum for the Secretary of the Air Force, through the Assistant Secretary of the Air Force.

Subject: Availability of fuels.

1. The relative availability of various kinds of fuel will change as mobilization and defense production are stepped up. Shortages of some fuels have already developed in some localities.

2. In order to give the maximum support to the over-all defense effort, and to reduce the possibility of fuel procurement difficulties, it is necessary that all fuel use be carefully revised, particularly for areas of limited fuel resources and for installations of large fuel consumption.

3. Coal is the Nation's largest fuel resource. It is available quite generally, except in west coast States. It should be employed, as far as practicable, at all military facilities—both command and industrial, as well as military sponsored industrial facilities. Mine production in general is expected to meet over-all requirements, but in some areas there will be difficulty in obtaining deliveries due to a shortage of coal cars. For this reason consideration should be given to obtaining requirements from the nearest mines even though quality is not up to that desired in normal times. Assurance of fuel supply and adjustments to defense needs should be basic guides in determining the fuel to be used.

4. Natural gas is a favorite fuel because of its convenience, cost, and labor-saving possibilities. Wherever the use of coal is impracticable, gas should be considered, although it will be necessary to make sure that its availability will continue for a reasonable period of time. The popularity of the fuel is expanding its use at such a rate that the demand may outrun the great expansion in pipelines

and distribution systems. In case it becomes necessary to regulate the use of gas, it will be well to keep in mind that first preference will probably be given to domestic- and small-space heating use and second preference to special industrial uses. Other uses will bear the brunt of control regulations.

5. Fuel oil has been abundant the past 2 years, especially in seaboard areas, but under the stepped up defense program the situation is changing. Petroleum products will be in great demand. There is a shortage in both tank cars and tankers. For this reason the use of heating oil and fuel oil should be kept to the practical minimum.

6. Liquefied petroleum gases (LPG) have been available in great quantities during the postwar period. Their availability for general use is now being greatly reduced. Butane is required for the synthetic rubber program and for certain high octane gasolines. Propane is still available but the shortage of pressure tank cars is delaying deliveries. This condition will grow worse. For these reasons use of LPG should be kept to a minimum except in areas within trucking distance of refineries where supplies are adequate.

7. Multiple fuel equipment: Installations having equipment for bunring more than one fuel should arrange to use the fuel most readily available under the present emergency conditions. In general, first preference should be given to the use of coal, second perference to natural gas and third preference to fuel oil

8. Conversion of facilities: In some areas the fuel situation will make necessary the consideration of converting fuel burning equipment. No general rule can be laid down for guidance. A decision should be made on the basis of the foregoing comments and the factors involved in making the conversion, i. e., the amount of fuel involved, the critical materials required for the conversion, and the man-hours of labor. In general, the fule preference should be: first, coal; second, gas; third, oil. Full weight must be given in all cases to local conditions.

JERRY V. MATEJKA,
Major General, United States Army,
Military Director for Production Management
(For the Chairman).

The Chairman. Mr. Hamblen.

Will you identify yourself for the record?

STATEMENT OF W. P. HAMBLEN, HOUSTON, TEX., REPRESENTING VARIOUS GULF COAST MINERAL SHELL PRODUCERS

Mr. HAMBLEN. My name is W. P. Hamblen, of Houston, Tex., representing a number of Gulf coast shell industries, producing mineral shell.

Mr. Chairman and gentlemen, I have filed a statement with the committee which I would like to ask to be considered as part of the record.

The CHAIRMAN. Yes, sir.

Mr. HAMBLEN. If so, I do not care to read the statement. As I think the record will be ready, anyhow, it will be unnecessary to read it.

The Chairman. It will go into the record.

Mr. HAMBLEN. However, sir, there is one matter that has come up since I prepared the statement.

The shell people get their shell under an arrangement with the Game, Fish and Oyster Commission of Texas, paying them a royalty of 7 cents a yard for shell produced. Yesterday I found a letter that they had written to the Defense Minerals Corporation giving their opinion of the time within which the shell in Galveston Bay, where we get our shell from, will be depleted. And I would like to ask permission of the committee to make copies of that letter and file it as a part of that statement.

The CHAIRMAN. Yes; you may do so. We shall be very glad to have you do so.

Mr. HAMBLEN. Thank you, sir. That is all I have to say.

Senator KERR. What is the gist of your statement?

Mr. HAMBLEN. It is largely a statement of the purposes that shell is produced for.

Senator KERR. What is your objective?

Mr. HAMBLEN. In the last bill, sir, they have permitted us a 5-percent depletion allowance.

Senator KERR. In the House bill?

The CHAIRMAN. That is included in the House bill.

Mr. HAMBLEN. It has been eliminated heretofore the last two times we have been up here, and I am hoping it will not get eliminated this time.

Thank you, sir.

Senator KERR. You mean, you get it and then they take it away from you?

Mr. HAMBLEN. We get it one time and then somebody reaches out and takes it away from us.

Senator KERR. The hand is quicker than the eye.

The CHAIRMAN. Thank you, Mr. Hamblen.

(The statement of Mr. Hamblen is as follows:)

STATEMENT OF W. P. HAMBLEN, OF HOUSTON, TEX., REPRESENTING VARIOUS GULF COAST MINERAL SHELL PRODUCERS

Mr. Chairman and gentlemen of the committee, I am W. P. Hamblen, of Houston, Tex. I am appearing on behalf of a number of companies engaged in the production of mineral shell deposits, all on the Gulf coast of Texas and Louisiana. I am a director of, and attorney for the W. D. Haden Co. of Houston, Tex., one of the larger producers of mineral shell.

The shell industry began about 40 or 50 years ago and I believe it was originally started by Capt. W. D. Haden, the founder of the W. D. Haden Co. At that time he had a small dipper dredge and were cutting the shell off of reefs which appeared above the surface of the bay waters. Now, practically all of these reefs have been depleted and we are getting the shell from the bottom of the bay. A good deal of confusion about the mineral-shell industry has arisen because a number of people think it is only a matter of using the shell after the oysters or clams have been taken from them. That is not true. The shell deposits are fossils and, according to the geologists, were formed 500,000 to 1,000,000 years ago and, of course, are not being replaced. The shell deposits are nearly always covered with from 2 to 4 feet of silt. This must be removed before the dredges can get to the shell.

Practically all of the known shell deposits in the United States are on the Gulf coast of Texas and Louisiana, but over 50 percent of the shell is produced in Texas. There are, however, a few large producers in Louisiana that are producing the shell for substantially the same purposes for which the Texas companies are producing it. Most of the shell dredged by the Texas companies in Texas is from Galveston Bay and Matagorda Bay. Galveston Bay is an arm of the Gulf reaching toward Houston, and the upper reaches of the bay are about 25 miles from the city. Matagorda Bay lies about 200 miles west of Houston; that is, that portion of the bay within which are the shell deposits. For practical purposes, all of the shell produced in and around Houston comes from Galveston Bay, as it is Galveston Bay that furnishes the only available shell for the near locations. The present shell deposits are almost 30 miles from Houston and the shell must be transported by tugs and barges. The haul to Freeport from the bay is about 65 miles and the haul to Beaumont and Port Arthur from Galveston Bay is about the same distance. While it is possible, it would be considerably more expensive to haul the shell from Matagorda Bay than from Galveston Bay as it would be necessary to cross two big rivers, the Trinity and the Colorado, and to haul the shell about 200 miles. Both of these rivers have water gates on them and when the rivers are up it is almost impossible for a towboat, or rather for barges and tugboats, to come through them.

Shell is produced by means of large dredges that bring the shell up from the bottom of the bay, carry it up to the top of the dredge where it goes down chutes

and is washed continuously and finally delivered into barges. There is a method on board the dredges of separating the fine shells from the large. The fine shell is used mostly by the chicken feed industry and the cement plants, although the cement plants have to take some of the larger shell as we are unable to produce enough of the fines from them to operate continuously. The other companies, such as Dow Chemical, Mathieson Chemical Co., and the alkali companies use the larger shell as it is more adaptable to their use from a processing standpoint.

The W. D. Haden Co. and Parker Bros. & Co., Inc., are the two larger producers in the bay area. There are a number of smaller producers, but I would say that two-thirds or three-fourths of the total shell produced from Galveston Bay is produced by either Parker Bros. & Co., Inc., or the W. D. Haden Co., both of whom produce from 200,000 to 250,000 yards per month, or between the two of them approximately 5,000,000 yards per year. After this shell is put into the barges it is picked up by towboats and hauled to Houston, Galveston, Beaumont, Port Arthur, and Freeport, or Texas City, wherever the shell is needed for the various purposes for which it is used.

I am not entirely familiar with the operation of the other companies, but I do know that the W. D. Haden Co. operates a fleet of some 7 or 8 tugs and about 30 barges that haul anywhere from 800 to 1,500 yards of shell each. In addition to the tugs and barges, it is necessary to have docks and unloading facilities, such as cranes and similar machinery, and hoppers so that the shell can be put into trucks and hauled to the site of their use, although the larger consumers, such as Dow Chemical, Mathieson Chemical Co., and the other companies have stockpiles and use cranes to put it into the stockpiles. From there it is pulled up by worm gears to its useful places. To produce the shell, as it is produced by W. D. Haden Co. and Parker Bros. & Co., Inc., requires an investment in excess of $2,000,000. The barges cost around $30,000 each and the tugboats from $60,000 to $75,000 each, so it is readily to be seen that outside of the other equipment the floating equipment alone is very expensive, and entails a large investment. The dredge boat which the Haden Co. recently built cost something over $400,000.

Shell is almost pure calcium carbonate, running from 98½ to 99½ percent pure. Originally, shell was largely used for building roads, but on account of its dryness it was not practical except when it had a waterproof covering. In 1929 the W. D. Haden Co. opened a plant near Houston which produced lime from shell. At about that time the Mathieson Chemical Co. and the Southern Alkali Corp. opened their Texas plants using mineral shell to make lime. Lime in turn is used to make caustic soda and soda ash. Caustic soda, as most of you doubtless know, is used in making soap, rayon, lye, in vegetable oil refining, in paper making, in oil refining and wool scouring, and in the manufacture of glass. The availability of caustic soda made from lime produced from shell caused construction of many plants in Texas for almost all of these processes. One of the plants is the Celanese Corp., established in Bishop, Tex., in about 1942. This plant uses mineral shell to make caustic soda to make chemicals essential in the manufacture of fabrics, plastics, textiles, drugs, varnishes, lacquer, dyes, paper, fungacide, antifreeze, soap, antirust materials, and many other products, including the making of film for moving pictures. In 1936 the Champion Paper Co. built its plant in Houston and became a large user of shell transforming it into lime, and in 1940 Dow Magnesium established its plant in Freeport, and became one of the largest users of shell. It makes shell into lime and uses the lime to precipitate magnesium from sea water. There are a number of cement plants in Texas and Louisiana along the Gulf coast using shell as its raw material. Consequently, today only a small portion of the production is used for road surfacing.

Prior to 1940 there was little thought given to the fact that the known shell reserves were exhaustible. However, when it was found that shell was a vital material in the defense program, the production and consumption of shell was more than doubled. Production was extended to the limit of the capacity of the shell producers to produce. In fact, during the war years an enormous amount of shell was being used in the construction of airfields and roads to war plants and docks, and cement plants increased their demand for shell on account of the great demand for cement; and Dow Magnesium was making increasing demands due to its strategic position in the war effort. In fact, at that time the Government found it necessary to require Parker Brothers & Co., Inc., and Haden Co. to sign a joint contract for the production of shell for the Dow Magnesium so that it would have sufficient shell to fulfill its war contracts. When it was found that shell could be used for all of the various purposes, the producers began surveys to try to determine the known reserves of shell which could be produced economically. These surveys

have continued to the present time and estimates of these reserves based on present production in Galveston Bay ranges from 7 to 10 years in most cases. The present dredges are equipped to dredge shell from 24 to 26 feet. We are finding, however, since the production of oil in the various bays, from the logs of the wells, that there are numerous bodies of shell from 60 to 80 feet deep. But, of course, none of the present equipment is able to produce that shell, and it will require much larger and different equipment to get the shell from that depth. As a matter of fact, it is somewhat doubtful in the minds of those who are producing shell now that it can be done at all. Two of the larger producers have recently built new dredges which are capable of producing to a greater depth and a larger supply, and I happen to know that the larger companies are now considering building larger towboats and barges to bring in from 2,000 to 3,000 yards in each barge instead of from 1,200 to 1,500 as they are presently doing, but this cannot be done unless we are able to get some type of percentage-depletion allowance, and we believe that a fair percentage-depletion allowance would provide the relief and inducement necessary to induce capital to invest in this essential industry.

The present bill provides for depletion of 5 percent. Of course, we do not think this is quite enough but we are glad to get that. We feel that this industry requires a depletion allowance because of the imminent complete depletion of the presently known shell deposits; in the event of such depletion some other use could probably be found for the tugboats that we are using, but it would be almost impossible and impracticable for the barges to be reconverted to other uses or the dredges reconverted to other uses. If the supply of mineral shell were exhausted or became unavailable, the only raw material which could be substituted for the present plants using shell is located several hundred miles away. This substitute does not contain the high percentage of calcium carbonate composition and is, therefore, not as desirable as shell. In addition, the freight rate to the present plants would increase the price to such an extent that it would be almost prohibitive. Thus, should the supply of fossil shell be exhausted, these plants would face a problem of suspending operations altogether.

One of our difficulties is to get the depletion allowed at the value of the shell at docks. It has no value at the dredge until it is hauled ashore. It is somewhat like coal at the bottom of a mine, or oil at the bottom of an oil well, only it doesn't come up by elevators or by pipeline but comes by barges and tugboats.

The industry requires a relatively heavy capitalization. As a matter of fact, the gross business per annum will not exceed the value of their capital assets and it is a very small net return for a dollar of investment. It is strictly a volume business and if the shell becomes depleted and it has to be searched for and is difficult to obtain, there is a very good likelihood that we will all be out of business.

I thank you.

The CHAIRMAN. Mr. A. C. Ford.

Will you identify yourself for the record?

STATEMENT OF A. C. FORD, DIRECTOR OF SALES, SOUTHERN LIGHTWEIGHT AGGREGATE CORP.

Mr. FORD. Mr. Chairman and gentlemen, my name is A. C. Ford, and I represent the Southern Lightweight Aggregate Corp., in Richmond.

I would like to express my appreciation for the opportunity to appear before the Senate Finance Committee in support of the equalization measure which will eliminate inequities that have existed as regards percentage depletion. Vermiculite lightweight aggregate has, for some time, received 15 percent depletion allowance, and the present tax bill already passed by the House of Representatives adds Perlite to the list of minerals to receive the same allowance. In order to permit an equitable allowance for competitive products we sincerely request that "slate when used in the manufacture of lightweight aggregate," the mineral used in the production of Solite, be included at the same figure.

Senator MILLIKIN. Is Solite a trade term?

Mr. FORD. Yes, sir.

Senator MILLIKIN. Is it a term that is restricted to some particular outfit?

Mr. FORD. Yes. That is our trade name, Senator, for our material that is composed of lightweight aggregate that is made from slate when used in the production of lightweight aggregate.

Senator TAFT. You want to move slate used for this purpose up from 5 to 15?

Mr. FORD. That is the idea. I think you will see in the rest of the brief what we are getting at, Senator. We have no depletion allowance at this time.

Senator TAFT. We had a man here on all slate.

Mr. FORD. On all slate, yes, sir. But this is the "slate when used in the production of lightweight aggregate," which is very, very hard to find in this country at the present time.

Senator TAFT. We could not restrict it to this one thing. We would have to restrict it to "slate used in the production of lightweight aggregates," or something of that sort. We could not name your particular product.

Mr. FORD. No. I am not trying to get that at all. I am only bringing out the name of our product. What I am after is the "slate when used in the manufacture of lightweight aggregate." That is my point.

Senator TAFT. I see.

Senator KERR. What percentage of your finished product is derived from slate?

Mr. FORD. What percentage of it is derived from slate?

Senator KERR. Yes.

Mr. FORD. Senator, it is all derived from slate in an altered or softened form.

Senator KERR. How much of the lightweight aggregate when it appears in that form is derived from the components of the slate that you put in it?

Mr. FORD. All of it is from the slate that we put in the kiln. It is all slate in an altered, or softened form, that is in a state of deterioration over thousands of years of exposure.

Are there other questions?

The CHAIRMAN. You may proceed. Maybe you will answer the question that is in my mind, later.

Mr. FORD. Yes, sir.

The CHAIRMAN. I want to see what you use if for.

Mr. FORD. The Southern Lightweight Aggregate Corp. produces a lightweight aggregate under the trade name of Solite, certain slaty minerals being used as the raw material for its manufacture. In the case of all three; Perlite, Vermiculite, and Solite, the raw material is expanded in certain heating equipment under high temperature, producing a lightweight aggregate suitable for the combination with portland cement to produce concrete products, such as structural concrete, roof slabs, buildings, building units, insulating concrete and precast shapes. The advantageous merits of lightweight aggregate are, the tremendous savings in steel, their high insulating qualities, their inertness, and durability.

Congress in the past has recognized the soundness of percentage depletion allowances for certain minerals. Laws passed by Congress have expanded the principle. In the past several years exhaustion

of certain nonmetallic minerals among which our own is identified has been enormous, and a revenue policy that enables our industry to explore for new sources of supply is essential.

In the establishment of our own company we investigated 46 deposits of slate and other materials which we thought would be suitable for our use in the manufacture of lightweight aggregate. After this extensive research program in a three State area, we found only one deposit that was suitable for our purpose.

True slate is found in Maine, New York, Vermont, Pennsylvania, Maryland, Virginia, and Georgia, along our Atlantic seaboard, and also in Arkansas and California. Slate of this type is ideally suited for production of shingles and similar units. However, there is a distinct difference between the slate we use for the manufacture of our lightweight aggregate and that used for the production of slate shingles and other slate products.

In the slate we use the forces of nature have caused an altering, or softening, of the slate deposit for a depth of 50 feet. The slate in this altered condition is ideal for the production of lightweight aggregate. This altered slate in our deposit is an extremely unusual occurrence.

Perlite as yet has been found only in the Western States. The material from which vermiculite is made is found in many sections of our country. The type of slate from which our solite is made is found only in the Arvonia vein of Buckingham County in Virginia, to the best of our knowledge, although we have not explored the other slate deposits mentioned previously.

The record of our lightweight aggregate in housing construction speaks for itself. Economical housing has been made possible with the use of solite lightweight aggregate wherein construction with building units made of our lightweight aggregate and portland cement can be put in the wall and protected with only two coats of cement waterproofing paint on the outside and one coat on the inside with no other interior or exterior trim or facing. This method of construction has been permitted by the FHA, to our knowledge, only with the use of our material. In addition, a new type of construction using machine methods, was developed by the Rockefeller Foundation and used in the Norfolk, Va., area wherein concrete houses were built meeting FHA standards. The job could not have been done economically and would not have served the useful purpose that it serves had there not been a lightweight aggregate having the qualities that solite has. Since other lightweight aggregates have been accorded a 15 percentage depletion it appears to us that it would be unfair to have a different percentage of depletion for "slate when used for the manufacture of lightweight aggregate" such as solite.

In the case of the reconstruction of the United States Capitol Building roof itself, vermiculite concrete fill was taken off of the roof and solite structural concrete was used for the structural slab of this building. Due to bearing walls and supporting trusses it was impractical to use a normal heavyweight concrete slab on the building since the supporting structures could not carry it. It was, therefore, absolutely essential that some strong, durable, inert, lightweight concrete aggregate be used in this project, resulting in substantial savings by being able to use lighter structural steel and less reinforcing steel bars.

At the present time under construction is Maryland's Chesapeake Bay Bridge, covering a distance of 4.3 miles over open water on which we are furnishing Solite lightweight aggregate for the concrete deck. The deck of this bridge was designed of lightweight concrete in order to effect tremendous savings in the necessary structural steel and reinforcing steel. Solite lightweight aggregate was specified for this project for its physical and durable qualities that are found only in a few of the lightweight aggregates that are on the open market today. By the use of solite lightweight aggregate in this project the savings in dead weight on the deck is over 3,000,000 pounds per mile when compared with normal heavyweight concrete.

Percentage depletions for our product will enable us to continue in business and especially serve the Nation in times of stress. The saving of other critical materials by the use of Solite, and the consequent reduction in design requirements of structure, is of untold benefit.

We will sincerely appreciate your kind assistance in seeing to it that an inequity is not written into the Revenue Act of 1951, and that slate when used in the manufacture of lightweight aggregate receives a percentage depletion of 15 percent which is identical to that already allowed for Vermiculite and proposed for Perlite. We believe such action will result in the best service to the public interest and in the rectifying of previous inequities in depletion allowances.

Senator MILLIKIN. Does your product have any special status under defense minerals?

Mr. FORD. Sir, I did not hear you.

Senator MILLIKIN. Does your product have any special status as a defense mineral?

Mr. FORD. Senator, we have been working quite hard on that. For your information, at Hiroshima, where the atomic bomb was exploded, I think it is official Government records that it was not the concrete that failed there; it was the steel that was encased within the concrete.

Senator MILLIKIN. I did not put my question clearly. Some of our products from the earth have a special classified status as strategic minerals and things of that kind, or critical materials. There are a couple of classifications. Do you come under any of those, as far as you know?

Mr. FORD. Not as far as I know right now, Senator, no, sir. All that we are asking is that slate——

Senator MILLIKIN. It seems to me that from rough memory, Vermiculite, or Perlite, or both, have some classification under the system that I am talking about. That is what prompted the question.

Mr. FORD. May I ask our geologist? He is here with me.

Mr. Hartless?

Mr. HARTLESS. I will save your time by attempting to answer it from here.

The product that Mr. Ford has been describing was given a very special status during the past war, as a great deal of that material was used extensively in the construction of lightweight floating drydocks, and in boats. I might say that the Navy has a very extensive research program on down in the Gulf of Mexico today, in which our material is being used.

Senator MILLIKIN. Do you happen to know whether it is classified as a strategic material, or has a formal classification as strategic?

Mr. HARTLESS. I do not know that, sir. I would say frankly that we have been so busy in other lines, that we have not thought of the laws of classification.

Mr. FORD. I am not familiar with that, Senator, and I would not like to answer it that we are or are not, but I do not believe that we are at the present time.

Senator MILLIKIN. You might take a look into that.

Mr. FORD. We have been trying to.

Senator MILLIKIN. No. Take a look at that classification.

Mr. FORD. Yes, sir.

You can effect tremendous savings in steel, which is very critical at this particular time, by the use of our aggregate.

Senator TAFT. Do you quarry your own slate?

Mr. FORD. Yes, sir; we quarry our own slate. We use approximately 50 feet depth, Senator.

Senator TAFT. Does anybody else produce this kind of slate?

Mr. FORD. Yes; it is produced under the name of Haydite in quite a few spots in the country; also, one plant at Buffalo, N. Y., and one in South Park, Ohio.

The CHAIRMAN. Can you use regular slate in this aggregate?

Mr. FORD. No, sir. It has to be, as I said here——

The CHAIRMAN. I understood what you said. Can it be used at all?

Mr. FORD. You can use ordinary slate, but you will not get the effect that you would like to get; in other words it would be too heavy, to be classified as a lightweight aggregate, and would not have the other durable qualities that you would want in it.

Senator KERR. Apparently you have to use a weathered slate.

Mr. FORD. We have to use a weathered, or altered slate. In other words, the forces of nature thousands of years ago turned this up and exposed it to the weather, and then over thousands of years it is in, you might say, a weathered state.

Senator KERR. The chemistry of nature has changed its formation.

Mr. FORD. Its formation from a solid mass into a more or less shaley slate, you might say.

Senator KERR. Do you get the durability and strength without the heavy weight?

Mr. FORD. Yes, sir. We are getting approximately 5,000-pound concrete, which is awfully strong concrete, on the Chesapeake Bay Bridge, and they are using our material for the deck, or roadway of that bridge right now, and our aggregate in concrete is being placed on that bridge.

Senator KERR. That is interesting.

Mr. FORD. And also, for your information, we have put approximately, I think it was, 2,500-pound concrete—wasn't that the compressive strength, Mr. Hartless?

Mr. HARTLESS. Three thousand.

Mr. FORD. Three thousand.

On the Capitol roof, which met all requirements, and as far as I know, Mr. Lynn, Architect of the Capitol, and all parties concerned were tickled to death with it.

Senator MILLIKIN. Let me suggest this to you again. I do not know that it is of any usefulness to you, but there is a classification

in the Defense Minerals office of "strategic" and "critical"; and I think that vermiculite and/or perlite are in one or the other of those. That carries, I think, certain advantages.

Take a look at that, and see if that helps your business any.

Mr. FORD. Yes.

Incidentally, Senator Kerr, getting back to your interest in the material, we have just completed—at least Doyle and Russell, contractors, have just completed—at Richmond, Va., a garage building down there. To my knowledge, and that of everyone connected with the company, it is the first all-lightweight concrete building that has been built.

Now, that cannot be done with any of these others, Vermiculite which has it, and Perlite, which has been proposed for the 15 percent.

There is not a beam in that whole building. You have your steel columns that go up. But by using our lightweight aggregate in the concrete, they have what ehey term a "flat slab" construction all through the building, and there was not one beam or one piece of steel between the columns in the building.

The CHAIRMAN. We thank you very much.

Mr. FORD. Thank you, Senator.

The CHAIRMAN. Mr. Engelbach.

Will you identify yourself for the record?

STATEMENT OF M. V. ENGELBACH, MANAGER, FIELD ENGINEERING, THE RUBEROID CO.

Mr. ENGLEBACH. My name is M. V. Engelbach. I am the manager of field engineering for the Ruberoid Co.

I have here a short prepared statement that I have distributed to the committee through the kindness of Mrs. Springer, and with your permission I should like to read it.

The CHAIRMAN. Yes, sir. We would like to finish the testimony this morning. Your statement is not long, is it?

Mr. ENGELBACH. No, sir; it is very short; probably too short.

Senator TAFT. Would you like to move asbestos from 5 percent to 10 percent?

Mr. ENGELBACH. We would like to move asbestos from 5 to 15 percent.

The CHAIRMAN. Proceed.

Mr. ENGELBACH. The asbestos mining industry is probably the smallest group in our country producing a scarce mineral, without which our civilian economy and defense effort could not exist. So small an industry cannot support vocal trade associations and advocates to speak for it. That is why we must appear before this committee as an individual.

Asbestos is the only known mineral fiber, and the only known incombustible fiber. It occurs in several types, and its grades are based on fiber length. Chrysotile asbestos is the most important and useful type. There is no exact way to determine which grade is the most strategic. All are of equal importance and cannot be done without. All types of asbestos are in short supply.

In war it would be hard to compare the value or relative importance of the telephone handset, essential to a forward command post, with the fire-fighter's asbestos coveralls, used at the air base back of

the lines. The plastic telephone case is made with extremely short asbestos fiber and the fireproof coveralls, of so-called long, or weaving fiber. In this case both are strategic because both are essential to our defense. This example shows that any grade of asbestos is essential and strategic.

At all times we must have a constant supply of asbestos to produce telephones, electric cables, radios, radar, automotive equipment of all kinds, combustion engines, many kinds of chemicals and explosives, ships and vessels, tanks, power plant and industrial thermal insulations, modern building materials, and many other things.

Asbestos is extremely scarce and hard to find in America. The only known deposits of commercial value are found in Georgia, Arizona, and Vermont. And just one mine in Vermont provides about 97 percent of our domestic production.

In 1949 America's domestic production was only about 47,000 tons, while imports amounted to 515,000 tons.

Senator MILLIKIN. Where does that come from?

Mr. ENGELBACH. Canada, mostly. Some of it comes from Africa. Prior to World War II, we got some from Russia. But they are not exporting any at all today.

This again shows how important asbestos of any type is to our economy, and how little we have in America.

Asbestos mining is in the category of a "low grade" mining venture. In order to recover our Vermont production in 1949 of only about 43,000 tons, we had to mine and process approximately 1,000,000 tons of ore, to say nothing of removal of waste. The average asbestos yield amounts to only 4 to 6 percent recovery.

Senator MILLIKIN. Is it a surface deposit, or do you mine it?

Mr. ENGELBACH. At present, it is a quarry operation, but shortly we shall have to go underground. In Arizona, it is an underground operation, but that accounts for practically nothing, sir.

Of that total the small amount of only 4 to 5 percent can be called long fiber, if we happen to find any at all.

Asbestos mining requires the expenditure of very large amounts of risk capital, not only to locate, prove, and develop the scarce deposits of ore, but to maintain production. In the period of 1941 to 1947, inclusive, our Vermont mine operated at a loss of nearly $1,000,000. But we continued to operate because America needed the production.

Percentage depletion is neither a "defect in the income-tax laws," nor a subsidy, nor a "tax escape"—it is a well-established and just principle. American asbestos mines require a just and proper percentage depletion allowance. Existing legislation already allows percentage depletion to all metals and some nonmetallic minerals, many of which are of lesser importance to our economy than is asbestos. Asbestos mining is a much more expensive operation than the recovery of relatively abundant clays, iron, talc, sulfur, and other minerals, all of which are granted allowances of from 15 percent to 23 percent.

In all revenue laws passed since the enactment of the income-tax amendment to the Constitution, Congress has justly included percentage depletion allowances in recognition of the following facts:

1. Mineral in the ground represents a major portion of the capital of any mining venture. When the mineral is recovered and sold, an important part of the money received is returned capital and not income.

2. Returned capital should not be taxed.

3. The well-established principle of percentage depletion allowance is intended to prevent, at least partially, the inequality of taxation of returned capital.

Obviously Congress has had no intention of discriminating against asbestos mines by withholding percentage depletion. Probably the only reason it was not granted before is that our industry is too small to be vocal.

There is a provision in the existing laws that grants an allowance to long-fiber asbestos only. But as I said before, that is relatively small, because we get only 4 or 5 percent of that, if we find any.

That is not proper because only a very small part of the total production can be graded as "long fiber," and all other grades have equal importance. We cannot choose to mine either long fiber or short fiber. We have to take what comes. The only method of separating grades of fiber is by a highly specialized milling operation.

The House Ways and Means Committee has put a provision in the proposed 1951 tax bill to allow asbestos, without reference to type or grade, a 5-percent percentage depletion allowance. We understand that this was based on the conclusion that asbestos is a building material in the category of abundant stone, sand, gravel, and so forth.

We wish to point out that while certain grades of asbestos are used as a component part of some building materials, asbestos fiber itself is not a building material, and should not be classified as such. It is a raw material of innumerable uses in industry, as are many other metals and nonmetallic minerals which are granted allowances of 15 to 20 percent or more.

The following is taken from a letter dated May 9, 1951, to the Honorable Charles Wolverton, from Mr. James Boyd, Administrator, Bureau of Mines:

> * * * regarding the need of the asbestos mining industry for percentage depletion, as well as having it included as a strategic material to come under the benefits of the excess profits tax law.
>
> As a matter of principle, we favor the use of percentage depletion for such mining industries as asbestos as a legitimate tool to encourage search for new reserves.
>
> Chrysotile asbestos, both long and short fiber, is an essential and strategic mineral in short supply. Development of healthy domestic industry should be encouraged.

In addition to the lack of appropriate percentage depletion allowance, American asbestos mines are at the following production and marketing disadvantages, which have an adverse effect upon the industry:

1. American producers are held to fixed ceiling prices in both domestic and export markets that are on the average 10 percent below world prices. By the same token, Americans must pay 10 percent more for the imported fiber they must have, than they can get for American fiber in either the domestic or export market.

2. American producers have much higher costs than their foreign competitors because they have to pay American wages, maintain American working conditions and pay higher maintenance and equipment costs.

3. American producers are in competition with Canadian producers who we are informed are granted 30 percent percentage depletion and complete relief from excess-profits tax.

In conclusion, because of the facts herein briefly presented we feel justified in petitioning the Senate Committee on Finance to grant American asbestos mines a percentage depletion allowance more nearly equitable to the nature of this scarce, essential, and critical mineral.

We request that asbestos of all types and grades be granted percentage depletion of not less than 15 percent and be designated as strategic to come under the benefits of the excess-profits law.

Senator TAFT. What is the logic of a situation of holding the price below the world price where we produce only one-tenth of what we need?

Mr. ENGELBACH. I wish I could answer that, Senator, but that is what we do. The reason that we have to go into the world market is this——

Senator TAFT. We get most of what we want from the outside?

Mr. ENGELBACH. That is true, sir. And another thing is, in a mine, you see, we have to take what comes. One period we can get what is usable, and the next we have to get something that may be usable in Belgium, so we have to export that.

Senator TAFT. We have that condition in copper, but in copper the justification is that the large copper mines have pretty cheap production in this country, and they make good profits on the lower American price as compared to what we are paying Chile. But I cannot understand any basis for such a rule in the case of asbestos.

Mr. ENGELBACH. To me there is no logical basis, sir. It is just one of the regulations of the NPA.

Another thing that I did not mention here on account of trying to save time is that we expect that our deposit in Vermont will be out in about 8 years. We have to spend a lot of money to search for new deposits. I believe that Senator George would know that the asbestos in his State is very limited.

The CHAIRMAN. It is very limited. I only know it in connection with a little mountain down there.

Mr. ENGELBACH. Yona Mountain?

The CHAIRMAN. Yes.

Mr. ENGELBACH. We have appropriated this year about a quarter of a million dollars for exploration. We havd not too much hope for getting enough to make it pay, but we have to do it.

The CHAIRMAN. Thank you very much, Mr. Engelbach, for your appearance here, and the information which you have given us.

Mr. ENGELBACH. Thank you for the opportunity, gentlemen.

The CHAIRMAN. All right, sir.

The CHAIRMAN. Mr. Ralph L. Dickey.

(The following information was subsequently for the record:)

NEW YORK 18, N. Y., *July 24, 1951.*

Re asbestos fiber—percentage depletion.

Senator HARRY FLOOD BYRD,
209 Senate Office Building, Washington 25, D. C.

DEAR SENATOR BYRD: Here is some additional official information having important bearing on percentage depletion for American asbestos mines and for establishing it as a strategic mineral.

1. Enclosed is a copy of a letter dated July 3 from Dr. James Boyd, Administrator, Defense Minerals Administration, to Senator Hubert H. Humphrey.

The second paragraph of this letter refers to the Internal Revenue Code, and the lack therein of anything granting percentage depletion to asbestos fiber. This statement, of course, did not contemplate the pending H. R. 4473.

This letter does, however, recommend that the Defense Production Administration declare all forms of asbestos as a strategic mineral under the provisions of the Defense Production Act of 1950. This paragraph refers to three types of long-fiber asbestos. For your information the major portion—approximately 97 percent (1949)—of American asbestos fiber production was of one type only—chrysotile.

2. Also enclosed herewith is a copy of a letter dated July 3 from Dr. James Boyd, Administrator, Defense Minerals Administration, to Hon. Manly Fleischmann, Administrator, Defense Production Administration, in which Dr. Boyd has set forth how Mr. Fleischmann can declare asbestos fiber as a strategic mineral under the Defense Production Act of 1950.

This letter arrived in Mr. Fleischmann's office on July 22 and is now in process of being transmitted to Mr. Nathaniel Knowles, Deputy Administrator for Staff Service, Defense Production Administration, who, we understand, will within the next few days render a decision.

It is our belief, however, that it might be well for H. R. 4473 to contain a provision declaring all types of asbestos mined in America as strategic minerals because the Defense Production Act of 1950 has a definite expiration date.

We will keep you informed as to Mr. Fleischmann's decision.

3. Also enclosed is a copy of a letter dated July 11 from the Hooker Electrochemical Co., Niagara Falls, N. Y., to Mr. H. A. King, of the Ruberoid Co.

This letter points out quite definitely that the chrysotile asbestos fiber mined by the Ruberoid Co. in its Vermont mine is absolutely essential for the production of 50 percent of the chlorine produced in America. It points out that in fact the chrysotile asbestos fiber from our mine is vital to the operation of these chlorine cells, and that no other material (or asbestos fiber) will accomplish the necessary results.

Also enclosed is a list of the new defense plants producing essential chlorine. These are in addition to the older plants also producing chlorine for defense by use of the Hooker cells made from our chrysotile asbestos.

All of this data shows how essential it is to the furtherance and maintenance of the asbestos fiber mining industry in America to have appropriate percentage depletion in the minimum amount of 15 percent, and to be declared a strategic mineral.

We take this opportunity to again thank you for your interest in and support of this project.

Respectfully yours,

THE RUBEROID CO.
M. V. ENGELBACH, *Manager, Field Engineering.*

DEPARTMENT OF THE INTERIOR,
DEFENSE MINERALS ADMINISTRATION,
Washington 25, D. C., July 3, 1951.

Hon. HUBERT H. HUMPHREY,
United States Senate, Washington 25, D. C.

MY DEAR SENATOR HUMPHREY: Reference is made to your communication to Defense Minerals Administration under date of April 30, to which was attached a letter to you dated April 13 from the Ruberoid Co., which indicated that that company would like to procure the allowance of percentage depletion for asbestos and also the inclusion of all grades of asbestos in the exemption from the excess profits tax.

An amendment of the Internal Revenue Code would be required to bring asbestos within the terms of the percentage depletion allowance for income tax purposes. I believe there is presently no bill pending in Congress for this purpose, and neither the Interior Department for the Defense Minerals Administration has been asked to report on any such proposed legislation. However, this agency can recommend to the Defense Production Administration inclusion of asbestos, in all its forms, as a strategic mineral for exemption from the excess profits tax. This will to some extent at least serve the purpose of the Ruberoid Co., inasmuch as it will provide the same benefits for their short-fiber asbestos production as is now given to the three types of long-fiber asbestos production.

Attached is a copy of my letter of this date to Mr. Manly Fleischmann, Administrator, Defense Production Administration, recommending the inclusion of all forms of asbestos in the exemption provisions from the excess profits tax.

In addition to the benefit of exemption from excess profits tax, this agency can place all forms of asbestos on its list of minerals which are the subject of governmental aid under the Defense Minerals Administration's exploration program. At present, this list includes only asbestos of spinning grade. For the future, you may consider and the Ruberoid Co. may consider that asbestos of all grades is included in the list of minerals and metals which are the subject of governmental aid for exploration.

Sincerely yours,

JAMES BOYD, *Administrator.*

DEPARTMENT OF THE INTERIOR,
DEFENSE MINERALS ADMINISTRATION,
Washington 25, D. C., July 3, 1951.

Hon. MANLY FLEISCHMANN,
Administrator, Defense Production Administration,
Washington 25, D. C.

MY DEAR MR. FLEISCHMANN: Section 450 (b) of the Excess Profits Tax Act of 1950 (64 Stat. 1137) provides that the agency utilized or created to exercise the powers given to the President by section 303 (a) of the Defense Production Act of 1950 (64 Stat. 798) to make provision for the encouragement of exploration, development, and mining of critical and strategic minerals and metals, shall have the power to certify minerals to the Secretary of the Treasury as essential. Excess profits net income derived from the mining of minerals so designated is exempt from excess profits tax.

As you know, the Defense Production Administration is the agency created to exercise the authority of the President under section 303 (a) of the Defense Production Act (E. O. 10200, 16 F. R. 61). As the result of delegations to the Secretary of the Interior (DPA Delegation 1, as amended, 16 F. R. 4594; NPA Delegation 5, as amended, 16 F. R. 2231, 16 F. R. 5024), this Administration is empowered to recommend to you the addition of specified minerals to the list of those that are strategic. I recommend that asbestos in all forms be certified as a strategic mineral under section 450 (b) of the Excess Profits Tax Act of 1950.

At present, long-fiber asbestos in the form of amosite, chrysotile, and crocidolite s included in the list of strategic materials under section 450 (b). Long-fiber asbestos is in shorter supply than short-fiber asbestos, but all forms of the mineral are in short supply, and all are needed for defense purposes. Furthermore, it is expected that increased production of short-fiber asbestos will result in increased production of long-fiber asbestos. The bulk of our supply of asbestos comes from abroad, and it is hoped that exemption from the excess profits tax will encourage the domestic mining and production of asbestos in all forms.

Sincerely yours,

JAMES BOYD, *Administrator.*

HOOKER ELECTROCHEMICAL CO.,
Niagara Falls, N. Y., July 11, 1951.

Mr. H. A. KING,
Manager, Asbestos Fibre Sales, The Ruberoid Co.,
500 Fifth Avenue, New York 18, N. Y.

DEAR MR. KING: This letter is written to point out to your company the importance to our industry of the asbestos fiber which you supply to us and our licensees of Hooker-type chlorine cells. A recent estimate indicated that approximately 50 percent of the chlorine produced in the United States is now coming from Hooker chlorine cells, which gives some idea of the importance of this cell to the industry. The treated fiber with which you supply us to make our cell diaphragm is vital to operation of the cell and we have found no other material which will accomplish the desired result in forming the cell diaphragms.

To give you some idea of the need for existing supplies and expanded production of chlorine, we attach a partial list of projected new chlorine plants on which the Defense Production Administration has issued certificates of necessity certifying these plants as needed for national defense and essential civilian requirements.

We trust that you will continue your current efforts to maintain adequate supplies of Hooker No. 1 and Hooker No. 2 asbestos fiber for operation of the existing and projected new plants.

Very truly yours,

HORACE W. HOOKER, Jr.,
Purchasing Agent.

	Tons chlorine per day	Certificate No.
Hooker Electrochemical Co., Niagara Falls, N. Y.	35	TA-268
Hooker Electrochemical Co., Tacoma, Wash.	88	TA-3394
Brown Co., Berlin, N. H.	14	TA-1967
Frontier Chemical Co., Wichita, Kans.	40	TA-2104
Innis Speiden & Co., Niagara Falls, N. Y.	5	TA-1002
Southern Alkali Corp., Lake Charles, La.	163	TA-976
Southern Alkali Corp., Natrium, W. Va.	124	TA-974
Southern Alkali Corp., Corpus Christi, Tex.	120	TA-977
Stauffer Chemical Co., Niagara Falls, N. Y.	75	TA-880
Wyandotte Chemicals Corp., Wyandotte, Mich.	220	TA-1723

DEPARTMENT OF THE INTERIOR,
DEFENSE MINERALS ADMINISTRATION,
Washington 25, May 9, 1951.

Subject: Ruberoid Co., Gloucester City, N. J.

Hon. CHARLES A. WOLVERTON,
House of Representatives, Washington 25, D. C.

MY DEAR MR. WOLVERTON: We have read with interest the letter of Mr. C. J. Danaher, general superintendent of the Ruberoid Co., regarding the need of the asbestos mining industry for percentage depletion, as well as having it included as a strategic mineral to come under the benefits of the excess profits tax law.

As a matter of principle, we favor the use of percentage depletion for such mining industries as asbestos as a legitimate tool to encourage search for new reserves.

Chrysotile asbestos, both long and short fiber, is an essential and strategic mineral in short supply. Development of healthy domestic industry should be encouraged.

We are enclosing a reprint on percentage depletion which we believe might be of interest to you.

Sincerely yours,

JAMES BOYD, *Administrator.*

Mineral products which enjoy percentage depletion allowance under present income tax laws (not proposed 1951 tax legislation)

	Percent of gross income allowed for depletion		*Percent of gross income allowed for depletion*
Oil and gas wells	27.5	Talc	15.0
All metal mines	15.0	Lepidolite	15.0
Coal	5.0	Spodumene	15.0
Sulfur	23.0	Barite	15.0
Fluorspar	15.0	Potash	15.0
Rock asphalt	15.0	Bauxite	15.0
Ball and sagger clay	15.0	China clay	15.0
Flake graphite	15.0	Phosphate rock	15.0
Vermiculite	15.0	Trona	15.0
Beryl	15.0	Bentonite	15.0
Feldspar	15.0	Gilsonite	15.0
Mica	15.0	Thenardite	15.0

Mr. DICKEY. This large volume is a report. I am not going to read all that. I merely have a prepared statement of four pages.

The CHAIRMAN. Proceed.

STATEMENT OF RALPH L. DICKEY, PRESIDENT, KELLEY ISLAND LIME & TRANSPORT CO.

Mr. DICKEY. Mr. Chairman and gentlemen of the committee, my name is Ralph L. Dickey. I am president of the Kelley Island Lime & Transport Co. of Cleveland, Ohio. Our company operates three quarries in Ohio, two of which have adjacent calcining lime plants, and one lime plant at Buffalo, N. Y.

I hasten to assure you that I fully appreciate the tremendous problem confronting this committee and that we in the limestone industry are willing and ready to bear whatever tax load this committee and the Congress may determine to be necessary in the present critical situation. We only ask that we bear our share of taxation on the same basis as others engaged in the extraction of natural resources from the earth.

I am a representative of a committee of the National Lime Association and am requesting that a percentage depletion allowance be provided for metallurgical and chemical grade limestone at a rate of 15 percent, as now provided in the bill before you, H. R. 4473. We make this request based on the premise that the Congress has recognized the principle of percentage depletion allowances for scarce and depletable minerals, that metallurgical and chemical grades of limestone are scarce and exhaustible, that most known workings are being measurably depleted, that in a number of most important locations reserves are being rapidly exhausted, and that unfair discrimination exists until limestone is granted an adequate percentage depletion allowance.

Limestone and lime are essential to and used directly in the production of steel, aluminum, and copper—our three most basic and strategic metals which form the basis upon which the controlled materials plan of the National Production Authority functions. They are equally essential for pig iron, refractories, magnesium, calcium carbide, soda ash, glass, sugar, water purification, and many other important uses.

For most applications of limestone and lime there is no substitute at any price.

It is evident that metallurgical and chemical grade limestone, as well as lime produced from it, are vitally necessary commodities in the Nation's industrial life and most essential in producing materials for defense.

I have placed before you today, as an appendix to my statement, a study which our industry had made by Dr. Kenneth Landes, geologist of the University of Michigan, which fully sets forth the situation in the United States with relation to the scarcity of high-quality limestone.

I would like to state the conclusions reached by Dr. Landes as a result of his very thorough research and study:

High quality (metallurgical grade) limestone is just as essential to the making of steel as iron ore; it is also necessary for the burning of lime and for the manufacture of many chemicals. Limestone, the rock, is common and abundant in the United States, but metallurgical stone constitutes only a very small part of the total volume of limestone rock. It is a valuable, essential, and exhaustible mineral resource.

Metallurgical stone occurs in deposits within geologic formations. Geologic maps show the areas of outcrop of formations and groups of formations, some of which are notable for their high quality limestone deposits. It should be observed, however, that the workable deposits themselves occupy but an insignificant part of the total area covered by the formations. In many places where a formation is mapped erosion has stripped away all of the good stone, or due to environmental conditions at time of deposition good stone was never present in this area, or the overburdened is too thick for removal, or the good stone is too deeply buried beneath poor stone to permit profitable exploitation.

The popular concept of an unlimited supply of limestone must be abandoned as far as metallurgical grade stone is concerned. Every metallurgical limestone quarry or mine today is working a deposit which has definite boundaries, either

physical or economic, or both, beyond which exploitation cannot go. Many of these deposits will reach those boundaries within the next 10 years. The writer of this report, who has been investigating limestone deposits in various parts of the United States during the last 23 years, knows of only two deposits that he believes will still be yielding metallurgical stone 50 years hence. Of course, new deposits will be discovered in the future as in the past, but their discovery is becoming increasingly difficult and expensive. For example, one steel company has spend $100,000 during the last 3 years in the search for new deposits, and it is still forced to buy over half of the needed fluxstone from other producers.

The conclusion is inescapable that metallurgical limestone is a valuable natural resource occurring in deposits definitely limited as to recoverable volume. Each year's withdrawals from a deposit of metallurgical grade limestone exhaust the value of the property.

End quotation from Dr. Landes.

Persistent and substantial efforts to locate quarriable quantities of metallurgical and chemical grade stone have uncovered few, if any, deposits which can be developed. Much the same methods are used in prospecting for deposits of limestone as for deposits of iron ore. Diamond drilling usually is employed, but due to erratic pinching out of good ledges and to the frequent and irregular occurrence of impure seams, it is necessary to do a great deal more drilling of a given area than is generally the case in proving out iron-ore bodies.

The present expansion of the steel industry is demanding more metallurgical and chemical limestone than the capacity in our industry can meet and the opening of new quarries and production of more high-quality limestone is absolutely essential to the defense effort.

The report of the Committee on Ways and Means filed in connection with H. R. 4473 states, among other things, with reference to the percentage depletion section:

The testimony received by this committee both in connection with this bill and the bill which became the Revenue Act of 1950 revealed that in a number of cases nonmetallic minerals which are not in the enumerated group under existing law are competitive with those receiving percentage depletion, or have just as good a claim for such treatment as the enumerated minerals.

As you know, the House bill made several changes in the percentage depletion section of the law and added a number of nonmetallic minerals at a percentage depletion rate of 15 percent. Among the new minerals are chemical and metallurgical limestone. The House committee in its report further states:

Most of these changes would have been made under the House version of the bill which became the Revenue Act of 1950 but they were eliminated from the final legislation largely because of the revenue loss involved. It is apparent, however, that the need for equalization is substantially greater now because of the additional taxes imposed under the legislation of 1950 and under this bill.

I firmly believe that the incentive which would be provided by the allowance of percentage depletion will result in greater returns to the United States Treasury, due to the increased activity in the limestone and other mineral industries, and encourage the expansion which is essential to the defense effort.

Thank you, sir.

The CHAIRMAN. Thank you very much.

Are there any questions?

Senator KERR. No questions.

The CHAIRMAN. Thank you very much.

(The report submitted by Mr. Dickey is as follows:)

Metallurgical Limestone Reserves in the United States

SUMMARY AND CONCLUSIONS

High quality (metallurgical grade) limestone is just as essential to the making of steel as iron ore; it is also necessary for the burning of lime and for the manufacture of many chemicals. Limestone, the rock, is common and abundant in the United States, but metallurgical stone constitutes only a very small part of the total volume of limestone rock. It is a valuable, essential, and exhaustible mineral resource.

Metallurgical stone occurs in deposits within geologic formations. Geologic maps show the areas of outcrop of formations and groups of formations some of which are notable for their high quality limestone deposits. It should be observed, however, that the workable deposits themselves occupy but an insignificant part of the total area covered by the formations. In many places where a formation is mapped, erosion has stripped away all of the good stone, or due to environmental conditions at time of deposition good stone was never present in this area, or the overburden is too thick for removal, or the good stone is too deeply buried beneath poor stone to permit profitable exploitation.

The popular concept of an unlimited supply of limestone must be abandoned as far as metallurgical grade stone is concerned. Every metallurgical limestone quarry or mine today is working a deposit which has definite boundaries, either physical or economic, or both, beyond which exploitation cannot go. Many of these deposits will reach those boundaries within the next 10 years. The writer of this report, who has been investigating limestone deposits in various parts of the United States during the last 23 years, knows of only two deposits that he believes will still be yielding metallurgical stone 50 years hence. Of course, new deposits will be discovered in the future as in the past, but their discovery is becoming increasingly difficult and expensive. For example, one steel company has spent $100,000 during the last 3 years in the search for new deposits, and it is still forced to buy over half of the needed fluxstone from other producers.

The conclusion is inescapable that metallurgical limestone is a valuable natural resource occurring in deposits definitely limited as to recoverable volume. Each year's withdrawals from a deposit of metallurgical grade limestone exhaust the value of the property.

Kenneth K. Landes.

INTRODUCTION

Limestones, if no limitation as to quality is set, are found very generally in tremendous quantities in most parts of the United States. However, limestones that are of suitable quality and are economically available are a very small proportion of the total of all limestones and are found only in a few areas.

In this report "limestone" will be used as in industry for both limestone and dolomite, except where the latter is specifically mentioned. Included within the broad heading "metallurgical stone" are not only the fluxes used in blast furnace and open hearth operations but also the purer grades of limestone needed for furnace linings, lime burning, and chemical manufacture.

Limestones that are satisfactory for metallurgical or chemical uses as stone or satisfactory for raw material for the production of calcined products may be classified in four grades as follows:

	A-1	A-2	B-1	B-2
	Percent	*Percent*	*Percent*	*Percent*
Silica, less than	1.0	3.0	1.0	2 0
Alumina, less than	1.5	1.5	1.5	1.5
Sulfur, less than	.1	.1	.1	.1
Magnesia, less than	5.0	5.0	21 8	21.8

These specifications are arbitrarily made to provide a means of identifying various classes of limestone since there are no generally agreed upon standards. Silica, alumina, and sulfur are impurities. Magnesia is an active basic agent, but limestones with varying proportions of magnesia may have different uses.

By far the greater part of the limestone quarried or mined in the United States has more than the maximum percentage of impurities listed above. This stone is used for concrete aggregate, road metal, railroad ballast, agricultural limestone, cement manufacture, and other purposes where chemical purity is not essential.

Descriptions of uses of metallurgical stone

Over half of the total volume of stone here classified as "metallurgical" consumed annually is used as blast furnace flux. The blast furnace is the fundamental unit in the conversion of iron ore to pig iron. An average of 900 pounds of limestone is used in producing each ton of pig iron. The function of the flux is to furnish basic constituents, namely lime and magnesia, which will combine with the acid compounds normally present in an ore, such as silica and alumina, and remove them in the form of the resulting slag at the top of the molten metal in the blast furnace. Also the flux is very important in the removal of sulfur present in the coke in the blast furnace charge. Because the efficiency of the flux is dependent upon the amount of basic elements it can contribute, it becomes obvious that the presence of such compounds as silica and alumina in the flux itself serves to reduce the effectiveness of the flux as a metallurgical agent. It is, of course, possible to compensate for these increases in acid compounds in a flux by the addition of more flux. However, this practice has its limitations because it not only increases the slag volume, decreasing the furnace capacity, but in addition more coke is required to heat the additional stone to flux the acid compounds already in the stone and further, the addition of more coke to a blast furnace means that more impurities present in the coke have to be fluxed as well. Therefore, grade A-2 stone is used only where the delivered cost of A-1 stone is more than the additional costs involved in using an A-2 fluxstone obtainable near by.

The presence of magnesia does not seem to interfere with the fluxing property of limestone; in fact some blast furnace operators specify from 5 to 9 percent MgO in the belief that with such stone they obtain a more satisfactory slag. Therefore, B-1 (and even B-2) grade stone may be used either directly as a blast furnace flux, or as a supplementary material to be added to the A-1 charge.

Metallurgical stone can only be used in lump form. The fines produced during mining and processing must be discarded or marketed elsewhere. Furthermore, pulverent types of limestone such as chalk and marl cannot be used for metallurgical purposes regardless of purity.

Most of the conversion of pig iron to steel is done in the open hearth furnace. During this operation from 130 to 370 pounds of flux, depending upon the amount of phosphorus that has remained in the pig iron, is added for each ton of steel produced. A-1 (or A-2) grade stone is used for this purpose; the dolomitic limestones (B-1 and B-2) are not used.

Dolomite and dolomitic limestone are refractory and are used in liming basic open hearth steel furnaces. About 2 percent, or 1,000,000 tons, of the metallurgical stone consumed annually in the United States is used for this purpose. Only B-1 grade, and that at or close to the pure dolomite end of the calcium-magnesium series, can be used.

The burning of limestone to produce lime consumes 25 percent of the stone here classified as "metallurgical" each year. One of the most important uses of calcined limestone (lime) is as a flux in the production of steel in the open hearth. Chemical stone, used in making such products as soda ash and calcium carbide, and in the refining of beet sugar, must be of A-1 grade in most instances, although B-1 stone is used in quantity for some purposes. Quality plasters can be made only from A-1 or B-1 stone.

The utilization of the various grades of limestone as metallurgical stone is summarized in the following table:

Grade	Blast furnace flux	Open hearth flux	Furnace linings	Lime	Chemicals
A-1	Yes	Preferred	No	Yes	Yes, for more uses than B-1.
A-2	do	Yes	do	No	No.
B-1	Yes, usually as a supplement to A-1.	No	Yes	Yes	Yes.
B-2	Yes	do	No	No	No.

The total metallurgical stone production is roughly one-third of the annual domestic crushed limestone produced (the amount of limestone mined for building stone is relatively insignificant). The remaining two-thirds of the crushed stone has many uses, especially in concrete and road metal, and as cement stone. For

these purposes lower grade stone, which does have large reserves, is adequate; in fact, the more silica and alumina in cement stone the less shale has to be added before burning. The emphasis for stone used in concrete aggregate and road metal is on physical character rather than chemical composition.

It can be seen from the above table that either nearly pure limestone (A-1) or nearly pure dolomitic limestone or dolomite (B-1) are essential to practically all metallurgical operations except in fluxing the blast furnace charge where A-2 (or B-2) quality stone can be used if necessary. Only the B-1 stone can be used as refractory material for steel furnaces.

Variations in quality in natural deposits of limestone.—Nearly pure deposits of limestone (A-1) or dolomite (B-1) are due to a combination of favorable geological conditions both at time of deposition and subsequently. The sea in which the carbonate minerals were being deposited must have been clear; no streams on nearby land surfaces were bringing in sand, silt, or clay particles to be deposited contemporaneously with the carbonate grains. Subsequently no circulating ground waters precipitated silica or sulfides in that particular rock.

Limestones vary in quality both vertically and laterally. Vertical changes are the result of changed environments in the geological past. Just as a limestone may be succeeded by a shale, sandstone, or other rock due to different conditions of deposition at different times, so may a pure limestone be succeeded by a highly impure limestone (such as a shaly or cherty limestone). Likewise limestones vary laterally in purity due to different environmental conditions at time of deposition, or due to more active ground water circulation subsequently. Lateral variations are not as sudden as vertical changes, but may be just as complete. Many instances are known of limestones merging into shales and even sandstones laterally.

It may be concluded that a deposit of nearly pure stone is the result of an unusual combination of circumstances and that this combination was in effect locally but not regionally so the deposit is definitely limited in scope.

Reasons for abandonment of quarries.—Abandoned limestone quarries are too numerous to count. Among the reasons for abandonment are the following:

1. Virtual exhaustion of limestone: This reason is applicable only where the stone occurred in an isolated hill which has been removed by quarrying.
2. Virtual exhaustion of stone of adequate quality: Many limestone bodies contain purer zones in the form of large lenses; when these particular masses are worked out mining ceases because the inferior quality stone into which the deposit grades laterally cannot be quarried at a profit.
3. Increased mining costs due to greater depth, or greater thickness of overburden.
4. Inability to meet the competition of a higher quality stone.
5. Inability to meet the competition of a stone produced more efficiently or deliverable to market at less transportation cost. The large quarries on the shores of the Great Lakes mine and deliver stone at much less cost than can most of the relatively small inland quarries.
6. Shut off from market by more stringent specifications. The market trend across the years has been consitently in the direction of higher and higher quality stone.

Reasons 2, 4, and 6 given above are directly concerned with the quality of the stone. The many quarries that have been abandoned because they no longer can produce acceptable stone at a profit is strong evidence of the important role played by quality. Furthermore, these rules are applicable to all limestone mining. The specifications for metallurgical stone are much higher than for other types, so many quarries cease producing metallurgical stone (if they ever did) long before they are stopped from producing lower grades.

Quarrying and underground mining costs compared.—Most stone is produced in open cut quarries. Underground mining is much more expensive, and is resorted to only where (1) no surface stone of adequate quality is available, and (2) the consuming district is so remote from open cut qaurries that local stone can be mined and delivered cheaper.

Because of much cheaper production costs the outcrop deposits of metallurgical limestone constitute the No. 1 domestic reserve. This stone carries down the regional dip from the outcrop and may underlie, at varying depths, hundreds of square miles of younger rocks. It, therefore constitutes a secondary reserve, which will be considered in this report in the discussion on geographical distribution which follows. But it should also be remembered that (1) quality varies laterally, and in many instances A-1 stone in the outcrop becomes A-2 or less, pure stone down the dip, and (2) not only does it cost much more to mine stone underground, but those already high costs increase with greater depth so that the

potential value of a deeply buried limestone, even though it be of the highest quality, is highly questionable.

(References: Oliver Bowles, Metallurgical Limestone, U. S. Bureau of Mines, Bull. 299, 40 pp., 1929; Oliver Bowles and D. M. Banks, Limestone, U. S. Bureau of Mines Information Circular 6723, 21 pp., June 1933; F. R. Thoenen, Underground Limestone Mining, U. S. Bureau of Mines, Bull. 262, 100 pp., 1926; Minerals Yearbook, 1946, U. S. Bureau of Mines, 1948, 1629 pp.)

DISTRIBUTION OF METALLURGICAL LIMESTONE RESOURCES

Each State in the United States containing significant and accessible reserves of limestone of metallurgical grade is discussed in this section. The State by State summaries are based almost entirely on published information; their accuracy, completeness, and freshness are therefore no better than the quality and dating of the source material. In every instance where specific publications were available on the limestone resources of a State those publications are listed at the end of the pertinent discussion.

Analytical data are not available for many deposits, and the available information is questionable for others. In many instances the published analyses are for isolated "grab" samples which are rarely typical of the deposit as a whole. Only where the deposit has been sampled by the technical methods employed in industry can the analyses be averaged to give a reliable picture of the chemical character of the "run of mine" stone. Where adequate chemical information is lacking the best clues to the quality of a deposit are to be found by a survey of its utilization, including changes in its marketability across the years. Although a premium grade stone may be sold for low quality uses, an inferior stone cannot be marketed for metallurgical purposes, especially in recent years.

It will be noted that some of the references consulted, although the latest available, are of such vintage that the information obtained can hardly be considered up to date, especially in regard to areas of current exploitation. However, this report is primarily concerned with the reserve picture, and it can be stated that, as a general rule, the reserve situation has deteriorated instead of improved since the publication of the source data. This has been due to the subsequent exhaustion of many deposits and to the increased quality of stone demanded by the metallurgical market. New discoveries have failed to equal these losses in the metallurgical stone reserve supply.

(General References: Oliver Bowles, The Stone Industries, McGraw-Hill Book Co., New York, pp. 519, 1939; U. S. Bureau of Mines, Minerals Yearbook, 1946, chapters on Stone and Lime, 1948.)

Michigan

Michigan is the largest producer of metallurgical limestone. This is due to a combination of strategic location in respect to the Great Lakes water-borne commerce and the presence of high quality stone in unusual abundance. Three formations, the Burnt Bluff, Engadine, and Dundee-Rogers City are exploited for metallurgical stone in Michigan.

Burnt Bluff formation.—The Burnt Bluff formation crosses the southern part of the Northern Peninsula from the Garden Peninsula to the east side of Drummond Island. Because of the lenticular character of the high calcium stone in this formation the number of years of operation of any single quarry is definitely limited.

Engadine formation.—The Engadine formation at the top of the Niagaran series contains some dolomite of B–1 grade. This formation crops in the Northern Peninsula only, from along the Lake Michigan shore near the Schoolcraft-Mackinac County line eastward across the foot of the St. Ignace Peninsula to southern Drummond Island where it is quarried. The amount of stone of B-1 grade in this formation is definitely limited by local topography and structural geology. The southerly dip, which carries the Engadine beneath the lake waters in a relatively short distance, makes underground mining virtually out of the question.

Dundee-Rogers City.—An exceptionally large deposit of A–1 grade stone lies within the Dundee-Rogers City formations southeast of the town of Rogers City. The belt occupied by these rocks extends from False Presque Isle north and west to Little Traverse Bay However, west of Black Lake, and perhaps west of Rogers City, the cover of glacial drift is too thick to permit exploitation of the underlying limestone. Down the dip, to the southwest of the outcrop zone between Rogers City and False Presque Isle, the Rogers City-Dundee stone continues beneath successively younger formations. The distance down-dip

over which it retains A–1 quality is not known, but it is probable that a large reserve exists in the first few miles basinward from the outcrop. This reserve cannot be tapped, however, until prices justify underground mining.

To the southeast from False Presque Isle the Rogers City-Dundee stone disappears beneath Lake Huron. The Dundee formation reappears in a belt of few outcrops which crosses almost the very corner of southeastern Michigan. One large quarry has been developed in the Dundee at Sibley, near Trenton (southeastern Wayne County). Unfortunately, however, the Dundee stone loses its A–1 quality between northeastern and southeastern Michigan, so at Sibley A–2 stone is quarried. Furthermore, the original exposure was a hill which has now been almost worked out and the operations are scheduled for abandonment in the near future.

Michigan contains many other limestone and dolomite beds besides those mentioned, but all other known deposits of adequate size for large-scale quarry operations are below A–2 and B–2 grade.

(References: R. A. Smith, Limestones of Michigan, Michigan Geological Survey, publication 21, pp. 103–311, 1915; K. K. Landes, G. M. Ehlers, and G. M. Stanley, Geology of the Mackinac Straits Region, Michigan Geological Survey, publication 44, p. 204, 1945.)

Ohio

Ohio ranks third in the production of metallurgical limestone, and first in lime. Four formations, the Brassfield, Niagaran, Columbus, and Vanport, are worked for metallurgical stone.

Brassfield formation.—This formation is confined in its occurrence to the southwestern counties. The quarries in this formation are few and the production is small.

The Niagara.—Niagaran rocks, also known as Peebles, Lilley, Cedarville, and Guelph, crop out widely in western Ohio. Most active quarrying is in Ottawa, Sandusky, Seneca, and Wood Counties. The greater part of the stone is burned to produce magnesium lime. The rock is B–1 in grade, an exceptionally pure dolomite, and the reserves are very large. The Niagara is not primarily a metallurgical stone as is the Columbus, but at the present time serves as a blending flux to bring up the magnesia content of the slag when such fluxes as the Vanport or high calcium fluxes from other localities are used. Because of its high magnesia content considerable of it is used both in the raw and sintered state in the building and repairs of furnace bottoms in the production of steel.

Columbus formation.—The Columbus, an A–2 stone, occurs along a belt which extends from Pickaway County in southern Ohio northward to Kelley's Island in Lake Erie. It is the outstanding blast-furnace stone produced in the State. The production exceeds 4,000,000 tons annually. Because the Columbus varies in composition and purity the resources of this stone are limited and recent exploration has failed to reveal any new areas for further development.

Vanport formation.—The Vanport is extensively quarried in western Pennsylvania and some of the workings extend across the line into Ohio. This formation is discussed under Pennsylvania.

Various other formations are quarried in Ohio for crushed stone, but all others are too impure for metallurgical use.

(Reference: W. E. Stout, Dolomites and Limestones of Western Ohio, Ohio Geological Survey, fourth series, bull. 42, 468 pp., 1941.)

Pennsylvania

The production of limestone is a major industry in Pennsylvania, and this State leads all others in the total annual output of limestone of all types (including cement rock). Pennsylvania is second in the production of metallurgical stone. For many years it was first, due to its highly strategic position with respect to both the iron and steel furnaces and to the major domestic coking coal supplies, and due to the presence of abundant limestone in the bedrock formations. The decline in the relative importance of Pennsylvanian metallurgical stone has been due to a number of reasons which are discussed below:

(1) Many quarries were originally opened up to supply local furnaces treating sedimentary iron ores mined nearby. When these mines were abandoned, most of the fluxstone quarries could not compete in distant markets with stone imported from other States so one by one they were abandoned, or diverted to nonmetallurgical stone production. In practically all cases these local quarries were producing A–2 or lower-grade stone in the first place.

(2) Exhaustion of individual deposits with exploitation: To an unusual extent the Pennsylvania deposits are lenticular and the total tonnage available relatively small.

(3) Increased operating costs due to increasing depth or thicker cover. Most of the limestones in the eastern half of Pennsylvania are dipping into the ground and can only be followed downward a short distance before increased mining costs make exploitation unprofitable.

(4) The continued rise in the quality of stone demanded: The buyers of metallurgical stone have become more and more restrictive in specifications; the producers of relatively low-grade stone have been able to keep their metallurgical markets only where they have been able to undersell materially the delivered cost of imported stone.

(5) High land values: In eastern Pennsylvania the normal search for, and development of, new deposits as older deposits are worked out and abandoned has been impeded, to say the least, by the relatively high cost of land due to the growth of real-estate subdivisions, country clubs of various types, and country estates. Considerable land has been completely withdrawn from possible mineral exploitation by being set aside as State park areas.

The metallurgical stone resources of Pennsylvania occur in various formations of early Paleozoic age and in the Carboniferous Vanport limestone of western Pennsylvania.

Early Paleozoic limestones.—Most of the older limestone formations utilized for metallurgical stone are Cambrian or Ordovician in age, but a few Siluro-Devonian rocks are also exploited for metallurgical purposes and lime burning.

Cambro-Ordovician limestones are quarried in at least 10 counties in central and southeastern Pennsylvania for fluxstone or lime rock. Centre County in central Pennsylvania contains the highest-grade limestone in quantity in the State. The so-called Bellefonte ledge which lies in the Black River (lower Ordovician) group of rocks is A–1 stone. The principal operations are in the vicinity of Bellefonte, where the high-quality stone is 77 feet in thickness. However, the ledge is lenticular; it thins in both directions from Bellefonte, and is missing completely in many places. The district contains many active quarries and two underground mines. At least three counties, Lycoming, Columbia, and Northumberland, all in east central Pennsylvania, contain Siluro-Devonian limestones which are burned for lime.

Vanport formation.—The Carboniferous (Pennsylvanian) Vanport limestone of western Pennsylvania is vigorously exploited because of its strategic location in respect to the blast furnaces of the Pittsburgh district. Although mostly A–2 in grade, it approaches A–1, and the location makes the exploitation of stone of marginal quality possible. Its use requires the blending with dolomite to produce a slag of the required chemical and physical specifications. As a general rule the Vanport limestone crops out along the sides of steep-walled valleys so it has been necessary to follow the stone beneath the overlying rock by underground mining in many places. The Vanport ledge is mined and quarried in Armstrong, Butler, and Lawrence Counties. It may be as much as 25 feet in thickness, but is missing altogether in places, due either to nondeposition or erosion.

(Reference: B. L. Miller, Limestones of Pennsylvania, Pennsylvania Geological Survey, fourth series, vol. M 20, 729 pp., 1934.)

New York

Although New York ranks fifth among the States in crushed limestone production, its annual output of fluxstone and lime rock is relatively insignificant. Most of New York's limestone is below A–2 or B–2 in grade and is used in concrete aggregate, road metal, and railroad ballast. The metallurgical stone resources are largely confined to the pre-Cambrian dolomites and to Silurian limestone.

Pre-Cambrian dolomite.—Some of the Grenville dolomite which occurs in St. Lawrence and Jefferson Counties in northern New York is B–1 in grade. It has been quarried near Natural Bridge, Jefferson County, and dead-burned for use as a refractory. Likewise some of the pre-Cambrian dolomites in Westchester and Dutchess Counties north of New York City are B–1 in grade and have been exploited for lime manufacture. These occurrences are, however, local in character and because of the variable silica content of the pre-Cambrian carbonate formations it is very unlikely that large deposits of B–1 grade stone are to be found in the New York-New England province.

Silurian limestone.—From the available analyses there appears to be little or no A–1 stone in New York in quarriable volumes. The Clinton limestone of Silurian age becomes fairly pure in the western part of the State and is there of A–2 grade. It has been extensively quarried in the vicinities of LeRoy and Stafford, Genesee County, and Lockport and Gasport, Niagara County, for use

as flux in the blast furnaces of the Buffalo district. Water-borne A-1 grade stone from Michigan has tended to displace local fluxstone in this district in recent years.

(Reference: David H. Newland, The Mineral Resources of the State of New York, bull. New York State Museum, Nos. 223, 224, pp. 255-268, 1921.)

Massachusetts

Massachusetts dropped from fourth place in lime production in 1932 to eleventh place in 1946, probably due to the working out of the higher-grade stone deposits. All of the commercial limestone deposits in this State are in Berkshire County in western Massachusetts. The calcareous formations are Cambrian and Ordovician in age. Some A-1 limestones are present and some of the dolomites and dolomitic limestones are of B-1 grade. The higher-quality stone is burned for lime, and a few thousand tons are marketed each year for flux.

(Reference: T. Nelson Dale, The Lime Belt of Massachusetts, United States Geological Survey, bull. 744, 1923, 71 pp.)

Maryland

Maryland is unimportant as a source of metallurgical stone, but does produce a little lime. The same Ordovician formations which contain the better quarry ledges in southeastern Pennsylvania to the north and in the panhandle of West Virginia and in northwestern Virginia to the south cross western Maryland at almost its narrowest part, passing through Frederick and Washington Counties. A-2 grade stone is quarried and burned for lime at several communities in the former county, and at Cavetown in Washington County. These infolded limestone bodies are lenticular and decidedly limited in volume.

West Virginia

West Virginia is the fourth State in the United States in annual production of metallurigical stone. In addition to a considerable volume of fluxstone, this State ranks high among the lime-producing States, and also produces some dead-burned dolomite for refractory purposes. The metallurgical stone is confined to the Ordovician Mosheim limestone and Tomstown dolomite which lie within the band of rocks which cuts across the northwestern or panhandle corner of West Virginia between Maryland and Virginia.

Mosheim limestone.—This is the only high quality limestone in West Virginia. It crops out in Berkeley County and to a lesser extent in Jefferson County in the northeastern corner of the State. It averages less than 1 percent silica and is likewise low in alumina; it averages less than 2 percent magnesia. The Mosheim, therefore, makes a very fine fluxstone and is ideal for lime burning.

Due to close folding and erosion the Mosheim limestone occurs in more or less isolated pockets. Many of the individual deposits have been completely worked out and except for smaller pockets which cannot be profitably exploited the volume of stone yet to be quarried is relatively insignificant.

Tomstown dolomite.—The Tomstown formation is a true dolomite of B-1 rank. Chemical analyses made of samples of this stone obtained from active quarries have shown a uniform silica content of less than 1 percent; therefore the stone is quarried in considerable volume for refractory purposes. The center of the Tomstown exploitation is in the vicinity of Millville in Jefferson County. Like the Mosheim limestone the Tomstown dolomite occurs in infolded deposits, many of which have already been worked out and the remainder are definitely limited as to reserves.

(References: G. P. Grimsley, Jefferson, Berkeley, and Morgan Counties, West Virginia Geological Survey, county reports, 644 pp., 1916; J. B. McCue, J. B. Lucke, H. P. Woodward, Limestones of West Virginia, West Virginia Geological Survey, vol. 12, 560 pp., 1939.)

Virginia

Virginia is seventh in both fluxstone and lime production. It also has a considerable chemical stone industry. Published analyses of the carbonate rocks in Virginia are few, but from those that are available it appears that Virginia produces little or no stone of A-1 or B-1 quality. The exploitation of A-2 and B-2 deposits for uses to which A-1 or B-1 grades are ordinarily specified is possible only because of the remoteness of this area in respect to the sources of supply of high quality stone.

The metallurgical stone resources of Virginia are confined to the upper Cambrian and Ordovician belt of rocks which crosses the western part of the State from northeast to southwest. Topographically this region is known as the Appalachian Valley and in it are found over 30 lime plants and fluxstone and chemical stone

quarries. Because of the pockety nature of the infolded early Paleozoic limestones of Vriginia the quarriable reserves of even the A-2 and B-2 materials are limited.

(Reference: William M. McGill, Outline of the Mineral Resources of Virginia. Virginia Geological Survey, bull. 47, pp. 32-36, 1936.)

Tennessee

Tennessee produces considerable crushed limestone, but most is below A-2 or B-2 in grade. Some stone is sufficiently pure, however, for lime burning. The lime rocks occur in both Cambro-Ordovician and Mississipian formations.

Cambro-Ordovician formations.—Within the broad belt of Cambro-Ordovician formations crossing southeastern Tennessee are several limestones and dolomites which are locally of A-1 or B-1 grade.

Mississippian formations.—Some of the purest limestones in Tennessee are the upper Mississippian Gasper oolite and St. Genevieve limestone which occur in deposits up to 150 feet in thickness in the Highland Rim area.

(Reference: George I. Whitlach, Limestone and Lime, Tennessee Geological Survey, Markets Circular No. 10, April 1941, 38 pp.)

Alabama

Alabama ranks fifth in annual output of both fluxstone and lime. Nine-tenths of the crushed limestone produced is used for flux in the Birmingham iron furnaces. The Alabama fluxstones and lime rocks occur in both Cambro-Ordovician and Mississippian formations.

Cambro-Ordovician formations.—Some of the marble of Cambrian or early Ordovician age which has been quarried in Talledega County is suitable for fluxstone, but is little used for this purpose. The largest quarries are in the Knox dolomite in the vicinity of Birmingham. Some ledges run less than 1 percent silica in carload lots and so qualify for B-1 rating. Some lump dolomite is also mined in this district for refractory purposes. Various Ordovician limestones have been quarried in northeastern Alabama, especially in Shelby County, for lime burning.

Mississippian formations.—Mississippian limestone has been rather extensively quarried, especially in Jefferson, Franklin, Blount, and Etowah Counties, for flux in the Birmingham iron district. All of these limestones are A-2 in grade as a general rule.

(References: Eugene A. Smith and Henry McCalley, The Mineral Resources of Alabama, Geological Survey of Alabama, 1904, 79 pp.; Ernest F. Burchard, The Cement Industry in Alabama, Geological Survey of Alabama, Circular 14, 1940, 32 pp.)

Indiana

Indiana, although the leading producer of limestone building stone, ranks eighth in crushed limestone and only an insignificant percentage of this material is used for metallurgical purposes. The reason for this is the virtual absence of metallurgical grade stone in quarriable deposits in the State. Niagaran rock, the outcrop of which extends into Indiana from the northwest, is not exploited. The only limestone which is quarried in volume is Mississippian in age. It is exploited in Washington and Harrison Counties in southern Indiana for lime. To the northwest, in Lawrence and Monroe Counties, it is quarried for dimension stone; some lime is burned and a little furnace flux is quarried as byproducts of the building stone industry.

Illinois

Illinois is the fourth State in the annual production of crushed stone. Most of this stone is used in concrete aggregate and for road metal, in which Illinois is the leading producer. It ranks sixth in the production of both fluxstone and lime. Although several formations are worked in Illinois for metallurgical stone the leading areas are in the Niagara and Mississippian.

Niagara dolomite.—Illinois has considerable production of dolomite of B-1 grade quarried from the Niagaran dolomite outcrop zone of northeastern Illinois (including Cook County). Some thick sections of the Niagara stone are fairly pure, but this situation is not true for the entire length of the outcrop belt. The dolomite is extensively quarried in Chicago and vicinity for use in lime burning, and for fluxstone as well as for other volumetrically much more important uses. Although there is a large quantity of Niagaran dolomite of good quality not yet quarried in the Chicago district, most of it is not available because of high land costs. Many of the quarries are completely surrounded by built-up areas, so the

only direction of expansion is downward. One such quarry is already 350 feet deep and has 150 feet more to go before abandonment. The quality of the Niagaran stone becomes poorer to the south and at Kankakee in Kankakee County the dolomite runs from 3 to 10 percent silica.

Mississippian limestone.—Much of the Mississippian Burlington and St. Louis limestone is A–2 in quality, but is exploited for uses to which A–1 grade stone is ordinarily employed. One lime-burning center is in the vicinity of Quincy and Marblehead, in Adams County in western Illinois. Burlington limestone is mined underground in this district. Farther down river in the Alton-East St. Louis districts of Madison and St. Clair Counties the St. Louis limestone of Mississippian age is quarried for many purposes, including lime burning, fluxstone, and chemical manufacture. The run-of-mine product is mostly A–2, but some of the ledges qualify for A–1 classification.

(Reference: Frank Krey and J. E. Lamar, Limestone Resources of Illinois, Ill. Geol. Survey, Bull. 46, p. 392, 1925.)

Wisconsin

Only minor amounts of limestone quarried in Wisconsin are used for lime and flux. By far the greater part of the production goes into concrete aggregate, road metal, and agricultural stone.

Practically all of the metallurgical stone quarried is the Niagaran dolomite which crops out in a broad band parallel to the Lake Michigan shore line from the Door Peninsula to northeastern Illinois. The largest lime production is in Manitowoc County. Lime is or has been burned in Sheboygan, Fond du Lac, Dodge, and Ozawkie Counties.

The Niagaran dolomite used for lime burning ranges in grade from B–1 to B–2. Scattered analyses show a silica content varying from 0.02 percent to 8.2 percent, with over half above 1 percent.

(Reference: Edward Steidtmann, Limestones and Marls of Wisconsin, Wisconsin Geol. Survey, Bull. 66, 1924, 208 pp.)

Missouri

Missouri ranks third in the annual production of lime. The yearly output of fluxstone is negligible, but much of the lime is used for metallurgical purposes. Some of the lime is obtained from the Ordovician Kimmswick formation, but most is burned from limestone of Mississippian age.

Kimmswick formation.—The Trenton Kimmswick formation contains deposits of metallurgical-grade limestone in eastern Missouri south of St. Louis. It is actively exploited for lime rock in Jefferson and St. Genevieve Counties.

Mississippian limestones.—Mississippian formations outcrop in a broad band fringing the Ozark upland area and extending northward into northeastern Missouri and western Illinois. The Mississippian rocks are predominantly limestones, and some of the limestones contain deposits of matallurgical grade stone. Three centers of lime production have been established in the belt of Mississippian outcrop. The largest of these is in the vicinity of St. Genevieve in St. Genevieve County. Here the lime rock is the Spergen formation. To the west, in southwestern Missouri, is a second lime-producing district. The largest plants are in Greene County in and near Springfield. The third district is in the vicinity of Hannibal in northeastern Missouri, where the Mississippian Burlington limestone is quarried and burned.

(Reference: El R. Buckley and H. A. Buehler, The Quarrying Industry of Missouri, Missouri Bureau of Geology and Mines, 2nd series, vol. 2, 1904, 371 pp.)

Colorado

Colorado's annual crushed limestone production is used mainly as a flux in the Pueblo iron furnaces and in the smelters of Colorado's mineral belt. Most of the limestones in this State are too impure for metallurgical purposes, but two formations, occurring in the Mississippian and the upper Cretaceous, are locally adequate for fluxstone and lime burning.

Mississippian rocks.—The Leadville and other massive limestones of the Mississippian system are exploited in Colorado for metallurgical stone. Biggest production is at Monarch west of Salida in Chaffee County where fluxstone is quarried for use at Pueblo and Leadville. Another Mississippian limestone deposit at Rockwood north of Durango in La Plata County, southwestern Colorado has been developed for both lime rock and flux.

Cretaceous rocks.—The Timpas member of the Niobrara is exploited in east central Colorado, especially in Pueblo, El Paso, and Fremont Counties, for cement, lime, and flux.

(Reference: John W. Vanderwilt, Mineral Resources of Colorado, Colorado Mineral Resources Board, 1947, pp. 244–246.)

Texas

Texas has a relatively small lime industry (seven plants were in operation in 1946) and a little fluxstone production. The State contains many limestones, but metallurgical-grade stone is scarce.

The smelters of the El Paso district are supplied with metallurgical lime and fluxstone obtained from Ordovician and Lower Cretaceous limestones which crop out in the immediate vicinity.

The principal lime rock in Texas is the Austin chalk formation, which locally has adquate purity for exploitation. This formation is quarried and burned for lime in several places in east central Texas, especially in Comal, Travis, and Williamson Counties.

California

California produces some lime, fluxstone, and chemical stone. It also is a source of refractory dolomite, but the annual output is small. The California limestones are in the main of Paleozoic age. They occur as inliers in the highly folded Mesozoic and Cenozoic sedimentary and volcanic rocks. The deposits are discontinuous, and it was estimated in 1944 that no deposit then undergoing exploitation would last over 20 years. Other deposits of metallurgical-grade stone are known, but without exception they are much more remote from markets than those currently being worked.

Although limestone has been reported from 52 of the 58 counties of California, in only 4 counties are the deposits sufficiently accessible and of adequate purity for large-scale lime burning. These counties are Eldorado in northern California, where two properties produced lime in 1946; San Bernardino, with two lime plants near the southwestern corner of the county, and Santa Cruz and Tuolumne; About 35 percent of the lime produced is used by the open-hearth steel furnaces. Smelter flux has also been obtained at Kennett in Shasta County. Dolomite has been quarried near Salinas in Monterey County for use as a refractory, and near Lone Pine in Inyo County for alkali manufacture as well as for refractory purposes.

(References: California Mineral Production for 1946, California Division of Mines, 1948, pp. 77–79; Economic Mineral Resources and Production of California, California Division of Mines, bull. 130, 1945, pp. 165–169; Structural and Industrial Materials of California, California State Mining Bureau, bull. 38, 1906, pp. 61–95.)

RÉSUMÉ OF STATEMENTS FROM PRODUCERS CONCERNING RESERVE SUPPLIES AND EXPLORATION COSTS

Statements have been received from various members of the National Lime Association concerning their reserve situation and their exploration costs. Examination of these reveals that the deposits currently being worked have a "life expectancy" of from 10 to 60 years, with an average span of less than 30 years, and that an average of $10,000 is being spent by each company each year in the search for new deposits. The latter figure is low because only the companies whose deposits are approaching exhaustion in the near future are really active in exploration. One steel company spent $100,000 in exploration during the last 3 years, but still has to purchase over half of its limestone requirements.

The "life expectancy" is based on a continued market for the quality of material available in each deposit. One producer emphasizes that most industries using lime "have very strict specifications on sulfur, fluorine, arsenic, and other impurities; and there are very few deposits in this country of sufficient purity to meet the increasingly rigid specifications that the material has to meet."

The CHAIRMAN. That concludes the witnesses for today.

The committee will adjourn until 10 o'clock tomorrow morning.

(Thereupon, at 12:40 p. m., the committee adjourned until 10 a. m., Friday, July 13, 1951.)

REVENUE ACT OF 1951

FRIDAY, JULY 13, 1951

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

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

Present: Senators George, Byrd, Kerr, Frear, Millikin, Butler, and Williams.

Also present: Elizabeth B. Springer, chief clerk; Colin F. Stam, chief of staff, Joint Committee on Internal Revenue Taxation.

The CHAIRMAN. The committee will please come to order.

Mr. Hill, you come around.

We are going to have a very limited number of Senators here this morning. Some of them will come in later. Some of the Senators are out of town, and some have other committee hearings but we will have to proceed. You will get your statement into the record, and I hope that the Senators will read the full record; most of them will.

Please identify yourself of the record, Mr. Hill.

STATEMENT OF J. RUTLEDGE HILL, CHAIRMAN, COMMITTEE ON TAXATION, NATIONAL SAND AND GRAVEL ASSOCIATION

Mr. HILL. My name is J. Rutledge Hill. My good friend, Senator Connally calls me "Perch."

The CHAIRMAN. How is that?

Mr. HILL. I said my good friend, Senator Connally, calls me "Perch."

The CHAIRMAN. Yes, sir.

Mr. HILL. I am the president of Gifford-Hill & Co., Inc., of Dallas, Tex., which has sand and gravel operations in Texas, Louisiana, and Arkansas.

I appear here as chairman of the committee on taxation of the National Sand and Gravel Association.

In behalf of the commercial sand and gravel industry of the United States, I respectfully request your committee to recommend to the Senate that it concur in the action of the House of Representatives which would add sand and gravel to the list of nonmetallic minerals entitled to percentage depletion.

In my appearance before the Ways and Means Committee on March 5 of this year, I asked that sand and gravel be accorded a percentage depletion allowance of 15 percent, which our industry believes to be fair and equitable. The bill adopted by the House, while recognizing that the sand and gravel industry qualifies under the

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statutory test for percentage depletion, provides for an allowance of only 5 percent. We ask your committee to increase the allowance to 15 percent, since no justification has been offered for denying to sand and gravel the same legislative consideration already extended to other nonmetallic minerals and, particularly, since our industry qualifies under the strictest standards for extension of the principle of percentage depletion.

It should not be forgotten that these other nonmetallic minerals, some of which are directly competitive with sand and gravel, have had a percentage depletion allowance of 15 percent for several years, while our industry has been forced up to now to contend with a cost depletion arrangement which is wholly inadequate if this country is to continue to get the sand and gravel which it must have in order to support a great defense construction program and, later, a great private and public works construction program

Everybody agrees that construction on a large scale is necessary in order to catch up with the tremendous accumulation of construction requirements caused by the suspension or drastic curtailment of essential civilian construction in World War II and now again in the present emergency.

The sand and gravel industry is a great industry in every sense of the term, even though it is composed of a large number of individual companies which are relatively small businesses. In the last 12 years, according to the records of the United States Bureau of Mines, our industry produced over 3 billion tons of sand and gravel, valued at more than $2 billion. Among the members of the nonmetallic minerals family, sand and gravel production is second only to coal. Our industry plays the basic role in fulfilling the construction requirements of the United States. There is no kind of construction, public or private, defense or nondefense, which does not involve the use of sand or gravel or both.

The CHAIRMAN. Do you discuss the other things that are competitive, in your statement?

Mr. HILL. No, Mr. Chairman.

The CHAIRMAN. What other material competes with sand and gravel?

Mr. HILL. Rock asphalt and vermiculite, and some others, to a lesser degree; rock asphalt, notably and vermiculite.

The CHAIRMAN. All right, sir.

Mr. HILL. The defense program starts with the use of our materials. It would be pointless, for example, to build a great Air Force unless there are airports from which the planes can take off and land. This is only an illustration of the essential role played by sand and gravel in the economy of the United States.

Our industry has had to produce sand and gravel since 1939 on a scale which could not have been anticipated. Production records were broken each year until what was then the record-breaking production of 1942. Your committee will not overlook the fact that in this first full year of World War II, our industry established an all-time figure for sand and gravel production. We did this without governmental subsidies and in the teeth of manpower and equipment difficulties, but a big hole was dug in sand and gravel reserves which had been thought to be enough for many years to come.

Production of sand and gravel successively declined from 1943 through 1945, but 1946 witnessed the beginning of an upturn and it is

estimated that sand and gravel production in 1950 amounted to approximately 350 million tons, a new all-time high figure. These record-breaking tonnages have developed an acute shortage of sand and gravel in many areas of this country. And, may I say at this point, that production this year appears to be going to outstrip even last year.

Perhaps the United States has come to expect that there will always be plenty of sand and gravel at economical prices. This is understandable, since most people have no adequate understanding of the astronomical tonnages of sand and gravel which our industry has produced in response to the great demand for our products. I say to your committee, however, in the utmost seriousness that the United States is on the threshold of critical shortages of sand and gravel in almost every area.

In some sections, sand and gravel reserves have already been exhausted and communities must reach out to more distant sources with higher transportation costs; and your committee should understand that cost of transportation of sand and gravel is always higher than the price of sand and gravel at the plant.

I refer to this fact because the principal problem of the country with respect to sand and gravel is to develop sources of supply which will make sand and gravel available economically and which will therefore make it unnecessary for the country to choose between the alternatives of curtaining defense and essential civilian construction or paying a prohibitively high price for sand and gravel, the basic materials of construction, thus substantially increasing the cost of construction.

In the 5-year period ended December 31, 1950, my company invested in exploration for and in the development of new sources of supply and new reserves of sand and gravel a sum of money greater than our depletion and depreciation reserves plus over 80 percent of our entire net profits for those 5 years. Today we have fewer sand and gravel operations and smaller and poorer sand and gravel reserves than we had 5 years ago, and yet the defense program in the southwestern part of the United States calls for great tonnages of sand and gravel. This is the story for my own company, but it is a common story for the sand and gravel industry.

Let me cite just one example: Air Force construction at Lake Charles, La., requires 800,000 tons of sand and gravel within the next year.

All sand and gravel producers in central Louisiana and southern Texas will have to contribute their share of this big order from their own limited reserves. No other industry is being confronted with such tremendous orders for single projects for the defense forces. Yet the Lake Charles project is only one of several in my company's marketing area.

We have a number of Air Force installations under way at Dallas; Shreveport; Bryan, Tex.; Waco, Tex., and other points.

We are trying to develop a deposit in an entirely new section of southeastern Louisiana. We may be able to find some commercially usable sand and gravel under overburdens from 40 to 60 feet in depth. My company will have spent $250,000 before we locate and develop a sand and gravel deposit from which we can produce materials to meet specification standards.

It is a grave but common error to suppose that sand and gravel can be found almost everywhere. The grim truth is that under modern conditions vast sums of money must be spent first to explore for and locate a satisfactory deposit and then to build plant facilities which will produce and process the materials in conformity with the severe specification standards now required to be met before our materials will be accepted.

Our problem is aggravated by the higher corporate, normal, surtax and excess-profits tax rates now in effect and which may remain on the statute books for a long time. The sand and gravel industry must make substantial investments in exploration and in the location of expensive plants on uncertain and possibly poorer deposits. Unless sand and gravel receives a percentage depletion allowance in the requested amount, we are not very far away from the day when commercially usable sand and gravel will not be available except at prohibitive prices.

Our industry believes that percentage depletion for the mining industry is sound public policy. Sand and gravel qualifies for inclusion under that policy. It seems to us an unreasonable discrimination against our industry to continue to be denied the benefit of a taxation policy already extended for many years to other members of the nonmetallic-minerals family whose situation is no different from our own.

I have spoken of sand and gravel as a material which is basic to public and private works in the United States. I am authorized by the National Industrial Sand Association to say to you that the case which I have made for the sand and gravel industry applies with equal force to the industrial sand industry. Industrial sand is a raw material used principally in the foundry and glass industries, but also finding employment as an essential raw material in many other manufacturing processes. Industrial sand plays a vital role in the production of practically every item of military equipment, and it plays an equally important role in the production of goods essential to civilian life in our country.

For these reasons, we ask that sand and gravel and industrial sand be accorded a percentage depletion allowance of 15 percent. We ask your committee to join with the Ways and Means Committee and the House of Representatives in recognizing the validity of the application of the principle of percentage depletion to sand and gravel and industrial sand, and we ask also that the 5-percent allowance presently incorporated in the bill before you be increased to 15 percent.

We believe that this will serve the public interest and that it will remove a discrimination against our two industries, which ought not be permitted to continue.

We implore you gentlemen to permit us to continue in our business.

I wish to thank you for your courteous attention.

The CHAIRMAN. Thank you very much, Mr. Hill. Are there any questions?

Mr. Hill, I have the impression that sand was available in almost all of the States or in a great many of them, while gravel, of course, is not. Is that correct?

Mr. HILL. Senator, there is sand and sand and sand.

The CHAIRMAN. Oh, yes; I know that.

Mr. HILL. But most of the material that you think of as being sand is sand, but it is not adapted to the use of what we are talking about.

Sand, to be usable, has to be graded from very fine particles which will pass the screen that water will not even go through, on up to the larger particles, and there must be a smooth gradation from the small up to the large, and for that reason 98 percent of the sand found in nature is useless to these industries.

Do I make myself clear?

The CHAIRMAN. Yes, I think I understand you.

Is there any chemical process by which you could take ordinary sand and convert it into usable form?

Mr. HILL. No, Senator. Most of the sand that you have in mind is extremely fine.

The CHAIRMAN. Yes.

Mr. HILL. And the problem is to incorporate and build up a material that goes from fine up to about a quarter inch in size.

The CHAIRMAN. Is this land you find along the seacoast usable?

Mr. HILL. Not at all. It is not any good. The grains are rounded, and it is inclined to be quickie.

Senator KERR. It is what?

Mr. HILL. Utterly useless in these industries.

The CHAIRMAN. Quicksand.

Senator KERR. What?

Mr. HILL. Quicksand. The particles are rounded, and when they become wet it is what we call quickie; in other words, you step on it and it gives under your foot, and it is not stable.

Senator KERR. Is that because the sand is smooth?

Mr. HILL. The particles are rounded, Senator; in other words, the particles of that sand are little miniature marbles, and there is no cohesion.

Senator KERR. Well, the shape of it alone does not determine that. Is not it whether or not the surface is glazed or smooth or rough, whatever it is, determinative as to whether or not it is quicksand, as the shape of the sand?

Mr. HILL. I would say that the shape of the particle is——

Senator KERR. Is more determinative.

Mr. HILL. That is correct.

Senator KERR. Yes.

The CHAIRMAN. Thank you very much, Mr. Hill.

Mr. HILL. Thank you, sir.

The CHAIRMAN. Mr. Brady?

Mr. Brady, I understand you wish to file a brief?

STATEMENT OF CHARLES BRADY, SALES MANAGER, B. V. HEDRICK GRAVEL & SAND CO.

Mr. BRADY. Senator George, Senator Millikin, and Senator Kerr, I am Charles Brady, sales manager for Hedrick Gravel & Sand Co., Salisbury, N. C.; and I represent here W. R. Bonsal Gravel & Sand Co. of Lilesville, N. C.; Cumberland Gravel & Sand Co., Fayetteville, N. C.; and Grove Stone & Sand Co., Swannanoa, N. C.

Mr. Hill has covered the question of percentage depletion as pertains to the national picture.

I would like the privilege of filing this brief statement which will cover the needs as they pertain to North Carolina and South Carolina, in particular.

Thank you, sir.

The CHAIRMAN. You may do that, sir. Senator Hoey is not here today.

(The document referred to follows:)

WHY PERCENTAGE DEPLETION FOR GRAVEL AND SAND IS ESSENTIAL IN NORTH CAROLINA

Prior to World War I there were only two gravel and sand plants in North Carolina and only one in South Carolina. their combined production would not equal that of any one of the five large rail plants in North Carolina or of either of the two large rail plants in South Carolina. In addition to the seven rail plants in North and South Carolina there are approximately five large portable type plants permanently operating in North Carolina and one new rail plant 75 percent completed now building in South Carolina. Every known commercially available sand and gravel deposit in the two States is being mined at present and several of the larger ones are thought to be nearing the exhaustion point. Unless new deposits are found and developed not only will construction in the Carolinas be retarded, but that construction which is done will be done at considerably higher costs.

During World War II gravel and sand built the following jobs in the Carolinas: United States Marine Air Base at Cherry Point, N. C.; Camp Lejeune Marine Base at Jacksonville, N. C.; Camp Davis at Holly Ridge, N. C.; Bluethenthal Air Base at Wilmington, N. C.; Laurinburg-Maxton Glider Base near Maxton, N. C., Camp Mackall at Hoffman, N. C.; Army Air Base, Greensboro, N. C., Army Air Base, Greenville, S. C.; Morris Field, Charlotte, N. C.; United States Quartermaster Depot, Charlotte, N. C.; Naval Shell Loading Plant, Charlotte, N. C.; Army Air Base, Florence, S. C.; Army Air Base, Sumter, S. C.; Charleston, S. C., Navy Yard; and the Charleston, S. C., Army Air Base.

At present in the Carolinas there is extensive construction activity involving the use of gravel and sand at the following defense installations: The H-bomb plant near Aiken, S. C.; Fort Bragg; Pope Field; Camp Mackall; Charleston Navy Yard; Camp Lejeune; Cherry Point Air Station Naval Air Base, Edenton; Fort Jackson; and the Charleston Naval Ammunition Depot. A site in Mecklenburg County and a site in Rowan County are two of the few locations in the United States still being considered for the proposed "College of the Air."

Navy and Army installations in Florida are experiencing difficulty in obtaining gravel for air-base construction and have applied to gravel producers in the Carolinas who are already shipping their capacities.

As important as defense construction is it is still necessary to maintain our regular economy—North Carolina is leading the nation in textile expansion and South Carolina is close behind North Carolina. During the past 3 years North Carolina has averaged more than $100 million per year for highway construction and maintenance. There are more than 40 ready-mix concrete plants in the Carolinas which before 1940 had less than a dozen; this better than any other method denotes the rate of industrial expansion. As a State grows its schools and hospitals must keep pace—North Carolina is in the midst of a $50 million school program. By reason of recent court decisions there is a great possibility of an additional $80 million school-building program in order to equalize opportunities for children of both races. Since 1947 the State has spent approximately $25 million on its mental and tubercular facilities and has advanced another $25 million for general hospital construction which sum represents about one-third of the total funds supplied by State, local, and Federal participation.

The largest known gravel deposit in the Carolinas consists of quartzite pebbles and is the purest known deposit in the United States. This gravel is increasingly valuable for metallurgical purposes. The owners of this deposit have spent and are spending considerable sums of money to find and develop deposits to take care of regular construction demands and conserve the metallurgical type gravel which is so essential to production of silicon, ferro-silicon, chrome silicate, and certain chemical processes. This metallurgical gravel is being shipped from North Carolina to Kentucky, South Carolina, New York State, and West Virginia. Because of its purity it should never be used for ordinary construction where chemical purity is of no particular value.

The tremendous demands of the past 10 years as outlined in the forgoing have greatly reduced the known reserves of gravel and sand in the Carolinas. Prospecting has necessarily moved farther away from the markets to be served. Encouragement in the form of percentage depletion is an economically sound tax policy as it promotes the finding and developing of deposits which experience has shown in turn promotes industrial growth and increased business volume.

The CHAIRMAN. Mr. Grassman is not here.

Mr. RAREY? You may have a seat, sir, and identify yourself for the record.

STATEMENT OF RUSSELL RAREY, PRESIDENT, MARBLE CLIFF QUARRIES CO.

Mr. RAREY. Mr. Chairman and gentlemen, my name is Russell Rarey and I am president of the Marble Cliff Quarries Co. at Columbus, Ohio, and I am a member of the Percentage Depletion Committee of the National Crushed Stone Association.

I wish to submit for the record this formal statement on behalf of the National Crushed Stone Association and Agricultural Limestone Institute in support of a percentage depletion allowance for the crushed stone industry, and I will not impose upon the time of the committee to read the statement, copies of which, I understand, have been placed before you.

The CHAIRMAN. You may put it into the record.

Mr. RAREY. Thank you, sir.

I do, however, desire to make the following observations in my own behalf in support of the formal statement.

My company operates a limestone open quarry or mine near Columbus, Ohio, and a limestone underground mine in western Ohio. The character of the stone is such that it is of value for chemical and metallurgical purposes, for burned lime, and for agricultural use, for railroad ballast, for highway construction and maintenance and for miscellaneous construction work, including airport runways, et cetera.

There are three general areas of need for a percentage depletion allowance for the crushed stone industry.

First, other natural resource industries that compete with the crushed stone industry now enjoy percentage depletion allowances of 15 percent and more, whereas the crushed stone industry has no such allowance. The inequity of this situation is so obvious that that point need not be labored further.

Second, the second area of need lies in the increases in profit taxes that are contemplated by the new tax bill. As the percent of profits to be taken by the Government to satisfy the needs of its program mounts, it follows that the percent of profits left to remain with industry is reduced. Any inequality of tax therefore becomes more punishing——

Senator KERR. More what?

Mr. RAREY. More punishing.

Senator KERR. More pungent?

Mr. RAREY. No, it hurts us more.

Any inequality of tax therefore becomes more punishing under higher tax schedules and while it is true that the Government does have real need for an increase in its revenues, we respectfully submit that the basis of those taxes should be distributed equitably and that regardless of need for revenue, it is inconsistent, with sound and fair practice, to knowingly continue discriminatory legislation as between competing natural resource industries.

Third, the third area of need is found in the rapid depletion of economically available sources of stone. It has been my observation that the depletion of these sources is much more rapid than is generally recognized by the industry itself and certainly by the laymen. The

operations of my own company are rapidly exhausting our supply of stone, a situation which is parallelled by many other producers in our State and to a very considerable degree throughout the Nation.

Today, we find ourselves by reason of the tax laws and regulations that apply to our industry figuring depletion on a cost basis while at the same time prospecting for replacement areas that, if and when available, cost many times the price of the acreage being currently depleted. Not only are stone lands becoming less available, but restrictions by zoning ordinances and through activities of planning commissions make expansion in many districts both difficult and expensive. The best deposits, the cheapest deposits and the more accessible deposits are depleted first. Replacements are higher in price, less economical to work and less favorably located with respect to our plants and markets. Small wonder then that those of us familiar with this situation are desirous of retaining a depletion allowance to compensate in some measure for the increasingly difficult conditions that we encounter in our efforts to maintain and expand our business. Today, under the stress of greatly increased construction and building activities and by reason of the sharp increases in the consumption of chemical and metallurgical stone for the production of steel, we find ourselves exhausting available stone deposits at a time when we are required by law to apply 50 percent and more of the profits from our operations for tax purposes.

In other words, we are reducing our available deposits at an accelerated degree and because of the need for higher and higher taxes, we are permitted to retain less and less for the continuation of our business——

Senator MILLIKIN. When you speak of available deposits, you are speaking of existing developed deposits, are you not? There is no lack of stone in the United States if you go to where it is?

Mr. RAREY. Well, yes, but if you consider it with relationship to the consuming points, we refer to it as being depleted rapidly and to our disadvantage.

Senator MILLIKIN. I grant that, but I am just trying to find out, when you speak of these deposits which deserve the depletion you are asking for, whether you are speaking of the existing deposits that are now being developed, rather than a lack of general supply of stone.

Mr. RAREY. Well, a deposit is of no value unless it has a plant and a market to it.

Senator MILLIKIN. I understand that.

But, would you answer the question, please?

Mr. RAREY. I think, in the way you intend the question to be answered, the answer would be yes, although it is not literally and a hundred percent true.

At this point may I suggest that a continuation of the crushed stone business is essential. Without suitable aggregates, there can be no modern construction; without agricultural limestone the productive capacity of our farm land would be reduced and our food supply lessened, and without metallurgical stone and lime, there can be no steel.

The need for our industry products continues to expand—the need for maintaining adequate stone reserves to support our production continues as a prudent and essential business requirement and the

need for cash to prospect for, to purchase and to develop those reserves should certainly come through a reasonable allowance for percentage depletion.

It is our hope and plea that your committee and the Senate will grant a percentage depletion allowance for our industries and that the percentage allowed us will be adequate. The Ways and Means Committee of the House has included in its bill a 5-percent allowance for agricultural limestone, crushed stone, and other aggregates, while at the same time continuing a 15-percent allowance for certain other competing industries and an even higher allowance for other natural resource industries that are confronted with discovery and development problems.

It is my request, therefore, that your committee and the Senate concur in the general recommendation of the House Committee that our industries be given a percentage depletion allowance and that you give studied consideration to increasing the percentage to a more adequate figure.

Senator MILLIKIN. Where do they get rock asphalt?

Mr. RAREY. Well, some in Kentucky, some in Alabama, and some in Texas.

The CHAIRMAN. Are there any further questions?

Senator KERR. What limestone formation with reference to geological age do you find prevalent in your area?

Mr. RAREY. Well, with us we are in the Devonian stone in the Columbia and Delaware formations, which are limestone, with a high percentage of calcium and relatively low percentage of magnesium.

Roughly divided into general stratas, the upper ledges contain silica that makes it unsuitable for chemical purposes, yet it is desirable for construction purposes; and the lower ledges are the chemical ledges that go into steel and lime, and the general chemical manufacturing processes.

Senator KERR. And which geological age, generally, provides the more abundant——

Mr. RAREY. I would not at this time be able to answer that.

Senator KERR. Opportunity.

Mr. RAREY. I would not know which geological formation or age—the common designation of those stones, such as granite or trap rock, as differentiated from limestone, each occur in different sections of the country, and are each applicable to their own particular uses, although there is a common use, or there is a use that is common to all of them and that is in the construction field.

Senator MILLIKIN. In terms of age, the oldest are the deepest.

Mr. RAREY. That is right.

Senator MILLIKIN. But the deepest may be exposed——

Mr. RAREY. In some places.

Senator MILLIKIN. By erosion or uplift.

Mr. RAREY. That is right, and not in others.

There has been some upheaval that exposes it in one place and not in another. In central Ohio we are all limestone.

The CHAIRMAN. Thank you very much, Mr. Rarey. Your prepared statement will be placed in the record at this point.

Mr. RAREY. Thank you, sir.

(The prepared statement referred to follows:)

Statement in Support of House Bill Provision To Include Crushed Stone Among Competing Minerals Allowed Percentage Depletion

In 1950, and again this year, the House has voted to eliminate an unjust discrimination against crushed stone and has included it among nonmetallic minerals entitled to percentage depletion.

Last year the Senate Committee did not deny that crushed stone is entitled to percentage depletion, but decided "to postpone action on these proposals until your committee can carry out a more careful analysis of the problems involved."

We urge this structural change in the act as a matter of equity. In fact, the House bill offers only partial relief since it provides a 5 percent depletion allowance for crushed stone, whereas certain competing minerals are granted 15 percent under existing law.

In its recent report the House Committee pointed out that percentage depletion is allowed certain nonmetallic minerals but is denied to competing minerals in the same classification. The report states that:

> "The testimony received by this committee both in connection with this bill and the bill which became the Revenue Act of 1950 revealed that in a number of cases nonmetallic minerals which are not in the enumerated group under existing law are competitive with those receiving percentage depletion, or have just as good a claim for such treatment as the enumerated minerals." (1951 Rept. No. 586, p. 30)
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> "Most of these changes would have been made under the House version of the bill which became the Revenue Act of 1950 but they were eliminated from the final legislation largely because of the revenue loss involved. It is apparent, however, that the need for equalization is substantially greater now because of the additional taxes imposed under the legislation of 1950 and under this bill. Therefore, the committee believes that the proposed extension of the percentage depletion system is necessary in spite of the revenue loss involved." (1951 Rept. No. 586, p. 30.)

Producers of crushed stone are fully aware that at first glance the addition of crushed stone to the depletion list appears somewhat inconsistent with the present need for revenue. However, in the first place, the revenue involved in this item is relatively inconsequential and, secondly, the need for revenue, however pressing, is not a valid basis for an inequitable distribution of the tax burden so as to discriminate between crushed stone and competing nonmetallic minerals.

For example, rock asphalt used in highway construction now benefits from percentage depletion and is competitive in the highway field with crushed stone. Contrary to popular belief, rock asphalt is not asphalt with just a bare trace of a relatively small percentage of rock in it. Rock asphalt is, in fact, largely stone impregnated with a relatively small amount of asphalt, varying roughly from 5 to 12 percent. The crushed stone industry uses stone to produce an asphalt mix quite similar to rock asphalt.

In the hearings before the Senate Finance Committee on the Revenue Act of 1942 in regard to percentage depletion allowances for the rock asphalt industry, Senator Elmer Thomas made a strong plea for that industry, as a result of which it has enjoyed percentage depletion ever since and at the rate of 15 percent. Yet, many crushed stone operators have carefully designed, expensive mining plants, where crushed stone meeting rigid specifications as to gradation, cleanliness, and wearing qualities is mixed in carefully weighed proportions with other materials, to make a cold or hot lay road of the highest quality, suitable and being used for all the purposes enumerated in Senator Thomas' statement regarding rock asphalt.

The competitive relationship between rock asphalt and crushed stone is such that failure to grant the same percentage depletion allowance of 15 percent to the crushed stone industry as is now enjoyed by the rock asphalt industry would be to continue an unjust discrimination.

A further example of unjust discrimination and obvious inconsistency in the present law lies in the fact that asphalt paving cement and liquid asphalt cement, materials used in conjunction or competitive with crushed stone, enjoy through the industry of their origin (petroleum) a 27½-percent depletion allowance.

The iron and steel industry uses large quantities of iron ore, coal, and crushed stone. Similar risks, hazards, problems, and difficulties, geological, physical, and chemical, met with in the mining of iron ore and coal are encountered in the recovery of the crushed stone used by the iron and steel industry. Unquestionably the outstanding factor in the maintenance of our present highly industrialized civilization, in both peace and war, is the iron and steel industry. The entire

structure of that industry rests largely upon three mineral resources, viz. iron ore, coal, and stone, each of which is of equal importance and without any one of which the industry could not exist in its present gigantic proportions.

The coal industry solves its most serious problem of safety by the use of pulverized stone for preventing coal dust explosions.

Agricultural limestone, a crushed stone product, is widely used for direct application to the soil and also as an ingredient in commercial fertilizers along with nitrogen, phosphorus, and potash. Yet, of the three mineral constituents of commercial fertilizer (limestone, rock phosphate, and potash salts), limestone alone is not subject to percentage depletion allowance, thereby discriminating against this product.

As frequently emphasized by Secretary Snyder, "We all know that the workability of our tax system * * * depends on the high regard our people have for the fairness of our tax laws and their administration." Hearings, 1950, vol. I, p. 17.

Further, it seems appropriate to point out that Secretary Snyder in his testimony before the House committee on February 5, 1951, while urging that reductions be made in certain percentage depletion allowances, did not voice any objection to the principle of a percentage depletion allowance for nonmetallic minerals.

In order to avoid repetition of evidence heretofore furnished the committee, we refer to the testimony on this subject given last year, which contains a fully documented discussion of the position of the crushed stone industry in this matter—House hearings, vol. I, February 9, 1950, pages 480–491.

For reasons set forth above we respectfully urge the committee to adhere to the position that it took last year of granting a percentage depletion allowance to crushed stone to remedy the discriminatory exclusion of crushed stone from the competitive minerals which are permitted depletion allowances.

We do, however, hold strongly to our previous position that the allowance should be 15 percent as now accorded rock asphalt, ball and sagger clay, china clay, bentonite, vermiculite, iron ore, lead, zinc, and barite, all of which are directly competitive with crushed stone and agricultural limestone; and as accorded potash, phosphate rock, and trona, which are indirectly competitive. Further, an allowance of 15 percent seems justifiable when it is realized that asphalt paving cement and liquid asphalts used extensively and directly in highway construction and maintenance enjoy, through the industry of their origin (petroleum), a 27½ percent depletion allowance.

The reasons which justified the Ways and Means Committee and the House in voting in 1950 and again this year, and the Senate in 1949, to grant a percentage depletion allowance to crushed stone are even more persuasive at this time in view of the increased tax burden, a fair share of which the crushed stone industry will gladly assume in the interest of the defense program.

NATIONAL CRUSHED STONE ASSOCIATION
AND
AGRICULTURAL LIMESTONE INSTITUTE,
RUSSELL RAREY,
HORACE C. KRAUSE,
Members of Percentage Depletion Committee.

The CHAIRMAN. Mr. Fernald, you may have a seat.

STATEMENT OF FRED C. FERNALD, GENERAL COUNSEL, GODFREY L. CABOT, INC., ACCOMPANIED BY CHARLES A. STOKES

Mr. FERNALD. Mr. Chairman, and Senators——

The CHAIRMAN. Identify yourself, please, for the record.

Mr. FERNALD. I am Fred Fernald, secretary and general counsel of Godfrey L. Cabot, Inc., Boston.

I might say that I will be followed by our Dr. Stokes, who is the director of research and development in our company, and he will be able to answer the more technical questions in connection with our petition.

It has been suggested that I read the statement which I prepared and filed.

This is the statement of Godfrey L. Cabot, Inc., before the Finance Committee of the United States Senate in support of proposal to add wollastonite to the list of minerals subject to 15-percent depletion under section 114 (b) (4) (A) of the Internal Revenue Code.

Godfrey L. Cabot, Inc. is a corporation organized under the laws of Massachusetts. Through subsidiaries it has offices and plants in Massachusetts, Pennsylvania, West Virginia, Florida, Ohio, Louisiana, Texas, Oklahoma, and Kansas. I might insert that New Mexico was omitted there.

We propose that wollastonite be added to the list of minerals subject to 15-percent depletion under section 114 (b) (4) (A) of the Internal Revenue Code. The exact language of our proposal is that section 304 (a) of the House bill be amended by inserting "wollastonite" in paragraph 4 (A) (iii) of Internal Revenue Code section 114 (b) between "gilsonite" and "thenardite."

Wollastonite is a nonmetallic mineral being mined and marketed today. This calcium metasilicate ($CaSiO_3$) has been used in floor and wall tile, welding rod coatings, alloying agents, and soil conditioners. It is white in color, brittle, and with a fibrous cleavage. It can be produced in large quantities and through milling it is prepared for use in industry.

Its use pattern is similar to that for talc which is already subject to the 15-percent depletion under section 114 (b) (4) (A) of the Internal Revenue Code.

Its greatest value in connection with the defense effort is in ceramic insulators of the steatite type for use by the United States Signal Corps and all branches of the armed services.

Senator MILLIKIN. Has this material been classified as strategic or critical by the defense authorities?

Mr. FERNALD. I do not know the answer to that. Dr. Stokes may know the answer.

The CHAIRMAN. Is Dr. Stokes in the room?

Mr. FERNALD. Yes, sir. He follows me.

The CHAIRMAN. Come around, Doctor. All right, go ahead.

Mr. FERNALD. Steatite talc during World War II was a strategic mineral of greatest importance, essential in use and extremely short in supply, and this condition still prevails. Under a contract with the Signal Corps, Rutgers University is studying the use of this material in making electrical insulators for use in radio, radar, and other critical electrical equipment. They have demonstrated that such insulators, made from wollastonite, in formulas similar to those used for steatite talc have outstanding properties, in many respects superior to those of steatite talc.

Senator MILLIKIN. May I ask where is this material found?

Mr. FERNALD. There is a deposit in New York, there is some in California, and I believe there are other deposits.

Mr. STOKES. Canada and Mexico.

Mr. FERNALD. Canada and Mexico.

Senator BUTLER. I see you have got Oklahoma, Texas, and Kansas listed here.

Mr. FERNALD. In Oklahoma and Texas and Kansas we have natural gas properties; we have carbon black factories in the Southwest, that is, in Oklahoma, Texas, New Mexico, and Louisiana. We also have

some oil production in that part of the country. In the Appalachian area we have natural gas.

Senator BUTLER. Yes.

What was your answer to Senator Millikin's question about whether it is classified now as either strategic or critical?

Mr. FERNALD. I do not know, but I do not think it has been.

Senator MILLIKIN. Does the gentleman with you know?

Mr. STOKES. That is correct. The material will not be classified as strategic, according to our information, until the deposit is recognized and worked as a commercially going venture, so that the Signal Corps can feel that it is readily available to their contractors.

Senator BUTLER. Is it classified as highly critical?

Mr. STOKES. Well, it cannot be classified as highly critical because the material is not now in commercial production other than in a very small way, and this is a newly developing industry.

Senator BUTLER. How long has it been known by this name?

Mr. STOKES. The wollastonite mineral has been known probably for 20 or 30 years. The beginning use of wollastonite is only in the last 5 or 6 years, beginnings of the development, that is.

Senator KERR. It is a nonmetallic mineral?

Mr. STOKES. Yes, sir.

The CHAIRMAN. All right, you may proceed.

Senator MILLIKIN. What other minerals does it resemble?

Mr. STOKES. It resembles most closely in its use the talc minerals, pyrophyllite, steatite, and other forms of talc. They are magnesium silicates. This is a calcium silicate.

Mr. FERNALD. Wollastonite is of great importance not only because of its superior qualities for making steatite-type insulators, but also because, unlike steatite talc, an adequate domestic supply is assured at a cost probably lower than that of steatite. It is also important due to the fact that wollastonite insulators may be easily processed in conventional kilns at a relatively low temperature.

Senator MILLIKIN. Is wollastonite a trade name or is it a geological formation name?

Mr. FERNALD. It is a geological name. I understand from Dr. Stokes that it was named after a man named Wollaston who discovered it.

Tile-manufacturing companies cannot make the steatite insulators because steatite insulators require higher-firing temperatures. But such tile companies can make the wollastonite insulators because the wollastonite insulators require only a low-firing temperature.

We mention briefly in addition the usefulness of wollastonite in the paper and paint industries because, of course, the committee is naturally most directly concerned with its connection with defense production.

We believe that this is the first committee of the Congress before whom anyone has appeared on behalf of wollastonite. To the best of our knowledge, nobody appeared before the Ways and Means Committee of the House of Representatives on behalf of wollastonite.

Senator MILLIKIN. Would this mineral come under the 5-percent classification of the bill?

Mr. FERNALD. No, sir.

Senator MILLIKIN. It is not and would not be classified as stone?

Mr. FERNALD. No, sir. It would not.

We note that the Ways and Means Committee of the House of Representatives added this year the following nonmetallic minerals to the list of those entitled to percentage depletion and allowed them percentage depletion as follows:

5 percent:
- Asbestos
- Sand
- Gravel
- Stone (including pumice, scoria and slate)
- Brick and tile clay
- Shale
- Oystershell
- Clamshell
- Granite
- Marble

15 percent:
- Borax
- Fuller's earth
- Tripoli
- Refractory and fire clay
- Quartzite
- Perlite
- Diatomaceous earth
- Metallurgical grade limestone
- Chemcial grade limestone

Senator BUTLER. Would not your wollastonite classify under some of those items—some one of them?

Mr. FERNALD. I do not believe they would, sir. There are some of them which are competitive items. For instance, quartzite, diatomaceous earth, and chemical grade limestone are all competitive items.

Senator KERR. What is diatomaceous earth?

Mr. FERNALD. I will ask Dr. Stokes to answer.

Mr. STOKES. It is essentially pure silica, of which there are very large occurrences in your State.

Senator KERR. There are what?

Mr. STOKES. There are very large occurrences in your State under the name of tripoli. Tripoli and diatomaceous earth are closely related.

Senator KERR. Where does it occur?

Mr. STOKES. In California. Diatomaceous earth occurs in California, and in the Midwest.

Senator KERR. Does it occur in Oklahoma?

Mr. STOKES. Yes, sir; it occurs very widely in small noncommercial deposits. It can be found in New Mexico, where we have stumbled onto it in exploring for oil, but they are not commercial deposits.

Senator KERR. What is its use?

Mr. STOKES. It is used as a filter aid; it is used as an ingredient in ceramics. It is used as an ingredient in refractories, as a filler for rubber, paint, and plastics, battery boxes, such essential uses.

Senator MILLIKIN. How do you distinguish it from stone? Why is it not a stone?

Mr. STOKES. It is not a stone because it occurs in a relatively finely divided state. It has no strength; it is porous, soft material.

Senator MILLIKIN. Is it a loose material?

Mr. STOKES. It is loose. It can be ground apart by your hand.

Senator MILLIKIN. Limestone is frequently a porous material?

Mr. STOKES. It is frequently porous but in nearly all cases except a chalky limestone, it is rather hard.

The CHAIRMAN. All right.

Senator WILLIAMS. Mr. Fernald, if that should be added to the list, how much difference would that make in the taxes in your own instance?

Mr. FERNALD. We are not in production, sir.

Senator KERR. As I understand the witness, they have discovered deposits, but there is none of it in commercial production so that with reference to past history it would make none. Their tax history is yet to be made.

Mr. FERNALD. I think there is a little production going on now, sir, but it is not large enough.

Senator KERR. It is limited?

Mr. FERNALD. Yes, sir.

Senator WILLIAMS. You do figure it would be advantageous taxwise, naturally, though?

Mr. FERNALD. Oh, yes, naturally.

Senator WILLIAMS. Do you have any estimate of what the change would be, what change it would make in your taxes?

Mr. FERNALD. It depends on whether the venture was profitable.

Senator WILLIAMS. Well, that is true, too. I just wanted to find out.

Senator KERR. What possibilities of production are there? Is it in terms of millions of dollars, or what? Or thousands of dollars?

Mr. FERNALD. I would say——

Mr. STOKES. Definitely millions of dollars.

Mr. FERNALD. Definitely millions of dollars.

Mr. STOKES. But it is limited to some reasonable number of millions. This is not going to be an industry of the size of limestone; it might grow to a 10-million-dollar industry in time.

The CHAIRMAN. Anything else?

Mr. FERNALD. Wollastonite is closely related to minerals which have been granted a 15-percent depletion allowance by the Ways and Means Committee of the House of Representatives under the revenue bill of 1951. We now ask that wollastonite be treated similarly.

Mr. Chairman, I believe we have permission for Dr. Stokes to read a short statement which he has prepared, which elaborates a little on mine.

I might point out that Dr. Stokes is a graduate of the University of Florida, with a degree of bachelor of science. He is a graduate of Massachusetts Institute of Technology, doctor of science in chemical engineering, degree in 1940.

Before coming with Cabot, Dr. Stokes was an assistant professor at MIT. Just this year he has received a professional degree from Florida in recognition of his good work as a student and in recognition of his industrial achievements.

Dr. Stokes.

The CHAIRMAN. All right, Doctor. Do you wish to make a statement?

Mr. STOKES. My name is Charles A. Stokes.

Gentlemen, as technical head or as head of technical work for our company, I think that there are a few points about this material that might well be brought out since it is a new material, relatively a new material.

The development of the uses of the mineral wollastonite will open up a relatively new mining industry at several locations. The industry will not at this time be limited, however, by the one deposit that we have in mind at the moment working.

There are deposits, as has been pointed out, widely occurring in California and in our neighboring countries and it is inconceivable to us that we will not find deposits by searching, but that it will require development expense. We do not know where they are at the moment.

Wollastonite occurs associated with the minerals garnet, diopside, and graphite.

These associated minerals, as well as wollastonite, have several strategic uses. However, the strategic uses alone we do not think will justify the expenditure of money to develop the mineral commercially.

Therefore, we have to develop markets and other uses in competition with existing minerals in order to make the exploitation of the mineral profitable.

Now, these competing minerals are talc and several types of clay.

We feel that by the willingness of private industry to take this competitive chance to develop larger markets, the country will, at the same time gain strategic minerals for use in replacing such materials as steatite talc, for making insulators, for radar and related electronic equipment.

The country will gain a new supply of the valuable abrasive garnet which is used in grinding aircraft-engine bearings, and the like.

It may well acquire a new source of high-grade graphite which, as you know, is now largely imported from Ceylon and Madagascar.

The high grade of steatite talc that wollastonite can replace and surpass in quality of end use occurs no farther east than Ogden, Utah, while the electronic industry that uses this type of talc to make insulators occurs principally in the East. The importance of this in wartime need not be emphasized.

Wollastonite insulators can be fired at a much lower temperature than steatite talc insulators.

Senator KERR. What other substance is used for those insulators? Does the talc at this time constitute the only substance?

Mr. STOKES. This particular form of talc, steatite talc, is absolutely essential at this time in that type of insulator.

Now there are other materials that enter into the insulator, but the talc is essential.

Senator MILLIKIN. You have the china type of insulator, do you not?

Mr. STOKES. That is correct, sir.

Senator MILLIKIN. That is made from what earthy material?

Mr. STOKES. I am sorry, sir.

Senator MILLIKIN. The china type of insulator is made from what earthy type of material?

Mr. STOKES. It is made from an admixture of clays and talc, and small amounts of limestone and pure silica.

Senator KERR. Is that type of insulator the type that you contemplate this material being useful in?

Mr. STOKES. Yes, sir; that is correct. The Signal Corps has made the study at Rutgers University and we have copies of reports that they have produced, showing that wollastonite, substituted for steatite talc, produces an insulator which has not only superior electrical properties, but can be fired at a lower temperature.

Now, the significance of this last statement is that the enormous wall-tile industry has a great deal of kiln capacity for low-temperature firing.

If Wollastonite is used in the insulator mix, these wall-tile kilns can be used for firing these electronic insulators.

The CHAIRMAN. What is the natural color of this wollastonite?

Mr. STOKES. It is white when finely ground.

The CHAIRMAN. White?

Mr. STOKES. Yes, sir.

Senator KERR. Is it white in appearance when found in its natural or native state?

Mr. STOKES. It is a grayish white because of associated garnet largely.

Senator MILLIKIN. Does it burn white?

Mr. STOKES. It would burn very white; yes, sir.

Senator KERR. What percentage of the insulator or tile in volume does the talc of this material supply?

Mr. STOKES. Very considerable percentages, varying from about 30 percent to as much as 70 or 80 percent.

Wollastonite can be produced so that it will run much more uniform in quality than steatite.

Senator KERR. The what?

Mr. STOKES. It will run much more uniform in quality.

Senator KERR. Wollastonite?

Mr. STOKES. Yes. Steatite talc is known to occur in nonuniform quality, so that in producing insulators from steatite there are many off-quality batches. This will apparently be reduced by the use of wollastonite. The mineral wollastonite and its associated minerals have no value until mined, crushed, and separated from each other, so that the situation is a situation analogous to coal, which must be mined, crushed, and freed from slate, and delivered to a shipping point before it be of any value.

Thus, we would request that wollastonite be valued for depletion-allowance calculations similarly to coal.

Senator BUTLER. Mr. Stokes, do you not think there is a chance for it to qualify under the heading of one of these items listed as included in the House bill?

Mr. STOKES. Those are the items listed in Mr. Fernald's statement?

Senator BUTLER. Is there not a chance for it to be included under one of them somewhere? It would not qualify as asbestos, but——

Mr. STOKES. It certainly would not qualify as asbestos or any of the materials.

Senator BUTLER. Is it not a form of sand?

Mr. STOKES. It is not a form of sand.

Senator BUTLER. Or gravel?

Mr. STOKES. It is a calcium silicate, so, therefore, partakes of the properties of diatomaceous earth and chemical-grade limestone. It is literally as if you took diatomaceous earth and chemical-grade limestone and put them in an electric furnace and fused them together to form the new chemical calcium silicate.

Senator BUTLER. Well, you have got two different grades of limestone over here on the 15 percent list.

Mr. STOKES. As I point out, our material is literally a chemical combination of two of those materials, so your judgment as to whether it should qualify under those materials would be better than mine.

Senator KERR. Of course, the answer to that is that if it is a similar material or one that can qualify either one of the terms or more than one of the terms, probably the most expeditious thing to do would be to include it in order that there be no question.

The CHAIRMAN. All right, Doctor. Have you anything further?

Mr. STOKES. No, sir. Thank you, gentlemen.

The CHAIRMAN. Thank you very much for your presentation.

Mr. FERNALD. Thank you, sir.

The CHAIRMAN. Mr. Krause? Just have a seat, Mr. Krause, and identify yourself for the record, please.

STATEMENT OF HORACE C. KRAUSE, NATIONAL CRUSHED STONE ASSOCIATION AND AGRICULTURAL LIMESTONE INSTITUTE

Mr. KRAUSE. My name is Horace C. Krause, president of the Columbia Quarry Co., St. Louis, Mo.

The CHAIRMAN. What company?

Mr. KRAUSE. Columbia Quarry Co., St. Louis, Mo.

The CHAIRMAN. Yes, sir.

Mr. KRAUSE. I am chairman of the percentage-depletion committee for the National Crushed Stone Association and the Agricultural Limestone Institute.

Our company is operating three plants in Illinois and one in Missouri. Some of these plants are operated as open quarries and some as underground mines. These plants produce riprap, derrick stone, agricultural limestone, ballast, fluxing stone, chemical limestone, crushed stone, and various types of fillers. Our products are used in the following industries: Construction, farming, aluminum, pig-iron, gray-iron, glass, copper, lead, feed, minerals, fertilizers, rubber, coal, roofing, explosives, paper, and chemicals; and other crushed-stone producers supply materials which go into the manufacture of the following: Carbide, soda ash, paper, rock wool, pharmaceuticals, carriers and extenders in paint, putty, titanium, livestock remedies, chalk, whiting, and so forth.

I am decidedly in favor of percentage depletion for our industry, not only because of the discriminatory unfairness of the present law but because the industry urgently needs proven future stone reserves. For example, in the span of 25 years my company has opened and been forced to close nine properties which, due to unforeseen geological alterations or characteristics of the deposits, were failures as business enterprises. The principal causes could not be determined by the usual means prior to opening.

I have spent thousands of days examining deposits in Midwestern and Southern States with a view to opening new properties and find that the problem throughout the industry of properly insuring an adequate future supply of stone is becoming increasingly difficult, if not virtually impossible.

Senator MILLIKIN. Is it difficult because of the lack of such deposits or because of the relationship of such deposits to transportation fringe areas?

Mr. KRAUSE. For those two reasons, and because of the impossibility of making stone that meets all of the specifications put up by the various Federal agencies, industries, and for such reasons as that.

There are probably, if we would add up all of the physical and chemical requirements in a set of specifications for all the uses I have cited here, at least 150 different qualities.

For example, on the mere matter of absorption. For some purposes, the United States Government on concrete for dams will reject any material where the stone will have more than 1 to 1½ percent absorption.

Senator KERR. What do you mean by that?

Mr. KRAUSE. In other words, the stone will absorb more than one percent of the moisture.

Senator KERR. Will absorb moisture?

Mr. KRAUSE. By weight within 24 hours.

Senator MILLIKIN. When you build a dam, you do not want to build a filter, it is obvious.

Mr. KRAUSE. That is correct.

Senator MILLIKIN. You do not want a spongy stone.

Mr. KRAUSE. I would say that the average absorption on all limestones in the United States would exceed 3 percent, and it is not uncommon to have 5, 6, 8, and 10 percent absorption.

Now, that factor of merely absorption sounds like a small thing, but you take a stone with 3 percent absorption, and put it into concrete and make concrete out of that, and it will absorb water, freeze, and under expansion and contraction break up readily. This is merely in the matter of absorption; I am not talking about the crushing characteristics, the wearing characteristics, the compatibility of the aggregate, whether it binds with an asphalt or with a cement.

Senator MILLIKIN. I think we are a little bit off the point that I was driving at.

Mr. KRAUSE. I beg pardon.

Senator MILLIKIN. I am thinking in terms of the rareness of the natural materials. Are we to gather from your testimony that outside of your existing developed deposits that the undeveloped part of stone of that type is not a type that would satisfy the usual run of commercial users?

Mr. KRAUSE. That is correct. I would say of the known stone deposits in the United States there is probably less than 1 percent of them, if it is even as much as one-half of 1 percent, that would be commercially feasible. They might be here and there occasionally for a short period, but for an extended time——

Senator MILLIKIN. Are they commercially not feasible by the inherent nature of the deposit or because of transportation difficulties or overburden and things of that kind?

Mr. KRAUSE. All of those causes.

Senator MILLIKIN. All of those factors?

Mr. KRAUSE. All of those causes.

Senator MILLIKIN. But would you say that less than 1 percent or whatever figure it was, of the deposits, of the United States that have not been developed are inherently incapable of commercial use had they been developed or were they developed?

Mr. KRAUSE. That is correct. Cite the State of Illinois, for example, in my opinion, of the deposits of stone that have been opened

up in the last 25 years, at least 95 percent of them have been failures.

Senator MILLIKIN. Well, that could occur, of course, for a number of reasons.

Mr. KRAUSE. That is correct.

Senator MILLIKIN. It might occur through bad management; it might occur through lack of capital; it might occur because of transportation difficulties. You can figure out a thousand different factors that might make a good stone deposit, as such, fail under particular circumstances.

Mr. KRAUSE. Well, there are probably 25 characteristics to operate successfully in a business, and in the stone business, whether it is the quality of the stone, whether it has a lot of bad characteristics like faults, or whether it pinches out completely——

Senator MILLIKIN. That is what I am driving at. I am driving at that, and the composition of the stone itself. Now, are you telling us of the remaining undeveloped deposits, less than 1 percent are good?

Mr. KRAUSE. Commercially feasible.

Senator MILLIKIN. Good, as compared to that part of those deposits which have faults, and so forth and so on?

Mr. KRAUSE. That is correct.

For example, on almost all concrete specifications you cannot have more than 1 percent clay or clay lumps, and there are really very, very few deposits, that as such, will meet that requirement—very, very few of them.

Senator MILLIKIN. How come that you hit these deposits that you have just right?

Mr. KRAUSE. Well, we do not. Most of it is by trial and error, by accident.

Senator MILLIKIN. Does it have any relation to transportation?

Mr. KRAUSE. It does, yes, of course.

Normally, to be commercially feasible you have to have transportation, you have to have a proper relationship to markets, otherwise the deposits would have no commercial value.

For example, at our Columbia, Ill., quarry, which was opened, I think, more or less by accident, because my father had a good friend in the railroad business, and they said they wanted some railroad ballast, and there was a small quarry operating there with a capacity of two 20-ton cars a day. He purchased it in 1905, and opened it up and built a larger plant in 1906; and at that time, at least 90 percent of the stone was classed as good stone.

Last year, because of the change in character and the stone rising up the hill—we have quarried at a much higher elevation, and we haul to the dump for refuse the stone that was not suitable for agricultural limestone or for any construction purposes, around 500,000 yards of material; and yet our sales of productive materials were only three-fourths of a million tons. Now, that is a very difficult deposit.

In the early days, we did not have that ratio, and it has gradually crept up, Senator, to that high ratio.

Senator KERR. In other words, it was 37½ percent of the material that you used that you excavated which was not usable, is that what you said?

Mr. KRAUSE. That is correct.

Senator MILLIKIN. You have difficulty in finding deposits of the nature that you are now developing?

Mr. KRAUSE. That is correct.

For example, to put it in an entirely different way, the Allied Chemical & Dye Co., I think, in 1930 or 1932 built a soda ash plant at Baton Rouge, La., originally intending to use oyster shells.

They found that in their process it was not practical, and searched in the late thirties for stone deposits, and finally found a relatively small deposit on top of a salt dome at Winfield, La., and they purchased that property, and the property was gradually depleted, so we sold them our Prairie du Rocher deposit in Illinois, which is located in the flood plains of the Mississippi River. The chemical strata that is mined there outcrops from the flood plain of the north edge of Prairie du Rocher and gradually rises to about 150 feet above the ground at a point 2 miles north of Prairie du Rocher.

You can measure the thickness of that strata, and the entire length of that 2-mile bluff, and it averages around 100 feet.

Now, they core-drilled the 600 acres that we sold them in that area, and the average of the 600 acres in 20 holes, instead of being 100 feet, which you can visibly see on that bluff, turns out to be only 55 feet.

One corner of that whole deposit drops 200 feet through some change. Yet any man can see there is—and see that tremendous bluff there, and you can see the thing for 2 miles.

Well, in the stone business you just bet it could not happen, but there is a case there that due to nature, why, they just do not have the reserves they thought they had bought, and instead of having some 75-year reserves, they have about two-thirds of that. But there are a lot of strange things that can happen in deposits.

Senator MILLIKIN. You think the best ones have been found already?

Mr. KRAUSE. Oh, very definitely. You still have the problem of place utility value. In other words——

Senator MILLIKIN. What value did you say?

Mr. KRAUSE. Place utility value. For example, in the city of Chicago today there is one quarry in the city of Chicago. That quarry is now 300 feet deep, and I don't know how many years it will last; but I would say that offhand, 5 years would be the limit of its life, because they are down 300 feet, and the chances are that they will run into a strata that will be unusable.

That quarry produces about 1,500 tons a day, and I venture to say that the city of Chicago uses normally about 25,000 tons a day.

When that deposit is gone they will have to move that and go out elsewhere and supplement that production, not in the heart of Chicago—this is within 5 miles of the Loop or less—they will have to go out 30 or 40 miles before they can open up a quarry from the downtown Chicago site to replace that.

Senator MILLIKIN. Will they be able to get a quarry that will be equally acceptable so far as its product is concerned?

Mr. KRAUSE. I do not know whether they will be able to. We have a similar situation in St. Louis.

When I started in the stone business 25 years ago, there were 25 quarries in St. Louis and St. Louis County. Of that number at

least half of them were in the city of St. Louis. They were closed up by zoning ordinances or they worked themselves out. They were just too deep.

Today in St. Louis and St. Louis County there are five quarries, and they have a zoning ordinance that requires that anyone seeking to open a quarry has to appear and file notice with the zoning board. The zoning board, if it so chooses, can send out notices to every property owner within 10 miles of the suggested location, and if one property owner objects, the zoning board has a right to turn down the opening of that quarry. It is a very difficult problem that we are faced with.

Senator WILLIAMS. May I ask a question? If limestone should be added to the list, how much difference would that make in your taxes?

Mr. KRAUSE. I beg your pardon?

Senator WILLIAMS. If limestone were to be added to the list for depletion allowances, how much difference would that make in your income taxes?

Mr. KRAUSE. Well, it depends on whether the company was making money.

Senator WILLIAMS. I am speaking about your specific case. How much difference would it have made had it been in existence?

Mr. KRAUSE. This past year it would probably have made a difference of $75,000. There are many years, however, when we would have gained no benefit whatever, because we were not on a profit basis. The maximum you can get is 50 percent of your net, and, of course, if you do not have a net profit you do not have an opportunity to get benefits of this kind.

Senator WILLIAMS. It could reduce your taxes by half, if there was a maximum, is that correct?

Mr. KRAUSE. That would probably be true temporarily, but I would say that in the long run that two things would take place: some competitors would, if they were in a profitable period, would and might use that to lower the marketing price. Others, who were wise, would spend it on future developments; they would spend it on a study of their property, and eventually those companies would be sounder and would be better taxpayers, and better industries for the country, and for the public as a whole.

Senator WILLIAMS. But the net result would be——

Mr. KRAUSE. Temporarily that would be true.

Senator WILLIAMS. A 50-percent reduction in your taxes.

Mr. KRAUSE. Temporarily that would be correct.

Senator WILLIAMS. All right.

The CHAIRMAN. Anything further, Mr. Krause?

Mr. KRAUSE. Some of these points I have already answered in answering the various questions.

The CHAIRMAN. Yes, sir.

Mr. KRAUSE. There are many considerations which make a stone deposit unfit for profitable commercial use, such as lack of economical transportation, lack of ready access to highways, failure to comply with State and Federal requirements for construction, failure to meet chemical and physical requirements of industry and consumers, and structural or geological characteristics which render the stone unfit for commercial recovery. There are other minor but important technical reasons why so few stone deposits are suitable. Most

quarries now in use were discovered by trial and error or by accident, and with the present high costs of opening a quarry it cannot be done on a trial-and-error basis.

The industry therefore needs the benefit of percentage depletion to assist in exploration costs. Without percentage depletion, the industry does not have an adequate profit to satisfactorily prospect for and acquire future stone deposits.

Man-made agencies and projects further contribute to the difficulties of protecting our future stone reserves. Such projects include dams, game preserves, State recreational areas, United States forests, State forests, State parks, forest preserves, highways, expressways, flood-control projects, palisades, parks, and local scenic areas. Rigid zoning requirements, such as exist in St. Louis County, Mo.—I will skip that part as I covered that.

Besides the operating uncertainties with which our industry is faced, we have the problem of competing with other metallic or nonmetallic industries for the customer's dollar. The farming industry is a typical example.

Experts agree that most farm lands need limestone, rock phosphate, and potash. Each of these materials are recovered by the same general production methods, yet limestone does not receive percentage depletion and rock phosphate and potash do receive it. Other industries such as lead and zinc receive percentage depletion and sell their byproducts in direct competition with our products at price levels below which we can sell our products, even though their usage by the farmer is identical.

Senator MILLIKIN. What are those byproducts to which you refer?

Mr. KRAUSE. All types of construction materials.

For example, at Iron Mountain, Mo., where they are producing iron ore, they have material, surplus material, which does not have sufficient iron content to warrant selling it as iron ore to the steel companies and it is sized and prepared to all commercial grades of crushed stone below 1 inch in size and competes with us, and sells at prices from 15 to 50 cents a ton; whereas, the average of the stone industry on crushed-stone products for 1949, the United States average was $1.30.

Senator MILLIKIN. This is a byproduct of lead or zinc mining?

Mr. KRAUSE. This is iron ore.

Now, in zinc, in the Joplin tri-State area, for example, they sell ballast and construction materials for road purposes and concrete purposes at prices that are at least a fourth to a fifth of our selling price.

On lead, such as produced at River Mine, Mo., Annapolis, Mo., Bonne Terre, Mo., they are priced to the railroads for ballast at 10 cents a ton; and agricultural limestone is sold at 50 cents a ton, and construction materials, such as a fine type of material graded similar to sand, is sold at prices from 25 to 40 cents a ton, and three-eighths-inch size crushed stone from 25 to 40 cents a ton or to the local road districts there for loading charge of about 5 to 10 cents a ton.

Senator MILLIKIN. Mr. Chairman, Mr. Palmer of Colorado is in the audience, and I would like to ask him whether our zinc and lead mines produce commercial stone as a byproduct.

Mr. ROBERT PALMER. None that I know of, Senator.

Senator MILLIKIN. Thank you very much. That was the reason for my question. I did not know about this practice in the areas——

Mr. KRAUSE. There are hundreds of thousands of tons, I would say, in the State of Missouri, in byproducts including this tri-State district.

Senator KERR. There are millions of tons, are there not?

Mr. KRAUSE. There are at least 50 million tons of byproducts above ground, and I would say that their sales are a minimum of a half million tons, if not 2 or 3 million tons per year, at the prices that I mention.

The hazards of finding and developing our deposits are equal and identical with such industries as lead, iron, potash, phosphate, and other metallic and nonmetallic minerals which now enjoy a percentage depletion allowance.

We, therefore, urge that your committee concur with the House action in granting percentage depletion to the crushed stone and agricultural limestone industries, but recommend that we be given 15 percent due to the fact that many of the similar industries that we compete with do receive 15 percent with the exception of the oil and gas industry, which has the benefit of 27½ percent.

The CHAIRMAN. We thank you very much.

Mr. KRAUSE. Thank you very much.

The CHAIRMAN. Mr. Webre. Identify yourself for the record, please.

STATEMENT OF LLOYD P. WEBRE, PRESIDENT, UNITED SALT CORP.

Mr. WEBRE. Gentlemen, my name is Lloyd P. Webre, and I am from Houston, Tex.

I am the president of the United Salt Corp., and vice president of the Texas Brine Corp.

My family has been in the salt business for 30 years and I have been in it for 15 years.

Salt is produced primarily in rock-salt form and in brine. The rock salt is produced very much the same way as coal or potash or limestone, and the equipment which is used to produce it is the same.

The units are used in all the mines and the same units exactly can be used for each purpose. In case of the production of brine, it is very similar to the process for producing sulfur, only we do not use any superheated steam; we use cold water. We just pump fresh water down into a salt deposit and force brine back.

Salt is somewhat like coal and, as far as resources in the country are concerned, there is certainly no doubt where coal or salt is, but the quality of the salt varies, and is different in different parts of the country, with different impurities in the deposits, and the purest salt in the world that I know of is produced in south Louisiana.

All salt which we know exists in this country is not necessarily suitable for production due to its contamination with other chemicals, like calcium chloride, magnesium sulfate, and calcium sulfate, and so on.

As far as I know there are not any salt producers doing any exploration work to develop new salt production. We have not done any and neither do any of the salt producers get any depletion allowance.

The quantity of salt in reserve is undoubtedly very extensive, but beyond the present sources of production it is not known whether or not there are extensive deposits which could be produced due to the purity of the salt being unknown.

For brine purposes, certain impurities can be removed from salt, but from rock salt, the salt must be used as such and is not refined, but is merely treated for human consumption.

Senator MILLIKIN. They have a pretty good deposit in Kansas?

Mr. WEBRE. Yes, sir. It is in Michigan, New York, Kansas, Utah, Louisiana, and Virginia. Now, those are some of the major salt-production points.

According to the Chemical Industries for the week of April 7, 1951, the national economy will require for war industries by the end of 1951 some 10,000 tons of chlorine per day. This is also in accordance with recent Government and industry estimates. Having this in mind, the Government has already issued certificates of necessity representing additional capacity of 3,121 tons per day and has under study 319 more tons daily capacity. In order to bring production to the amount estimated, there will be required over 6,000 additional tons of salt per day or an increased yearly capacity of over 2,000,000 tons of salt. Production in the United States in recent years has been as follows, expressed in short tons:

	Tonnage	Value
1947	16, 053, 882	$52, 191, 688
1948	16, 403, 293	54, 331, 782
1949	15, 590, 697	54, 048, 226

These figures are taken from the Bureau of Mines, Department of Interior, and are the official statistics.

Figures for 1950 are not yet available. An increase of 2,000,000 tons of salt would therefore represent a percentage increase of approximately 12.5 percent. That is just for chlorine.

Senator KERR. You say this production here is all used in the production of chlorine?

Mr. WEBRE. No; it is not. That is total production in the United States.

Senator KERR. What you are saying is that the additional 2,000,000 tons will be for chlorine.

Mr. WEBRE. Yes, sir; alone. Chlorine and caustic.

Senator KERR. Yes, sir.

Mr. WEBRE. In addition to these requirements of the war industries, synthetic rubber plants, military installations, and expanding industry will also require more salt, materially increasing the chlorine requirements, as well as the increased needs accompanying normal increases in population.

Industrial surveys show that existing plants are already operating full capacity and since there has been a negligible amount of capacity added in recent years, it follows not only that the capacity of these plants must be increased, but also that modernization and arrangement for better efficiency are required. Only in this way may the increased capacity and increased production be attained. Salt yields a comparatively low return and the returns have not justified the

large investment required to produce an additional amount. It is therefore necessary that salt producers be given stimulus for expansion and an incentive to increase their capacity.

Upon the basis of the figures furnished, the yield per ton in the years listed has been as follows—these are Government statistics, also:

	Yield per ton
1947	$3.25
1948	3.31
1949	3.47

These figures not only show a low return, but also demonstrate that salt as a commodity has not enjoyed the increase which has taken place in the realization upon other commodities. These figures include, of course, salt of all types and methods of production.

In view of the high rates of current income taxes, and the probably higher rates yet to come, it is obvious that the salt industry finds it difficult to retain enough of its earnings to invest in new plant facilities, and, furthermore, that the low rate of return after deduction of taxes leaves little incentive for the investment of new private capital in salt-producing facilities.

Senator WILLIAMS. Is that not about true with every corporation now?

Mr. WEBRE. Well, in our particular case it hurts us materially because we were under the impression, as I will point out a little later, that we were going to get tax relief on excess profits; that salt was provided some relief from excess profits due to the war effort. But the way the bill is drawn up, we get absolutely no relief. In other words, if we produce any more salt we pay more taxes, and we cannot very well justify the investment.

Senator WILLIAMS. That is what I say, but is not that getting to be about true with a lot of our businesses?

Mr. WEBRE. Yes, sir. I am afraid that is true.

Senator WILLIAMS. At least it has reached the point——

Mr. WEBRE. I am afraid we are in the same boat with everybody else in that respect, that is correct.

There are, of course, two methods of securing a greater net income; one, to secure an increased realization for the product; and the other, to reduce cost of production, operating expenses, and other charges. In the present case, it seems that there is little, if any, chance for a material increase in realization and the tendency of operating and other costs is to increase; it therefore appears that the only means by which the industry can secure a greater net income is through permitting it to retain a greater portion of its earnings. It is manifestly not feasible to provide for a special schedule of rates for income taxes to be applied only to the salt industry; but it is possible to effect a reduction in such taxes by granting to the salt industry the benefit which is already accorded many other minerals through the allowance of percentage depletion. Among the minerals which are already allowed percentage depletion are the following:

Metal, coal, sulfur, potash, and the following other mines:

Bauxite, fluorspar, flake graphite, vermiculite, beryl, feldspar, mica, talc, lepidolite, spodumene, barite, ball, sagger and china clay, phosphate rock, rock asphalt, trona, bentonite, gilsonite, and thenardite.

Senator WILLIAMS. The inclusion of salt in those minerals would be the equivalent of giving you a 50-percent reduction in taxes; is that correct?

Mr. WEBRE. No, sir; I do not think that is correct.

Senator WILLIAMS. The mathematical figure is that.

Mr. WEBRE. I have a figure on the next page.

If the 15-percent depletion were given to the whole industry, the total cost to the Government would be $2,700,000, which would be a small amount of money for the amount of increased production available.

Senator WILLIAMS. How much is that below the taxes that you are now paying—how much below the taxes that are now being paid?

Mr. WEBRE. I could not tell you what taxes the industry is paying today. I just do not have the information so that I can tell you.

Recent discussions in Congress concerning the matter of percentage depletion on oil and gas have brought out very clearly the argument that one of the most important reasons for the allowance of depletion at the present level is that to do so stimulates exploration and exploitation, whereas a reduction of the allowance will make the risks unprofitable, thus stifling continued exploration and the discovery of new deposits. It is quite evident that in the case of many of the minerals listed, the purpose of the allowance is to make attractive their recovery and processing by allowing the operators to retain a larger proportion of their realization.

The effect of the refusal to allow to salt the same advantage as is enjoyed by many other minerals is to place salt operators at a disadvantage in spite of the fact that they are dealing with a depletable resource. The inclusion of salt with other minerals in the depletion provisions of the Internal Revenue Code would have the immediate effect of making investments in salt-producing plants more attractive, both for present producers and for capital not now employed in the salt industry.

Upon the basis of statistics released by the Bureau of Mines in its 1949 Minerals Yearbook, the total value of naked salt produced in 1949 amounted to approximately $54,000,000. Carried further, this figure may be translated into effect upon Federal income and excess profits taxes as follows:

Value of salt	$54, 000, 000
Cost of mining, treatment, etc	27, 000, 000
Gross income from property	27, 000, 000
Percentage depletion, 15 percent	4, 050, 000

If it is assumed that the selling and general expenses, interest, and so forth, are 80 percent of the gross income from the property, and that the depletion allowance is limited to 50 percent of the net income from the property, the deduction would be as follows:

Gross income from property	$27, 000, 000
Selling and general expenses, etc	21, 600, 000
Net income from property	5, 400, 000
Limitation at 50 percent	2, 700, 000

Senator WILLIAMS. That is the point I was raising. I mean your 50 percent limitation would work in that case.

Mr. WEBRE. That is right.

Senator WILLIAMS. So, therefore, it would have the net result of reducing the taxes by about half.

Mr. WEBRE. That would depend upon the excess profits, and so on.

Senator WILLIAMS. Depending on the same assumptions that you are operating on here.

Mr. WEBRE. Yes, sir.

Well, in our case, in our particular case, I think that it would mean something like $50,000 to our company per year.

Senator WILLIAMS. It may vary—there may be variations—in different companies, but the over-all net result would average out about the way you are speaking here, about 50 percent.

Mr. WEBRE. When we say "naked salt," we mean the salt before it is packed, you see, and the average net plant after deduction of production cost, and then 15 percent of that, you see——

Senator WILLIAMS. That is true, but you would come into the 50 percent limitation; your volume would come into the 50 percent limitation.

Mr. WEBRE. Yes, I certainly assume we would. Yes. The reduction in taxes at 47 percent normal and surtax and 30 percent excess-profits tax would be $3,118,500 in the first case and $2,079,000 in the second.

Salt is of far greater importance to the national economy than many of the minerals for which percentage depletion is allowed by the present Internal Revenue Code.

It is the most basic of all chemicals. It is used for caustic, chlorine, sodium, and there are just hundreds of things made from salt.

Senator MILLIKIN. Do your prices reflect the——

Mr. WEBRE. The salt business is extremely competitive, like many others, and the freight rates influence it, and the location of the deposits from the markets have an effect on the price.

Senator MILLIKIN. Generally speaking, you are making money at the present time?

Mr. WEBRE. On the basis of the, say, 10 years of operation in our particular company, I think we have earned less than 5 percent on the basis of the appraised value of our property, and that is not too much money.

Senator MILLIKIN. Were there not periods when you were making no money?

Mr. WEBRE. Yes, sir; we certainly have had periods like that.

Senator MILLIKIN. I am talking about the industry generally.

Mr. WEBRE. I would say that there are periods when the business was not profitable over some years, but at the present time it is profitable.

Senator MILLIKIN. Has that been true since World War II, since the close of World War II?

Mr. WEBRE. Well, the most unprofitable period in the industry was back around 1933, in that area, between 1933 and 1938, I would say.

Senator MILLIKIN. Thank you very much.

Mr. WEBRE. In spite of the greater importance of salt as compared with many of the minerals for which percentage depletion is allowed, salt is omitted from the list of these materials in the Internal Revenue Code. The fact of its larger supply, more extensive deposits, etc., is not a sufficient reason for this discrimination, since the greater availability of salt results in a low value for the finished product as compared with the scarcer minerals, resulting in turn in a lower rate

of return to the salt producer, with less incentive to further production than in the case of the products of higher value.

Senator MILLIKIN. Do you set up depletion reserves in your management of your company?

Mr. WEBRE. No, sir, we do not. We are not permitted depletion.

Senator MILLIKIN. I mean for your own purposes.

Mr. WEBRE. No, sir, we do not.

Senator MILLIKIN. For your internal purposes, irrespective of taxes?

Mr. WEBRE. No, sir, we do not.

Senator MILLIKIN. Thank you. Is that true as to the industry generally?

Mr. WEBRE. I could not say, but in our companies it is true. I could not tell you.

This is, of course, only aggravated by the fact that the tax rates are higher on salt than on other minerals due to the depletion allowance as presently constituted.

The importance of salt to the national economy is recognized by Congress and the Treasury Department by the inclusion of salt in section 453 of the Internal Revenue Code providing for the exemption from excess-profits tax of certain income earned from certain mining and timber operations, from natural gas properties, and from salt. In determining the nontaxable "exempt excess output" so-called, there are four steps or conditions:

1. Determination of the units of excess output, defined as the excess of production for the taxable year over the normal output.

2. Ascertainment of percentage ratio of excess output to recoverable reserves. In the case of salt producers, we all have large reserves of salt and therefore we cannot take advantage of that depletion.

Senator MILLIKIN. Let me put my question to you another way. Does not your price reflect the fact that you are exhausting your resources?

Mr. WEBRE. I think that the price is determined by the law of supply and demand. I think that is the answer to your question. I do not mean to evade the question, but I do not know how else to answer it.

Senator BUTLER. You have some competition, do you not?

Mr. WEBRE. Yes, sir.

Senator MILLIKIN. But those competitors are confronted with the fact that they have to replace exhaustion of their capital.

Mr. WEBRE. That is true, but——

Senator MILLIKIN. Would you say that the industry as a whole does not price itself so that it will get back the capital it is losing?

Mr. WEBRE. I would say that provisions for replenishing salt in deposits as they are being explored and driven to completion, that is, from the economical recovery, are not being made as a general rule. Does that answer your question?

Senator MILLIKIN. That answer my question.

Mr. WEBRE. We do not deplete our reserves, because the internal revenue has never allowed it.

Senator MILLIKIN. That is a different angle. I am talking about what you do for the preservation of your own company, irrespective of what the Federal tax impact may be.

Mr. WEBRE. In that case we do not set up any depletion.

Senator MILLIKIN. Thank you very much.

Mr. WEBRE. 3. Ascertainment of the units of exempt excess output as a percentage of the excess output.

4. Multiplying the units of exempt excess output by the normal unit profit, defined as the average profit by the normal period per unit of output.

The amount so determined is deductible in computing the excess profits net income. The term "exempt excess output" for any taxable year means a number of units equal to prescribed percentages of the excess output for that year. The smallest bracket, however, is one where the percentage of excess output, to estimated recoverable units is more than 5 percent and not more than 10 percent, in which event the exempt excess output is 20 percent of the excess output for that year.

Because of the fact, however, that salt usually occurs in very large deposits the recovery of the deposit requiring a very considerable number of years, the intended relief is no relief at all so far as salt is concerned, since the condition as to an excess output of 5 percent to 10 percent of the estimated recoverable reserves could be met only in the case of an unusually small deposit. The salt producers are therefore placed in the position of being unable to secure relief by reason of the lack of equipment which they cannot secure and pay for unless relief is granted—what is known as a "vicious circle."

The only case in which relief could be obtained under this provision of the code is where the producer is able to mine his deposit at such a rate that it will be exhausted in not more than 20 years. As a matter of fact, the situation is worse than this, since the percentage is based upon the excess of production for the taxable year over normal output.

It is therefore evident that salt is allowed no relief whatever. It is notable in this connection that section 453 includes among the minerals, not only those previously listed as the subject of percentage depletion but also many which are not allowed percentage depletion. To this extent it is evident that Congress recognized the special conditions attendant upon the recovery of minerals and gave cognizance to the fact that they are entitled to relief, at least under the conditions of accelerated recovery attendant upon war economy.

We feel that salt needs a depletion allowance, like many other minerals do. We think that it would be fair if one were granted.

Senator MILLIKIN. Did you present your case to the House Ways and Means Committee?

Mr. WEBRE. Well, sir, I did not have time, and the reason I did not have time, was that I was laboring under the false impression that we had some relief under excess profits and we got an extension for filing of returns up to June 15, and we woke up and found out that we were out in the cold; so that was the reason it was not presented.

Senator MILLIKIN. You have not presented it?

Mr. WEBRE. That is correct.

Senator MILLIKIN. Have you been before any committees of the Congress before?

Mr. WEBRE. No, sir.

Senator MILLIKIN. Thank you.

The CHAIRMAN. All right. Is there anything further?

Mr. WEBRE. No, sir. I would be glad to answer any questions.

The CHAIRMAN. Thank you, sir.

Any questions? Thank you very much for your appearance.

Mr. WEBRE. Thank you, Mr. Chairman.

The CHAIRMAN. We have a witness who was not here when he was reached, Mr. Grassman.

STATEMENT OF EDWARD J. GRASSMAN

Mr. GRASSMAN. Senator, I am sorry I was not here when you called my name, but I thought I was at the bottom of the list.

The CHAIRMAN. Well, you are.

Mr. GRASSMAN. So, I went around to your office.

The CHAIRMAN. You were very nearly at the head, but you are now the illustration of "the first shall be last."

Mr. GRASSMAN. Well, that is where I belong down near the bottom anyway.

The CHAIRMAN. Just have a seat.

Mr. GRASSMAN. Thank you.

My name is Edward J. Grassman.

The CHAIRMAN. Did not the House take care of your situation?

Mr. GRASSMAN. They did. I am only here to answer questions, Senator.

We were taken care of in the act of the Eightieth Congress, 1946 and there has been no change made, so I am here to answer any questions you may wish to ask, but also on behalf of some of my friends in the ball and sagger clay industry. We would like to ask, on their behalf, that the wording of section 304 on the twentieth line——

Senator BUTLER. What page?

Mr. GRASSMAN. Page 85. We ask that the wording be changed. We want the "and" stricken from the twentieth line and a comma inserted, and then it will be the same as the existing legislation. The present legislation says, "ball, sagger, and china clay."

We are afraid that the Treasury Department may contend under the present wording "ball and sagger clay, china clay"—that unless it was both a ball and a sagger clay it might not be allowed depletion.

We had considerable experience with the technicalities of the Treasury Department, and we are always suspicious when we see a little change; perhaps unfairly so, but we are suspicious.

Senator MILLIKIN. Have they refused to allow you depletion?

Mr. GRASSMAN. I beg pardon?

Senator MILLIKIN. Have they refused to allow you depletion?

Mr. GRASSMAN. Oh, no, we are all right. This is a present change.

Senator MILLIKIN. A change in the punctuation.

Mr. GRASSMAN. We do not know why it occurred, but the proposed legislation now inserts the word "and" and eliminates the comma, and we are fearful that that might mean it would be necessary to be both things, and that would be rather difficult under certain circumstances.

The CHAIRMAN. That was probably just a draftsman change, Mr. Grassman.

Mr. GRASSMAN. Well, I imagine so, because I could not find any reasons for it over in the Ways and Means Committee.

Senator WILLIAMS. Mr. Grassman, you say you were included under the depletion a couple of years ago?

Mr. GRASSMAN. In the Eightieth Congress in 1946, yes, sir.

Senator WILLIAMS. How much of a savings has that been percentagewise to your industry from the standpoint of reducing taxes?

Mr. GRASSMAN. I do not know about the industry. As far as we are concerned, my testimony before the Ways and Means Committee pointed out that we had spent last year in drilling over $164,000 without taking into consideration actual expenditures. I am just talking about actual out-of-pocket cash, expenditures, and I should estimate that it saved us about $70,000,000 on that—I am guessing now.

Senator WILLIAMS. About 40 percent?

Mr. GRASSMAN. About that in our taxes. We are only a small industry. We do not go into millions, you know.

Senator WILLIAMS. But it was the equivalent, the inclusion of your product under that, was the equivalent of about a 40 percent reduction in your income tax rates.

Mr. GRASSMAN. That is correct. What our situation is, that we must spend so much money for prospecting that unless we had some tax allowance which would assist us in the prospecting, we could not find new supplies; and I pointed out before the House committee that our bankers had refused to advance to us, loan to us money, for capital improvements that we needed, because they stated that we did not have enough reserves to warrant building additional plants.

Senator MILLIKIN. You are expending your capital any time you are in a wasting-resource business, you are spending your capital with every unit of production, and you either have to get it back—it is confiscation of capital, unless there is some way to get it back.

Senator KERR. Replace it.

Mr. GRASSMAN. In our case we would be in a very few years at the point where we would have no money left.

Senator MILLIKIN. Anybody who spends his capital without getting it back winds up without money.

Senator KERR. There are a lot of folks who are interested in whatever remedy you find for that situation. [Laughter.]

Mr. GRASSMAN. I think we will have to stop spending money and keep a little for some other purposes. While we are on the subject of taxes, I know your company is giving consideration to this problem of eliminating the $25,000 lower bracket, and the surtax exemption in companies that are owned by the same people in different lines, where corporations have deliberately split themselves up in the last few years to save taxes. I can see some justification for attacking them, but some of us who started out 20 years ago when we had a company in one business in Virginia, and another company down in Georgia, entirely separate, and then I happened to be in the aerial tramway business, and I happened to be in a patent pipe business, would be ruined under the contemplated legislation. I would be ruined good and plenty because I am not very rich, and I would not have any $25,000 lower limit, and with the excess-profits tax base being cut down to 75 percent, it certainly is going to be murder.

It does not seem cricket. When you are playing poker—perhaps none of you gentlemen ever do anything as wicked as that—but when you are playing poker and all the cards are dealt and someone says "Wait a minute, we have got a new rule now," after you put your money in and everybody else does, you say "We have got a new rule

now." You generally change the rule before the cards are dealt, and I felt that with respect to these companies, which have been in existence for, say, 10 years that this new legislation should not affect us to the same extent that it does someone who has a big corporation and now splits it up into 10 or 15 or 20 pieces.

Senator WILLIAMS. Of course, you would not want to preclude a young man starting out in business today from the opportunity of doing what you did 10 or 15 years ago?

Mr. GRASSMAN. Well, I know how hard it is going to be for me where I am already in the business, and that young man is certainly going to be in a fine mess.

Senator BUTLER. Mr. Grassman, I might say I have had letters of protests where the corporations were organized as much as 40 or 50 years ago.

It was not done for the purpose of tax evasion.

Mr. GRASSMAN. I started my first corporation about 40 years ago, but some of them I have started in the last 10 or 15 years, and most of them 20 years ago. But it does not seem cricket, that is all. It is changing the rules after the cards are dealt.

Does anyone want to ask any questions?

Thank you, gentlemen.

The CHAIRMAN. We are very glad to have had you here, Mr. Grassman.

(Whereupon, at 11:50 a. m., the committee went into a strict executive session to reconvene in open hearings at 10 a. m., Monday morning, July 16, 1951.)

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REVENUE ACT OF 1951

MONDAY, JULY 16, 1951

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

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

Present: Senators George (chairman), Kerr, Millikin, and Butler.

Also present: Elizabeth B. Springer, chief clerk; Colin F. Stam, chief of staff, Joint Committee on Internal Revenue Taxation.

The CHAIRMAN. The committee will come to order.

Mr. Ruttenberg, you come around, please, sir. Some of the other members will probably report later. The Senate is in recess, and they feel like it is more or less of a holiday. [Laughter.] You have a seat and identify yourself for the record.

STATEMENT OF STANLEY H. RUTTENBERG, DIRECTOR, DEPARTMENT OF EDUCATION AND RESEARCH, CIO

Mr. RUTTENBERG. My name is Stanley H. Ruttenberg, and I am director of the department of education and research of the Congress of Industrial Organizations, a member of the CIO Committee on Economic Policy, and responsible for tax matters in the organization.

Mr. Chairman, I have a statement that runs about 35 minutes, I guess, to read.

With your permission, if I could have the whole thing incorporated into the record, I will try to skip certain spots as I go through.

The CHAIRMAN. You may insert the entire statement in the record, and then emphasize such parts of it as you wish to.

Mr. RUTTENBERG. I will read through the first seven or eight pages, and then summarize the rest.

The CIO is happy once again to present its views on taxation to this committee. We have made a long and detailed study of the whole tax situation, and are prepared to make the results of that study available to this committee.

There has been considerable debate about the amount of taxes which must be raised during the current fiscal year in order to balance the budget. There were original estimates that ran as high as $16 billion. Those estimates have since been reduced to about $10 billion, and there are even some who think it will be less.

To a considerable extent, the size of the deficit will depend upon how successful the Congress is in eliminating unnecessary expenditures. There have been estimates made by various Members of Congress and by outside organizations that indicate the budget can be

reduced $8 to $9 billion. If the budget can be reduced by this amount, there will obviously be no need, from a balanced budget point of view, to increase taxes.

The easiest way to balance the budget is, of course, to simply cut down expenditures to meet expected income. We are skeptical, however, of claims that the budget can be cut by $8 or $9 billion. We recommend, however, and encourage careful scrutiny of each single, individual item in the budget.

Certainly our defense expenditures should produce a dollar of real value for every dollar spent, just as we demand of our nonmilitary expenditures. Anti-Fair Dealers find special pleasure in attacking the "all other" (nondefense) component of the budget. But it should be remembered that, in fiscal 1952, this category actually includes $2.5 billion of expenditures directly or indirectly related to the mobilization program, and it includes other expenditures basic to the operation of the Government and the long-run welfare of the Nation. We will not be strengthening America by destroying essential programs that are designed to protect and develop the human and physical resources of this Nation.

We wish it were possible to reduce the level of Government expenditures to the extent necessary to avoid increases in taxes. No one, obviously, wants his taxes increased. However, we in CIO believe very strongly that a sound national policy is one which is based upon the principle of pay-as-you-go, certainly pay-as-you-go within the concepts of present contemplated Government expenditures.

If the Congress is not successful in reducing unnecessary Government expenditures, then Federal taxes must be increased to balance the contemplated budget for fiscal 1952.

It is our firm belief, after careful scrutiny of the budget for the current fiscal year, that the Congress will have to enact tax legislation that will increase Federal revenue by approximately $10 billion. We, however, earlier this year, developed a tax program that would produce an additional $16 or $17 billion in Federal revenue. These tax recommendations of ours involve raising approximately 50 percent of that total from corporations, 25 percent from individuals, and an additional 25 percent by closing the loopholes that now exist in our tax laws.

We firmly believe that such a tax program must be based upon the principles of ability to pay and equality of sacrifice. There is no need for imposing a sales tax or even increasing existing excise taxes beyond their present level. There is no need for reducing the personal individual income-tax exemption now permitted taxpayers.

We can still raise this amount of taxes without increasing the tax burden on any individual whose total amount of taxable income does not now exceed $1,000. For all practical purposes, this means that a married couple with two children with a gross income between $3,000 and $4,000 would not be subject to additional taxation.

We believe that at least $10 billion in taxes must be raised to balance the revised budget for fiscal 1952.

We therefore recommend to this committee that, in raising the $10 billion, at least $5 billion come from corporations; that approximately $2½ billion come from individuals, and that the additional $2½ billions be gotten by closing many of the existing loopholes in our tax laws.

The tax bill H. R. 4473, passed by the House of Representatives, in certain aspects, as far as it goes, is a good bill. In certain other areas, it is, in our judgment, defective.

I should like, therefore, to indicate to you the ways in which we think the House bill is inadequate and can be improved upon.

However, before I do so, I should like to discuss some of the testimony which has already been presented before this committee.

The National Association of Manufacturers and other representatives of big business have come before this committee and proposed the adoption of a sales tax. These employer organizations have gone before other committees of this Congress and testified on the type of stabilization program needed during the mobilization period.

They have testified that there is no need for direct controls, such as over prices and wages. They have indicated that we can stabilize this economy of ours through use of indirect controls with the main emphasis on credit and taxation. These same employer groups, after testifying on the stabilization program, come before this Finance Committee of the Senate, when it is considering tax legislation, and reveal a tax program designed to relieve themselves of tax increases and impose the burden upon those least able to afford an increase.

This type of tax program, they believe, is sufficient as an indirect control measure that would aid our mobilization program. Their program is to tax the poor, tax the low-income individual, give relief and incentive to the wealthy. They say the wealthy cannot afford to be taxed more, because they are already paying exorbitant tax rates. They indicate that the wealthy's incentives to engage in the patriotic endeavor of increasing production in the mobilization program would be seriously hampered if they were subject to higher individual income taxes. They further say to this committee that corporations cannot afford to pay higher taxes, because corporations need their increased income to expand production and improve plant efficiency.

They say, "Shift the burden from the backs of these corporations and wealthy individuals to the backs of the poor and low-income people."

The facts are, however, that, even with the 12½ percent individual income-tax increase proposed by the House, individuals earning $50,000 a year will still be left with $28,000 after taxes, individuals earning $100,000 will still be left with $41,000, individuals earning $500,000 will still be left with $67,000 after taxes, while individuals earning $3,000 will be left with only $2,600, and those earning $5,000 with $4,100.

In a time when we are talking about equality of sacrifice, not too much hardship will be imposed upon the high-income individual who will be called upon to reduce just his standard of luxury, and maybe not even that in many cases, while the low-income individual will be called upon to reduce his basic standard of living which does not even provide for more than the basic mere necessities of life, to say nothing of the standard of luxury.

The corporation-tax increase proposed by the House of Representatives, while, in our judgment, it does not go far enough, will leave corporations, according to the House Ways and Means Committee in their report, with approximately $20 billion after the tax increase incorporated into the present bill goes into effect. This $20 billion is

only 10 percent less than corporate profits after taxes for 1950 and higher than any other year except 1948 and 1950.

These representatives of the employer organizations, such as the National Association of Manufacturers and others, say the solution is a sales tax. The facts on sales taxes are well known. The fact that a sales tax bears most heavily upon the low- and middle-income individuals, in other words, upon those least able to pay, is irrefutable and undeniable.

It was argued by other witnesses before this committee also that all Americans ought to readily accept a lower standard of living as a contribution to meeting the needs of this emergency and that, therefore, higher taxes on low-income families are now highly justified. This viewpoint, which is particularly attractive to the well-off, emphasizes that we must tax where spending is done, and that, since such large aggregate sums accrue to the millions of low-income families, here is where taxes should be greatly increased. Furthermore, taxes from wage and salary earners are easiest to collect, either by direct deductions from payrolls or by the impositions of sales or excise taxes. Almost 100-percent enforcement can be assured.

The injustice of this tax theory should be apparent to all. For millions of families there is no "loose" money floating around which is bidding up the demand for goods in short supply. For millions of American families there is hardly enough income to support minimum standards of decent family life. To increase further the taxes upon these individuals simply will deprive them of the ability to buy goods that are essential to a healthy and decent existence.

On the other hand, tax rates on middle- and high-income individuals can be substantially increased and existing loopholes closed without curtailing their ability to buy the necessities of daily life. Even after substantially higher taxes, their incomes and savings will remain adequate to assure them the ability to buy a substantial quantity of goods and services.

As proof of this fact, I should like to refer this committee to some basic findings derived from the Federal Reserve Board's Survey of Consumer Finances and from the National Income Statistics of the United States Department of Commerce. All figures refer to 1948—our boom postwar year. They indicate, according to table I, which is attached at the rear, that the top 10 percent of our families by income—with earnings above $6,000 a year—bought 25 percent of the total amount of consumer goods purchased in 1948. This top 10 percent represents only slightly over 5,000,000 American families. On the other hand, as we can see from table I, the bottom 50 percent of our families, who earned less than $2,840 in 1948, accounted for only 28 percent of total expenditures. This group represents 25½ million families. In other words, the upper 10 percent of our families spent approximately as much as the lower 50 percent—that is, almost the same amount was spent by the upper 10 percent as was spent by five times as many families in the lower 50 percent.

Certainly, the incomes falling within the bracket of the top tenth could be taxed a sufficient amount to reduce their expenditures to the level of the second tenth without reducing their families to anywhere near poverty levels. This would produce $18.5 billions—more than the increased revenue we now need. We do not suggest that such a drastic step be taken. But we do suggest that here is a large area for

taxing, if "ability to pay" and "equality of sacrifice" are to be given real meanings, before we seriously consider reducing still further the standards of the low-income families of America.

There are those, of course, who argue that higher taxes upon this upper 10 percent of our people would reduce incentive, initiative, et cetera. But let us not forget that incentives are essential to all individuals, not only those in the higher-income brackets.

In connection with the House bill:

1. We think the recommendation of increasing the individual income tax by 12½ percent is a good one. It is based upon a sound and fundamental principle of developing and maintaining a progressive tax structure, one which is based upon the ability to pay, which places the tax burden upon those individuals most able to afford the tax increase.

We would have only one major suggestion to make in connection with the individual income-tax increase as passed by the House. We believe that the first $1,000 of taxable income of any individual whose total taxable income does not exceed $1,000 should be exempt from this 12½-percent increase. The amount of revenue lost through this proposal can be made up by increasing the total percentage increase on all other taxpayers by an average of ½ to 1 percent.

There has been much discussion before your committee about the effect of further increases in individual income-tax rates upon the higher income-tax brackets. It has been pointed out that the top bracket rate of 94½ percent, as recommended by the House, places too great a burden upon the wealthy individual.

Too many individuals, I think have misrepresented the effect of this 94½-percent rate. As this committee fully understands, the 94½-percent rate applies only to that part of income in excess of $80,000 a year. This means, for example, that an individual with $100,000 in income has only the last $20,000 of that income subject to the 94½-percent rate. The total effective rate of taxation upon an individual with an income of $100,000 is 59.4 percent.

As a matter of fact, the maximum effective rate of 90 percent, while high, still leaves an individual with a gross income of $1 million with $100,000 after taxes.

A discussion of the 90-percent or 94½-percent rate in a vacuum sounds as if we are taxing away almost the entire income of our wealthy individuals. Such is not the case, however, as I have already indicated. We must relate our discussions to the effective rate of taxation and not to the bracket rate. In other words, we must relate them to the rate of 59.4 percent on the $100,000-a-year man, and not the 94½-percent rate. No great hardship is imposed upon an individual with a gross income of $1,000,000 a year if he is able to retain, after taxes, a cold $100,000.

2. We believe that the corporation-tax increase, as recommended by the House of Representatives, is a good one, as far as it goes, but it does not go far enough. We commend the House for reducing the exemption from 85 percent of the best 3 out of 4 years from 1946–49 to 75 percent. In addition, the increase of the corporate rates by 5 percentage points all the way up the line is also a good recommendation as far as it goes.

We think, however, that instead of raising $2,855,000,000 from corporations, as the House recommends, that we should raise at least

a minimum of $5,000,000,000 from corporations. This can be done by raising the excess-profits tax rate to 85 percent, by requiring them to average their profits for all 4 years, from 1946–49, instead of the best 3 out of 4 years, and by closing other major loopholes in the present excess-profits tax law.

The House Ways and Means Committee, in its report accompanying H. R. 4473, estimated that—

> corporate profits after taxes in the calendar year 1951, after full allowance for this bill, are expected to be about $20 billion as contrasted to corporate profits after taxes during World War II ranging from $8.5 billion to $10.8 billion. Thus, even after considering the increases made in corporate taxes by this bill, in 1951 these profits will be from about 180 to 230 percent of corporate profits after taxes during the last war.

The projects of major corporations in the United States are at an all-time high, and they continue to rise. Table II, which is attached, indicates that 1950 corporate profits, before taxes, increased substantially quarter by quarter. In the first quarter of 1950 they were running at an annual rate of over $29 billion. They increased to $37 billion in the second quarter, skyrocketed to $46 billion in the third quarter, and went up further to $50 billion in the fourth quarter. The fourth-quarter profit rate of $50 billion annually was 79 percent greater than the average profit earned by all corporations for the 4 years immediately succeeding the end of World War II.

Corporate profits, after taxes in the fourth quarter of 1950 were running at a record annual rate of $28.5 billion—even after the excess-profits taxes enacted by Congress in the last session. This is more than 60 percent greater than the $17.6 billion rate, after taxes in the 4-year period 1946–49. Even though the last Congress enacted an excess-profits tax and increased income- and corporate-tax rates, there is still a large source of revenue to be derived from the corporate-profits sector of our economy.

I should just skip over the testimony on the rest of that page which relates to the fact that an excess profits tax is, in our judgment, a very strong anti-inflationary weapon, as contrasted to a straight increase in the corporate tax rate, for reasons which I think are clear, and I shall not elaborate on them here.

We think that corporation profits in 1951 will be in the neighborhood of about $47 billion and we, therefore, feel that a $5 billion increase by this committee would still leave corporations with $18 billion to $19 billion after taxes, which is still a substantial profit.

Now, on page 9 there begins a discussion on excise taxes, and I shall not burden the committee with reading the material on excise taxes, which covers about two and a half pages, but I should like just to refer you to the tables which are attached. Table III at the end of the testimony—which, I think, is a very interesting one—based upon an old study which has since been brought up to date by Professor Musgrave of the University of Michigan, indicates beyond question of a doubt—and I think the facts are irrefutable—that the percentage of income spent on excise taxes is much higher for low-income individuals than for higher-income individuals, and that it supports the basic doctrine that an excise or a sales tax bears most heavily upon those less able to pay, that is, it is borne in inverse proportion to income. The higher the income——

Senator MILLIKIN. Have you gentlemen made any studies of the total impact on all brackets of all forms of local taxes, direct and in-

direct; I mean, of all forms of direct local taxes, State, municipal, and so forth?

Mr. RUTTENBERG. There have been studies made. This table that I have referred to refers only to the Federal excise-tax impact.

Senator MILLIKIN. I looked at those tables and that is why I asked the question.

Mr. RUTTENBERG. But this same study from the TNEC monograph Who Pays the Taxes? did estimate local and State excise taxes—their impact upon individuals.

Senator MILLIKIN. Do they include indirect taxes?

Mr. RUTTENBERG. Indirect? You mean the——

Senator MILLIKIN. I mean concealed taxes.

Mr. RUTTENBERG. That study did not, but recently Professor Musgrave, of the University of Michigan, testified before the Joint Committee on the Economic Report. The study has since been published or is about to be published which analyzes the entire impact of the passing on of corporation taxes, and of individual income taxes and of excise taxes, both Federal, State, and local on the income of individuals by income brackets; this is a very interesting and revealing study in terms of the impact of these.

Senator MILLIKIN. Do you regard that as a competent study?

Mr. RUTTENBERG. Yes; I do.

The excise tax discussion comes to a conclusion, in our judgment, that this committee should not recommend any increases in existing excise taxes and, as a matter of fact, strongly urges opposition to any such increases, as well as to a sales tax.

I could discuss at some length the effects of a sales tax upon low-income individuals, but I think the facts are clear to the committee members, and I need not go into that.

On the bottom of page 10 begins a discussion of closing existing loopholes. We have studied loopholes, or various aspects of the tax laws which permit relief to certain income groups, and have come up with an analysis that would indicate that we could raise at least four and a half to five billion dollars by closing existing loopholes.

We certainly think that it would not be difficult for this committee to raise 25 percent of the new revenue bill from this source by closing any one of a group of these loopholes, and these loopholes include such well known ones as the split-income provision enacted by the Revenue Act of 1948; the estate and gift tax structure, capital gains structure, interest from tax-exempt securities, loopholes relating to depletion allowances, the problem of stock options, and taxes upon life-insurance companies.

We estimate that just by eliminating the split-income provision, by making mandatory the filing of joint returns without the splitting of income in community States as well as all other States, that you could raise at least two and a half billion dollars from this provision alone. And if the many loopholes in the estate and gift taxes were closed, you would raise about a billion dollars. The total from these seven sources of loopholes would be four and a half to five billion, and it would not be difficult to raise two and a half billion of the new 10-billion bill from this source.

The discussion on page 11 begins the analysis of each of the seven major loopholes to which I have referred. I shall just briefly go over that for the benefit of the committee.

The split-income provision is, as we all know, a provision which benefits a married couple having two children and an income in excess of $4,900. It does not give one single penny of relief to any married couple with two children with an income of below $4,900.

This means that there are 35.8 million taxpayers, or over 80 percent, who are not benefited at all by the split-income provision; while, on the other hand, 8 million taxpayers, or 20 percent of the total, receive the entire benefit from the existence of this provision of the law tax.

It is hard to speak of equality of sacrifice to low-income individuals when a two-and-a-half-billion handout is enjoyed by the well-off.

Now, not only are there 8 million above $5,000, but the major benefit of this provision goes to those with incomes in excess of $10,000. In this category there are only one and three-quarter million taxpayers or 4 percent of the total.

We, therefore, feel that this provision should be eliminated. We believe that the provision contained in the House bill, H. R. 4473, which extends this principle, in part, to heads of households, while justified by the existence of the split-income provision, is, in our judgment, not justified because we feel the split-income provision itself should be repealed and, therefore, it would be unnecessary to extend the principle to heads of households.

On the estate and gift tax structure, we feel that about a billion dollars could be raised if we closed the multitude of loopholes that exist in the structure, and the suggestions we make include: Integrating the estate and gift-tax structure; repealing the splitting of property for estate and gift-tax purposes, which was validated by the Revenue Act of 1948, which, as you will recall, was invalidated by the Revenue Act of 1942; eliminating the life estate problem; and the reducing of exemptions. There is discussion which follows relating to each of those individual items.

On the capital gains tax, we recommend that the increase be not to 28¼ percent, as recommended by the House, but to at least 50 percent, and that the holding period be extended from the present 6 months to at least 1 year.

We, of course, support the House proposal that profits received from the sale of a house should be exempt from capital gains taxation when they are used to purchase another house, assuming, of course, that both houses are occupied by the owner.

We feel that a capital gains tax is a very common source of income to the wealthy, and that an analysis, for example, indicates that one-half of 1 percent of the income in the lowest net income class comes through capital gains, while, in the $500,000 class, one-third of the incomes derived are from capital gains.

The 28¼ percent recommendation by the House is not very much greater than the first bracket tax or the first few bracket taxes recommended in the House bill. We feel that at least the capital gains tax should be increased, certainly in proportion to the increases that have been imposed on the low-income brackets since the war. If we take the 16.6 percent rate, which was the lowest one since the war, and the 25 percent capital gains, at least that gap of 9 or 10 points ought to be maintained. In addition, we feel that the capital gains rate ought to go to at least 50 percent.

We have then a discussion of tax-exempt interests from State and local securities.

We feel that a considerable sum of money could be raised from this source of income. This problem is very familiar to the members of the committee, and I shall not go into that.

Then there is a discussion of the problem of depletion allowances. We take the very strong position that depletion allowances should not be included in tax legislation.

We feel strongly that there is no need for such incentives. We recommend the elimination of existing provisions for gas, oil, mineral companies, and so forth, and look with considerable disturbance upon the recommendation of the House Ways and Means Committee which extends this principle to certain new metals and commodities. There follows a discussion of that problem.

Then there is a discussion of stock options and life-insurance companies, and we end up on page 18 with the statement, that I should like to read:

> Each and every one of these tax loopholes represents a concession either to big business or to wealthy individuals. The failure to close these loopholes will lose for the Federal Government between four and a half and five billion dollars of revenue. But revenue not thus collected must be collected elsewhere.
>
> It appears that, because the common folk have less political influence than corporations and wealthy people, they are to be forced to pay a greater proportion of the tax bill than they can reasonably afford.
>
> The continuation of tax loopholes makes the wealthy still richer at the expense of the mass of Americans. This is inequitable and intolerable. Congress will be remiss in its responsibilities to the mass of its constituents if it fails to close these loopholes even if the well-off object.
>
> There will be no equlaity of sacrifice if these loopholes are continued on the statute books at the same time as the Congress imposes higher taxes upon the low- and middle-income individuals.
>
> We hope that the Senate will agree with the House proposal to apply a withholding tax to dividends and interest.

Senator MILLIKIN. If you had complete equality of sacrifice, you would reduce everybody to the same income, would you not?

Mr. RUTTENBERG. A complete equality of sacrifice certainly would involve reducing every individual in level of income. We, of course, as I pointed out in the testimony, do not advocate that. But, when we talk about sacrifice, we want everybody to make the same amount of sacrifice during the current period, and we do not feel——

Senator MILLIKIN. If everyone made the same amount of sacrifice, I suggest you are arguing contrary to your main thesis. If the man with $1,000,000 income made a $100 sacrifice in behalf of the interests of taxes, the same as some of the lower-bracket people do, that does not meet your objective.

Mr. RUTTENBERG. No. But that is precisely why we are not proposing to this committee that you raise taxes by a flat $100 on everybody or by a flat percentage-point increase in the bracket rates. That is why we strongly support and feel that the House recommendation of 12% percent across the board is more in line with the principle of equality of sacrifice than is the original recommendation that the administration made to the House.

Senator MILLIKIN. Well, No. 1, you made it clear you do not favor complete equality of sacrifice; that is No. 1.

Senator KERR. He said not yet, he did not.

Senator MILLIKIN. I did not get that; not yet.

Mr. RUTTENBERG. Not yet. I also think I made it clear, Senator, that equality of sacrifice does not imply that everybody must be reduced to a $2,000, $3,000 or $4,000 income level. I am not suggesting—I do not think that is equality of sacrifice.

Senator MILLIKIN. You believe in progressive sacrifice.

Mr. RUTTENBERG. Progressive sacrifice.

Senator MILLIKIN. What you want to do is to make it a little more progressive; is that correct?

Mr. RUTTENBERG. No. I want to maintain the same degrees of progression that now exist in the tax law.

Senator MILLIKIN. There is nothing at all left in your argument, because there is a higher progression in the middle and higher brackets.

Mr. RUTTENBERG. I am proposing here, when you propose a 12½-percent increase across the board——

Senator MILLIKIN. I am not proposing that.

Mr. RUTTENBERG. When I propose that, and when I support the House recommendation in this field, I think that is a step in the direction of maintaining the progressivity of the tax structure, which progressivity would not be maintained if instead of the 12½ percent tax increase there were a 4-percent increase or any percentage point increase in the brackets.

Senator MILLIKIN. Well then, I am correct when I analyze your testimony to the effect that you would step up the equality of taxation in the middle and higher brackets, is that not correct? Does it not come to that?

Mr. RUTTENBERG. Step up the progression in the middle and higher income brackets; yes.

Senator MILLIKIN. I do not think there is going to be much trouble in balancing the budget in fiscal 1952, whether via the mechanics of the House bill or via the mechanics of what may be a Senate version or a compromise version. I think the budget for fiscal 1952 will be balanced, or approximately balanced.

What is worrying some of the members of the committee—and I think all of them—is that under most any estimate, including extreme economy ideals, with any kind of an estimate you want to make, we will have a deficit of from 20 to 30 billion dollars in fiscal 1953 if the present military programs are continued, not enhanced, but just continued, and assuming no further inflation.

We are all worried about how you are going to cover that deficit on a pay-as-you-go basis. What is your suggestion?

Mr. RUTTENBERG. Well, we feel that revenues could be raised up through and including a level budget of $80 billion, $75 to $80 billion, without too great difficulty.

Senator MILLIKIN. Do you think you could add another 20 or 30 billion on top of the tax bill we are now considering, and balance the budget?

Mr. RUTTENBERG. That would not be involved, sir.

Senator MILLIKIN. Sir?

Mr. RUTTENBERG. It would not be involved.

Senator MILLIKIN. It would be involved if you go on a pay-as-you-go.

Mr. RUTTENBERG. Now, wait a minute, excuse me. The current budget will run about 68 or 70 billion dollars for fiscal 1952, assuming

now that we balance that with whatever tax increase bill comes to the Congress.

We then, in our judgment, feel that you could raise an additional 7 to 8 to 10 billion dollars up to a level of about $80 billion, without too great difficulty, as far as taxes are concerned.

Senator MILLIKIN. You are not confronted with——

Mr. RUTTENBERG. When you get above an $80 billion level budget then you have a totally different problem.

Senator MILLIKIN. I am suggesting to you that the evidence—and take my assumption on it, because we have been listening to a lot of evidence here—that the evidence suggests a deficit of from 20 to 30 billion dollars in fiscal 1953, under the assumptions which I mentioned, and if that be true, how would you suggest that we raise those additional taxes?

Mr. RUTTENBERG. Our thinking has not gone beyond raising revenue to the extent of about $80 billion, assuming the present current levels or the anticipated levels of gross national product for the year 1951.

Senator MILLIKIN. Are you suggesting that we confine our expenditures to $80 billion?

Mr. RUTTENBERG. I am not. We certainly are not experts on what the level of military or Government expenditures ought to be. We feel that as far as our whole over-all defense program is concerned, we ought to spend what is necessary to do the job.

If that budget goes above $80 billion we would have to take another look, in our own minds, as to how we would suggest either pay-as-you-go or deficit financing.

Senator MILLIKIN. We have had the experts in here, and we have jiggled their figures around, and you can jiggle them around any way you want to, and you will find that they indicate a deficit of from 20 to 30 billion dollars in fiscal 1953. Now, that is only a year from now—that is less than a year from now—and it is not only a question so far as this committee is concerned of the budget for 1952, which I am quite sure will be met; we must think now about 1953, and that the kind of taxes you impose now has some relation to additional burdens if they should be imposed for fiscal 1953, and I am trying to get the benefit of your thinking on it.

This does not strike you as a matter of complete surprise, I am sure of that.

Mr. RUTTENBERG. No, I had not seen many estimates that ran Government expenditures for fiscal 1953 much above $80 billion though.

Senator MILLIKIN. Did you hear the testimony of the budget man who was here? Did you hear the testimony of the people who are in charge of the military program? I mean, did you read it?

Mr. RUTTENBERG. Well, I saw Mr. Staats' testimony, and I thought that his estimates ran about $80 billion for fiscal 1953, with the possibility that maybe in fiscal 1954 they would go above that.

Senator MILLIKIN. No; it was just the other way.

Senator KERR. Just the opposite.

Senator MILLIKIN. In fiscal 1954 they would drop to a plateau or on what they hoped would be a plateau—roughly to the plateau of spending in fiscal 1952; it was very clearly to that effect. I mean there is no question about that.

Mr. RUTTENBERG. The fiscal 1953 budget went to what level then? I did not realize it went above $80 billion.

Senator MILLIKIN. I do not have the exact figures, but, I mean, after careful calculations on all this testimony I am referring to, the budget man, the military man in charge of our production, it is very clear that you cannot escape the conclusions that you will have a deficit of from $20 to $30 billion if you maintain the present planned programs of expenditure.

Mr. RUTTENBERG. Certainly if we are talking about the current anticipated level of revenue, without the House bill added to it, the deficit would still be about $20 billion.

Mr. MILLIKIN. No, it would be 20 to 30 billion dollars—take my assumption for it, just take my assumption for it—assuming there is a deficit of from $20 to $30 billion in fiscal 1953 how are we going to cover it if we follow the pay-as-you-go principle?

Mr. RUTTENBERG. As I said, Senator, our policy of supporting the concept of pay-as-you-go goes as far as saying that the pay-as-you-go is within the concept of the present contemplated fiscal 1952 budget. Now, we have not considered the problem——

Senator MILLIKIN. That, Mr. Ruttenberg, I would say is quite easy. It may be very disastrous to some of the income tax brackets and other brackets, but that, I am quite confident, will be done. I do not know of anyone around here who suggests that it cannot be done for fiscal 1952, but I am speaking, and I am asking you to take my assumption there, that there will be a deficit of $20 to $30 billion for fiscal 1953, and I want to ask how are we going to meet it if we follow pay-as-you-go?

Mr. RUTTENBERG. I am not so sure that the deficit is going to be 20 or 30 billion.

Senator MILLIKIN. Do not take your word for it. Take my assumption with respect to it.

Mr. RUTTENBERG. Let me finish my statement. I am going to take your assumption. If it were going to be that, I am not so sure that we would support a pay-as-you-go program.

Senator MILLIKIN. That is a candid answer.

Mr. RUTTENBERG. I did not mean to question your assumption. We would alter our thinking on a pay-as-you-go budget if the budget gets much above $80 billion, and we would then support deficit financing.

Senator MILLIKIN. Your answer brings us right up against a number of things that we are going to be asked to think about.

Mr. RUTTENBERG. I am assuming, of course, that we are both talking about the current level of gross national product, no expansion in that way.

Senator MILLIKIN. To put it another way, you would not now suggest that we could add $20 to $30 billion to the brackets that are now paying the taxes.

Mr. RUTTENBERG. Assuming the situation that exists after the passage of the bill this session——

Senator MILLIKIN. That is right.

Mr. RUTTENBERG (continuing). I would agree to the point that we have got to look pretty carefully once we get above an additional 10 billion above what might come out of the committee this year——

Senator MILLIKIN. And it is perfectly obvious, you being a far-

seeing man and several jumps ahead of me, that if you impose $20 to $30 billion—if we had to impose $20 to $30 billion, and if you do not think it is wise to put it on the middle and upper brackets, it would have to be imposed in the lower brackets, and that would be one of the reasons, I assume, why you would want to think again as to whether to follow pay-as-you-go or go into deficit financing?

Mr. RUTTENBERG. It is a fair assumption.

Senator MILLIKIN. I think so.

The CHAIRMAN. Had you finished your statement?

Mr. RUTTENBERG. Yes, I have, sir.

The CHAIRMAN. Any questions, Senator Kerr?

Senator KERR. Just one question, if I may.

Senator MILLIKIN. May I say just one more thing, Mr. Chairman?

The CHAIRMAN. Yes.

Senator MILLIKIN. If you gentlemen have any studies other than the one you referred to that will show the total burden of taxes, direct or indirect, open or concealed, on the lower income tax brackets, personally I would appreciate it if you would send it to the committee, with copies, so that it can be circulated.

Mr. RUTTENBERG. I have copies of Professor Musgrave's study. You have not seen that?

Senator MILLIKIN. Is that the only one that you can supply?

Mr. RUTTENBERG. Yes. Have you seen that?

Senator MILLIKIN. No.

Mr. RUTTENBERG. I will see that you get copies of that.

The CHAIRMAN. You might send us a copy of that. Send it so that we may have that here, but get it here before the close of the hearings, so that we can have it before us.

Mr. RUTTENBERG. Yes.

Senator KERR. On page 17 of your statement in the section with reference to stock options in the third paragraph of that section, you say:

> In the past, this difference between the market price of the stock at $100 and an option to buy at $50 was taxed at the normal individual income tax rates.
> However, the present law permits this profit to be taxed at the so-called capital gains tax rate of 25 percent.

I am sure that you are aware that that would and could be read to mean something which does not coincide with the facts.

Mr. RUTTENBERG. That is right; you are right, sir. This is not a clear statement of the law as passed in 1950.

Senator KERR. I read your statement and listened to it with a good deal of respect, because it has seemed that with reference to your factual matters, you have made quite an effort to be accurate; and I wonder if you want to leave the statement in that manner?

Mr. RUTTENBERG. No. As a matter of fact—this is something that I had meant to correct, because this is not completely accurate in terms of that statement of how much the present law permits.

However, the next paragraph, I think, the example that is given, is totally consistent with the existing law.

The CHAIRMAN. You may make such corrections as you wish to in the copy that is going into the record, and going into the reporter's hands.

Mr. RUTTENBERG. I will revise that sentence.

Senator KERR. Fine.

The CHAIRMAN. Any further questions, Senator Kerr?

Senator KERR. No.

The CHAIRMAN. Senator Millikin?

Senator MILLIKIN. No.

The CHAIRMAN. Your complete statement will be inserted at this point. Thank you for your appearance.

Mr. RUTTENBERG. Thank you, sir.

(The prepared statement of Mr. Ruttenberg follows:)

STATEMENT OF STANLEY H. RUTTENBERG, DIRECTOR, DEPARTMENT OF EDUCATION AND RESEARCH, CIO

The CIO is happy once again to present its views on taxation to this committee. We have made a long and detailed study of the whole tax situation and are prepared to make the results of that study available to this committee.

There has been considerable debate about the amount of taxes which must be raised during the current fiscal year in order to balance the budget. There were original estimates that ran as high as $16 billion. Those estimates have since been reduced to $10 billion and there are even some who think it will be less.

To a considerable extent, the size of the deficit will depend upon how successful the Congress is in eliminating unnecessary expenditures. There have been estimates made by various Members of Congress and by outside organizations that indicate the budget can be reduced $8 to $9 billion. If the budget can be reduced by this amount, there will obviously be no need, from a balanced budget point of view, to increase taxes.

The easiest way to balance the budget is to simply cut down expenditures to meet expected income. We are skeptical, however, of claims that the budget can be cut by $8 or $9 billion. We recommend, however, and encourage careful scrutiny of each single individual item.

Certainly our defense expenditures should produce a dollar of real value for every dollar spent, just as we demand of our nonmilitary expenditures. Anti-Fair Dealers find special pleasure in attacking the "all other" (nondefense) component of the budget. But it should be remembered that, in fiscal 1952, this category actually includes $2.5 billion of expenditures directly or indirectly related to the mobilization program, and it includes other expenditures basic to the operation of the Government and the long-run welfare of the Nation. We will not be strengthening America by destroying essential programs that are designed to protect and develop the human and physical resources of this Nation.

We wish it were possible to reduce the level of Government expenditures to the extent necessary to avoid increases in taxes. No one, obviously, wants his taxes increased. However, we in CIO believe very strongly that a sound national policy is one which is based upon the principle of pay as you go, certainly pay as you go within the concepts of present contemplated Government expenditures.

If the Congress is not successful in reducing unnecessary Government expenditures, then Federal taxes must be increased to balance the contemplated budget for fiscal 1952.

It is our firm belief that after careful scrutiny of the budget for the current fiscal year, that the Congress will have to enact tax legislation that will increase Federal revenue by approximately $10 billion. We, however, earlier this year, developed a tax program that would produce an additional $16 or $17 billion in Federal revenue. These tax recommendations of ours involve raising approximately 50 percent of that total from corporations, 25 percent from individuals, and an additional 25 percent by closing the loopholes that now exist in our tax laws.

We firmly believe that such a tax program must be based upon the principles of ability to pay and equality of sacrifice. There is no need for imposing a sales tax or even increasing existing excise taxes beyond their present level. There is no need for reducing the personal individual income-tax exemption now permitted taxpayers.

We can still raise this amount of taxes without increasing the tax burden on any individual whose total amount of taxable income does not now exceed $1,000. For all practical purposes, this means that a married couple with two children with a gross income between $3,000 and $4,000 would not be subject to additional taxation.

We believe that at least $10 billion in taxes must be raised to balance the revised budget for fiscal 1952.

We, therefore, recommend to this committee that, in raising the $10 billion, at least $5 billion come from corporations, that approximately $2½ billion come from individuals and that the additional $2½ billion be gotten by closing many of the existing loopholes in our tax laws.

The tax bill, H. R. 4473, passed by the House of Representatives, in certain aspects, as far as it goes, is a good bill. In certain other areas, it is, in our judgment, defective.

I should like, therefore, to indicate to you the ways in which we think the House bill is inadequate and can be improved upon.

However, before I do so, I should like to discuss some of the testimony which has already been presented before this committee.

The National Association of Manufacturers and other representatives of big business have come before this committee and proposed the adoption of a sales tax. These employer organizations have gone before other committees of this Congress and testified on the type of stabilization program needed during the mobilization period.

They have testified that there is no need for direct controls, such as over prices and wages. They have indicated that we can stabilize this economy of ours through use of indirect controls with the main emphasis on credit and taxation. These same employer groups, after testifying on the stabilization program, come before this Finance Committee of the Senate, when it is considering tax legislation and reveal a tax program designed to relieve themselves of tax increases and impose the burden upon those least able to afford an increase.

This type of tax program they believe is sufficient as an indirect control measure that would aid our program. Their program is to tax the poor, tax the low-income individual, give relief and incentive to the wealthy. They say the wealthy cannot afford to be taxed more, because they are already paying exorbitant tax rates. They indicate that the wealthy's incentives to engage in the patriotic endeavor of increasing production in the mobilization program would be seriously hampered if they were subject to higher individual income taxes. They further say to this committee, that corporations cannot afford to pay higher taxes, because corporations need their increased income to expand production and improve plant efficiency.

They say, "Shift the burden from the backs of these corporations and wealthy individuals to the backs of the poor and low-income people."

The facts are, however, that even with the 12½ percent individual income tax increase proposed by the House, individuals earning $50,000 a year will still be left with $28,000 after taxes, individuals earning $100,000 will still be left with $41,000, individuals earning $500,000 will still be left with $67,000 after taxes, while individuals earning $3,000 will be left with only $2,600 and those earning $5,000 with $4,100.

In a time when we are talking about equality of sacrifice, not too much hardship will be imposed upon the high income individual who will be called upon to reduce just his standard of luxury and maybe not even that in many cases, while the low-income individual will be called upon to reduce his basic standard of living which does not even provide for more than the basic mere necessities of life, to say nothing of the standard of luxury.

The corporation tax increase proposed by the House of Representatives, while, in our judgment it does not go far enough, will leave corporations, according to the House Ways and Means Committee in their report, with approximately $20 billion after the tax increase incorporated into the present bill goes into effect. This $20 billion is only 10 percent less than corporate profits after taxes for 1950 and higher than any other year except 1950.

These representatives of the employer organizations, such as the National Association of Manufacturers and others, say the solution is a sales tax. The facts on sales taxes are well known. The fact that a sales tax bears most heavily upon the low- and middle-income individuals, in other words, upon those least able to pay, is irrefutable and undeniable.

It was argued by other witnesses before this committee that all Americans ought to readily accept a lower standard of living as a contribution to meeting the needs of this emergency and that, therefore, higher taxes on low-income families are now highly justified.

This viewpoint, which is particularly attractive to the well-off, emphasizes that we must tax where spending is done, and that, since such large aggregate sums accrue to the millions of low-income families, here is where taxes should be greatly increased. Furthermore, taxes from wage and salary earners are easiest to collect —either by direct deductions from payrolls or by the impositions of sales or excise taxes. Almost 100 percent enforcement can be assured.

The injustice of this tax theory should be apparent to all. For millions of families there is no "loose" money floating around which is bidding up the demand for goods in short supply. For millions of American families there is hardly enough income to support minimum standards of decent family life. To increase further the taxes upon these individuals simply will deprive them of the ability to buy goods that are essential to a healthy and decent existence.

On the other hand, tax rates on middle- and high-income individuals can be substantially increased and existing loopholes closed without curtailing their ability to buy the necessities of daily life. Even after substantially higher taxes, their incomes and savings will remain adequate to assure them the ability to buy a substantial quantity of goods and services.

As proof of this fact, I should like to refer this committee to some basic findings derived from the Federal Reserve Board's Survey of Consumer Finances and from the National Income Statistics of the United States Department of Commerce. All figures refer to 1948, our boom postwar year. They indicate (see table I attached) that the top 10 percent of our families by income, with earnings above $6,000 a year, bought 25 percent of the total amount of consumer goods purchased in 1948. This top 10 percent represents only slightly over 5 million American families. On the other hand, as can be seen from table I, the bottom 50 percent of our families—who earned less than $2,840 in 1948—accounted for only 28 percent of total expenditures. This group represents 25½ million families. In other words, the upper 10 percent of our families spent approximately as much as the lower 50 percent—i. e., almost the same amount was spent by the upper 10 percent as was spent by five times as many familes in the lower 50 percent.

Certainly, the incomes falling within the bracket of the top tenth could be taxed a sufficient amount to reduce their expenditures to the level of the second tenth without reducing their families to anywhere near poverty levels. This would produce $18.5 billions—more than the increased revenue we now need. We do not suggest that such a drastic step be taken. But we do suggest that here is a large area for taxing, if "ability to pay" and "equality of sacrifice" are to be given real meanings, before we seriously consider reducing still further the standards of the low-income families of America.

There are those, of course, who argue that higher taxes upon this upper 10 percent of our people would reduce incentive, initiative, etc., but let us not forget that incentives are essential to all individuals, not only those in the higher-income brackets.

In connection with the House bill:

1. We think the recommendation of increasing the individual income tax by 12½ percent is a good one. It is based upon a sound and fundamental principle of developing and maintaining a progressive tax structure, one which is based upon the ability to pay, which places the tax burden upon those individuals most able to afford the tax increase.

We would have only one major suggestion to make in connection with the individual income tax increase as passed by the House. We believe that the first $1,000 of taxable income of any individual whose total taxable income does not exceed $1,000 should be exempt from this 12½ percent increase. The amount of revenue lost through this proposal can be made up by increasing the total percentage increase on all other taxpayers by an additional ½ to 1 percent.

There has been much discussion before your committee about the effect of further increases in individual income-tax rates upon the higher income-tax brackets. It has been pointed out that the top bracket rate of 94½ percent, as recommended by the House, places too great a burden upon the wealthy individual.

Too many individuals, I think, have misrepresented the effect of this 94½ percent rate. As this committee fully understands, the 94½ percent rate applies only to that part of income in excess of $80,000 a year. This means, for example, that an individual with $100,000 in income has only the last $20,000 of that income subject to the 94½ percent rate. The total effective rate of taxation upon an individual with an income of $100,000 is 59.4 percent.

As a matter of fact, the maximum effective rate of 90 percent, while high, still leaves an individual with a gross income of $1 million with $100,000 after taxes.

A discussion of the 90- or 94½-percent rate in a vacuum sounds as if we are taxing away almost the entire income of our wealthy individuals. Such is not the case, however, as I have already indicated. We must relate our discussions to the effective rate of taxation and not to the bracket rate. In other words, we must relate them to the rate of 59.4 percent on the $100,000 a year man, and not the 94½ percent rate. No great hardship is imposed upon an individual with

a gross income of $1 million a year, if he is able to retain, after taxes, a cold $100,000.

2. We believe that the corporation tax increase, as recommended by the House of Representatives is a good one, as far as it goes, but it does not go far enough. We commend the House for reducing the exemption from 85 percent of the best 3 out of 4 years from 1946-49 to 75 percent. In addition, the increase of the corporate rates by 5 percentage points all the way up the line is also a good recommendation as far as it goes.

We think, however, that instead of raising $2,855,000,000 from corporations, as the House recommends, that we should raise at least a minimum of $5 billion from corporations. This can be done by raising the excess profits tax rate to 85 percent, by requiring them to average their profits for all 4 years, from 1946 to 1949, instead of the best 3 out of 4 years, and by closing other major loopholes in the present excess profits tax law.

The House Ways and Means Committee, in its report accompanying H. R. 4473, estimated that "corporate profits after taxes in the calendar year 1951, after full allowance for this bill, are expected to be about $20 billion as contrasted to corporate profits after taxes during World War II ranging from $8.5 billion to $10.8 billion. Thus, even after considering the increases made in corporate taxes by this bill, in 1951 these profits will be from about 180 to 230 percent of corporate profits after taxes during the last war."

The profits of major corporations in the United States are at an all-time high, and they continue to rise. Table II indicates that 1950 corporate profits, before taxes, increased substantially quarter by quarter. In the first quarter of 1950 they were running at an annual rate of over $29 billion. They increased to $37 billion in the second quarter, skyrocketted to $46 billion in the third quarter, and went up further to $50 billion in the fourth quarter. The fourth quarter profit rate of $50 billion annually was 79 percent greater than the average profit earned by all corporations for the 4 years immediately succeeding the end of World War II.

Corporate profits, after taxes, in the fourth quarter of 1950 were running at a record annual rate of $28.5 billion—even after the excess-profits taxes enacted by Congress in the last session. This is more than 60 percent greater than the $17.6 billion rate, after taxes, in the 4-year period, 1946-49. Even though the last Congress enacted an excess-profits tax and increased income and corporate tax rates, there is still a large source of revenue to be drived from the corporate profits sector of our economy.

All indications seem to be that corporate profits during 1951 will be very close to the rate of profits during the fourth quarter of 1950. While all forecasting is hazardous, it is my feeling, after careful consideration, that 1951 corporate profits before taxes will approximate $47 billion. Certainly our corporations can shoulder a much larger tax load as their contribution to our national needs.

This is why we recommend that the excess-profits tax be strengthened. We must remember that an excess-profits tax is anti-inflationary. This point has been developed at considerable length in testimony by CIO last year before this committee.

We pointed out at that time that an excess-profits tax rate of 85 percent is anti-inflationary, because corporations knowing that they could keep only 15 cents on every dollar of increased sales would be less inclined to increase prices.

However, this is in contrast to a straight increase in the corporate tax rate to 55 percent. Such an increase means that corporations would retain 45 cents out of every dollar. When a corporation contrasts this possibility, of retaining 45 cents as against retaining 15 cents on every dollar, it obviously is more inclined to push up prices under the first condition than under the latter.

A straight increase in corporate normal and surtax rates is desirable at the same time that the excess-profits rate is increased. The last type of tax is particularly useful as an anti-inflationary device, and it must not be weakened in favor of the first type. Both should be strengthened and combined to increase tax revenues and to prevent large-scale profiteering as the result of the mobilization program.

If companies and corporations have increased their profits considerably over the base period, there is no reason why these increased profits should be taxed at only the normal and surtax rates. They should be taxed at an excess-profits tax rate, an excess-profits tax rate based upon a considerably lower exemption than that provided in the Excess Profits Tax Act of 1950.

We think considerably more revenue than that proposed by the House bill should now be raised from corporations. If the excess-profits tax is strengthened

and loopholes tightened, and surtax and corporate rates increased to 55 percent, we feel certain that $5 billion can be raised from this source without harm to the present financial structure of American corporations.

In the face of the level of anticipated 1951 corporate profits, we believe that $5 billion more in corporate taxes can be raised and still leave corporations with $18 to $19 billion after taxes, which is still a substantial profit.

3. Excise taxes should not be increased, and your committee should not give serious consideration to the proposal which has been made before it by the NAM for a Federal sales tax.

Excise and sales taxes hit low- and middle-income individuals harder than they hit high-income individuals. In other words, consumption taxes are borne in inverse proportion to income, the higher the income the lesser the burden; the lower the income, the greater the burden. This is clearly shown in table III.

This table shows that taxation upon public consumption at the Federal level takes 2.4 percent or more of the income of those individuals earning less than $5,000 while it takes 2 percent or less of the income earned by individuals making over $5,000, the two extremes being individuals earning under $500 (who have 3 percent of their income going into Federal consumption of taxes) and those with incomes of $20,000 and over (who have only eight-tenths of 1 percent of their income going into Federal consumption of taxes).

Tables IV and V illustrate this same principle for excise taxes on gasoline and cigarettes. Table IV shows the total expenditure for gasoline for six cities in the United States during 1947 and 1948. This table shows also the percentage which these expenditures are of the total of the average income for the income class. It can be seen from this table that the percentage of income spent for gasoline is much higher for the lower- and middle-income individuals than it is for the higher-income individuals.

Table V shows the estimated tax paid on gasoline and cigarettes and the percentage which this expenditure for taxes is to the total average income for the income class, again illustrating the point that consumption taxes are borne in inverse proportion to income.

Specifically, the excise taxes increases on automobiles and electrical appliances proposed in H. R. 4473 are discriminatory. We in CIO strongly oppose increasing excise taxes not only on commodities like cigarettes and alcoholic beverages, but also upon these categories of consumer durable goods. The enactment of increases of excise taxes on consumer goods in practice will establish privileged classes in our society—privileged because these taxes increase the ability of the wealthy few to buy. Those who cannot afford the increased excises will be unable to buy. Therefore, scarce consumer durable goods items will be, in effect, rationed to the privileged class with enough income to pay the price plus the excise tax.

Excise taxes should not be used to curtail the use of scarce materials. To impose higher excise taxes is to ration commodities according to the ability to buy and not according to need. It is wholly and highly inequitable to force low-income individuals out of the market to make room for high-income families to buy the reduced supply of goods.

The House Ways and Means Committee clearly recognizes that excise taxes bear most heavily upon low-income individuals. On page 39 of their report accompanying H. R. 4473, they say in reference to increasing the excise taxes on beer that "The increase provided in the bill for beer is smaller than that provided for distilled spirits because your committee believes that beer to a greater extent is consumed by the lower-income groups and, therefore, that an increase in this tax generally is more burdensome than the tax on distilled spirits."

The committee in this quote clearly recognizes that excise taxes are much more burdensome upon low-income individuals than upon the high-income people. The imposition of any increased excise taxes or sales taxes will reverse the progressive character of our whole tax structure.

4. We believe that at least $4½ to $5 billion in additional revenue could be raised by closing existing loopholes, and we recommend that at this time at least 25 percent of the total increase in Federal revenue be raised from this source. On the basis of raising $10 billion, some $2½ billion can be raised from closing loopholes.

I should like to review the major loopholes which cover such well-known practices as (1) the split-income provision, (2) estate and gift taxes, (3) capital gains, (4) interest from tax-exempt securities, (5) depletion allowances, (6) stock options, and (7) taxes upon life-insurance companies.

The committee can take its choice from any of these specific recommendations and come up with at least $2 billion of additional revenue from closing loopholes without any great difficulty.

The community property and split-income-tax loopholes, if closed, would provide $2.5 billion; the estate and gift-tax loophole, if closed, would provide another billion. By closing the five other loopholes mentioned above, another $1 to $1½ billion would be secured for the United States Treasury.

I would like briefly to refer to each of the types of taxes which I have mentioned above and outline specific proposals in connection with these.

CLOSING THE LOOPHOLES

(1) *Splitting incomes*

In the Revenue Act of 1948 the community-property principle of splitting income between husband and wife is extended. As a result of the enactment of this handsome tax loophole for the well-off, the Federal Treasury is currently losing $2½ billion in revenue per year.

The maintenance of this provision on the statute books is grossly unfair. It is an outright discrimination against individuals with incomes of less than $5,000 as well as a discrimination against single persons.

With the bracket rates higher than at the peak of World War II, taxes paid are less in the brackets below $5,000 because of the $100 increase in personal income-tax exemptions, and they are substantially less in the higher brackets because of the enactment of the split-income-tax loophole.

Table No. 6 shows the effect of the existence of the split-income-tax provision upon the amount of taxes paid by individuals at various income levels. It shows, for example, that a married couple with two dependents, with a $3,000 income, would pay $144 in income taxes or $131 less than the wartime peak. Individuals with a $10,000 net income before exemptions will pay $349 less; an individual with a $50,000 net income will pay $6,077 less; and an individual with a net income of $500,000 will be paying $20,625 less than he paid at the peak of the war in 1944.

If we are talking about equality of sacrifice, we cannot enact additional taxes upon low-income individuals, as long as this grossly unfair and inequitable split-income loophole continues on the statute books.

The community-property principle is rank discrimination against single individuals and grossly unfair to low-income married individuals.

We should understand just how this community-property principle operates. A married person with two dependents must have an income of $4,900 before he receives $1 of tax benefit from this provision. According to table No. 8, page 12, of House Ways and Means Committee report accompanying H. R. 4473, approximately 35.8 million—or over 80 percent—of our taxpayers earn too little income to benefit from the split-income-tax loophole. On the other hand, a little over 8 million taxpayers, constituting less than 20 percent of the total, receive the entire benefit from the existence of this inequitable provision. It is hard to speak of equality of sacrifice to low-income families, when a $2½ billion hand-out is enjoyed by the well-off.

One does not really begin to receive significant benefits from the existence of this provision until his income is in excess of $10,000. In this category, we have only 1¾ million taxpayers, or 4 percent of the total.

I cannot see how an equitable tax structure can be developed until this provision is eliminated. The community-property principle can be eliminated first by straight outright repeal of the provision in the Revenue Act of 1948 with the requirement of mandatory joint returns without splitting of income; or the same result could be accomplished by establishing special tax rates for married couples. In either case the split-income tax provision should be repealed; and, if it is, would produce $2.5 billion in revenue.

The proposal of the House of Representatives to extend the principle of split income at least in part to the heads of households is justified only because of the existence of the split-income provision itself. However, we are opposed to the extension of the principle of the split income to the heads of households, as the House has done in its bill. There would be no injustice between married individuals and heads of households if the split-income tax provision were eliminated. We, therefore, recommend that the Senate eliminate the split-income provision, thereby making it unnecessary to extend the principle to heads of households.

(2) *Estate and gift taxes*

Almost $1 billion can be raised in this field by an all-out approach to the multitude of loopholes that exist in the estate and gift tax structure.

There are four major loopholes affecting estate and gift taxes which must be closed. To close them, we must—

(*a*) Integrate the estate and gift tax structure;

(*b*) Repeal the splitting of property for estate and gift tax purposes which was validated by the Revenue Act of 1948;

(*c*) Eliminate the life estate problem;

(*d*) Reduce exemptions.

The following is a brief discussion of each of these major points:

(*a*) *Integrated estate and gift tax.*—The present system is a dual system with separate exemptions and lower rates for gifts. As a result, considerable juggling is possible to reduce the tax on transferring wealth. This is particularly true with respect to gifts made in contemplation of death. The necessity to prove that a gift made shortly before death was or was not in contemplation of death involves time-consuming litigation, with the Government often unable to prove that the gift was made in contemplation of death. Only in about 20 percent of the cases has the Government been successful in proving its charges. Substitution of a single set of rates and exemptions, and integration of the taxes so that taxwise the time of the transfer would not affect the tax, would not only increase revenue, but would close loopholes in the tax.

(*b*) *Splitting property for gift and estate tax purposes.*—In 1942, tax amendments were enacted to equalize the treatment of estate and gift taxes between the community-property States and those other States not having the advantage of community-property laws. These amendments required equal treatment in all States, thus in effect setting aside the provisions of community-property laws in those States having such benefits.

The Supreme Court of the United States States has upheld the validity of these 1942 amendments. The repeal of these amendments by the Revenue Act of 1948 weakens our estate and gift tax structure. The Secretary of the Treasury has estimated that this results in a loss of revenue amounting to $245 million or 30 percent of the yield of the estate and gift taxes.

(*c*) *Life estates.*—At present a man may place his property in trust, make provision that his wife (or anyone else) have the income for life (i. e., life tenant) and that at her death the income or the property go to their children or someone else. Although ability to enjoy the income is, in effect, virtual ownership, no estate tax is imposed on the life tenant for the value of the life estate. The effect of this is to skip at least one estate tax on the property. This procedure may, with skillful drafting of the trust instrument, be extended so that trust property is subject to estate tax only once every 100 years. Ordinarily, property is subject to estate tax once every generation (say 30 years); the exemption of life estates may, therefore, postpone the tax for an additional 70 years. This is the largest single loophole in the law. Closing that loophole alone could at least double the yield of the death tax.

The British, wo whom settled property is at least as important an institution as it is to us, saw through the tax avoidance possibilities of life estates about 50 years ago and provided that the value of property subject to a life estate should be included in the gross estate of the life tenant. A similar procedure in the United States would represent a major step forward in equitable taxation.

(*d*) *Reduce exemption.*—Present law provides for a $30,000 gift tax exemption, plus a $60,000 estate tax exemption, plus an annual gift tax exclusion of $3,000 to each of as many persons as the donor wishes. It is not too difficult for a man to pass $250,000 to his relatives, free of tax. Such liberality in the law allows most estates to escape any tax. Reduction of the combined estate and gift tax exemption to $25,000, and the annual gift tax exclusion to $1,000, would not only increase revenue but would increase the equity of the tax.

No basis exists for estimating the revenue potentialities of these four suggested changes. A modest guess, however, would be that they would yield $1 billion additional annually.

(*3*) *Capital gains*

The existing rate of 25 percent for capital gains held for 6 months or more is extremely inequitable. We do not think that the raise to 28¼ percent recommended by the House is sufficient. We would, however, recommend that the rate be increased to at least 50 percent and the holding period extended to at least 1 year.

We support the House proposal—that profits received from the sale of a house should be exempt from capital gains taxation when they are used to purchase another house, assuming, of course, that both houses are occupied by the owner.

Capital gains are a common source of income to the wealthy. For example, less than one-half of 1 percent of the income in the lowest net income class comes

through capital gains, while in the $500,000 class one-third of income is derived from capital gains.

The amount of the income derived from long-term capital gains, under present House proposal is subject to only a 28¼ percent tax, while the suggested rate for individuals in the $500,000 bracket is 94½ percent for all income in excess of $80,000.

The 28¼ percent rate would be only a few percentage points higher than the rate recommended for the lowest bracket. Increasing the rate for capital gains to 50 percent would set the rate equal to that applicable to surtax net income of $14,000 to $16,000. This is still a modest proposal.

There is one additional loophole in the capital gains structure which should be closed. That has to do with accretions in the value of securities held until death. No capital gains tax is now levied on securities when the owner dies and their "basis" to the heir is their appreciated security value for estate tax purposes. This situation encourages holding securities until death to avoid income tax. It could be corrected by considering transfers at death as a realization. If this were done, a capital gains tax would be payable in the year of the death by the decedent's estate.

The enactment of these recommendations in capital gains would bring into the Federal Treasury at least one-half billion dollars.

(4) *Tax exempt interest from State and local securities*

There is today over $20 billion of State and local securities in the hands of individuals, income from which is wholly exempt from taxes. It is these securities which should be taxed, if the tax-exempt interest question is to be eliminated. There is, naturally, opposition by State and local communities to this proposal, so a compromise measure to tax only future issues of State and local securities has been presented. However, it would be 1975 before 90 percent of the current outstanding State and local securities would expire. Thus, little would be accomplished in the immediate future by a proposal to tax only future issues of State and local securities.

Needless to say, those with vested interests in these exemptions defend its continuance on the ground that they paid for this benefit when they bought the securities. It is clear, however, that they did not pay for benefits at the present rate.

The States and localities claim that elimination of the exemption would raise interest costs. However, a subsidy by income taxpayers to the States and localities is clearly inequitable. Certainly it cannot be stated that States and localities could not finance their operations without this benefit.

If this provision to tax interest from State and local securities were enacted, at least one-quarter of a billion dollars in Federal revenue could be collected.

(5) *Depletion allowances*

At the present time oil, gas, and mineral companies are permitted excessive exemptions for depletion. One-half billion dollars a year in taxes could be collected merely by taxing these companies and corporations at the same rate as everyone else.

The United States Treasury has shown that in 1947 the oil companies that are worth over $100 million claimed percentage depletion of more than 13 times actual depletion on an original cost basis. In plain language, that is practically equivalent to allowing a businessman to recover the cost of his plant 13 times through tax-free depletion or depreciation deductions. As long as we are going to play that game, I suppose it is only fair to allow taxicab drivers to deduct the cost of their cab 13 times for income tax purposes. The cab drivers certainly need it and probably deserve it just as much as the oil companies.

Referring to the lush, tax-free profits which a few companies are enjoying in the name of depletion allowance, Senator Hubert Humphrey recently pointed out:

"For example, during the 5 years 1943–47, during which it was necessary to collect an income tax from people earning less than $20 a week, one oil operator was able, because of these loopholes, to develop properties yeilding nearly $5,000,000 in a single year without payment of any income tax. In addition to escaping the payment of tax on his large income from oil operations, he was also able through the use of his oil-tax exemptions to escape payment of tax on most of his income from other sources. For the 5 years his income taxes totaled less than $100,000, although his income from nonoil sources alone averaged almost $1,000,000 each year.

"This is a shocking example of how present tax loopholes permit a few to gain enormous wealth without paying their fair share of taxes * * * Indeed, the com-

parative profitability of the oil and gas industry is found in recent statistics showing net income expressed as a percentage of sales, released by the National City Bank in its monthly letter for April 1950. This report shows that in 1948, 40 companies producing oil and gas had a return of 34.8 percent on their book assets as compared with an average of 13.6 percent for 3,322 companies drawn from all industries. In 1949 the comparable ratios were 21.7 percent for oil and gas, and 11 percent for all industries. Expressed as a percentage of sales, profits of the oil and gas producers were 33.1 percent in 1948, and 26.9 percent in 1949. The equivalent percentages for the entire group of 3,322 corporations were 7.3 percent in 1948 and 6.6 percent in 1949."

"A dean of tax experts and former counsel of the Treasury has well summed up the case against percentage depletion on oil and gas: '(Subsidies) are inexcusable when they serve no public purpose and indiscriminately favor entire industries which are in an established financial position far beyond need of special Government help. For then their effect is to shift part of the tax burden to the shoulders of others who are less able to bear that burden. A sound tax system would permit no one segment of business to ride roughshod over others.' (Randolph Paul, Taxation for Prosperity (1947), p. 307.)"

We see no reason why special benefits should be given to oil companies, oil well owners, and to the owners of various other mineral properties.

(6) *Stock options*

One wide loophole was opened up by the Revenue Act of 1950 and that has to do with the employee stock options.

Many corporations give their top executives the right to buy stocks in the corporation at a price below the open market quotation.

In the past, this difference between the market price of the stock and an option to buy at less than market price was taxed at the normal individual income tax rates.

However, under the present law corporation executives would be taxed at the so-called "capital gains" rate on that part of income received in the form of options to buy company stock at less than market price.

For example, if a corporation wants to give one of its $30,000-a-year executives a $20,000 cash bonus, such a cash bonus would be subject to the normal individual income tax rate. That tax would amount to $12,000. If the corporation wants to take advantage of the stock options under this new tax bill and give to the executive the equivalent of the $20,000 cash bonus in a stock option, the executive would save $7,000 in taxes.

Wage earners do not benefit at all from this option clause.

In order to benefit, one's income before exemptions must be in excess of $15,000. The higher the tax bracket of the individual the more profitable it would be.

The repeal of this provision would increase Federal Revenue by another quarter of a billion dollars.

(7) *Life insurance companies*

The Revenue Act of 1950 imposed a retroactive tax on life insurance companies for the years 1949 and 1950. This was just a stopgap provision, as Secretary Snyder indicated in his testimony to this committee a few days ago.

Serious consideration should be given to the enactment of provisions which would keep life insurance companies from enjoying unjustified special treatment. This is an extremely involved and complicated problem, but, if properly tackled, it could produce additional revenue needed by the Government.

Each and every one of these tax loopholes represents a concession either to big business or to wealthy individuals. The failure to close these loopholes will lose for the Federal Government between $4½ and $5 billion of revenue. But revenue not thus collected must be collected elsewhere.

It appears that because the common folk have less political influence than corporations and wealthy people, they are to be forced to pay a greater proportion of the tax bill than they can reasonably afford.

The continuation of tax loopholes makes the wealthy still richer at the expense of the mass of Americans. This is inequitable and intolerable. Congress will be remiss in its responsibilities to the mass of its constituents if it fails to close the loopholes even if the well-off object.

There will be no equality of sacrifice if these loopholes are continued on the statute books at the same time as the Congress imposes higher taxes upon the low- and middle-income individuals.

We hope that the Senate will agree with the House proposal to apply a withholding tax to dividends and interest.

In summary, therefore, the CIO believes that we must raise approximately $10 billion in revenue now in order to be on a pay-as-you-go basis for the current fiscal year. This can be done by retaining the House provision on individual income tax with a slight modification for the group having only $1,000 or less in taxable income, by raising the corporation tax an additional $2–$2½ billion for a total of $5 billion, and by closing loopholes—at least to the extent of raising a minimum of $2½ billion from this source.

This $10 billion can be raised, we feel, without resort to increasing excise taxes, as the House has recommended, and certainly without resort to a sales tax, which certain witnesses before your committee have already advocated.

The CIO, therefore, urges that this committee give serious consideration to placing the tax burden where it should be in our economy. We believe the proposals which we have made are both fair and equitable, and are based upon sound tax and economic principles that are in the best interest of our economy as a whole.

TABLE I.—*Distribution of personal income and expenditures, 1948*

Spending units ranked according to income	Range of money income	Personal income after taxes [1]		Net savings	Expenditures	
		Billions of dollars	Percent of income		Billions of dollars	Percent of expenditures
Highest tenth	Over $6,000	51.6	29.0	8.5	43.1	25.8
Second	$4,500 to $6,000	26.7	15.0	2.1	24.6	14.7
Third	$3,750–$4,500	21.4	12.0	1.6	19.8	11.9
Fourth	$3,200 to $3,750	17.8	10.0	.7	17.1	10.2
Fifth	$2,840 to $3,200	16.0	9.0	.6	15.4	9.2
Sixth	$2,400 to $2,840	14.2	8.0	.2	14.0	8.4
Seventh	$2,000 to $2,400	12.5	7.0	–.1	12.6	7.5
Eighth	$1,500 to $2,000	8.9	5.0	–.3	9.2	5.5
Ninth	$860 to $1,500	7.1	4.0	–.5	7.6	4.5
Lowest tenth	Under $860	1.8	1.0	–1.9	3.7	2.3
Total		178.0	100.0	10.9	167.1	100.0

[1] Excludes income in kind and change in value of farm inventories.

Based on Income and Savings estimates of Department of Commerce, and on Distribution of Income and Savings estimates in Federal Reserve Board Survey of Consumer Finances.

TABLE II

[Billions of dollars]

Period	Corporate profits before taxes	Corporate profits after taxes
1939	6.5	5.0
1944	24.3	10.8
1946	23.5	13.9
1947	30.5	18.5
1948	33.9	20.9
1949	27.6	17.0
1946–1949 Average	28.9	17.6
Annual rates, seasonally adjusted, 1950:		
First quarter	29.2	16.0
Second quarter	37.4	20.9
Third quarter	46.4	25.8
Fourth quarter	50.8	28.5

Source: Department of Commerce.

TABLE III.—*Federal taxes on specific consumption as percent of consumer income, 1938–39* [1]

Income class	Percent
Under $500	3. 0
$500 to $1,000	2. 9
$1,000 to $1,500	2. 8
$1,500 to $2,000	2. 8
$2,000 to $3,000	2. 7
$3,000 to $5,000	2. 4
$5,000 to $10,000	1. 9
$10,000 to $15,000	1. 5
$15,000 to $20,000	1. 3
$20,000 and over	. 8

[1] Source: TNEC Monograph No. 3, Who Pays the Taxes, p. 12.

TABLE IV.—*Total expenditures for gasoline for 3 cities in United States, 1947–48*

Income level	Average expenditures	Percentage average expenditures of average income
WASHINGTON, 1947		
Under $1,000		
$1,000 to $2,000	$1. 12	0. 07
$2,000 to $3,000	32. 53	1. 3
$3,000 to $4,000	59. 12	1. 6
$4,000 to $5,000	82. 96	1. 8
$5,000 to $6,000	121. 48	2
$6,000 to $7,500	96. 43	1. 4
$7,500 to $10,000	131. 45	1. 5
$10,000 and over	119. 09	. 4
RICHMOND, 1947		
Under $1,000		
$1,000 to $2,000	$8. 07	0. 5
$2,000 to $3,000	18. 65	. 7
$3,000 to $4,000	51. 88	1. 4
$4,000 to $5,000	91. 24	2
$5,000 to $6,000	73. 18	1. 3
$6,000 to $7,500	170. 74	2. 5
$7,500 to $10,000	120. 29	1. 3
$10,000 and over	162. 54	. 7
MANCHESTER, 1947		
Under $1,000	$9. 18	1. 8
$1,000 to $2,000	1. 12	. 07
$2,000 to $3,000	33. 88	1. 3
$3,000 to $4,000	53 96	1. 5
$4,000 to $5,000	76. 06	1. 6
$5,000 to $6,000	30. 52	. 5
$6,000 to $7,500	150. 67	2. 2
$7,500 and over	154. 50	. 6

TABLE V.—*Estimated tax on gasoline and cigarettes, 1947*

WASHINGTON, 1947

Income level	Estimated tax		Tax as percentage of income
	Gasoline	Cigarettes	
Under $1,000			
$1,000 to $2,000	$0.075	$10.43	0.6
$2,000 to $3,000	2.20	17 99	.8
$3,000 to $4,000	4 02	21.42	.7
$4,000 to $5,000	5.65	17.22	.4
$5,000 to $6,000	8.28	27.37	.5
$6,000 to $7,500	6.51	22.68	.4
$7,500 to $10,000	8 95	24.99	4
$10,000 and over	8.11	30.94	.1

RICHMOND, 1947

Income level	Gasoline	Cigarettes	Tax as percentage of income
Under $1,000			
$1,000 to $2,000	$0 54	$14.28	0.9
$2,000 to $3,000	1 26	17 36	.7
$3,000 to $4,000	3 52	18.20	.6
$4,000 to $5,000	6.25	23.31	.6
$5,000 to $6,000	4.98	19 95	.4
$6,000 to $7,500	11 64	32 97	.5
$7,500 to $10,000	8.19	20.16	.3
$10,000 and over	11.07	39.48	.1

MANCHESTER, N. H., 1947

Income level	Gasoline	Cigarettes	Tax as percentage of income
Under $1,000	$0.62	$8.26	0.2
$1,000 to $2,000	.08	11 13	.7
$2,000 to $3,000	2.37	23.24	.9
$3,000 to $4,000	3.68	26.39	.8
$4,000 to $5,000	5.18	23.24	.6
$5,000 to $6,000	2.07	43.05	.7
$6,000 to $7,500	10.26	24.50	.4
$7,500 and over	10.53	28.35	.4

TABLE VI.—*Married person, 2 dependents*

Net income before exemptions	Amounts of tax			Difference between wartime peak and proposed rates
	1944 act	Present law	Proposed rates	
$1,000	$15			
$1,500	30			
$2,000	45			
$2,400	137			
$3,000	275	$120	$144	$131
$5,000	755	520	624	131
$8,000	1,585	1,152	1,376	209
$10,000	2,245	1,592	1,896	349
$15,000	4,265	2,900	3,404	861
$20,000	6,785	4,464	5,168	1,617
$25,000	9,705	6,268	7,172	2,533
$50,000	26,865	18,884	20,788	6,077
$100,000	68,565	51,912	55,816	12,749
$500,000	442,985	402,456	422,360	20,625
$1,000,000	[1] 900,000	857,456	897,360	102,640

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

NOTE.—Assumes all income is owned by one spouse.
Source: Treasury Department, February 5, 1951.

Mr. Schutzer, come around. Have a seat there, please, and identify yourself to the reporter.

STATEMENT OF ARTHUR SCHUTZER, STATE EXECUTIVE SECRETARY, AMERICAN LABOR PARTY

Mr. SCHUTZER. Arthur Schutzer, 17 Murray Street, New York City. I am executive secretary of the American Labor Party.

Mr. Chairman and members of the committee, in behalf of the American Labor Party, I want at the outset to thank you for your courtesy in giving us an opportunity to present our views on the vital issue of tax measures before you now, and I would like to state at the outset that I will confine my remarks to the 10 minutes, as requested in the telegram that I received.

The bipartisan tax measure now threatening the American people ought to be entitled: "An Act for the Relief of Greedy Wealth and for the Further Reduction of the American Family's Living Standards."

That title fully fits the kind of tax program sought by the National Association of Manufacturers and the Chamber of Commerce. Operating through a determined lobby, the profiteers are spreading the big lie to impose their selfish, predatory aims.

Senator KERR. Just one moment. Do you understand that the National Association of Manufacturers has been here opposing many of the provisions of this bill, and seeking substitute provisions? Are you or are you not aware of that?

Mr. SCHUTZER. I am fully familiar with that, sir, but I am also familiar with the fact that the National Association of Manufacturers and the Chamber of Commerce are, in our opinion, spreading a campaign for a Federal sales tax, and they are, as we allege here, spreading the big lie about an excess purchasing power, which subject is the main burden of my discussion this morning.

Senator KERR. All right.

Mr. SCHUTZER. And that is what I had reference to, sir.

Senator MILLIKIN. You speak of a bipartisan tax measure. I want to remind you that a President of the United States once referred to a tax measure then before the Congress as "An act for the relief of the greedy," and there was not any bipartisan business about it, but he almost chopped his own party in two. It was a bipartisan effect in that it made two parts of his own party, where one had tenuously existed before.

Mr. SCHUTZER. Well, I would like to say that, sir, if I may, the Republican Party——

Senator MILLIKIN. Do not speak of the Republican Party. I am not speaking of either party.

Mr. SCHUTZER. All right. Well, if either party—let me put it that way——

(Discussion off the record.)

Mr. SCHUTZER. May I continue?

Senator MILLIKIN. Yes, go ahead.

Mr. SCHUTZER. They seek to create the myth that workers have an "excess of purchasing power." This so-called excess must be drained off, they cry. And they have just the right drainage system, namely: Increase income-tax rates on low incomes, lower individual income-tax exemptions, and enact a Federal sales tax.

These eager drainers do not, of course, suggest any tax to siphon off the unprecedented corporation profits which totaled an estimated 40 billion dollars in 1950 (twice as high as corporation profits in the

profits-lush year of 1944). They humbly admit that they know only how to drain the contents of the already thin pay envelopes of middle- and low-income group brackets.

Let us turn the spotlight of truth—and official Government statistics—upon the big lie of "excess purchasing power." Is it excess purchasing power, gentlemen, when 60 percent of families and households in early 1950 either had no liquid assets at all or had liquid assets of less than $500?—Federal Reserve Bulletin, December, 1950, page 1591. Is it excess income when we find that, in 1949, 14 percent of all families had incomes of less than $1,000; 53 percent had less than $2,000; 54 percent had less than $3,000; and 73 percent had less than $4,000?—Economic Report of the President, January 1951, page 226.

Moreover, gentlemen, is it excess purchasing power when 60 percent of the Negro families had incomes of less than $2,000 a year? (National Guardian, June 27, 1951, p. 4.)

Where is the "excess purchasing power"? Surely not in the pockets of workers.

In all the fancy full-page advertisements inspired by the Chamber of Commerce and the National Association of Manufacturers to push the "big lie," they do not see fit to mention a few interesting figures about the total take—salary, bonus, and stock—received by corporation executives, according to reports filed with the Securities and Exchange Commission in 1950. At the risk of embarrassing the the crusaders against nonexistent "excess of purchasing power," let me set forth merely a few of these figures:

Charles E. Wilson (General Motors)	$626, 300
Crawford H. Greenwalt (du Pont)	539, 550
J. C. Dellinger (Anderson, Clayton)	468, 271
Arthur B. Homer (Bethlehem Steel)	381, 932
J. F. Drake (Gulf Oil)	343, 000
Seton Proter (National Distillers)	302, 206
T. M. Girdler (Republic Steel)	279, 166

Source: CIO News, June 18, 1951, p. 5.

Senator MILLIKIN. How much excess purchasing power have those gentlemen after you apply the taxes to them?

Mr. SCHUTZER. I would imagine quite an excess; but the point I am trying to make, Senator——

Senator MILLIKIN. Take $626,000. How much taxes would you pay on that?

Mr. SCHUTZER. Well, I will tell you one thing, I have not heard of any one of these gentlemen having applied to the Government for relief.

Senator MILLIKIN. How much taxes would be applied to $600,000?

Mr. SCHUTZER. I would apply much more than is applied now.

Senator MILLIKIN. How much would you apply at the present time?

Mr. SCHUTZER. I am not here to fashion a tax bill; I am here to fashion the principles that we would apply.

Senator MILLIKIN. You may not be here to fashion a tax bill, and I doubt whether you will, but you are here giving your own testimony on the salaries of these people.

Mr. SCHUTZER. That is right.

Senator MILLIKIN. And it is relevant, I suggest, to find out how much they have after they pay the taxes which you are objecting to.

Mr. SCHUTZER. Well, I would say this, unless you want to dispute me, Senator, that after they pay their taxes they certainly, to put it mildly, and to understate it, are in an infinitely better position than the income groups whose percentages I read a few minutes ago.

Senator MILLIKIN. Oh, yes; I do not challenge that at all.

Mr. SCHUTZER. Would you say, sir, that these total taxes represent a fair return, comparing it with what the workers in these industries and these companies get?

Senator MILLIKIN. I suggest to you that those total taxes reflect the rate of taxes that we are now imposing on people that have large incomes. That is what I suggest to you, and that is why it would be interesting, if you have not done so, to apply the tax rates to those brackets and see where you come out.

Mr. SCHUTZER. I would be very happy, with your permission, Senator, to file a supplemental statement with this committee showing what the total is that is left after all taxes are paid by these super-top-salaried executives.

Senator MILLIKIN. That is right. I would like to see that.

Mr. SCHUTZER. Another example of excess purchasing power a la the National Association of Manufacturers is, I suppose, the fact that by January 31, 1951, nearly 48 percent of E bonds had been cashed in (Treasury Department release, U. S. Savings Bonds Issued and Redeemed). Moreover, 16 percent of E bonds purchased in 1950 were cashed that same year. These bonds were cashed to buy food, clothing; to pay for medical expenses; to help meet the soaring cost of living and profiteering prices. What happens to the "big lie" about excess purchasing power in the light of such facts?

Yet, the glib slogan continues to be proclaimed by those who, while raking in unprecedented billions in profits at the expense of the living standards of the American family, seek to shift the tax load more and more on to the sagging shoulders of those least able to pay. The indefensible and utterly unconscionable drive to impose a Federal sales tax represents the latest effort in this direction by the tax hogs.

Realizing the huge stakes involved, it is understandable that the monopolists would promote the "big lie." But, it is shocking to see agencies of the Government adopt the same tactic. For example, the Wage Stabilization Board has relied upon the excess purchasing power fantasy as its major warrant for wage freezes and for increasing taxes from low incomes.

Senator KERR. Does the Wage Stabilization Board levy taxes?

Mr. SCHUTZER. No; it does not, but it can make recommendations, which it has, sir, and which I am referring to. This is the statement that I am referring to of December 18, 1950, release No. ESA GPR-18.

Similarly, in a 1951 version of pure Alice-in-Wonderland economics The Council of Economic Advisers actually declared that "* * * we must stop eating so much cake" (appendix B of the January 1951 Economic Report of the President). Our answer is: The people need more bread, not less cake.

Tax measures, gentlemen, do not originate or exist in a void. They reflect the total outlook, program and policies of the Government. Taxes can be sought to pour billions into the coffers of war profiteers

in executing a blueprint for a war economy or taxes can be sought to build homes, hospitals, schools, roads and to advance the well-being of the American people through peaceful, democratic progress.

The American Labor Party respectfully urges that, instead of war spending, which rose from $12½ billion before Korea to more than $30 billion and is going to $60 billion—or $400 for every American—let us spend to put up the 5 million homes the Nation needs, the thousands of new schools, the more than 1 million hospital beds that are urgently required. The $16 million the Government dribbled out last year on cancer research was less than the cost of a flight of group bombers.

We respectfully submit that this committee should as a most proper exercise of its duties and powers, recommend prompt completion of a cease-fire in Korea as a first essential step in achieving peaceful negotiation of all outstanding differences. The profit-wallowing monopolists who are gorging themselves on lush war orders will not like it. But, the American people, regardless of differences in political affiliations, will welcome it as the beginning of a return to the peace policies of Franklin Delano Roosevelt.

To help achieve a democratic, progressive tax program for an America in a world at peace, the American Labor Party respectfully recommends:

1. Increase the individual income-tax exemption as follows: Single person, $1,600; married couple, $2,400; dependents, $600.
2. Reduce—instead of increase—income-tax rates in low-income brackets.
3. Remove Federal excise taxes on essential everyday items like cigarettes, transportation, household appliances, and so forth.
4. Reject decisvely the proposal for a Federal sales tax.
5. Increase by $7 billion the tax on huge corporation profits.
6. Tie up the tax loopholes of income splitting.
7. Revise upward the estate and gift taxes.

We urge in conclusion, gentlemen, that you reject the "big lie" about excess purchasing power and that you act upon the big truth about excess profits. There is the key to a democratic and progessive tax measure for the American people.

Senator MILLIKIN. Prior to reaching a durable peace with Communist Russia, do you favor cutting down on military preparedness—cutting down on our military preparedness program?

Mr. SCHUTZER. I favor taking every step immediately, Senator, that will achieve a peace which, in turn, would make it unnecessary to raise the billions of dollars now being raised for armaments.

Senator MILLIKIN. That was not my question. My question was prior to the time—prior to that time that a dependable peace is reached, do you favor the abandonment or the serious curtailment of our present military program?

Mr. SCHUTZER. Senator, the time for peace is here right now, so I do not see that we have to phrase it prior to that.

Senator MILLIKIN. We have not got it.

Mr. SCHUTZER. I want us to have it, and immediately.

Senator MILLIKIN. My question is a very simple one. I ask, prior to the time that we have the kind of peace you are talking about, shall we cut down our military program?

Mr. SCHUTZER. My answer to you, sir, in absolute earnest good faith, is that the time for peace is right here now today, and if we could get peace, and a complete peace—and there is no reason why we cannot—then the entire tax measure would have to be, and should be, revised for peaceful progress rather than for war spending.

Senator MILLIKIN. I am cutting out your "if" because it is "iffy;" I am asking you if prior to the time that we secure a durable peace, whether you would cut out or seriously cut down on our military program.

Mr. SCHUTZER. I certainly would cut down on the profiteering involved in it, which is vast and inflated.

Senator MILLIKIN. Cut down the profiteering on it. Would you cut down on the program?

Mr. SCHUTZER. I am not military expert. I only know what the American people feel and say, that is that we have got to get peace as quickly as possible, and that is what I am urging this committee to recommend.

Senator MILLIKIN. I do not know anyone who opposes peace. What I am asking you is whether prior to peace you would cut down or eliminate the military program.

Mr. SCHUTZER. I would cut down and eliminate the policies of both the Republican and Democratic Parties which are now in effect, which envisage a war economy and a blueprint for war, and which produced the kind of a tax measure which is now before the committee.

Senator MILLIKIN. I repeat my question.

Mr. SCHUTZER. I repeat my answer, Senator.

Senator MILLIKIN. Just let me repeat my question first.

Prior to the time that we have the kind of peace that you are talking about, would you abandon or seriously cut down the existing military program? You answer me by saying you think the time for peace is right now.

Mr. SCHUTZER. That is right, sir.

Senator MILLIKIN. Well, are you in a position to make a peace right now?

Mr. SCHUTZER. No, but you can help, and the American people can help.

Senator MILLIKIN. I am willing to help.

Mr. SCHUTZER. So am I.

Senator MILLIKIN. I am talking about, are you in a position to make good your assurance?

Mr. SCHUTZER. No, I am only in a position——

Senator MILLIKIN. Of course, you are not.

Mr. SCHUTZER. I am only in a position as an American citizen to raise my voice so that peace can be achieved.

Senator MILLIKIN. I am not so sure that raising your voice will achieve peace. [Laughter.] I wish raising your voice could achieve peace.

Mr. SCHUTZER. It may not achieve it in this room, but I am talking about world-wide peace.

Senator MILLIKIN. But, passing that, I repeat my question, that prior to the time that we have a durable peace, do you favor abandoning or seriously cutting down the present military program?

Mr. SCHUTZER. I must respectfully repeat, Senator, that the Government should now do everything possible to hasten a cease-fire as a first

step toward achieving peaceful negotiations of all outstanding differences. If the Government does that immediately, Senator, if I may be permitted to answer the question fully, if the Government and if both parties honestly and earnestly do that, and if peaceful negotiations are achieved, then I say, with all respect to this committee, that this committee would have no alternative in good faith but to immediately revise the entire structure of the tax measures because by that time the billions that are now going into war orders would not be essential, and instead would go into peaceful progress and peaceful building for the American people.

Senator MILLIKIN. Of course, you are talking about something which is perfectly obvious. After we got through with World War II we reduced expenditures; we balanced the budget; we reduced taxes.

Mr. SCHUTZER. I do not want to wait until we get through with world war III; I want to stop it, Senator.

Senator MILLIKIN. You want to stop it? You want the assurance that we will not have a war; is that right?

Mr. SCHUTZER. Do I have the assurance? I think that we can help to make that assurance. I have no assurance in my vest pocket. All I am asking is that we take every step within our means to help make that assurance come true.

Senator MILLIKIN. Let us assume that you are entirely correct, let us assume that. Prior to the time that we have a durable peace, would you abandon the present military program or seriously cut it down?

Mr. SCHUTZER. I would abandon the profiteering in defense orders that is going on now.

Senator MILLIKIN. Let us assume that we should abandon that. I hope we do cut it out.

Mr. SCHUTZER. If you abandon it, you are going to save several billion dollars.

Senator MILLIKIN. Let us assume that. I am still asking you—let us cut out the profiteering—assuming you cut out the profiteering, do you favor the abandonment of the present military program, or do you favor seriously cutting it down?

Mr. SCHUTZER. The military program, Senator, does not exist in a void, as citizens have testified, citizens from the Pentagon. The military program is an extension of the entire policy that I am attacking here and, therefore, I will not separate one from the other.

Senator MILLIKIN. Assume that it does not exist in a void, and assuming that you are attacking the entire policies; prior to the time that we have a durable peace, do you favor abandoning the present military program?

Mr. SCHUTZER. I favor abandoning—I will repeat again—those policies which make it necessary to have the kind of military program which looks for a war economy instead of a peace economy.

Senator MILLIKIN. Well, everyone will agree with you on that.

Mr. SCHUTZER. Then, there is no dispute.

Senator MILLIKIN. Everybody will agree with you on that. I do not know whether there is any dispute on that, after I get an answer to my question as to whether you would abandon the present military program or seriously cut it down prior to the time that we have the durable peace that everyone is praying for.

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Mr. SCHUTZER. I would immediately abandon and throw in the ash-can the present bipartisan program of the Government which, in our opinion, is not a program for peace, but is a program for war and which, in turn, is used to justify the kind of military program to which the Senator is addressing himself now.

Senator MILLIKIN. Is it your theory that the present military program is a program to encourage war?

Mr. SCHUTZER. I definitely and most firmly believe that.

Senator MILLIKIN. Then, if you believe that, you are in favor of abandoning that military program, are you not?

Mr. SCHUTZER. I am in favor of converting that program into a program for peace; yes, sir.

Senator MILLIKIN. And you are in favor of doing that prior to the time when we have an assurance of a durable peace?

Mr. SCHUTZER. I am in favor of doing that simultaneously with active steps for peace.

Senator MILLIKIN. But not wait until after we have the dependable assurance?

Mr. SCHUTZER. I think whether we can get that dependable assurance rests largely within our own hands and our own efforts, sir.

Senator MILLIKIN. Let us assume that is true. You have already answered the question. You are not in favor of the present military preparation, and I am just putting the reverse on that, you favor abandoning it prior to the time that we have a durable and dependable assurance for peace.

Mr. SCHUTZER. I believe I have answered it, sir. If you want to go through it again——

Senator MILLIKIN. I believe you said we should do it simultaneously, before we have——

Mr. SCHUTZER. I think doing it simultaneously will be the greatest step for giving us the assurance of peace, sir.

Senator MILLIKIN. But you favor cutting out this military program prior to the time you have a durable assurance, is that right?

Mr. SCHUTZER. Well, I simply want to repeat that I do not regard the military program as an entity by itself. It is part of the governmental policies for war.

Senator MILLIKIN. Assume that is all true.

Mr. SCHUTZER. If that is all true, I respectfully suggest we would like to see this governmental bipartisan policy for war abandoned, thrown away, rejected, and a substitute for it be installed, and active policies for peace, and if that policy were adopted today, when I walk out of this room, by the Government, then in my humble opinion the entire military program would have to be revised instead of one for war, it would be one for peace.

Senator MILLIKIN. Without any of the ifs and buts, you are in favor of getting rid of the military program, are you not?

Mr. SCHUTZER. No; I am not; I am in favor of getting rid of the bipartisan war policies out of which the military program flows, and is a part; I am not an expert on military matters.

Senator MILLIKIN. Assuming you get rid of that, do you favor the abandonment of the military program, and seriously to cut it down, and accepting your assumption of cutting the profiteering out, if you wish?

Mr. SCHUTZER. With all due respect, Senator, I repeat again what I have said several times here, that I will not venture an opinion on cutting down or doing anything concerning the military program per se by itself; because I do not believe that program has any merit or validity, standing by itself, without relation to the governmental war policies of which it is the voice, and an essential part.

Therefore, any opinion that I could humbly submit to this committee would have to be directed in the first instance to the general governmental policies, as I have stated in my statement.

We believe if those general policies, sir, are changed from war policies to peace policies, then the military program would perforce have to change similarly to a peace policy, which would mean infinitely reduced expenditures, and all the rest that would come with it; and I urge that this committee do everything in its power to bring about that change in the over-all policies of the Government so that the military policy would perforce have to change.

Senator MILLIKIN. But prior to the time that all of those things are done, and before we have a durable assurance of peace, you favor cutting down or abandoning the military program?

Mr. SCHUTZER. I respectfully submit that I have answered to the fullest degree possible.

Senator MILLIKIN. You have answered to the best of your ability, have you not?

Mr. SCHUTZER. Yes, sir.

(Discussion off the record.)

The CHAIRMAN. All right, sir.

Mr. SCHUTZER. Thank you, sir.

The CHAIRMAN. Mr. Hertwig.

Would you please identify yourself for the record? Of course, I know you as a citizen of Macon, Ga. But you are here representing the American Cotton Manufacturers Institute.

STATEMENT OF CHARLES C. HERTWIG, PRESIDENT, AMERICAN COTTON MANUFACTURERS INSTITUTE, INC., ACCOMPANIED BY CLAUDIUS T. MURCHISON AND JAMES S. RANKIN

Mr. HERTWIG. My name is Charles C. Hertwig and I reside in Macon, Ga. I am president of the Bibb Manufacturing Co. of that city and also serve as president of the American Cotton Manufacturers Institute of Charlotte, N. C., in whose behalf I present my testimony today.

At this point I might say that Dr. Murchison is an economist and Mr. Rankin is an attorney for the American Cotton Manufacturers Institute.

The CHAIRMAN. Very well.

Mr. HERTWIG. Further to identify myself, I would like to say that the American Cotton Manufacturers Institute is the central trade association for the entire cotton manufacturing industry, and serves as its spokesman in matters of national interest. The industry is one of the country's largest, providing employment to more than 500,000 workers, and having a production output valued in the primary market at more than $6 billion per year. It is, therefore, a major factor in the economic well-being of our country and is a dominant factor in the prosperity of the area extending from Maine to Texas.

The cotton manufacturing industry is also a vital factor in the Nation's program for preparedness. In the last war it ranked well up in essential, ranking second only to iron and steel. In serving the demands of the civilian population, and from the standpoint of its impact on the typical family budget, its importance is exceeded only by food and shelter.

It is an industry of small, intensely competitive units, despite its aggregate magnitude. There are over 1,000 manufacturing enterprises which constitute the cotton industry, no one of which represents more than 4 percent of the total. Essentially, they are all small business, but they go to make up a large industry.

Thus, the cotton manufacturing industry has always been distinctive as the most competitive and individualistic of the Nation's major manufacturing industries, and represents, to the maximum degree, the spirit of free business enterprise. The mills constituting the membership of the American Cotton Manufacturers Institute, Inc., are distributed throughout the industry's entire area, and operate about 85 percent of the industry's total spindles.

My statement to this committee is divided into two parts. The first part deals with general considerations such as tax rates and effective dates. The second part deals with discussion of detail provisions and inequities contained in the House bill. I ask permission of this committee to limit my oral statement to the first or general discussion and to insert into the record the second or detailed discussion.

The CHAIRMAN. You may do so, Mr. Hertwig.

Mr. HERTWIG. We are fully conscious of the many tedious hours which this committee has spent listening to the varied and diverse views of many interests relative to the new revenue act. So thinking, we are deeply grateful for this opportunity to make an appearance in behalf of the cotton textile industry. At the same time, it is not our intention at this late date in the hearings to further weary the committee by needless repetition of opinions which have already been many times stated. We realize that we can bring little which is new to the discussion, and our purpose is mainly to strengthen the emphasis which we feel should be given to certain basic considerations.

The first of these is the extraordinary speed with which underlying economic changes have occurred within the past 6 months. We feel that certain executive divisions of the Government have been prone to disregard these, and insist upon pursuing the thinking which appeared to be valid on the basis of circumstances which existed at the beginning of the year. For example, when the President's January budget was submitted, the Treasury predicted a June 30 deficit of $2.7 billion. As we all know, there was on June 30 an actual surplus of $3.5 billion.

We appreciate fully that it is the time-honored custom of the Treasury, and probably for good reasons, to underestimate prospective Government revenues and overestimate prospective expenditures. In this instance, however, the disparity which developed between the two was far greater than could be explained by the usual conservatism. In appraising the remarkable fiscal showing of the past year, it is well to point out that the net receipts of the Government exceeded by $11 billion the receipts of the fiscal year 1950. This great increase was in part due to the changed provisions of the Revenue Act of 1950, but

to a still greater degree, it was due to the tremendous increase in personal and corporate incomes. There is sound reason to believe that the latter tendency will continue during the fiscal year 1952 and that the greater part of the additional revenues, which may justifiably be needed, will be supplied from the increased volume of national income without benefit of further changes in tax rates. In support of this view, we wish to call attention to certain data which have just been purblished by the President's Council of Economic Advisers in their July report on Economic Indicators. According to this report, the total gross national product in 1950 was $280 billion. In the first quarter of 1951, the gross national product was at the annual rate of $314 billion, an indicated increase of 34 billion over 1950, and an increase of 58.4 billion over 1949.

Average weekly earnings in all manufacturing industries in 1950 were $59.33. In March, April, and May of 1951, weekly earnings have averaged above $64.50, an increase of more than $5 per week. Total disposable personal income has also risen sharply. In 1949 it was 187.4 billions. It rose to 202.7 billions in 1950, an increase of 15.3 billions. From 1950 to the first quarter of 1951 disposable personal income zoomed to an annual rate of $214.9 billion, an increase of 12.2 billion. The wage advances and greater employment of the second quarter indicate currently a further rise of total disposable income.

The index of total industrial production, seasonally adjusted, has climbed from the 1950 monthly average of 200 to a level of 223 during the 4 months, March to June inclusive of 1951. Even more striking is the change which has occurred with respect to corporate profits. In 1950 corporate profits before taxes were $41 billion. In the first quarter of 1951 the revised data show that profits are running at an annual rate of $49.5 billion, an increase of 8.5 billion, or more than 20 percent. If we compare on an annual basis, first quarter profits of 1951 with the first quarter profits of 1950, the indicated increase is $20 billion, an expansion of about 70 percent.

If we convert these figures of corporate profits into figures of corporate tax liability, we find that in 1950, according to the Department of Commerce, the total corporate tax liability was $18.2 billion. In the first quarter of 1951 corporate tax liability, on an annual basis and seasonally adjusted, was $25.8 billion, an increase over the 1950 figure of $7.6 billion, and an increase of $15.2 billion over 1949. If the comparison is made between the first quarter of 1951 and the first quarter of 1950, in terms of an annual rate, the difference becomes much greater since the corporate tax liability of the first quarter of last year was only $13.2 billion. Incredible as it may seem, the increase is 95 percent.

Current data which has just become available with respect to industrial production, agricultural production, and employment, indicate that the great production activity of the first quarter is being maintained. With a steadily increasing trend in personal incomes of wage earners, we can make due allowance for some decline in the profit rate, due to increased costs and stable prices, and still conclude that the major portion of additional revenue needs for the coming fiscal year can be derived from the tax rates now in effect.

The report of the Treasury Department for the periods July 1 to July 11, 1950, and same days in 1951, shows the extent to which current tax receipts exceed those of last year.

For that period in this year, the total of income tax withheld and social-security taxes and other income taxes was $721,433,908, compared with the same period of last year at $294,812,819.

This means an increase of almost 145 percent.

Senator KERR. I do not understand that.

Mr. HERTWIG. That is the report of the Treasury Department for those days, compared for the 2 years, Senator.

Senator KERR. Those are the total of the current tax receipts?

Dr. MURCHISON. Those are for the first 11 days of July, compared with the same period for a year ago. They have just been published.

The CHAIRMAN. These are the receipts?

Dr. MURCHISON. Yes, sir.

Senator KERR. These are the receipts from the two sources; is that it?

Mr. HERTWIG. Yes, sir. One is income tax withheld and the other is other income tax. There are two sources. And then, included in the income-tax-withheld figure is the social-security taxes.

Senator KERR. Your second item is "Income taxes, other." Does that mean, other than income taxes withheld and social security?

Mr. HERTWIG. I think that means income tax paid directly as a payment on the tax rather than withheld from the employee.

Senator KERR. Then what you mean is that that total that you had here represents that collected by the Treasury from the income tax withholding fees, and the social-security taxes and from all other income taxes paid into the Treasury, both individual and corporate?

Mr. HERTWIG. Yes, sir.

Senator KERR. All right, sir.

Mr. HERTWIG. The economic developments which we have enumerated have become fully evident only within the past few days, and for that reason have not received the very earnest attention which they deserve. They could not have been so fully evident to the House Committee on Ways and Means when it was giving consideration to the new revenue bill, and they had not yet come to the clear attention of many of the witnesses which have appeared before this committee. We feel that they are so pertinent to the great task of providing adequate revenues at this time that they should be given further study and analysis before final decisions are reached on the Revenue Act of 1951.

We believe there is universal agreement that the tax burdens already borne by the American people and the American economy approximate the maximum which can safely be imposed without impairing maximum production. Certainly any further additions to this burden should be held to the absolute minimum permitted by budget requirements and by the ability of the Nation to pay without suffering needless injury.

Senator KERR. Right there, Mr. Chairman, if I could just have a minute with the witness, I would like to say to him that I agree with the last sentence in the paragraph that—

> any further additions to this burden should be held to the absolute minimum permitted by budget requirements and by the ability of the Nation to pay without suffering needless injury.

I want to agree with that statement wholeheartedly. I would like to ask the witness if he has anything other than just his opinion. And I do not depreciate that. I have quite a respect for that. But I would

like to ask him what other than his opinion he has as a basis for the first statement in the paragraph.

Mr. HERTWIG. Are you asking me in what way we might reduce the budget?

Senator KERR. No. You say there, "We believe there is universal agreement." Now, I would say that if you were present here during the testimony that has already been heard here this morning, you would be compelled to admit that there was evidence that there are at least some exceptions to the "universal agreement" that the tax burdens already borne by the American people and the American economy approximate the maximum which can safely be imposed without impairing maximum production.

I would be glad to have you document that for the record if you can. I am one member of the committee that is greatly interested in ascertaining the relationship of the present rate of taxation to the maintaining of the strength of the economic system, and also if circumstances would indicate that additional revenues be required, to what extent can we go to increasing the rate of taxation and still safeguard the inherent strength, vitality, and capacity to grow of the economy.

You make the statement here that we have reached the maximum which can safely be imposed. And if you can document that statement, I would be very grateful if you would do it.

Mr. HERTWIG. We will be very glad to submit a supplement of that, sir, and attempt to document it for you.

The CHAIRMAN. Very well, Mr. Hertwig.

(See supplemental statement at end of Mr. Hertwig's testimony.)

Mr. HERTWIG. Since the Korean War it has been customary to regard increased taxation as a necessary weapon with which to fight inflation. Until 3 months ago we ourselves accepted this doctrine. We now know that this attitude was the natural result of: (1) the scare buying of the early war period, (2) a general underestimate of the Nation's productive power, and (3) an exaggerated estimate of the Nation's military requirements relative to the adequacy of facilities for supplying them.

What has actually happened is that the Nation's productive power both with respect to agriculture and industry has exceeded all expectations. Defense spending in the fiscal year ending June 30 was $20.34 billion, most of it concentrated in the last 7 months, yet the Nation took this diversion of product without visible strain. The few exceptions to the condition of plenty are confined to strategic war materials; and even in this category the cut-backs in manufacture for civilian consumption have not produced visible scarcity as is evidenced by the ready availability of automobiles, refrigerators, television sets and other appliances.

Clearly American productive power and the unexpected balancing of the budget have stopped the inflationary trend for the time being. Certain Government officials say it will be resumed when Government buying increases, but this is only a repetition of the argument of 6 months ago. Agriculture and industry are now dealing with a capacity and with a rate of production which look forward to increased Government buying not as an inflationary influence, but as a sustaining influence. On the basis of our own experience since April 1, and our observation of other industries since that time, our well considered

belief is that the diversion of from 20 to 25 percent of the Nation's industrial capacity to defense needs will leave the remaining 75 or 80 percent of capacity fully able to take care of civilian requirements without generating any inflationary pressure in consumer markets. This assumes, of course, that money and manpower are not wasted by Government prosecution of nonessential activities at home and abroad.

Senator BUTLER. Mr. Hertwig, do you care to elaborate just a little on that last sentence?

Mr. HERTWIG. Senator, it is a very complex question. I believe in the President's contemplated budget, we contemplated sending abroad some $8 billion, if I remember correctly. I assume that we want to maintain our position abroad in whatever area we desire to maintain it, but the question is how far we can go in this country and hold the whole world up without wrecking our whole economy. I think that is a question to be seriously considered by all people who are familiar with these expenditures. I do not know what that should be. It brings in a great mass of information necessary, for instance, from the State Department and from the Department of Commerce and from all other areas.

Senator BUTLER. Thank you.

Mr. HERTWIG. On the basis of the economic facts which we believe we have objectively analyzed, our conclusion is that an anti-inflation purpose should not be a major factor in the Revenue Act of 1951. With respect to Government fiscal policy, we believe that anti-inflationary objectives are now important only on the side of appropriations.

Taking this approach to the problem, we find that a substantial part, perhaps a major part of the additional needed revenue would be attainable under existing law because of the great upsurge of industrial activity and national income. We also find that the Nation's agricultural and industrial output has met and solved the problem of inflation insofar as it can be solved by private action. We also find that this productive power is adequate to meet prospective defense needs without impairment of civilian requirements.

If these conclusions which are based on the record are valid, as we believe them to be, it would seem as if your committee, Mr. Chairman, is under somewhat less pressure with respect to added sources of revenue than was the case with the corresponding House committee because of economic evidence only recently available. Consequently, this greater leeway provides the opportunity for changed judgment regarding those taxes which bear directly on production and production incentive. These two factors have solved the problem of defense needs and inflation, and will continue to do so, if they are unimpeded.

We believe it to be unnecessary for fiscal purposes to increase corporation taxes and believe that such action, if taken, would be definitely injurious to the country's production effort. We especially object to the proposed increase of the normal tax rate to 30 percent and to the proposed reduction of the excess profits credit to 75 percent of normal earnings.

It is our judgment that the normal and surtax rates should remain unchanged and that the excess profits credit should not be lower than 85 percent. We also believe that the existing ceiling of 62 percent for a corporation's income and excess profits liability should not be raised.

As we have previously pointed out, the maintenance of existing rates does not preclude substantially heavier receipts from corporations during the coming fiscal year. To raise them would throw serious impediments into the production effort when high points of output are reached and might actually curtail both production and revenues.

We are not now engaged in a major war. We are engaged in a program of preparedness. The purpose is to become stronger, to grow greater in productive capacity, to build new activities. These things cannot be accomplished by private enterprise within the framework of a tax program which takes from industry its means of expansion and its incentive to maximum effort.

If despite all the considerations set forth above, higher rates should be imposed on corporate income, it is very important to industry that they not be made retroactive. Retroactive tax increases do great injury to a corporation by forcing arbitrary financial readjustments backward through periods where accounts and settlements have become past history. They cause serious embarrassment and possibly heavy losses where important commitments have been made to creditors and stockholders and where capital goods have been contracted for, or lines of credit arranged, or corporate issues planned, or new wage contracts entered into, or raw materials purchased against seasonal needs.

With respect to tax rates on individual incomes, there is grave doubt of the wisdom of any increases over those contained in the 1950 act. The hardship of the average individual under existing rates is known to all of us, and we have only to look at the sharply progressive rates in the tax table to realize that this hardship cannot be relieved in proportion to extra effort. In many cases the point of no incentive is quickly reached.

Although a majority of men are under the occupational necessity of year-round performance in order to protect the interests of a firm or corporation, there are many others not so restricted. Professional people such as lawyers, doctors, engineers, independent accountants, surveyors, actors, authors, may well take extended vacations or frequent fishing trips, when their earnings within the year have reached the point where the greater part of additional income must be surrendered to the Government.

Senator KERR. Right there, you would not want to limit a man's opportunity to participate in more frequent fishing trips through the conditions which you have laid down there?

Mr. HERTWIG. Not if you like fishing, Senator.

Senator KERR. All right.

Mr. HERTWIG. In like category are many business people such as contractors, builders, certain types of traders and commissionmen, real estate developers and others, to mention only a few, who, without the ties of heavy fixed investment, are free to curtail activities when the rate of tax becomes all out of proportion to further effort.

In the aggregate, the number of people in the country who work or cease to work as they are affected by taxes must be tremendous. Many examples can be found even in the wage earning classes as every employer knows. Steeply progressive income tax rates, therefore, which rapidly mount to the point of no incentive, in the case of individuals as well as corporations, are an active and powerful deterrent to productive effort and as such tend to reduce the total national

product even though they may add temporarily to the revenues of the Government.

It is our contention that the current financial requirements of the Government are not of the emergency character to justify any increase in individual tax rates.

In large part, this proposal to increase was actuated by the theory that the surplus spending power of the public should be taxed away as an anti-inflation device. The idea is fallacious because surplus spending power is the only source of savings which should be diverted into investment rather than confiscated. There is the further practical consideration that at the present time tax increases on the individual are considered as an addition to the cost of living and, in the final analysis, as history shows, they would serve only as a stepladder to compensatory wage increases, and therefore to further inflation. We feel that the individual tax increases for 1951 already provided for in the act of 1950 have reached the limits of safety as regards both the economy and the public welfare.

We are most grateful, Mr. Chairman, for this opportunity to present our views on the basic considerations underlying the revenue bill, and on certain of its specific features.

The CHAIRMAN. Now you wish to put the further statement in the record?

Mr. HERTWIG. Yes, sir. I would like to put the other statement in the record, if I may.

The CHAIRMAN. You may do so.

(The statement referred to is as follows:)

DETAILED DISCUSSION

A. EXCESS-PROFITS CREDIT BASED ON INCOME

In a statement filed before the two committees of Congress in the fall of 1950, Secretary of the Treasury Snyder admitted that the problem of excess-profits taxes was filled with difficulties. It is extremely difficult to define "excess profits," and it is almost impossible to define in the general terms of a statute an acceptable standard of so-called "normal" earnings. Many inequities are already manifest in the Excess Profits Tax Act of 1950.

When Secretary Snyder appeared before the House committee in connection with H. R. 4473, he stated that it was too early to make recommendations until the Excess Profits Tax Act of 1950 had been in operation for a fair length of time. We believe that the Excess Profits Tax Act of 1950 was wrong in allowing a credit of only 85 percent of normal earnings. The effect of the limited credit was to subject 15 percent of such earnings to a 77-percent tax (a 25-percent normal tax, 22-percent surtax and 30 percent excess-profits tax). Thus, if a company in 1951 has only normal earnings, it is subjected first to an increase in the normal tax and surtax and also to an additional 30-percent tax on 15 percent of such normal earnings.

For these reasons, we feel there should be no change in rates, and that the only change in the Excess Profits Tax Act should be to increase, rather than decrease, the credit. Instead of fixing the credit as provided in the House bill at 75 percent, it should be 100 percent. This will more accurately measure normal earnings if we must have an excess-profits tax.

B. INCREASE IN CEILING RATE FROM 62 PERCENT TO 70 PERCENT

The House bill provides for an increase in the over-all ceiling rate of income and excess-profits tax from 62 percent to 70 percent, together with an increase in the normal income-tax rate from 25 percent to 30 percent. The combined effect of these proposals is to widen the income bracket to which the highest tax rates apply. The following example will illustrate this:

Assume a corporation has an excess-profits credit of $100,000. Under existing law, it will pay 47 percent on the first $100,000 (disregarding, for the sake of

simplicity, the $25,000 surtax exemption). Until its income reached $200,000, it will pay 77 percent on all income in excess of its excess-profits credit of $100,000. At the $200,000 level, the 62 percent over-all ceiling will take effect; and it will pay a rate of 62 percent on all income in excess of $200,000. Thus, under the present law, there is a $100,000 bracket to which the highest tax rates apply.

Under the House bill, this same taxpayer would pay 52 percent on its first $100,000, 82 percent on the next $150,000, and 70 percent on all income in excess of $250,000.

It is immediately apparent that the House bill has increased by 50 percent the bracket to which the maximum tax rates apply.

This disparity would be eliminated if the increase in the over-all ceiling rate were limited to the increase in the income-tax rate. To illustrate, if the income-tax rate is to be increased by 3 percent, then the ceiling rate should be 65 percent, not 70 percent.

C. SURTAX EXEMPTIONS AND MINIMUM EXCESS-PROFITS TAX CREDIT OF RELATED CORPORATIONS

Section 123 of H. R. 4473 deals with the surtax exemptions and certain credits of related corporations. The Ways and Means Committee explains the reason for its proposed enactment by contrasting the present law in the following language:

"This treatment confers an unwarranted tax advantage on business carried out by means of a series of corporations, rather than a single corporation, and sets up incentive for the artificial splitting up of corporations. This effect of existing law is difficult to reconcile with the fact that the surtax exemption and the minimum credit were intended to confer tax advantages on small business. Therefore, section 123 of this bill reduces to one the number of surtax exemptions which may be claimed by a group of 'related' corporations and limits the minimum excess-profits tax to a single credit of $25,000 for the entire group."

We believe that this provision in the proposed bill should be eliminated, because many small businesses find it necessary to use several corporate entities, due to differences in State corporation laws. If, however, this claimed loophole must be blocked, then the penalties which exist in the present law, insofar as multiple corporations are concerned, likewise should be removed. In other words, if related corporations are to be treated as a single corporation and accorded a single credit of $25,000, then the tax on intercompany dividends within related corporations and the penalty for filing consolidated returns by related corporations should be removed from the statute. Section 26 (b) (1) should be amended to provide for 100 percent credit on dividends received by corporations that are related within the purview of proposed section 123 of the law, and section 141 should be amended not only to eliminate the 2 percent penalty provision on consolidated returns of "related" corporations but also to permit the filing of consolidated returns by all "related" corporations as that term is defined in section 123 of the proposed law.

The existing situation can be analyzed in the following manner: While related corporations secure a possible tax advantage from the multiple credit, nevertheless, they incur a penalty because of the intercompany dividend tax and a further penalty for filing consolidated returns. These penalties more or less offset the present advantages which are discussed in section 123 of the proposed bill. If the advantages are to be eliminated, certainly the disadvantages likewise should be eliminated.

D. TAX-EXEMPT CORPORATIONS

The House bill, at section 501, provides for exemption for taxable years beginning prior to 1951 of so-called "feeder" organizations, the profits of which inure to the benefit of educational organizations, and which under section 302 of the Revenue Act of 1950 might have been required to pay tax on their income for certain previous years. There is no justification in providing a special exemption to corporations that "feed" educational institutions, and discriminate against the Red Cross, hospitals, or any other exempt organization.

We would recommend that this change should be made to include all exempt organizations under section 101 (6) of the code, in order that the administrative practices of the past 20 years would not be disturbed and uniformity of treatment would be extended to all similarly situated exempt organizations.

E. CAPITAL GAINS OFFSET

In connection with the House proposal to offset long-term against short-term capital gains, it was estimated that the increase in revenue would be about 28 million dollars. It is our opinion that this nominal revenue advantage will be more than offset by the further adverse effect of this provision on the marketing of securities and commodities. It is therefore recommended that this aspect of the House's proposals be eliminated.

F. AMENDMENT OF SECTION 22 (D) (1) OF THE INTERNAL REVENUE CODE—LIFO

The last-in, first-out method of inventory pricing has now been generally accepted throughout the country as sound accounting procedure. However, the provision in the existing law which requires the taxpayer to value its Lifo inventory at cost rather than at cost or market, whichever is lower, may require a taxpayer to reflect totally unrealistic and misleading financial records. Lifo was designed to eliminate from profits and financial statements fictitious increments due to price inflation and (for those who adopted Lifo) has served that purpose over the period of the last decade. It is submitted that it was not the intent of Congress, however, to require taxpayers to continue to use cost in valuing inventories when market value was lower than cost. Attached hereto as exhibit A is a draft of a statutory change which would accomplish the desired results.

We believe that the change in the law will have little or no present effect upon the revenues because market is generally well above Lifo costs. The insertion of this provision in the law, however, will have a beneficial effect in that taxpayers would know that in electing to use Lifo at the present time they would not be required to value inventories at cost when the deflationary period sets in.

Stated another way, it may be said that Lifo and Fifo are two different methods of treating the utilization of specific units of inventory during fiscal periods and that when it comes to the valuation of those inventories at balance-sheet dates it is sound to use cost or market, whichever is lower.

G. CARRY-BACK CARRY-FORWARD PROVISIONS OF NET OPERATING LOSSES

The Revenue Act of 1950 amended section 122 (b) of the Internal Revenue Code by changing the provisions for deductions of net operating losses from a 2-year carry-back/-year carry-forward to a 1-year carry-back/5-year carry-forward basis.

We believe the provisions now in effect do not provide the necessary relief in businesses subject to radical cyclical changes. In these industries a decline may set in rapidly and continue for 3 or 4 years. This potential is especially true today because there is no pent-up demand such as existed following the close of World War II.

Under such circumstances we sincerely doubt that the current tax provisions will be adequate to provide the necessary relief that will be required to keep many cyclical businesses from going bankrupt when deflation occurs. Therefore, we suggest the adoption of a 3-year carry-back/3-year carry-forward provision.

H. TECHNICAL-CHANGE SESSION

The present tax law is the result of numerous changes and amendments over a long period of years rather than an over-all rewriting of the code. The resulting inequities are understandable. Over a period of years Congress has promised hearings, as well as a tax bill designed solely to make technical changes in the law to correct existing inequities.

The need for such procedure is especially emphasized by the Excess Profits Tax Act of 1950. Inequities doubtless exist in that law, many of which will only come to light after the current year's returns have been prepared.

We sincerely believe that the Senate Finance Committee would render a real service by assuring taxpayers in its committee report on the present bill that such hearings and a bill to correct tax inequities will be forthcoming early in 1952.

EXHIBIT A

SUGGESTED REVISION IN INTERNAL REVENUE CODE [1]

SEC. 22 (D) (1)

(1) A taxpayer may use the following method (whether or not such method has been prescribed under subsection (c) in inventorying goods specified in the application required under paragraph (2)):

(A) (1) Inventory them at cost *or (2) at cost or market, whichever is lower.*

(B) Treat those remaining on hand at the close of the taxable year as being: First, those included in the opening inventory of the taxable year (in the order of acquisition) to the extent thereof, and second, those acquired in the taxable year; *and if the taxpayer has adopted the basis of valuation prescribed in subparagraph (A) (2) and the basis so determined is in excess of the most recent cost or market value at the close of the taxable year, such most recent cost or market value, whichever is lower, shall be the basis of valuation of inventory at the close of the taxable year and the opening of the next succeeding taxable year*; and

(C) Treat those included in the opening inventory of the taxable year in which such method is first used as having been acquired at the same time [and determine their cost by the average cost method] *and at the same aggregate value at which such goods are included in the closing inventory of the preceding taxable year.*

SEC. 22 (D) (2)

No change.

SEC. 22 (D) (3)

No change.

SEC. 22 (D) (4)

(4) [In determining income for the taxable year preceding the taxable year for which such method is first used, the closing inventory of such preceding year of the goods specified in such application shall be at cost.]

The CHAIRMAN. We wish to thank you for your appearance here. You strike a hopeful note. Almost everyone who has appeared here has tried to scare us and convince us that it is necessary to raise quite an additional large sum of money at this present time.

You do not, of course, advocate in your statement cutting down our necessary defense program?

Mr. HERTWIG. No; not at all. Whatever we need for defense, we should spend. I do not know what that should be.

The CHAIRMAN. Are there any questions the members wish to ask of Mr. Hertwig or Dr. Murchison or Mr. Rankin?

Mr. RANKIN. Senator George, have you not always found Mr. Hertwig cheerful?

The CHAIRMAN. Yes, sir; but sometimes he does have problems.

Mr. RANKIN. He does not show it.

Senator KERR. Mr. Chairman, I am tremendously interested in the opinion of these gentlemen as to the maximum tax rate the economy can stand, or the maximum tax rate we could impose if we found it necessary in the furtherance of our desire to pay as we go.

Mr. RANKIN. And as tied to maximum production.

The CHAIRMAN. And that would still maintain production at a high level.

Senator KERR. And still have a situation where an adequate incentive for further expansion would be present.

Mr. HERTWIG. We shall be glad to submit a memorandum on that, sir.

[1] Italics indicates revisions in statute; matter in black brackets indicates elimination of present provision in statute.

(The information referred to, subsequently submitted, follows:)

THE AMERICAN COTTON MANUFACTURERS INSTITUTE, INC.,
Charlotte, N. C., July 27, 1951.

Senator W. F. GEORGE,
Chairman, Senate Finance Committee,
Washington, D. C.

DEAR SENATOR GEORGE: In compliance with the request of Senator Kerr, we are transmitting herewith a supplementary statement substantiating further our testimony regarding the effect of the proposed tax program on maximum industrial production.

Sincerely yours,

AMERICAN COTTON MANUFACTURERS INSTITUTE, INC.
CHAS. C. HERTWIG.

SUPPLEMENTAL STATEMENT OF CHARLES C. HERTWIG

Request was made that further substantiation be supplied in support of the following statement, which appears on page 5 of the testimony presented by Mr. Charles C. Hertwig, president of the ACMI, to the Finance Committee of the Senate on July 23:

"We believe there is universal agreement that the tax burdens already borne by the American people and the American economy approximate the maximum which can safely be imposed without impairing maximum production."

This expression of belief specifically refers to the tax burden as it relates to production, the key phrase being the words "without impairing maximum production." It reflects no opinion regarding the tax burden which can be borne in the event of a major emergency when conditions demand immediate maximum diversion of gross product and manpower to the national defense without regard to over-all production expansion and maintenance of civilian consumption.

The statement itself is in a context which contemplates the present defense program as a means of strengthening the Nation's production powers with respect both to civilian and military requirements in order to serve the dual purpose of economic "stabilization"—that is, noninflation—and defense preparedness.

Taking this approach to the dual and long-range objective before us, the most pertinent question applicable to increased tax rates is how will they affect the growth of production. If the other approach is taken—that of maximum diversion of product to the military as an immediate goal, rather than broad industrial growth—the adverse effect of increased taxation on production may be disregarded even though admitted. The advocates of this approach would offset inadequate production by taxing away "surplus spending power" or otherwise forcibly restraining the volume of civilian consumption.

The two approaches, therefore, do not differ as to the fact of an adverse effect on production from the proposed tax increases. They differ only in their evaluation of the fact.

The proponents of the first approach include virtually every representative spokesman of the country's manufacturing, transportation, and extractive industries as well as the spokesman for the various financial and banking institutions.

Specifically they include such organizations as the American Cotton Manufacturers Institute, the National Association of Manufacturers, the National Chamber of Commerce, the Council of State Chambers of Commerce, the New York Chamber of Commerce, the Commerce and Industry Association of New York, the American Mining Congress, the New York Board of Trade, the Association of American Railroads, the American Retail Federation, and the National Retail Dry Goods Association.

The views expressed by these representative associations show that those who are responsibly engaged in the operation of the country's production activities believe that the tax proposals of the administration would impair the Nation's production power. The same may be said of the leaders of the business and industrial press such as the Journal of Commerce, the Wall Street Journal and Newsweek, as well as the majority of the multitude of trade journals too numerous to mention which specialize in particular industries. The same attitude is prevalent in the many business services which analyze economic issues for their clients. We find it likewise in the writings of the leading economic columnists and commentators such as Lewis Haney, Manuel Rukeyser, and David Lawrence.

Prof. Summer L. Slichter of Harvard, one of the Nation's leading economists in the analysis of current problems and issues, has questioned the validity of certain

of the administration's tax proposals both with respect to production and consumption. He states "the principle of an excess-profits tax is so unsound that it is virtually impossible to draft a good excess-profits law." Speaking of the pay-as-you-go policy, he says: "Such a policy would be a blunder, particularly if carried out mainly by higher personal income taxes and an excess-profits tax." Of the corporate income tax, he says: "* * * it reduces outlays on plant, equipment, and inventories. Expenditures on plant and equipment are the very kind that must not be cut very much if the country is to continue to expand its capacity at a good rate."

Colin Clark, internationally known economist of Australia and Australian Under Secretary of State has published the most recent authoritative book on taxation policy in its relation to economic prosperity. His conclusion in his words is: "The safe political and economic limit of taxation is somewhere near 25 percent of the national income." This figure includes all forms of taxes and is based on historical studies of the experience of European countries as well as the United States and Australia. The present aggregate taxes, Federal, State, and local of the United States are one-third of the national income.

Even those who favor the administration objective of large tax increases, including those who are officially a part of the administration, usually do so with grave misgivings as to the effect of the tax program on production. They belong to the second group above referred to which, being given two choices, selects immediate and maximum diversion of product to the military, at the sacrifice of expansion of general production, and with the acceptance of reduced spending power.

The attitude typically held by this group was forthrightly expressed by Mobilization Director Charles E. Wilson before the Senate Finance Committee. When asked how high a tax rate corporations could stand and continue to expand, he replied "Less than 50 percent." He asserted further than corporations could not stand the proposed 70 percent tax ceiling beyond the year 1955. Yet Mr. Wilson demanded the revenue increases proposed by the administration.

Quite similar was the attitude of Secretary Snyder before the committee. He was unwilling to give any support whatever to the proposal to increase the excess-profits tax rate. As in the case of Mr. Wilson, he conceives great urgency in the need for larger revenues, but would minimize that portion of the tax burden which bears directly on the maintenance and expansion of production, and enlarge excises.

Mr. Leon H. Keyserling, Chairman, President's Council of Economic Advisers, is wholly aware of the danger of production impairment. Before the Conference Board Economic Forum he stated "We advocate only a balancing of the budget, partly for practical reasons as to what is attainable and partly because Government outlays are so high that we have to balance the stabilization argument against the production and incentives argument." Also, "We would like to see a lot taken out of the consumer durables supply and restraints placed upon consumption." And also "I would generally agree with the common statement that in normal peacetime when Government outlays and, presumably, taxes get above 25 percent there is an excessive strain upon the economy."

In the mid-year report of the Council of Economic Advisers we find this remarkable statement: "The proposed increases in corporate taxes will contribute to stabilization through a reduction in dividend payments and by curtailing the supply of funds available for corporate spending or investment." Since "corporate spending or investment" is the sine qua non of production the conclusion is obvious.

Regarding the effect of tax increases on individual income: "While on the average, income after personal taxes will probably rise under the impact of the defense program, even with the proposed individual income tax increases, many families with relatively fixed incomes will have no alternative but to adjust to a lower level. Even when disposable income rises, this does not necessarily mean an improvement in the individual's real income position and in his standard of living. In measuring real income, price rises must be taken into account."

In its conclusion the Council declares that "pyschological factors" will cause the taxpayers to "work longer and harder" and thereby offset the lack of tangible incentive to greater production effort.

Resort to this kind of argument is the equivalent of a mopping of the brow and reveals by indirection that the Council knows better.

The Committee for Economic Development is illustrative of the type of organization which supports the policy of higher taxation, while at the same time being fearful of the possible effect on production. The research and policy committee of this organization in its booklet, An Emergency Tax Program for 1951, says: "The

taxation of corporate profits is already very close to the maximum limits that would be safe even in a temporary emergency and far beyond the limits that would be tolerable for any protracted period." They proceed more specifically to protest against "the losses of efficiency that result from having a large part of the Nation's business done by corporations that can retain, after taxes, only 23 cents out of any dollar they may earn by being more efficient."

In testimony before the Senate Finance Committee, J. Cameron Thompson of the committee, although supporting additional revenue demands up to the amount of the House bill, would change the application of rates and broaden the tax base. Regarding the individual income tax, he stated "The House bill has gone dangerously beyond the point at which excessive tax rates undermine the forces that make the economy strong and dynamic." At the same time he advocated no increase in corporate taxes.

The research and policy committee of the CED is so distinguished that it would be appropriate to include here its membership.

Meyer Kestnbaum, chairman, Hart Schaffner & Marx.
Beardsley Ruml, vice chairman.
John D. Biggers, Libbey-Owens-Ford Glass Co.
James F. Brownlee, J. H. Whitney & Co.
S. Bayard Colgate, Colgate-Palmolive-Peet Co.
S. Sloan Colt, Bankers Trust Co.
Gardner Cowles, Des Moines Register & Tribune and Cowles Magazines, Inc.
Jay E. Crane, Standard Oil Co.
Harlow H. Curtice, General Motors Corp.
D. W. Figgis, American Can Co.
Marion B. Folsom, Eastman Kodak Co.
Clarence Francis, General Foods Corp
Philip L. Graham, The Washington Post.
John M. Hancock, Lehman Bros.
George L. Harrison, New York Life Insurance Co.
Robert Heller, Robert Heller and Associates, Inc.
Jay C. Hormel, Geo. A. Hormel & Co.
Amory Houghton, Corning Glass Works.
Thomas Roy Jones, Daystrom, Inc.
Ernest Kanzler, Universal C. I. T. Credit Corp.
Roy E. Larsen, Time, Inc.
Fred Lazarus, Jr., Federated Department Stores, Inc.
Fowler McCormick, International Harvester Co.
W. A. Patterson, United Air Lines.
Philip D. Reed, General Electric Co.
Nelson A. Rockefeller.
Harry Scherman, Book-of-the-Month Club, Inc.
S. Abbot Smith, Thomas Strahan Co.
H. Christian Sonne, Amsinck, Sonne & Co.
Wayne C. Taylor.
J. Cameron Thomson, Northwest Bancorporation.
W. Walter Williams, Continental, Inc.
Theodore O. Yntema, Ford Motor Co.
J. D. Zellerbach, Crown-Zellerbach Corp.

Among representative professional economists, there is probably no more representative group than the one which participated in the June meeting of the Conference Board Economic Forum. Those who engaged in the discussions were Solomon Fabricant of the National Bureau of Economic Research and—

Jules Backman
Grover W. Ensley
Martin R. Gainsbrugh
Edwin B. George
A. D. H. Kaplan
Leon H. Keyserling
Theodore J. Kreps
Roswell Magill
Malcolm P. McNair
Clyde L. Rogers
Merryle S. Rukeyser
O. Glenn Saxon
George J. Stigler
Rufus S. Tucker

The purpose of this meeting was to discuss with Mr. Keyserling and Mr. Kreps the objectives and issues of the controls program including the administration tax proposals. The discussion related primarily to the content of the annual report of the Council of Economic Advisers. It would not be possible here to relate the expressed views of each individual. The consensus favored generally the objectives of the administration. There was sharp divergence of view how-

ever regarding the incidence of controls and taxation as formulated by the administration. But, without exception, the danger of impairment of production was recognized either through the impairment of work and production incentives or through the diminution of capital investment. In those instances where such an outcome was anticipated, there was natural acquiescence in the necessity of reduction in consumer spending either through taxation or forced savings. The majority of the group emphasized the importance of safeguarding those factors incident to expanding production. In those instances where this view was not so strongly held, the tacit recognition of a lagging production necessarily suggested emphasis on the varied devices leading to consumption restraint.

The pattern here indicated is seemingly typical throughout the entire range of those who are in active support of a strong defense program.

No one could be more stanch in his support of a strong defense program than Mr. Roswell Magill, chairman of the Committee on Federal Tax Policy and former Under Secretary of the Treasury. Yet recognizing the importance of maintaining maximum production, he is unqualifiedly opposed to increased corporate income or excess-profits taxes. He considers that the House bill would promote inflation, discourage new investments and retard production. He advocates a greater use of excise taxes as a source of additional revenue.

Especially noteworthy in the tax controversy is the position taken by the retail trade as expressed through the American Retail Federation and the National Retail Dry Goods Association. Although the members of these two associations are not engaged directly in production, they recognize the importance of its maintenance and conclude that the most desirable source of new revenue is a retail sales tax.

Our conclusion is that throughout the area of informed and representative tax opinion, there is universal recognition of the danger of the administration tax program with respect to the maintenance and expansion of production. Divergence of views develops only on the point whether the goal should be maximum production or a concentration and diversion of product into immediate military requirements with consumption reduction as a necessary consequence.

The CHAIRMAN. I think, Mr. Hertwig, you would agree, and the other gentlemen would, that the cotton textile manufacturing business is a peculiarly sensitive industry, is it not?

Mr. HERTWIG. Very sensitive, sir.

The CHAIRMAN. So when you take this rather optimistic viewpoint, it becomes more impressive to me.

Are there further questions?

Senator KERR. No further questions.

The CHAIRMAN. Thank you very much.

Mr. Scoll.

Mr. SCOLL. Mr. Chairman, I am David E. Scoll, of American Research & Development Corp. The statement for American Research & Development Corp. will be made by Mr. Merrill Griswold, who is chairman of the executive committee of American Research & Development Corp. I am their attorney, so that I shall be happy to answer any special technical questions.

Senator KERR. As counsel, you are advised of the provisions of the law with reference to any statement he might make, and so forth?

Mr. SCOLL. Yes, sir.

Senator KERR. That is fine.

The CHAIRMAN. We are glad to have you, Mr. Griswold.

Senator KERR. You are not here to pass on the quality or accuracy of the statement, but upon the position of the witness as he makes it?

Mr. SCOLL. That is right, Senator.

Senator KERR. You will help him evade it if the answer is not available?

Mr. SCOLL. That is right, sir.

Senator KERR. Very well.

The CHAIRMAN. Please identify yourself, Mr. Griswold.

STATEMENT OF MERRILL GRISWOLD, CHAIRMAN OF THE EXECUTIVE COMMITTEE, AMERICAN RESEARCH & DEVELOPMENT CORP., ACCOMPANIED BY DAVID E. SCOLL, COUNSEL

Mr. GRISWOLD. My name is Merrill Griswold. I am the chairman of the executive committee of American Research & Development Corp. I appeared before this committee just about a year ago, to suggest an amendment to the Internal Revenue Code which would encourage the formation and growth of venture capital investment pools, of which American Research & Development Corp. is an example.

The proposal which I then made, namely, an amendment to section 361 of the Internal Revenue Code, to permit venture capital companies which are organized as management investment companies to be taxed under the provisions of supplement Q, although more than 50 percent of their assets are invested in companies in which they hold more than 10 percent of the voting securities, has not been adopted by the House of Representatives and incorporated in H. R. 4473 which is before you for your consideration. This amendment is embodied in section 312 of the House bill beginning on page 100 of the committee print. It is discussed in section X of part V, Structural Changes in the Income Taxes, at page 34 of the report of the Committee on Ways and Means of the House of Representatives to accompany H. R. 4473. We urge this committee to approve the amendment with certain minor changes which I will refer to later.

The function of venture capital corporations such as American Research & Development Corp. is, as the name suggests, to invest in new enterprises. This distinguishes such a company from the ordinary investment company which invests in seasoned securities. The investing activities of American Research & Development Corp. are primarily carried on in technological fields. In the 5 years of our existence we have helped to finance new businesses in applied physics, including nuclear energy, chemical techniques, power-combustion systems, including rocket engines, and specialized engineering equipment. Most of our companies are new ventures in applied science and engineering, and they provide new products and processes which help in the expansion of American industry into new fields. The combined annual sales of our affiliated companies are currently at a level in excess of $40,000,000. The affiliates already give employment to more than 3,000 persons.

The number of our affiliates is now between 25 and 30. All these new companies are new taxpayers that probably never would have existed if we had not helped finance them in the first instance.

It might interest you to know that Senator Ralph Flanders, United States Senator from Vermont, was prominent among those who were responsible for the creation of American Research & Development Corp.

The CHAIRMAN. Senator Flanders is now a member of this committee. He is not here today. So you might assume that you will have a staunch advocate for this provision in the House bill.

Mr. GRISWOLD. I wish he were here.

Senator MILLIKIN. He wrote, Mr. Chairman, expressing his great regret that he would not be here, and told us of the coming of these gentlemen and of his great interest in their testimony.

The CHAIRMAN. I am glad you mentioned that, Senator.

Mr. GRISWOLD. When the need for developing new sources of venture capital to finance worth-while ideas was discussed among business and financial people in Boston, shortly after the war, he epitomized the theory behind venture capital corporations in words better than anything I could say:

During the last year of my incumbency as president of the Federal Reserve Bank of Boston, I became seriously concerned with the increasing degree to which the liquid wealth of the Nation is tending to concentrate in fiduciary hands. This in itself is a natural process, but it does make it more and more difficult as times goes on to finance new undertakings.

The post-war prosperity of America depends in a large measure on finding financial support for that comparatively small percentage of new ideas and developments which give promise of expanded production and employment, and an increased standard of living for the American people. We cannot float along indefinitely on the enterprise and vision of preceding generations.

To be confident that we are in an expanding, instead of a static or frozen economy, we must have a reasonably high birthrate of new undertakings.

There are in particular two large-scale repositories of wealth which have a stake in the Nation's future and which should be concerned with a healthy basis for the prosperity of these postwar years. These two groups are the life insurance companies and the investment trusts.

A project on which we have been making excellent progress in the last few months is for a development corporation financed in a large measure by these two groups of institutions, under the directorship and management of the most capable men available in the fields of business and technology.

American Research and Development Corp. is patterned somewhat after the mutual investment companies with which this committee is familiar. As this committee also knows, mutual investment companies enjoyed an enormous growth after 1936. In that year the Internal Revenue Code was amended to tax such companies and their shareholders on the "conduit" theory. The "conduit" theory of taxing mutual investment companies operates just as the word "conduit" suggests. The tax on the net income of the investment company is paid by its shareholders if all of the net income of the investment company is distributed to them. The taxable income thus passes through the investment company to the shareholder. The shareholder pays the entire income tax on any ordinary income he receives from the investment company, and also a capital gains tax on any capital gains which are passed on to him.

Under the "conduit" theory of taxing investment companies pursuant to the provisions of sections 361 and 362 of the Internal Revenue Code, the Government thus collects the same tax as it would collect if all of the shareholders had invested directly in the underlying securities.

The reason for the amendment approved by the House is this:

A management investment company, in order to qualify as a regulated investment company under section 361, cannot have more than 50 percent in value of its total assets invested in securities of companies in which it owns more than 10 percent of the outstanding voting securities. A venture capital company when it invests in a new enterprise almost inevitably acquires more than 10 percent of the voting securities of such enterprise, even though it frequently happens that the bulk of the money so invested is represented by nonvoting securities. In other words, a usual pattern is to invest most of the money in senior securities, that is, notes or preferred stock, receiving for a small consideration varying proportions of the common stock,

usually more than 10 percent. As a practical matter, therefore, it is impossible for a venture capital company to qualify as a regulated investment company under section 361 as it now stands, but it would be possible if it were relieved from the present strict requirements as to 10 percent ownership. Thus this 10 percent limitation is a severe handicap on venture capital companies, and is perhaps the greatest obstacle in inducing investors to participate in pooling such funds as they have available for these purposes.

If it is made possible for a venture capital company to qualify as a regulated investment company, then the investor is placed in the same position, both with respect to dividends and to capital gains, as if he invested his money directly in the securities of the new enterprise. By pooling his funds with those of others he obtains continuous supervision of the enterprises, as well as diversification of risk and careful selection. Yet these advantages may well lose their appeal so long as the venture capital company is taxed as an ordinary corporation, with the result that the dividends which it receives and the gains which it realizes are first taxed to the corporation and then, if distributed, taxed to him as ordinary income.

The amendment of section 361 as passed by the House is intended to remove the handicap above described by enabling a venture capital company to qualify as a regulated investment company. There are, however, two or three points in which we feel that the language of the amendment should be clarified, and at one point amplified to make sure that it will accomplish its purpose. These points are rather technical, and, to avoid any misunderstanding, I have set them out and explained them in a memorandum which I should be glad to read, but which in the interests of brevity I suggest might be embodied in the record without now reading it. Very briefly the points which it covers are three:

(1) To make it clear, as it is undoubtedly intended, that the diversified 50 percent of assets may include all of the securities of an issuer held by the investment company, and not merely the voting securities, although the voting securities held by the investment company consists of more than 10 percent of the voting securities of the issuer, but subject of course to compliance with all the other conditions.

(2) To make it clear that disqualification of the investment in the securities of a particular issuer occurs only when ownership of 10 percent or more of the voting securities has continued for more than 10 years.

(3) To clarify the concept that the investment company is principally engaged in the furnishing of capital to certain types of other companies by specifying that an investment company shall be deemed to be furnishing capital to another company if it has furnished such capital within 10 years and still holds securities so acquired. This change is very desirable in order to avoid difficulties of interpretation as to just what is meant by being engaged in furnishing capital.

In closing, I would like to say again that if Congress approves this amendment, it will encourage the formation of more venture capital corporations like American Research and Development Corporation, and provide new and worth-while enterprises with access to the great pools of capital which are now in the hands of large fiduciary institutions like the insurance companies, the mutual investment companies, and the foundations.

As stated in the report of the Ways and Means Committee on the amendment—

> The venture capital company promises to serve as an instrument for directing an increasing portion of the current savings of the country into the small innovating ventures which are so important for long-run economic progress.

Thank you.

The CHAIRMAN. Do you wish to put into the record your technical amendments?

Mr. GRISWOLD. Shall I read them?

The CHAIRMAN. No. You may put them into the record. You suggested that you have touched on the high points in them, unless you wish to read them.

Mr. GRISWOLD. No. These are very technical and difficult to explain. I shall file this. With whom shall I file it?

The CHAIRMAN. With the reporter. He will put them into the record following the statement.

(The memorandum of proposed technical changes is as follows:)

MEMORANDUM OF PROPOSED TECHNICAL CHANGES IN H. R. 4473

(Submitted by Merrill Griswold, American Research and Development Corp.)

There are one or two points where the amendment could and should be clarified to make certain that the basic intention will not be frustrated by ambiguities, a possibility which always exists in the administration of the technical provisions of supplement Q, unless the language is stated as clearly as it is possible to state it. Specifically, I refer to the clause contained in lines 5, 6, and 7 on page 101 of the committee print, which reads as follows:

"* * * include with respect to any issuer securities which constitute more than 10 percentum of the outstanding voting securities of such issuer * * *".

The effect of this language may be to include in the diversified 50 percent of the investment company's assets only that portion of the investment in the new company which consists of voting securities. As pointed out in the hearings and in the conferences on the amendment, the greater part of the investment in new ventures consists of notes or other nonvoting securities, and only a small part of the investment is made in voting securities.

While no ruling appears to have been issued on the point, it appears to have been understood by the Securities Exchange Commission, by the investment companies themselves, and also by the Treasury, that if an investment company holds more than 10 percent of the voting securities of an issuer, its entire investment in the securities of that issuer (including nonvoting, as well as voting securities) is excluded from the diversified segment which, under section 361 (b), must amount to at least 50 percent of the assets. This interpretation is borne out by the forms for registration and annual reports prescribed by the Securities Exchange Commission under the Investment Company Act of 1940. It is also implied in examples given under Treasury Regulation 111 (b), entitled "Limitations Requiring Diversification of Investments" under section 361 (b) (3) of the Internal Revenue Code, particularly examples 1 and 2. Under Treasury Regulation 111 (b), if we take examples 1 and 2 as illustrative of the meaning of the regulation, none of the securities of an issuer held by an investment company may be used to meet the 50 percent test if the investment company owns more than 10 percent of the voting securities of that issuer. In other words, the regulation takes an all or nothing approach to the 50-percent diversification requirement.

Since the purpose of the amendment is to include within the 50-percent diversified segment of the investment company's assets the entire investment in a particular company, which would now be excluded under section 361 (b) if the investment company holds more than 10 percent of the voting securities, the language of the amendment in H. R. 4473, cited above, should be stated with sufficient clarity to avoid any interpretation which would place in the 50-percent diversified segment only that portion of the investment which consists of voting securities. We therefore suggest as a desirable substitute for the clause quoted above, the following:

"* * * include any securities of an issuer although the investment company holds more than 10 percent of the outstanding voting securities of such issuer * * *."

A second ambiguity occurs in the references to the securities which may be held 10 or more years. In lines 8 and 9, and again in 20 and 21, on page 101 of the committee print, the words "any security" are used in the 10-year holding-period limitation. This has the effect of denying the application of the provision to an investment company if it holds nonvoting securities during the 10-year period, even though such an investment in nonvoting securities would otherwise be within the diversification requirements of section 361 (b). We suggest, therefore, that the words "any security" in lines 8 and 9, and again in lines 20 and 21, should be changed to read "more than 10 percent of the outstanding voting securities."

There is a further point as to the necessity for including a provision in the amendment to make it clear that the concept of furnishing capital to qualified issuing companies would be satisfied if the investment company makes only one security acquisition during the 10-year period. We suggest that the text of the bill include the following provision to cover this point:

"For the purposes of the Certification required hereunder an investment company shall be deemed at any date to be furnishing capital to any company whose securities it holds if within ten years prior to that date it has acquired from such other company or predecessor thereof any securities issued by such other company or predecessor."

We suggest that it might be desirable for purposes of clarification if this clause were reinserted after the period following the word "engaged" in line 9 of page 102 of the committee print.

The CHAIRMAN. Are there questions?

Senator KERR. No questions.

The CHAIRMAN. Senator Millikin?

Senator MILLIKIN. No. Thank you.

The CHAIRMAN. Senator Butler?

Senator BUTLER. No questions.

The CHAIRMAN. Thank you very much for your appearance.

Mr. GRISWOLD. Thank you, sir.

The CHAIRMAN. Mr. Kaiser.

Will you identify yourself for the record?

STATEMENT OF ARTHUR R. KAISER, SEARS, ROEBUCK & CO.

Mr. KAISER. My name is Arthur R. Kaiser. I am general manager of the tax department of Sears, Roebuck & Co. Sears, Roebuck & Co. employs about 200,000 people. It has about 100,000 stockholders.

Part of my duties in that connection are to look after the tax problems, not alone of Sears, Roebuck & Co., but also of the profit sharing and pension fund of Sears, Roebuck & Co., and it is the latter to which I wish to address myself this morning.

We feel that there is a considerable inequity in the taxation of withdrawals from profit-sharing funds. I might preface my remarks, Senator, by saying that before you are two memorandums. One is a summary of five pages; the other is a much fuller statement. I propose, with your permission, to read the summary and make some comments and some reference to the schedules in the other memorandum, in the interests of time. The other statement is very much fuller.

The CHAIRMAN. You may do so, and you may put your other statement in the record in its entirety if you wish to do so.

Mr. KAISER. I wish to do so.

The CHAIRMAN. Yes, sir.

Mr. KAISER. The profit sharing and pension fund of Sears, Roebuck & Co., is in general principle very similar to that of hundreds of others in the country. Our fund has been approved by the Internal Revenue Department and is, therefore, an exempt fund under section 165 of the Internal Revenue Code. The exempt part, as you probably understand, means that the income on the fund is not taxable in the fund, but it is taxable at the time of withdrawal.

The CHAIRMAN. Yes, sir.

Mr. KAISER. The Sears' fund is directed toward providing a source of income for the support of its employees, upon their retirement at the age of 60 to 65.

Each employee after being with the company 1 year is eligible to join the fund, and invests 5 percent of his or her salary up to a maximum of $250 per employee a year. I might say that is for the purpose of preventing the higher-salaried people from getting the lion's share of the benefits of the fund. In other words, a $5,000-a-year employee can get as much out of the fund as a $50,000-a-year employee, years of service being equal.

The company contributes from 5 to 9 percent of its profits on a sliding scale, the greater the profits the greater the percentage of contribution to the fund.

The amounts thus deposited by the employee and the employer go into an undivided trust. Up until a few years ago, all of the funds were used for the purchase of the capital stock of Sears, Roebuck & Co. In recent years, however, because of the tightness of the market in Sears' stock, the trustees of the fund have been compelled to secure other sources of investment.

The allocation of the company's contributions are in the ratio of the employees' investments in the fund, after weighting according to the years of service. The next sentence explains that. The employees who have been with the company over 5 years and less than 10 years have twice the weighting of those who have been with the company under 5 years. The employees who have been with the company from 10 to 15 years have three times the weighting of the earliest group. Those who have been with the company more than 15 years and are over 50 years of age, have four times the weighting of the earliest group. You will note that this all points to providing retirement for those who have long years of service with the company.

When an employee retires, he may, at the option of the trustees, receive his interest in the fund in cash.

Senator KERR. You mean, now, without his agreeing to it, the trustees of the fund may take him out of his interest in the fund by paying him off in cash?

Mr. KAISER. That cannot be done as long as he is an employee of the company.

Senator KERR. I mean, upon his retirement or upon his ceasing to be an employee.

Mr. KAISER. Upon his retirement, that is right, sir. That is done because the trustees sometimes feel that employees, as we have evidence of in the past, have not known what to do with their funds, and consequently the six trustees have the right to decide how the retiring employee shall get his interest in the fund, whether it is in cash or annuities or in stock, or some combination.

Senator KERR. I am curious to know if maybe that does not create a hardship or a hazard on an employee, who might feel that his interest would be better served by leaving his investment in the fund and taking out the benefit in the form of income rather than taking it all out by receiving his capital back and having no further interest in the fund.

Mr. KAISER. Senator, that is a practical matter, and if the trustees of the fund have confidence in the employee, his requests are almost always heeded as to how he wants to receive his investment in the fund.

Senator KERR. Maybe I misunderstood this——

Mr. KAISER. Let me interrupt you first, if I may, Senator, and say that when he ceases to be an employee of the company, he must retire from the fund. That is one of the provisions in the fund. He cannot remain in the fund as a participating member after he ceases to be an employee of the company. But there is another provision that I have not mentioned, because of brevity. He can, however, leave his funds with the company and draw them out year by year. That is another provision that I have not mentioned.

Senator KERR. Plus the increment?

Mr. KAISER. That is right.

Senator KERR. You mean, at his option, he may?

Mr. KAISER. Practically, at his option, legally the trustees——

Senator KERR. In other words, the first provision here that "when an employee retires, he may at the option of the trustees receive his interest in the fund," includes the situation that he may receive this money in cash if he applies for it and if they approve it?

Mr. KAISER. If they feel that he is competent to look after it.

Senator KERR. And does that not mean that he must take it out in cash if they want him to?

Mr. KAISER. The trustees would lean very definitely toward some other form.

Senator KERR. I beg your pardon. Go ahead. I did not get that.

Mr. KAISER. Or the fund may be converted into an annuity. That is, he will draw it out over the years of his life. Or he may receive his interest in the stock of the company.

Senator KERR. Would that be on the basis that he may use the money to purchase the stock?

Mr. KAISER. The major portion of the assets of the fund are in the capital stock of Sears, Roebuck & Co. They now own about 23 percent of the capital stock of Sears, Roebuck & Co.

Senator KERR. And when he gets his part of it out, does he get the benefit of the increase in value that has taken place from the time that his money went into the fund to buy stock?

Mr. KAISER. Indeed he does.

Senator KERR. All right.

Mr. KAISER. And then it may be taken out in any combination of these various ways.

The Internal Revenue Code provides that on retirement a tax must be paid at the capital-gains rate on the difference between the employee's investment and the value that he receives. I might say that the capital-gains feature is very essential, because this money has been invested since 1916, and, of course, you know the rates have been small in earlier years; salaries of the employees have been small in earlier

years. So there is a bunching of income at the time he retires from the fund, which would, of course, tax him very heavily.

I might say that if you will refer to the big schedule at the back of the other memorandum, I would like to refer to one case, there, Joseph Heitlinger, as an example. Joseph Heitlinger has been with the fund ever since the fund was formed in 1916. He was a very small salaried man. He was nothing more than a clerical worker, and his salary at the time of retirement was only $2,639. He put into this fund $2,742. When he retired from the fund, he had a profit, in the second column in that schedule, of $80,000. Now, if he had been taxed at the regular rates, the tax would have taken more than 50 percent of his interest in the fund, and that is why it is very essential that the capital-gains provision for taxing retirement from these funds be in the law.

I will go on now with my statement.

If he takes his interest in cash, there is no problem involved because he has realized his profit in cash. And, of course, he is taxed accordingly. There is no problem at all.

If he has his interest converted into an annuity, there is no tax at the time of conversion, even though the stock is sold to pay for the annuity. And he pays the tax on the annuity as he receives it annually. In this case there is no problem.

The inequity arises when he withdraws his interest in stock. Then he must pay a tax on his interest determined by deducting his investment from the market value of the stock. This creates a great inequity if he withdraws when the market price is high, because he is paying a tax on a greatly appreciated value of the stock before it is sold. The stock then may go down to much lower levels. In our case the price of the stock was $58 a share in January, but in June it went down to $51.50. It may go much lower. Who knows?

Senator KERR. Is that just an estimate with reference to this statement, or is that a tip?

Mr. KAISER. I would not venture a guess, Senator.

Now, at this particular point, I would like you to refer, if you will, to schedule 1 at the back of the big statement. We have set up there for a few of the past years the status of the fund at the end of each year.

For instance, dropping down to recent years, let us take the year 1948. December 31, 1948, the market value of the stock in the fund was $176 million.

Do you see where I am reading from, Senator?

Senator KERR. I do.

Mr. KAISER. The cost of that stock in the fund was $118 million. Therefore, there was about $58 million appreciation in the fund.

Now, go 2 years later, which was the end of last year, December 31, 1950. The market value of the stock was $284 million. The cost was $166 million, and the appreciation is $118 million. So you see that in the 2 years, the appreciation in the stock has gone from $58 million to $118 million. And that is the problem involved with regard to the taxing of stock on the market value.

We contend that when the employee withdraws his interest in stock he should not pay a tax on the appreciation in the stock until such time as he sells it—just as you would not pay a tax on stock which you

bought at $20 a share, and which advanced to $58, unless you sold the stock. The profit should first be realized before it is taxed.

When there was great appreciation in the stock market in 1928 Congress changed the law to provide that the only amounts on which tax should be paid at the time of withdrawal—unless the stock is sold—would be the company contributions plus the earnings, in the form of dividends and interest, by the fund. The appreciation in value was not taxed at the time of withdrawal, not until the appreciation was realized.

The above provision was changed in 1932, because in the depths of the depression the market value of the stock which had been purchased with the employee's own investment and the company contributions and the earnings, was oftentimes less than the amount of the company contributions plus the earnings of the fund. I understand it was at the suggestion of Senator Reed, of Pennsylvania, that it was changed to eliminate that inequity.

The inequities could have easily been remedied by providing that he would pay a tax on the lesser of the two amounts, namely, on the difference between his investment and the company contributions plus the earnings of the fund, on the one hand, and the difference between his investment and the market value of the stock, on the other hand. That is, one or the other, whichever is the lesser. If that had been done in 1932, we would not be here today asking for the revision.

Senator KERR. That is, if the revision you want were already in the law, you would not be asking that it be put in.

Mr. KAISER. That is right.

Senator KERR. I think that is a logical conclusion.

Mr. KAISER. What we are now requesting is an equitable change in the law.

If all the members who retired in January had withdrawn from the fund last July when the stock was $40 a share, they would have paid about one-third less in tax than they did pay when they withdrew in January; that is, those who took stock. This makes their tax dependent upon the caprice of the stock market, when they have not sold the stock. This seems very unfair.

Senator MILLIKIN. Is it not also dependent upon the caprice of the trustees? The stockholder cannot control the action of the trustees. They could buy or sell the stock any time they wanted to, could they not?

Mr. KAISER. Yes; they have that power, Senator Millikin. But the trustees will not set themselves up as an authority to know when to sell the stock and hold it for an employee.

Senator MILLIKIN. No. But they do, for the benefit of the trust.

Mr. KAISER. They buy stock.

Senator MILLIKIN. Yes; and they sell it.

Mr. KAISER. They do not sell it until the employee retires. And then if he wants the cash or some of it in cash, it is given to him that way, ordinarily.

Senator MILLIKIN. They never sell the stock?

Mr. KAISER. The trustees do not trade in the stock, except to buy the stock for the fund and hold it for the earnings from the securities, the dividends or interest.

Senator MILLIKIN. They never sell the stock?

Mr. KAISER. They have never sold the stock so far as the corpus of the profit-sharing fund is concerned.

Senator MILLIKIN. That is what I am talking about.

Mr. KAISER. They do not trade in it.

Senator MILLIKIN. As far as the portfolio of the trust is concerned, they do not sell the stock?

Mr. KAISER. They buy, but they do not sell.

Senator MILLIKIN. They buy, but they do not sell?

Mr. KAISER. That is right, sir.

Senator MILLIKIN. Do they have the power to sell?

Mr. KAISER. They have the power.

Senator MILLIKIN. I think there is an equity in your argument that ought not to be overlooked, to wit, if this gentleman who retires owned a share of stock in his private capacity during the time that he was working for the company, he could have bought or sold any time he wanted to, and thus by not selling he could have averted the tax consequences of a large appreciation in the value of the stock. But as it is, he has no control over that. When he retires, he must take the stock at its appreciated value which is the basis of the tax.

Mr. KAISER. I might say this, Senator, that if the stock——

Senator MILLIKIN. Or at its depreciated value, depending upon the state of the market.

Mr. KAISER. Of course, the trustees have the power, but as I said before, they ordinarily accept the retiring employee's suggestion of how he wants it if they have confidence in his ability to look after his estate.

Senator MILLIKIN. But they do not have to?

Mr. KAISER. They do not have to.

Senator KERR. And as a practice, they do not?

Mr. KAISER. As a practice, they do not. That is there in order to protect those——

Senator KERR. The only stock that they get rid of is what they give to the employees as they retire?

Mr. KAISER. That is right, sir. Now, they do have, however—and this has been encouraged sometimes if the stock market has gone to a very high figure, and nobody knows whether it is at a very high figure now or not, or was in January—in some individual cases, the employee has gone to the trustees and said, "I would like for you to sell that stock of mine and keep it in liquid funds, or in Government bonds, until my retirement."

Now, that is a privilege within the trust if they are 55 years of age.

Senator MILLIKIN. I was merely trying to suggest to you that an individual taxpayer who owns and holds his own securities has a daily choice of what he wants to do with them.

Mr. KAISER. That is right.

Senator MILLIKIN. And he must take the benefits and the hazards of not making the right choice.

Mr. KAISER. That is right, sir.

Senator MILLIKIN. Whereas in your case, he does not have that control of the securities that come to him on his retirement.

Mr. KAISER. That is right.

Senator MILLIKIN. He must accept someone else's decision.

Mr. KAISER. That is right, sir.

Senator MILLIKIN. And I suggest that that adds to the equity of your argument.

Mr. KAISER. I appreciate that.

Refer to the schedule No. 2 in the large memorandum. I have only listed there for your information 7 employees out of about 12,000 who retired during the year 1950. These are typical, because they show big profits and small profits. I have already mentioned Heitlinger. He was a small-salaried man. None of these people had received a salary of as high as $5,000, not one of them.

In the column shown there, profit on withdrawal, shows what his profit is, the way the law is now written. The next column shows the amount of money contributed. The next column shows the earnings in the fund which have been credited to his account during his membership in the fund.

The next column shows the appreciation in the stock at the time of his withdrawal, which he had to pay a tax on the way it stands, the way the law now stands.

Senator KERR. He had to pay a Federal tax at the time he withdrew it?

Mr. KAISER. That is right, sir. And then the next column shows the percentage of his profit that is in the form of appreciation. And you see, all of them are around 50 percent or more. The amount they paid the tax on was appreciation on the value of the stock, which has not yet been realized.

Now, the last three columns I have set up just for your information. The third column from the end shows the present tax on the total profit. Beginning with Heitlinger, it was $20,000, and it ranges down, depending on the amount they had in the fund. The last column shows what tax they would have paid if those same people had withdrawn last July when the stock was $40 a share, which you see is roughly about one-third less, whereas on the other hand, the next to the last column shows the tax he would have paid if he had paid on the company contributions and on the fund earnings, which was the provision in the 1928 act. And that is where the inequity lies.

The way the thing now is, you see, this fellow Heitlinger, is an example. He would have been about $4,000 better off if he had retired last July and not worked the last 6 months of the year. He would have been that much better off if he had withdrawn, because he would have saved so much more in the form of tax than he earned for working. And this condition, you see, destroys initiative. It gets the employees to figuring, "Now, the stock is up pretty high; should I retire now before my retirement date?"

It hurts our economy.

To tax the appreciation on the stock before it is sold is contrary to the other policies of the Government which encourage retirement security. The old-age and survivors insurance was recently increased, but there is no tax on these payments. In the cases referred to above, that is, our cases, there is a tax before the realization in cash.

Recently Congress enacted a provision respecting restricted stock options which gives employees an opportunity to become investors in the employer company without being penalized taxwise. The provision taxing appreciation of stock on retirement from the fund is contrary to this general governmental policy.

When annuities are purchased, the stock of the employee is sold, of course, in order to purchase the annuities, but there is no tax at that time. But in the case of retirement and the acceptance of stock,

there is a tax on the appreciation in the stock, even before the stock is sold. This is not consistent.

Taxing appreciation of stock upon retirement greatly reduces the amount of the employee's estate on which he depends for his support during the remaining years of his life. This is contrary to the spirit of Congress in enacting social-security legislation.

When tax is paid on the appreciation of stock, that employee seldom could get any advantage of a possible loss, if, and when, he is compelled to sell some of the stock in order to live, because of the fact he can deduct only $1,000 loss a year for 5 years. In fact, in most cases a retired employee would have little or no taxable income beyond his exemption against which he could deduct the loss. Therefore, under the present situation, he has paid a tax on appreciation, but cannot take advantage of the loss, if he should sell. That does not seem fair.

Because of the reasons stated above, it seems very inequitable to tax the appreciation on the stock until such time as it is sold. We, therefore, request a change in the law to the effect that if the fund is taken out in stock, that the employee would pay a tax on the difference between his investment and the sum of the company contributions and the earnings in the fund credited to his account on the one hand, or the difference between his investment and the market value of the stock, whichever is the lesser. That is the provision that was in for 4 years, 1928 to 1932.

This, gentlemen, is a summary of my statement. This does not involve very much in the form of revenue to the Government. It simply is to eliminate the very obvious inequities in these few cases of these older people retiring after their years of productivity are ended.

Senator KERR (presiding). Very well, Mr. Kaiser. Your full statement will be included in the record.

(The prepared statement of Mr. Kaiser is as follows:)

STATEMENT CONCERNING INEQUITIES IN THE TAXATION OF WITHDRAWALS FROM EMPLOYEE PROFIT-SHARING FUNDS EXEMPT UNDER SECTION 165, INTERNAL REVENUE CODE

(By Arthur B. Kaiser, general manager, tax department, Sears, Roebuck & Co.)

As general manager of the tax department of Sears, Roebuck & Co., I am entrusted with the supervision of the income-tax affairs of the Sears' profit-sharing fund. My duties in connection with the profit-sharing fund have given me a first-hand knowledge of the tax burden that is imposed on the members of the fund when distributions are made to them. The distributions to the members represent their lifetime savings and are frequently the only funds that they and their dependents have to live on the rest of their lives.

These distributions are taxed under section 165 (b) of the Internal Revenue Code. Section 165 (b) has remained unchanged since 1942 when it was amended to provide that under certain circumstances a complete distribution could be taxed as a long-term capital gain. This amendment has furnished considerable relief to the members who are making complete withdrawals. At that time, it appeared that an equitable method had been reached for taxing profit-sharing distributions, and that no further relief was necessary.

However, conditions have changed in the last 9 years. We have witnessed a tremendous inflation in values with the result that the tax on profit-sharing distributions has sharply increased to the detriment of the retirement security of the profit-sharing members. The purpose of this memorandum is to present for your consideration the facts concerning the problem caused by the inflation in values, and to submit a proposal which would remove the present inequity. Before discussing this problem, however, we will review briefly the manner in which distributions by the Sears' profit-sharing fund are taxed at the present time.

THE PRESENT METHOD OF TAXING PROFIT-SHARING DISTRIBUTIONS

The increased tax on profit-sharing distributions due to the inflation in values has created a problem that affects all deferred profit-sharing trusts which distribute securities to their members. I can best illustrate the gravity of this problem by reference to the Sears' profit-sharing plan.

Under the Sears' profit-sharing plan, contributions are made by both the employees and the company. Each member has a separate profit-sharing account. A major portion of the company's contributions, the employee's deposits, and the fund earnings are invested in shares of capital stock of Sears, Roebuck & Co., which shares are credited to the member's account. The portion of the fund income which is not used to purchase Sears' stock is termed "uninvested cash," and is also credited to the members' accounts.

When an employee withdraws from the fund, a valuation is made of his account for income-tax purposes. The value of the withdrawal is determined to be the sum of the uninvested cash and the stock which is valued at the market price at the time of withdrawal. For example, let us assume that an employee who has reached the retirement age is making a complete withdrawal. There is credited to his account 100 shares of stock and uninvested cash in the amount of $2,500. Let us further assume that the employee's own contributions to the fund were $2,000 and the market price of the stock at the time of withdrawal is $55 per share. The total value of this employee's account is as follows:

Uninvested cash	$2, 500
100 shares of stock at $55	5, 500
Total value	8, 000
Less employees' contributions	2, 000
Taxable value	6, 000

As shown above, the taxable value of the withdrawal is the total value of the account less the employee's contribution.

In our example, the 100 shares of stock the employee had to his credit were purchased piecemeal by the fund over a period of years and credited to the employee's account. The price the fund paid for these shares was substantially less than the current market price that was used in determining the taxable value of the employee's account. If we assume that the cost of the stock to the fund was $30 per share and the withdrawal value is $55 per share, the appreciation in the value of the stock amounts to $2,500.

Value of stock at time of withdrawal, 100 shares at $55	$5, 500
Cost of shares to fund, 100 shares at $30	3, 000
Appreciation on value of stock	2, 500

The method of valuation employed results in the employee being taxed on the amount of company contribution, the fund earnings, and any increase in the value of stock which was purchased for his account—the appreciation. With these facts in mind, let us consider some of the inequities involved in this method of taxing profit-sharing distributions.

THE INEQUITIES INVOLVED IN TAXING THE APPRECIATION IN THE VALUE OF THE STOCK DISTRIBUTED

Before we consider the inequities in the present method of taxing profit-sharing distributions, we wish to point out that the heavy tax on complete withdrawals is primarily due to the "bunching" of the employee's total accumulation in the fund in one taxable year with the result that the accumulation is subject to tax in the higher surtax brackets. It may be claimed that this "bunching" of income could be avoided if the trustees of the fund purchased an annuity for the employee, in which case he would be taxable in the years in which he received the annuity payments. The objection to this is that the trustees are reluctant to purchase a fixed income obligation for the employees at a time when the prospects for inflation are so alarming. They have before them the example of thousands of people who retired in the 1930's on what were then liberal pensions, and who are now living in straitened circumstances because the value of their pensions has been reduced by the inflation.

The trustees are also hesitant about purchasing annuities because the interest yield on annuities is rather low at this time. The trustees know that the dividend

yield on Sears' stock approximates the payments from an annuity, and the corpus of the investment is not lost if the employees keep the stock.

Because of these facts, the trustees consider that under the present circumstances the purchase of an annuity for many employees is not a practical solution. However, if the employees withdraw their profit-sharing interest in the form of stock, their benefits are substantially reduced by the tax. The inequities in the present method of taxing these stock withdrawals are discussed below.

1. The tax reduces the retirement income which the employees may obtain from their profit-sharing accumulations

The tax on stock appreciation is inequitable in that it results in such a substantial reduction in the employees' profit-sharing accumulation. It thus deprives the employee of income on which to live after his years of active service with the company are ended. In order to show the extent to which the retirement income of Sears' profit-sharing members is reduced by the tax, we will first show the amount of stock appreciation in the fund at the present time.

We have seen that the benefits distributed by the Sears' profit-sharing fund represent an accumulation which is attributable to——

(1) The employees' own contributions.

(2) The company's contributions.

(3) The earnings (dividends, interest, and lapses) on the employees, credits in the fund.

(4) The increase in the value of stock credited to the employees' accounts—appreciation.

These items are reflected in the total assets which the fund owns today. As of December 31, 1950, the fund had total assets of $350,534,000. The source of these assets is set forth below:

Company contribution	$124, 253, 821
Fund earnings	52, 998, 420
Increase in value of stock—Appreciation	118, 106, 000
Total taxable value	295, 359, 000
Employees' contributions	55, 175, 000
Total value of fund	350, 534, 000

Of the total taxable value of $295,359,000, approximately 40 percent, or $118,106,000, is attributable to the appreciation in the value of stock. As of December 31, 1950, the fund owned 5,426,574 shares of the capital stock of Sears, Roebuck & Co. which was valued at $52.50 per share, or a total of $284,895,000. The average cost price of this stock was $30.74 per share, or a total cost for all shares of $166,789,000. If the Sears' stock increases in value by only $1, it means that the taxable value of the fund is increased by $5,426,574 of appreciation. In fact, the stock recently went to $58 a share, and the appreciation was increased to $29,846,000 (5,426,574×$5.50) since the close of the year. As of this date, the market value is hovering around the value as of December 31, 1950, and the taxable value has increased by $2,713,000 since that date.

On schedule 1 attached, there is set forth the appreciation in stock at the close of the fund's accounting years from 1941 through 1950, inclusive. It will be noted that as of January 31, 1942, the cost of the stock held by the fund was about $7,134,000 more than the market price. By December 31, 1950, the market price of the shares then held by the fund was $118,106,000 higher than the cost. Appreciation has increased in these years by over $125,200,000.

A substantial part of the appreciation in value has occurred within the last 2 years. On December 31, 1948, the appreciation was only $57,849,000. The total appreciation increased by $60,257,000 within the next 2 years to $118,106,000 on December 31, 1950.

These over-all figures are somewhat misleading as the increase in value of stock held by the members who have been in the fund for a number of years is far greater than the 40-percent average increase for all members. This is due to the fact that much of the stock purchased for the older members was obtained in the early 1920's and 1930's when the price was depressed. The tax problem is most urgent with these older members as they are nearing retirement and must withdraw, and are compelled to dissipate a large part of their share in the fund by paying the tax thereon.

The impact of the tax due to the appreciation in value of the stock can best be seen by referring to some actual cases of members who have just retired. We have analyzed the accounts of seven employees who retired in January 1951 and

made complete withdrawals from the fund. None of them had earned in excess of $5,000 per year, and only two of them had earned as much as $4,000. Although two of the members had used part of their fund interest to purchase small retirement annuities, they were all still largely dependent on the dividends they received for their retirement income. With respect to these seven members, we have attached, as schedule 2, a table showing the total amount of profit on their withdrawals and a breakdown of this profit between company contribution, fund earnings, and appreciation in the value of stock.

As shown on schedule 2, the stock appreciation varies from 46 percent to 56 percent of the total profit. The inclusion of the stock appreciation substantially raises the amount of tax the members are required to pay on their withdrawals. The impact of the tax on the withdrawals by these seven members is set forth as follows:

Name	Age	Present tax on total profit	Tax on profit without stock appreciation	Additional tax due to stock appreciation
Joseph Heitlinger	65	$20,115.75	$6,263.64	$13,852.11
Miss A. S. Lang	60	18,370.84	5,907.42	12,463.42
Miss G. S. Trostrud	60	12,290.49	3,597.60	8,692.89
John Kasuba	65	6,664.54	2,268.64	4,395.90
R. J. Eichorn	65	2,957.16	1,166.08	1,791.08
F. Santi	65	2,071.04	851.26	1,219.78
R. F. Reid	65	1,937.16	671.74	1,265.42

The tax in these examples was computed on the basis that the profit would be taxable as a long-term capital gain at 25 percent. Under the proposals of H. R. 4473, the capital gains rate is increased to 28½ percent, and thereby the inequity has been aggravated. In every one of these cases, about two-thirds of the tax the employee paid on his withdrawal is due to the stock appreciation. In the case of Mr. Heitlinger, the tax on the stock appreciation amounts to $13,852.11. On the smaller withdrawals, the tax is less, but the ratios are about the same, and the smaller the amount the employee withdraws, the more he needs to keep what he does withdraw for his support.

This tax on the stock appreciation substantially reduces the employees' profit-sharing accumulation and his retirement income. The employee's profit-sharing accumulation is the result of a lifetime of service with the company. When the employee retires to enjoy the fruits of his labor, he finds that the retirement income he expects to receive for the rest of his life is substantially reduced by the tax.

The members of the Sears' profit-sharing fund are providing for their old age through their own efforts. This is commendable and should be encouraged by the Government. Instead, we find their efforts discouraged by the imposition of a tax which severely reduces their retirement income. In this sense, the tax on stock appreciation is fundamentally inequitable.

II. The tax on stock appreciation is contrary to other policies of the Government which encourage retirement security

The tax on stock appreciation appears contrary to other policies of the Federal Government which are designed to promote retirement security. For example, the Government has recently made a substantial increase in the social-security retirement benefits. Although in most cases only a small part of the social-security benefits are paid for by the tax on employees, the benefits are wholly exempt from tax. On the other hand, the Government continues to impose an unduly heavy tax on the retirement benefits distributed by privately financed profit-sharing trusts.

We do not wish to infer that a tax should be imposed on social-security benefits, nor do we believe that the benefits distributed by profit-sharing trusts should escape from taxation. We do believe, however, that relief should be given to thousands of beneficiaries of profit-sharing trusts whose lifetime accumulations are being so heavily taxed by the Government when they reach the retirement age.

III. Restricted stock options are given special tax consideration; distributions from profit-sharing trusts should also be given special consideration

When a restricted stock option is granted under section 130 (a) of the Internal Revenue Code, the difference between the market price and the option price is

not considered to be taxable income to the employee at the time the option is exercised. There are restrictions placed on these options, but on the whole it is a very favorable tax treatment. The basis of this special consideration is that Congress recognizes that it is desirable for employees to acquire a stock interest in the corporations that employ them.

However, this favorable handling has not been extended to distributions by profit-sharing trusts, although the need is even greater. When a distribution by a profit-sharing trust is taxed on the unrealized appreciation in the value of the stock, the effect may be to substantially reduce the employee's retirement income for the rest of his life. It appears there is more justification for deferring the tax on the unrealized profit involved in profit-sharing distributions than in the case of restricted stock options.

IV. Stock appreciation is not taxed when annuities are withdrawn; the appreciation should not be taxed when stock is withdrawn

The rules and regulations of the Sears fund provide that payment of the moneys and securities to which any member is entitled may be made at the option of the trustees, wholly or partially, through the purchase of a single-premium annuity contract. The trustees have the authority to apply to the payment of the premium so much as may be required of the moneys and securities to the credit of the member's account.

For example, if a member's account is credited with $10,000 in uninvested cash and 1,000 shares of stock worth $52 per share at the current market price, the trustees may purchase a single-premium annuity costing $62,000. In order to pay the premium, the trustees would sell the 1,000 shares of stock in the employee's account. The employee is not taxed on the appreciation in the value of the stock at the time that it is sold but he is taxed when he receives the annuity payments.

On the other hand, if the employee withdraws the 1,000 shares of stock, he is taxed on the appreciation at the time he withdraws although he may never sell the stock. This tax treatment of withdrawals is inconsistent. In one case, the appreciation is not taxed although the stock is sold. In the other case, the appreciation is taxed although the stock may never be sold. This handling discriminates against the profit-sharing member who receives his interest in the form of stock. This discrimination against the employee who withdraws stock should be corrected by taxing him on his stock appreciation when he actually sells the stock.

V. The appreciation in the value of the stock is not realized until the employee sells the stock

The Federal income tax ordinarily applies to gains in the value of property that are finally realized by a sale or exchange. When an employee receives a distribution of stock from the profit-sharing fund, he does not realize the appreciation in the value of the stock. This appreciation is not realized until he subsequently sells the stock and converts it into cash or the equivalent.

When many Sears' employees leave the fund, they take their interest largely in the form of stock, except for their uninvested cash. In substance, when the employee withdraws stock, he has realized no more if the stock is at $52 per share than if the stock is at $40 per share. The employee considers that he is withdrawing retirement income from the fund in the form of dividends and not a speculative profit on the appreciation in the stock. After the employee withdraws, the stock may go down in value and, when he finally sells it, his realized gain may well be less than the appreciated value he was taxed on at the time of withdrawal. The amount of appreciation on the stock at the time of withdrawal is a speculative profit as far as the employee is concerned, and he has not realized it until he ultimately sells the stock.

When an individual purchases stock at $40 per share and it increases to $52, he is not taxed on his profit unless he sells the stock. The employee who withdraws stock from a profit-sharing fund should be given the same consideration. He should not be taxed on his paper profit at the time he withdraws, but should be taxed when he sells the stock and realizes the gain.

VI. The employee is taxed on the gain on the distribution of the stock, but he cannot deduct a loss on a subsequent sale

The employee is taxed on the gain on the appreciation in the stock when it is distributed to him. The basis of the stock which he receives is the fair market value at the time of distribution. If an employee withdrew from the fund today,

the basis of his stock would be about $52.50 per share. If, at some time in the future, it is necessary for him to sell the stock, it is quite possible that he would sustain a loss. Although he had previously been taxed on the gain on the distribution, he would not be allowed to deduct the loss except as an offset against capital gains, or as a deduction from ordinary income up to a maximum of $1,000 for 5 years.

This limited deduction of the capital loss is more illusory than real to most Sears' employees who have retired. For the most part, they would not have capital gains against which to utilize their capital losses. If they are married and over 65, their personal exemptions amount to $2,400. This personal exemption along with the optional standard deduction is usually sufficient to absorb their dividend income. As a result, they would have no taxable income to offset against the $1,000 capital loss deduction that they may carry forward for 5 years against ordinary income. The practical effect is that although the employee is taxed on the stock appreciation at the time of withdrawal, if he subsequently sells the stock at a loss, he may never have the opportunity to utilize the loss as a deduction.

VII. The amount of tax the employee must pay is dependent on the fluctuations of the stock market

Under the present method of taxing withdrawals, the amount of tax the employee must pay is dependent in a large measure on the fluctuations of the stock market.

We have previously referred to the withdrawal of Mr. Heitlinger who left the fund in January 1951. Mr. Heitlinger had a profit on his withdrawal of $80,463 which consisted of 1,416 shares of Sears' stock valued at 52¼ and $6,445 in uninvested cash. The tax on his profit was the maximum 25, percent or $20,116. Now let us assume that Mr. Heitlinger had withdrawn 6 months earlier in July 1950, when Sears' stock sold at $40 per share. In that event, his profit would have been $63,085, and the tax on that profit would have amounted to $14,636. Thus, Mr. Heitlinger paid a tax of $5,480 ($20,116 — $14,636) due to the fluctuations of the stock market over the last 6 months of his employment. He would have been better off financially if he had not worked the last 6 months. It is bad when a tax can discourage an employee from working.

On the attached schedule 2, we have set forth the amount of tax the other six employees we have referred to would have paid if their final withdrawal was valued at $40 per share. In every case, their tax has been substantially increased due to the appreciation in the value of the stock between July 1950 and January 31, 1951.

Making the employees' tax dependent on the fluctuations in the stock market is fundamentally inequitable, as the employee has not realized his profit on the appreciation until he sells the stock.

SUMMARY OF INEQUITIES

We have reviewed the present method of taxing profit sharing distributions, and the inequities that are involved. At this point, we will briefly summarize these inequities:

I. The tax on the stock appreciation substantially reduces the employee's profit sharing accumulation. It thus deprives the employee of income on which to live after his years of active service with the company are ended.

II. The burdensome tax on profit sharing distributions is contrary to other policies of the Federal Government which favor retirement security. For example, the Government has recently increased the nontaxable social security retirement benefits.

III. Restricted stock options are given special tax consideration. In providing for these stock options, Congress recognized that there are matters of public policy which justify the deferment of tax on stock appreciation. There is also a public interest in providing for the retirement security of thousands of members of deferred profit sharing trusts. It appears that there is more justification for deferring the tax on the unrealized profit in profit sharing distributions than in the case of restricted stock options.

IV. The present law favors the employees who receive their profit sharing interest in the form of annuities, and discriminates against those who made their withdrawals in the form of stock. When an employee's stock is used to purchase an annuity, he is not taxed on the stock appreciation at that time. Why should the employee who withdraws the stock be taxed on the appreciation?

V. The tax on the stock appreciation is a tax on unrealized profits. The employee has not realized his profit on the stock he withdraws until such time as he sells the stock.

VI. The employee is taxed on the gain on the appreciation of the stock when it is distributed to him. If he subsequently sells the stock at a loss, as a practical matter he may never have the opportunity to utilize the loss.

VII. The amount of tax the employee must pay is dependent on the fluctuations of the stock market. Two employees may withdraw the same number of shares, but on different dates. If the market price of the stock increases after the first withdrawal, the second member may pay substantially more tax although he has withdrawn the same number of shares. The fact that the employee's tax liability is dependent on the fluctuations of the stock market is fundamentally inequitable.

We have pointed out some of the inequities that are caused by taxing the appreciation in stock value when a withdrawal is made. We now set forth a proposal for your consideration which would remove these inequities.

A PROPOSAL TO REMEDY THE INEQUITIES IN THE PRESENT METHOD OF TAXING PROFIT SHARING DISTRIBUTIONS

The proposal that we submit in order to remedy the inequities in the present method of taxing profit sharing distributions will require an amendment of section 165 (b) of the Internal Revenue Code. Before discussing this proposal, let us review briefly the background of section 165.

The predecessor of the present section 165 was enacted in the Revenue Act of 1921 as section 219 (f). This section read as follows:

"The amount actually distributed or made available to any distributee shall be taxable to him in the year in which so distributed or made available to the extent that it exceeds the amount paid in by him."

It is to be noted that this section is similar to the present section 165 (b) in that the employee is taxed on the profit distributed to him, including the appreciation in the value of any securities.

By 1928, the Nation was experiencing the great stock market inflation of the late 1920's. The amount distributed by profit-sharing funds included in many cases a substantial amount of stock appreciation. To alleviate the tax on this unrealized appreciation, section 165 (b) was amended to provide that:

"The amount contributed to such fund by the employer and all earnings of such fund shall be taxed to the distributee in the year in which distributed or made available to him. Such distributees shall for the purpose of the normal tax be allowed as credits against net income such part of the amount so distributed or made available as represents the items of dividends and earnings specified in section 25 (a) and (b)."

Under this section, the stock appreciation was not taxed. The employee was required to include in his tax base only the amount of company contributions and fund earnings, and he was allowed a credit for the part of the distribution attributable to dividends and tax-exempt interest against the normal tax.

By 1932, the values on the stock market had declined so low that in many cases the total of the employee's deposits, fund earnings, and company contributions was in excess of the value of the stock distributed to the employees. Some legislative relief was in order. However, instead of amending section 165 (b) so that the employee would be taxed on whichever amount was the lesser—the sum of company contribution and fund earnings distributed to him, or the amount of profit that was distributed—Congress restored section 165 as it was before the 1928 amendment.

There were no significant amendments to section 165 as far as the taxation of distributees was concerned until the Revenue Act of 1942. At that time, there was no stock appreciation in the Sears' fund. As we have previously mentioned, at the close of the fiscal year 1941, the cost of the stock held by the Sears' fund was $7,134,000 greater than the market value. However, even then employees were being taxed on substantial profits when they made their final withdrawals from the fund.

In order to reduce the heavy tax on employees who were making their final withdrawals, Congress in 1942 amended section 165 (b) to provide that—

"If the total distributions payable with respect to any employee are paid to the distributee within one taxable year of the distributee on account of the employee's separation from the service, the amount of such distribution to the extent exceeding the amounts contributed by the employee shall be considered a gain from the sale or exchange of a capital asset held for more than 6 months."

The relief afforded by the capital gain provision in the Revenue Act of 1942 was designed to reduce the heavy tax resulting from the "bunching" of the accumulated employer's contributions and fund earnings in one taxable year. It was not primarily intended to afford relief due to an appreciation in stock values.

Conditions have now changed. Inflation in the stock market is again a major factor to be reckoned with in determining the manner in which profit sharing distributions are to be taxed. In the proposal that is submitted on exhibit A attached, this fact is recognized.

In our proposal, we have included the provision in the Revenue Act of 1928 which taxes the employee only on the amount of company contributions and fund earnings. As this amount in itself is a sizable figure in most cases, we have retained the capital gain feature of the 1942 act. As there is always the possibility that the stock market may decline in the future, the proposal is submitted in the alternative so that the employee would be taxed on whichever is lesser—the profit that is distributed to him, or the sum of the company contribution and fund earnings. This amendment is offered for your consideration.

Schedule 1

Appreciation in value of Sears' stock held by the profit sharing fund at the close of the years 1941 through 1950

	Market value	Cost	Appreciation
Jan. 31, 1942	$39,423,255	$46,557,342	($7,134,087)
Jan. 31, 1943	48,876,832	47,482,592	1,394,240
Jan. 31, 1944	68,631,603	49,599,434	19,032,169
Jan. 31, 1945	87,345,175	56,264,780	31,080,395
Dec. 31, 1945	122,016,811	60,164,497	61,852,314
Dec. 31, 1946	137,909,801	76,113,100	61,796,701
Dec. 31, 1947	150,670,916	95,064,755	55,606,161
Dec. 31, 1948	176,118,175	118,268,261	57,849,914
Dec. 31, 1949	217,828,225	138,998,617	78,829,608
Dec. 31, 1950	284,895,135	166,788,712	118,106,423

Schedule 2

A computation of the tax on the profit of 7 profit sharing members who withdrew in January 1951. The tax on their profit without the stock appreciation. The tax on their profit if the market value of the stock was determined at $40 per share

Name	Years of profit sharing partici-pation	Profit on with-drawal	Com-pany con-tribu-tion	Fund earn-ings	Appre-ciation in value of stock	Ratio of appre-ciation to profit	As-sumed other income	Present tax on total profit	Tax on profit with-out appre-ciation	Tax on profit at $40 per share (July 1950 mar-ket)
						Percent				
Joseph Heitlinger	35	$80,463	$7,783	$27,276	$45,404	56.43	$3,540	$20,116	$6,264	$14,636
Miss A. S. Lang	35	74,148	8,907	24,512	40,729	54.93	3,215	18,371	5,907	13,245
Miss G. Trostrud	35	56,149	6,549	18,009	31,591	56.26	2,583	12,290	3,598	8,184
John Kasuba	35	49,742	7,337	15,646	26,759	53.80	2,173	6,665	2,269	4,706
R. J. Eichorn	22	29,831	8,271	7,099	14,461	48.48	1,275	2,957	1,166	2,007
F. Santi	26	23,738	6,860	5,810	11,068	46.63	1,035	2,071	851	1,452
R. F. Reid	28	23,095	4,280	6,557	12,258	53.08	980	1,973	672	1,398

Exhibit A

PROPOSED AMENDMENT OF SECTION 165 (B) OF THE INTERNAL REVENUE CODE

(New matter proposed to be inserted is printed in italics.)

Sec. 165 (b). The amount actually distributed or made available to any distributee by any such trust shall be taxable to him in the year in which so distributed or made available, under section 22 (b) (2) as if it were an annuity the consideration for which is the amount contributed by the employee, except that if the total *remaining* distributions payable with respect to any employee are paid to the distributee within one taxable year of the distributee on account

of the employee's separation from the service, *there shall be taxed to the distributee, as a gain from the sale or exchange of a capital asset held for more than 6 months, whichever of the following amounts is the lesser:*

(1) *The amount contributed by the employer to the trust and the earnings of such trust which are distributed or made available to him (excluding any appreciation in the value of securities which may be distributed), or*

(2) *The amount of such distribution to the extent exceeding the amounts contributed by the employee.*

Senator KERR. We thank you for your appearance.

Mr. KAISER. Thank you.

Senator KERR. Mr. Koss.

Will you give your name to the reporter?

STATEMENT OF GEORGE C. KOSS, PRESIDENT, KOSS CONSTRUCTION CO., APPEARING ON BEHALF OF THE ASSOCIATED GENERAL CONTRACTORS OF AMERICA, INC.

Mr. Koss. My name is George C. Koss, president of the Koss Construction Co., Des Moines, Iowa, and I am appearing on behalf of the Associated General Contractors of America, Inc.

I would like to read this statement, please, sir.

Senator KERR. Very well.

Mr. Koss. This statement is filed on behalf of members of the Associated General Contractors of America, for your consideration in connection with proposed tax legislation.

The Associated General Contractors of America is the Nation-wide association representing more than 5,800 of the Nation's leading general contractors, who execute all types of construction and annually perform approximately 80 percent of the volume of contract construction in the Nation. There are 113 affiliated local associations throughout the United States and Alaska.

The operations of the general contractor are unlike the operations of members of any other industry in the Nation. The general contractor has no inventory, depending entirely on skill and ingenuity and the various types of construction equipment to produce a profit. The general contractor's equipment must be used in all kinds of weather and under varied conditionss. It is not protected from the elements and when in operation cannot be completely maintained. In this respect it differs very materially from industries where the machinery and equipment are well housed and completely maintained. To eliminate the undue hardship on the general contractor, the following changes in the existing and proposed tax laws are respectfully requested:

Item No. 1: To permit a contractor to treat as a net operating loss, subject to the carry-back and carry-over provisions of section 122 (b) of the Internal Revenue Code, an amount representing the excess of the replacement cost of equipment used in the trade or business over the original cost of the same type of equipment actually replaced in the year it becomes fully depreciated, or prior thereto.

A provision of this kind is urgently needed to enable many general contractors now operating in the field of construction to continue in business. The existing as well as the proposed rates of tax and the abnormal appreciation in the cost of construction equipment have created a condition that only legislative relief can alleviate. The impact is particularly severe on general contractors operating in the

heavy and highway-construction fields, where large stocks of construction equipment are necessary to their operations. This is true regardless of whether the general contractor operates as a corporation or as an individual. The life of the equipment used in the operation is short, and a certain portion of the equipment must be replaced every year. Because of this, the high rates of tax, and the abnormal appreciation in the cost of this equipment, the problem facing the general contractor is where to get the money necessary to replace the old equipment with new. It is self-evident that it must come either from borrowings or from past earnings or future charges. What this critical situation means in dollars may be seen in the following assumed example:

A contractor, this year, is confronted with the necessity of purchasing a new tractor to replace the same type of tractor that is no longer able to perform the work required. He finds that this particular type of tractor, for instance, a large crawler equipped with a bulldozer, that was purchased in 1945 at a cost of $10,000, now costs $19,500. This means that this contractor, in order to remain in business and own the same type of equipment this year that he owned in 1945, must expend an additional $9,500, or practically two times the original cost, for the same type of tractor. Actually, the contractor must replace more than one piece of equipment each year; so, instead of merely being faced with the purchase of one tractor, he is actually faced with the purchase of several other similar pieces of equipment that likewise have practically doubled in cost. It is not uncommon for the small contractor to be faced in a particular year with replacement of equipment originally costing as much as $50,000, which today will cost approximately $100,000. This means that a contractor must double his original capital investment. The smaller contractor, in the main, to secure the additional amount necessary for him to remain in business, must either borrow the money out of future earnings or out of retained profits. Due to the high rates of tax, as proposed, there is small possibility of future profits or retained earnings.

For instance, a contractor operating as an individual, who is married, who finds it necessary to replace equipment requiring an additional expenditure of $50,000 over the original cost of the equipment, must earn in excess of $150,000 merely to leave him in the same position, with similar equipment, that he had when the original equipment was purchased.

A contractor operating as a corporation, subject only to the combined normal tax and surtax of 52 percent as proposed in the new tax bill, must earn in excess of $100,000 to assure his operation with similar-type equipment now as at the time the original equipment was purchased.

A contractor, operating as a corporation, with excess-profits tax credit so low that it is subject to the proposed ceiling rate of 70 percent, must earn, before taxes, to merely cover the additional cost of new equipment in the amount of $50,000, in excess of $125,000.

Examples of the appreciation in cost of a few of the items of equipment commonly used by general contractors are as follows—we have listed under the column for 1945 and 1950 the costs:

A D-8 tractor with bulldozer, $10,105 in 1945; in 1950 it was $19,401.

A No. 12 motor patrol, for example, was $6,916 in 1945; in 1950 it had gone up to $13,461.

A 20-ton motor crane, in 1945, was $15,090; in 1950 it was $27,671.

A 2-yard shovel in 1945 cost $25,000; in 1950 it went up to $51,595.

The hardship now confronting general contractors is comparable to situations that have confronted members of other industries in past years. Congress in the past recognized the then existing abnormal conditions and enacted legislation to alleviate the condition, in order to safeguard the right of members of the affected industries to continue in business.

Item No. 2: To permit a general contractor a carry-back and carry-forward of all unused depreciation allowances on equipment.

This suggested provision in the tax laws is needed because of the uncertain conditions under which general contractors operate. There is no guaranty of a continuity of work in this industry. It does not necessarily follow that a general contractor that has a profitable operation this year will have work the following year. It is, therefore, important that the right of carry-back and carry-forward of the unused depreciation allowances be written into the tax law to permit the general contractor to recoup the original investment in his equipment, which, in a small degree, will merely offset the hazards involved in the general contractor's operation.

Senator KERR. How much of a carry-back do you recommend?

The CHAIRMAN (presiding). All the unused depreciation.

Mr. KOSS. That is right.

Senator KERR. For how long? Unlimited?

Mr. KOSS. Then we would come under the general provisions of the law, to have a 1-year carry-back and a 2-year carry-forward, for example, if that were it now.

Item No. 3: That section 3475 of the Internal Revenue Code with reference to transportation of property tax be amended as follows:

> The tax imposed under this section shall not apply to the use of motor vehicles by contractors in the movement of earth, rock, or other excavated material within the boundaries of or incidental to a construction project.

The purpose of this amendment is to bring to an end the confusion that now exists throughout the highway and heavy divisions of the general-contracting industry. It likewise would permit uniformity with reference to administrative rulings and would eliminate conflicting court decisions. An example of how confused this situation is is reflected in an administrative ruling with reference to the movement of excavated material. Under this ruling the general contractor is permitted to use a bulldozer to push the excavated material to the desired location without being subject to the transportation-of-property tax. However, if a power shovel is used to pick up the excavated material and deposit it in an owner-trucker's truck and the truck then dumps the material in the same location where it was pushed by the bulldozer, it is ruled to be transportation of property and subject to tax.

That concludes my statement, Mr. Chairman.

The CHAIRMAN. Are there any questions?

Senator KERR. No questions.

The CHAIRMAN. Senator Millikin?

Senator MILLIKIN. No questions.

The CHAIRMAN. Thank you, sir, very much.

Mr. KOSS. Thank you.

(The tables referred to are as follows:)

TABLE I.—*Married couple with no dependents* [1]

Net income	Amount of tax		Taxpayer allowed to keep (new bill)
	Present law	Proposed (new bill)	
$25,000	$6,724	$7,565	$17,435
$50,000	19,592	22,041	27,959
$100,000	52,776	59,373	40,627
$500,000	403,548	433,161	66,839
$1,000,000	858,548	900,000	100,000

[1] Figures on rates of tax taken from committee report accompanying H. R. 4473.

TABLE II.—*Corporation subject only to combined normal tax and surtax* [1]

Net income subject to normal tax and surtax	Pre-1950	Amount of present	Proposed	Taxpayer would be permitted to keep
$25,000	$5,750	$6,250	$7,500	$17,500
$50,000	19,000	18,000	20,500	29,500
$100,000	38,000	41,500	46,500	53,500
$200,000	76,000	88,500	98,500	101,500
$500,000	190,000	229,500	254,500	245,500
$1,000,000	380,000	464,500	514,500	485,500

[1] Figures on rates of tax taken from committee report accompanying H. R. 4473.

TABLE III.—*Corporation subject to ceiling rate* [1]

Net income subject to ceiling rate	Amount of tax			Taxpayer would be permitted to keep
	Pre-1950	Present (62 percent)	Proposed (70 percent)	
First $25,000	(2)	(2)	(2)	$17,500
Next $25,000	$9,500	$15,500	$17,500	7,500
Next $50,000	19,000	31,000	35,000	15,000
Next $100,000	38,000	62,000	70,000	30,000
Next $200,000	76,000	124,000	140,000	60,000
Next $500,000	190,000	310,000	350,000	150,000
Next $1,000,000	380,000	620,000	700,000	300,000

[1] Figures on rates of tax taken from committee report accompanying H. R. 4473.
[2] Subject only to normal tax.

The CHAIRMAN. Mrs. Griswold.

Will you identify yourself to the reporter, please?

STATEMENT OF MRS. ENID H. GRISWOLD, VICE PRESIDENT, NATIONAL ECONOMIC COUNCIL

Mrs. GRISWOLD. I represent the National Economic Council in New York City. I would like to state that while we have made a study from an economic standpoint, the statement which I have prepared is a very simple one, because there are only two or three points that I would like to stress at this time.

I appear before this committee in opposition to the Revenue Act of 1951, as presently constituted. I believe that the drastically increased taxes provided in this bill are unnecessary and are a threat to the economic structure of our country and to our form of government.

As these hearings have progressed—and I have watched them very carefully, from the reports that have appeared in the New York press, particularly—I have noted that several witnesses who have expressed their opposition to the 12½ percent increase in personal-income taxes and to the increase in corporation taxes have suggested other means of raising additional revenue, such as Federal sales tax.

I contend that all of these measures are not only unnecessary but dangerous. Why have our domestic expenditures increased from $3,600,000,000 in 1946 to $9,800,000,000 for the proposed 1952 budget? And are we to continue the tremendous outlay for foreign economic as well as military aid after having poured out over $20,000,000,000 in foreign aid since the end of the war?

On June 28 the Secretary of the Treasury, Mr. Snyder, appeared before your committee to demand that this proposed tax rise be increased another 50 percent in order to raise $10,720,000,000 in new taxes. An official from the Bureau of the Budget stated that for next year, the 1953 budget, another 10 to 20 billions of dollars would be required. It was also contended by these gentlemen that high taxes would curb inflation. With this I disagree. What would be more inflationary than to place at the disposal of Government bureaucrats increased billions of dollars of the taxpayers' money?

The waste in government must be curtailed. The increase in the number of Federal employees during the past year is a public scandal. From June 30, 1950, to January 1, 1951, according to reliable statistics, I find that 1,000 civilians per day were added to the public payroll. Since January 1, 1951, this has increased to 1,500 per day. The report of the investigating committee of the House under the chairmanship of Mr. Williams, of Mississippi, discloses numerous specific instances of waste in manpower and administrative costs. I do not need to go into that, because that is a report that is available to you and with which you are probably thoroughly familiar.

The Federal debt in 1929 represented a liability of $571 a family; in 1939, $1,165 per family; in 1950, $6,786 per family. How long do you gentlemen think that these policies of deficits and exorbitant taxation and waste can continue if we are to remain a solvent nation and if the people are to remain free? If you vote for the proposed tax bill, as it now stands, for the continuation of the needless extravagance and inefficiency and socialistic schemes which are now being tolerated we shall soon become a bankrupt nation.

Can it be that those who drew up this revenue bill and those who were responsible for its presentation in the House of Representatives under the ruling which precluded any amendments, had in mind the furtherance of economic manipulation which would bring socialism in the United States to the point it has now reached in Britain?

I wish to point out that during the 10 years that the late Andrew Mellon served as Secretary of the Treasury he proved his contention that a moderate tax rate actually brings in a larger revenue than an exorbitantly high rate.

As a woman, I am particularly concerned with the provision in this bill which would require corporations to withhold 20 percent of dividends and interest. The expense of the corporation and the cost to the Government of administering such a tax would be enormous. What would you expect the many persons of small means, dependent

in whole or in part, upon such income for their daily living, to do during the year and more that they would be deprived of this revenue? What of the forms they would be required to fill out for its return and the length of time the Government clerks would take to process these forms before any refund would be forthcoming? It is estimated that 47 percent of investors in this country are little people, receiving incomes of $5,000 a year or less. I should also like to have you give some thought to the charitable and educational institutions and trusts that depend largely upon dividends for their incomes. How are they supposed to operate during the time when their incomes would be greatly depleted? It seems to me that this provision of the tax bill is discriminatory, expensive to administer and thoroughly un-American in its approach. I can imagine Marx, Lenin, and Stalin would doubtless give it their wholehearted approval.

Senator KERR. You do not think that the differences of opinion they had about other things would keep them from being unanimous in their approval of this bill?

Mrs. GRISWOLD. I think that this is something that is particularly discriminatory against those people who have——

Senator KERR. I understood you to say that. But you have developed something here that interested me, in that you thought you had found a common ground which Marx, Lenin, and Stalin would have found unanimity of thought.

Mrs. GRISWOLD. Yes; I think they would have.

Senator KERR. That is an interesting angle to it.

Mrs. GRISWOLD. I simply feel this, that it is the communistic point of view that you must level people off, and that people who are not actually working and earning money are not really supposed to have anything. That is one of the tenets of the Communist Party, to have people earn what they actually use, is it not?

Senator KERR. I thought another one was that they must disagree with other people and to find something about which these three were supposed to be in such complete agreement really interested me.

Mrs. GRISWOLD. I think that they would have agreed on that pretty thoroughly. I may be mistaken, but that is a conclusion that I personally have come to.

We have already burdened our children and our grandchildren with an enormous debt, denied to them the opportunities and rewards from which we and previous generations have benefited. We have inflated our currency, thereby depriving the thrifty and the aged of the real value of their capital savings. I submit to you that we cannot stand further confiscatory taxes and preserve our traditional American system. Under the present tax structure there is already a serious burden upon the citizens of this country. Through the efficient administration of Government it would be possible to save the billions of dollars which are required for the present defense program, which we are all agreed is necessary to our survival. It would be very reassuring to the voters of this country if the Senate of the United States had the fortitude and foresight to refuse to countenance further encroachments upon the lives and property of our citizens.

I would like to add, Senators, that we do wholeheartedly believe in the defense program. We feel that had we not abandoned our military strength as we did so precipitously at the end of the war, we would not at this point be where we are. But we do feel that absolutely every

possible saving should be made in the running expenses of the Government so that we can save in that way as many billions as possible for the defense program.

The CHAIRMAN. Are there any questions of Mrs. Griswold?

Senator KERR. No questions.

The CHAIRMAN. Thank you for your appearance.

The CHAIRMAN. Mr. Snyder.

Will you identify yourself for the record?

STATEMENT OF CALVIN K. SNYDER, SECRETARY, REALTORS' WASHINGTON COMMITTEE OF THE NATIONAL ASSOCIATION OF REAL ESTATE BOARDS, ACCOMPANIED BY LEONARD J. CALHOUN, ATTORNEY

Mr. SNYDER. Mr. Chairman and members of the committee, I am Calvin K. Snyder, secretary of the realtors' Washington committee of the National Association of Real Estate Boards. Our offices are located at 1737 K Street NW., Washington, D. C., and 22 West Monroe Street, Chicago., Ill. Our membership consists of 1,101 local real estate borads and 45,000 individuals and firms of realtors. Our membership is engaged in every phase of the real estate industry.

We are grateful to you, Mr. Chairman, for this opportunity to appear before your committee. Associated with me in this presentation is Mr. Leonard J. Calhoun of the firm of Harter and Calhoun, Washington, D. C.

The CHAIRMAN. Yes. Mr. Calhoun is well known to this committee having worked with us for a good many years on social security and other problems.

Mr. CALHOUN. Thank you, sir.

Mr. SNYDER. We have had the privilege of having him associated with us on a number of matters concerning tax legislation, and are delighted to have him here with us today.

I should like to speak briefly to the statement, reading perhaps a portion of it and making a few comments, and then I shall ask Mr. Calhoun to elaborate on just one or two points, in the interest of saving your time.

The CHAIRMAN. Yes, sir; you may do that.

Mr. SNYDER. I should like to devote my comments first to section 303 of H. R. 4473, pertaining to the sale or exchange by a taxpayer of his home where he reinvests the proceeds in another home and as applied to the trade of one home for another home.

We concur most heartily, Mr. Chairman, with the provisions of section 303 of H. R. 4473, because we believe that this section will remove what has been a gross inequity in the law for many years.

Under the present law, if my home is destroyed by fire or flood or some other catastrophe, or if it is taken by the Government for public purposes, the gain, if any, resulting from the insurance indemnity or the condemnation award is not recognized, provided I use the proceeds thereof to acquire another home for my own occupancy.

However, if I am forced to move from one city to another because of change of my employment, as is the case among thousands of defense workers today, I am caught in a trap. If my old home has increased in value over the original purchase price, this increase will

be taxed to me as a gain, yet at the same time I am required to pay a comparable price for my newly acquired residence. I had a home and now all I have is another one which costs all the proceeds from the sale of my first home. Neither is worth any more or less than the other. But in changing my home, I have incurred a substantial tax liability. The home owner does not believe that this is fair or equitable.

Let me give you a glaring example of what the present law does. Suppose that in 1946 I bought a home in Detroit for $10,000 and my brother bought one in Cleveland for $10,000. As a result of the cheapening of the value of the dollar, the fair market value of my home in Detroit is now $15,000 and the fair market value of my brother's home in Cleveland is similarly $15,000. I am transferred to Cleveland from Detroit and my brother is transferred to Detroit from Cleveland, and we decide simply to trade homes.

The law now says that I realize a taxable gain of $5,000 when I take over my brother's house, and he realizes a taxable gain of $5,000 when he takes over my house. Because we are transferred in our jobs, we are each penalized to the extent of the tax on $5,000 worth of increased value which, I submit, is not a real gain.

We believe that it is extremely important in this period of defense mobilization not to have provisions in the laws of the land that discourage or impair the mobility of working men and women. We believe that the existing provisions of the Internal Revenue Code—in their treatment of gains and losses from sales or exchanges of homes—do have this effect, because they penalize the people who have to move from one place to another in response to the demands of the mobilization program.

The staff of the Joint Committee on Internal Revenue Taxation recognized the gross inequity in the present law, and 2 years ago made recommendations that, if adopted, would have remedied the situation. At that time the Treasury was opposed to any change. We are happy to see that the Treasury now also recognizes this inequity.

With your permission, Mr. Chairman, I should like to insert in the record at this point a very brief excerpt of about four paragraphs from the hearings in the House Ways and Means Committee of the House of Representatives on the Revenue Revision Act of 1951, February 5, 1951, being some colloquy between Mr. Mason, a member of the committee, and Secretary Snyder, where the Secretary recognizes this inequity.

The CHAIRMAN. Very well, sir. You may put it in the record.

(The excerpt referred to is as follows:)

EXCERPT FROM HEARINGS BEFORE WAYS AND MEANS COMMITTEE, UNITED STATES HOUSE OF REPRESENTATIVES, ON REVENUE REVISION ACT OF 1951 (H. R. 4473), FEBRUARY 5, 1951

Mr. MASON. Your proposal on capital gains, increasing the rates on capital gains, is of interest to me, because you say that is a loophole that we ought to close.

I want to use an illustration, and it is an actual illustration. It is an actual situation.

I have two sons. Both of them built $10,000 homes in 1940. Both of them built in the same year. Each of them has been offered $20,000 for his home. One is in the suburbs of Cleveland the other is in the suburbs of Chicago.

Now, then suppose that the one boy is transferred to Chicago and the other one, who works for General Motors, is transferred to Cleveland, and they make arrangements to trade their homes on just an out-and-out even trade.

The Treasury Department would collect, under our capital gains, and they would have to pay, each of them, $1,000 or more in order to make an even trade under the present law, would they not?

Secretary SNYDER. That is true under the present law. That is what would happen. That is one of the points that we have under study. We have run into that in increasing numbers of cases in recent years.

Mr. MASON. Suppose that they did not even trade. Suppose that the one boy was transferred to Cleveland and he had to sell his house and sold for $20,000, but he had to buy a new house in Cleveland for $20,000. He would have to pay, would he not?

Secretary SNYDER. That is correct.

Mr. MASON. So there are inequities in the present rates.

Secretary SNYDER. That is correct. We recognize that.

Mr. MASON. If we increase the rates, we are bound to increase the inequities.

Mr. SNYDER. We believe the inequity should be removed, and removed now, for every increase in the tax rate only serves to make the inequity greater.

The committee report accompanying H. R. 4473 indicates that there might be a slight loss to the Treasury from this proposed section. We take issue with this conclusion because this proposal would result merely in a tax deferment rather than a tax exemption due to the broadening of the tax basis.

Since real property is subject to capital gains tax, we should like to recommend further that losses on the sale or exchange of an owner-occupied residence, which for the required holding period was used by the taxpayer as his residence, be recognized and allowed as a deduction. We believe that if it is fair to impose a gain tax against real property in the event of gain, it is only fair that the owner be permitted to take a deduction in event of loss.

We believe that our recommendations do no more than extend the existing policy of sections 112 (b) (1) and 112 (f) of the Internal Revenue Code to sales and exchanges of homes, and we believe that it is necessary to do this in order (1) to promote free mobility among our working forces, (2) to permit our working men and women to meet mobilization requirements without being severely penalized therefor, and (3) to treat all home owners fairly under the tax laws.

I should like to make reference, Mr. Chairman, to the proposed increase in the alternative tax on long-term capital gain.

We feel that this proposal to increase the alternative tax is something that should be considered because of the principle and precedent involved in the proposal and because of its practical effects of further discouraging the normal transfer of property and of further inflating real estate prices.

I should like also to refer to the tax treatment of related corporations, where we are not certain how effective the provision would be in preventing deliberately contrived corporate split-ups of a business, since any corporation could escape it through a planned distribution of 6 percent of the voting power. But it would seem to apply to any two or more corporations with a specified degree of common control through voting membership, even though their respective histories and business purposes and activities may demonstrate conclusively that they are in no sense tax shams, but are in fact separate entities with entirely separate businesses.

On these two points, Mr. Chairman, with the permission of the committee, I should like to ask Mr. Calhoun to elaborate for us just a moment or so briefly, and then we shall have concluded our testimony, if I may have the privilege of filing the remainder of my statement.

The CHAIRMAN. Yes, sir; you may file your statement.

(The prepared statement of Mr. Snyder is as follows:)

STATEMENT OF CALVIN K. SNYDER, SECRETARY OF THE REALTORS' WASHINGTON COMMITTEE, ON BEHALF OF THE NATIONAL ASSOCIATION OF REAL ESTATE BOARDS

Mr Chairman and members of the committee, I am Calvin K. Snyder, secretary of the Realtors' Washington Committee of the National Association of Real Estate Boards. Our offices are located at 1737 K Street NW., Washington D. C., and 22 West Monroe Street, Chicago, Ill. Our membership consists of 1,101 local real estate boards and 45,100 individuals and firms of realtors. Our membership is engaged in every phase of the real estate industry.

We are grateful to you, Mr. Chairman, for this opportunity to appear before your committee. Associated with me in this presentation is Mr. Leonard J. Calhoun of the firm of Harter and Calhoun, Washington, D. C.

CAPITAL GAINS TAX ON SALES AND EXCHANGES OF OWNER-OCCUPIED HOMES

With your permission, Mr. Chairman, I should like to devote my comments first to section 303 of H. R. 4473, pertaining to the sale or exchange by a taxpayer of his home where he reinvests the proceeds in another home and as applied to the trade of one home for another home.

We concur most heartily, Mr. Chairman, with the provisions of section 303 of H. R. 4473, because we believe that this section will remove what has been a gross inequity in the law for many years.

Under the present law, if my home is destroyed by fire or flood or some other catastrophe, or if it is taken by the government for public purposes, the gain, if any, resulting from the insurance indemnity or the condemnation award is not recognized, provided I use the proceeds thereof to acquire another home.

However, if I am forced to move from one city to another because of change of my employment, as is the case among thousands of defense workers today, I am caught in a trap. If my old home has increased in value over the original purchase price, this increase will be taxed to me as a gain, yet at the same time I am required to pay a comparable price for my newly acquired residence. I had a home and now all I have is another one which cost all the proceeds from the sale of my first home. Neither is worth any more or less than the other. But in changing my home, I have incurred a substantial tax liability. The home owner does not believe that this is fair or equitable.

Let me give you a glaring example of what the present law does. Suppose that in 1946 I bought a home in Detroit for $10,000 and my brother bought one in Cleveland for $10,000. As a result of the cheapening of the value of the dollar, the fair market value of my home in Detroit is now $15,000 and the fair market value of my brother's home in Cleveland is similarly $15,000. I am transferred to Cleveland from Detroit and my brother is transferred to Detroit from Cleveland, and we decide simply to trade homes.

The law now says that I realize a taxable gain of $5,000 when I take over my brother's house, and he realizes a taxable gain of $5,000 when he takes over my house. Because we are transferred in our jobs, we are each penalized to the extent of the tax on $5,000 worth of increased value which, I submit, is not a real gain.

Let us take another example. I have been employed by the X corporation in Midville, United States of America, for 20 years. Midville is essentially a one-industry town. The X corporation at its plant in Midville produces aluminum windows. It also has a plant in Centerville, United States of America, where it produces various other aluminum products. The National Production Authority prohibits the Midville plant from making any more aluminum windows, and the Centerville plant has received a large order from the Military Establishment for the production of vital parts for military aircraft. Because of the National Production Authority order it is necessary for the X corporation to close down—at least temporarily—the Midville plant, but it needs all of its key Midville employees to work on the military contracts at its Centerville plant. I am one of the employees transferred to Centerville.

Because of the closing down of the plant at Midville, I, along with many other employees in Midville, am forced to sell my home. But because Midville is essentially a one-industry town, and the industry is shutting down, I cannot sell my home even for what I paid for it, and I am forced to take a substantial loss. Yet, when I purchase a comparable home in Centerville, I am compelled to pay a higher price.

Can I deduct the loss in computing my tax? Uncle Sam says, "No, I will tax you if you have even a theoretical gain, but I will not let you deduct a real loss." So at the present time, the Internal Revenue Code bestows upon Uncle Sam a heads-I-win-tails-you-lose home-owner hunting license. And we hope the committee will agree with us that the home-owner should receive the more equitable consideration provided under the provisions of section 303.

We believe that it is extremely important in this period of defense mobilization not to have provisions in the laws of the land that discourage or impair the mobility of working men and women. We believe that the existing provisions of the Internal Revenue Code—in their treatment of gains and losses from sales or exchanges of homes—do have this effect because they penalize pelple who have to move from one place to another in response to the demands of the mobilization program.

The staff of the Joint Committee on Internal Revenue Taxation recognized the gross inequity in the present law, and 2 years ago made recommendations that, if adopted, would have remedied the situation. At that time the Treasury was opposed to any change. We are happy to see that the Treasury now also recognizes this inequity. When the Secretary was before the House committee he stated, in answer to questions from members of the committee, that the existing situation was inequitable and that the Treasury had it under study.

We believe the inequity should be removed, and removed now, for every increase in the tax rate only serves to make the inequity greater.

The committee report accompanying H. R. 4473 indicates that there might be a slight loss to the Treasury from this proposed section. We take issue with this conclusion because this proposal would result merely in a tax deferment rather than a tax exemption, due to the broadening of the tax basis.

Since real property is subject to capital gains tax, we should like to recommend further that losses on the sale or exchange of an owner-occupied residence, which for the required holding period was used by the taxpayer as his residence, be recognized and allowed as a deduction. We believe that if it is fair to impose a gain tax against real property in the event of gain, it is only fair that the owner be permitted to take a deduction in event of loss.

We believe that our recommendations do no more than extend the existing policy of sections 112 (b) (1) and 112 (f) of the Internal Revenue Code to sales and exchanges of homes, and we believe that it is necessary to do this in order (1) to promote free mobility among our working forces, (2) to permit our working men and women to meet mobilization requirements without being severely penalized therefor, and (3) to treat all home owners fairly under the tax laws.

PROPOSED INCREASE IN ALTERNATIVE TAX ON LONG-TERM CAPITAL GAIN

Our members, Mr. Chairman, also oppose the proposal to increase the alternative tax on long-term capital gains. We are concerned both because of the principle and precedent involved in the proposal, and because of its practical effects of further discouraging the normal transfer of property and of further inflating real estate prices.

As implied by its name, a long-term capital gain normally means an economic gain which has been built up gradually over an extended period. Such gains have regularly received special treatment for income tax purposes, as there are essential differences between them and ordinary income such as wages, salaries, earnings from self-employment, dividends, interest, etc. There are, therefore, special considerations which must be borne in mind in levying the capital gains tax.

The pending bill would subject these long-term capital gains to a temporary "defense tax" if the property is sold in the period the tax is in effect, even though the appreciation in dollar value occurred principally or wholly outside this temporary period.

Furthermore, the capital gains tax has been rapidly moving in the direction of becoming a transaction tax measured by the degree the dollar has lost purchasing power between the date the property was purchased and the date it was sold. By way of illustration, it might be pointed out that a few years back capital gains taxes were rarely paid in the sale of a person's residence. Only when the home

was originally purchased at a great bargain or when subsequent community development enhanced its value was it likely that it would be sold for more than its original cost. In such case the seller could buy a similar home and have a substantial sum left over. But with today's debased dollar it is extremely rare for a person to sell his home without paying a very substantial capital gains tax, and if he buys a similar house he has no dollars left over from his sale. We do not feel that it is equitable to increase the rate of a tax which is already inflated in amount and changed in effect by the progressive decline in the buying power of our dollar.

Our recent experiences have made clear that in the real estate field the capital gains tax is highly inflationary. Prospective sellers ascertain the amount of capital gains tax which must be paid and add this to the purchase price which otherwise might satisfy them. This either results in the purchaser paying a price further inflated to include the capital gains tax, or in the prospective seller holding onto a property which could be better utilized by others.

The tax on long-term capital gains is fundamentally a nonprogressive tax. The effective tax presently is and for a long time has been 25 percent of the capital gain. In the case of individuals with low or moderate incomes, there is an alternative of counting one-half of the gain as ordinary income, when doing so would give them a smaller tax than if they paid their regular tax plus their capital gains tax. The value to these taxpayers of the option of including half their capital gain as ordinary income has varied considerably during the last few years as tax rates have increased, decreased, and increased again.

Whether or not you again reduce the value of the option for paying less than the standard 25 percent rate, the question of increasing the standard rate itself is a separate matter which you have been faced with on several prior occasions. The Congress has always decided to retain this rate, and we see no basis for presently reversing these decisions.

During the high rates of the war years it was decided to leave this alternative tax at the 25 percent rate, and during the postwar tax breathing spell it was decided to continue at this rate.

Even under the extreme pressure for the need of revenues during full-fledged World War II, your decision, which we still think sound, was to leave the standard capital gains tax at 25 percent. By way of illustration, while normal and surtaxes were at a rate of 50 percent in the $14.000 to $16,000 bracket, you deemed it wise to reduce inflationary trends by holding to the standard 25 percent rate. It is significant that, at least for a married person, the proposed rate under the pending bill for the $14,000 to $16,000 bracket is only approximately 37 percent; and it is not until such income reaches a level of between $26,000 and $28,000 that the rate becomes in excess of 50 percent.

We know of nothing before your committee which would afford any reason to reverse your repeated decisions with respect to the appropriate rate of this alternative tax.

I shall only briefly mention the corporate capital gains tax. The explanation in the Ways and Means Committee report for the proposed corporate capital gains tax increase is simply that it "is increased by the 12½ percent defense tax to match the change made in the rate applied to individuals." I should take this justification to mean that this proposal fails if the proposed capitals gains tax on individuals is rejected. The proposed increase is unsound for the same reasons that the proposed increase in capital gains tax on individuals is unsound.

TAX TREATMENT OF RELATED CORPORATIONS

Section 123 of the bill is designed to remove what the Ways and Means Committee report describes as "an unwarranted tax advantage of businesses carried out by means of a series of corporations rather than a single corporation," and thus to remove "an incentive for the artificial splitting up of corporations."

The report points out that under existing law each corporation has a $25,000 corporate surtax exemption and a $25,000 minimum excess profits tax credit, and that these features of the law which afford favorable tax treatment to small corporations are available "to each member of a group or chain of related corporations even though the degree of their association is sufficiently great so they are virtually a single business enterprise."

In such situations the section would limit corporations constituting the group to an aggregate of $25,000 in surtax exemptions and $25,000 in minimum excess profits tax credit if their commonly held voting power control is 95 percent or more, as computed under this section. For example, if there were four members of

such a group, the four as a group would have only one-fourth the exemption and minimum credit they would otherwise have.

It is not certain how effective the provision would be in preventing deliberately contrived corporate split-ups of a business, since any corporation could escape it through a planned distribution of 6 percent of voting power. But it would seem to apply to any two or more corporations with the specified degree of common control through voting stock ownership even though their respective histories, business purposes, and activities may demonstrate conclusively that they are in no sense tax shams but are in fact separate entities with entirely separate businesses.

If an individual or a group acquires the stock of a well-established fire insurance agency, it would be difficult to justify drastically changing the tax treatment of this corporation merely because this same individual or group also owns the stock of a real estate brokerage corporation or of some other kind of corporation. Yet, as I read the section, these two corporations would lose half their surtax exemption and minimum excess profits credits. If the individual or group also acquired the stock of a corporation which owned an office building, the result would be that the three corporations would thereby lose two-thirds of their combined surtax exemptions and two-thirds of their combined excess profits credits.

You have consistently deplored the favoritism which results when one entity receives a more favorable tax treatment than another entity in substantially the same position. Yet that is exactly the effect of the proposed change; for the small corporation which might legitimately have common-stock holders with another small corporation might find its tax burden twice that of a competitor otherwise identical in character. I cannot think it wise so to ingore the identity of many such small corporations.

If I have correctly interpreted and applied this section, it would do much more than plug tax loopholes. It would, to a substantial degree, disregard corporate entities and increase the taxes of corporations merely because their stockholders were the stockholders of other corporations. Such tax treatment would, in effect, deny the very foundation of our laws taxing corporations on their earnings and again taxing stockholders on their dividends. For the law would deny normal tax treatment to a corporation, not because it is a sham, but solely because its stockholders are stockholders of some other corporation or corporations, and even though its bona fide separate entity is demonstrated by every other test.

We cannot believe that administrative convenience in dealing with artificial corporate split-ups would warrant adoption of a rule which would also apply to situations such as I have described. Instead, we recommend that if this section is retained it should be drastically modified. Common ownership should be recognized as rebuttable evidence that the corporations concerned may be tax shams, but should not be conclusive of this fact. And we believe that the section should be limited in scope to situations of suspect recent or future split-ups, and thus eliminate the uncertainty which might otherwise exist as to the status of corporations formed before the existence of the recently accentuated tax advantages of corporate split-ups.

The CHAIRMAN. Mr. Calhoun, we shall be glad to hear from you.

Mr. CALHOUN. Mr. Chairman, I should like to make only a couple of very brief comments on the matter of the long-term capital gains tax. This has always, of course, been the subject of special treatment by your committee, and anyone who claims to know all the answers we automatically suspect.

Nevertheless, I think that it is of primary importance that two or three matters be borne in mind in levying a capital gains tax. The top, which has regularly been put on what might be referred to as the normal rate, is not put on there primarily out of any consideration for the individual concern. It is put on there to a very considerable degree in recognition of the fact that an unwise tax may bring in less revenue than a wise tax, and that there are some consequences of capital gains taxes on the normal transfer of properties which have to be very carefully borne in mind.

The pending bill would subject the long-term capital gains to a temporary defense tax if the property is sold in the period that this

temporary tax is in effect, even though the appreciation in dollar values occurred principally or solely outside of the temporary period.

I think if we were deliberately contriving to enact a tax which would discourage the free sale of real estate because we for some reason had a national policy against free transfers, and if we wanted to make certain that there was an artificial enhancement in the price asked for transfers that did occur, we would probably accomplish both of these advantages by an increased capital gains tax.

Senator KERR. Would you say both of these advantages or both of these objectives?

Mr. CALHOUN. Objectives. I stand corrected.

I think that that yardstick is true even though our present objective, I think, is to facilitate transfers of property, because we want all properties used to the best advantage, and we do not want an unnecessary restriction. For example, a three-member family might be living in a five-bedroom house at a time when it is to everybody's advantage for the family to purchase a smaller house, but the family might be directly prevented, taxwise, from making such a change.

That same thing is true of business facilities which might be better transferred to some other company.

We cannot fail to recognize that in view of the universal inflation—and you have heard various witnesses indicating the degree, not only in the case of real property but in the case of all types of property—there is such a close eye on the tax consequences of transfers today that an increase in the capital gain tax cannot help but discourage that.

Furthermore, the capital gains tax has been steadily moving in the direction of a transactions tax measured by the depreciated value of the dollar. In normal times, with a reasonably stable currency, for example, to return to the example of homes, an individual who sold his residence rarely had to pay a capital gains tax. It was only where he bought it at a tremendous bargain or where the community development resulted in a great enhancement in value that a capital gains tax would be due. And in those occasions when he sold his house he would always be in a position to buy a similar one and have a substantial amount of money left over.

It was truly an economic gain. But in recent years, this has not been an occasional but an almost universal accompaniment of the transfer of property. It has been measured more by the depreciation of the dollar than by any real economic gain.

I think both of those are very substantial reasons for not increasing the capital gains tax at this time.

Now to make only one or two comments about the related corporations provisions, we find that in the Ways and Means Committee report, it is stated that section 123 of the bill is designed to remove what that committee described as unwarranted tax advantages of businesses carried out by a series of corporations rather than a single corporation, and thus to remove an incentive for the artificial splitting up of corporations.

I think that when you examine into the scope of the legislation, though, it is rather apparent that it goes far beyond the situation described, and applies, as I read it, to situations where I do not think there would be any justification in referring to them as loopholes.

For example, as I read the section, you can have corporations in entirely unrelated businesses. An individual, for example, or a group

of individuals can own, say, a fire-insurance company—a small fire-insurance company. This same group, or this same individual, decides he will go into the rather risky business of constructing homes, or perhaps acquiring an office building, or some other unrelated activity.

As I read the tax bill, this individual, however unrelated those activities are in risk and every other normal yardstick, by the mere acquisition of the prescribed degree of control, would cut out half, where there were two, or two-thirds where there were three, of the excess profits credit to these small corporations.

I cannot believe that these situations were referred to as loopholes, but I believe that the bill does apply to them, so as to deprive them of excess profits taxes.

We have done an extremely dangerous thing whenever we substitute an inflexible rule for evidence. I think it is quite true that common ownership, coupled with some other considerations, may demonstrate that a particular situation is a tax sham, but I think by the same token that common ownership is at best a rebuttable presumption, a rule of evidence, if you please, which could be overcome by other evidence that the particular series of corporations are unrelated in so many practical ways that they could not be considered tax shams.

For those reasons, we ask your very careful consideration, both as to the matter of scope of the proposal and as to the matter of this being an inflexible rule of law, whereas we feel that it should be a more flexible rule of evidence of intent to evade.

Those are my comments.

The CHAIRMAN. Are there any questions?

(No response.)

The CHAIRMAN. Thank you very much, Mr. Calhoun.

Mr. SNYDER. Mr. Chairman, with your permission, I have here four editorials in support of section 303 of the House bill, and I also have three telegrams from New Orleans, New York, and Chicago in support of this testimony.

With your permission, we should like to offer them for the record.

The CHAIRMAN. Yes, sir; you may give them to the reporter.

(The documents referred to are as follows:)

[Editorial from Life magazine, June 25, 1951]

A BREAK FOR THE HOUSEHOLDER

Nearly 19 million Americans move every year. This means that many people have had to sell their homes and buy new houses. In the past when they made a profit they had to pay a capital gains tax even when, as so often happened, the new house cost as much or more money. Now the House Ways and Means Committee has recommended that people who sell houses at a profit will be relieved from capital gains taxes if they reinvest in a new home within 12 months. This is an act of simple justice for people on the move. We're for it.

[Editorial from Cedar Rapids Gazette, June 1, 1951]

THIS TAX UNFAIR

A good example of why some citizens become embittered over taxes they must pay can be found in the capital gains tax applying to the increased value of a home over the original purchase price.

Of course this is meant to catch the speculator. The idea is to put a bridle on some of his speculations. But it isn't fair to the little fellow who must sell his

home for some good reason and go into the market to buy another. That's why the National Association of Real Estate Boards wants to exempt a home owner from paying this tax.

Here's how it works: A resident of town A is transferred to town B. He gets $12,000 for his home in town A which originally cost him $6,000. He has to pay a capital gains tax on the $6,000 increase in value. But when he gets to Town B he finds that he must pay $12,000 there to buy a home that was built a few years ago for $6,000. Net result: The resident is out the amount of the capital gains tax. Is it any wonder there's grumbling over a tax of this nature which makes no provision for exempting the hard-working individual who isn't trying to speculate his way to fortune by taking advantage of an unusual situation? Fortunately, there are signs that Congress may do something to correct this injustice. But as yet it hasn't.

[Editorial from Washington Post, June 25, 1951]

Relief for Home Buyers

Section 303 of the House tax bill provides that "if property * * * used by the taxpayer as his principal residence is sold by him and, within a period beginning 1 year prior to the date of such sale and ending 1 year after such date, property * * * is purchased and used by the taxpayer as his principal residence, gain (if any) from such sale shall be recognized only to the extent that the taxpayer's selling price of the old residence exceeds the taxpayer's cost of purchasing the new residence." This involved language means that a man who sells residential property costing him $5,000 for $10,000 will not have to pay taxes on the profits from the sale if he buys another $10,000 residence within the set time limits. However, if the new house should cost only $8,000, he would pay taxes on the $2,000 excess gain.

This is a form of tax relief that we heartily endorse. For it would remove impediments to sales by owners who for reasons of convenience or necessity would like to sell their homes and buy new ones. At present they are restrained by the fact that part of the proceeds from the sale of old residences is taxed away and not enough is left to purchase new houses of comparable value. Consequently fewer houses are offered for sale and more people are living in quarters that do not meet their special requirements.

Exemption from taxation of the profits from the sale of residences would be in the public interest. For it would encourage owners whose homes are remote from their places of business to move to more suitable locations and facilitate recruitment of men for work outside their home towns. The resultant increase in the mobility of the working population would minimize the effect of industrial dislocations caused by our mobilization program. We hope that the Senate, which is expected to apply a pruning knife to the House bill, will not use it to excise section 303.

[From Fortune magazine, May 1949]

Taxes—An Informal Letter From a Tax Lawyer. Subject: Selling a House

(The fourth of a series of letters on current tax problems written for Fortune by Merle H. Miller of Indianapolis.)

Dear Ken: There have been thousands of others caught in your same predicament, if that is any consolation to you. The person today who has to sell his home and buy another usually finds himself in a tax squeeze from which there is no escape. As you point out, in your case it is a particular shame since you have just paid off the last remnants of a mortgage, and now as a result of the move you may have to put a mortgage on the new house in order to pay your income taxes on this necessary exchange of houses. And the house that you wind up with will not be any better than the one you now have.

Our applicable tax laws were written when most people were feeling indignant over not being able to deduct the loss incurred on selling their houses. Everyone assumed that if he were lucky enough to make a profit, the tax would be the least of his worries. But that was before inflation had changed the dollar mark on all property so that the mathematical profit was not really profit at all. Congress has been urged to do something to relieve those who are compelled to sell and buy again, but so far the mountain has not brought forth even a mouse. So we

must explore your situation under the laws as they now exist, and not as they should be.

I understand that you bought your house 8 years ago for $8,500 and now you can sell it for $17,500, making a net profit before expenses of $9,000. That is a nice profit for doing nothing but living in the house for 8 years and trimming the spirea on Decoration Day. The fly in the ointment is that you will have to buy another house when you get to Omaha and will have to pay at least $17,500 to get a house probably not quite so good as your present one. You are bound to lose some on this change of location, for the real-estate men have to be paid by somebody, but apart from that you will still owe the Government a capital-gains tax on the so-called profit, which is the difference between your cost and the net selling price.

Your inquiry as to whether you could trade houses with somebody in Omaha is becoming such a stock question that I am able to answer it without opening a book. As you suggest, you would not receive any money if you were able to find someone in Omaha who would trade you even for your house in Indianapolis, but it is not necessary for you to receive money to incur an income-tax liability to Uncle Sam. Even though you are on the cash basis for reporting income, you may realize gain on any exchange regardless of whether cash is involved, and you must find some provision in the statute that makes the gain nontaxable if you are not going to pay a tax on it.

Section 112 (b) (1) of the Internal Revenue Code provides that when property held for productive use or investment is exchanged for like property there shall be no recognition of gain or loss. That special treatment does not extend to securities or to property held primarily for sale. But it does include real estate, and you could trade an office building for a farm or any other type of real estate without incurring any tax liability, if both the real estate exchanged and the real estate received were held for productive use or investment. So you could exchange rental property that you owned in Indianapolis for rental property in Omaha without paying any tax whatsoever on any theoretical gain realized on the exchange. But the home owner is the forgotten taxpayer in that section and there is no provision in our present income-tax laws that allows you to exchange your residence for another residence without paying a tax on the difference between the cost of your present house and the market value of the house you receive.

I know what your next proposition will be and that will not work either. You are thinking already of renting your home in Indianapolis so that it will be held for investment and then exchanging that for a house in Omaha, which you would hold for investment. But where would you live in the meantime? And if you did find a place to live for a year while you were renting the house in Indianapolis for 6 months and then renting the house you acquired on the exchange in Omaha for 6 months, would you have been holding either house for investment, or would you have been merely trying to comply with the literal wording of the clause in the statute? Back when taxpayers were trying to convert their houses to business use so they could claim a loss on the sale, the courts were quite rugged in requiring more than a temporary business use and I imagine a court would treat you the same way if you tried to utilize a temporary business use as evidence of a bona fide investment.

You could avoid this substantial capital-gains tax if you could find a place to rent in Omaha and then rent your home in Indianapolis. Don't assume, however, that you would break even on the deal even though you could rent your Indianapolis home for as much as you would have to pay for rent in Omaha. The rent from the Indianapolis property would be income on which you would have to pay a tax and you would get no deduction for the rental you would be paying in Omaha. Assuming you get $1,200 a year rent from the Indianapolis property, you would pay a tax of about $400 a year in your present bracket, so that if you paid the same rental in Omaha you would have to chip in $400 each year out of your own pocket.

It would not help any if you could find someone in Omaha who was moving to Indianapolis who would agree to trade living quarters with you for a while. Even if you could arrange such a deal you would still have to pay an income tax on the rental value of the property you were occupying in Omaha. Legally you would be leasing your property in Indianapolis, and the rent you received would be the right to live in the property in Omaha. You would each be liable to Uncle Sam for a tax on the rental value of the property you were occupying and you would be paying a tax of around $400 a year for the privilege of living in somebody else's house. (Incidentally, a taxpayer in England must always pay a tax on the rental value of the house he owns and occupies, if that is any consolation.)

☞ Under these circumstances I think you might as well sell your house in Indianapolis and buy another one in Omaha and pay your capital-gains tax in as philosophical a manner as you can muster. You should, of course, build up your original cost of $8,500 by adding any capital expenditures you have made in the meantime. If, for example, you assumed some of the taxes due by the previous owner, you are entitled to include that in the purchase price. If you have paid any tax assessments for improvements, such as sidewalks, sewers, street improvements, etc., you are entitled to add those to your original cost. You may not add the ordinary real-estate taxes for which you have been claiming deductions as you paid them.

Then you may add the cost of any capital improvements you have made, but not the cost of repairs. Capital improvements are those that increase the value or prolong the life of your property. Repairs just put the property back where it once was. Sometimes the dividing line gets mighty thin but, of your outlays that come to mind, you could include the cost of finishing the attic and putting in the extra bath, as well as installing a shower in your old bath. You could also include storm windows, and the shrubbery you planted (but not your doctor bill for your lumbago after you did all that digging).

You could not include in your total cost any painting or papering, or pointing the brickwork, nor the cost of repairing the part of the roof you ruined trying to put up the television aerial. If you had put on an entire new roof you could add that cost, but the new gutters you put on the old roof is not a capital item. I told you the line is thin.

I almost forgot that you converted to oil and then had to convert back to coal during the war. The cost of both conversions can be added, and also the cost of waterproofing your basement. Make a list of any other major items you remember and we'll make a guess at them.

From the selling price you would deduct all expenses of sale, such as commissions, bringing the abstract up to date, etc., to get your net selling price and the total cost. You have the option of paying either the flat 25 percent on that gain, or of including half of the gain in your income, whichever results in the lesser tax. A married man, such as you are, with an income of less than $44,000, would elect to include half of the capital gain in his ordinary income-tax computations.

Now comes the crowning blow, which I have decided you might as well receive now, rather than wait and get it a few years from now. You said your company has generously agreed to pay your moving expenses to Omaha, which you felt was quite a break since the cost would probably exceed $900. But you will have to include as your income whatever the company pays for moving your family to the new location. Moving your family is primarily your responsibility and the payment of your obligations by your employer is income to you.

You wouldn't mind including those moving expenses in your income if they were deductible, but they are not. Section 24 of the code disallows any deduction for personal living expenses and, despite anguished appeals by taxpayers, the courts have consistently held that such expenses of moving a family to a new location were primarily personal, even though the move was necessary to keep a job. Such a result is certainly not realistic, but any relief will have to come from Congress, unless some courts start legislating for the taxpayer the way they have been for the Government these past years.

As matters now stand you will be taxable on those family moving expenses your company pays, so if it really wants to make you whole it should give you enough to pay the tax on those moving expenses, plus enough to pay the tax on what it gave you to pay the tax. Are you still there? Anyway, if you do muster the courage to suggest this to Mr. Dingle, please let me know the hour and place so I can be in the vicinity.

In the meantime, happy reveries, and now you know why I preferred not to answer your questions at the dinner party the other night and suggested I would write you a letter instead. You also know why I try to steer the conversation away from taxes whenever we do go out, and why, when I fail in those efforts, we are so seldom invited back.

Sincerely yours,

MERLE H. MILLER.

NEW YORK, N. Y., *July 13, 1951.*

HERBERT U. NELSON,
Executive Vice President, National Association of Real Estate Boards, Washington, D. C.:

Essential points objection capital-gains-tax increase.

(1) The higher the raise in tax the more it discourages the transaction, cite 1921-22 results.

(2) Can increase only so far until it freezes the results.

(3) Higher rate will postpone any gain.

(4) Many gains are only paper versus real profits in relation to value of dollar at beginning of the transaction.

(5) So-called present gains thus may actually be losses when completed taxwise.

LEE THOMPSON SMITH,
President.

NEW ORLEANS, LA.

HERBERT U. NELSON,
National Association of Real Estate Boards, Washington, D. C.:

Strongly urge that proposed 12½ percent increase tax on capital gains be given no consideration by Congress. We believe that this increase, if adopted, would result in a decrease in total taxes collected, as it has been our experience over a period of years that many properties are not sold because of tax angles. Present capital tax itself has resulted in numerous properties being held off the market * * *. Numerous commercial and industrial properties would be frozen and would probably result in leases instead of sales which would diminish the total taxes which might be collected on the present basis which we believe is the breaking point. Any increase would diminish sales.

F. POCHE WAGUESPACK.

CHICAGO, ILL., *July 12, 1951.*

HERBERT U. NELSON,
National Association of Real Estate Boards, Washington, D. C.:

In the interest of developing increased production facilities or using capital assets to the best advantage, whether for civil or military needs, it is often necessary that properties be sold to those who can use them to the best advantage. When the tax on such a sale is high, it discourages the owner from selling. In fact, in many cases owners refuse to sell property that, in the best interests of the country, should change hands. This applies not only to industrial and commercial properties but also to housing. It also applies to properties held under group ownership as well as to that individually owned. The higher the capital-gains tax, the less profit is left for the owner and the less incentive to sell, expecially if the funds must be reinvested. The capital-gains tax even at present levels tends to immobilize capital assets of all kinds.

FRANK C. WELLS,
President, Chicago Real Estate Board.

The CHAIRMAN. Thank you.

Mr. SNYDER. We appreciate very much your permitting us to testify at this late hour.

The CHAIRMAN. We were glad to have you.

I insert in the record at this time numerous statements submitted in lieu of personal appearances. These statements will be properly reviewed in connection with an executive consideration of H. R. 4473.

RESOLUTION OF INDEPENDENT THEATER OWNERS OF ARKANSAS, LITTLE ROCK, ARK.

Whereas on May 17, 1951, the House Ways and Means Committee voted to remove the Federal admissions tax from high school athletic contests and other gatherings where the proceeds benefit nonprofit educational charitable and religious institutions;

Whereas such action of the committee effects a 20 percent Government subsidy to the gross receipts of the named groups;

Whereas such action constitutes an unjust discrimination against the patrons of motion picture theaters and the operators of such theaters;

Whereas the loss in tax revenue to the United States will be far in excess of the estimate of $21 million made by the House Ways and Means Committee;

Whereas the motion picture industry is today suffering a serious decline in admission due principally to economic conditions (the high cost of living and taxes);

Whereas many motion picture theaters in smaller towns will be compelled to cease business if the proposed favoritism in the administration of Federal admission taxes is allowed to become law;

Whereas it is our belief that in times of national emergency every citizen, every business, and every group should bear equally the added tax burden, and that no concessions should be made to privileged persons, businesses, or groups;

Whereas this association, collectively and individually, has established an outstanding record of service to the Government, and intends to continue such record on a local State and National level by disseminating information to the public, aiding in the sale of bonds, sponsoring civil defense programs, and extending itself in every particular in progressive cooperation: Therefore, be it

Resolved, That this association unqualifiedly condemns and denounces the unfair and discriminatory provisions of tax free admissions contained in section 402 of the Revenue Act of 1951; be it further

Resolved, That this association request the Finance Committee of the United States Senate to eliminate such tax free admission privileges; be it further

Resolved, That a copy of this resolution be spread upon the minutes of the association, and a copy sent to each member of the Senate Finance Committee and the chairman of the House Ways and Means Committee.

Dated July 13, 1951.

I, Sam B. Kirby, state on oath that I am president of Independent Theater Owners of Arkansas; that I have possession and custody of the records of said association; that the above and foregoing is a true and correct copy of a resolution of the association made and adopted at Little Rock, Ark., on July 13, 1951, as appears on the said records of said association.

SAM B. KIRBY.

Subscribed and sworn to before me this 13th day of July, 1951.

[SEAL] JULIE BLOUNT, *Notary Public.*

My commission expires March 14, 1955.

PAN-AM SOUTHERN CORP.,
New Orleans 6, La., July 10, 1951.

The Honorable HALE T. BOGGS,
The House of Representatives, Washington 25, D. C.

DEAR MR. BOGGS: A tax of 2 cents per gallon on Diesel fuel used on the highways, which has been approved by the House Ways and Means Committee, is objectionable for the reasons stated below:

1. The cost of administering this tax would probably exceed the total revenue. Less than 3 percent of all Diesel fuel produced is used on the highways at the present time. The tremendous task of bookkeeping and policing that would be involved in determining which Diesel fuel was purchased for highway use and which was not, clearly points to the impracticability of imposing this tax on the American people.

2. The responsibility for collecting the tax could not feasibly be discharged by the refiner. Certainly there would be no way of knowing the end use of the fuel when it was shipped. The refiner would face a hopeless task if charged with the responsibility of determining the quantity and collecting the tax on Diesel fuels that would ultimately be used in Diesel equipment on public highways.

3. The proposed tax on Diesel fuel is highly discriminatory. It singles out a particular product to carry a tax burden without regard to the undesirable and uneconomical consequences of such action.

As you know Pan-Am Southern Corp. is engaged in extensive distribution of petroleum products in the State of Louisiana, and I respectfully solicit your careful consideration of the objectionable features of this proposed tax measure, and hope that you will find, or have already found, that you can unquestionably lend your active support to defeat this impractical, uneconomical, and discriminatory tax proposal.

Yours very truly,

ROY J. DIWOKY.

YARDARM, CHILMARK, MASS., *July 29, 1951.*

Hon. HENRY CABOT LODGE, Jr.,
Washington, D. C.

DEAR SIR: As one of your constituents and loyal supporters, may I call to your attention the enclosed statement prepared by the Mystery Writers of America, Inc., of which I am a member, pointing out the inequities of the new tax bill, as applied to book authors. I understand this bill has already passed the House, and is now under consideration by the Senate Finance Committee.

As a professional author, deriving practically my entire income from book royalties, it is a matter of deep concern to me that such royalties should be classed with salaries for purposes of tax withholding, rather than with royalties from income-producing real property.

I am confident that after glancing over the enclosed statement you will agree that this plea is valid.

Very truly yours,

KATHLEEN MOORE KNIGHT.

STATEMENT BY MYSTERY WRITERS OF AMERICA, INC., NEW YORK, N. Y., RE THE PROPOSED WITHHOLDING TAX ON BOOK ROYALTIES

Section 201 of H. R. 4473 as passed by the House adds a new chapter 6 to the Internal Revenue Code. Section 1221 of this chapter provides for the withholding of a 20 percent tax on "royalties" paid after December 31, 1951, and the definition of "royalties" in section 1220 (b) includes royalties paid by a publisher to an author. Under these sections, as is true under the entire section relating to the withholding of dividends, interest, and royalties, tax will be withheld at 20 percent of the entire amount of the royalties without any allowance for personal exemptions. This is clear from the provisions of the sections themselves and also from the statement on page 17 of the report of the Committee on Ways and Means.

This statement, pointing out the inequities of the above provisions as applied to authors' royalties, is made at the behest of the Board of Directors of Mystery Writers of America, Inc., an organization of nearly 300 authors, including new writers as well as the top names in their specialized field. The organization was founded in New York in 1945 and now comprises branches in the Midwest, southern California, and northern California. The inequities to which we object, however, apply equally to the thousands of American writers in other fields than ours—the authors of the 11,022 book titles published in the United States in 1950.

Mystery Writers of America, Inc., believes that the withholding of tax on book royalties should be only after the allowance of personal exemptions. Withholding of tax as applied to book royalties should be on the same basis as the withholding of tax on salaries, rather than in accordance with the withholding method to be applied to interest, dividends, and royalties from income-producing real property such as oil wells. The present proposed provisions will impose undue hardship on many writers.

DEFINITION OF BOOK ROYALTIES

It may be pertinent at this point to explain briefly how book royalties are paid by a publisher to an author. They represent a percentage of income from sales. In the case of so-called trade editions—the hard-cover books—the percentage is usually 10 percent of retail price on the first few thousand copies sold, ranging upward to 12½ and 15 percent when sales pass 5,000 and 7,500 copies. In the case of "reprint editions"—paper-bound books usually sold at 25 cents—the reprint publisher pays the original trade publisher a royalty of 1 cent per copy for the first 150,000 copies, and 1½ cents per copy thereafter; the trade publisher then pays the author one-half of the reprint royalties. Royalty statements are rendered by publisher to author at 6-month intervals, with payment made from 3 to 5 months thereafter. Thus an author frequently has to wait nearly a year to collect his earnings.

On the other hand, most publishers pay to the author an "advance on royalties." In the case of a new writer this may be $500, half on delivery of the manuscript, half on publication. For an established writer the amount is $1,000—in rare cases even more—with the same interval between delivery of manuscripts and publication. The "advance" therefore, is an advance only from the publisher's point of view; in that it constitutes payment out of anticipated revenue. From the author's point of view, it is payment for work already done.

OBJECTIONS TO THE PRESENT PROVISIONS OF H. R. 4473

The board of directors of Mystery Writers of America, Inc., wish to make it clear that they are in no way opposed to the principle of a withholding tax on royalties as such. We do object to a proposed tax on royalties in which no allowance is made for personal exemptions and which would, in many cases, cause the tax on the author to be overwithheld.

Although we realize that any overwithheld tax will be ultimately refunded, we feel strongtly that the proposed delay which will deny the royalty earner the use of money which is rightfully his will work great hardship on many new writers and on slow-writing or slow-selling authors whose income is already close to the subsistence level. Many young writers have no income except the royalties on their written work, and their income is low enough so that a 20-percent tax on their total income, even though it is in part returnable, will work a real hardship upon them. We are certain that the framers of this bill have no desire to cause undue suffering to low-income writers by imposing on them a tax at a higher effective rate than that imposed on persons receiving commensurate salaries for personal service.

We feel that book royalties should be classed with salaries for purposes of tax withholding, rather than with dividends, interest, or royalties from real properties. Whereas dividends, interest, and royalties from real property represent a return on invested capital, book royalties represent exclusively earned income, a return from work performed and skills exercised. The investor of capital may be assumed to possess other income; the writer of books too frequently has none but the product of his own skills.

We feel that the tax should therefore be levied on writers on the same basis basis as it is levied on persons paid a salary for personal services, and that it should operate in the same manner as does the withholding tax on salaries. We do not think the administrative problems of withholding tax on royalties after the allowance of personal exemptions would be any greater than they are in the case of tax withheld on salaries. Most writers have only one publisher. In the few cases in which an author may be drawing royalties from more than one publisher simultaneously, the administrative problems are no more serious than in the case of an employee drawing salary from more than one employer, or of an actor who during the same year earns pay from such varied sources as the stage, radio, television, motion pictures, and a night club. His tax is withheld by each of his various employers, each of whom sends him statements reporting the amount of tax withheld. The same method could be used with the author.

SUGGESTED REMEDY

We therefore, respectfully propose that section 201 of H. R. 4473 should be amended so as to provide that income tax should be withheld on royalties paid by a publisher to an author only after the allowance of personal exemptions.

OFFICE OF THE MAYOR,
Phoenix, Ariz., February 17, 1951.

Senator CARL HAYDEN,
Senate Office Building, Washington, D. C.

DEAR SENATOR HAYDEN: It has come to my attention that in the President's tax message early this month he suggested that Congress "plug loopholes" and referred to the removal of the present and constitutional exemption of municipal bonds as one possibility. Later the Secretary of the Treasury appeared before the House Ways and Means Committee to outline the administration's program and advocated the removal of the exemption privilege upon some reasonable basis in the taxation of future issues of local and State securities.

This matter has been before Congress a number of times. I believe that it would be most unwise to institute this because it would not place the burden upon the wealthy bond holder but upon the borrowing city or State government. Studies made indicated that if the Federal tax were applied to cities they could expect an increase of about 1 percent in interest rates. As you know we do not receive very much by way of lieu taxes from any Government agencies operating within our areas and we render some service to them. It would seem no more than proper that we continue to have this slight exemption in the issue of our municipal bonds, many of which are most important to this city in its problems brought about by the rapid growth in population of the Southwest.

I felt that it would be well to bring this matter to your attention so that you would know the feeling of Phoenix in the event you have the matter before your body.

Cordially yours,

NICHOLAS UDALL, *Mayor.*

DOMINION MINERALS, INC.,
Piney River, Va., June 23, 1951.

Senator WILLIS ROBERTSON,
Washington, D. C.

DEAR SENATOR ROBERTSON: I trust you will pardon a letter from one of your constituents, however, this is written with the hope that you can assist in two ways.

1. We have been mining the rock product aplite (not a trade name, but the geological name of a rock) here for the past 13 years. This material is shipped to manufacturers of glass located in Maryland, Pennsylvania, New Jersey, West Virginia, Arkansas, Louisiana, Kansas, Ohio, Indiana, etc. There are two companies operating in this area and the tonnage produced and shipped is substantial. We hope you can include this material as one of the natural resources in Virginia that will appear in the new revenue bill and subject to depletion charges. Feldspar is included in the list but aplite is not and we would like for aplite to be included. Aplite is used in the same manner and for the same purpose in the manufacture of glass.

2. Controls. My ideas are: Controls do not control. One control or perhaps several controls are piled one up on the other and to control controls is like trying to make water run up hill on the basis of defying gravity. Gravity is a natural law that cannot be changed nor can it be controlled any more than trying to cause darkness by attempting to eliminate the sun. Here in our blessed country we should follow the natural and inexorable law of supply and demand. Our American way of life is based on this. Every time a control is started it is another step toward all-out regimentation and then socialism and then a dictatorship. The latter thrives on want, poverty, disease, hunger, etc. Just precisely what England is passing through and what Russia has been experiencing for a number of years. Stop controls or accept regimentation and communism. Any form of socialism is a fundamental error. Its purpose may be one thing but its accomplishments mean scarcity, error, negation, etc. In other words it is based on scarcity, fear, want, hunger, disease, etc.

I ask for your support and extend to you warm personal regards.

Sincerely yours,

V. V. KELSEY.

STATEMENT OF FRED O. WILSON, ATTORNEY GENERAL OF THE STATE OF ARIZONA, SUPPORTING OBJECTION OF STATE TO PROPOSED TAXATION OF INCOME FROM STATE AND LOCAL SECURITIES

The over-all opinions which we hold regarding the proposed taxation of State and municipal securities are in accord with those which have been and are now being asserted by the Conference on State Defense. We subscribe to the lucid and exhaustive presentation of the views of the minority of the Special Committee on Taxation of Governmental Securities and Salaries created by Senate Resolution 303, Seventy-fifth Congress, submitted by the Honorable Warren R. Austin, September 18, 1940. The case for tax-exempt governmental bonds as detailed in the minority report seems to us unanswerable from whatever angle viewed. The evils to result from the proposal, bearing most strongly against State and local government and State and local taxpayers, cannot but far overshadow any alleged benefits in the form of increased Federal revenues. We will in the course of this statement point out the peculiar importance of the proposal to Arizona.

It must first be said that the proposal to tax the income from State and municipal bonds is in direct violation of the fundamental constitutional precept recognized by the United States Supreme Court in 1895 in *Pollock* v. *Farmers Loan and Trust Co.* (157 U. S. 429, 15 S. Ct. 673, 39 L. Ed. 759), and adhered to without departure to this day, to-wit: The Federal Government completely lacks the constitutional power to tax the income from State and municipal bonds.

Unanimous State and municipal objection has demonstrated again and again that the proposal is economically unsound, that it is based upon a theory of tax

avoidance which is contrary to established facts, that the tax return to the Federal Government would be comparatively insignificant, while being most costly to the States and their political subdivisions, and that it would threaten the fiscal integrity of local government.

That the enactment of a statute taxing income from State and municipal securities would inevitably result in an increase in current State and municipal interest rates ranging from three-quarters of 1 percent to 1 percent is recognized by everyone. This cost must necessarily be passed on to the State and local taxpayer largely in the form of increased taxes on real estate and other property. The burden would be borne by homeowners, farmers, and rent payers. In a new and growing State such as Arizona the burden of such increased taxation would prove particularly detrimental.

Indeed, no sound fiscal argument for imposing the proposed tax exists, nor does it find support in economic and social considerations. The fallacy in each of the arguments presented in this regard by proponents of the proposal has been conclusively demonstrated by the figures pointed out in the Austin minority report and by the Conference on State Defense.

How does the proposal affect Arizona in particular? Emphasis cannot be placed too strongly on the fact that tax-exempt State and municipal securities are an absolute must for Arizona. For this State is now undergoing an unparalleled growth and expansion in every phase of its economic and social life. Whereas other areas of the Nation have long been built up and the emphasis there is necessarily on consolidation and betterment, Arizona is now experiencing in major proportions State-wide growing pains heralding an era of limitless expansion and opportunity. The benefits to accrue to the Nation as a whole as a result of Arizona's potentially brilliant future defy estimation.

The continuation of the transformation of this State depends upon its ability of its political subdivisions and municipalities to meet the ever-increasing demands of its rapidly expanding population for essential public services, as for example, the construction and expansion of schools, sources of power, and of water, gas, and electric systems. The success of these endeavors and projects turns upon their financing through the borrowing of the necessary funds at rates that the State and its municipalities can pay. Even now, because of its unique situation, Arizona is obliged to pay a higher rate of interest for the funds it borrows, and the increased burden necessarily resulting from the imposition of the proposed tax on the interest of State and municipal securities would be unbearable. Take away the tax-exempt feature from the securities issued by this State and its municipalities and you take away their marketability. Take away the marketability of our securities and you take away our ability to move forward. While the imposition of the proposed tax would seriously cripple other States and municipalities, it could well strike a death blow to Arizona's future.

No one can blind his eyes to the fact that Arizona is now playing and will continue to play a greater and greater part in the defense of our country during the present period of national crisis. Day by day there is a growing influx of population within the borders of Arizona, military and civilian alike. There is a proportionate increase within the State in the number and size of projects of great importance to both the State and the Nation. Do not divest us of the means by which we may continue to do the job which we must and want to do, equally our right and our duty.

The foregoing expresses in but a brief and summary manner the main reasons for the firm stand taken by the State of Arizona in opposition to the present proposal of the Treasury Department.

STATEMENT OF J. M. HOME, EXECUTIVE SECRETARY, INDEPENDENT THEATER OWNERS OF WASHINGTON, NORTHERN IDAHO AND ALASKA, SEATTLE, WASH., RE FEDERAL ADMISSION TAXES

The theater owners of the State of Washington, northern Idaho and Alaska protest the action of the House Ways and Means Committee eliminating the Federal admission tax on school athletic contests, opera companies, community supported symphony orchestras and nonprofit civic organizations, and especially nonprofit or community center movie theaters.

All of these entertainments are done for the purpose of securing funds and now with the increasing of personal taxes, withholding taxes and others, the tax should apply to everyone paying admission to any place.

The theaters also protest the ruling of Charles J. Valaer, Deputy Commissioner of the United States Treasury Department, Washington 25, D. C., in a letter to

Mr. Sam B. Kirby, president of the independent Theater Owners of Arkansas, 1717 Wright Avenue, Little Rock, Ark. Valaer's letter to Mr. Kirby deals with driven-in theaters.

In the second paragraph the letter treats a drive-in theater who advertised "all you can pile in a vehicle—car, bus, truck, wagon, etc.—for 25 cents." Also in the last few paragraphs the Deputy Commissioner gives his reasons for the Bureau's position with an example of a $1 admission being charged for a car regardless of the number of patrons admitted in the car.

Under the Federal Revenue admission tax, if this practice in drive-in theaters is allowed by the Revenue Department and becomes universal over the United States, it will not only be discrimination but will have a decidedly bad affect on exhibitors who have many thousands of dollars invested in regular theaters where they are supposed to tax every person who attends the show.

Drive-in theaters should not be allowed to admit any number of people in a vehicle with only the payment of one admission and one tax collected. As an example and to show the vast amount of money the Government is losing on this kind of a ruling. I have been informed that the average is about four persons per car. In a 400-car drive-in at $1 per car that would be $400, of which $0.20 of each dollar would be the Federal admission tax. Under that arrangement the Government would be losing the tax on 1,200 patrons. In the course of 1 year the Government would be losing several millions of dollars besides being highly unfair to the exhibitors who go out of their way to collect the admission tax on each patron according to the law, We quote the last three paragraphs of Mr. Valaer's letter, which explains the ruling.

"While admission charges are admittedly levied on an individual basis in the normal mode of the business operation, there is nothing in the imposing statute which forecloses the right of an establishment to levy a group admission charge. The tax under section 1700 (a) of the code is imposed 'on the amount paid for admission to any place.' Each person admitted free or at a reduced rate, however, at a time when and under circumstances under which an admission charge is made to other persons is liable for tax in an amount equivalent to the tax on the amount paid by such other persons for the same or similar accommodations.

"Since each car at a drive-in theater is provided with substantially the same or similar accommodations whether there be one or several passengers, the per car admission charge would appear to be more equitable than a per person charge. The seating accommodations are provided by the owner of the automobile. The drive-in theater furnishes no more in the way of accommodations to automobiles with five passengers than it does to an automobile and its driver. Since all cars receive the 'same or similar accommodations', the admissions tax is the same with respect to each car admitted.

"With respect to drive-in theaters, therefore, the Bureau's position is that where a set amount, such as $1, is charged for every car admitted, regardless of the number of persons therein, the set price made for the admission of the car is the established price of admission to the theatre. Under such circumstances, the admission of a group of persons in a car constitutes one admission regardless of the number of persons in the group, and the tax is based on the established price of admission for the car."

Congress should do something about this condition of affairs. If the Federal Revenue Act needs an amendment, then the amendment should be put on. Every person whether he attends a regular brick and mortar theater or a drive-in should be compelled to pay the tax. What can be done about this, and may we have your support?

MASONIC GRAND LODGE CHARITIES OF RHODE ISLAND,
Cranston, R. I., June 19, 1951.

CHAIRMAN, SENATE FINANCE COMMITTEE,
Senate Office Building, Washington, D. C.

HONORABLE SIR: The board of managers of the Masonic Grand Lodge Charities of Rhode Island has noted that the 1951 emergency tax bill as now drafted by the House Ways and Means Committee of the Congress includes a provision which would require withholding at the source of 20 percent of the gross amount of all interest and dividend payments. We respectfully call your attention to the fact that the enactment of any such provision in the Federal tax law, without providing for exemption in the case of tax-exempt charitable institutions and funds would unquestionably result in substantial hardships in many cases to their beneficiaries, which include the sick, the incurables, the crippled, the aged, and the fatherless children or orphans.

It is realized that under the proposed provision the amounts so withheld would be credited against any income taxes due, and any excess amount withheld would be refunded by the Government after the close of the year. However, the effect upon the charitable institution or fund which as such is exempt from income tax, and which depends upon income from invested funds to cover part or all of its charitable activities or disbursements, is to deprive it of one-fifth of such income for a substantial period of time, possibly a year or more, and put it to the trouble and expense of filing yearly claims with the Federal Government for refund of withheld amounts.

In the case of a charitable institution or fund which requires all of its income to carry the charitable obligations it has assumed or to take care of present beneficiaries—and most do—to deprive it of one-fifth of its income on invested funds for a substantial period of time can have tragic consequences. It would mean that some of its charitable activities would have to be eliminated or curtailed, and some of its beneficiaries would have to be deprived of needed care or assistance.

The Masonic Grand Lodge Charities of Rhode Island, like many other charitable institutions, has substantial invested funds, received as bequests and gifts under the terms of which the principal must be retained and the income used for designated charitable purposes. These funds are invested in United States Government bonds, some other bonds, and high-grade preferred and common stocks, and out of the interest and dividend income therefrom many sick, incurables, crippled, and needy persons who would otherwise of necessity be on public welfare rolls or in State-supported institutions are given care, support, and assistance.

On behalf of the many thousands of persons in Rhode Island who have made this and other of its charitable institutions possible, and in behalf of all the beneficiaries of the same, we solicit your utmost efforts to prevent the enactment into the Federal tax law of any provision for the withholding at the source of any portion of interest and dividend payments unless provision contains proper exemptions from any such withholding in respect to any such payments due tax-exempt charitable institutions and funds. We do not believe that you or the other Members of the Congress would desire to assume responsibility for the effect upon beneficiaries of charitable institutions if withholding became law without such exemptions.

We also believe that there are many other types of cases where the withholding of portions of interest and dividend payments will cause substantial hardship, among which are older people who do not have sufficient income to be subject to tax and yet depend upon regular small income from interest and or dividends to cover their current living expenses. How are they expected to exist while waiting for refunds of amounts withheld? The result would in some cases be increased case loads for public-welfare agencies.

Because of these and other reasons, it would appear that the Congress should give careful consideration to all the unfavorable consequences before approving any such withholding provision.

Respectfully yours,

MASONIC GRAND LODGE CHARITIES OF RHODE ISLAND,
ALBERT P. RUERAT, *President.*

STATEMENT OF J. L. BAYLESS, JR., PRESIDENT, JEFFERSON ISLAND SALT CO., LOUISVILLE, KY.

The total salt production in the United States for the peak war year of 1944, according to the United States Department of Interior, Bureau of Mines, was 15,717,171 short tons. The average yearly production of salt from 1944 to and including 1949 was 15,714,831 short tons, or within 2,340 short tons of the country's requirements during the last war.

Recent Government and industry estimates[1] point out that 10,000 tons of chlorine per day will be required by war industries by the end of 1951. In view of this the Government has issued certificates of necessity for 3,121 tons of chlorine per day additional capacity and 319 more tons per day are under study. This additional chlorine capacity will require over 6,000 additional tons of salt per day, or an increased yearly capacity of over 2,000,000 tons of salt.

Synthetic-rubber plants, military installations, and expanding industry will also require more salt, which will substantially increase the 2,000,000-ton chlorine requirements.

[1] As reported in Chemical Industries, week of April 7, 1951.

In recent years there has been a negligible amount of capacity added to existing salt plants, because the returns on this low-price commodity have not justified the large investment required to produce additional salt. In order to alleviate the forthcoming shortage, it is essential that the salt producers be given stimulus for expansion and modernization of existing facilities and incentive to invest in additional productive capacity.

The most feasible way of providing this incentive is for the Federal Government to allow a percentage depletion on salt, comparable to the depletion allowed on similar minerals such as coal, oil, sulphur, phosphate, etc.

Based on statistics released by the Bureau of Mines in its 1949 Minerals Yearbook the total value of naked salt produced in 1949 amounted to $54,048,226. Assuming a 50-percent cost of extraction, treatment, etc., for the industry, and a 15-percent percentage-depletion allowance, disregarding possible interim excess-profits taxes, the cost to the Federal Government of this depletion allowance would be only about 1½ million dollars per year. This is an insignificant figure when compared with the benefits to be derived from expanding the salt industry commensurate with the increased needs for salt during the present emergency.

It is therefore recommended that Congress provide for a 15-percent percentage-depletion allowance on salt by including the word "salt" in section 114 (b) (4) of the Internal Revenue Code of 1950, between the words "rock asphalt" and "phosphate rock".

JUNE 26, 1951.

Hon. HOMER FERGUSON,
United States Senate, Washington, D. C.

DEAR SENATOR FERGUSON: Reading our recent newspaper, I noticed that the new tax bill had passed the House and was now in the Senate. This prompted me to wire you yesterday, and your reply was received this morning suggesting that I address my opinion of the matter to the Senate Finance Committee, who will be holding hearings on the bill during the next few weeks. I appreciate the opportunity of explaining to you what a great harm is being done to small business by continually increasing the tax burden on industries that are not in a position to absorb same as are larger industries in the same line.

With respect to the above and to our own position in the paper industry, there are what are known as self-contained or marginal mills, producing their own pulp, having their own paper mills and, lastly, their own converting mills producing the final product. Then there are the nonintegrated mills, buying all or part of their pulp from outside sources, of which we are one of many in the United States. The larger self-contained mills, if they are operated separately, can show a profit in the pulp division at the high prices of same today; their paper mill can show a profit with reasonable pulp costs for their own use; and, likewise, the converting plant can also operate profitably. We, as a small concern that only converts pulp into paper, have accordingly only one source of profit from which we must absorb these increased taxes together with the increased costs of manufacture.

We are sorry that we are in that predicament, but it requires capital and with the small amount of earnings a plant has left today to pay on bonded indebtedness, there is not much chance of obtaining recognition on loans for expansion. It is quite a long story. We are one of the concerns that have not shown any earnings so far this year, and the continual increasing of taxes is bound to be very serious. Another recent imposition passed on to us involves our obligation to pay the freight on our raw materials coming in, and we must also pay on our finished product going out.

I think the various reports required by the Government should be made use of and be the means of investigating these increases as to whether they are a burden to certain industries more than others, as I am sure the Government is dependent greatly on all industries for their income. I do not wish to criticise what the lawmakers are doing, but I am sure that you appreciate that there is quite a difference in the advantages that some industries have over others, and that this should be taken into consideration so as not to allow the burden that falls on the concerns able to absorb it, to also fall in the same proportion on the smaller concerns who cannot stand the additional costs and remain in business. The danger lies in the fact that, even though the smaller concerns are allowed increased prices to absorb all the increased costs, such increases will price us out of business as there can be no securing of higher prices than our competitors.

I sincerely trust you will give this matter careful consideration before the bill appears for Senate approval. I note in the June 19 Legislative Daily on

Government Affairs that Senate Majority Leader McFarland said the Senate Democrats will meet to decide whether to take a summer recess before acting on a tax bill. I trust careful attention will be given the matter before making any decision.

It certainly would be a wonderful gesture on the part of our representatives if they would in some way cut expenses that would allow our Government to be operated under a certain budget rather than the continual increasing of taxes to take care of increased Government expenditure. I hope that you are in favor of such a program and will support it.

Thank you for your prompt reply to my telegram. I shall be awaiting further developments with interest.

Yours truly,

THEO. W. DUNN,
President, Dunn Paper Co.

NATIONAL ASSOCIATION OF FAN MANUFACTURERS, INC.,
Detroit 26, Mich., August 1, 1951.

MEMORANDUM

Re: Proposed clarifying amendment to section 484 (p. 138), H. R. 4473, Revenue Act of 1951.

Hon. WALTER F. GEORGE,
Chairman Committee on Finance,
United States Senate, Washington, D. C.

Section 484, H. R. 4473, page 138, amends section 3406 (a) (3) of the Internal Revenue Code by the addition of certain items including electric belt-driven fans of the household type. The reason for such addition is covered on page 46, House Report No. 586, to accompany H. R. 4473, as follows:

"The items added to the base of this tax by your committee are directly or indirectly competitive with many items now in the base of the tax. An example of direct competition exists in the case of the direct motor-driven fans subject to tax under present law and belt-driven fans which are presently free of tax."

The intent of the House is clear from the foregoing that a tax shall apply equally on electric belt-driven fans and on electric direct motor-driven fans of the household type.

The problem does not involve the intent of the House or the tax. Rather it involves the final wording of section 3406 (a) (3) as amended by section 484, H. R. 4473 and the interpretation placed thereon by the Treasury Department. The point is best illustrated as follows:

1. "Electric belt-driven fans of the household type" (amendment, sec. 484, H. R. 4473). The wording clearly defines the type of fan subject to tax.
2. "Electric direct motor-driven fans" (present law, sec. 3406 (a) (3)). The wording is broad and no limitations are placed on the type of fan to be taxed.

Lacking specific limitations the Treasury Department in the administartion of the present section 3406 (a) (3) has ruled that the tax applies on electric direct motor-driven fans for all purposes, for example, in homes, in institutions, in power plants, on farms, for all industrial plant applications and for shipboard use. (See sec. 316.110, Regulations 46 of the Treasury Department.)

A tax on an industrial fan is unfair and discriminating on the grounds that Congress has not placed a tax on similar industrial machinery units. Either the tax should apply on all such industrial machinery or no tax should apply on any such item.

Accordingly there is a conflict in the intent of the House, as expressed in House Report No. 586 to accompany H. R. 4473, and in administration of the present law by the Treasury Department regarding electric direct motor-driven fans.

To resolve the conflict and to follow the intent of the House a proposed amendment which accurately describes the types of fans subject to tax is offered below. These types are recognized as basic types in the industry and are illustrated in Bulletin No. 108 enclosed herewith. The proposed amendment to the present bill, which retains all present amendments to section 3406 (a) (3) as found now in H. R. 4473 is as follows:

PROPOSED AMENDMENT—H. R. 4473

On page 138, line 25, strike out all words after the word "amended" and insert the following: "to read as follows:

"'(3) ELECTRIC, GAS, AND OIL APPLIANCES.—Electric direct motor-driven fans of the ceiling, wall bracket, desk, pedestal, and air circulator types and those types of propeller fans for household use only, commonly called kitchen, window, and attic fans, both direct motor-driven and belt drive; electric, gas or oil water heaters; electric flat irons; electric air heaters (not including furnaces); electric immersion heaters; electric blankets, sheets and spreads; electric, gas or oil appliances of the type used for cooking, warming, or keeping warm food or beverages for consumption on the premises; electric mixers, whippers, and juicers; and the following applicances of the household type: electric or gas clothes driers; electric door chimes; electric dehumidifiers; electric dishwashers; electric floor polishers and waxers; electric food choppers and grinders; electric hedge trimmers; electric ice cream freezers; electric mangles; electric motion or still picture projectors; electric pants pressers; electric shavers; and power lawn mowers; 10 per centum.' "

To provide for an orderly administration of the act as related to fans, it is respectfully requested that the proposed amendment offered above be adopted. Such adoption will clarify the types of fans subject to tax and will eliminate the unfair and discriminatory application of the tax on an industrial product as now applied.

L. O. MONROE, *Secretary.*

EXHIBIT A

(By National Association of Fan Manufacturers, Detroit, Mich.)

NAFM STANDARDS FOR CLASSIFYING AIR MOVING EQUIPMENT

Classification of products, clearly defined, is desirable to an industry and to the public. It is helpful in understanding the terms and names used in an industry, and illustrates the distinctions between similar or closely related products, To assist the public in the use of terminology and the general functions of various types of fans, NAFM has compiled this information.

Classification of air-moving equipment

Types of air-moving equipment	Group classification	Function
Ventilating and industrial fans, centrifugal, axial, and propeller types.	Centrifugal fan: Either belt drive or direct connection.	The centrifugal fan is designed to move air or gases over a wide range of volumes and pressures. The fan wheel may be furnished with straight, forward curve, backward curve, or radial tip blades. The fan housing may be constructed of sheet steel or cast metals with or without protective coatings such as rubber, lead, enamel, etc. The centrifugal fan is used in systems for heating, ventilating, and air conditioning; for drying and cooling of materials and products, for pneumatic conveying of materials and dust exhaust, and for forced and induced draft for steam boilers.
	Vaneaxial fan: Either belt drive or direct connection.	The vaneaxial fan is designed to move air or gases over a wide range of volumes and pressures. It is generally constructed of sheet metal although cast metal fan wheels are sometimes furnished. The vaneaxial fan is used in systems for ventilation on board ships, in mines and for industrial applications, and for drying and cooling purposes.
	Tubeaxial fan: Either belt drive or direct connection.	The tubeaxial fan is designed to move air or gas through a wide range of volumes at medium pressures. Its construction is similar to the vaneaxial fan. The tubeaxial fan is generally selected for ventilation in industrial applications and for drying of materials.
	Propeller fan: Either belt drive or direct connection.	The propeller fan is designed to move air from one enclosed space to another or from indoors to outdoors or vice versa in a wide range of volumes at low pressure. The propeller fan is generally intended for ventilation in industrial, commercial, home, farm, and marine installations, and for drying a wide variety of products. (The automatic type of shutter illustrated in cut opposite is not a part of the propeller fan but is an auxiliary device to protect the fan when not operating by keeping out wind, rain, snow and cold).
Electric fans, buzz fans, and air circulators.	Wall or bracket fan	The wall or bracket fan is generally used in offices and in commercial establishments to circulate the air within the room from a fixed position.
	Desk fan	The desk fan is generally used in offices and homes to circulate the air within the room in which it operates.
	Air circulator or pedestal fan	The air circulator or pedestal fan is generally used in commercial establishments and in homes to circulate the air within the room in which it operates.
	Ceiling fan	The ceiling fan is generally limited to use in commercial establishments to circulate the air from a fixed position.

NATIONAL COUNCIL OF FARMER COOPERATIVES,
Washington 6, D. C., June 25, 1951.

OBJECTIONS TO SENATOR WILLIAMS' CO-OP TAX BILL [1]

S. 892, entitled "A bill to amend the Internal Revenue Code so as to provide special income-tax treatment for cooperative corporations," was introduced in the Senate by Senator John J. Williams, of Delaware, on February 19, 1951. In introducing the bill, Senator Williams stated that its "purpose is to repeal certain inequities in the income-tax laws as related to cooperative organizations." According to Senator Williams, S. 892 is the same proposal which he presented to the United States Senate on August 25, 1950, and which was later withdrawn. In introducing the measure again this year, the Senator stated that it was his intention to reintroduce the bill as an amendment to the first revenue-producing measure which comes to the Senate from the House.

In view of the prospect for early consideration of tax legislation in the Senate it seems appropriate at this time to take a look at Senator Williams' bill to determine just what changes it would bring about in the taxation of farmer cooperatives and what are the basic objections of farmers and farmer cooperatives to the measure.

Before taking up the specific provisions of the Williams bill we would like to point out that the over-all effect of passage of this proposal would be to weaken the family farm in America by denying to it the opportunity of efficient-sized purchasing and marketing operations which are available to large farm units. Thus the enactment of this legislation would "tip the scales" away from the family farm which has been, and is, the backbone of our agricultural economy.

I. The bill in section (b) "Imposition of Income Tax and Computation of Income" would amend chapter 1 of the Internal Revenue Code by inserting after section 421 a new Supplement V subjecting cooperatives to discriminatory and punitive rules and regulations in the computation of their Federal corporation income taxes to which no other types of business are subject.

A. Cooperatives would be penalized for operating on a cooperative or nonprofit basis.

Farmer cooperatives that are now nonexempt (taxable) under existing law are subject to the provisions of the Internal Revenue Code which apply to corporations generally. Under Senator Williams' bill, there would be no exempt cooperatives, and he would make farmer cooperatives and other "cooperative corporations" amenable to the special provisions contained in the new supplement V as a special class of corporations in addition to the provisions of the Internal Revenue Code applicable generally to taxable corporations.

B. Under the new supplement a cooperative could not exclude patronage refunds paid or payable to its patrons in computing the cooperative's net income for Federal tax purposes, unless during the taxable year—

1. The cooperative dealt exclusively with members (a cooperative apparently would not be able to market products or procure farm supplies for any farmers unless they were members of the cooperative); and

2. The patronage dividends were paid in money exclusively not later than 60 days after the close of the taxable year, and there were no conditions either precedent or subsequent as to the application or use of such money by the members.

These are the main requirements proposed in the bill for the excludability of patronage refunds from gross income by farmer cooperatives. There are some additional requirements that appear objectionable and inequitable but they will not be dealt with here.

The above requirements in reality are not tax legislation, but they strike at the very basis of operation of cooperative associations. A former cooperative is a group of farmers who have joined together to market their products or procure necessary farm supplies under an agreement that, after paying all operating expenses, the proceeds of operation belong to and shall be returned to the patrons in proportion to their volume of business. Frequently farmers agree by contract with the cooperative that the amount, or a part thereof, returnable to them over and above expenses shall be allowed to remain with the cooperative as capital and be returned in money at some later date. These amounts returnable to the farmer over and above the costs of operating the group enterprise are what have come to be known as patronage refunds or patronage dividends.

[1] Prepared by L. James Harmanson, Jr., administrative counsel, National Council of Farmer Cooperatives, Washington, D. C.

Senator Williams' bill would have Congress tell the farmer that he has no right to set up a nonprofit service organization for the purpose of returning to him, the farmer, a maximum of the returns from his products and obtaining his supplies at the lowest possible net cost. The revolutionary proposal in this bill would label these funds "of the farmer" as the "funds of the cooperative corporation" if the group enterprise in the course of the year handled any products for persons who were not actual members. How could the enterprise grow and increase its service to the rural community unless other farmers than those in the current membership group were encouraged to participate and acquire a membership interest?

Senator Williams would have Congress tell the cooperative-minded farmer that he could not sign an agreement with the cooperative whereby a part or all of the farmer's share in the net margins over and above, expenses would be invested in the capital of the cooperative for a specified period and to be redeemed in cash later, without the cooperative having to pay corporation tax on these funds of the farmer, as well as the farmer having to pay tax on them.

Cooperatives thus are the only type of business against whom it has been proposed that their capital be taxed as income.

These provisions illustrate the flagrantly penal and discriminatory character of the purposes of the bill. This bill would attempt to have the Federal Government invade the field of contract law and upset by legislative edict well-settled principles that have been established and confirmed by the courts over a period of over three decades.

As a matter of equity, logic, and law, there can be no justification for any distinction in computing its net income between patronage dividends paid in money in 60 days by a cooperative and patronage dividends paid at some other time or in some other form. If there is a preexisting obligation upon the cooperative to return the patronage dividend to the patron, then it belongs to the patron regardless of his voluntary agreement with the cooperative as to the time and manner of its distribution to him. For Congress to undertake to dictate to the farmers of America, as Senator Williams advocates, how they will market their products and procure their farm supplies in this area of their operations would represent paternalism at its worst. These proposals in Senator Williams' bill are comparable to the Government requiring corporations to liquidate accounts payable within 60 days after the close of the tax year or pay Federal corporate income tax on such unliquidated accounts. Imagine the consternation that would pervade the business world if, under the guise of tax legislation, Congress attempted to compel the settlement of all debts in cash only—outlawing the settlement of debts by the transfer of property, issuance of notes, securities, etc.—where the creditor and debtor agree voluntarily to such other manner of settlement.

The other provisions in the bill are all tied to the paramount issue of whether the Federal Government can and will attempt to say by legislation that a portion of the proceeds of sale from the farmer's crop is not the farmer's income but the income of the cooperative through which the crop was marketed. Senator Williams in his bill in effect asks Congress to do this. The farmers of this country are solidly opposed to any such invasion of their individual property rights at the instance of those who are primarily interested in making a profit out of handling the farmers' business and not primarily interested in assisting the farmer to raise the income level of himself and his family.

II. Senator Williams' bill would repeal the exemption accorded under section 101 (12) and (13) of the Internal Revenue Code to those farmer cooperatives which meet the requirements set out therein as necessary to qualify for the exemption.

Cooperative-minded farmers are opposed to the repeal of this exemption.

Contrary to popular belief and frequent representation, the only exemption to cooperatives from payment of Federal corporation income taxes is contained in sections 101 (12) and (13) of the Internal Revenue Code. This exemption is available only to farmer cooperatives; slightly more than half of the farmers' cooperatives in the country meet the statutory requirements necessary to qualify for the exemption; and the estimate of the value of this exemption in terms of additional tax revenue that the Government would obtain if the exemption should be repealed varies from a minimum of about $10 million to a maximum of about $25 million per year.

Except as provided in section 101 (12) and (13) of the Internal Revenue Code, farmer cooperatives and other cooperatives pay Federal taxes on the same basis and in the same manner as all other businesses which operate in the same manner as cooperatives.

The exemption accorded to farmer cooperatives in section 101 (12) and (13) is clearly an exemption to the qualifying farmer cooperative from the Federal corporation income tax, but note it is an exemption from that tax only. Just as Congress has deemed it wise in the public interest to grant and continue this exemption from corporation income taxes, so does the Congress undeniably have the power and right to take away the exemption if in the public interest the Congress should deem it wise to do so. This point should be understood and we are glad to make it clear.

We believe, however, that what the country as a whole, and agriculture, gains in stability of human and economic values through the exemption is worth far more than what the Government would gain in tax revenue through its repeal.

In order to appreciate why Congress originally granted and has continued through the years the Federal income-tax exemption for farmer cooperatives, it is important that one understand exactly what is involved in the exemption and what a farmer cooperative must do in order to qualify for the exemption.

Section 101 (12) of the Internal Revenue Code exempts "farmers, fruit growers, or like associations organized and operated on a cooperative basis (a) for the purpose of marketing the products of members or other producers * * * or (b) for the purpose of purchasing supplies and equipment for the use of members or other persons."

In addition to the above limitations as to their activity, cooperatives in order to be eligible for exemption must also meet the conditions outlined below:

A. All proceeds from the sales of products, less necessary marketing expenses, must be returned to patrons in proportion to either the quantity or value of the products furnished by them, and supplies and equipment must be furnished to patrons at actual cost, plus necessary expenses. All patrons must be treated alike in the distribution of proceeds, regardless of whether they are members or nonmenbers of the cooperative.

B. The value of products marketed for nonmenbers may not exceed the value of products marketed for members, and the value of supplies and equipment purchased for nonmembers may not exceed the value of supplies and equipment purchased for members, with the additional proviso that only 15 percent of the total value of purchases may be made for nonmembers who are not agricultural producers.

C. The requirement that all net proceeds be distributed to patrons is modified by the statute (sec. 101 (12)) to the extent that there is allowed the accumulation and retention of reserves required by State law, and other reasonable reserves for necessary purposes. The Bureau of Internal Revenue prescribes by regulations what are reasonable reserves for necessary purposes. Such reserves, if not immediately allocated must be susceptible of allocation on a patronage basis to insure equality of treatment of members and nonmembers in the event of dissolution of the cooperative. These reserves when not presently allocated in such a manner as to make them taxable to the patron are generally referred to as "unallocated reserves." The term may be used to include those which are actually allocated on the books but as to which notice of allocation has not been given the patron. These unallocated reserves are differentiated from noncash patronage refunds by the Bureau of Internal Revenue. The unallocated reserves are not taxable to the patrons; the noncash patronage refunds are taxable to the patrons. It is a fact, however, that as a matter of administrative practice the Bureau of Internal Revenue is gradually reducing and in many cases appears to be attempting to eliminate the amounts of the reasonable reserves for necessary purposes which exempt cooperatives may set aside without being taxed to the patrons in accordance with their allocable interests therein.

D. Substantially all capital stock, other than nonvoting, nonparticipating preferred stock, must be owned by farmers who market their products or purchase supplies through the cooperative.

E. The dividend rate on capital stock must be limited to either 8 percent or the legal maximum in the State of incorporation. In actual practice, however, dividends of those cooperatives which are organized on a stock basis are generally 3 to 6 percent per annum.

If the exemption statute should be repealed, as Senator Williams proposes, cooperatives now qualifying for the exemption would become subject to corporate income tax (1) on funds used to pay dividends on capital stock, (2) on amounts retained in unallocated reserves required by State law and reasonable reserves for necessary purposes as described above; and (3) on their nonoperating income, if any.

The report on the Taxation of Farmers' Cooperative Associations, issued by the Division of Tax Research, United States Treasury Department, in October 1947, stated that the amounts which would thus, in the event of the repeal of the exemption, be subjected to tax would be relatively small. On November 4, 1947, the then Under Secretary of Treasury Lee M. Wiggins in a statement before the House Ways and Means Committee estimated that on the basis of the most recent available data exempt cooperatives, in the absence of the exemption, would have paid between $10 million and $20 million in taxes on earnings devoted to dividends on stock and reserves. Since 1947, with higher price levels, larger volumes of business, and higher tax rates we do not know of any impartial sources which have estimated that repeal of the exemption would bring into the Treasury more than $25 million additional revenue.

As far as farmers are concerned, however, the amount of money involved in Senator Williams' proposal is probably not as important as the blow which would be dealt to the successful operations of farmer cooperatives by enactment of the bill.

Through years of bitter struggle and in the face of determined opposition farmers won the right to organize and operate their agricultural cooperatives. Amid all the confusing and misleading propaganda in recent years about so-called tax equality and above the din of political allegations of those who would put farmer cooperatives out of business, there stand out sound reasons why Congress originally granted exemption to bona fide farmer-owned and farmer-controlled cooperative associations and why Congress has consistently refused in the face of one of the most violent attacks ever made upon any major segment of the national economy to revoke or narrow that exemption.

The elected representatives of the people, from all sections of the country, recognize that farmer cooperatives are basic rural business institutions, peculiarly adapted to farmers' needs. Congress knows that farmer cooperatives serve to discourage the imposition of undue margins and spreads by proprietary handlers, who, until the advent of the cooperatives, were accustomed to paying farmers any price they pleased and making for themselves all the possible profits that the traffic would bear. The history of the development of farmer cooperatives in this country dating back to the early part of the nineteenth century is that the presence of a farmer cooperative in a community enables both member and nonmember producers to obtain a fairer share out of the so-called consumer's dollar. Any Member of Congress who lives in a section where a successful farmer cooperative is operating almost certainly knows of the improvement in quality of merchandise, standardization of products, and stabilization of farmer income that have come about partly if not largely through the beneficial practices inaugurated by the cooperatives.

Any exempt farmer cooperative is under obligation to return all net proceeds to patrons without discrimination between members and nonmembers. The primary purpose of the cooperative is to increase the income which the farmer members derive from their farming. The traditional policy of the United States Government since the turn of the century—under both Republican and Democratic administrations—has been to encourage the organization and operation of farmer cooperatives as a means of increasing the income of the farm family and strengthening the family-sized farm in stabilizing agriculture and hence our total economy.

If the Government should reverse this policy—which has withstood the tests of time and severe opposition—and repeal the exemption as Senator Williams advocates, the Government would thereby reduce the incentive which farmers have to finance cooperatively their own production and marketing operations and to try thereby to stabilize agriculture through their own self-help rather than Government help. Repeal of the exemption would remove the requirement that the savings effected through working together must be returned to the producer-patron and would tend to transform the character of cooperatives from instruments of service for the producer to corporations of profit for the investor. Thus to repeal the exemption would impair the incentive to retain the cooperative structure wherein the ownership and profits accrue to the producers who patronize the enterprise. With this result, farmer cooperatives would tend to take on the dominant structure and characteristics of proprietary corporations wherein the profits would accrue to third-party investors, management, and dealers rather than to the producers themselves.

We have not attempted to give any exhaustive statement of the objections to Senator Williams' co-op tax bill. We have attempted only to summarize some of the basic reasons given by Members of Congress and others who have studied

objectively the cooperative tax question, why the provisions contained in Senator Williams' bill and other like proposals would not advance the sound interests of agriculture or the country as a whole.

STATEMENT PRESENTED BY GEORGE RANDOLPH, OF RANDOLPH & RANDOLPH, MEMPHIS, TENN.

CHAPTER 6 OF THE REVENUE BILL OF 1951 RECENTLY PASSED BY THE HOUSE IS UNCONSTITUTIONAL AND VOID

This chapter is the one which provides for collection of income tax at source on dividends, interest, and royalties.

It violates the fourth amendment to the Constitution of the United States as a careful analysis of the facts will clearly demonstrate.

The fourth amendment to the constitution of the United States provides as follows:

"AMENDMENT 4. UNREASONABLE SEARCHES AND SEIZURES. The right of the people to be secure in their persons, houses, papers and effects, against unreasonable searches and seizures, shall not be violated, and no warrants shall issue but upon probable cause, supported by oath or affirmation, and particularly describing the place to be searched, and the persons or things to be seized."

In dealing with this amendment the Supreme Court of the United States has ruled:

"The rights guaranteed under this amendment and amendment 5 are indispensable to the full enjoyment of personal security, personal liberty, and private property, and are to be regarded as the very essence of constitutional liberty (*Gouled* v. *United States*, 255 U. S. 298, 65 L. ed. 647, 41 Sup. Ct. 261)."

Again it has ruled:

"The guaranties of this amendment are to be liberally construed to prevent impairment of the protection extended (*Grau* v. *United States*, 287 U. S. 124, 77 L. ed. 212, 53 Sup. Ct. 38).

And again it has ruled:

"The abuse of the drastic proceeding by search warrant led to the adoption of this amendment which, together with legislation regulating the process, should be liberally construed in favor of the individual (*Sgro* v. *United States*, 287 U. S. 206, 77 L. ed. 260, 53 Sup. Ct. 138)."

In view of the foregoing authorities, let us see what the provision contemplates doing. We will confine the subject to dividends, as it is broader than interest and royalties, but what will be said with reference to dividends will be applicable to the other two subjects.

It is proposed to require all corporations to withhold 20 percent of all dividends declared and remit quarterly to the Federal Government and there is no distinction drawn between those persons who are not subject to income tax and those persons who are subject to such a tax.

What right has the Federal Government to require a corporation to withhold 20 percent of the dividends belonging to a person who is not subject to an income tax? Manifestly it has none, and the seizure of the dividends of such a person is unreasonable.

It is true the individual whose dividend has been wrongfully taken has the right to apply for a refund, but this does not cure the vice resulting from the violation of the constitutional amendment. That amendment prohibits the original unreasonable seizure and the fact that the refund may be applied for is no palliation. Besides, the law requires the withholding on all future dividends and, as long as the law remains unrepealed, the corporation as each dividend is declared would be required to withhold and the stockholder after each withholding would be required to make his application for refund. This shows how unreasonable the act of withholding would be.

Besides this burden of withholding where the individual is not subject to a tax falls upon the poorest class of our citizens and the ones least able to bear it, and the fourth amendment should be liberally construed in their favor. That there are many such persons is manifest and they may be divided into the following classes:

(1) Those whose gross income is less than $600.

(2) Those who are entitled to $600 exemption and whose net income is less than $600 a year.

(3) Those who are more than 65 years of age and are entitled to an additional $600 exemption with net income of less than $1,200.

(4) Those who are blind and over 65 and are entitled to an additional exemption of $600 and whose net income would be less than $1,800.

Statistics will show that included in the four classes are 10,000,000 or more persons who by express legislation are relieved from income tax. But by chapter 6 now under investigation the Federal Government through the instrumentality of corporations, under the guise of collecting an income tax, will seize 20 percent of all dividends as declared, though the class of individuals now under consideration are subject to no income tax whatever.

In common language we may describe the situation in this way. The Federal Government says to the four classes of persons above described you are not subject to any income tax whatever, but, because you hold some shares of stock, we are going to require the corporation to deduct from each dividend 20 percent and send it to the Treasury and you will have to apply for a refund in order to get it back, and this process will continue as long as the law remains unrepealed and you own the stock.

If the foregoing is not an unreasonable seizure, I fail to understand the English language.

We will carry the analysis a bit further, using as our object lesson one of those persons forming part of that great body of our humble citizens whose gross income is less than $600 per annum and who endeavor to increase their meager income by investing what little capital they have in stocks. He owns $5,000 in capital which he invests in capital stock of a corporation paying an annual dividend of 6 percent payable quarterly. His first quarterly dividend is $75 but when he receives his dividend check, he finds it is for only $60. He makes complaint to the corporation and is informed the United States required the corporation to seize $15 as income tax. He protests, claiming he is not subject to income tax as his gross income is less than $600. The corporation replies it is sorry but the law compels it to make the deductions. He then wants to know what he can do and the officers of the corporation advise him that his only remedy is to employ a lawyer or a certified accountant who for a fee of say $10 will make application to have his money refunded and that if he fails to pursue this course, his money is lost and that this procedure will be followed each quarter as long as the law remains in effect and he continues a stockholder.

He is outraged at this situation and denounces the corporation for making the deduction and he also denounces the United States Government for requiring the corporation to deduct. His mind is thus prepared for the reception of communistic ideas or he decides to sell his stock and use his funds in making purchases, thus increasing the danger of inflation.

It will be noticed that in the case supposed the individual has been deprived of his right to make an estimate of his income tax, which estimate if made would show his income would be too small to justify the levying of an income tax.

Section 1201 of the revenue bill of 1951 (the section now complained of) provides as follows:

"SEC. 1201. INCOME TAX COLLECTED AT SOURCE.

"(a) REQUIREMENT OF WITHHOLDING. Every person making payment after December 31, 1951, of a dividend or interest shall deduct and withhold upon such dividend or interest a tax equal to 20 per centum of the amount thereof."

It will be observed this section requires the 20-percent deduction and no provision whatever is made to determine whether the individual is or is not subject to an income tax. At present the method of procedure is to require the individual sometime prior to March 15 of each year to make an estimate of his income for the ensuing year and if his estimate shows no tax, then no tax is levied until the end of the year when he makes his final return which shows whether or not he had any taxable net income.

What has been stated applies not only to those persons whose gross income is less than $600 but it also applies to those individuals in classes 2, 3, and 4 above who on their final annual report show they have no taxable income.

The Internal Revenue Code to which the revenue bill of 1951 is an amendment in section 11 provides as follows:

"SEC. 11. NORMAL TAX ON INDIVIDUALS.

"(a) TAXABLE YEARS BEGINNING AFTER SEPTEMBER 30, 1950. In case of taxable years beginning after September 30, 1950, there shall be levied, collected, and paid for each taxable year upon the net income of every individual a normal tax of 3 per centum of the amount of the net income in excess of the credits against net income provided in section 25. For alternative tax which may be elected if adjusted gross income is less than $5,000, see supplement T."

Notice the above provision levies a tax on the "net income," not on the "gross income." By "net income" the law means the gross income less the deductions allowed by law and on this balance, which is called the net income, the tax is levied. The whole basis of the tax is the net income and unless that net income exceeds the sum of $600, no tax can be collected.

For a great many years the amount of the income tax could not be determined until the end of the taxable year when the taxpayer, using the form furnished by the United States, showed his gross income and deductions to which he was entitled and the balance was the net taxable income, on which the tax was figured.

Later the law was changed and it was provided that prior to the 15th of March each year individuals should make estimates of the tax for the ensuing year and if such estimates showed no tax liability, no tax was collectible. One of the purposes of these estimates was to enable those persons who were not subject to the tax to show the Government they were not and thus prevent the Government from seizing any part of their property or income. These estimates showed tentatively whether there was any net taxable income and by this means the person was relieved of paying tax if there was no taxable income. But this right of the individual to show beforehand he will not be subject to income tax for the ensuing year is taken away by the provision in the revenue bill of 1951 copied above in which every corporation without any limitation or qualification whatever is required to collect and remit to the Treasury 20 percent of the amount of all dividends and interest.

In short, the fact that you are not subject to any income tax makes no difference so far as the Federal Government is concerned. You may be so poor as to compel you to become an occupant of the public poorhouse and yet if you own a few shares of stock, the corporation must seize 20 percent of any dividends declared and you are left with the remedy of applying for a refund, and this procedure must be repeated after the declaration of each dividend. And if you do not make application for the refund, the Treasury will keep the money to which it had no right because you were not subject to the tax. We have come to a pretty pass when the Federal Government in order to carry on is forced to take from our poorest citizens 20 percent of the dividends which they may derive from the meager capital they have invested. This taking is done under the guise of collecting a tax and the individual is given no opportunity of showing in advance that no tax is due. Such a procedure is unreasonable and in direct violation of the fourth amendment to the Constitution.

THE MUSEUM OF MODERN ART,
New York 19, N. Y., July 2, 1951.

Hon. WALTER F. GEORGE,
The United States Senate, Washington, D. C.

DEAR SENATOR GEORGE: On behalf of the trustees of the Museum of Modern Art, a nonprofit educational institution, I am writing in support of section 402 of H. R. 4473 which is before the Senate Finance Committee. This section provides for the exemption from excise taxes on admissions of all religious, educational, and charitable institutions.

In the light of the grave need for additional Federal revenue which can only be met through increasingly higher taxes for all, the trustees of the museum recognize the serious responsibility of recommending any reductions in existing revenue. However, these very increases in individual income taxes are having a most serious effect on the public support of our religious and our private educational and charitable institutions—the institutions which have provided the great strength of our free society. Their future must be jealously guarded particularly today when religious and cultural freedom is threatened the world over.

The case of the Museum of Modern Art is typical. It is a nonprofit educational organization which serves the public by representing and interpreting the visual arts of today in the many ways they affect the lives of the people of this country. Its activities are Nation-wide in scope and it plays an important part in interpreting American cultural life to foreign nations and peoples.

The museum pays its own way without support from public funds. As it has only a small endowment it must depend in great measure on the income derived from admissions to public exhibitions which constitutes roughly a quarter of its total earned income. For additional income, it depends on membership fees, contributions, and other fees.

Despite stringent economy measures, the trustees of the museum are faced with the alternatives of a serious deficit or drastic curtailment of activities.

Exemption from the admissions tax would go a long way toward solving the problem for the museum as it would for countless other institutions throughout the country facing the same financial crisis.

I earnestly solicit your favorable consideration of section 402 of this bill.

Sincerely,

NELSON A. ROCKEFELLER, *President.*

FLORIDA THOROUGHBRED BREEDERS' ASSOCIATION,
Hialeah, Fla.

Whereas it has come to the attention of the Florida Thoroughbred Breeders' Association that the Treasury Department is asking Congress to amend the present income-tax laws so as to limit the amount of loss that can be deducted from any side business to the amount of $4,000 per year and then only for a period of five consecutive years; and

Whereas under the present law a person engaged in business which is not his main business and source of income, is allowed a loss deduction on his income tax from said side business of $50,000 per year for five consecutive years and should this drastic amendment pass Congress that it would be detrimental to the best interest of the State of Florida and of the United States and, in addition to checking the development of the resources of this State, would stifle industries which contribute huge sums of money into the treasury of the State of Florida as well as the counties thereof and would tremendously harm and injure thoroughbred horse racing, the thoroughbred breeding industry of Florida, by making it impractical and impossible for a businessman to engage in either of these enterprises and in the long run would force him to sell and dispose of his racing stable, as well as his breeding farm and would likewise force business men to sell and dispose of ranches, farms, and any other types of side businesses which they were attempting to develop and expand: Therefore, be it

Resolved by the Florida Thoroughbred Breeders' Association, in session assembled:

1. That we are inalterably opposed to the enactment into law of the above-described amendment to the income-tax laws of the United States.
2. That a copy of this resolution be sent to both of the United States Senators and to each Member of the Florida House of Representatives delegation in Washington urging and requesting them to oppose enactment of this amendment.
3. That a copy of this resolution be forwarded to both our State senate and State house of representatives at Tallahassee, urging them to pass appropriate resolutions in opposition to said proposed amendment.

I hereby certify that the above resolution was duly passed by the Florida Thoroughbred Breeders' Association this 9th day of May A. D. 1951.

EVERETT A. GRAY, *Secretary.*

NORTH CAROLINA FAIR TAX ASSOCIATION,
Statesville, N. C., June 30, 1951.

Re 20 percent withholding tax on dividends.

Hon. WALTER F. GEORGE,
Chairman, Senate Finance Committee,
Hon. HARRY F. BYRD,
Chairman, Joint Committee on Reduction Nonessential Federal Expenditures and Member Senate Finance Committee, Washington, D. C.

MY DEAR SIRS: Due to personal conversations and correspondence with you gentlemen, and the wide publicity given your views, I am reasonably familiar with the sound and statesmanlike positions you have always taken with reference to the spending and taxing policies of our Federal Government. I know that you are in accord with our contention that strict economy, and the elimination of waste and extravagance in government, offer the best means of giving taxpayers relief from excessive tax burdens during perilous times like these when essential defense programs and actual fighting in the field call for huge appropriations to support our Armed Forces. We appreciate the fact that you are opposed to deficit financing which would add to the Federal debt, which we feel already poses a real threat to our national solvency.

It is heartening to note that you, along with other economy-minded Members of the Senate, have already served notice that you will oppose adding another $7

billions to the Federal tax load, as provided in the new tax bill passed by the House—notwithstanding this amount is 3 billion under the President's request. We are delighted by your assertions that you plan to fight for reduction of at least $2 billions in the amount to be levied by this new revenue measure, and will endeavor to offset this reduction by cutting nondefense appropriations by an even larger amount.

But I have not, as yet, seen any published statement relative to the attitude of either of you two gentlemen toward the dangerous departure in tax-collecting procedure contained in this new tax bill, which would require corporations to withhold 20 percent of dividends voted stockholders, and turn this amount over to the Government quarterly. I hope that you feel as I and millions of others do about this proposal and will do all you can to eliminate it from the Senate's version of the bill.

To my way of thinking, this dividend-withholding provision of the House bill is not only a dangerous departure in tax-collecting methods, but it is also unnecessary and unfair, and actually borders on an outrageous reflection on the patriotism, honesty, and integrity of millions of American citizens who have evinced their faith in our capitalistic and free-enterprise system—the system which has made our country the peer of all nations—by furnishing the funds for our great financial and industrial development through stock ownership.

As I understand it, the primary purpose of the promoters of this provision of the new tax bill, is to attempt to collect existing taxes now evaded by stockholders who do not report their dividends as income. To me this is a very flimsy excuse for adoption of a system which would work a hardship on millions of honest stockholders who may be entitled to legal exemptions which remove tax liability for the one-fifth of their dividend income which corporations would be forced to withhold from them, and which the Government would use until refund claims could be processed. Many stockholders would not go to the trouble of filing claims for refunds to which they would be entitled, and the Government would then be guilty of using money to which it was not entitled.

If the socialistically inclined Members of Congress who are always seeking to gain the political favor of the masses by promoting tax measures designed to "soak the rich," they are certainly "barking up the wrong tree" in this instance. There are millions of American citizens in all walks of life and in all financial brackets who are dependent on dividend income to finance moderate living expense. Stock ownership is by no means limited to people of wealth. To be deprived of even a fifth of this expected income would not only work a personal hardship, but would create, also, a feeling of resentment against the corporations from which the dividends are accustomed to come, along with resentment against those in Washington responsible for the system depriving them of funds. I fear that in many cases their ire would be vented on the corporations, instead of the real offender, the Government. A deplorable condition would thus be created to the detriment of corporations absolutely innocent of any wrongdoing, calling for much explanation which is absolutely unwarranted.

Evil effects would be endless, just as the waste of time and manpower on the part of corporations, stockholders, and the Internal Revenue Bureau would be enormous. Surely the Congress can think of a better way to collect the few hundreds of millions of dollars they hope to get, at great inconvenience and expense, by adoption of this withholding tax. By elimination of one of the mammoth Government projects calling for the spending of billions of tax dollars, this amount could be saved in a lump sum. And that is just what a large number of citizens will be thinking about when they get notices from corporations that the Government is preventing the sending of the usual dividends in full.

For more than 20 years I have publicly advocated the mutualization of business, industry, and commerce through stock ownership in bona fide corporations rather than through the organization of mutual societies and cooperative organizations, which, by the way, legally evade their just portion of the tax load. I was one, if not the first, speaker in America to compile information and tabulate figures showing to what extent the stock of large financial institutions is distributed among the public. In recent years I have noted with gratification the growth in number of stockholders participating in the financing and benefits of the industrial development of my own good State. I fear the adoption of a dividend withholding tax would prove a serious blow to this development, just as the exemption of refunds by cooperatives provided in the House bill would prove a boost to the cooperatives.

Congress should realize that if private corporations do not expand to meet the requirements of our defense program, the Government will be called upon to make available funds for this expansion. This would mean further inroads

into our private enterprise system, and additional steps toward the complete socialization of our whole economy. Instead of adopting tax measures which serve as a deterrent to private corporate development, the Government should do everything to encourage more people to promote and invest in private business. Let's not deviate from the American way, which has proven so successful.

With personal esteem and admiration, and with due respect, I am,

Sincerely and faithfully yours,

J. PAUL LEONARD, *Secretary.*

STATE TEACHERS COLLEGE,
Kutztown, Pa., July 6, 1951.

The Honorable WALTER F. GEORGE,
Chairman, Senate Finance Committee,
Washington, D. C.

MY DEAR SENATOR GEORGE: This letter represents a request for tax exemption for all 101 (6) corporations all of whose net income is donated for the benefit of public education.

This institution is the beneficiary of $4,000 over a 4-year period from a 101 (6) corporation. This amount provides scholarships for five students who are preparing for elementary teaching.

All 101 (6) corporations should be required to be audited annually at their own expense by a reputable firm of accountants.

Such 101 (6) corporations should be required to contribute to public education at least as much as their Federal income tax amount would be if they were not in an exempt category. This requirement is necessary to control unfair competition.

All 101 (6) corporations must be controlled so that benefits accruing to directors, officers, employees and stockholders shall represent only salaries with the amount no greater than the service rendered.

Sincerely yours,

Q. A. W. ROHRBACH,
President.

HUDSON TRUST CO.,
Union City, N. J., June 6, 1950.

The Honorable ROBERT L. DOUGHTON,
Chairman, Ways and Means Committee,
House of Representatives, Washington, D. C.

DEAR MR. DOUGHTON: I read with a great deal of interest the House Ways and Means Committee voted tentatively to levy corporate taxes on the earnings of mutual savings banks and savings and loan associations after dividends, but before reserves. It was also interesting to read the reasons given to your committee why the mutual savings banks and savings and loan associations should not be taxed. These very same reasons apply to commercial banks, which, as you know, have paid Federal income taxes for a great many years. Under existing laws, mutual savings institutions certainly enjoy an undue advantage of the commercial banking institutions. Within the past several months, a number of mutual savings institutions located in New York and New Jersey have increased the interest rates on time deposits from 1 percent to 2 percent per annum. Very few of the commercial banking institutions located in the metropolitan district of New York and New Jersey have increased their interest rates to meet the unfair competition of tax exempt mutual savings institutions, because, among other reasons, the commercial banking institutions must provide for Federal income tax.

While I do not wish to bore you with statistics, I should like to recite the following facts, which appear on page 96 of the annual report of the chairman of the Federal Deposit Insurance Corporation for the year ending December 31, 1948, and filed with the President Pro Tempore of the Senate and the Speaker of the House of Representatives under date of July 27, 1949. As of December 31, 1948, the total deposits of 13,419 insured commercial banks amounted to $140,682,521,000, which included $35,527,666,000 time deposits and the total deposits of 193 insured mutual savings banks amounted to $12,771,527,000, practically all of which are time deposits. Although the total number of savings depositors in each class of banks is not available, it should be noted however that the time deposits in the insured commercial banks are almost three times the amount on

deposit in mutual savings banks. It is evident the so-called penalties to be suffered by the depositors of mutual savings banks, if the institutions are made subject to Federal income taxes, have long existed for the same type of depositor of insured commercial banks. I do believe savings depositors in the commercial banks are entitled to the same consideration as those of the mutual savings banks and savings and loan associations.

I have been informed that the savings banks located in New York State are not required to carry any legal cash reserve. Institutions located in the State of New Jersey are required to carry cash balances of not less than 3 per centum of their aggregate deposits other than capital deposits. You are undoubtedly familiar with the regulations of the Federal Reserve System governing the reserves to be maintained by commercial institutions on both demand and time deposits. These reserves are substantial. As of December 31, 1948, there were 193 mutual savings banks members of the Federal Deposit Insurance Corporation; 131 are located in New York State and 24 in the State of New Jersey. These institutions constitute 80 percent of the total membership of mutual savings banks in the Federal Deposit Insurance Corporation. According to the annual report of the chairman of the Federal Deposit Insurance Corporation, all of the savings banks located in the States of New York and New Jersey are members of the Federal Deposit Insurance Corporation.

I hope that Congress will enact only such tax legislation on banks as will constitute an equal burden on mutual savings banks and savings and loan associations and commercial banks rather than legislation which would constitute an unfair advantage to be enjoyed by any particular group.

Very truly yours,

O. W. Beaton,
Executive Vice President.

Alberhill Coal and Clay Co.,
Los Angeles, Calif., July 3, 1951.

In re percentage depletion allowance for clays.

Senator Walter F. George,
Chairman, Senate Finance Committee,
Senate Office Building, Washington, D. C.

Dear Senator George: On June 8, 1951, I wrote a letter to the Honorable Robert L. Doughton, chairman of the House Ways and Means Committee on the subject of technical clarification of the allowances for percentage depletion for brick and tile clay and refractory and fire clay as provided in the new tax bill under consideration at that time. Mr. Doughton acknowledged receipt of my letter but it evidently arrived too late for the matter to be investigated and a change made in the tax bill.

As passed by the House of Representatives, the new tax bill allows percentage depletion of 5 percent for "brick and tile clay" and 15 percent for "refractory and fire clay". I assume the two different percentage figures have been used on the theory that "brick and tile clays" are more plentiful than "refractory and fire clays." The suggestion behind the wording used is that the end use of a clay shall determine the percentage grouping into which it shall fall.

The use of these terms does not make a definable grouping of clay products that can be segregated one from the other or is related to the supply of clay available for the manufacture of the products in either group. May I briefly illustrate these two points. First, the word "brick" includes firebrick as well as common brick. Firebrick are also refractories. Second, the word "tile" includes glazed bathroom tile as well as drain tile. Glazed bathroom tile are made from clays in relatively short supply and drain tile from clays that are plentiful. Further, many of the same clays are used in brick, tile, refractories and fire clay. For these reasons the end use yardstick of segregating clays for percentage depletion purposes will only create confusion in administering the law and will divide clays in a manner not related to scarcity or plentiful supply. It is conceivable that under the present wording of the proposed law the higher refractory clays made into many clay products would not be allowed any percentage depletion since on the face of it these clay products are not included in the definition of any of the clay products named.

I assume from the particular wording of the proposed bill that an attempt is being made to separate low grade clays that are mainly used for the manufacture of the class of low temperature fired clay products such as common brick and

drain tile from the more refractory clays that are necessary for the manufacture of higher temperature fired clay products such as fire brick, face brick, flue lining, sewer pipe, conduit, pottery, glazed bathroom tile, etc.

Common brick and drain tile clays are sometimes mixed with the more refractory type of clays to manufacture some higher temperature fired clay products. Common brick and drain tile clay is generally a surface alluvial or adobe clay and is very common and plentiful in most parts of the United States. Large tonnages of this type of clay are used. The more refractory type of clays necessary for the manufacture of the higher temperature fired clay products are more rare and are only found in a limited number of localities. This type of clay is used in much less tonnage than the common brick and drain tile type of clay.

The easiest to define difference between these two types of clays is in their relative fusing temperature, that is the temperature at which the clays would fuse or melt. Common brick and drain tile clays fuse or melt when heated to a temperature of not higher than the pyrometric cone equivalent of cone 5. The more refractory type of clays have a fusing or melting temperature of higher than the pyrometric cone equivalent of cone 5. The pyrometric cone equivalent (P. C. E.) is the standard American Society of Testing Materials designation for temperature used in the ceramic industry. This is as outlined by the American Society of Testing Materials, located at 1916 Race Street, Philadelphia 3, Pa., in their procedure C24-46.

In its present wording the proposed tax bill will cause a great deal of confusion as to the eligibility of clays for different percentage depletion rates. It would seem clearer to allow the 15 percent depletion rate for all clays having a fusion or melting point above the pyrometric cone equivalent of cone 5 and the 5 percent depletion rate for all clays having a fusion or melting point of the pyrometric cone equivalent of cone 5 or less. For the Internal Revenue Department and our industry this would make a definite dividing line between clays for the different depletion rates and would thereby make a law that would be easier and cheaper to administer.

I suggest in the proposed tax bill that the wording "Clays with a fusion point of the pyrometric cone equivalent of cone 5 or less" be used in place of "brick and tile clay" in the 5 percent depletion allowance group and "clays with a fusion point above the pyrometric cone equivalent of cone 5" be used in place of "refractory and fire clays" in the 15 percent depletion allowance group.

If reference to a technical test is not desired "clays with a fusing temperature of 2,200° Fahrenheit or less" for the 5 percent depletion group and "clays with a fusing temperature of over 2,200° Fahrenheit" for the 15 percent depletion group may be used.

Both of these sets of definitions are substantially the same although the pyrometric cone equivalent is more accurate as it takes into consideration time as well as temperature. Time becomes a factor as additional heating time will bring about fusion at a lower temperature.

Use of either of the above definitions will not affect depletion allowances now provided for ball, sagger, and china clay. These three clays have a fusion point above the pyrometric cone equivalent of cone 5 and would fall in the 15 percent depletion group as under the present law.

Very truly yours,

CHAS. J. BIDDLE, *President.*

Copies mailed to Senators William F. Knowland and Richard M. Nixon and Mr. Colin Stam.

STATEMENT OF J. R. KILLIAN, JR., PRESIDENT, MASSACHUSETTS INSTITUTE OF TECHNOLOGY

MEMORANDUM RE CHARITABLE CONTRIBUTIONS BY INDIVIDUALS AND THE FEDERAL INCOME TAX

1. *Present statutory provisions.*—(*a*) Under section 23 (o) of the Internal Revenue Code, in computing his income tax, an individual may not deduct more than 15 percent of his adjusted gross income on account of contributions to religious, educational, and charitable institutions. (*b*) Section 120 of the code provides, exceptionally, that if, for the current and each of the 10 preceding tax years, the aggregate of the taxpayer's income taxes and contributions exceeds 90 percent of his net income, there is no limitation on his deduction for contributions.

2. *Effect of these provisions.*—(*a*) Obviously, the exceptional provisions of section 120 apply only to a handful of taxpayers, because they require that very strin-

gent conditions be satisfied in each of 11 consecutive years. The Board of Tax Appeals (now the Tax Court) has held that the section may not be invoked by averaging the figures for 11 consecutive years.

(*b*) For high-bracket taxpayers who cannot satisfy section 120, the 15 percent provision tends to place an effective limit on their contributions from income. When a taxpayer in the 75 percent tax bracket gives $5,000 within the 15 percent limitation, the total he pays to the donee and the Federal Government is $5,000. When he gives $5,000 above the 15 percent limitation, his payments total $8,750.

3. *Proposals.*—(*a*) The 15 percent limitation should be substantially raised or eliminated.

(*b*) If any percentage limitation is to be retained in section 23 (o), the provisions of section 120 should be liberalized—as, for example, by reducing the period to five consecutive years and permitting averaging, provided the 90 percent rule is satisfied not only as to the average but in each of at least 3 of the 5 years averaged.

4. *Justification for these proposals.*—(*a*) Our educational, religious, and charitable institutions are, to a major extent, the very institutions on which we must rely to preserve, develop, and transmit the cultural, spiritual, and humanitarian values which are indispensable to western civilization in general and to American democracy in particular. Their continued existence and growth are essential in the gravely troubled climate of our times.

(*b*) Many, if not most of these institutions are facing financial crises. To the extent that educational and charitable institutions falter and fail, the services they perform will devolve upon some level of government, with a resultant increase in taxes. To the extent that religious institutions falter and fail, the country will be the poorer, even though government, because of constitutional limitations, cannot take over their functions.

(*c*) The 15 percent provision, coupled with the necessarily high individual income rates, is a material factor in limiting contributions at the very time when rising prices and costs of all kinds are squeezing institutional budgets.

5. *Probable fiscal effects of these proposals.*—(*a*) The taxpayers affected will be primarily those with net taxable incomes of $50,000 or more. In brackets above that figure, most of the taxpayers affected will be those who are currently contributing the deductible 15 percent. In no bracket comprising a substantial number of taxpayers does the average amount contributed closely approach 15 percent. Thus it appears probable that only a rather small minority of high-bracket taxpayers will be affected. However, no precise estimate of the number of taxpayers who would take advantage of these proposals can be made from currently available information.

(*b*) Estimates made by competent tax students, based on 1946 and 1947 figures, are that direct loss in Federal revenue, from adoption of these or similar proposals, would be $100,000,000 annually or perhaps more. The Treasury might be able to make more accurate estimates on the basis of more recent tax returns.

(*c*) If adoption of these proposals resulted in a substantial increase in contributions to the institutions, then necessarily the direct revenue loss to the Federal Government in dollars, would also be substantial. However: (1) Percentagewise, the gain to the institutions would be much greater than the loss to the Federal Government. (2) In dollars, the amount received by the institutions would always materially exceed the dollars lost in tax revenue. Thus, the percentage of national income devoted to the public welfare would increase. (3) By indirection, the Treasury would recoup a substantial portion of the revenue directly lost. This is true because, while the institutions would pay no income tax on the contributions received, they would spend much of the money for salaries and other items which would produce income and other tax payments.

ELYRIA, OHIO, *July 2, 1951.*

Hon. WALTER F. GEORGE,
Chairman, Senate Finance Committee,
Senate Office Building, Washington, D. C.

DEAR MR. GEORGE: I am writing in connection with the revenue act which your committee will be considering during the next few weeks.

I refer particularly to one phase of the present act covering excess-profits taxes on corporations. In the present act, various alternate provisions were made to give effect to hardship cases and various ways of computing the excess-profits tax base to correct such hardship cases. Our auditors have told us that despite all these alternate provisions, that there is none which gives relief to our particular situation, and for this reason we would like to outline the conditions for which the excess-profits tax penalizes our company quite harshly.

Our company was organized and started operations late in 1945 after the close of World War II. In getting operations started it was not until the middle of 1946 that our volume was large enough to absorb all costs, and show a profit. During the balance of 1946 we were able to earn sufficiently to overcome the initial loss and show a very small profit for the year. Then the years 1947 and 1948 were years that we would call normal, but again in 1949 due to a general slow down in business in our line of production, we again showed a very small profit. Perhaps the actual figures will show this condition, and we tabulate these below:

Year	Sales	Profit before Taxes	Percentage of profit
1946	$355,980.73	$8,848.14	2.89
1947	630,953.57	66,637.75	10.56
1948	655,013.69	56,182.07	8.58
1949	450,703.48	4,029.36	.89

We think that this graphically shows the situation, and how our excess-profits-tax base is essentially figured on 2 of 4 years in the base period, instead of 3 of the 4 years permitted. Is it possible that some alternate provision might be written into the new Revenue Act to give relief in this situation? A provision to use 2 of the best 3 years under such a condition would be one way, instead of 3 of the 4-year period. You will also realize that the provision passed by the House in their version using a 75 instead of 85-percent figure to calculate the base only accentuates the unfairness of this outlined situation. The consideration of your committee would be appreciated in this instance.

Yours very truly,

OHIO SCREW PRODUCTS, INC.,
N. A. HEWITT, *President.*

[Telegram]

WASHINGTON, D. C., *July 10, 1951.*

Hon. WALTER GEORGE,
Chairman, Senate Finance Committee,
Senate Building, Washington, D. C.:

The position taken by the National Association of Manufacturers, American Farm Bureau, and others, advocating Federal sales tax is opposed by the National Federation of Independent Business. The opposition expressed is not the voice of any officer or group of officers, but is obtained through a Nation-wide poll of the federation members made up of independent business and professional men. The results of this poll were as follows: "For a Federal retail sales tax, 20 percent; against, 78 percent; and 2 percent, no vote." To reduce the increasing tax load facing the American people and independent business, we urge (1) that you vote "No" on the Federal sales tax, (2) the elimination of all subsidies in any segment of our economy, and (3) a complete and all-inclusive investigation and overhauling of the entire foreign-aid program. Independent business today is already carrying an excessive tax load which they are less able to bear than are other factors in our economy. Please file this message in the record of the committee hearings.

Thanks.

GEORGE J. BURGER,
Vice President in charge, Washington Office, National Federation of Independent Business.

CHICAGO, *July 6, 1951.*

Senator WALTER F. GEORGE,
Chairman of Committee on Finance,
United States Senate, Washington, D. C.

DEAR SENATOR: I would like you to give consideration to section 51 of H. R. 4473 as reported by the House Ways and Means Committee, June 18, 1951, C. C. H. No. 28, June 27, 1951, page 101.

I suggest that mandatory estimated returns be abolished, effective January 1, 1952, and in place thereof, provision made for the Commissioner of Internal Revenue to issue a bill to the individual taxpayer who is now required to file an estimated return, for one-fourth of the 1951 tax liability. This bill should be

due April 15, 1952 instead of the present requirement of payment on March 15, 1952, based upon the estimated returns for 1952, due on March 15, 1952. This bill should have provision on the back, like the present bills rendered for payment June 15, September 15, and January 15 following, whereby the taxpayer can amend so as to reduce or increase the current tax payment. Subsequent bills rendered on June 15, September 15, and January 15 should have like provisions for amendment.

The purpose of this is to abolish the estimated tax return without reducing or interfering with the collections by the Revenue Department. The advantages of this change are as follows:

Abolishing mandatory estimated returns will relieve the public at large from the worry of preparing and filing this return which gets nowhere, and should reduce personnel in the collectors' offices. Considering the millions of returns that are now filed, it is a tremendous job for collectors' offices throughout the country to take care of. Most people, as many as 90 percent, hold a bill from the collector in very high esteem and respect, and will pay such bills. There could be no objection to such a bill because the taxpayer should still maintain the privilege of amending this bill if he wants to pay more or less as each bill is received. The collector must issue bills, beginning with June 15. Under this plan, he merely adds one more bill, April 15.

At the present time, the theory of quarterly payments is upset between September 15 and January 15 filing. The taxpayer is also pressed by paying the balance of the preceeding year's tax, plus the first installment of the estimated tax for the current year. This pressure has, on occasions, resulted in the taxpayer paying less on his first installment then he should. By making the first payment April 15, the taxpayer gets a breathing spell and is more likely to pay as much as one-fourth of last year's tax and not to reduce it, to conform with the pressure now existing when he must pay the balance of last year's tax, and the 1st installment of this year's tax. Not only will this save labor and personnel in the collectors' offices but it will save paper, which is scarce, and will save printing, and the facilities can be utilized for other more urgent purposes. It will save storing the vast quantities of estimated returns now received by collectors.

Accordingly, I have outlined many advantages in abolishing mandatory estimated returns, easing the pressure on the taxpayer, and maintaining the flow of revenue to the Government in an orderly and smooth manner. I trust that this recommendation will meet with your favorable consideration.

Yours respectfully,

JULIUS BARNARD.

[Telegram]

DENVER, COLO., July 4, 1951.

Senator EUGENE D. MILLIKIN,
Senate Office Building, Washington, D. C.:

Urge your defeat of section 488 of H. R. 4473, the increase in Federal gasoline tax. An increase at this time works an unnecessary hardship on the airlines as the new proposed tax would amount to more than the industries' net profits in 1949 and approximately 50 percent of the net profits of '50 and '51. The increase would constitute 28 percent of Continental's net operating income creating an effect similar to a vast increase in corporate income tax. I personally urge you consider the seriousness of this increase.

CONTINENTAL AIR LINES, INC.
ROBERT F. SIX, *President.*

RESOLUTION NO. 1—FEDERAL GASOLINE TAX

Whereas a bill has been proposed for introduction at the present session of the Congress of the United States to increase the Federal tax on gasoline, and

Whereas the Federal tax on each gallon of gasoline sold for consumption in and the operation on motor vehicles upon the public highways of the Nation is now 1½ cents, and

Whereas the Federal tax on gasoline if increased as proposed by the bill now about to be presented to Congress will levy a tax of 3 cents on each and every gallon of gasoline sold for consumption in and the operation of motor vehicles upon the public highways of the Nation, and

Whereas the proposed Federal tax on gasoline along with the present State tax on gasoline will combine to make a tax of 9 cents per gallon for each and every gallon of gasoline sold in the State of Maine for use in the operation of an automobile upon the public highways of the State. Therefore, be it

Resolved, That Highland Lake Grange No. 87 of Westbrook, Maine, go on record as opposing any additional tax levy on gasoline; and be it further

Resolved, That a copy of this resolution be presented to Cumberland County Pomona No. 15, Patrons of Husbandry, at the next meeting of that body, for consideration and record.

WILLIAM L. MALIA,
FRANK M. BATEMAN,
ARTHUR C. GORDON,
Legislative Committee.

Approved by Cumberland County Pomona No. 15, Legislative Committee.

[SEAL]

GENEVA P. HASHELL,
Secretary.
EUGENE E. NORTON.
GLADYS E. WEST.

PORTLAND, MAINE, *April 4, 1951.*

Whereas present Federal automotive excise taxes levied on gasoline, automobile tires, accessories, etc. cost Maine highway users about $8,000,000 last year and Secretary of Treasury Snyder wants Congress to increase the tax on gasoline from 1½ cents to 3 cents and excise tax on new cars from 7 to 20 percent which would cost Maine automobile owners an extra $5,000,000: Therefore, be it

Resolved, That Stroudwater Grange No. 480 Patrons of Husbandry is opposed to passage of any further legislation increasing the tax on our automobiles and trucks as they are no longer a luxury but a necessity in our transportation sytem; and be it further

Resolved, That a copy of this resolution be sent to each of our Senators and Congressmen from the State of Maine.

Approved by Cumberland County Pomona No. 15, Legislative Committee.

SEAL]

GENEVA P. HASHELL,
Secretary.
EUGENE E. NORTON.
GLADYS E. WEST.

Whereas present Federal automotive excise taxes levied on gasoline, automobile tires, accessories, etc., cost Maine highway users about $8,000,000 last year and Secretary of the Treasury Snyder wants Congress to increase the tax on gasoline from 1½ to 3 cents and excise tax on new cars from 7 to 20 percent which would cost Maine automobile owners an extra $5,000,000: Therefore be it

Resolved, That Cape Elizabeth Grange No. 242 Patrons of Husbandry is opposed to passage of any further legislation increasing the tax on our automobiles and trucks as they are no longer a luxury but a necessity in our transportation system; and be it further

Resolved, That a copy of this resolution be sent to each of our Senators and Congressmen from the State of Maine.

Dated at Cape Elizabeth, April 7, 1951.

The members of the legislative body of the Cape Elizabeth Grange No. 242 favor this resolution and wish to refer it to the Grange for further action.

——— ———, *Chairman.*

Approved by Cumberland County Pomona No. 15, Legislative Committee.

[SEAL]

GENEVA R. HASKELL,
Secretary.
EUGENE E. MARTIN.
GLADYS E. WEST.

SAN ANTONIO 5, TEX., *July 9, 1951.*

Senator WALTER F. GEORGE,
Chairman, Senate Finance Committee, Washington, D. C.

DEAR SENATOR: I am unable to personally appear before your committee in opposition to pending tax bill, and therefore would like to present my protest against the socialistic measure passed by the House. I would like to endorse the remarks of Hon. Noah M. Mason, Member of Congress, appearing in the Congressional Record of June 11, as well as the article on the tax measure written by Dr. Willford I. King, included in the address by Congressman Mason.

I would like to state in the beginning that nonsense that is being put out by members of the administration, including the President, about inflation being caused by people spending money is so obviously propaganda that Members of Congress should not be influenced by it. What has caused inflation is that billions of dollars are spent by the Government, included in which are the billions of foreign aid. Why should American taxpayers be impoverished to aid foreign nations? We got along without all of this foreign aid until the "Great Roosevelt" and the shopkeeper, Truman. No businessman would think of using his income for the purpose of aiding someone else when it became necessary for him to borrow in order to keep going. Every Member of Congress knows the origin of foreign aid. The lend-lease program was devised by Roosevelt to evade the law of the Nation prohibiting loans to foreign nations. The aid to Europe, or Marshall plan, was carrying out a bribe engineered by Morgenthau to induce Churchill to accept the stupid pastoral plan for destruction of Germany. Should there be anyone so poorly informed in Congress as not to know this, then it would be well for him to read Secretary Hull's article on the Quebec Conference.

The Government is not only trying to tax its citizens into poverty, but at the same time it is pressing them day after day to buy Government bonds which are decreasing in value day after day after they are bought, so much so that the patriotic citizen who bought bonds in 1941, 1942, and thereafter has lost 50 percent of his purchasing power. He gets $2\frac{1}{2}$ percent but that $2\frac{1}{2}$ percent is worth only $1\frac{1}{4}$ percent in purchasing power, and out of which $1\frac{1}{4}$ he must pay taxes

Could there be a Member of Congress so stupid as not to realize that our whole New Deal and Fair Deal program is socialistic under just another name, which is heading direct for the same destruction that has led England and France into bankruptcy, and which socialistic governments we are maintaining with our foreign aid, as otherwise they would go into disintegration?

The corporation tax is confiscation purely and simply. There are 14 million corporation stockholders. On them a double tax is imposed; first, a prohibitive confiscatory corporation tax upon earnings without any exemption. Secondly, a tax on the distribution of the remaining profits and secured by withholding tax which in effect means 72 percent of the net profits if distributed without taking into consideration any excess profits tax, and the man that is demanding this is Mr. Truman who enjoys a $50,000 gift from the Congress not subject to taxation, which is the equivalent of approximately a million dollars in income if subject to taxation, and the Members of Congress enjoy a $2,500 gift which they have taken without consent of the people, not subject to income tax, by the subterfuge of calling it an expense fund.

I can only say that our Government is based upon dishonest practices and deception. No government can long endure under such practices, no more so than an individual can. I, therefore, trust that this committee will try to be fair and just with the citizens of this Nation before it throws away billions to other nations, all of whom have practiced dishonesty toward us, excepting only Finland.

Very truly yours,

JOHN P. PFEIFFER.

Copies to Senators Tom Connally and Lyndon Johnson and Hon. Paul Kilday.

NEW YORK, *July 12, 1951.*

Re section 122 (b) of the Internal Revenue Code, as amended by section 215 (a) of the Revenue Act of 1950.

To the Honorable Members of the Finance Committee of the United States Senate:

HONORABLE SIRS: We wish to endorse the testimony given before your committee on July 10, 1951, on behalf of the Pennsylvania Bar Association relating to the 1950 amendment to section 122 (b) of the Internal Revenue Code.

The 1950 enactment was basically salutary. It amended the former provision for a 2-year carry-back, and a 2-year carry-over, of the losses of a corporation. The new enactment substituted a 1-year carry-back and a 5-year carry-over. It was designed to aid small and new businesses incurring losses early in their history.

The 1950 enactment, however, contained one manifest but unintended inequity. The framers of the bill seemed to have overlooked the inharmonious application of the bill to corporations in the process of dissolution.

As applied to those corporations which sold their assets and liquidated prior to this enactment, on September 23, 1950, the amendment works a hardship. Typical of such cases is the small closely held corporation with inventory and depreciable assets actually worth less than book where the sale was made on the justifiable assumption that the loss could be carried back 2 years. It is also characteristic in such cases that the law in effect at the time unquestionably had a definite bearing on the selling price simply as one of the bargaining factors, and the effect was to reduce the selling price.

Corporations going out of business, frequently on a distressed-sale basis, should not be penalized in order to compensate the revenues for relief extended to continuing or new corporations. Section 215 (a) of the Revenue Act of 1950 unintentionally created a very inequitable situation for corporations in the process of liquidation, prior to the date of the enactment of section 215 (a) of the Revenue Act of 1950. Nothing in the committee reports indicates that there was an intent to create this unfortunate situation for corporations in dissolution.

The inequity could be corrected by a simple measure which would provide that the 1950 amendment is inapplicable to corporations completely liquidating, or which were in process of complete liquidation on September 23, 1950, if the liquidation is completed by the end of the second taxable year beginning after December 31, 1950.

We represent an estate owning the controlling interest in a corporation. Over a year prior to the enactment of the Revenue Act of 1950, the estate, for many reasons, decided to dissolve the corporation. One of the factors in the decision was, of course, the tax law existing at the time of the decision. There are a number of other corporations in dissolution which are inadvertently prejudiced by the 1950 measure. To these corporations, the harm is severe; yet the correction of the inequity would result in a disproportionately small loss of revenue to the Treasury.

For the foregoing reasons, we endorse the testimony of the Pennsylvania Bar Association, and recommend that the 1950 amendment be made inapplicable to corporations completely liquidated, or which were in the process of complete liquidation on September 23, 1950, if the liquidation is completed by the end of the second taxable year beginning after December 31, 1950.

Respectfully yours,

THAYER & GILBERT.

NEW YORK 5, N. Y., *August 1, 1951.*

Re: Section 122 (b) of the Internal Revenue Code, as amended by section 215 (a) of the Revenue Act of 1950.

TO THE HONORABLE MEMBERS OF THE FINANCE COMMITTEE OF THE UNITED STATES SENATE

HONORABLE SIRS: On July 12, 1951, we wrote to you for the purpose of pointing out an inequity which seems to have been inadvertently created by section 215 (a) of the Revenue Act of 1950 amending section 122 (b) of the Internal Revenue Code.

We respectfully set forth for your consideration the following proposed amendment which will eliminate the inharmonious application of the 1950 amendment to corporations in the process of dissolution on September 23, 1950, the date of the passage of the Revenue Act of 1950:

Paragraph (B) of section 122 (b) (1) is hereby amended to read as follows:

"(B) LOSS FOR TAXABLE YEAR BEGINNING AFTER 1949.—*Except as hereinafter provided in paragraph (C)*, if for any taxable year beginning December 31, 1949, the taxpayer has a net operating loss, such net operating loss shall be a net operating loss carried back for the preceding taxable year." [New matter is italicized.]

Section 122 (b) (1) is hereby further amended by adding the following paragraph (C):

"(C) LOSS FOR TAXABLE YEAR BEGINNING BEFORE 1953 WITH RESPECT TO DISSOLVED OR DISSOLVING CORPORATIONS.—If for any taxable year beginning after December 31, 1949, and ending before January 1, 1953, a corporation which

(1) had completely liquidated by September 23, 1950, or (2) was in the process of complete liquidation on September 23, 1950, and completes its liquidation before January 1, 1953, has a net operating loss, such net operating loss shall be a net operating loss carry-back for each of the two preceding taxable years, in the manner and subject to the exceptions, additions and limitations provided in paragraph (A) of this subsection (b) (1). The Commissioner shall have power to implement this provision by appropriate regulations."

We trust that this proposed amendment or one which accomplishes the same result will meet with your approval.

Respectfully yours,

THAYER AND GILBERT.

WALLSTEIN, MENSCHEL & WALLSTEIN,
New York 7, N. Y., July 12, 1951.

Re revenue bill of 1951 (H. R. 4473) as passed by the House of Representatives on June 22, 1951

Hon. WALTER F. GEORGE,
Chairman, Senate Finance Committee,
Senate Office Building, Washington, D. C.

DEAR SIR: Section 123 of the above bill reduces to one the number of surtax exemptions which may be claimed by a group of corporations in common ownership and limits the minimum excess profits tax credit to a single credit of $25,000 for the entire group. Under existing law, each member of such a group is entitled to a full $25,000 exemption and a full $25,000 minimum credit under the excess profits tax.

The purpose of the change made by the bill is stated in the report of the House Committee on Ways and Means (82d Cong., 1st sess., H. Rept. No. 586, pp. 23-24). The purpose is to close the existing loophole by which a tax advantage can be obtained by artifically splitting up corporations which, but for the influence of tax considerations, would constitute a single business enterprise. The existing loophole is particularly attractive, as the report points out, in a period of high corporate tax rates.

The closing of this loophole is certainly desirable. But it seems to me that the language of the bill is so broad as to go beyond the purpose sought to be achieved and to penalize business situations not within the evil sought to be remedied.

I refer to those situations in which separate corporations have come under common ownership and have remained so for many years Originally separately owned, they have been brought into common ownership by the normal operations of the profit motive, unrelated to tax considerations. In such situations, there has not been an artificial splitting up for tax reasons of a preexisting single corporation; there has been a normal business evolution of preexisting separate corporations into common ownership.

I suggest that it is not, and in any event should not be, within the congressional purpose to penalize such corporations now. I therefore suggest that section 123 (a) be amended so as to limit it to the category of cases in which it is likely that splitting up has occurred and has been motivated more by a desire to secure multiple tax exemptions and credits than by nontax business considerations. A practical method would be to make section 123 (a) apply only to cases in which the entry of corporations into common ownership has occurred after January 1, 1940, and to continue the present full exemption and credit for each corporation which has been in common ownership continuously since January 1, 1940. The lower corporate tax rates and the absence of substantial specific exemptions for corporations before that date make it unlikely that there was then much splitting up of corporations for tax reasons. The continuance of the separate corporate entities in common ownership for more than 10 years is some assurance that legitimate business purposes other than tax reduction were served thereby.

I enclose as an appendix a proposed revision of section 123 (a) incorporating this change.

Respectfully yours,

LEONARD M. WALLSTEIN, Jr.

PROPOSED AMENDMENT TO SECTION 123 (a) OF THE REVENUE BILL OF 1951 (H. R. 4773) AS PASSED BY THE HOUSE OF REPRESENTATIVES ON JUNE 22, 1951

In section 123 (a) of the bill, adding to code section 26 a new subsection (j) entitled "Surtax Exemptions," subsection (j) should be amended by changing paragraph (2) to read as follows (language of present bill to be omitted is enclosed in brackets; new matter proposed to be inserted is italic):

"(2) RELATED CORPORATIONS.—In the case of a corporation which *(a)* on December 31 of any year is a member of a controlled group as defined in paragraph (3) *and (b) has not been a member of such group continuously since January 1, 1940,* a surtax exemption, for the taxable year which includes such [date] *December 31,* in an amount equal to $25,000 divided by the number of corporations in such group at the close of such date. In lieu of such exemption, a surtax exemption of $25,000 for the controlled group may be divided (in any manner) by the corporations which at the close of such date are members of such group by making and filing with the Secretary a consent setting forth the portion of the $25,000 which will be taken by each member as its surtax exemption for its taxable year which includes such date. The consent shall be made and filed at such time and in such manner as the Secretary by regulations may prescribe. If a member of a controlled group has a taxable year which does not include December 31, the surtax exemption for such member for such taxable year shall be an amount equal to $25,000 divided by the number of corporations in such group at the close of such taxable year."

AMERICAN TELEPHONE & TELEGRAPH CO.,
Washington, D. C., July 10, 1951.

Hon. WALTER F. GEORGE,
Chairman, Senate Finance Committee,
The United States Senate, Washington, D. C.

DEAR MR. CHAIRMAN: In your consideration of the provision in H. R. 4473 (Revenue Act of 1951) with regard to the 20-percent withholding on dividend and interest payments, may we respectfully call your attention to the wide distribution of the stock of the American Telephone & Telegraph Co. among small stockholders who will be adversely affected by this withholding.

Our stock is owned by more than 1,000,000 stockholders in every walk of life. They reside in 19,000 communities throughout the Nation, and better than 1 in every 45 families shares directly in this ownership.

About 300,000 own 1 to 5 shares each and more than 210,000 own 6 to 10 shares each. In addition, about 230,000 own 11 to 25 shares each, making a grand total of almost 750,000 of our stockholders who are receiving dividend income from us of less than $250 annually.

From our daily correspondence, we are led to believe that a notable proportion of these holders are elderly people who are largely dependent upon investment income for their living. We know for a fact that 270,000 of our stockholders have owned the stock for 15 years or more; and half of these are presumably women, since women comprise more than 50 percent of our total ownership list. It is probable that in a majority of cases A. T. & T. is the only stock that our holders own. We base this assumption on a survey sponsored by the Federal Reserve Board of Governors in 1949 from which it appeared that 54 percent of those owning common stocks held only one such stock among their possessions.

I thus seems probable that tens of thousands of our stockholders are men and women who are past their earning years and subject to little or no income-tax liability. To have a substantial withholding made from their income, even though it would be refundable in the following calendar year, would be a regrettable hardship.

During the past year, we have received many letters from stockholders complaining about the burden which such a withholding would impose on their personal finances. A copy of a particularly interesting letter recently received from a stockholder is enclosed as an example of these communications.

We should be glad to furnish you with such further information regarding the nature of our stock ownership list, as you desire.

Very truly yours,

FRANK QUIGLEY, *Attorney.*

AMERICAN TELEPHONE & TELEGRAPH CO.,
Washington, D. C., July 10, 1951.

Hon. WALTER F. GEORGE,
Chairman, Senate Finance Committee,
The United States Senate, Washington, D. C.

DEAR MR. CHAIRMAN: H. R. 4473 (Revenue Act of 1951), as passed by the House of Representatives on June 22, 1951, and now under consideration by your committee, contains a provision for withholding on dividend and interest payments which will have a very heavy impact on the capital requirements of the Bell System.

During 1950 the American Telephone & Telegraph Co received approximately $291 million of dividend income from domestic corporations and, if the proposed withholding had been in effect, about $58 million of such income would have been withheld although its actual tax liability with respect to such income, payable in 1951, would amount to only $18 million. Presumably, such overpayments of tax would not be refunded until some time after the first quarter of 1951, with the result that the American Co. would have paid to the Government some $58 million of its funds and its capital requirements would be increased on the average $30 to $40 million. The raising of such an amount of money in the market constitutes a very sizable undertaking.

Section 201 of the bill as proposed includes a provision for an exemption from withholding in the case of dividends distributed between members of an affiliated group provided a consolidated tax return was filed by the group in the preceding taxable year of the payor corporation. We do not believe that relief should be conditioned upon the filing of a consolidated return which, for other reasons, may not prove to be a desirable procedure. Further, a number of the Bell System companies would not be eligible for inclusion in such a return and withholding would still be required with respect to the substantial amounts of dividend income received from such companies.

The stated purpose of withholding dividends at the source is to prevent tax evasion but it would appear that tax evasion on dividends distributed by one corporation to another must be of negligible proportions. In view of the abovementioned inequities, we urge that, if a withholding plan is to be enacted, consideration be given to exempting from withholding dividends distributed by one corporation to another or, as an alternative, to exempting dividends distributed by a subsidiary to its parent corporation.

For any further information or action in connection with any consideration you may give this matter we are at your disposal.

Yours very truly,

FRANK QUIGLEY, *Attorney.*

FRANKLIN, MASS., *June 13, 1951.*

DEAR MR. WILSON: Just a few lines to tell you that 2 years ago I had an operation and since that operation I have been in very poor health and I haven't done a day's work in 2 years on account of my poor health.

Last year I bought those 30 shares of the telephone so I could get little more dividend than the bank, to live on, because I have no other income at all. I am alone, no family.

Now I read in the paper that they are going to take 20 percent on the dividend.

That sure is going to hurt me, because that is the only income I have. They are doing that to withhold the 20-percent dividend at the source because people don't declare their dividend in their income-tax return, but that's all right for the people who work, but I am not working. I don't get enough to fill the income-tax return. Please, Mr. Wilson, if this becomes law that they are going to take 20 percent on the dividend can you tell me where can I go to see if I can get exempt from such tax on account that I have to depend on that to live on as I am unable to work.

If I get 20 percent less on my dividend I wouldn't have enough to live on. I may have to sell the shares, which I don't like to do it.

I hope you will help me out of this matter. If I was working I wouldn't mind to get 20 percent less on the dividend, but that's the only income I have.

Wishing to hear from you soon.

Yours very truly,

CHARLES MIGNELLI.

P. S.—I am nearly 60-years old honest I struggle along just on $22 per month just what you send me every 3 months $67.50 comes little over $5 per week, and what can anyone do with $5 per week today, things so high.

CHAPMAN SLATE CORP.,
Bath, Pa., July 11, 1951.

Hon. JAMES H. DUFF,
Senate Office Building, Washington, D. C.

DEAR SENATOR DUFF: There is scheduled before the Senate Finance Committee a hearing, on Thursday, July 12, regarding depletion allowance for slate; slate as quarried in the State of Pennsylvania, as well as Vermont, New York, Maryland, Virginia, California, Arkansas, Georgia, and Maine.

Attached herewith, please find a statement in support of the slate producers' request for independent classification in the bill now being introduced, which bill does not place slate in a category by itself. The facts attached are submitted for your consideration in support of our claim for this separate classification.

We trust that the facts as presented will enable you to conscientiously act in our behalf.

Very truly yours,

CHAPMAN SLATE CORP.,
H. B. BROWN, *Secretary-Treasurer.*

STATEMENT IN SUPPORT OF PERCENTAGE DEPLETION ALLOWANCE FOR SLATE PRODUCERS BY INDEPENDENT CLASSIFICATION IN BILL

This statement is submitted in behalf of the slate producers in the Vermont-New York, Pennsylvania-Maryland, Maine, and Virginia slate districts. The slate industry has been overlooked heretofore in the development of the application of the concept of percent depletion. The following facts are submitted for your consideration in support of our claim.

FACTS

1. *Small business.*—The slate industry is composed of approximately 80 relatively small companies operating on low profit margins.

2. *Industry location.*—Slate is a nonmetallic mineral product manufactured in various grades and types and in various States; namely, Vermont, New York, Pennsylvania, Virginia, California, Arkansas, Georgia, Maine, Maryand. Annual total production is about 800,000 tons with a total value of about $12,000,000.

3. *Uses.*—Slate is used in a variety of products; namely, natural roofing, roofing granules, siding, electrical switchboards, paints, ceramics, structural slate products, blackboards and bulletin boards, school slates, expanded aggregates, billiard table tops, and has other numerous and miscellaneous uses important to the economy of the country.

4. *Problems.*—The problems of exploration, development, production, and processing of slate are the same as those involved in metallic and nonmetallic mineral products, both competitive and comparative, already granted depletion allowance. In addition, the slate industry is further handicapped by a limitation of 15 to 20 percent recovery of salable slate from a ton of raw material, the balance of 85 to 80 percent being waste material.

5. *Competitive position.*—Competitively, in addition to the depletion factor (wasting of capital assets without tax relief), slate has been at a disadvantage with competitive synthetic products because of greatly increased freight rates in recent years. Slate producers are located by nature and cannot place plants strategically as they see fit.

6. *Others receiving depletion.*—Competitive or comparative mineral industries already receiving depletion allowances are talc, ball and sagger clay, feldspar, china clay, trona, vermiculite, mica, beryl, flake graphite, and others. A workable slate deposit is depleted in the same manner as any of the above industrial minerals. Additional similar industries dealing with industrial minerals are under consideration to be included in the present tax bill being considered by Congress.

7. *Quality product.*—Slate is a specialized nonmetallic mineral product currently having a market value ranging from $10 to $50 per ton. It should be classified independently as are marble, granite, quartzite, tripoli, etc. Definitely it should not be classified with low-cost bulk products such as stone, shale, sand,

and gravel that have values per ton only a fraction that of specialized slate products.

8. *Bureau of Mines recognition.*—The Bureau of Mines and United States Geological Survey have published many papers on the subject of slate by such eminent mining engineers and geologists as Oliver Bowles and T. Nelson Dale, and have long recognized our problems of survival to be the same as any other natural resource, be it oil, sulfur, coal, or gilsonite.

9. *Discrimination.*—Any tax bill (or law) that allows percentage depletion to competitive products such as feldspar, talc, china clay, asbestos, granite, and marble and not to slate is discriminatory and will destroy the industry.

10. *Help needed.*—Depletion is loss sustained through the removal of natural resources from the earth. Once resources are used they cannot be replaced except by uncertain and costly exploration and development of new deposits. Depletion allowances to other industries with identical problems assist their continued operation. Slate is fairly entitled to the same consideration.

CONCLUSION

Slate, because of its limited supply in quantities as well as areas, together with the necessity of expending substantial sums to provide adequate raw material, should be recognized as a separate and distinct item in the percentage depletion legislation now proposed, and should be included with competing items entitled to depletion under existing law.

For the reasons stated above and particularly because it is a quality product, slate is entitled to a specific listing separate and apart from the stone classification.

(NOTE.—Supporting material is appended hereto as follows: (*a*) Survey of slate industry; (*b*) statement of Winston L. Prouty, M. C., Vermont, to Ways and Means Committee, March 5, 1951; (*c*) bibliography.)

THE SLATE INDUSTRY—A SURVEY

Introduction

The production of slate is a small industry consisting of a small number of independent operators which has apparently been overlooked heretofore in the development of the application of the concept of percentage depletion as a means of encouraging the exploration and development of natural resources and providing an equitable method for recovery by the owner of the value of a wasting asset.

The Bureau of Mines Minerals Yearbook for the year 1949 shows that for that year the slate industry consisted of 80 operators who sold slate products having a total value of approximately $12,200,000.

Slate is a metamorphic deposit formed during earth disturbances of geologic time by the action of wear and pressure on shales and other finely divided sedimentary deposits. During this process secondary minerals were formed, principally mica, the crystals of which when properly orientated give to slate its outstanding characteristic of uniform cleavage. This unusual feature, which is fully developed only in limited deposits of slate within the major slate districts of the United States, makes it possible to cleave slate in slabs for processing in various commercial forms.

Geographical distribution of slate deposits

While the number of commercial slate deposits in the United States is limited, the slate industry is a part of the economy of a good many States.

Producing localities

Slate is known to occur in many localities but there are only five principal districts, all located in the eastern section of the United States, that contain deposits of commercial material. These districts are generally referred to as follows:

Maine: Monson, North Blanchard, and Brownsville districts.
New York-Vermont: Rutland County, Vt., Washington County, N. Y.
Pennsylvania: Lehigh district, Chapman Quarries, Belfast-Edelman, and Pen Argyl-Windgap areas.
Pennsylvania-Maryland: Peach Bottom district.
Virginia: Buckingham and Fluvanna Counties, Albermarle County.

Slate has also been produced on a small scale in Arkansas, California, Georgia, Michigan, Tennessee, Utah, and New Jersey.

The slate belts in all these districts are extensive—from 5 to 20 miles in length and from 1 to 3 miles in width. The commercial deposits within these belts,

however, are extremely limited and individual quarries seldom extend for more than a few hundred feet in length and considerably less in width.

Mode of occurrence

The commercial slate deposits are similar to all metallic and nonmetallic ore deposits in that they are generally lenticular in shape, limited in horizontal and vertical extent, and contain a high percentage of material which must be discarded as waste. Like other metallic and nonmetallic deposits, the commercial slate deposits are wasting assets and have relatively short lives as compared to some of the great copper, lead, and zinc deposits of the Western States.

Uses of slate

Slate is well-suited to engineering uses because of its high strength, low absorption, resistance to weathering and chemical attack, low electrical conductivity, uniformity of composition, and permanent stability of dimension. Dimension slate or slab slate is used for roofing, electrical panels, architectural panels, laboratory fixtures, sanitary ware, blackboards and bulletin boards, flagstones and miscellaneous uses. Slate granules are used chiefly in surfacing prepared roofing and siding. Slate flour is used as a filler in putty, wallboard, phonograph records, crayons, blotting paper, linoleum, insulation, facing pavements, building paper, wood filler, abrasives, pencils, plastics, metal polish, firebrick, tiles, ceramic ware, composition flooring, artificial stone, cement, dentifrices, roofing compound, artificial leather, sweeping compound, explosives, paints, washing compound, and fiber.

Industry problems

The production problems of the slate industry are described in Bulletin No. 47 issued in 1947 by the Mineral Industries Experiment Station of the School of Mineral Industries of Pennsylvania State College, at page 12, as follows:

"Slate tends to occur in narrow beds standing at high angles. Progressive development of quarries therefore produces very deep excavations in which recovery costs constantly increase. Marketable rock could be recovered only by skilled selection, careful handling, and the employment of hand labor. Because of the narrowness of the beds large tonnages of adjacent, noncommercial rock had to be moved. Imperfections in the slate causing rejection added to the tonnage of worthless material. In addition, the use of explosives in blasting and the employment of channeling machines in cutting rock produce large quantities of shattered rock without value. It has been estimated that the quantity that had to be disposed of as waste varies from 70 to 90 percent in most quarries. This waste material was expensive to handle; its accumulation interfered with quarrying; and large quantities remain for which no use has been found."

Competition.—The general problem of competition is discussed in Bulletin 47 referred to above as follows at page 15:

"The magnitude of the entire industry and the drastic decline of the last 20 years are apparent. The decline has been caused almost entirely by the diminishing volume of construction during the depression and then during the war, plus the rise of competitive materials. The slate industry, in common with other postwar industries, faces the problem of effecting every possible economy of it is to maintain its existence."

The problem of the producers of dimension or slab slate is discussed in Bulletin 47 as follows at page 16:

"Through hundreds of years slate has proved superior as a roofing material; but in the past 30 years the asphalt shingle has become the most common roofing on the average home, displacing slate in thousands of structures. The asphalt shingle can be applied with common labor; it comes in attractive colors; it has high fire resistance and is reasonably permanent. To some extent this loss has been compensated for by the use of slate granules for surfacing the asphalt shingle.

"In the public-school market, the white 'blackboard', a sheet of white or light green glass with a ground surface has displaced slate to an appreciable degree. Thus slate is encountering increasing competition not only in its most important markets, roofing and granules, but in one of its oldest uses, the blackboard as well."

The problem of the producers of slate granules is discussed in Bulletin 47 as follows at page 133:

"Business conditions in the industry are subject to change for a number of reasons. Granule technology has been developing rapidly. Almost yearly one or another of the producers offers new or improved products. There is an ever-present possibility that new patentable discoveries will make present practice obsolete. This technological pressure has led to the expenditure of large sums

on research, and more highly trained men are required to control production. Quality demands of the consumers are becoming increasingly stringent."

Slate for roofing is by far the most important product derived from commercial slate. This industry has been active in the United States since the middle of the nineteenth century.

Its competitive position, however, has been seriously invaded during the past 25 years by many types of roofing substitutes. The steadily increasing freight rates, almost 100 percent in the past 10 years, has placed a severe burden on the slate industry. Manufacturing plants producing substitute roofing media can be located close to the centers of major consumption. The slate deposits, however, fixed in locality by nature, must rely on long hauls by public carriers to reach the consumer. Steadily increasing State and Federal taxes which have been levied without regard to a great natural resource of our Eastern States, or recognition of the fact that slate quarrying is a wasting asset have done serious harm to the normal development of the industry. The combination of these factors has forced many large slate operations employing thousands of men to suspend operations entirely. The deposits of natural slate are not uniform in color or quality, with the result that in spite of core drilling it is almost impossible to determine the life of a quarry in that at any time off-color or an entirely different color slate, or intrusions may be encountered, with the result that either the entire quarry operation must be changed, or a new quarry site developed. It is costly to develop a new face in an existing quarry, but even more costly to abandon a quarry, locate a new deposit, and develop a new quarry location. Because of these many unknown factors it is necessary to constantly explore new deposit possibilities to assure a continuing source and supply of a satisfactory commercial slate.

Need for tax relief

Mr. Oliver Bowles, associated with the Bureau of Mines for more than 25 years and recognized as the leading authority on the slate industry in the United States, has published many technical papers which definitely state that commercial slate is extremely limited in occurrence within the major slate districts. The hundreds of worked-out and abandoned quarries which can be seen in all the slate districts amply support this contention. Commercial slate must be explored, tested, and developed in a manner similar to all ore deposits and operating slate quarries should obviously be allowed to build up reserve funds to carry out such development work if the industry is to survive. The theory of percentage depletion is based on the assumption that a wasting asset such as a mining or quarrying operation can continue to explore, develop and, if necessary, purchase new deposits to be operated when the old ones are exhausted, using funds which have been set aside, tax free, for this purpose. The soundness of this theory is proved by the healthy condition of the American mining industry which continues year after year to develop new natural resources. The slate industry has to date been denied the benefit of percentage depletion. This fact, combined with the steadily weakened competitive position of slate with its low margin of profit, has precluded the exploration and development of new slate deposits during the past 25 years of severe competition from substitute products. The attached list reflects that many competitive and comparable minerals enjoy depletion allowances which are denied the slate industry. Commercial slate in its original state was a clay which has been converted to its present form through the process of metamorphism. It naturally follows that slate should enjoy the depletion benefits which have been granted to the mining and quarrying industry in general including the products which are in direct competition with slate as well as those products which are analogous in form and character.

The slate industry endorses and supports the statement of Congressman Prouty of Vermont regarding the need for percentage depletion for the slate industry which was submitted to the Committee on Ways and Means of the House of Representatives at its hearing held on March 5, 1951.

Slate, because of its limited supply in quantities as well as areas, together with the necessity of expending substantial sums to provide adequate raw material, should be recognized as a separate and distinct item in the percentage depletion legislation now proposed, and should be included with competing items entitled to depletion under existing law.

(NOTE.—Bulletin 47 referred to above has been quoted from extensively because it represents an unbiased, objective study of the industry.)

Mineral products which are now allowed percentage depletion

Product	Percent of gross income allowed for depletion	Date legislation was enacted	Product	Percent of gross income allowed for depletion	Date legislation was enacted
Oil and gas wells	27.5	1926	Talc	15.0	1943
All metal mines	15.0	1932	Lepidolite	15.0	1943
Coal	5.0	1932	Spodumene	15.0	1943
Sulfur	23.0	1932	Barite	15.0	1943
Fluorspar	15.0	1942	Potash	15.0	1943
Rock asphalt	15.0	1942	Bauxite	15.0	1947
Ball and sagger clay	15.0	1942	China clay	15.0	1947
Flake graphite	15.0	1943	Phosphate rock	15.0	1947
Vermiculite	15.0	1943	Trona	15.0	1947
Beryl	15.0	1943	Bentonite	15.0	1947
Feldspar	15.0	1943	Gilsonite	15.0	1947
Mica	15.0	1943	Thenardite	15.0	1947

STATEMENT OF HON. WINSTON L. PROUTY, MEMBER OF CONGRESS, REGARDING THE NEED FOR PERCENTAGE DEPLETION FOR THE SLATE INDUSTRY, AT HEARING BEFORE THE COMMITTEE ON WAYS AND MEANS, HOUSE OF REPRESENTATIVES, MARCH 8, 1951

I would like to submit for the consideration of the committee a few reasons why I believe the slate industry should be given the benefit of percentage depletion.

As is quite commonly known, the slate industry is made up primarily of small businesses. According to the Bureau of Mines, there were 80 operators in 1949, doing a business of $12,200,000. This means about $150,000 apiece. The industry is located principally in Pennsylvania, Vermont, and New York State, with scattered quarries in Arkansas, California, Maine, Georgia, Maryland, and Virginia. Recent years have seen the slate industry considerably weakened by the following features:

1. The steadily increasing freight rates, almost 100 percent in the past 10 years, has placed a severe burden on the slate industry.

2. Unlike the situation in the making of other roofing materials, the use of mechanical appliances has not been completely feasible in the production of natural-slate products.

3. Steadily increasing State and Federal taxes have been levied with no consideration for the fact that slate quarrying is a wasting asset and consequently this lack of consideration has caused many slate operations to be suspended.

It seems only equitable that the slate industry should be given the same consideration as is given its competitors. Oliver Bowles, associated with the Bureau of Mines for over 25 years, has pointed out that slate quarries should be allowed to build up reserve funds to carry out development work if the industry is to survive.

As you well know, the theory of percentage depletion is founded on the assumption that a wasting asset such as a mining operation can continue to explore if funds are set aside tax-free for this purpose. Our mining experts from coast to coast have hailed this theory as being one of the chief causes of the fine development of the American mining industry. Mica is processed into roofing materials, and it is significant to note the 15-percent depletion that this industry is allowed. Talc has a 15 percent depletion, and feldspar has a 15-percent depletion. It would seem that all of these industries which are similar in nature should enjoy similar depletion privileges.

At a time when many of our people are beginning to feel that it is not worth while to attempt to make a go of a small business, I think it is important that we make sure that industries like the slate industry, made up primarily of small-business concerns, be allowed to grow and develop and also that they should be given an equal footing taxwise with their competitors.

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2. Minerals Industries Experiment Station, School of Mineral Industries, Pennsylvania State College: Bulletin No. 47, 1947.

3. Slate in the United States, by T. Nelson Dale and others: United States Geological Survey: Bulletin No. 586.

NEW YORK, N. Y., *June 28, 1951.*

Re H. R. 4473—Revenue Bill of 1951.

Senator WALTER F. GEORGE,
Senate Office Building, Washington, D. C.

DEAR SENATOR GEORGE: A copy of the above bill has been received, as passed by the House, together with Report No. 586. We understand that the principle of withholding is to collect taxes that are due, and that it is not designed to collect taxes that are not due.

We find on page 34 under section 1201 beginning at line 18 the following:

"(a) REQUIREMENT OF WITHHOLDING.—Every person making payment after December 31, 1951, of a dividend or interest shall deduct and withhold upon such dividend or interest a tax equal to 20 per centum of the amount thereof."

We find on page 35 under section 1202, Exemptions from Withholding, a series of exemptions, and on page 36, at subsection (f), we find the following wording:

"(f) Dividends or interest paid by a corporation to another corporation if both corporations are members of the same affiliated group which filed a consolidated return under chapter 1 for the preceding taxable year of the payor corporation."

In the case of Beneficial Loan Corp. and Beneficial Corp., both of which have wholly owned subsidiaries in a variety of separate businesses, we find that there would be as much as half a million dollars tied up annually by such requirement where no tax is due, a simple illustration being that present law only taxes corporations 15 percent of intercompany dividends, which might be said to be an effective 7 percent, and yet you are requesting a withholding of 20 percent.

We believe it is bad business, unnecessary Government interference, and clearly not the intent of either the Commissioner of Internal Revenue or any of his agents, of the Congress, or the public at large, that obviously erroneous and excessive amounts of withholding should be had. We think that your statute should be amended so as to exempt dividends or interest paid by a corporation to another corporation. Through the established routine of audit reports and corporate accounting, the detail of income and intercompany interest must be appropriately cared for.

If you will turn to page 19 of Report No. 586, you will find the following sentence:

"Dividends paid by Federal Reserve banks, Federal land banks, Federal home loan banks, the Central Bank for Cooperatives or a Bank for Cooperatives are exempt because such dividends are received entirely by corporations."

The next paragraph reads as follows:

"For similar reasons withholding will not apply to dividends paid by a corporation which is a member of an affiliated group of corporations to another member of the group. However, this exemption is effective only when the affiliated group filed a consolidated return for the preceding taxable year."

It would seem that, if the logic for the first-quoted paragraph is correct, it should apply equally to the succeeding paragraph. We do hope that this practical correction will be made as the bill progresses through the Congress. We also think that much can be and should be said for withholding being limited to payments other than a corporation, for both dividends and interest for the very reasons that Report No. 586 has set forth in the paragraphs above quoted.

Very truly yours,

JACKSON R. COLLINS.

THE CONSOLIDATED ROYALTY OIL CO.,
Casper, Wyo., July 10, 1951.

Hon. WALTER F. GEORGE,
Chairman, Senate Finance Committee,
Washington, D. C.

DEAR SENATOR GEORGE: Inasmuch as the House of Representatives has acted on the 1951 Revenue Act and as the bill will soon be up for consideration by your committee, I wish to bring to your attention a very unnecessary provision in the bill which will, if passed by the Senate, work a great hardship on the corporations and stockholders with little or no benefit to the Government from a tax standpoint.

The provision referred to is the withholding of 20 percent of all dividends at the source from the account of each individual stockholder, and if the measure is approved by your committee and passed by the Senate it would necessitate a complete revision of our voluminous dividend records at considerable expense and require the services of almost double the number of employees in the preparation

of each dividend distribution, at a time when it is very difficult to find experienced employees for such purposes.

As is the case with all corporations, a considerable number of our stockholders is made up of widows and others, each with a total income of less than the $600 exemption allowed for income-tax purposes, and to withhold 20 percent at the source from amounts exempt from tax would require the filing of a claim for refund by each of such stockholders in order to recover the amounts to which they are justly entitled. In most cases the amounts unjustly withheld would never be recovered, as very few individuals have any knowledge of tax procedure, and the complicated methods prescribed by the Government for the recovery of taxes erroneously assessed.

The measure is also unnecessary for the reason that all corporations are required by law to file with the Bureau of Internal Revenue a separate information return for each and every stockholder receiving $100 or more, showing the total amount of dividends received by each during the calendar year for which the returns are filed. Those stockholders receiving less than $100 a year have always been considered as among the low-income group insufficient for tax purposes, which accounts for the fact that no separate information return in such cases was ever deemed necessary by the Bureau.

The argument of the Government as losing a large amount of taxes by not withholding 20 percent of all dividends at the source is entirely without foundation, as only those stockholders receiving less than $100 a year could possibly be involved; and, as most of them do not receive enough income to be subject to tax, there would be little possibility of any loss to the Government. It would be much more satisfactory for the corporations to file a separate information return for all stockholders, regardless of the amount of the dividend received by each, rather than to go to the other costly extreme of withholding the tax at the source.

Dividends, as you no doubt know, are the only source of income subject to double taxation. After the corporation has paid an enormous tax on its annual earnings, the stockholders are also subject to tax on the same earnings when received in the form of dividends. This is clearly a duplication of tax and in some instances even more than double when considering the dividends received by the parent company from its subsidiaries, 15 percent of which is subject to tax by the parent company and 100 percent by the stockholders after the subsidiary companies have paid the tax on the earnings distributed.

To further burden the stockholders who are already the victims of double taxation would be a grave injustice. The withholding of 20 percent at the source should in all fairness be eliminated from the bill.

Yours very truly,

L. A. PARKER.

CHICAGO, *July 11, 1951.*

Protest against the proposed tax bill.

Hon. WALTER F. GEORGE,
United States Senator, Senate Office Building,
Washington, D. C.

MY DEAR SENATOR: An appeal from residents of Illinois to a Georgia Senator may be a long-distance call under less trying circumstances; but there comes a time when the people of the Nation become alarmed for their country and their own welfare, when State boundaries fade away and national citizenship speaks out and cries for representation among the legislators in particular and at large. The crisis is at hand when Democrats and Republicans must join hands in order that the Nation's malignant tumor, known as the New Deal, may be removed. This country prospered and came to greatness under the alternating influence of these parties, and the wholesome system of checks and balances was preserved. Today the situation is otherwise, and since the advent of the New Deal matters have been going from bad to worse. The public craving for novelty is proving the country's own destruction.

Such is my feeling, and I am sure also the feeling of the law-abiding, self-respecting, and self-sustaining citizens of this land who feel the pressure of ever-threatening legislation and executive pronouncements. We feel that the combined forces of the Senate are necessary to check this nefarious bill which has already been passed by a House of Representatives the majority of whose Members no longer represent the people of this Nation. Though not familiar with this confiscatory and well-nigh communistic measure, the public does know how it was railroaded through the House under a closed rule with no opportunity for discussion or amendment.

I. THE BILL IN GENERAL

This new revenue bill puts a blight on industry, destroys incentive, victimizes honest workers, and discourages investors whose support is necessary to the welfare of our country. The preservation of the traditional American economic system is the wish of the conservative and constructive element among our people; but this act is the devilish work of a conspiring combination of evil factors that have come forth to strangle a prosperous and once-respected nation. Economies were not thought of in cooking up this brew. Its pretended motives of national defense and a check on inflation are but thin veils through which any discerning man can readily see. To "Tax and tax and tax" is its opening theme; to "Spend and spend and spend" its avowed and ultimate object. Many apparently sincere citizens, Democrats and Republicans alike, do not realize that this bill is but a spoke in the heavy wheels of the juggernaut that will ultimately grind this Nation nto the dust.

The proposed rates of taxation are confiscatory and unjust, and, unless the Senate severely prunes down the looting ambitions that lurk behind this measure, there will be no end to the scandalous spending spree that infests high and low places. The bill is so vicious in numerous respects that a revision cannot improve the situation. It should be rejected in its entirety, a fresh start made, and the Senate bring forth a bill fair to the Nation, its citizens, and its industries, and that will automatically check the national spiral toward bankruptcy.

These may be words of wrath, but they represent a growing resentment on the part of the people at large. They represent the feelings of my colleagues in the profession to which I have belonged for half a century. A Chief Executive is determined to give us "hell," to use his own rabid language; but the time is not far off when this Nation will speak its piece; and the purchase of lukewarm Democrats and weak-kneed Republicans will not avail the party in power.

II. WITHHOLDING PROVISIONS

The 20 percent withholding provision would prove a serious blow to the financial activities of the country and discourage millions of investors upon whose substance our industries must rely. It will write down their nest eggs, representing a life of saving, by the arbitrary reduction of gross income at the source. It will dam up one-fifth of the Nation's income and withdraw it from circulation. What investor can feel an interest when he knows in advance that someone is standing by to write down his income, only to spend it ruthlessly before he ever gets the "feel" of his money.

There are many good people who have had their turn at the wheel of labor and industry, and who have retired or been obliged to retire at 65 or sooner, thrifty in the hope of a secure old age, too proud to be on the dole, too conservative to squander their substance. They are the people who pay the taxes, in due time, and without being booted into line long before the taxes are due. The contemplated procedure is a tax-anticipating subterfuge with premature spending as its goal.

This 20 percent reduction is outrageous and has all the earmarks of a vicious capital levy. There are numerous taxpayers whose income under retirement falls entirely within their exemptions, and in such cases how can advance deductions from gross income be legally justified?

Moreover, the enforcement of this provision will require a staff, the cost of which will nullify the alleged benefit, and afford just another happy opportunity to augment the Government payroll by countless additions of clerks whose votes and the votes of whose freinds will make for the perpetuation of the party in power. And let us not forget the terrific accounting burden thereby placed upon disbursing corporations and brokerage houses: and also the fact that financial houses have invested millions in educating investors to the benefits of securities. This act will turn investments so sour that the public will lose interest.

And think of the complications, red tape, endless correspondence, checking and rechecking, and the delays involved in refunding excess withholdings, in many cases entire withholdings, to millions of people. Months will pass ere the taxpayer receives his refund or has returned to him deductions that should never have been made. Withholding provisions that ignore exemptions, allowed in the very same act, are illegal, inconsistent, and unfair. Like provisions were eliminated last year.

III. EXEMPTIONS

The purpose of an exemption is to set aside as tax-free enough of a man's income to enable him and his family to live decently and to have the benefits of food, shelter, and clothing. Decreases in personal exemptions are not justified in the face of the increased cost of living. Once upon a time the exemption was fixed at $3,000 per head. Show me the man who can live on $600 per year and even less in these trying times—$50 per month for food, shelter, and clothing. And even this is to be reduced. Exemptions mean most to men of humble or moderate incomes, to large families, and to those who have attained 65 years of age or more. An elderly person has two exemptions, an aged couple has four, and their incomes are threatened in like proportion. Every man feels the pinch of the increased costs of living and soaring taxes; and what is this squandering Government doing about that? It purposes to give the taxpayers the double pinch. Who would not welcome the words of a Senator spoken in favor of an increase of these much-needed exemptions as against the ruthless provisions of the worst tax bill that has ever been proposed by an Executive?

Senator, the people of my State are not only looking to their own two Senators for relief, but are invoking the entire Senatorial body of the Nation as American citizens. Your loyalty to your country, your energetic representation of the people of this land, have attained Nation-wide proportions. We feel that we are speaking to a man of courage who, in the discharge of a patriotic duty, defies the lash of patronage; and may we ask you to pass on this appeal to your worthy colleague?

Respectfully yours,

W. W. SCHMAUCH.

NEW YORK 28, N. Y., *July 11, 1951*.

CHAIRMAN, SENATE FINANCE COMMITTEE,
United States Senate, Washington, D. C.

HONORABLE SIR: William Jackman, a so-called spokesman for "Investors" but in reality a spokesman for management opinion since he receives funds from this source, as was brought out at the annual meeting of Consolidated Edison of New York has testified before your committee against the proposed withholding tax.

This same Mr. Jackman is, as you know, the head of Investors League, and as such he pretends to talk for 10 million investors. Many investors have in recent years resigned from his league because they are entirely out of sympathy with the views expressed, of which the latest example is the manner in which he describes the withholding tax as an insult to investors and similar rubbish.

The truth of the matter is that the writer and many other investors are entirely in sympathy with the idea of a withholding tax, since it involves less bookkeeping for us. True, it may involve more bookkeeping from the standpoint of the corporation, but this is deductible from the cost of doing business for the corporation.

It is quite possible that the figure fixed by the House of 20 percent may be too high, because it can be a hardship for the small investor, who lives on a very small budget. Therefore it may be wise to revise downward the amount of the proposed withholding tax, but the principle should be maintained.

I happen to also own British and Canadian shares, and we have long had a withholding tax, without anyone bringing up nonsense about police-state methods.

As an indication of stockholder sentiment on this subject and to prove that the investors are distinctly of two minds on this subject I enclose a copy of pages 15–16–17 of the postmeeting report of Socony-Vacuum Oil. Both viewpoints are presented, and neither was the writer's since he was not present. Likewise the views of Mrs. Wilma Soss, president of the Federation of Women Shareholders, is given on page 19 of the same report which also shows the truth of the assertion there are two schools of investor thought on the subject.

What your committee should do is revise the poorly drawn up legislation in regard to stock options, so that officers are compelled to pay real taxes on options which when exercised are sold as soon as the 6 months period is up. The intent of Congress was to see that officers of corporations kept stock and became partners. This does not happen and they are given a tax hand-out which other investors object to when they are giving the 25 percent deduction credit. It should only apply after they have kept the stock for a number of years and are ready to retire from business—then I have no objection to their getting the benefit of the capital gains tax.

I ask that this letter be made a part of the testimony before your committee.

Sincerely yours,

LEWIS GILBERT.

Mr. CASE. I will have to look it up.

Mr. HENRY. In connection with that, there is a refining method, I understand, that they call the Gyro process. Do we use that?

Mr. TEITSWORTH. There was a Gyro process that was used about 15 or 20 years ago. I think it has been abandoned.

I wonder if you question is pointed to the Gyro process. That was a process that was developed by the Pure Oil Co. in the old thermal cracking days. I think it has gone out of use.

Mr. HENRY. There is not connection with the process we are using today then?

Mr. TEITSWORTH. No.

Mr. HENRY. You have notes payable to banks in the amount of $75 million. I was wondering why you do not pay them off. You seem to have quite a lot of marketable securities—or do you plan to spend that in additional exploration.

Mr. SEAL. You will notice that in the annual report we forecast about $200 million in capital expenditures and we think that the cash we have should be used for that rather than for loan reduction.

I might also call your attention to the fact that of our total invested capital, only about 12 percent is borrowed, which is a rather low ratio. We can well maintain that volume of borrowing in comparison with the size of the company and our total investment.

Mr. HENRY. Do you think that will be enough then?

Mr. SEAL. I think we will be able to take care of our capital expenditures without increasing any borrowings.

Now, things change pretty rapidly in the oil business. I would not want to say that for too long a period ahead. But the way it looks now, we confidently expect that we shall be able to carry out our capital-expenditure program without resorting to any borrowings [Applause].

Mr. V. D. NEWMAN. Mr. Chairman, in view of your remarks in regard to the affairs of the Government and the election of proper officers and such matters, I would like to inquire as to what action the officers of this corporation have taken in regard to the 20-percent withholding tax, that has been proposed by the United States Treasury and is to be voted upon by the Ways and Means Committe and they expect to put pressure enough on Congress to get it passed.

What action have the officers of the company taken in regard to this matter?

Chairman HOLTON. As a company we have not taken any action. As a company we do not take sides politically and have to be very careful in connection with influencing legislation.

What action individual officers may have taken or what action they do take on these various problems that do come up, I don't know.

Mr. NEWMAN. It seems to me it isn't a matter of politics. It's a matter of self-preservation of our property rights.

For many years there has been a 10-percent withholding tax that they have continuously tried to remove from the statute books. Now the Treasury comes up with a 20-percent withholding program.

It seems to me as though that is a confiscation of the earnings of our property before it is paid over to the actual owners of the property. If they can get away with this, it would seem to me it would be only a matter of time before they would withhold all of the dividends due and payable to the stockholders quarterly—and perhaps at the end of the year they might decide to give us a few dollars!

I have written to the Ways and Means Committee and I hope the rest of the stockholders here will do likewise if they have not done so.

Chairman HOLTON. I think there is a lot in your point of view. I am glad you have written and I hope other stockholders will voice their opinion on these controversial questions that arise.

Mr. JACOBS. I normally do not like to speak more than twice at one meeting, but I have a strong viewpoint on this. I may add that I own quite some shares of stock, so that any money withheld by 20-percent withholding tax would definitely be withheld from me in an extended scale.

It so happens there is practically nobody in this room who is not in the class of paying the minimum income tax. In other words, I don't think there is anybody in this room whose income is less than $600, or any married couple whose income is less than $1,200 a year. I believe that the minimum rate of Federal taxation is about 20 percent.

All of you know there is a great evil going on in this country where many persons who own a small number of shares or who are in low brackets do not pay on or report their dividend income. I think it is to the interest of all of you to see to it that all taxes which should be legally collected are available to the Government. It will be money in your pocket if this 20-percent tax goes through,

because at the end of the year you don't have to get it back—you merely put it in as a deduction in your report. Meanwhile, those persons who have been getting away with not paying on the income tax—and there are a very large amount, hundreds of millions—no one has estimated it so far—that amount will be paid out automatically. It is to the interest of everybody in this room to have a withholding tax whose level will be at the minimum rate payable.

Chairman HOLTON. I think that points up very well why we as a company do not take stands on these various issues. If we took the stand you advocate, we would offend the gentleman across the aisle, and vice versa. That is the reason we would prefer to let the stockholders know the facts as we see them and let them make up their own minds.

We appreciate your point of view.

Mr. NEWMAN. This withholding tax is a levy against money that is due and payable to the stockholders. It should be paid to the stockholders before it goes into the hands of anyone else.

Mr. ISRAEL. Are your remarks and the President's going to be circulated to the stockholders?

Chairman HOLTON. Yes, sir.

Mr. SAMUEL APPELBAUM. I notice all the bugaboo about the proposed reduction of the 27½-percent depletion allowance is being stirred up in Washington.

No doubt the company has been going ahead on that matter, and no doubt they have thought of what I am suggesting: to put in with the dividend checks a little notice that the stockholders should get in touch with their Representatives and have them talk against it.

Chairman HOLTON. We are very glad to have your advice on that. That is a very complicated subject and if we can summarize it in a way likely to be informative to our stockholders, I think we would consider sending a statement with the dividend checks.

Mr. APPELBAUM. I have already received several notices from companies.

Chairman HOLTON. Yes, I know several have sent notices out.

Mr. APPELBAUM. Thank you.

Mrs. SOSS. If I may just say a word about this withholding tax, I find a great difference of opinion between the small stockholders and large stockholders. Apparently, many of the large stockholders say they like this idea of a withholding tax and the small stockholders, particularly the widows and those who are living on fixed incomes, who really look forward to that money coming in and find it very difficult to wait for a recalculation by the Government, are quite upset about it.

Perhaps it is proper to say at this time—I hope it is—that the Federation of Women Shareholders will be very pleased if any of the women in this audience, expressing their views one way or another, will write to us, so that we can help to express it for them in Washington. That is, if they will just write to the Federation of Women Shareholders, 66 Park Avenue, and say whether you are for it or against it, we would welcome your views. Thank you.

Mrs. CLARE O. SALTER. Mr. Holton, may we revert for one minute to the matter of entertainment? You have given us an increase in the dividend and that's the most beautiful entertainment there is. [Applause.]

Chairman HOLTON. I think the inspectors have completed their report on the voting for the directors. The polls are now declared closed. The candidates nominated have been elected.

The inspectors have also reported the result of the voting on the resolution to approve the appointment of Arthur Young & Co., auditors for the calendar year, and that resolution has been carried.

If there is no further business to come before the meeting, a motion for adjournment is in order.

(The motion to adjourn was duly made, seconded, and unanimously carried.)

(The meeting was adjourned at 12:10 o'clock.)

THE THEATER OWNERS OF OKLAHOMA, INC.,
OKLAHOMA CITY, OKLA., *July 2, 1951.*

Hon. WALTER F. GEORGE,
Senate Office Building, Washington, D. C.

DEAR SIR: Your honorable Finance Committee is being requested to exempt numerous nonprofit cultural, charitable, and religious organizations from paying Federal admission taxes upon public entertainment supplied by them or under their sponsorship. More than 20,000 theaters must, under this same law, collect

this 20 percent tax upon every ticket sold. In many instances this exceeds their profits.

To exempt any group from collection of the tax is but to add handicap to legitimate business and to discriminate in favor of those who, under guise of philanthropy, follow show business as an avocation rather than as a vocation. This tax is an obligation of the customer, merely collected for the Government by the theaters. To waive it will relieve one group of citizens while penalizing another. It is easy to understand that this too would create an unfair competitive advantage against regular established business institutions.

Such favoritism will only lend encouragement to the growing practice of designing operators, who have found that, by being sponsored, they derive decided advantage and opportunity to circumvent normal overhead incumbent upon similar business. Individuals, opera companies, circuses, carnivals, community movies find fertile fields when lodge, police, fire, and veteran organizations allow them to exhibit under their banners. Many of these procure a waiver of licenses, exhibit in tax-supported buildings and auditoriums, and at reduced expense save most of the charity receipts for themselves.

Cultural organizations generally sponsored by social groups pay their symphonies and artists prevailing salaries, and like these other groups are definitely in business. Just why these should have tax preference as against businessmen who provide year-round facilities, employ thousands, pay many taxes, and rely upon their own ability to show profit, and who must stand any losses without appealing for subscribers' aid, is beyond our understanding.

However, should your honorable committee decide for exemption, may we suggest that such exemption be made to apply solely to the gross receipts, without any expense allowable. In this way persons and organizations with truly charitable intent could provide their efforts and talents for causes of their choice, with full return to such channels, rather than unwittingly set up a subterfuge for increased profit for others who promote for their own advantage.

We offer your members this analysis, based upon the experience of those who have spent many years in the amusement business, in hope of acquainting you with existing facts. Your sincere consideration is requested.

Respectfully,

THEATRE OWNERS OF OKLAHOMA, INC.,
By M. LOEWENSTEIN, *President.*

STATE OF NEW YORK,
PUBLIC SERVICE COMMISSION,
Albany, July 9, 1951.

Hon. WALTER F. GEORGE,
Chairman, Finance Committee of the Senate,
United States Senate, Washington, D. C.

DEAR CHAIRMAN GEORGE: The New York Public Service Commission is greatly concerned about the possibility that increased Federal income taxes may be applied retroactively to the public utilities subject to regulation.

The tax bill as it passed the House of Representatives provides that the new tax rates are to be effective July 1. There is, however, a general impression that the taxes may be made effective January 1, 1951. If the bill is not finally adopted until late in September or October, any retroactive feature would make it extremely difficult for this commission to fix rates currently that are fair both to the public and to the utility companies.

This commission now has before it a number of important rate cases involving large electric, gas, and telephone utilities. If we establish rates now on the basis that a retroactive increase in Federal income taxes will be in effect for all or most of the year 1951 and this should not occur to the extent predicted, consumers will have been treated unfairly. On the other hand, if the commission gives no consideration to the prospect of increased tax rates, it holds a threat over the utility companies that they may be called upon to pay taxes for which they cannot obtain reimbursement. This latter feature is already making it difficult and expensive for utilities under our jurisdiction to obtain funds they need to carry out necessary capital expenditures to meet increased demands for service by the public.

This commission strongly urges that any final tax bill should not apply to regulated public utilities retroactively or to any period prior to the date of enactment. If the bill is made retroactive to any material extent, it will be necessary for this commission in many cases to consider imposing a special surcharge over

a period in the future to enable the utility concerned to recover such retroactive taxes, in addition to whatever permanent increase may be required to meet the increased taxes after the effective date.

You undoubtedly are aware that even at the present tax rate it is necessary, whenever other factors require an increase in the net income of a public utility, to increase the gross revenues collected from consumers by over 2 dollars for every dollar of net income required to yield a fair and reasonable return to the utility.

Very sincerely yours,

BENJ. F. FEINBERG.

F. L. BODMAN CO.,
Philadelphia, July 9, 1951.

Hon. WALTER F. GEORGE,
Chairman, Senate Finance Committee,
Senate Office Building, Washington, D. C.

DEAR SIR: We operate a small business upon a partnership basis here in Philadelphia as manufacturers' representatives, the partnership consisting of myself and two associates. Jointly and individually we are all opposed to one of the sections of the tax measure known as H. R. 4473 which was approved by the House on June 22 by a vote of 233 to 160.

I refer to that section which provides for withholding at the source 20 percent of all dividends being paid by our various American corporations.

In the first place, we are already confronted with double taxation as corporate earnings are first subject to a tax by the corporation and then the individual who receives the dividend is again taxed when making up his income tax.

It has been my practice and the practice of my partners when we have made a little money at the end of the year to invest the surplus in American business by purchasing some of their common and preferred stocks and although we quite realize the necessity of having our Government stop up the leaks by making it impossible for those who receive dividends and who have been accustomed not to report their receipts to the collector of internal revenue, we believe that there is a very much simpler and less burdensome method which might be voted upon by your committee to collect this tax.

Why couldn't the law be so amended to require corporations to send a small slip stating that "John Smith" was being paid a dividend of so much and at the same time send a duplicate to the stockholder either at the time each dividend is paid or say at the end of a stated period.

It seems to us that this would be a very much simpler method of solving this particular problem.

We also wonder if your committee has given any consideration to the hardship that would be inflicted upon some small scattering investors who purchase corporation stocks in a small way but who do not have to pay an income tax. In such instances, 20 percent of their money would be withheld and they would be compelled to await the adjustment by the United States Treasury which means additional Government expense for which we all pay taxes.

The foregoing opinion is respectfully submitted to you and your associates for consideration.

Yours very truly,

F. L. BODMAN.

HARRY FERGUSON, INC.,
Detroit 11, Mich., July 10, 1951.

Re section 1202 (j) of proposed Revenue Act of 1951.

Hon. WALTER F. GEROGE,
Chairman, Senate Finance Committee,
Senate Office Building, Washington, D. C.

DEAR SIR: The proposed Revenue Act of 1951, in the form passed by the House (H. R. 4473) provides for 20 percent withholding on corporate dividends. Section 1202 provides certain exemptions from such withholding.

Subdivision (j) (1) of section 1202 exempts from withholding "Any payment of a dividend or interest (except coupon bond interest) to (A) a foreign corporation not engaged in trade or business within the United States, (B) a nonresident alien individual * * *."

Subdivision (j) (2) of section 1202 authorizes use of ownership certificates on coupon bonds, but does not authorize their use for dividends or for interest payments generally.

If section 1202 is enacted in the form passed by the House, serious inconvenience will arise in the case of dividend payments made by American corporations to British stockholders. Such dividends are subject, by treaty, to a maximum withholding of 15 percent. In most cases such British shareholdings have been delivered by the British shareholder to the British Treasury and pledged with our own RFC as collateral for a loan to Britain. In such cases, the shares may be registered on the books of the American corporation in either the name of the beneficial owner or in the name of the nominee of and for the RFC and the British Treasury, yet by a dividend mandate the dividends are payable to the RFC.

Subdivision (g) of section 1202 would appear to exempt from withholding dividends paid to the RFC only if the ownership of the stock (the entire class of stock) is in the RFC or in a government or governmental instrumentality.

In our particular case, which is probably typical, the situation is as follows:

Beneficial ownership	Preferred shares	Record holders	Dividends to—
Individual A—British resident	405	Corey & Co., New York City.	RFC.
Individual B—British resident	500		
Individual C—British resident	500		
British corporation not in trade or business in United States.	3,000 20,352	British corporation	

Under the proposed law, 20 percent would have to be withheld although the beneficial owner would at most be subject to a 15 percent tax. This would require the filing of refund claims, with attendant delays and without interest (sec. 1203 (b)).

It is respectfully suggested that the use of ownership certificates, or the express exemption from withholding of dividends paid to the RFC on stock pledged under the British loan (or any similar arrangement) would simplify things not only for the taxpayer but also for the Bureau of Internal Revenue. The RFC could readily set up a standard procedure for whatever withholding is proper on remittances it in turn makes to Britain with respect to such dividends, quite probably such a procedure is already in operation.

Yours very truly,

ROBERT G. SURRIDGE,
Vice President and General Counsel.

Copies to Eldon P. King, Special Deputy Commissioner, Bureau of Internal Revenue, Washington 25, D. C.

GENERAL REDUCTION CO.,
Chicago 13, Ill., July 16, 1951.

Hon. WALTER F. GEORGE,
Chairman, Committee on Finance, United States Senate,
Senate Office Building, Washington, D. C.

DEAR SENATOR GEORGE: Early this year, as president of the General Reduction Co., owners and operators of a fuller's earth mine in Georgia, I gave testimony before the House Ways and Means Committee requesting 15 percent of gross sales depletion for fuller's earth, comparable to that allowed other nonmetallic clays and minerals. The Ways and Means Committee in its proposed tax bill to Congress, allowed the 15 percent depletion for fuller's earth, as well as for other clays.

Because of a misunderstanding I was unable to appear before the Senate Committee on Finance during the hearings on depletion, it being held July 12 and 13, 1951. Accordingly, I have been asked to submit this written testimony for the record. I am also sending copy of it to each member of your committee.

Each member of the Committee on Finance, I am sure, is familiar with the reasons for the various depletion charges granted companies engaged in mining operations because mining products are a wasting asset used up in the process of mining. Thus time-consuming effort and expenditures are constantly required in developing new deposits.

Unless a depletion program, based upon a definite percentage of gross income, is followed in mining operations insufficient reserves are made available for development needed for continuing mining operations on a practical basis. In our own particular fuller's earth industry, the former depletion based upon unit cost per ton averaged around 1 cent per ton. The Bureau of Mines reports 320,906 tons of fuller's earth mined in 1949 and approximately the same amount in 1950. On the basis of 1 cent per ton, total depletion for all companies in the business would amount to only $3,209.06 for 1949. This amount is negligible even if one company was privileged to spend all of it. Using $5,100,642 gross sales for all producers the total depletion for the fuller's earth industry would amount to only $78,000 on the basis of 15 percent depletion, using 1949 figures. This is the minimum amount needed for developing new deposits in our industry.

I therefore hope that the Committee on Finance will concur with the recommendations made by the Ways and Means Committee of granting 15 percent depletion for fuller's earth so that our percentage of depletion will be comparable to that allowed other similar mining projects. I respectfully refer your committee to page 1618, part 3, revenue revision of 1951, hearing before the Committee on Ways and Means, House of Representatives, Eighty-second Congress, first session—for further details on this matter.

C. E. GLASSER, *President.*

UNITED COMMERCIAL TRAVELERS,
July 10, 1951.

Hon. WALTER F. GEORGE,
Chairman Senate Finance Committee,
Senate Office Building, Washington, D. C.

DEAR SENATOR GEORGE: The House of Representatives, having passed a bill providing for an increase of $7.5 billion in taxes, the Senate, of course, will next be called upon to consider the measure. According to reports, hearings have already been undertaken by the Senate Finance Committee.

While realizing that our increased military expenditures must be financed, this organization feels strongly that the time has come when the Federal Government must itself practice some economies such as it continues to urge upon the citizens, especially insofar as domestic expenses are concerned.

We are decidedly opposed to some of the provisions of the tax-raising bill passed by the House, particularly those which contemplate increased taxes on gasoline and on new automobiles. A great many of our members are traveling salesmen who spend considerable time on the highways and whose automobiles are a necessity in making a livelihood.

Gasoline taxes now paid by the user of a passenger automobile and the taxes on the automobile itself are now at a very high level, and it is our considered judgment, viewing the question in broad fairness, that it is quite unjust to add additional taxes on gasoline and on new automobiles. Any increase in taxes on these items will be a hindrance to the business activities of salesmen and a handicap to everyone who uses an automobile, and could well result in reducing rather than increasing tax revenues from those sources.

We respectfully request that when this tax bill is up for consideration in the Senate that you consider most carefully the already heavy taxes now applying to gasoline and new automobiles and bear in mind the burden which they already place on persons who must pay them for the purpose of conducting their business and earning their living.

We desire to go on record as being opposed generally to continuing increases in taxes and urge that our Government initiate some economies and reduce some of its nondefense expenditures so that some, at least, of the more onerous provisions of the House bill, such as those requiring increased taxes on gasoline and new automobiles, will not be enacted into law.

Very truly yours,

HARRY L. HANSEN, *Grand Counselor.*
W. J. MCCALLUM, *Grand Secretary.*

JUNE 30, 1951.

Senator LESTER C. HUNT,
Senate Office Building, Washington, D. C.

DEAR SENATOR HUNT: We have corresponded with Senator O'Mahoney previously (see attached letters) concerning the excess profits tax situation our company encounters. Deputy Commissioner McLarney has not contacted us nor have we had any indication of action on our requested ruling.

It is our desire, therefore, to call to your attention that we are subjected to immediate control by our Wyoming Public Service Commission at the choice of the Interstate Commerce Commission. Our attorneys made inquiry directly to the Interstate Commerce Commission in Washington at the time our system was extended to hook up with interstate pipelines at Lance Creek, Wyo.

The Interstate Commerce Commission informed us that they were overloaded with governing and regulating utilities of a much larger status than ours. They told us to look to our Wyoming Public Service Commission for our jurisdiction. Our system operates only intrastate but the crude moving through our lines passes to interstate carriers.

It is our belief that the fact that the Interstate Commerce Commission is not presently exercising jurisdiction is not conclusive, that it does have power to exercise such jurisdiction but has chosen to have us under the control of a State regulatory body.

Therefore, we request that an effort be made to have the excess profits tax law amended retroactively as to include in section 448 oil pipeline common carriers which are subject to the jurisdiction of public service commissions of any State. In this connection your attention is directed to section 448 (e) of the Internal Revenue Code which expressly extends to certain public utilities if regulated by State regulatory bodies.

We are very anxious to solicit your personal attention in our behalf to help adjust an inequity which we feel definitely discriminates against our company, a Wyoming corporation.

Kindest personal regards.

Very truly yours,

PLAINS PIPE LINE CO.,
G. L. CULVER, *President.*

FEDERATION OF WOMEN SHAREHOLDERS
IN AMERICAN BUSINESS, INC.,
New York 17, N. Y., July 16, 1951.

Senator WALTER F. GEORGE,
Chairman, Senate Finance Committee,
Washington, D. C.

DEAR SENATOR GEORGE: The Federation of Women Shareholders asks for equality of sacrifice in taxation in these crucial times. Before passing a withholding tax on dividends, we ask that the loophole in the tax law created by section 130A in the Revenue Act of 1950 be plugged.

As chairman of a committee on Federal tax policy, Mr. Roswell Magill has made a great outcry in the press against the House approved bill increasing taxes as probably the "most badly devised tax measure in our history." Where was Mr. Magill when section 130A of the Revenue Act of 1950 was passed?

In an address before the tax section of the A B A at its 1950 annual meeting, Dean Griswold of the Harvard Law School said (Griswold: The Blessings of Taxation—Recent Trends in the Law of Federal Taxation 36 ABAJ 999, 1057 (1950)): "* * * in the midst of a real shooting war, we are apparently about to enact a new tax law which contains some gross, almost crude inequities. Where has the voice of the tax section been in these matters? What about * * * stock options? Is there any decent justification for the handouts which are about to be given to a special class of taxpayers in these matters?"

I call your attention to an editorial by Ralph Hendershot which appeared in the New York World-Telegram, May 7, 1951, after the Big Steel meeting in which the management through the proxy mechanism which operates to perpetuate those who are in office, arrogated to itself 5 percent of the stock for optioning, escaping income taxes and allowing capital gains. Referring to this tax dodge by corporate leaders in his editorial captioned the "Blind Mule" "who knows better but doesn't care," this financial editor says: "* * * the general public will not go along with the idea of setting up a preferred tax group when they are being called upon to dig until it hurts."

The withholding tax will be "digging until it hurts" for widows and those who, elderly, are forced to live on small fixed incomes in an inflationary era and can ill afford to wait for a tax refund from the Government. It will represent the difference between butter or oleomargarine on their bread or no oleo at all. Some consideration needs must be given to their plight.

Also there are the "Vivian Kellomses" who believe that such a tax may not be constitutional and would like to see an organization representing stockholders make a test case of it.

We ask that this letter and the enclosure, a reprint of a letter on "Option-itis" with which stockholders have been afflicted since section 130A of the Revenue Act of 1950, be made part of the record of the tax hearings. The enclosed was printed as an editorial which appeared about a month ago in the Commercial & Financial Chronicle.

When this section of the Revenue Act of 1950 was passed by the House, it is my understanding that the Korean "police action" had not flamed out. This section was shoved through, I am told by the Senate in a compromise session with the House, under pressure I have been told from an organization representing industry, but financed, of course, by the stockholders of those industries.

Added to the abuses arising under this legislation are such interesting occurrences as the large amounts of stock optioned by managements in contrast to the small amount previously owned through their careers with their companies. For example: chairman of the board, Irving S. Olds, of United States Steel who within 2 years of retirement age may now purchase thousands of shares of stock, only held a couple of hundred shares until last year when management generally appeared to be readying for the forthcoming legislation by increasing their holdings. When asked about his former meager holdings at the annual meeting this year, Mr. Olds visibly perturbed, mouthed: "I am a poor man * * * my wife owns stock!"

When taxes are out of the paper and into the pocket stage and dividends are down and elections are up, this preferred class tax legislation is likely to come home to the Senate to roost.

Being sensible of the pressure upon you and your distinguished colleagues and the need for wisdom from above, also being sensible that taxes, when unequal, breed the birth of new governments, we wish you the courage of correction and Godspeed.

Yours for home and for country—

Sincerely,

WILMA SOSS, *President.*

DON W. SNYDER CO.,
Los Angeles 54, Calif., July 12, 1951.

Hon. WALTER F. GEORGE,
Chairman, Senate Finance Committee,
Senate Office Building, Washington, D. C.

DEAR SIR: During the last war, distilled spirits taxes were increased heavily from $6 to $9 per gallon—a rate nine times greater than the value of the product itself—with the implied promise that the rate would return to $6 with the cessation of hostilities. The industry, from distiller to wholesaler to retailer, patriotically agreed without hesitancy to carry the additional $3 load without profit to itself. This, I assure you, has been an extreme burden and has cut seriously into returns rightfully expected from such heavy capital investments as is required in this business.

Now it is proposed that this industry be subjected to a further burden with the imposition of another increase of $1.50 per gallon.

To all good things there has to be a limit and the law of diminishing returns must eventually assert itself. Public resentment and vastly increased illegal production can and certainly will make this incontrovertible law effective, to the detriment of the national economy.

These sporadic and frustrated tax sorties only point up the crying need for a completely new and modern approach to the whole idea and concept of taxation. The heaping up of increases upon a tax framework conceived in post Civil War days and World War I days is crumbling of it's own inequitable weight.

Patchwork and shoring-up of a sagging structure only represents a shirking delay in facing fact and realism. Horses and buggies and candles won't do in 1952—and neither will archaic, antiquated tax measures.

If a completely new and modern concept is required and a national sales tax is indicated, so that all will be taxed alike, then let's face it and be about the job and desist in the punitive and confiscatory approach.

Respectfully,

JACK MARSHALL.

NATIONAL ASSOCIATION OF AMUSEMENT PARKS, POOLS AND BEACHES,
Agawam, Mass., July 12, 1951.

Senator WALTER F. GEORGE,
Chairman, Senate Finance Committee,
Senate Office Building, Washington, D. C.

DEAR SENATOR GEORGE: As president of the above organization I should like to offer some pertinent facts regarding our industry before you and your committee for consideration should the matter of increased excise taxes be placed on your agenda.

We have already filed similar information with Hon. Robert L. Doughton and his House Ways and Means Committee and have received sympathetic understanding of our problems.

We understand and support the defense production plans and the need of additional funds for same. However we feel that we already are overburdened with taxes and the load should be shifted to other avenues of revenue. Unlike the motion picture industry we are subject to price stabilization regulations and cannot increase rates to offset added taxation and costs.

Furthermore, may we respectfully point out the following reasons why we cannot stand added taxes:

(*a*) Our patrons are primarily and almost solely from the lower income classes, family groups, etc., who are currently burdened with miscellaneous taxes and high expenses.

(*b*) Free admission prevails in most of our parks and beaches.

(*c*) Many organized groups come in picnics at reduced prices; the taxes in these instances double many times for a total of 40 percent.

(*d*) Most of us operate a short season—the average being about 15 weeks. Most of our property is "dead" for a good portion of the year but the investment is there and the reconditioning must go on year after year even when not producing any revenue whatsoever.

(*e*) The taxes in parks is repetitive—not a single admission tax, but a succession of taxes on almost everything.

(*f*) In many States where our members operate they are subject to additional State, county, and city taxes pyramided on the Federal tax structure.

We trust you will give serious consideration to our problem. Furthermore, should any plans for extra taxation as applied to our industry be planned, we respectfully request an opportunity to have our representatives appear before your honorable committee.

Thank you.

Respectfully yours,

EDWARD J. CARROLL, *President.*

THE TOILET GOODS ASSOCIATION, INC.,
New York, N. Y., July 7, 1951.

Hon. WALTER F. GEORGE,
Chairman, Senate Finance Committee,
Senate Office Building, Washington 25, D. C.

DEAR MR. CHAIRMAN: The Toilet Goods Association, Inc., which is the official representative organization of the manufacturers of toilet preparations in the United States, wishes to record, with the Senate Finance Committee, the association's opposition to the recommendations of the Secretary of the Treasury that the retail tax on toilet preparations be extended to include shampoos containing more than 5 percent of saponaceous matter (soap.)

The Secretary, in his prepared statement to the committee, did not furnish the committee with any justification for this recommendation, unless it can be said he justified it on the basis of the need for additional revenue. The revenue affects of such recommendation, however, would be negligible, for it would produce, according to the Secretary, only $3,000,000.

The Toilet Goods Association, Inc., has on several previous occasions sought to show the committee that, with the existing system of "selective" excises, a tax on toilet preparations discriminates unfairly against women, and that in normal peacetime periods, such a tax cannot be justified. The proposal to extend the excise tax to shampoos would add to this discrimination since women are the chief users of these products. We do not believe that the discrimination should be accentuated in emergency periods, and we hope that the committee will reject this recommendation of the Secretary.

Respectfully submitted.

S. L. MAYHAM,
Executive Vice President.

HERBERT & CARR,
Cleveland 14, Ohio, July 19, 1951.

Hon. WALTER F. GEORGE,
Chairman, Finance Committee,
Senate Office Building, Washington, D. C.

DEAR SENATOR GEORGE: We respectfully call your attention to the provisions of section 123 of the revenue bill of 1951 (H. R. 4473) now under consideration by your committee. Section 123 (a) proposes to permit only one $25,000 surtax exemption, to be divided among a controlled group of corporations. Section 123 (c) proposes the same limitation wherever applicable in computing minimum excess profits credits.

Our client, United States Truck Lines, Inc. of Delaware (with its principal office located in Cleveland, Ohio) which is and has been for more than 17 years the parent corporation of a group of subsidiary corporations, is seriously and adversely affected by these provisions. In 1934 its 26 subsidiary corporations were merged down to the number of 8, and subsequently 8 additional subsidiaries were acquired. It has been the continuous practice of this group to file separate income tax returns. The history of this group clearly indicates no conscious effort to secure any tax advantages.

Under the 1950 act each corporation was allowed a surtax exemption of $25,000, and, in the case of seven of the subsidiaries, the $25,000 minimum credit for calculation of excess profits tax allowed by the 1950 Excess Profits Tax Act was available. In 1950 these corporations paid normal taxes of approximately $650,000, surtaxes of approximately $450,000 and excess profits taxes of approximately $120,000. Applying the rates provided in the 1951 revenue bill to the 1950 tax returns of these companies results in an increased tax of approximately one half million dollars of which $115,000 would be due to the provisions of section 123. Of this $115,000 $88,000 is directly attributable to the provisions of section 123 (a), denying in effect 16 of these corporations from the $25,000 surtax exemption.

The companies, of course, expect to pay increased normal and surtax rates. On the basis of their 1950 net profits before taxes and with the same exemptions and credits then authorized, they will be required under the general rateincreases contained in the 1951 revenue bill to pay almost $400,000more for this year, an increase in their tax burden of 33⅓ percent. If section 123 is enacted into final law their tax burden will be increased by almost 50 percent. It is difficult to believe that such a harsh and destructive result was intended.

All of these subsidiaries are engaged in various forms of motortrucking, and under varying conditions, some in interstate transportation, some in local operations, and some in transporting special commodities. Some of the States require domestic incorporation. Most of these companies are relatively small companies, and in many instances are in competition with individually owned companies and unincorporated operators in the same general or local areas, all in a highly competitive field.

We respectfully submit that, inasmuch as the 1951 revenue bill proposes to raise normal and surtax rates, the exemption and minimum credit foundations provided in the 1950 Revenue Act and in the 1950 Excess Profits Tax Act should be left undisturbed by deleting section 123 (a) of the proposed bill.

Sincerely yours,

THOMAS J. HERBERT,
HERBERT & CARR.

Memorandum From Carnegie Corp. of New York on Proposal for Withholding of Tax on Dividend and Interest Payments, Including Those Made to Tax-Exempt Organizations

The purpose of this memorandum from Carnegie Corp., of New York, is to recommend that if a withholding tax on interest and dividend payments is adopted such payments to organizations exempted from tax by section 101 of the Internal Revenue Code should not be made subject to withholding.

Carnegie Corp. was established in 1911 by Andrew Carnegie. Its charter provides that it shall use the income from its endowment "to promote the advancement and diffusion of knowledge and understanding among the people of the United States, by aiding technical schools, institutions of higher learning, libraries, scientific research, hero funds, useful publications, and by such other agencies and means as shall from time to time be found appropriate therefor." An amendment to the charter has given the corporation power to use a portion of its income in a similar manner in the British Dominions and colonies. The regular practice of the corporation has been to appropriate substantially all of its annual income for educational purposes, and no attempt has been made to accumulate income for future uses.

It has been proposed that the Internal Revenue Code be amended to provide for the withholding of a 20 percent tax on all dividend and interest payments by private corporations and the Federal Government, including payments to organizations exempted from tax by section 101 of the Internal Revenue Code. A provision for the withholding of a 10 percent tax on dividends alone was included in section 601 of the House of Representatives' version of the Revenue Act of 1950, but the Senate eliminated this section and the House acceded (H. Rept. No. 2319, 81st Cong., 2d sess., pp. 32–35, 136–142 (1950); S. Rept. No. 2375, 81st Cong., 2d sess. pp. 52–53 (1950); H. Rept. No. 3124, 81st Cong., 2d sess. p. 37 (1950)).

The proposal for withholding a tax on dividend and interest payments to tax-exempt organizations contemplates the filing by such groups of a tax return or refund claim in order to recover the sums withheld. The delay in obtaining a refund would disrupt the normal scheduling of the activities of charitable foundations, and in many instances would seriously retard both the progress of projects already undertaken and the commencement of additional worthwhile programs. Carnegie Corp. frequently pledges grants on a long-term basis to educational and research institutions which in turn make their plans in reliance upon periodic payment of the promised sums. Since the corporation may not invade principal, the postponement of the receipt of a significant amount of income because of a withholding tax is bound to affect the institutions which the corporation helps support. Many tax-exempt organizations would be faced with serious hardship if the receipt of dividend and interest income was delayed even for a relatively short time by a withholding tax. Further, any withholding tax embracing payments to tax-exempt organizations would impose upon the Government the burden of processing the refund claims of these organizations.

Carnegie Corp. does not, of course, offer any opinion on the merits generally of a withholding tax on dividends and interest payments. However, it does suggest that, if the proposed withholding tax is enacted, payments to tax-exempt organizations may be excluded from withholding without impairing the practical operation of the withholding tax. Some of the numerous precedents for special withholding-tax treatment of different categories of taxpayers are referred to in the discussion below.

RECOMMENDED PROCEDURE FOR EXCLUDING PAYMENTS TO TAX-EXEMPT ORGANIZATIONS FROM WITHHOLDING TAX

It is recommended that, if a withholding tax on dividends and interest is adopted, tax-exempt organizations be permitted to file with withholding agents a form of exemption certificate notifying them not to withhold a tax from payments to such organizations or their nominees because such organizations had been ruled exempt by the Commissioner of Internal Revenue. Even if the withholding law were not to require withholding agents to furnish individual withholding statements, the exemption certificate procedure would not result in any appreciable inconvenience to withholding agents, and it would not complicate the withholding structure for the Government. Instead of the withholding agent reporting merely the gross dividend and interest payments made during a particular period and remitting to the Government 20 percent thereof as the withholding tax (except as otherwise required by present Internal Revenue Code

and treaty provisions referred to hereinafter), withholding agents would simply modify their report by deducting from gross payments the total of payments to tax-exempt organizations or their nominees and would remit 20 percent of the balance.

Such differentiation by withholding agents among different classes of recipients of dividends and interest would be far from an innovation. Section 143 (b) of the Internal Revenue Code requires withholding of a 30 percent tax from dividends, interest and other payments if they are made to a nonresident alien individual or a partnership not engaged in trade or business in this country and composed in whole or in part of nonresident aliens. That section expressly contemplates the further differentiation of a reduction in rate, as may be provided by treaty, for nonresident alien individuals who are residents of Western Hemisphere countries. Section 144 contains similar provisions with respect to payments to foreign corporations subject to tax and not engaged in trade or business in this country. Resident aliens and resident foreign corporations may, however, guard against the inconvenience of withholding by filing, respectively, with withholding agents certificates of residence on Form 1078 or letters calling the withholding agent's attention to the corporation's status (U. S. Treasury Regulation 111, secs. 29.143-3, 29.144-2).

As contemplated by section 22 (b) (7) of the Internal Revenue Code, various tax conventions between the United States and other countries have exempted certain income of nonresident aliens and foreign corporations from the United States income tax or lowered the rate of tax. Consequently, such payments have been exempted from withholding or made subject to withholding at the lower rate. For example, as a result of the convention with Canada, Canadian charitable and educational organizations coming within the scope of section 101 of the Internal Revenue Code are exempted from United States income tax. Such organizations or their nominees may obviate withholding on dividends, interest and various other income items by filing with withholding agents Form 1001 or similar statements notifying the withholding agents of the organization's exempt status (T. D. 5206, 1943 Cum. Bull. 526; T. D. 5157, 1942-2 Cum. Bull. 137, 141).

The convention with the United Kingdom has resulted in a reduction of the withholding rate on dividends paid to a nonresident alien or a foreign corporation whose address is in the United Kingdom from the usual 30 percent to 15 percent to reflect a corresponding reduction in tax liability. There is complete exemption from tax and hence from withholding on interest payable to a nonresident who is a resident of the United Kingdom or a foreign corporation which is managed and controlled in the United Kingdom, if such alien or corporation is subject to a United Kingdom tax on the interest and at no time during the taxable year had a permanent establishment within the United States.

To obviate withholding on interest payments the nonresident alien or foreign corporation may file Form 1001-UK with each presentation of interest coupons for payment, and in the case of interest other than interest payable by means of coupons, Form 1001A-UK may be filed with the withholding agent. Provision is also made to eliminate withholding on patent and copyright royalties and film rentals, real property rentals, natural resource royalties and pension and life annuity payments by filing the prescribed form or, in some cases, merely a letter with the withholding agent. The withholding agent forwards the form or letter to the Commissioner of Internal Revenue (T. D. 5532, 1946-2 Cum. Bull. 73, as amended, T. D. 5580, 1947-2 Cum. Bull. 88; T. D. 5569, 1947-2 Cum. Bull. 100).

Tax conventions with Denmark, France, the Netherlands, and Sweden and other provisions of the convention with Canada likewise have resulted in exemption from, or reduction in the rate of, withholding on various types of payments, and in appropriate cases exemption forms or letters are filed with withholding agents. (Denmark: T. D. 5692, 1949-1 Cum. Bull. 104; T. D. 5777, 1950-1 Cum. Bull. 76. France: U. S. Treasury Regulation 111, sec. 29.143-3; T. D. 5499, 1946-1 Cum. Bull. 134. Netherlands: T. D. 5690, 1949-1 Cum. Bull. 92; T. D. 5778, 1950-1 Cum. Bull. 92. Sweden: T. D. 4975, 1940-2 Cum. Bull. 43; U. S. Treasury Regulation 111, sec. 29.144-2. Canada: T. D. 5157, 1942-2 Cum. Bull. 137; T. D. 5206, 1943 Cum. Bull. 526.) Except in the case of Canada, these conventions do not confer any special exemption from United States income tax upon foreign charitable and educational organizations.

Withholding of tax on tax-free covenant bonds under section 143 (a) of the Internal Revenue Code may be obviated in specified cases by the filing of Form 1000 with withholding agents when presenting coupons for payment (U. S. Treasury Regulation 111, sec. 29.143-3).

The foregoing shows that in a variety of situations where income has been exempted from tax or is taxed at a reduced rate, there is a parallel exemption from, or reduction in, withholding requirements. The result is that withholding agents are frequently called upon to differentiate among recipients of dividends, interest, and other payments. With respect to dividends, the pattern of withholding shows the variations of a 30 percent rate generally upon payments to nonresident aliens and foreign corporations subject to withholding, a 15 percent rate pursuant to treaties with Canada, Denmark, the Netherlands, and the United Kingdom, and a 10 percent rate pursuant to the treaty with Sweden. With respect to interest, there is a 30 percent rate applied generally upon payments to nonresident aliens and foreign corporations subject to withholding, a 15 percent rate in accordance with the treaty with Canada, and no withholding in accordance with treaties with Denmark, the Netherlands, and the United Kingdom. The general 15 percent rate of the Canadian treaty is not applied to payments to Canadian charitable and educational organizations since such payments are not subject to withholding.

If the present general 20 percent withholding proposal is adopted, a provision to preclude withholding on payments to tax-exempt organizations or their nominees would simply conform to familiar practice and would accord United States charitable and educational institutions the same treatment now given similar Canadian organizations. Indeed, it would seem apparent that such a provision is called for in the case of tax-exempt organizations to prevent substantial interference with their normal functions and possibly severe financial hardship. Particularly in view of present high costs should no added difficulty be put in the way of continued solvent operation of the country's charitable and educational institutions.

FABER, COE & GREGG, INC.,
New York 18, N. Y., July 12, 1951.

Hon. WALTER S. GEORGE,
Finance Committee, United States Senate,
Senate Office Building, Washington, D. C.

DEAR SENATOR GEORGE: Our attention is called this morning to an amendment to paragraph 605 of the Tariff Act of 1930, which amendment is being sponsored by Senator Holland, of Florida.

This firm is the largest importer of Habana cigars in the United States. We call your attention to the fact that the total importations of Habana cigars into the United States for the calendar year 1950 was 11,000,000 cigars. If you compare this quantity with that of the total cigars sold in the United States, namely about 5,600,000,000 per year, you will see that this amendment is applicable to a pitifully small segment of the cigar industry, and as its only purpose could be a questionable desire to better inform the smoking public through outside markings as to the origin and type of product, its value, if the proposal was meritorious, is woefully small.

It is our opinion that the proposed amendment is completely without merit, and to substantiate this contention we are shipping to you by parcel post a box of imported cigars, so that you can compare the present outside markings with those proposed in the amendment. In the first place, as related to cigars as a whole, over 90 percent of all the containers of all types of cigars do not in any way identify the product as to its character, the origin of the tobacco, or the place of manufacture, and there is of course no reason why they should. In the manufacture of what we in the industry refer to as clear Habana cigars many of the leading factories, particularly those located in the city of Tampa, Fla., are permitted under regulations to designate a certain area of their factory as a bonded warehouse. These factories use tobacco of Cuban origin exclusively in the manufacture of their cigars, and this tobacco is held in these warehouses in bond until the manufacturer is ready to use it. The duty is paid and then the tobacco is withdrawn. This practice started before I commenced my career in the industry, which was 36 years ago. At that time the sales of cigars in the United States imported from Cuba were probably as high as 100,000,000 a year, and as factories in this country started to make a similar type of merchandise out of similar tobacco with workers who were almost entirely immigrated from Cuba they desired to identify these products in the minds of the smoker and this was done with a bonded stamp which appears on the outside of the package. At the same time there are a large number of producers of these cigars in the United States who do not make them in bond.

An inspection of the cigars we sent you would certainly indicate that any additional markings on the outside of these boxes would serve no useful purpose. The

greatest protection to the consumer on this type of cigar, which prevents fraud in any way, is the official warranty stamp of the Cuban Government itself. Please bear in mind that only a small proportion of the cigars imported from Habana, Cuba, are sold to the consumer by the box. Probably 80 percent of them are purveyed one, two, or three cigars at a time out of a box which is open, and obviously additional markings on the outside of the box can serve no useful or practical purpose when the box is open and the consumer does not even see the outside.

The packaging of cigars in boxes is a very expensive proposition. The labels today cost more than ever before, and the change in the markings as suggested by this amendment would either require a separate ruling involving a long period of time before the change-over was made, otherwise all present labels would have to be junked at a terrific expense. Certainly you must agree upon inspection of the box of cigars submitted to you that the external adornments already required and used exceed that of any other product sold in the United States. We strongly protest the adoption of this amendment as being illogical, impractical, and wholly unnecessary, and serving no useful purpose. We sincerely trust that you will do us the courtesy of permitting the other members of your committee to read this communication. If there is any further information that you would like to have as supporting our opposition to this amendment, please feel free to call on us.

Sincerely yours,

R. S. WILLIAMS, *President.*

P. S.—After the box of cigars previously referred to has served the purpose of yourself and your committee please feel perfectly free to retain them for your personal use if you are a cigar smoker; otherwise they might serve a useful social purpose in your office. R. S. W.

PROPOSED REVENUE ACT OF 1951 (H. R. 4473, 82D CONG., 1ST SESS.)

Subject: Twenty percent withholding of tax at source on dividends, etc., as it applies to organizations exempt from tax.

From: The National Social Welfare Assembly, New York 10, N. Y.; the National Committee on Foundations and Trusts for Community Welfare, Chicago, Ill.; Community Chests and Councils of America, Inc., New York 17, N. Y.

The above organizations and their thousands of affiliated and related charitable agencies all over the United States have a natural interest in the proposal for withholding at source of taxes due on dividends. A special problem arises because such organizations are tax-exempt and in many cases receive a substantial proportion of their income from dividends and such sources. The seriousness of the problem is, of course, related to the extent to which an organization is dependent upon this type of income.

Determination of necessity and soundness of such a withholding procedure is left to those more competent to express an opinion. However, it is desired to call attention to potential hardships for tax-exempt organizations involved in this proposed legislation, such as:

1. Additional bookkeeping and paper work and thus an additional overhead cost in the administration of contributed charitable funds,

2. Possible loss of interest on funds to the extent of the delay between payment of the dividend and date of the refund,

3. Interruption of the normal flow of income to an organization which could cause delay in meeting its obligations.

Tax-exempt organizations are innocent bystanders in this matter as there is obviously no intention of changing their tax status. In view of these difficulties, exemption from such withholdings at source (as is provided in the case of nonresident aliens, for example) for tax-exempt organizations would be preferred. If such an exemption is considered administratively unfeasible, certain safeguards must be provided:

1. Provision for immediate crediting of such withholdings against social security and employee withholding tax liability must be made. It should be understood that while this may eliminate all but the first hardship for some agencies, there are numerous organizations such as community trusts, where income from dividends is large and the number of employees negligible.

2. The refund procedure must be simple, quick, not less frequent than quarterly and should not require completion of an income-tax return.

UNITED CLAY MINES CORP.,
Trenton 6, N. J., July 17, 1951.

Subject: H. R. 4473 (Rept. No. 586).

Hon. WALTER F. GEORGE,
Chairman, Senate Finance Committee,
Senate Office Building, Washington, D. C.

DEAR SIR: With reference to subject we would like to call your attention to section 304, Percentage depletion, page 85, lines 20 and 21. In these lines the words "ball and sagger clay," appear and, in the interest of clarity and better understanding and to obviate any possible differences of opinion in the interpretation of these words, we believe that they should be modified by striking out the word "and" and replacing it with the word "clay" followed by a comma. These words would then read "ball clay, sagger clay."

As the words now appear it seems to us that there is a possible interpretation that the two types of clay, ball clay and sagger clay, must occur together in the same mine and be mined concurrently to be eligible for percentage depletion. This, of course, is not the intent and because of this we feel that the aforementioned modification would be to the best interest of all parties concerned.

Yours very truly,

UNITED CLAY MINES CORP.,
C. W. HALL, *President.*

STATEMENT OF RALPH A. FLETCHER ON BEHALF OF NATIONAL BUILDING GRANITE QUARRIES ASSOCIATION, INC.

The granite industry, although today only a shadow of the proportions which it attained in the early part of this century, can and will be a strong, vital part of the national economy again if given the proper consideration by the Government in the question of depletion.

Granite is a natural resource, having been commercially produced in more than 75 percent of the States in the Union at one time or another. Although the material itself is common, deposits which are profitable to work under present conditions are not. They are difficult to discover and costly to develop. The risk involved is far too great in view of any possible reward, with the result that venture capital is not available to this industry on any terms. We know of but one instance in which new capital has entered the granite business since 1929, but we do know of many, many failures since that time and this trend still continues. The great economic disturbances occasioned by two world wars and the boom and the bust of the twenties have brought tremendous sufferings to this industry.

The Bureau of Mines reports that in 1949 there were only 139 active producers in the United States, although in 1928 the same Bureau reported 464 active units. This is not a case of fewer having more as is instanced by the volume used in rough construction which decreased from 356,000 tons in 1928 to 55,000 tons in 1949, while in the same period dressed architectural granite dropped from 1,400,000 cubic feet to 540,000 cubic feet.

It seems obvious that granite, as an industry, is threatened with extinction and that there is great danger that the art of production may become forgotten and necessary skills lost. This in itself is extremely important when one recalls that during the two world wars the granite industry provided a substantial reservoir of highly skilled and trained help from which many war industries benefited.

Granite concerns have always been considered as small business and seem destined to remain in that category. As such, it has suffered the numerous ills which small business has experienced in the present economy, but to a greater degree than most of them, especially in its inability to obtain finance. It derived no financial benefit from the two world wars as did so many of its competitors.

Granite is recognized to be one of the best of construction materials, and its use is only retarded by its cost. There are definite long-range prospects of much lower costs and greater volumes if modern technology can be applied to this material, but technological improvement is retarded by lack of capital.

Currently, as a Nation, we are exhausting limited resources of various metals and minerals. In some instances, the supplies already are dangerously depleted. By using granite, which is not only suitable but in many instances better for the purpose, the interests of the Nation in terms of development and security will be better served.

It seems obvious that a business organization engaged in the exploitation of a natural resource will die with the exhaustion of that resource if it cannot obtain

new capital, or accumulate reserves sufficient for exploration and development of new resources. This exhaustion of resources has been taking place in the granite industry and will, in the not-too-distant future, result in the extinction of the industry. In view of this and the diminishing returns on sales, there is a strong tendency for the owners of good deposits to sit on them and to limit sales.

Many of the ills which are now plaguing the granite industry can be remedied by granting to those in the industry the right to use the percentage depletion method for income-tax purposes in determining the exhaustion of the deposit. This would have a very stimulating effect on the granite industry. The reserves that would be provided by the use of the percentage-depletion method would enable members of the granite industry to go ahead with the technological development of the industry which, in turn, would result in much lower costs to the consumer and greater volume. It would also help to encourage exploration and development of new resources. Both of these factors are very important if granite is ever to relieve some of the burden from those minerals which are rapidly nearing the point of exhaustion of resources and which are so important to the security of the Nation.

It is quite apparent, therefore, that the right to the use of the percentage-depletion method would be a tremendous shot in the arm for the granite industry, a stimulant that it needs very badly. However, one should not lose sight of the fact that this provision will also tend to serve the best interests of the Nation.

This incentive to granite producers will lift the industry to its former high position in the Nation's economy by encouraging increased production, which, in turn, will provide additional revenues to the Government from profits and wages arising from the increased activity in the industry. The reserves resulting from the use of the percentage-depletion method will provide the funds necessary for the exploration and development of new resources and thus add greatly to the national wealth.

The granite industry should be given the right to the use of the percentage-depletion method of determining the annual exhaustion of deposits, not only because it will aid the interests of the industry, itself, but also because it will further the interests of the Nation.

Statement by American Potash & Chemical Corp., Searles Lake, Calif., Re Extension of Percentage Depletion Allowance to Borax

The purpose of this statement is to summarize the facts which support the extension to borax of the percentage-depletion allowance which is not granted to a large number of so-called nonmetallic minerals by paragraph 114 (b) (4) of the Internal Revenue Code.

DESCRIPTION AND OCCURRENCE

Borax (tincal or tincalconate) is a natural compound found at the present time principally in California and Nevada. The word "borax" is derived from an Arabian or Persian word "borak" meaning "white." In mineralogical dictionaries it is an anhydrous sodium tetraborate with a chemical formula of $Na_2B_4O_7 \cdot 10\ H_2O$, theoretically composed of 36.6 percent boron tetroxide or anhydrous boric acid (B_2O_3), 16.2 percent soda (Na_2O) and 47 percent water (H_2O), but this composition varies. It is a white powder readily soluble in water, producing a faintly alkaline solution.

Borax is found in the state of nature in a considerable variety of forms, such as brines in prehistoric desert lakes and in various rocks or ores known as colemanite, rasorite, kernorite, etc. In commercial or trade parlance it is the crude or unrefined commercially marketable product derived from the application of various ordinary treatment processes to these brines and/or ores. An important secondary product, boric acid, is obtained by the reaction of borax to sulfuric acid. In certain desert lake brines in California, borax is found in conjunction with such minerals as potash, thenardite (sodium sulfate), and trona which have previously been granted percentage depletion. The commercial value of the borax is largely determined by the boron oxide content.

The Minerals Year Book of the Bureau of Mines for the year 1947 contains the following data with respect to the production of boron minerals in the United States:

	Gross weight	B_2O_3 content	Borax equivalent	Value
	Tons	*Tons*	*Tons*	
1943	256,633	87,600	239,901	$6,401,507
1944	277,586	91,700	251,130	6,579,587
1945	325,935	104,600	286,458	7,635,365
1946	430,689	129,800	355,470	9,575,866
1947	501,935	145,700	399,014	11,844,108

B_2O_3 converted to borax at ratio of 2.7386.

The United States is the world's main source of boron products at the present time. The Minerals Year Book, 1943, states: "With the exception of small quantities of boron minerals produced in Italy, Turkey, Tibet, and certain South American countries the United States has been virtually the world's supplier in recent years."

In 1946, the following firms reported production:

Pacific Coast Borax Co., Boron, Kern County, Calif.

American Potash & Chemical Corp., Searles Lake, San Bernardino County, Calif.

West End Chemical Co., Searles Lake, San Bernardino County, Calif.

Pittsburgh Plate Glass Co. (Columbia Chemical Division), Owens Lake, Inyo County, Calif.

United States Borax Co., Los Angeles, Calif.

It will be noted from the production figures set forth above that there has been a steady and rapid increase in the production of boron minerals in the United States during the past 5 years, reflecting the increasing variety and magnitude of uses to which borax is being put by industry and agriculture. Production has almost doubled in this short period. Borax can in no sense be condidered a war baby. On the contrary, it is a material of ever-increasing importance in an expanding peacetime economy.

HISTORY OF BORAX INDUSTRY

The first discovery of borax in the United States was in 1856 at Red Bluff, Calif., and in 1864 small quantities were obtained from Clear Lake in that State. The first commercial deposit was opened up in Teales Marsh, Nev., by F. M. Smith, and production was also obtained about that time from Rhodes Marsh, Nev.

Production in California was begun about 1873 by a group of miners on the east side of Searles Lake in the Mojave Desert, then known as Borax Lake. In the 1880's, however, the discovery of crude borax in the form of colemanite in the salt crust on the marshes of Death Valley revolutionized the industry and became the major source of boron products for a number of years. From these deposits came the familiar "20 Mule Team Borax" for household use. Production at Searles Lake and at the Nevada marshes was discontinued.

The next major step in the industry began in 1908 with the formation of the California Trona Corp. to work the brines at Searles Lake. However, actual production at this place was not undertaken on an important scale until 1913, when the American Trona Co., the predecessor of American Potash & Chemical Corp., was organized. Production of borax from the American Potash plant at Searles Lake has been almost continuous since about 1916. Today this plant accounts for about 30 percent of the United States output, while another 5 to 10 percent of such output is derived from Searles Lake brines by the West End Chemical Co.

The last major change in the production of borax products occurred in 1926 with the discovery of extensive deposits of rasorite, a new borax mineral, in the Kramer district of the Mojave Desert in Kern County, Calif. This new deposit proved a more economical source of borax than Death Valley. As a result Pacific Coast Borax Co. shifted its operations from Death Valley to the new mines in the Kramer district, and production from this source now accounts for more than 60 percent of the United States output.

USES OF BORON PRODUCTS

Borax enjoys a wide and growing variety of uses and is consumed in virtually all portions of the United States. It is so easily fusible that it is of great value as a flux. By reason of this property, borax is used in the manufacture of many iron

and steel articles such as bathtubs, kitchen and bath fixtures, cooking utensils, and laboratory equipment, and for the making of heat-resistant glass of the Pyrex type, used in baking dishes, laboratory glassware, lamp chimneys, electric lamp bulbs, and pottery glazes, as well as in smelting various metal concentrates, in soldering and welding of metals, and in brass smelting.

Borax is of great value in the manufacture of glass not only because it lowers the melting point but because boron compounds impart high refractiveness, reduce the tendency to devitrification, and lower the coefficient of expansion.

Borax is used in extremely large quantities in the laundry and kitchen. It is employed extensively for its detergent qualities. It is an efficient water softener and, reacting with the soap, destroys constituents of hard water, thereby effecting economy in soap consumption. It is a constituent of certain high-gloss starches and is used in paper mills for imparting a gloss to book paper and playing cards. It has important uses in the pharmaceutical industry by reason of its antiseptic and therapeutic qualities.

Borax is also used in the citrus industry as a preservative, and has been found to act as a preservative for wood. It is employed as an anticoagulant in the manufacture of rubber latex. One of its very important fields of commercial use is in the tanning industry, where it has wide application in the soaking and cleaning of hides and the dressing of leather for subsequent processes of manufacture. In the textile industry, borax is used in dyeing and as a means of rendering certain cloths fireproof, and it is also employed as one of the reagents in the chemical degumming of silk. Borax is an effective larvicide and has manifold applications throughout the chemical industry.

During World War II boron gained military significance as a means, when used in small amounts, of increasing the hardenability of steels, and also proved very valuable as a fire retardant in the paint used on naval vessels and equipment. Recently, publicity has been given to the possible use of boron products in rocket fuels, as refractories for jet and rocket engines, and as a catalyst in the manufacture of rubber, gasoline, and chemicals.

Of major importance in its relation to future demand for borax and boron materials is their growing use in the field of agriculture, both as a weed killer and a plant nutrient. Exhaustive recent studies from agricultural experiment stations and university research laboratories have shown that soils in various sections of the United States suffer from boron deficiency. In such areas the addition of boron in fertilizers and soil dressings results in a marked improvement in the quality and size of a large number of commercial crops. Borax production here stands on the threshold of a vast new market and demand.

Imports of boron products are very small because the bulk of world production at present comes from California. There is a tariff, going back to 1922, of one-eighth cent a pound on borax, and a tariff of one-half cent a pound on boric acid, a reduction from 1 cent a pound on the latter having been made in 1949 by the Annecy Agreement. It is believed this reduction was made at the request of Italy, which has some boric acid production.

In 1949 American Potash & Chemical Corp. paid very substantial royalties to the Federal Government on account of production under leases of public domain, of which amounts $107,899.48 was assessed against borax alone.

Exact comparable data on domestic prices for borax for various years are not available, inasmuch as freight costs are a very substantial element in the cost to the user or consumer, and the practices of the industry with respect to freight absorption, quotation of delivered prices or prices f. o. b. mill have varied considerably. Notwithstanding deviations in some years, the general price trend has been noticeably downward. The January 1, 1949, price of American Potash & Chemical Corp. for borax in bags per ton f. o. b. Trona, with no freight allowance, was $35.25 per ton, as compared with a price of $151 per ton in 1920. Of this 1949 price, $4 per ton represents charge for bags.

In 1947 and 1948, the American Potash & Chemical Corp. increased its productive capacity as regards borax by about 30 percent. The demand for borax has grown rapidly in the last few years and threatens to outrun the supply. The known major sources of supply are rather dangerously concentrated within a single limited geographical area. The general welfare and national security would be well served by energetic and widespread exploration for new deposits and reserves of boron materials to meet the ever-growing market demands and to place the industry itself upon a broader base. The most effective way to supply a needed incentive for such exploration and development would be to extend the percentage depletion allowance to borax production.

The exploration for and development of boron mineral deposits has shown by experience to be a costly affair, involving the investment of large amounts of risk

capital. Important deposits have generally been found in isolated and sparsely populated regions. Large outlays for construction of metallurgical treatment plants, water supply, transportation facilities, and housing and living accommodations for workers are necessary. At Trona on Searles Lake, American Potash & Chemical Corp. has had to develop a modern town of about 3,500 people, equipped with a fine school, up-to-date hospital, medical and sanitary facilities, stores, and athletic and recreation features—all this in the middle of one of the most barren deserts on the American continent.

By reason of its many varied uses, borax is competitive at different points with several mineral products already enjoying the percentage depletion allowance. The same considerations of policy which have induced the Congress to extend the allowance in recent years to a large number of other nonmetallic minerals are plainly applicable to it. The existing rate of 15 percent of gross income from the property, limited to 50 percent of net income, is believed to be no more than a reasonable allowance, and is the minimum required to stimulate the exploration and development of new deposits which the national interest requires.

In the event that section 114 (b) (4) of the code is amended to include borax among the minerals entitled to the percentage depletion allowance, a correlative amendment should be made to section 114 (b) (2) to exclude it from the scope of the depletion allowance based upon discovery value. Your committee is respectfully requested and urged to approve such amendments.

Community State Bank,
Lake Preston, S. Dak., July 10, 1951.

Hon. Senator Karl Mundt,
United States Senate, Washington, D. C.

Dear Honorable Mundt: We noticed in the press that mutual savings banks, Federal savings and loan associations, and cooperates in general will again escape Federal income tax unless the House bill is amended by the Senate.

We want to call your attention to the fact that we believe that 90 percent of the population of South Dakota who are not members of the Farmers Union organizations are very much opposed to the fact that any of these organizations should go tax-exempt free and the rest of the businessmen and organizations pay additional tax. We want to call this to your attention in a very firm manner that we believe that banks are now paying more than their just share of Federal income tax.

I am in favor of a repeal of certain portions of the Internal Revenue Code under which co-ops and mutuals escape Federal income taxes, and further to define all business net income of co-ops and mutuals as income taxable at the corporate level before its distribution as patronage dividends. Anything less will not be tax equality.

Existing income-tax laws exempt the following from paying Federal income tax: Federal- and State-chartered building, savings and loan associations, mutual savings banks, cooperative banks, credit unions, production credit associations.

Last year the total resources of these tax-exempt organizations exceeded $32 billion on which they earned more than $800 million. Taxpaying commercial banks would have paid nearly $260 million in Federal income taxes on the same amount of earnings. These tax-favored organizations paid none.

Here are the facts:

There are 6,000 Federal- and State-chartered building, savings and loan associations with assets of nearly $12 billion and annual earnings of $400 million. If they paid Federal income taxes like other commercial banking corporations have to pay, their annual income-tax bill would be $125 million or more. There are 530 mutual savings banks with total resources of almost $20 billion and annual earnings of $375 million. They are able to avoid payment of $130 million a year in Federal income taxes.

Other cooperative financing organizations include 500 production credit associations, 1,250 national farm loan associations, and 9,000 federally and State-chartered credit unions. Their combined assets exceed a billion dollars upon which they earn $25 million annually, paying no Federal income tax on these earnings.

These organizations have ample ability to pay Federal income taxes just like any other financial institution. In many cases their earnings are greater and their resources much larger than taxpaying institutions.

With the advent of the present 45 percent corporation income-tax rate and the imminent threat of further increases, this issue has assumed an importance second to none.

An ever-mounting tax burden is virtually certain in order for this country to meet the necessary increase in military expenditures. Mutual and cooperative organizations such as mutual savings banks, savings and loan associations, etc., were permitted during two world wars to escape paying their part of the crushing costs of preservation, while their taxpaying competitors paid a great part of their earnings to the Federal Government. Congress must not permit this to happen again.

The 45-percent tax rate now makes it more apparent than ever that two competitive businesses cannot in fact compete if one of them is required by law to pay out almost half its earnings to the Federal Government, while the other is legally excused from paying anything. We are convinced that appropriate taxes should be imposed upon building and loan associations, savings banks, and so-called mutuals.

We should be interested in seeing that the businesses on the west side of the street are placed on the same footing as are the businesses on the east side of the street. No man can operate a business, pay taxes under the existing rates, and compete with a tax-exempt business on the other side of the street.

Cooperatives, mutual organizations, building and loan groups—these are all useful types of associations with a legitimate and valid place in the American economy. They perform valuable services, but we believe they should be taxed on the same terms as other corporations doing business in the United States. Their exemption is now costing the Treasury about $1 billion a year.

Your consideration in this matter will be appreciated.

Very truly yours,

H. KOPPERUD.

ERNST & ERNST,
Cleveland, July 17, 1951.

Hon. WALTER F. GEORGE,
Chairman, Committee on Finance,
United States Senate, Washington, D. C.

DEAR SIR: As suggested in your letter of July 11, I am pleased to submit the attached statement to be incorporated in the printed record of the current hearings of the Senate Finance Committee re H. R. 4473, with respect to a proposed amendment to the Internal Revenue Code to permit the use of the cost or market, whichever is lower, principle in connection with the last-in, first-out (LIFO) inventory method.

I would like to emphasize the need for immediate consideration of this amendment. An exhaustive study of this subject should not be required as both of these inventory principles are already in the revenue code. Furthermore, the amendment should have no appreciable effect upon the total amount of available taxable income and will eliminate, for all the future years, the unsound practice of taxing the price-inflation segment of profits.

This amendment will keep out of income that fictitious profit element (price inflation) which creeps into the continuous investment in inventories in a rising market. In drafting revenue legislation this fictitious profit element certainly is not being relied upon by Congress as available for taxation, for if the objective of Congress to control prices is achieved, it will not exist.

On the other hand, if action on this amendment is deferred, industry generally will continue to postpone the adoption of LIFO until price declines occur and if prices do go up before such a decline occurs, profits will continue to be overstated. Thus the only result from deferring action on this amendment will be a possible contribution toward further inflation.

I understand that the substance of this amendment has been advocated before your committee by Mr. Charles C. Hertwig, president of the Bibb Manufacturing Co., of Macon, Ga., and also president of the American Cotton Manufacturers' Institute. Also Mr. Samuel H. Swint, president of the Graniteville Co., of Augusta, Ga., has discussed this subject with your secretary, Mr. McDaniels.

There are many, many other taxpayers and industrial groups who share the views herein expressed concerning the constructive value of this amendment as being in the interest of sound business economy. The writer has been active in connection with the application of the LIFO method in many industries over the past 10 years. As a consequence, I can make available to you much specific

information showing the importance of immediate consideration of this amendment and would welcome an opportunity to do this at your convenience.

Sincerely yours,

H. T. McAnly, *General Partner.*

Statement Submitted by H. T. McAnly, Partner, Ernst & Ernst, Covering Suggested Revision in Internal Revenue Code, Section 22 (D), To Permit Use of the Lower of Cost or Market in Last-In, First-Out (LIFO) Inventory Pricing as Is Permitted Generally in Other Methods of Inventory Pricing

This statement to your committee is not in the interest of any particular segment of taxpayers but for the sole purpose of offering a refinement in the revenue code with respect to a sound business principle which already has been recognized by Congress.

This recognized sound business principle is the use of the last-in, first-out order of inventory pricing which has the effect of excluding price inflation from the required basic inventory investment.

Soundness of LIFO recognized in 1939.—Last-in, first-out (LIFO) inventory pricing which keeps price increases out of the value of the continuous inventory investment needed in a business, was made available to all taxpayers by Congress in 1939—just before the beginning of an inflationary price trend which has continued to this date.

Interpretations too restrictive.—The Commissioner of Internal Revenue's original interpretations (1939) were so narrow and restrictive that the tax regulations implied that the use of LIFO was to be limited to taxpayers having very simple inventories. Relatively few taxpayers adopted LIFO in the face of these adverse interpretations. Those regulations remained in effect until 1949—nearly 10 years.

Meanwhile inflation struck.—The inflation spiral carried the Bureau of Labor Statistics "all commodities" index from 77.1 in 1939 to 155.0 in 1949. Many taxpayers who were so effectually discouraged by regulations from electing LIFO in 1939, 1940, or 1941, have feared to adopt it subsequently because of the danger of "freezing" a high-cost inventory. Reason: The LIFO tax law (then and now) prohibits writing down inventories computed thereunder to current cost or market if prices recede below the starting point.

Tax Court overrules original restrictive interpretations.—In January 1947 The Tax Court, in *Hutzler Bros.* v. *Commissioner* (8 TC 14), upheld the application of LIFO to the diversified inventory of a large department store. However, not until November 1949 were the income-tax regulations broadened in harmony with the original intent of the law. But it was 10 years too late.

Inequities and confusion.—Inequities exist today among taxpayers. Those who adopted it at low price levels, notwithstanding the implied restrictions in the tax regulations, are enjoying its benefits. Others (in far greater numbers) who could not prudently adopt LIFO at higher price levels because the law fails to recognize the possibility of price declines, are at great disadvantage.

Furthermore, in many industries, there are some companies wholly on LIFO, some for only part of their inventories, and still others (probably the greatest number) not as yet using LIFO at all. Financial reporting to stockholders, to Government agencies, and to the public is thus enormously confused.

Conditions growing worse.—Even though price levels continue to rise (BLS index in March 1951 was 183.6) many taxpayers continue to defer the adoption of LIFO because of the risks involved by being prohibited from recognizing price declines that might go below the beginning level at time of adoption. As a consequence, price inflation continues unabated in inventory valuations and profit determinations.

The remedy.—A simple amendment to permit adjustment of LIFO cost base if future prices decline below the beginning level—a privilege tax laws have long granted to taxpayers using other acceptable methods of inventory pricing. Suggested wording for such an amendment is attached.

This amendment merely provides that if current year-end cost or market is lower than the LIFO computed cost, the current year-end cost or market will be used as the new LIFO cost base. This in effect gives the taxpayer no greater deductions from earnings than had the taxpayer deferred his adoption of LIFO until prices declined to this lower current cost.

This amendment will permit the universal adoption of this LIFO pricing method without concern as to future price trends. It will thus prevent further inflation of profits if cost price levels increase.

Keeping inventory inflation out of taxable profits conforms to the intent of Congress in 1939 when the use of this last-in, first-out pricing method was made available to all taxpayers.

Available taxable income.—Over the span of an upward and downward price cycle, the amendment will have no effect on the amount of available taxable income. But the income determined annually under LIFO would be free from the fictitious increment of profit due to price inflation.

SUGGESTED REVISION IN INTERNAL REVENUE CODE

[Italics indicate revisions in statute; black brackets indicate elimination of present provision in statute]

Section 22 (D) (1):

"(1) A taxpayer may use the following method (whether or not such method has been prescribed under subsection (c) in inventorying goods specified in the application required under paragraph (2):

"(A) (1) Inventory them at cost *or (2) at cost or market, whichever is lower. (Whichever basis is adopted shall be used in all subsequent taxable years unless a change in such basis is authorized by the Commissioner.)*

"(B) Treat those remaining on hand at the close of the taxable year as being: First, those included in the opening inventory of the taxable year (in the order of acquisition) to the extent thereof, and second, those acquired in the taxable year; *and if the taxpayer has adopted the basis of valuation prescribed in subparagraph (A) (2) and the basis so determined is in excess of the most recent cost or market value at the close of the taxable year, such most recent cost or market value, whichever is lower, shall be the basis of valuation of inventory at the close of the taxable year and the opening of the next succeeding taxable year;* and

"(C) Treat those included in the opening inventory of the taxable year in which such method is first used as having been acquired at the same time [and determine their cost by the average cost method] *and at the same aggregate value at which such goods are included in the closing inventory of the preceding taxable year.*"

Section 22 (D) (2): No change.

Section 22 (D) (3): No change.

Section 22 (D) (4):

"(4) [In determining income for the taxable year preceding the taxable year for which such method is first used, the closing inventory of such preceding year of the goods specified in such application shall be at cost.]"

STATEMENT OF HENRY KLONOWER (DIRECTOR, TEACHER EDUCATION AND CERTIFICATION, DEPARTMENT OF PUBLIC INSTRUCTION, COMMONWEALTH OF PENNSYLVANIA; SECRETARY, COMMITTEE ON HIGHER EDUCATION, STATE COUNCIL OF EDUCATION; SECRETARY, BOARD OF PRESIDENTS, STATE TEACHERS COLLEGES, COMMONWEALTH OF PENNSYLVANIA) ON EXEMPTION FROM FEDERAL INCOME TAX FOR 101 (6) CORPORATIONS ORGANIZED AND OPERATED SOLELY FOR THE BENEFIT OF CHARITY AND EDUCATION

This is an appeal to the members of the Senate Finance Committee to consider the desirability of some form of exemption from Federal income tax for 101 (6) corporations, where these corporations can amply demonstrate that they are legally organized and operated for the benefit of charity and education. Adequate safeguards could be written into the Internal Revenue Code to make certain that only such corporations as are incorporated for charitable and educational purposes would be included. This plea is made so that funds created by private initiative may be dedicated to the use of institutions of higher learning. Funds for the support of institutions of higher learning secured from such sources would necessarily relieve pressure on the Congress and other legislative bodies for money secured from taxes. Such exemptions as might be provided would reasonably mean more local support for higher education and less governmental support at either the State or National level.

An illustration of the point involved follows:

In the Commonwealth of Pennsylvania a corporation devotes its entire earnings to public education, except for reasonable operating and administrative costs.

Its charter specifically limits the use of the funds to this specific purpose. Scholarships are made available to young men and young women who desire to become teachers in the public schools. The funds are given to the State teachers colleges so that these scholarships may be awarded to worthy young men and young women.

It is obvious that, if the company were exempt from such taxes as are now imposed by the Internal Revenue Code, more scholarships would be available. What the situation may be in other States cannot be stated in this presentation with accuracy, but it seems reasonable to conclude that if institutions of higher learning can secure more financial support in these critical times from such private sources it may be reasonable to assume that the need for such support of higher education from the Congress might be diminished.

In brief, the granting of exemption to 101 (6) corporations, which give all their earnings, funds, and property to private colleges, State colleges, State teachers colleges, or public schools, will provide much-needed support for education in these critical times. The granting of such exemption might reasonably reduce the pressure for public tax money to support programs of higher education. Such exemption would encourage wealth derived from such enterprises to become dedicated for the public good and curb the rising criticism that the flow of tax money to institutions of higher learning means Government control of education.

I trust that some member of the committee may find an opportunity to review the statement presented in this brief, and that it may in some way assist in the consideration of a problem which has many difficult angles.

[Telegram]

DULUTH, MINN., *June 26, 1951.*

The Honorable EDWARD J. THYE,
United States Senate, Washington, D. C.

In regard present income tax bill being considered by Senate. Imperative differentiation be made between new small growing corporations and large established ones. Present excess tax law is destroying incentive for new and small business ventures. New increase proposed by house bill makes it dangerous for any small business to even exist. New growing small corporations need good share earnings to take care of increased capital needs as growth progresses. How then can new small corporations reserve earnings for capital growth and yet pay out present 62 percent and now new proposed 70 percent maximum tax in cash to government and yet exist. Let's be realistic. New corporations cannot just increase their percentage of gross profit so that net after taxes is still substantial and sufficient. General Motors and other large corporations can and have done so by policy of passing on increased tax cost to consumer. This results in never-ending wage and cost-of-living increases. New small corporations are governed by competitive factors and cannot charge all traffic will bear in order offset increased taxes. Urgently request your immediate and exerted action in Senate to demand following:

Raise minimum excess profits tax credit from $25,000 under present law to $100,000 for all small new corporations. The excess profits credit for new small corporations under the present law does not provide sufficient credit for a corporation that has grown as we have. This will enable small new corporations to reserve fair amount for growth capital needs and yet pay excess profits tax on its earnings exceeding $100,000 a year. Imperative to welfare of this country that small new growing corporations be provided for. Otherwise you will be destroying fundamentals of our heritage. Also sincerely urge Senate action in incorporating in new defense law restrictions on percentage gross profits of large corporations to pre-Korean levels. That will stop price increases more than anything. We must stop this billion dollar profit policy of large corporations for it is reflection on all Corporations no matter how small. Will be most happy appear in person to personally assist in securing tax assistance for small corporations. Please advise collect wire your reaction. Have wired same message as above to Senator Humphrey. Am mailing copy this telegram to all Senators.

CHUN KING SALES INC.
JENO F. PAULUCCI, *President.*

SENATE CONCURRENT RESOLUTION NO. 16—OBJECTING TO THE PROPOSAL BY THE FEDERAL GOVERNMENT TO INCREASE THE FEDERAL GASOLINE TAX

Whereas it has been proposed that the 1½ cents a gallon Federal tax on gasoline be doubled to 3 cents a gallon as one of the means of raising additional revenue; and

Whereas this Federal gasoline tax at its present rate now costs the people of Delaware more than $1,000,000 each year; and

Whereas, the proposed doubling of the Federal gasoline tax rate would make a total State and Federal tax of 8 cents on every gallon of gasoline purchased in Delaware; and

Whereas the Federal Government entered the field of gasoline taxation in 1932 on a temporary, emergency basis, later increased the tax by 50 percent to its present rate, and has tended to turn attention to this levy each time there appeared to be a need for additional revenue; and

Whereas while there is an imperative need for increased Federal revenue on some scale to meet the demands of the national defense emergency, heavily taxed gasoline is not a suitable subject for this additional taxation; and

Whereas, an increase in the Federal gasoline tax would make the total tax on this product so high as to jeopardize a major source of State revenue, impair vital transportation services, add to the cost of all kinds of consumer goods, spur inflationary price trends and threaten a condition of diminishing returns for both State and Federal gasoline tax revenues: Now, therefore, be it

Resolved by the Senate of the State of Delaware, the House of Representatives concurring therein, That this One Hundred and Sixteenth General Assembly of the State of Delaware does hereby petition the Congress of the United States to refrain from increasing the Federal gasoline tax and to find some more equitable and economically feasible means of raising this portion of needed revenue; and be it further

Resolved, That copies of this resolution be transmitted to the Speaker of the House of Representatives and the President of the Senate of the Congress of the United States, and to the Chairman of the Ways and Means Committee of the Finance Committee of the Senate of the Congress of the United States, and to Hon. John J. Williams and Hon. J. Allen Frear, Jr., Senators from the State of Delaware in the United States Senate, and to Hon. J. Caleb Boggs, our Representative in Congress from the State of Delaware, urging them to oppose the unreasonable proposal to double the Federal gasoline tax and to strive for the substitution of a fair and sound method of raising this revenue.

Approved May 1, 1951.

ELBERT N. CARVEL, *Governor.*

STATE OF DELAWARE

OFFICE OF SECRETARY OF STATE

I, Harris B. McDowell, Jr., secretary of state of the State of Delaware, do hereby certify that the above and foregoing is a true and correct copy of Senate Concurrent Resolution No. 16, entitled, "Objecting to the Proposal by the Federal Government to increase the Federal Gasoline Tax," which was passed by the One Hundred and Sixteenth General Assembly and approved by the Governor under date of May 1, 1951.

In testimony whereof, I have hereunto set my hand and official seal, at Dover, this 4th day of May in the year of our Lord one thousand nine hundred and fifty-one.

[SEAL] HARRIS B. McDOWELL, Jr., *Secretary of State.*

NATIONAL TOBACCO TAX RESEARCH COUNCIL, INC.,
Richmond, Va., July 13, 1951.

HON. WALTER F. GEORGE,
Senate Office Building, Washington 25, D. C.

DEAR MR. GEORGE: The enclosed information is respectfully submitted to assist you while deliberating the issue of whether or not the present excise tax on cigarettes should be increased.

The present Federal tax of 7 cents per package represents 34 percent of the retail price. The pack-a-day smoker (below average) now pays $25.55 a year in Federal taxes alone. The combined Federal and State tax on cigarettes today represent 60 percent of the retail price. The Federal excise tax alone amounts to 100 percent of the manufacturing cost of a package of 20 cigarettes.

Only 45 percent of the population smoke cigarettes. Last year, these smokers paid the Federal Government $1,200,000,000, representing 16.2 percent of all excise taxes collected by the Federal Government. In addition to that, they paid nearly $500,000,000 in taxes, ranging from 2 to 8 cents per package, to 40 State governments. More than 100 municipalities collected yet another $50,-000,000 from the same smokers.

Cigarette taxes fall heaviest on those least able to pay. Current Federal cigarette taxes imposed on the pack-a-day smoker, earning less than $1,000 a year amounts to 526.8 percent of the average income tax paid by such person. It is 45.7 percent of the income tax paid by one earning from $1,000 to $2,000 per year, and 19.7 percent of the average income tax return paid by an individual earning from $2,000 to $3,000 per year.

Additional information is contained in the charts and graphs annexed hereto.

Respectfully,

National Tobacco Tax Research Council, Inc.,
F. M. Parkinson, *Executive Director.*

Cigarette taxes

[Cents per package]

State	Federal	State	Municipal	Total current taxes	Total if Federal excise is increased 1 cent
Alabama	7	3	2	12	13
Arizona	7	2		9	10
Arkansas	7	6		13	14
Connecticut	7	3		10	11
Delaware	7	2		9	10
Florida	7	5	5	17	18
Georgia	7	3		10	11
Idaho	7	3		10	11
Illinois	7	3		10	11
Indiana	7	3		10	11
Iowa	7	2		9	10
Kansas	7	3		10	11
Kentucky	7	2		9	10
Louisiana	7	8	1	16	17
Maine	7	4		11	12
Massachusetts	7	5		12	13
Michigan	7	3		10	11
Minnesota	7	4		11	12
Mississippi	7	4		11	12
Montana	7	4		11	12
Nebraska	7	3		10	11
Nevada	7	3		10	11
New Hampshire	7	3		10	11
New Jersey	7	3	2	12	13
New Mexico	7	4		11	12
New York	7	3		10	11
North Dakota	7	6		13	14
Ohio	7	2		9	10
Pennsylvania	7	4		11	12
Rhode Island	7	3		10	11
South Carolina	7	3		10	11
South Dakota	7	3		10	11
Tennessee	7	5		12	13
Texas	7	4		11	12
Utah	7	2		9	10
Vermont	7	4		11	12
Washington	7	4		11	12
West Virginia	7	4		11	12
Wisconsin	7	3		10	11
Wyoming	7	2		9	10

Federal and State cigarette taxes compared with Federal income tax liability for various income groups

Adjusted gross income	Number of returns filed	Total income taxes	Average tax per return	Federal cigarette tax 1-pack-a-day smoker		2 cents State tax added		3 cents State tax added	
				Amount	Percent	Amount	Percent	Amount	Percent
Under $1,000	7,771,021	$37,706,000	$4.85	$25.55	526.8	$32.85	677.3	$36.50	752.6
$1,000 to $1,999	11,145,284	622,438,000	55.85	25.55	45.7	32.85	58 8	36.50	65.4
$2,000 to $2,999	12,459,410	1,619,226,000	129.96	25.55	19.7	32.85	25.3	36.50	28.0
$3,000 to $3,999	9,396,744	1,990,235,000	211.80	25.55	12.1	32.85	15.5	36.50	17.2
$4,000 to $4,999	5,094,747	1,687,046,000	331.13	25.55	7.7	32.85	9.9	36.50	11.0

Adjusted gross income	4 cents State tax added		5 cents State tax added		6 cents State tax added		8 cents State tax added	
	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent
Under $1,000	$40.15	827.8	$43.80	903.1	$47.45	978.4	$54.75	1,128.9
$1,000 to $1,999	40.15	71.9	43.80	78.4	47.45	85.0	54.75	98.0
$2,000 to $2,999	40.15	30.9	43.80	33.7	47.45	36.5	54.75	42 1
$3,000 to $3,999	40.15	19.0	43.80	20 7	47.45	22 4	54.75	25.8
$4,000 to $4,999	40.15	12.1	43.80	13.2	47.45	14.3	54.75	16.5

No State cigarette tax:
- California
- Colorado
- Maryland
- Missouri
- North Carolina
- Oregon
- Virginia

2 cents:
- Arizona
- Delaware
- Iowa
- Kentucky
- Ohio
- Utah
- Wyoming

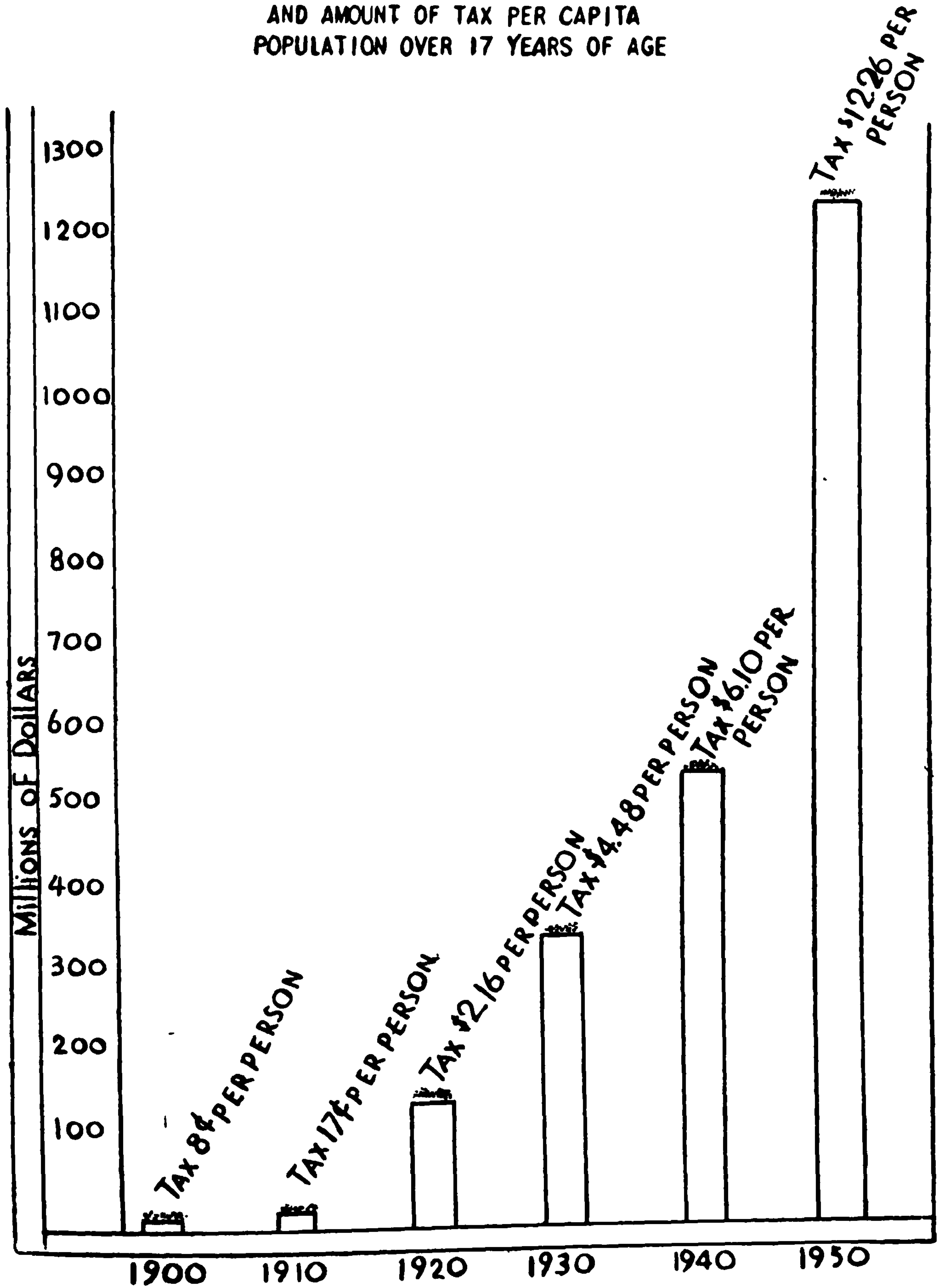
3 cents:
- Alabama
- Connecticut
- Georgia
- Idaho
- Illinois
- Indiana
- Kansas
- Michigan
- Nebraska
- Nevada
- New Hampshire
- New Jersey
- New York
- Rhode Island
- South Carolina
- South Dakota
- Wisconsin

4 cents:
- Maine
- Minnesota
- Mississippi
- Montana
- New Mexico
- Pennsylvania
- Texas
- Vermont
- Washington
- West Virginia

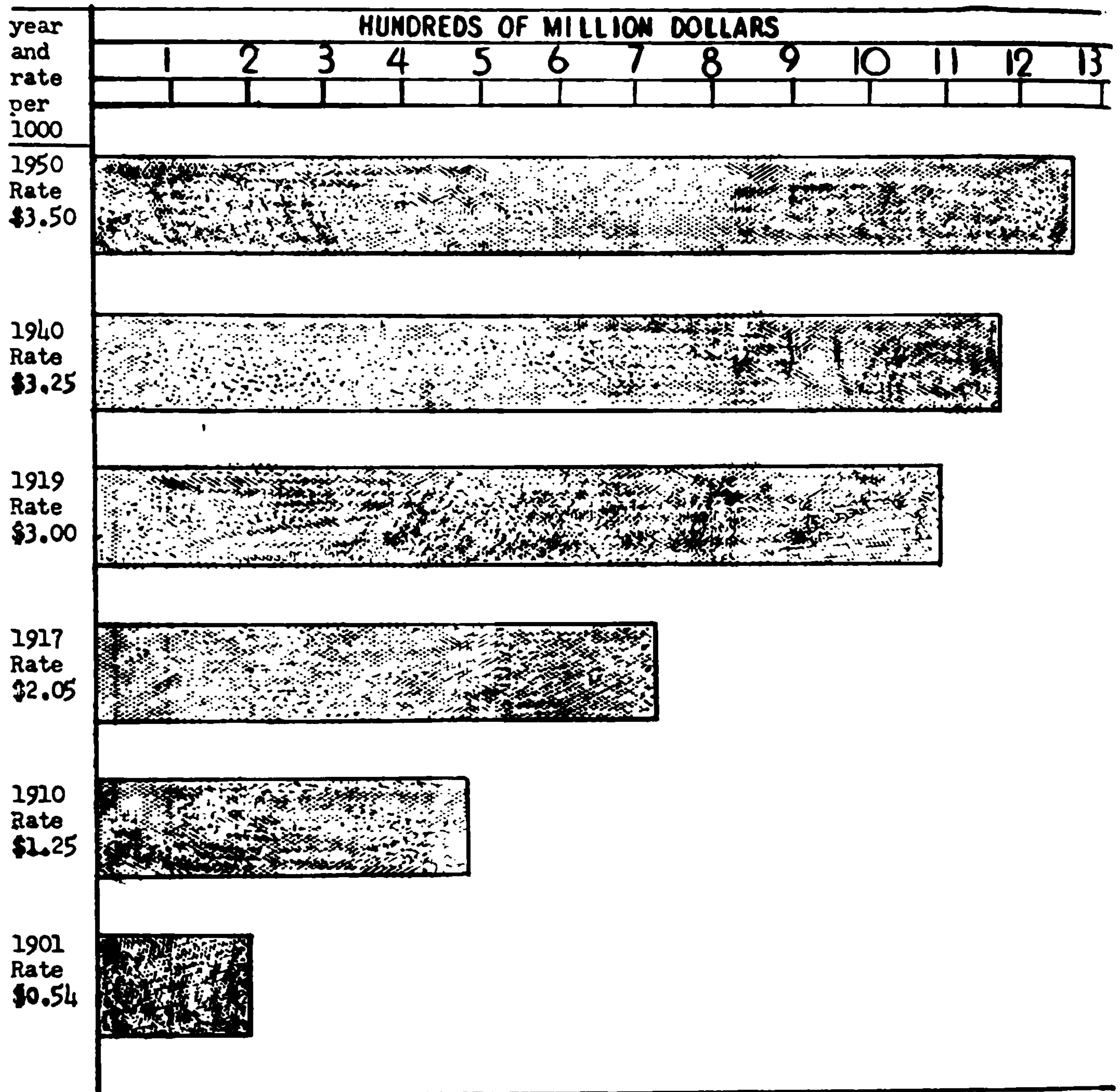
5 cents:
- Florida
- Massachusetts
- Oklahoma
- Tennessee

6 cents:
- Arkansas
- North Dakota

8 cents:
- Louisiana


YIELD OF FEDERAL CIGARETTE TAX 1900-1950
AND AMOUNT OF TAX PER CAPITA
POPULATION OVER 17 YEARS OF AGE
Millions of Dollars
1300
1200
1100
1000
900
800
700
600
500
400
300
200
100
TAX 8¢ PER PERSON
TAX 17¢ PER PERSON
TAX $2.16 PER PERSON
TAX $4.48 PER PERSON
TAX $6.10 PER PERSON
TAX $12.26 PER PERSON
1900
1910
1920
1930
1940
1950

FEDERAL CIGARETTE TAX COLLECTIONS *
TO SHOW ACTUAL 1950 RECEIPTS AND WHAT THESE RECEIPTS WOULD
HAVE BEEN AT RATES APPLICABLE FOR EARLIER YEARS



*The bars presented in the chart above are designed to show the effect of successive tax rate increases imposed by the Federal government since 1901. The top bar reflects the yield of actual Federal cigarette tax collections for the calendar year 1950 in the amount of $1,262,705,187. The second bar shows the tax that would have been paid in 1950 if the rates applicable in 1940 had been applied. The successively lower bars show what the 1950 tax collections would have been had the rates prevailing for the earlier years been applied to the 1950 production.

ATHLETIC GOODS MANUFACTURERS ASSOCIATION,
St. Louis, Mo., July 23, 1951.

Hon. WALTER F. GEORGE,
Chairman, Senate Finance Committee,
Senate Office Building, Washington, D. C.

DEAR SENATOR: We realize time is limited for testimony on excise taxes before your committee, so we are presenting this memorandum which we will appreciate your having placed in the record of the hearings before your committee.

Representatives of our association appeared before the House Ways and Means Committee last March and requested that the manufacturer's excise tax of 10 percent be removed from such articles of athletic equipment as are used by the youth of this country, and also by the public schools. It has never been the intent of Congress to tax the youths, and the public schools are purchasing free of excise tax because they are subdivisions of the State. We also suggested the tax continue at 10 percent on the remaining athletic goods items of tennis and golf.

A year ago the House of Representatives passed H. R. 8920, which provided for the rewriting of section 551, 1941 Revenue Act, section 3406 (a) (1) to eliminate the tax on all articles of baseball, football, basketball and miscellaneous school equipment, and to continue the tax on remaining articles at the 10 percent rate. The bill reached the Senate about the time the Korean situation developed, and Senate action was postponed.

We wish to review H. R. 4473, which passed the House of Representatives last month. Section 483 covers the repeal of tax on certain sporting goods and the increase in the present tax rate on others. Under the present law, this tax covers virtually all types of athletic equipment, although certain toys or children-sized items are exempted, such as baseball bats under 26 inches in length, golf bags under 26 inches in length, golf clubs under 30 inches in length, and tennis rackets under 22 inches in length. However, other articles, such as sleds and skates, used largely by children, are taxable, regardless of size. These other articles are used largely as a part of school and athletic programs. The present law allows exemption of the excise tax to State or political subdivisions upon filing a tax exemption form, which means that every public school, State college or university, tax-supported institution and municipality are exempt. The net revenue to the Federal Government from taxing these articles is small, because practically the only sales of these articles that are producing tax revenue are those made at retail, principally to the youngsters, and team equipment which is purchased by parochial schools, YMCA's etc. Of course, that in itself is discriminating against the youngsters and the denominational institutions. The manufacturers of, and all the dealers in, athletic equipment are compelled to assume a terrific item of expense represented by additional clerical personnel necessary to process and audit these exemption certificates.

The first action under section 483 of H. R. 4473 is to remove from the application of the tax under section 3406 (a) (1) of the code specific articles used predominantly by schools and children. The second is to raise the tax rate on remaining articles from 10 to 15 percent.

We feel that H. R. 4473 should provide for the removal of the excise tax on baseball equipment, which is predominantly used by children and the public schools—just the same as football, basketball, and other types of equipment—and that the tax on the remaining articles should remain at the present 10 percent rate.

It is our purpose to show:

(1) Baseball is America's national game and participated in largely by the youth and schools of this country.

(2) Only a small portion of baseball equipment is used by professional teams.

(3) The removal of baseball equipment from the application of the tax will have very little effect upon the net revenue.

(4) Unless there is to be a general excise tax placed on additional products, we feel our small industry is now paying more than its share, and the rate of tax should not be increased from 10 to 15 percent.

BASEBALL IS AMERICA'S NATIONAL GAME AND IS PLAYED PREDOMINANTLY BY THE YOUTH OF THIS COUNTRY

For more than 100 years baseball has been the game of American youth and is participated in by six groups, as follows:

(1) Very small children up to about 9 years of age, using mostly small size balls and gloves to play "catch."

(2) Children between ages of 9 and 12, who are beginning to play baseball. "Little leagues" have been organized during the past 10 years, in which over 50,000 boys are now playing.

(3) American Legion junior baseball, ages 12 to 17. Organized in 1926 as a part of the American Legion Americanization program; over 250,000 boys now are playing.

(4) High-school baseball. Over 9,000 high schools have teams, and more than 200,000 students participate.

(5) Sand-lot teams. These teams are made up of players who are not members of other groups.

(6) Professional leagues. These leagues comprise only 387 teams and 6,753 players.

ESTIMATED PRODUCTION OF BASEBALL EQUIPMENT IN 1952

The last official Department of Commerce census report of our industry was made for the 1947 year. The year 1947 was the first full production year following World War II; so, production was at its peak as to top-quality goods produced, as dollar volume.

In arriving at estimated production for the year 1952, we have used the 1947 figures and reduced them by about 20 percent, which will be more in line with volume in 1952, even considering slightly higher prices on certain materials during the past few months.

The details of the 1952 estimated production are shown in schedule A, attached, made up as follows:

(1) Small-size equipment and of construction and material not suitable for game use, such as listed in group No. 1:		
Balls	$1, 012, 000	
Bats	612, 000	
Gloves	2, 827, 000	
		$4, 451, 000
(2) Baseball equipment suitable for game use, and used by groups No. 2 to No. 6, inclusive:		
Balls	$4, 111, 000	
Bats	1, 428, 000	
Gloves	3, 585, 000	
		9, 124, 000
Total production estimated for 1952		13, 575, 000

ESTIMATED QUANTITY OF BASEBALL EQUIPMENT USED BY EACH GROUP OF PLAYERS

The approximate quantities of baseball equipment used by each group of players in 1952 follows (explained in detail in schedule B, attached):

	Balls	Bats	Gloves	Total
Group No. 1: Youth up to 9 years	$1, 012, 000	$612, 000	$2, 827, 000	$4, 451, 000
Group No. 2: Little leagues, 9 to 12 years	283, 500	100, 800	252, 000	636, 300
Group No. 3: American Legion, 12 to 17 years	1, 249, 200	740, 500	1, 604, 400	3, 594, 100
Group No. 4: Public schools, 12 to 18 years	1, 188, 000	405, 000	1, 300, 000	2, 893, 000
Group No. 5: Sand-lot, up to 18	505, 100	65, 600	293, 600	864, 300
Group No. 6: Professional players	885, 200	116, 100	135, 000	1, 136, 300
Total	5, 123, 000	2, 040, 000	6, 412, 300	13, 575, 000

We will comment upon each of these groups:

Group No. 1.—Youths up to 9 years of age: It has never been the intent of Congress to tax toys, and equipment in this class is of the toy type. The present H. R. 4473 removes the application of the tax to sleds, roller skates, etc., because they are used by the children of this country. Baseball equipment comes in the same classification.

Groups Nos. 2 and 3.—Little Leagues and American Legion junior baseball: These are two very important youth baseball programs, as they cover boys of 9 to 17 years of age, the age when boys should be encouraged to participate in wholesome outdoor activities, instead of meeting at the corner and eventually getting into trouble for want of something to do. The equipment used for this purpose should not be subject to an excise tax.

Group No. 4.—Baseball in public schools: The public school officials have been very much interested in baseball in public schools. There are more than 9,000 of the 28,000 high schools in this country sponsoring baseball, and the number is increasing each year.

This equipment will be paid for out of school funds; so, the articles will be exempt from excise tax. Therefore, no tax will accrue, but our industry will be faced with the burden and expense in the administration of the exemption certificates.

Group No. 5.—Sandlot players: These are the boys of all ages—mostly up to 17—who are not members of organized teams, such as Little League, American Legion, or public schools, but who play "sand lot" baseball.

Group No. 6.—Professional players: This group covers the players in organized baseball. The figures in schedule B, attached, show there are less than 7,000 professional players, as compared to more than 500,000 youths playing baseball. The total estimated volume of equipment used by professional baseball is less than 9 percent of the total production of baseball equipment in 1952. These figures clearly show professional baseball does not use the major share of baseball equipment produced in this country.

BASEBALL EQUIPMENT ASSISTS IN THE CORRECTION OF JUVENILE DELINQUENCY

Juvenile delinquency continues to be a problem and particularly in the larger cities. The importance of playgrounds and sports activities in diverting youths' attention from crime to clean living has been proved again and again.

The chairman of the Greater Cincinnati Baseball Fund, which was formed for the purpose of bringing baseball to the youths of the city, writes:

"I know that juvenile delinquency in our city is no different than in any other metropolitan city throughout the United States. The best manner to combat juvenile delinquency is through supervised and organized sport. There should be no premium on this asset in the way of taxes in any form. Our slogan this year is as follows: 'given an opportunity, a boy would rather steal a base than a bicycle.' This we believe is a true statement of fact."

No tax should be placed upon baseball equipment.

THE RATE OF TAX ON REMAINING ARTICLES UNDER SECTION 3406 (A) (1) SHOULD NOT BE INCREASED FROM 10 PERCENT TO 15 PERCENT

In our testimony before the House Ways and Means Committee last year and this year, we mentioned our industry is appreciative of the necessity of raising revenue to cover present budgets. We did not suggest the removal of excise tax on tennis and golf equipment, although quite a large quantity is purchased by the schools and the youth of the country, but not to as large an extent as baseball, football, basketball, etc. Tennis and golf equipment cannot be considered as luxury items, and should not be taxed, and most certainly the present rate should not be increased from the present rate of 10 percent to the suggested rate of 15 percent, unless many articles other than athletic goods are included in the tax base.

CONCLUSION

We respectfully request:

1. That section 483 of H. R. 4473 be amended to exclude the excise tax on the following articles:
   - Baseballs
   - Baseball bats
   - Baseball body protectors and shin guards
   - Baseball gloves and mitts
   - Baseball masks.
2. And that the rate of tax on remaining articles in section 3406 (a) (1) 1941 Revenue Act remain at the present rate of 10 percent, because—
   1. Approximately 91 percent of the production of baseball equipment is used by the youth of the country; boys up to 17 years of age. Baseball is not a luxury sport and should not be subject to excise tax.

2. Approximately 25 percent of the production of baseball equipment is used by public schools and will be purchased free of excise tax, because they are subdivisions of the State.

3. Less than 9 percent of the baseball equipment produced in the country is used by professional baseball players and leagues.

4. A tax should not be placed on baseball equipment, which is vital in combatting juvenile delinquency.

5. The athletic goods industry is a small industry. We feel we are now paying more than our share of excise taxes, and the present rate of 10 percent should not be increased.

Respectfully submitted.

ATHLETIC GOODS MANUFACTURERS' ASSOCIATION,
By CLAUDE E. CARR, *President.*
By PHILIP H. GOLDSMITH, *Secretary.*

SCHEDULE A.—*Estimated production of baseball equipment during year 1952*

The last United States Department of Commerce Census Report of Baseball Equipment is for the 1947 year (Forms MC79F1 and M79A–07). The next census will not be until 1954 and will be for the 1953 year.

The year 1947 was the first full-production year following World War II, and production that year was at its peak as to top quality merchandise and dollar volume.

The production of baseball equipment can be divided into two classes:

(1) Small size and of such construction and materials as not suitable for game use.

(2) Suitable for game use.

Referring to census Forms MC79F1 and M79A–07, the 1947 production was as follows:

	Small size, not suitable for game use		Suitable for game use		Together	
	Dozen	Amount	Dozen	Amount	Dozen	Amount
Baseballs	273,000	$1,265,000	381,000	$5,139,000	654,000	$6,404,000
Bats	66,000	765,000	156,000	1,785,000	222,000	2,550,000
Gloves and mitts:						
Gloves	75,000	2,412,000	50,000	3,234,000	125,000	5,646,000
Basemen's	20,000	744,000	16,000	873,000	36,000	1,617,000
Catchers'	9,000	378,000	4,810	374,400	13,810	752,400
Total, gloves and mitts	104,000	3,534,000	70,810	4,481,400	174,810	8,015,400
Grand total		5,564,000		11,405,400		16,969,400

NOTE.—Because of lack of information on baseball masks, body protectors and leg guards, no estimates are made as to 1952 production. The volume, however, will be very small.

These figures are for the 1947 year, which was the peak year. It is estimated the 1952 production will be about 80 percent of 1947 and, on this basis, the 1952 production will be—

(1) Small size and of such construction and materials as not suitable for game use	$4,451,000
(2) Suitable for game use	9,124,000
Total estimated for 1952	13,575,000
or	
Baseballs	5,123,000
Bats	2,040,000
Gloves and mitts	6,412,000
Total	13,575,000

SCHEDULE B.—*Estimated quantity of baseball equipment used by each group of players*

(1) *Baseball equipment of small size and of such construction and materials as not suitable for game use—used by the youth of the country.*—The estimated production during 1947 of this type of equipment was—

Baseballs	$1,265,000
Bats	765,000
Gloves and mitts	3,534,000
Total 1947	5,564,000

Production in 1952 is estimated at 80 percent of 1947, which will give a 1952 production of—

Baseballs	$1,012,000
Bats	612,000
Gloves and mitts	2,827,000
Total 1952	4,451,000

(2) *Little league baseball.*—Little league baseball was organized in Williamsport, Pa., in 1938 and is designed for boys under the age of 12. A team consists of 12 players; no team may have more than 5 12-year-old players, nor less than 3 10-year-old players. The bases are 60 feet apart (as compared with 90 feet in regular baseball), and the pitching distance is 44 feet (as compared with 60 feet, 6 inches in regular baseball). The balls are regulation but special bats have been designed and smaller-size gloves, masks, body protectors, and leg guards are used.

At present writing there are 700 leagures registered with Little League Headquarters, Williamsport, Pa., but there are about 700 more leagues operating which are not registered. There are 72 players in each league, making approximately 100,800 players in the age limits of 12 years and under.

Usage of equipment is as follows:

Baseballs: An average of 5 dozen balls per team for 4,200 teams per year, or a total of	21,000 dozen.
at a price per dozen of $13.50	$283,500.
Bats: An average of 2 dozen bats per team for 4,200 teams per year, or a total of	8,400 dozen.
at a price per dozen of $12	$100,800.
Gloves: On the basis of 12 players to each team, there is a total of 50,400 players in Little League baseball; each player would use a glove, baseman's mitt or a catcher's mitt, at an average cost of $5 each	$252,000.
Total	$636,300.

(3) *American Legion baseball.*—Beginning in 1926 (25 years ago) the American Legion started a junior baseball program to create interest in baseball and athletics in general among the youth of the country. Their program was carried on through the Legion Americanization committee and was actively sponsored by all Legion posts.

During 1950 a total of 16,456 teams were registered, and the American Legion headquarters report all teams playing did not register with headquarters. The Legion estimates 1,000,000 boys take part in this program each year.

The age limits of boys participating in the American Legion program are from 12 to 17 years.

The American Legion headquarters, Indianapolis, Ind., report 16,456 teams registered, but all Legion teams playing baseball did not register. They estimate 1,000,000 boys take part in the Legion baseball program each year.

The age group of these boys is 12 to 17, and they use medium-quality equipment. Usage of equipment is estimated as follows:

Baseballs: An average of 5 dozen baseballs per team of 16,456 teams, or ---------- 83,280 dozen.
at an average price per dozen of $15 ---------- $1,249,200.
Bats: An average of 3 dozen bats per team per year, or a total for 16,456 teams of ---------- 49,368 dozen.
at an average price per dozen of $15 ---------- $740,520.
Gloves: On the basis of 15 players to each team, there would be a total of 246,840 players (although Legion estimates 1,000,000); each player will use a glove, baseman's mitt or catcher's mitt at an average cost of $6.50 each, or a total value of ---------- $1,604,460.

A summary:

Balls	$1, 249, 200
Bats	740, 500
Gloves	1, 604, 400
Total	3, 594, 100

(4) *Baseball in public schools.*—The National Federation of State High School Athletic Associations, 7 South Dearborn Street, Chicago, Ill., is the governing body in athletics in the high schools. The figures they have compiled for the 1950 year indicate 9,000 high schools sponsor baseball teams, with an estimated 200,000 students participating in high-school teams. They also report an additional 600,000 boys in informal baseball practice connected with the public-school programs.

All of the baseball equipment used by these public schools is being purchased free of excise tax, because the schools, being subdivisions of the State, are entitled to the tax exemption.

Usage of baseball equipment, which can be purchased free of excise tax, is as follows:

There are 9,000 high schools playing baseball with an estimated 200,000 students participating.

Baseballs:
Each school will use an average of 8 dozen baseballs during a season, or a total of ---------- 72,000 dozen.
At a price per dozen of $16.50 ---------- $1,188,000.

Bats:
In addition they will use an average of 3 dozen bats or a total of ---------- 27,000 dozen.
At a price per dozen of $15 ---------- $405,000.

Gloves:
The 200,000 players will use at least 1 glove or mitt per year, or a total of ---------- 200,000.
At an average price of $6.50 each ---------- $1,300,000.

A summary of these figures shows the following used by schools:

Baseballs	$1, 188, 000
Bats	405, 000
Gloves	1, 300, 000
Total	2, 893, 000

(5) *Sand-lot teams.*—There is a small amount of baseball played by sand-lot teams and boys who are not members of Little League, American Legion, high school, or professional teams. These purchases are small as compared with other groups.

We estimate these sales in 1952 would be:

Baseballs	$505, 100
Bats	65, 600
Gloves	293, 600
Total	864, 300

(6) *Professional baseball teams.*—Only a small portion of baseball equipment produced in this country is used by professional teams.

At the present time there are 52 leagues in professional baseball. The teams in each of these leagues have a player limit of 15 to 25 players. Most of these leagues ar made up of eight teams, although some of the leagues consist of six teams.

A total of 6,750 players are in organized professional baseball, as follows:

Class of league	Number of leagues	Number of teams	Player limit	Number of players
Majors	2	16	25	400
Class AAA	3	24	23	552
Class AA	2	16	19	304
Class A	4	30	19	570
Class B	9	68	17	1,056
Class C	13	100	16-17	1,676
Class D	19	133	15-17	2,195
Total	52	387		6,753

Usage of baseball equipment by professional baseball teams is as follows:

Baseballs: There are 387 teams playing in professional baseball. With the exception of the major leagues—National League and American League—the yearly usage of balls would average 100 to 150 dozen per team. If the 371 teams use an average of 150 dozen balls per year, the total would be 45,650 dozen. Add the usage of the 2 major leagues of 8 teams each or 16 teams, of 8,000 dozen, and the total is .... 53,650 dozen.

As a total of 654,000 dozen baseballs was produced in 1947, the usage by professional leagues of 53,650 dozen equals about 8 percent of total production.

At an average price of $16.50 per dozen (exclusive of excise tax), the dollar value of baseballs used is .... $885,225.

Bats: The 387 teams in professional baseball will use an average of 20 dozen bats per season, or a total of .... 7,740 dozen.

At an average price of $15 per dozen (exclusive of excise tax), the total value per year is .... $116,100.

Gloves and mitts: There are 6,753 players in organized baseball. It is estimated each player will use an average of 2 gloves per season, or a total of .... 13,500.

At an average price of $10 each (exclusive of taxes), the total value of gloves is .... $135,000.

Summary:

Total value:

Balls	$885,200
Bats	116,100
Gloves	735,000
	1.136.300

Resolution No. 749

In regular adjourned session of the City Commission of the City of Madison, S. Dak., on June 25, 1951: Be it

Resolved, That the said City Commission of the City of Madison go on record as being unalterably opposed to any revision of or amendment to section 3411(c) of the United States Internal Revenue Code, which exempts publicly-owned utilities from an energy tax;

That it further go on record as denouncing the action of the House Ways and Means Committee on Tuesday, May 22, 1951, wherein it voted 18 to 7 to extend the base of the 3⅓ percent electrical-energy tax "to include sales by Government-owned plants," and wherein it agreed to continue the exemption of the REA-financed electrical cooperatives, as being discriminatory action and contrary to the democratic and time-honored precepts of the sovereignty of State and local

government, and upon which precepts the principle of reciprocal tax immunity has existed between the States and the Federal Government from the very beginning: Be it further

Resolved, That the above resolution be spread on the minutes of said commission verbatim, and that copies of said resolution be sent forthwith to the South Dakota Senators and Representatives in Washington, D. C.

Passed and adopted June 25, 1951.

[SEAL]

Attest:

R. E. HALL, *Mayor.*
GEO. H. SIMPSON, *City Auditor.*

CIGAR MANUFACTURERS ASSOCIATION OF TAMPA,
Tampa, Fla.

Re amendment by Mr. Holland to H. R. 4473 to paragraph 605 of the first section of the Tariff Act of 1930 as amended (19 U. S. C. 1001).

COMMITTEE ON FINANCE,
Senate of the United States.

GENTLEMEN: The Cigar Manufacturers Association of Tampa, hereinafter called the association, is composed of 14 cigar manufacturers located in Tampa, Fla. About 75 to 80 percent of all cigars manufactured by these 14 factories are manufactured out of all Cuban imported tobacco. The remainder are manufactured out of imported Cuban filler tobacco and wrapped with shade-grown domestic tobacco.

Three members of the association, Garcia & Vega, Inc., Morgan Cigar Co., and Corral Wodiska y Ca, manufacture cigars under bonded cigar-manufacturing warehouses as set forth in the Tariff Act of 1930. Section 311 of the act (title 19, par. 13.11 U. S. C. A.), in the eighth grammatical paragraph thereof, provides that cigars manufactured in such bonded cigar-manufacturing warehouses and sold domestically shall show on the boxes or packages containing such cigars their character, origin of tobacco from which made, and place of manufacture.

The pertinent part of the section is as follows: "*Provided*, That cigars manufactured in whole of tobacco imported from any one country, made and manufactured in such bonded manufacturing warehouses, may be withdrawn for home consumption upon the payment of the duties of such tobacco in the condition as imported under such regulations as the Secretary of the Treasury may prescribe and the payment of the internal-revenue tax accruing on such cigars in their condition as withdrawn, *and the boxes or packages containing such cigars shall be stamped to indicate their character, origin of tobacco from which made, and place of manufacture.*" [Emphasis added.]

Section 19.16 (b) of Customs Regulations of 1943 provides that cigars manufactured in such bonded manufacturing warehouses for home consumption shall not be removed therefrom until the Internal Revenue stamps, the caution notice, and the customs stamp shall have been affixed to each box containing cigars.

Section 19.16 (e) of the regulations provides:

"Before removal of cigars from bonded premises for consumption, there shall be affixed to each box thereof the stamp provided by the Government indicating their character according to the method of manufacture, origin of tobacco, place of manufacture, and that they were manufactured in bond. These stamps shall be sold to manufacturers by collectors of customs."

Under this latter regulation, the stamp provided by the Government and sold to the manufacturers contains various information showing that the tobacco used was imported from a particular country, that the cigars were manufactured in bond, the place of manufacture, and that the cigars are one of the following types or classes:

1. Machine precisioned, of long filler.
2. Machine precisioned, of short filler.
3. Hand bunched, machine wrapped, of long filler.
4. Rolled by hand, of short filler.
5. Rolled by hand, of long filler.

Under the foregoing statutes and regulations, each box of cigars contains one of the above types of stamps depending on whether the cigar is machine made or rolled by hand or hand bunched and machine wrapped. This has been a requirement, as to domestic cigars manufactured in bond, for many, many years, and it affects all bonded manufacturing warehouse cigar manufacturers in the United States.

A purchaser purchasing a cigar manufactured by one of the three named Tampa manufacturers from a box containing such a stamp has the absolute assurance that he is purchasing a cigar manufactured out of all imported Cuban tobacco. Such a purchaser also knows whether or not the cigar is rolled by hand or whether it is made by machine.

Manufacturers in the Republic of Cuba have manufactured and imported into the United States for years past cigars made, of course, of all Cuban tobacco and either all hand made or rolled by hand, and the American consumer, over this long period of years, has purchased such cigars with the belief and understanding that the same were so made. There is no requirement under present laws that these Cuban imported cigars shall show how the same are manufactured.

Recently, Cuban manufacturers have commenced to manufacture some of their cigars by machine, the same as some of our manufacturers in Tampa, and they are importing same into the United States without showing that they are machine-made cigars. Therefore, the American consumers are not advised by the Cuban manufacturers that they are machine made. Such cigars are now being sold under the same brand names as Cuban hand-made cigars long imported into the United States, and the American consumers naturally think they are buying hand-made cigars when, in fact, they are purchasing machine-made cigars.

One important factor in connection with these machine-made imported Cuban cigars is that they are selling the same on the American market at a considerably reduced price over which they previously sold the hand-made cigars. For example, one size previously made by hand and sold in this country at 35 cents is now imported and sold at retail at two for 55 cents. Such reduction is due to the lesser cost of manufacturing a machine-made cigar. The American consumer naturally asks why it is, if Cuban manufacturers at this time can reduce the price of their cigars, that the American manufacturers do not reduce their prices. This creates an unfair competitive situation because the American consumer has not been advised that the Cuban imported cigars are machine made.

The association and the three manufacturing members thereof who manufacture bonded cigars are firmly of the opinion that imported cigars should be required to carry the same information as those manufactured in this country and that the amendment proposed by Mr. Holland should be promptly enacted into law.

The amendment by Mr. Holland only requires the same information on the boxes containing imported cigars as American manufacturers are required to put on boxes containing cigars manufactured in bonded warehouses. Mr. Holland's amendment adds to paragraph 605 of the first section of the Tariff Act of 1930, as amended (19 U. S. C. 1001) the following: "*Provided*, That boxes or packages containing such imported cigars shall be stamped on the outside in English to indicate the character, origin of tobacco from which made, and place of manufacture of such cigars, and such information shall be the same as the information relating to character, origin, and place of manufacture required to be placed on boxes or packages of cigars subject to the provisions of section 311 of the Tariff Act of 1930."

The requested amendment is not anything new, novel, or unusual in our customs law. For example, paragraph 367 of section 1001 of the Tariff Act of 1930 provides how imported watch movements shall be marked.

Paragraph 361 of said section 1001 provides how slip-joint pliers shall be marked.

It is respectfully submitted that the proposed amendment should be adopted

CIGAR MANUFACTURERS ASSOCIATION OF TAMPA,
By RAMÓN FERNÁNDEZ REY, *Vice President.*

NEW YORK UNIVERSITY SCHOOL OF LAW,
New York 3, N. Y., July 18, 1951.

Hon. WALTER F. GEORGE,
Chairman, Senate Finance Committee,
Senate Office Building, Washington, D. C.

DEAR SENATOR GEORGE: Enclosed is a short memorandum in support of the adoption by the Committee on Finance and by the Senate of section 501 of the pending revenue bill of 1951, as passed by the House of Representatives and now pending in the Senate.

This memorandum sets forth some of the reasons why colleges and universities feel that possible income-tax liabilities in these cases should be set at rest for years prior to 1951 by specific statutory enactment. We strongly urge your support of this provision.

Sincerely yours,

RUSSELL D. NILES, *Dean.*

MEMORANDUM RE SECTION 501 OF THE PENDING REVENUE BILL OF 1951 (H. R. 4473)

Until the passage of the 1950 Revenue Act, the Congress had made no attempt to tax the unrelated business income of colleges and universities, or of "feeder" organizations, so long as all of the income inured to the benefit of an educational institution which met the statutory standard. As pointed out in the unanimous opinion of the Court of Appeals for the Third Circuit in *C. F. Mueller Company* v. *Commissioner*,[1] section 101 (6) of the Internal Revenue Code has been interpreted consistently for 30 years to give exemption to certain charitable organizations on the theory that it was the destination of the income, not its source, which was controlling. Although the decisions so interpreting the code were several times called to the attention of the Congress, especially in 1942, no action was taken to change the law until 1950. The colleges and universities which relied on the existing law did so reasonably and in good faith, and in the case of New York University, did so in further reliance on a letter of exemption [2] obtained before the first company was acquired for the benefit of the university.

Section 301 (a) of the Revenue Act of 1950 added a new Supplement U to chapter 1 of the Internal Revenue Code taxing the unrelated business income of colleges and universities and certain other tax-exempt organizations. This provision was specifically made applicable only with respect to taxable years beginning after December 31 1950. Section 301 (b) of the Revenue Act of 1950, furthermore, denied tax exemption to so-called feeder organizations which are operated for profit even though all of their profits are payable to tax-exempt organizations. This amendment was also made applicable only with respect to taxable years beginning after December 31, 1950. With respect to the effective date of the act, section 303 provided:

"The determination as to whether an organization is exempt under section 101 of the Internal Revenue Code from taxation for any taxable year beginning before January 1, 1951, shall be made as if section 301 (b) of this Act had not been enacted and without inferences drawn from the fact that the amendment made by such section is not expressly made applicable with respect to taxable years beginning before January 1, 1951."

It seems clear from sections 301 (a), 301 (b), and 303, that the Congress had no intention of imposing a tax on income which had inured to the exclusive benefit of a college or university in past tax years, but the act did not expressly set the matter at rest. The uncertainty as to taxability was caused not by the Revenue Act of 1950 but by the decision of the Tax Court on May 29, 1950, in the case of *C. F. Mueller* v. *Commissioner.*[3] This unexpected and unprecedented decision made statutory relief for past years imperative, but by May 29, 1950, the Ways and Means Committee had nearly completed its draft of the 1950 act and lacked an adequate opportunity to consider the matter. The matter was called to the attention of the Senate Finance Committee and an attempt to give partial relief was made by the committee but the provision as drafted was not broad enough to satisfy the conference committee and therefore the question of relief for past years was left to subsequent legislation. The report of the conference committee made the following statement on this point:

"The conferees were unable to consider the question of taxability for years prior to 1951 of income derived by a college or university from the conduct of a trade or business whether carried on directly by the institution or through a subsidiary. This matter is in litigation and was not in conference. However, it is the view of the conferees that undue hardship will arise if such institutions are required to pay taxes on income which has already been spent to carry out their educational programs; and the conferees express the hope that this matter may be reviewed in subsequent legislation."[4]

[1] Decided June 20, 1951, reversing 14 T. C. 992.
[2] Letter from the Commissioner of Internal Revenue to Medlaw Corp., dated June 22, 1945.
[3] 14 T. C. No. 111 1/2.
[4] P. 35, conference report (Rept No. 3124), 81st Cong., 2d sess.

Section 501 [5] of the pending revenue bill of 1951 was adopted by the House of Representatives in June of this year in conformance with the views of the conference committee in 1950.

On June 20, 1951, after the passage of the House bill, the United States Court of Appeals for the Third Circuit reversed the decision of the Tax Court and held that the C. F. Mueller Co. was exempt from income tax as a corporation organized and operated exclusively for charitable purposes within the meaning of section 101 (6) of the Internal Revenue Code. The need for section 501 of the pending bill has not been ended, however. Without section 501, it is virtually certain that litigation will continue. On May 5, 1951, the United States Court of Appeals for the Fourth Circuit, reversing a district court decision, held that a South Carolina corporation named Community Services, Inc.,[6] was subject to employment tax; and in the course of its opinion indicated clearly its conviction that the decision of the Tax Court in the Mueller case was correct. In view of the clash of opinion between the third and fourth circuits,[7] it is clearly predictable that the Attorney General will apply for certiorari and ask the United States Supreme Court to review the decision of the court of appeals in the Mueller case. In view of the conflict of opinion between the Courts of Appeals for the Third and Fourth Circuits, it is practically certain that the Government's anticipated application for certiorari in the Mueller case will be granted by the Supreme Court.[8]

The purpose of section 501 of the House bill is to set at rest the question of possible tax liability for years prior to 1951. Colleges and universities still need the relief provided by the House bill for several reasons. First of all, educational institutions are facing an immediate financial crisis because of the mobilization program. The need for relief is now; 1 or 2 years from now may be too late. The colleges and universities have either spent the income involved or have made commitments in reliance on it. Delay itself involves hardship. Secondly, even if the Mueller case is ultimately won by the taxpayer in the Supreme Court, other litigation will follow. Not all fact patterns are exactly like the one involved in the Mueller case. Other colleges and universities with business income, for example, Amherst, Baylor, Emory, Loyola of New Orleans, and the University of Georgia, may have to submit to the expense and risk of further litigation.

Without express legislative relief, a considerable number of colleges and universities affected by this question will continue in financial jeopardy and uncertainty until all possible threats of litigation are ended. This period of doubt and uncertainty will continue until the statute of limitations has run unless the Congress settles the question once and for all in the manner which the House bill provides. If by any chance, the Supreme Court should decide the Mueller case in favor of the Government, the resulting hardship would be extreme.

Section 501 of the House bill appears clearly to express the intention which the Congress has consistently maintained on the point in controversy. The Committee on Ways and Means of the House in its report on the pending revenue bill explained its reasons for adopting section 501 in the following language:

"In conformance with the views expressed by the House conferees on the Revenue Act of 1950, section 501 of your committee's bill amends section 302 of the Revenue Act of 1950 to provide that for years prior to 1951 exemption is not to be denied feeder corporations if their profits inure to a regularly established school, college, or university.

[5] Section 501 of the pending revenue bill adds a new subsection to Section 302 of the Revenue Act of 1950 which relieved certain charitable organizations carrying on business activities from the threat of income-tax liability for years prior to 1951. It provides that for any taxable year beginning prior to January 1, 1951, an organization which carried on business for profit, all of the earnings of which inured to the benefit of an educational organization which normally maintains a regular faculty and curriculum and has a student body in attendance at the place where its educational activities are carried on shall not be denied exemption on the ground that it was carrying on business for profit.

[6] *United States* v. *Community Services, Inc.* (4th C., May 5, 1951), (not reported). Community Services, Inc., arrived on business activities for the purpose of providing income for local charities. However, its business activities were apparently also carried on for the convenience of the employees of Graniteville Co., a nonexempt business corporation.

[7] The opinion of the Court of Appeals in the Mueller case attempts (in footnote 8) to distinguish the Community Services, decision from the Mueller case. Although there may be a basis for distinguishing the result in the two cases, the language of the two opinions is hardly reconcilable.

[8] That this is the Government's intention is manifest from the position which it took in opposing the taxpayers' petition for certiorari in *Universal Oil Products Company* v. *Campbell* (181 F. (2d) 451 (Seventh Circuit 1950), cert. denied, 340 U. S. 850). In its memorandum opposing certiorari in the Universal Oil case the Government denied that there was a conflict between that case and other decided cases and opposed certiorari unless the Supreme Court should be willing to resolve the general question of whether a charitable organization engaging in business activities thereby forfeited exemption. The memorandum stated that the "court may wish to await a case which squarely presents the questions such as *C. F. Mueller Company* v. *Commissioner* (14 T. C. 111 1/2), decided May 25, 1950, pending an appeal in the Court of Appeals for the Third Circuit" (p. 9, Government's Memorandum).

"This provision is expected to have no permanent effect on revenues." [9]

The unrelated business income of colleges and universities is clearly taxable for 1951 and future years under the provisions of the Revenue Act of 1950. Section 501 of the House bill is not in any way inconsistent with this policy. Its effect is confined solely to years prior to 1951 and it is in complete conformity with the views expressed by the conference committee in 1950 in which views the Senate conferees concurred.

The adoption of section 501 of the House bill by the Committee on Finance and by the Senate would bring this matter to a final and equitable conclusion.

MORRIS, KIXMILLER & BAAR,
Washington 5, D. C., July 23, 1951.

Hon. WALTER F. GEORGE,
Chairman, Committee on Finance,
United States Senate, Washington 25, D. C.

SIR: This is a request that the Senate Committee on Finance add to the revenue bill of 1951 a new section relating to the inclusion of insurance proceeds in the gross estate subject to the Federal estate tax.

DISCOVERY OF NEED FOR LEGISLATION

The need for the proposed new section has been discovered in the course of representation before the Treasury Department of the Federal estate tax case of the estate of a decedent who died in May 1941. One of the questions at issue is the includability in the gross estate of the proceeds of life-insurance policies which were irrevocably assigned by the decedent to a trust several years before his death. There is no apparent reason in the circumstances of this case for including the proceeds in the gross estate unless the decedent had a reversionary interest in the policies. It is believed that under the applicable State law, the decedent did not have a reversionary interest in the policies. Nevertheless, since there are so frequent differences of opinion as to whether a decedent has a reversionary interest in property given in trust to others,. since our decedent's reversionary interest, if any, was worth much less than 1 percent of the value of the policies, and since the application to a situation such as this of the 5-percent rule contained in section 503 (a) of the Revenue Act of 1950 should automatically exclude the proceeds of the decedent's policies from his gross estate, we wish to point out the reasons why, in this kind of case, the enactment of the proposed new section would give relief from an inequitable situation and be consistent with the legislative intent which produced section 503 (a) of the 1950 act.

The present legal anomaly and the need for legislative relief are explained in detail below.

TREASURY POLICY CULMINATING IN THE SPIEGEL'S ESTATE DECISION

Section 811 (g), Internal Revenue Code, prior to its amendment by section 404 (a) of the Revenue Act of 1942, provided that there should be included in the estate, subject to the Federal estate tax, the proceeds of life insurance "to the extent of the excess over $40,000 of the amount receivable by all other [other than the executor] beneficiaries as insurance under policies taken out by the decedent upon his own life." This section was amended by section 404 (a) of the 1942 act to include in the estate the proceeds of life insurance.

"To the extent of the amount receivable by all other [other than the executor] beneficiaries as insurance under policies upon the life of the decedent (A) purchased with premiums, or other consideration, paid directly or indirectly by the decedent, in proportion that the amount so paid by the decedent bears to the total premiums paid for the insurance * * *."

Section 404 (c) of the Revenue Act of 1942 provided that the amendment to section 811 (g), I. R. C., made by section 404 (a) of the 1942 act should be applicable only to estates of decedents dying after the date of enactment of the 1942 act (October 21, 1942), but that "in determining the proportion of the premiums or other consideration paid directly or indirectly by the decedent (but not the total premiums paid) the amount so paid by the decedent on or before January 10, 1941, shall be excluded if at no time after such date the decedent possessed an incident of ownership in the policy."

[9] P. 36, H. Rept. 586, 82d Cong., 1st sess.

Until the Revenue Act of 1950 was passed to modify the Treasury Department practice in one respect, it had been the Treasury policy in those cases where, in its opinion, the decedent's estate held a possibility of reverter in the insurance proceeds to include the proceeds (to the extent of the excess over $40,000 where the decedent died on or before October 21, 1942, and to the full extent where the decedent died after October 21, 1942) in the estate. This was on the evident theory that, where the decedent died on or before October 21, 1942, the insurance proceeds were receivable "under policies taken out by the decedent upon his own life" within the meaning of section 811 (g), I. R. C., prior to its amendment by section 404 (a) of the 1942 act effective in the case of decedents dying after October 21, 1942; and that, where the decedent died after October 21, 1942, the possession of a right of reverter was "an incident of ownership in the policy" within the meaning of section 404 (c) of the Revenue Act of 1942 effective in the case of decedents dying after October 21, 1942.

The United States Supreme Court supported this Treasury policy, at least so far as it rested upon the theory that the right of reverter was an incident of ownership in the policy, in *Spiegel's Estate* v. *Commissioner* (335 U. S. 701, 93 L. ed. 330). The question in that case did not involve the proceeds of a life insurance policy but rather the includibility in the estate of a decedent of the corpus of a trust where, in the Court's opinion, the decedent had retained a possibility of reverter by operation of law. Nevertheless, the rationale of the decision (which treats death as the event which makes the transfer effective in possession or enjoyment within the meaning of sec. 811 (c), I. R. C., because by operation of law the trust property might conceivably revert to the decedent) justified the Treasury Department in holding that the decedent retained an incident of ownership in a policy where, by operation of a State law, the proceeds might possibly be payable to his estate.

LEGISLATIVE RELIEF FROM HARDSHIP OF SPIEGEL'S ESTATE RULE AS APPLIED BOTH TO TRANSFERS AND INSURANCE

In order to relieve the hardship caused by the Spiegel's Estate decision, Congress made two related changes in the estate tax provisions of the Internal Revenue Code. The first of these changes was made by section 7 (a) of the Technical Changes Act of 1949, Public Law 378, Eighty-first Congress, first session. A portion of this section provided in effect that property which would be includible in the estate as a transfer intended to take effect in possession or enjoyment at or after death only because the decedent had a reversionary interest in the property, should not be thus taxed unless the value of the reversionary interest immediately before death exceeded 5 percent of the value of such property. Subsection (b) of section 7 of the same Technical Changes Act of 1949 made subsection (a) applicable to estates of decedents dying after February 10, 1939 (the date of enactment of the Internal Revenue Code).

This provision was not in the House bill but was included at the instance of the Senate Finance Committee. The Senate committee in its report (Rept. No. 831, 81st Cong., 1st sess., pp. 8, 9) in the first draft of this amendment (somewhat different from the form in which it was adopted) discussed the severity of the decision in the Spiegel's Estate case and quoted from a dissenting opinion in that case which pointed out that under the facts of that case, the value to a decedent just prior to death of a reverter in a $1,000,000 trust fund would be about $70. Subsequently, the bill was amended in conference to take the form in which it was passed.

The second change to overcome the effect of the Spiegel's Estate decision dealt with insurance and was contained in section 503 (a) of the Revenue Act of 1950. This section amended section 404 (c) of the Revenue Act of 1942 to provide, effective as to estates of decedents dying after October 21, 1942, that, for the purpose of that sentence in section 404 (c) of the Revenue Act of 1942 which, in determining the proportion of premiums paid by the decedent, excludes premiums paid by the decedent on or before January 10, 1941, if at no time after such date the decedent possessed an incident of ownership in the policy, "the term 'incident of ownership' includes a reversionary interest only if (1) at some time after January 10, 1941, the value of such reversionary interest exceeded 5 percent of the value of the policy, and (2) the reversionary interest arose by the express terms of the policy or other instrument and not by operation of law." One of the main purposes of this amendment was to give the same kind of relief from the Spiegel's Estate rule in the case of reversionary interests in insurance proceeds that had been given by section 7 (a) of the Technical Changes Act of 1949 in the case of transfers which might otherwise be deemed effective in possession or enjoyment

at or after death. This amendment by the Revenue Act of 1950, like that by the Technical Changes Act of 1949, was brought about by the Senate Finance Committee (Rept. No. 2375, 81st Cong., 2d sess., pp. 130, 131).

FAILURE TO GIVE RELIEF IN CASE OF REVERSIONARY INTERESTS IN INSURANCE POSSESSED BY DECEDENTS DYING ON OR BEFORE OCTOBER 21, 1942

This change in the treatment of insurance proceeds, however, unlike the amendment made applicable to reversionary interests in transferred property other than insurance, was by section 503 (a) of the Revenue Act of 1950 made effective only with respect to estates of decedents dying after October 21, 1942. This was the date of passage of the Revenue Act of 1942 which contained section 404 referred to hereinbefore.

There does not seem to be any explanation in the legislative history, either of the Revenue Act of 1942, or of the Revenue Act of 1950, as to why section 503 (a) of the Revenue Act of 1950 was made effective at a later date than section 7 (a) of the Technical Changes Act of 1949. The application of the Spiegel's Estate rule to insurance in which the decedent has no interest except a possibility of reverter worth not more than 5 percent of the value of the policy, is just as inequitable as it is applied to property transfers where the decedent has no interest except the possibility of reverter worth not more than 5 percent of the value of such property.

The explanation for the difference in the effective date of the two similar provisions may well be purely mechanical. Section 503 (a) of the Revenue Act of 1950 was a limitation on section 404 (c) of the Revenue Act of 1942. Section 404 (c) contained the provision that the premiums paid by the decedent on or before January 10, 1941, should be excluded under certain conditions in determining the proportion of premiums paid by the decedent. This proportion was, by section 404 (a) of the 1942 act which became applicable only to estates of decedents dying after October 21, 1942 (the date of its enactment), made one of the principal criteria of taxability. Thus, the remedial provisions of section 503 (a) of the 1950 act were tied to a formula which, so far as expressly provided by statute, was first applied to estates of decedents dying after October 21, 1942, and it would seem logical, upon first examination, that the remedial provisions should also be applicable only to estates of decedents dying after October 21, 1942.

The objection to this explanation as a logical basis for not making section 503 (a) of the 1950 act applicable to estates of decedents dying on or before October 21, 1942, lies in the Treasury Department policy. This policy is to apply, where the decedent died between January 10, 1941, and October 21, 1942, the same proportion-of-premium-payment test that it applies where the decedent died after October 21, 1942, with this difference: If the decedent had a reversionary interest after January 10, 1941, the Treasury Department includes the proceeds in the estate, however small the value of the reversionary interest (Regulations 105, sec. 81.27 (c)), whereas, if the decedent died after October 21, 1942, it does not tax the proceeds unless the reversionary interest is worth more than 5 percent of the value of the policy (sec. 503 (a) of the 1950 act). This policy is also apparently to include the insurance proceeds in the estate where the decedent died before January 10, 1941, if the decedent paid the premiums and at death had a reversionary interest, however small its value (Regulations 105, sec. 81.27 (c)). Thus, where the decedent died on or before October 21, 1942, and paid the premiums, the Treasury policy includes the proceeds in the estate if at death, or if at any time after January 10, 1941 (in case the decedent died thereafter), the decedent had a reversionary interest regardless of the smallness of its value. In such a case, the same inequity exists that was remedied by section 503 (a) of the 1950 act for the estates of decedents dying after Otcober 21, 1942.

THE SUGGESTED REMEDY

It appears equitable, therefore, to grant to the estates of decedents dying on or before October 21, 1942, at least to the estates of those dying after February 10, 1939 (as in the case of sec. 7 of the Technical Changes Act of 1949 which amended sec. 811 (c), I. R. C.), the same relief that was provided by section 503 (a) of the 1950 act for the estates of those dying after October 21, 1942. It is accordingly urged that a new section be added to the revenue bill of 1951 (H. R. 4473). The only substantial difference between this proposed addition and section 404 (c) of the 1942 act as amended by section 503 (a) of the 1950 act, and section 503 (b) of the 1950 act, lies in the effective dates; the proposed new section is applicable

to the estates of decedents dying after February 10, 1939, and before October 22, 1942, whereas section 404 (c) of the 1942 act, as amended, is applicable to estates of decedents dying after October 21, 1942. The italicized portion of the addition set out below, except for the effective dates, is similar to section 404 of the 1942 act, as amended, but chiefly because of the statutory formula in section 404, as explained hereinbefore (first paragraph on p. 5), the verbal mechanism is necessarily different. The remaining, nonitalicized part of the addition, however, is identical with the corresponding part of section 503 of the 1950 act. The proposed new section is as follows:

"(*a*) *Effective with respect to estates of decedents dying after February 10, 1939, and before October 22, 1942, the proceeds of life insurance receivable by beneficiaries other than the executor shall not be included in the gross estate of a decedent under the provisions of section 811 (g) applicable in the case of such decedent solely by virtue of a reversionary interest possessed by him unless* (1) at some time after January 10, 1941, *or, in the case of a decedent dying no or before such date, at the time of his death,* the value of such reversionary interest exceeded 5 per centum of the value of the policy, and (2) the reversionary interest arose by the express terms of the policy or other instrument and not by operation of law. As used in this section, the term 'reversionary interest' includes a possibility that the policy, or the proceeds of the policy, (A) may return to the decedent or his estate, or (B) may be subject to a power of disposition by him. The value of a reversionary interest at any time shall be determined (without regard to the fact of the decedent's death) by usual methods of valuation, including the use of tables of mortality and actuarial principles, pursuant to regulations prescribed by the Secretary. In determining the value of a possibility that the policy or proceeds thereof may be subject to a power of disposition by the decedent, such possibility shall be valued as if it were a possibility that such policy or proceeds may return to the decedent or his estate.

"(b) No interest shall be allowed or paid on any overpayment resulting from the application of subsection (a) with respect to any payment made prior to the enactment of this Act."

It is requested that this letter be made a part of the record of hearings before the Senate Committee on Finance and that the undersigned be given a chance to testify on the subject matter of this letter.

Sincerely,

Allen H. Gardner.

National Association of Concert Managers,
White Plains, N. Y., July 18, 1951.

Hon. Walter George,
Chairman, Senate Finance Committee,
Senate Office Building, Washington, D. C.

Dear Sir: In connection with H. R. 2524 and pursuant to resolution adopted at the semiannual meeting of our directors on last June 4, I have been directed to advise you of our approval of the proposed exemptions from admissions taxes as described in the Congressional Record of May 17 with the exception that the nonprofit concert associations referred to shall be revised and defined as "being resident within the community, of local origin and purpose, with autonomy and control resting with the local organization's officers and, more specifically, that the organization not be affiliated with groups, movements or chains in other cities or States."

From the standpoint of independent local concert managers this is an extremely important stipulation and we hope you will qualify these admissions tax exemptions accordingly when they are put in final form.

Yours sincerely,

Julian Olney, *Secretary.*

Motion Picture Theater Owners of New York State, Inc.,
Buffalo, N. Y., July 17, 1951.

To the Members of United States Senate Finance Committee,
Senate Office Building, Washington, D. C.

Honorable Gentlemen: At a general membership meeting of the Motio Picture Theater Owners of New York State, Inc., representing 400 theaters in western New York, it was—

Resolved: That 1701-A of H. R. 4473, which seeks to exempt nonprofit organizations from the 20 percent admissions tax be opposed by this organization as an

unfair exemption which will tend to create unfair competition to legitimate businesses, which are subject to this tax; and that the Senate Finance Committee be informed of this action and be requested to delete this section from the proposed law.

We most earnestly solicit your close attention to this matter, since it covers a matter of vital importance to all motion picture operators in these United States.

Very truly yours,

GEORGE J. GAMMEL, *President.*

ELEANOR SHOPS, INC.,
New York 18, N. Y., July 18, 1951.

HON. WALTER F. GEORGE,
Chairman, Finance Committee of the Senate,
Senate Office Building, Washington, D. C.

DEAR SIR: We address this communication to you in reference to section 123 of the House bill, H. R. 4473, now pending before the Senate Finance Committee. We respectfully urge that the enactment of this section treating of "Surtax exemptions and certain credits of related corporations" would be detrimental to our economy, discriminatory among taxpayers and inadvisable on considerations of public policy. Our criticism of this proposed legislation is based upon the following reasons:

1. The operation of business via a corporate structure consisting of parent and subsidiaries constitutes a well recognized and customary form of doing business. This method has its origin prior to the existence of tax considerations resulting in any particular form of doing business. Accordingly, it cannot be contended that the parent and subsidiary relationship represents an artificial structure created for tax purposes. There are many business reasons why separate corporations are formed in the very locality in which such corporation carries on its operations. For instance, as an aid in the development of good will, or in facilitating the obtaining of credit, or for operational purposes, a separate corporation must often be formed in the State in which it operates. There is no reason for the retroactive penalization of such related corporations which have been formed for good business reasons.

2. The purpose behind the granting of a surtax exemption and the minimum excess profits tax credit was to confer tax advantages on small business. The proposed legislation while intending to further this purpose, actually does not accomplish it. In corporations like ourselves, each separate corporation operates on its own as a small business. Thus, in each locality it competes with other small businesses with all conditions being equal. If one small business were to be granted a tax advantage as against our own affiliate, it would discriminate against our separate corporation carrying on its own small business operation.

3. Big businesses, such as United States Steel, have their own big business subsidiaries with excess profits tax credits greatly exceeding the minimum credit of $25,000. Consequently, such businesses would not be affected by the limitation imposed by section 123, allocating a single minimum credit of $25,000 for an entire group. This limitation would affect only the small business subsidiaries whose earnings during the base period years were not in excess of $25,000.

4. Section 123 would effectuate a consolidation for purposes of exemptions and credits without granting any of the advantages of consolidation, such as elimination of intercompany profits.

5. In the committee's report on the proposed House bill, it is stated that at least 70 percent of all the corporations have incomes less than $25,000. And the committee proposed that "Since corporations with incomes of $25,000 or less are not subject to the surtax, their rate is increased from 25 to 30 percent." If the surtax exemptions and the minimum credits are eliminated, additional revenue may be obtained but only at the sacrifice of equitable treatment that should be accorded to smaller profitable corporations.

6. Section 123 would only affect related corporations. However, a corporation and a proprietorship owned by the same person would escape the effects of section 123. Accordingly, wherever two corporations are owned by the same people, one corporation will be liquidated and run as an unincorporated business. This legislation would necessitate the creation by alert management of artificial forms of doing business so as to avoid coming within its purview. Sections 45 and 129

of the Internal Revenue Code are of sufficient breadth to avoid any subterfuges that may be employed by related corporations in order to avoid tax.

7. A parent may avoid the application of section 123 by having its employees exercise stock options from its subsidiaries to the extent of 6 percent of the subsidiaries' stock. The stock is ordinarily so fettered with restrictions that the net effect of such purchase by the employees is to leave the parent in the same position as prior to such purchase but outside the confines of section 123. Even if 6 percent of the stock is held unrestrictedly by employees, it is difficult to see what effect 6-percent ownership has for tax purposes. This point must also be considered in relation to the favorable treatment granted stock options under the 1950 act.

8. Section 123 would foster unreal stock issues. For instance, where common stock is the only stock outstanding, preferred stock may be issued as a tax-free dividend in such manner that the preferred has the entire corporate value. With common stock being the only voting stock outsiders can be given a sufficient number of voting common to avoid the application of section 123 even though the common to such outsiders may have a zero value and zero effective vote.

9. Under section 123 there may be many corporations affiliated because of voting stock ownership. However, each corporation might have different and unrelated preferred stockholders whose ownership might constitute most of the equity in the corporation. It would be unfair to these preferred-stock holders to subject the profits relating to their shares to greater taxation than similarly situated corporations who do not happen to be affiliates.

10. Many so-called big businesses operate effectively through separate corporations without any actual ownership of such corporations. For example, Coca-Cola Co. operates through many corporations which are nothing more than franchise holders for Coca-Cola Bottling. Naturally, Coca-Cola could always "pull the string" on these franchises and therefore remains fully in control of these corporations. The fact that ownership is in different people does not detract from the extent of big business control. There is no reason to allow this type of control to exist and yet penalize the same sort of control where there happens to be ownership too.

11. Administratively, section 123 will be difficult to carry out. Where groups of two or more corporations are involved, five individuals must own proportionately the same voting power in each corporation to the extent of 95 percent of the voting power. However, the porportion may be computed by increasing voting power in one of the corporations by 10 percent and decreasing voting power in the other corporation by not more than 10 percent. Obviously, if one adds the problems relating to direct and indirect ownership, the lay public as well as the administrative body will be hard put to determine whether section 123 applies to any particular situation.

As is evident from the above—

(*a*) The creation of related companies is an historically accepted method of doing business, and sections 45 and 129 of the present law are adequate to prevent tax advantages being accorded artificial relationships established for tax purposes.

(*b*) Section 123 consolidates affiliated companies without requiring computations of income based on the principles of consolidated returns.

(*c*) Small business, under section 123, would be discriminated against as contrasted with big business, assuming all factors are the same except size.

(*d*) "Innocent" common- and preferred-stock holders of one corporation would be penalized by section 123 due to ownership by other stockholders of stock in other corporations.

(*e*) Section 123 offers so many opportunities to avoid its application by transactions having no other effect or purpose than such avoidance, its enactment would be advisable.

(*f*) The difficulty to the lay public technicians and the administrative body, of understanding and applying section 123 far outweigh the possible plugging of an alleged loophole in the tax law.

Accordingly, we respectfully urge that our analysis of section 123 impels the conclusion that it should be omitted from the proposed legislation.

Very truly yours,

ELEANOR SHOPS, INC.,
by S. J. ROSENTHAL, *President.*

STATEMENT OF GEORGE H. FRATES, WASHINGTON REPRESENTATIVE, NATIONAL ASSOCIATION OF RETAIL DRUGGISTS, WITH REFERENCE TO A PROPOSED EXCISE TAX ON ALL SHAMPOOS

Mr. Chairman, gentlemen of the Senate Finance Committee, my name is George H. Frates. I am the Washington representative of the National Association of Retail Druggists located at 1163 National Press Building, Washington, D. C. Our organization represents a membership of 35,000 independent retail druggists practicing their profession in every State of the Union and the District of Columbia.

When Secretary Snyder appeared before this committee February 5, 1951, he advocated an extension of the 20 percent tax on toiletries to include all shampoos. The Miscellaneous Tax Division of Internal Revenue ruled that all shampoos containing 5 percent or less of saponaceous matter were taxable at the rate of 20 percent of the retail price. Those containing over 5 percent saponaceous matter were declared to be tax-exempt. Later, the Department rescinded this ruling and declared that all shampoos, regardless of their saponaceous content, were subject to the tax if they were recommended as a hair tonic, dressing, or for waving, bleaching, dyeing, tinting or otherwise imparting an artificial appearance to the hair. Thus, it will be noted that the way in which a shampoo was advertised would determine whether it was subject to the 20 percent sales tax or not. We use the term "sales tax" advisedly.

The independent retail druggists of the Nation are cognizant of the emergency through which we are traveling and they realize that as patriotic American citizens it is their privilege, as well as their duty, to render an all-out accounting to our Government in order that freemen and free enterprise might endure side by side. As a result they gratuitously collect excise taxes for Government—and this is no easy job for a small independent retailer.

In our American way of life, cleanliness is not considered a luxury. Witness the millions of dollars spent by Government during the last war to equip our armed personnel with toiletries which had become necessary requisites in America's everyday process of living.

Mr. Snyder has stated that if all shampoos are taxed at the 20-percent rate, $3 million more estimated revenue will accrue to the Treasury. We contend that this $3 million will be assessed against those in the lower-income brackets, embracing veterans' and GI's wives, housewives, saleswomen, and other women who are employed. To penalize women an extra 20 percent for products used for cleanliness and a well-goomed appearance is a regressive tax similar to that imposed upon a woman when she buys a $10 purse and must pay a $2 excise tax, which represents 16⅔ of the total purchase price. One cannot in fairness blame the purse industry for high prices. Likewise, a woman cannot blame the shampoo manufacturer for high prices if the Congress imposes a tax on all shampoos. Shampoos, to a woman, are as necessary as shave cream is to a man. Cleanliness has long been the first law of good grooming. Before soap was invented and running water was available, the ancients used milk, water, and even wines for cleansing purposes. Surely it should not be the intent of Congress to tax cleanliness. The fact that Uncle Sam needs the money, as we all know, does not warrant sex or class discrimination.

The very emergency for which we are being taxed affords ample proof that "toilet necessities" is not a misnomer. During the last World War it is a matter of record that in all war industries employing women there was a direct relationship between grooming and war production. It was good business to provide free hand lotions and protective creams to women workers. Many war factories increased their output by installing beauty salons. Our War Production Board, after carefully weighing the effect of the use of toiletries on morale and production, allocated scarce materials to the toilet-goods industry. They rightly conclude that toiletries are as necessary a wartime economy as many other essentials of life.

We think that if the committee will realize that a 20 percent Federal tax is still collected on baby creams, baby oil, baby powder, and foot powder, it would seriously consider the effect of an across-the-board tax on all shampoos. Maybe the Congress could capture the estimated $3 million additional revenue on shampoos by considering a tax on polo ponies, yachts, and men's neckties.

Only quantity production has held the price on shampoos at present levels. We do not believe it is equitable to tax products used almost exclusively by women which are essential to their appearance and personal care.

Eric Johnston, Administrator of the Economic Stabilization Agency, appeared before your committee February 15, 1950, in the capacity of president of the

Motion Picture Association of America and said: "I never heard it argued, that a man shouldn't object to being unfairly treated until he can supply a substitute victim whose sufferings will be more justified." The National Association of Retail Druggists feels the same way in regard to Mr. Snyder's proposal to tax the women as Mr. Eric Johnston did when he issued the above statement.

A list of taxable and nontaxable shampoos compiled by the National Association of Retail Druggists and informally discussed with representatives of the Bureau of Internal Revenue is filed for the information of the Senate Finance Committee.

[Telegram]

FITCHBURG, MASS., *July 5, 1951.*

Hon. HENRY CABOT LODGE, Jr.,
Senate Office Building, Washington, D. C.

In reference continuation 1948 Sugar Act: We will appreciate your giving consideration to a reduction in requirement of 6 percent nonsugar solids in fancy Barbados molasses. Americans should have privilege buying top quality; does not make sense to degrade quality, making us laughingstock of entire Barbados industry.

C. A. CROSS CO., INC.

THE AUTHORS LEAGUE OF AMERICA, INC.,
New York 16, N. Y., July 23, 1951.

To the SENATE FINANCE COMMITTEE,
Senate Office Building, Washington, D. C.:

The Authors League of America, Inc., is a corporation incorporated under and by virtue of the laws of the State of New York, comprising some 7,000 members all engaged in various forms of writing. We have been in existence some 25 years for the purpose of helping in whatever way possible, writers in every medium and are fully conversant with all of their problems. We are deeply concerned over the provision of title 2 of the Revenue Act of 1951, particularly sections 1220 and 1221 relating to the withholding of tax at the source on royalties.

The afore-mentioned sections of the proposed act would greatly confuse the already difficult financial lot of the individual author. The average author in the United States earns less than $3,000 a year from a number of separate sources, such as magazines, book publishers and reprint houses, newspapers, theatrical producers. The amount of his earnings varies greatly from year to year and in most cases, the author lives from day to day on the income received from his last work.

As we understand it, sections 1220 and 1221 of the Revenue Act of 1951 require every publisher of books, magazines, newspapers, or similar literature to withhold from payments made to writers an amount equal to 20 percent of the total royalties paid. We feel that the afore-mentioned section of the proposed act would work an unnecessary hardship upon the individual author with no corresponding benefit to the United States Treasury Department for the following reasons:

1. Even at the high tax rates prevailing today, the over-all tax paid by the average author is far less than 20 percent of his gross royalties. This is so for the reason that he has many business expenses including commissions paid to agents, research, travel, and usual office expenses to deduct before arriving at his taxable income, so that his net income in many cases is less than 50 percent of his gross income. In order for his over-all tax to be 20 percent of his gross, his net income would have to be taxable at rates at least averaging 40 percent. There are few, if any authors, whose income is such as to warrant the imposition of such a high tax rate.

2. The withholding of the tax before payment of the income to the author puts him in the position of paying this exorbitant rate on his gross income out of which he must also pay the expenses referred to in item 1 and of having to wait for a year or more before receiving a refund to which he would be entitled by reason of the withholding and which he needs to live. This is grossly unfair to the author since it places him in a position of having to live on approximately one-quarter of his income at a time when he can ill afford to do so.

3. If the tax is withheld at the source, the author who receives his income from many different sources, as is the usual situation, is placed in the position of being dependent upon the many publishers with whom he deals for an accurate record of the payments made on his behalf. Let us take, for example, the case of a dramatist whose work has been produced on the Broadway stage and has completed its run thereon. Assuming that the play has not been unsuccessful in its

first-run performances and is susceptible of reproduction by "second-class" producers, the dramatist might very well receive income from the following distinct sources:

1. Touring companies.
2. Summer stock companies of which there might be as many as from 10 to 60 separate companies.
3. Amateur productions, of which there might be from 10 to 250 in a season, each company paying the dramatist separately sums as little as $35.
4. In the event of a musical—income might be received from a music publisher.
5. Simultaneously with all the above, the dramatist might be receiving an income from a book publisher who has published the play.
6. There might also be additional separate income from a radio and/or television program.

By reason of the fact that an author's income is derived from so many separate and distinct sources, the bookkeeping processes involved in the computation of withholding the tax will become onerous for both the withholding agent and the author.

The Treasury Department has an adequate check on the income of authors simply by an examination of the record of any publisher in the United States. The effect of requiring a withholding by the publisher, is very likely to prove detrimental by creating extensive confusion as to amount of royalties received and taxes paid on behalf of the many authors in the United States without a corresponding benefit to the Treasury Department. This is in addition to the added expense which will be incurred by the publishers and the authors in keeping track of the amounts involved in this withholding process.

For the afore-mentioned reasons we respectfully submit that there is no evidence to justify the enactment of these provisions.

Respectfully,

OSCAR HAMMERSTEIN 2d, *President.*

AMERICAN BAR ASSOCIATION,
Baltimore 2, Md., July 23, 1951.

Senator WALTER F. GEORGE,
Senate Office Building,, Washington 25, D. C.

DEAR SENATOR GEORGE: I thought that the Finance Committee of the Senate would be interested to know that the excess profits tax committee of the section of taxation of the American Bar Association is studying the relief provisions of the excess profits tax law in an attempt to bring to light any inequities and also to examine into the practical workability of the relief sections.

The provisions are, of course, both complex and novel. No doubt experience will develop those circumstances which will require remedial legislation but in the light of this background it will be some length of time before our committee will be in a position to make constructive recommendations and channel them for approval in accordance with the established procedures of the American Bar Association.

Under the circumstances, the section of taxation is not requesting the opportunity for its representatives to appear before the Finance Committee during its current sessions.

With kindest regards, I am

Yours very sincerely,

MORTON P. FISHER, *Chairman.*

CLEVELAND, *July 20, 1951*

Senator WALTER F. GEORGE,
Chairman, Senate Finance Committee,
Washington, D. C.

DEAR SENATOR: I want to thank you for the opportunity to testify before your committee, Monday, July 9, 1951.

In view of the fact that the time which was available was so limited that I did not have the opportunity to present but the barest outline of two points, I believe that a more detailed statement of what we believe the issues involved in the present tax bill will be helpful to you as outlining the position taken by most small business corporations.

The House proposal of a straight five-point increase on all corporations bears most heavily on smaller corporations, since their tax would be increased by 20 percent on the first $25,000, while corporations earning more than $25,000 would be subject to an increase of only 6 to 10 percent.

We believe that small corporations should be entitled to a credit of at least $1,000 upon any additional tax. And we believe that you should either lower the point increase on the first $25,000 of net taxable income or apply a uniform percentage increase on the dollar amount of taxes accruing under the present act, as the House has done with the personal income tax. Such a uniform percentage increase on the present dollar amount of taxes could actually result in obtaining a larger amount of tax revenue.

The second point which I briefly presented involved the insertion in the present act of a provision granting excess-profits relief for those corporations who do not have adequate earnings in the base period year, and for whom no adequate relief is granted by any of the relief formulas in the present act. Smaller Business of America, Inc., has just passed a formal resolution on this point, which I enclose herewith.

Indeed, I have not only discussed this matter with scores of corporation officers, accountants, and attorneys, but have discussed it with several members of the Internal Revenue Department. All agree that the present excess-profits-tax law is a mess, and that inequity is piled on top of inequity by the refusal of the administration to present adequate excess-profits-tax relief provisions.

The excess-profits tax is based upon the theory that in a period in which defense or war preparations constitute a substantial part of the economy, it is proper to tax earnings in excess of 85 percent of the normal base period earnings at a high figure. That raises the question: What are normal base earnings?

For most large corporations they are the three best years out of four highly successful years. A more or less casual examination of Moddy's manual, or any other manual giving the earnings of corporations for the year 1946 through 1949 and 1950, will reveal that many large corporations had unusual earning years, the best earning years of their entire history. But for most corporations, especially for most small corporations, much less favorable earnings prevailed.

As relates to excess-profits taxation, most small corporations fall into six classes:

(1) Corporations which had operating losses during the base-period years.

(2) Companies organized some years prior to 1946, but which had not attained sufficient growth to earn substantial profits during the base-period years, and are just now attaining that profit, or will attain it in 1952 or 1953.

(3) Companies which organized after the start of the base period.

(4) Companies organized after January 1, 1950.

(5) The great majority of small corporations which do not have sufficient invested capital to afford them any relief on the invested capital basis.

(6) Those few corporations which have satisfactory base-period earnings.

For example, the R company is a corporation which has been in existence for some 30 years. It has done some outstanding work and has had many good earning years. But in the years 1946, 1947, 1948, and 1949, it had very substantial operating losses, largely because it retained its organization in a declining market. It made a profit of perhaps $65,000 in the year 1950. In the year 1951 its profit will be substantially greater. Nor does it obtain anything but nominal relief on the invested capital basis, since its invested capital base would be only some $31,000.

The J company is a corporation which was organized in 1945. It acts as distributor and jobber, and renders services in an important phase of the automotive industry. In its first full year of business, 1946, it had a small net loss. During 1946 it was found necessary to increase its invested capital to slightly over $75,000, in addition to borrowing $30,000 to construct a new building. In 1947 it had a profit of $8,000. In 1948 it had a net profit of $10,000. In 1949 it encountered some difficulties and unusual expenses, which reduced its profit to less than $2,000. In 1950 it had an operating profit of nearly $26,000, and in 1951 its profit should exceed $50,000. Its increase in 1950 and 1951 is solely due to the fact that it has now become established in the industry and is reaping the normal results of a great deal of hard work, much of which was contributed by the management, intensive advertising and sales effort, backed up by good personal management at the local level. None of its increase in 1950 and 1951 is due in any respect to the defense effort. The J company is a perfect illustration of the many companies which were organized slightly before the base period, who have gone through the normal growth period during which companies do

not make large profits, and who are just now attaining, in 1951 and succeeding years, a profit position, for which they are given no relief whatsoever by the present Excess Profits Act.

A third example is Corporation S, which was organized in 1947. It manufactured and marketed an unusual and new product which has proved of increasing value to many industries. It has, incidentally, just completed the development of a product for the Army which has proved of tremendous value to the Army engineers. It made a small profit during its first year, all of which had to be plowed back into the business. It made a little larger profit in 1948, but still less than $25,000. Again, all of the profits had to be plowed back into the development of the business, together with new money from the stockholders. In 1949 it had a profitable year. Its profits in 1951 and 1952 will probably be no greater than its profits in 1949. If they were allowed to use the 1949 profits as the base, it would probably not have any complaint, but the present act would force it to include its starting year, 1947, and its second year, 1948, in the average. Naturally, these would prove inadequate.

Company B was organized after January 1, 1950. It is solely a distributing company and distributes a widely advertised industrial product. It has no base whatsoever, already its profits are already rather substantial.

All of these corporations have invested capital basis which is lower than the $25,000 specific exemption.

For all practical purposes, the formulas in the present tax bill afford no tax relief for new corporations or corporations considered new because organized in the base-period years. Such corporations, if they are small corporations, do not have sufficient invested capital to grant any relief under the present formulas, so that effectively there are no relief provisions for small new corporations, other than the specific exemptions. They grant no relief to any but the exceptional corporation.

The question has undoubtedly occurred to you: Doesn't the $25,000 exemption afford sufficient relief for small corporations? Unfortunately, as you well know, profits are not expressed in cash available either for working capital or for distribution to the stockholders. On the contrary, profits are expressed in terms of investment in new equipment and machinery, in expanded inventory (in these days inventory purchased at far higher prices), in accounts receivable, which grow with increased sales, and in higher costs paid for labor of all kinds. You know that when machinery and equipment wear out and become outmoded, you cannot replace that machinery and equipment in today's market for the price paid for the machinery and equipment replaced. Nor can a corporation do business without inventory. The more the business expands, the more inventory is required. And even if the business is not growing, the higher dollar value of the inventory sucks more and more cash out of the operating capital. So, with accounts receivable. The cheapening of the dollar requires more of an investment of operating capital in accounts receivable.

The statements of many large corporations show large cash balances or large amounts of Government securities and other current assets, together with ample reserves for the payment of taxes. The reserves for depreciation and obsolescence of plant and equipment are usually ample to take care of most of the replacements which are necessary. Not so with the small company. They neither possess large cash balances nor adequate reserves to take care of replacement of plant and equipment or the payment of taxes. In fact, the records of the Internal Revenue Bureau for the Cleveland district show that — percent of small companies reporting are delinquent in the payment of their corporation income tax—some of them so badly delinquent that the taxes cannot be collected.

The committee will readily appreciate, therefore, that for many small companies, with no adequate tax base and no present adequate relief formula, to pay excess-profits taxes at the proposed rate on an income of $50,000 or $100,000 would be utterly impossible, if that company is to continue to grow or even to remain in business. The requirements of machinery and equipment replacements, of additional inventory purchases, of additional funds tied up in accounts receivable and of large increases in labor costs far exceed what is left on net incomes above the $25,000 figure.

But, someone may say, can't they go to the banks and get loans to tide them over? But the banks will not, and, under existing Federal Reserve regulations, cannot loan them funds for operating capital, except, perhaps, on a specific defense order. Nor can such a small company obtain additional equity capital. For, who will invest money in a small company today, when that company has insufficient allowances for reserve and depreciation? Small business is a major channel through which flow individual initiative, new ideas, new enterprise, new services, new profits, which spark the progress of the American industrial machine.

If that channel of small business is allowed to dry up, we shall no longer have any medium for carrying out that independent action which goes in large part to make up American liberty and freedom.

In the drive for more taxes, Senators, keep in mind that it should be, and usually is, the desire of the Congress to build an economy, not to wreck it. It is your wish in framing this tax bill to infuse life into America, not to inject embalming fluid into its economic veins.

There is before you already a formal resolution of Smaller Business of America, Inc., in which it is urged:

(1) That all possible economies, consistent with effective operation of the Government and an adequate preparation for defense, be effected. It goes without saying that it will be destructive of everything which you are trying to accomplish if taxes are increased unnecessarily. On the other hand, smaller business wants to do its full part in meeting the burdens which are necessarily imposed upon us.

(2) All income and profits from so-called nonprofit corporations, which are earned as a result of business operations, exclusive of educational and religious purposes, should be taxed on the same basis and at the same rates as corporations organized for profit.

(3) A provision should be inserted in the present law to require gamblers and racketeers to keep written and detailed records of their incomes, so that they be taxed to the fullest extent.

(4) That, instead of a straight five-point increase from the present 25 percent to a 30 percent return on the first $25,000 of taxable income, an increase be made of 20 percent on the tax dollar, computed on the basis of the present tax, providing that every corporation, after computing its additional 20 percent tax, shall be entitled to reduce such additional tax by $1,000.

We ask, then, that the present tax for corporations be changed to grant relief to small corporations.

We ask that liberal and adequate relief formulas be set up to provide for new corporations and corporations having loss years, formulas such as are contained in the enclosed resolution of Smaller Business of America, Inc.

Lastly, we urge that you resist the request of the administration for such large sums of money, and force the administration to greater economy, in order that we may not only achieve the defense of America, but also maintain the morale of the American people by retaining at least a reasonable part of our high standard of living.

Otherwise, we may not actually be building a wall of defense. We may be undermining it.

Respectfully submitted.

SMALLER BUSINESS OF AMERICA, INC.,
JULES ESHNER, *First Vice President.*

RESOLUTION RE EXCESS-PROFITS TAX

Whereas Congress has enacted an excess-profits tax, the provisions of which are exceedingly rigorous to many smaller corporations; and

Whereas Smaller Business of America, Inc., believes that present inequities should be reduced by liberalized and adequate relief formulas: Therefore, be it

Resolved, That the following relief provisions be added to the Excess Profits Act:

(1) A corporation organized during or subsequent to the base-period years may compute its base-period earnings by taking the best three out of its first six full years of business.

(2) The present growth formula shall be extended to include the year 1951, for corporations organized on or after January 1, 1944.

(3) Corporations organized after January 1, 1950, shall be entitled to an excess-profits-tax exemption of $35,000 for the first 3 years, provided they are not, directly or indirectly, split-ups from existing corporations.

RALPH WEST, *President.*
S. R. CHRISTOPHERSON, *Secretary.*
E. J. KALTENBACK,
JULES ESHNER,
S. S. PARSONS,
WM. JEDLICKA,
WM. FRANZ,
HARRY JACKMAN,
Tax and Legislative Committee.

MEMORANDUM OF KENNETH W. BERGEN, BOSTON, MASS.—EXPLANATION OF A PROPOSED AMENDMENT TO THE 1951 REVENUE BILL, H. R. 4473, IN FORM ATTACHED HERETO

GENERAL BACKGROUND

This memorandum relates to a brief amendment, in form attached hereto, which would add an additional section to H. R. 4473. The proposed additional section would amend the estate-tax law. It deals specifically with the estate tax on trust funds which decedent had created by irrevocable transfers prior to the time when there was any estate-tax law.

PRESENT LAW

Under a law enacted by Congress in 1949, if a decedent at any time created a trust in which he expressly reserved a right to get the property back under certain circumstances, the entire trust fund is included in the estate of the person who transferred the property in trust (often referred to as the "settlor") at his death and is taxed if the actuarial value of the possibility of his getting it back exceeded 5 percent of the value of such property. This is true even though he never did, and his estate never will get the property back. This result also follows even though the trust was absolutely and irrevocably established and completed prior to September 8, 1916, the effective date of the first Federal estate-tax law; in other words, even though the settlor created the trust at a time when there was no Federal estate tax and when there could not have been any incentive toward or intention of avoidance of estate tax, and even though the trust was irrevocably established so that thereafter the settlor was powerless to change its terms.

Constitutional doubts exist as to the power to include such transfers in the estate of a decedent, but the trend of the court decisions would appear to be to uphold such power with the resultant inequity indicated in this memorandum.

Incidentally, under the present state of the law, if the draftsman had been less careful and had neglected to spell out this reversionary interest in the settlor, the result would be different and the trust would not be included, even though by operation of law the same result would have followed.

SCOPE AND EFFECT OF THE PROPOSED LEGISLATION

The effect of the proposed legislation is limited to transfers in trust which were absolutely and irrevocably completed prior to September 8, 1916, when the first Federal estate-tax law became operative. As developed above, under existing law, such trusts are includible in their entirety in the estate of the settlor and are taxed if the instrument expressly reserved and spelled out any possibility of the settlor getting the property back upon some future contingency. If the proposed amendment were adopted, such pre-1916 irrevocable trusts would be excluded from the estate of the settlor unless, of course, prior to his death the remote contingency on which he was to get the property back occurred and the trust had ended. In that event obviously the trust property would be back in his estate for all purposes and would be taxed. The amendment would have no effect on any trusts created after September 8, 1916.

EXAMPLE

In 1900, Mr. Jones transferred property to a trustee under an instrument which provided that the trust should continue until the death of the survivor of Mr. Jones' son and daughter, and further provided that the income should be paid to Mr. Jones if he were living and to his children or his issue if he were not, and on the termination of the trust that the principal should be paid to Mr. Jones if he were then still living, but if he were not that it should be paid to his issue then living. The instrument creating the trust was irrevocable, and after its execution Mr. Jones had no further power to change its terms. In 1949, Mr. Jones died. His son was still living, but his daughter had predeceased him, leaving two young children. The property will continue in trust until the death of the son, the daughter's two children, and the son receiving the income after Mr. Jones' death in his stead, by reason of the original provisions of the instrument. Mr. Jones never did get the property back and it never will come back to his estate. At the time he created the trust in 1900, the chances of his outliving his two children were small. Immediately prior to his death, the actuarial value of this possibility that

he would survive both of his children and get the property back was only 6 percent of the total value of the trust fund itself. Nevertheless, under the existing statute, the entire trust property would be includible in the gross estate of Mr. Jones solely by reason of the existence immediately prior to Mr. Jones' death of this remote possibility that the property might come back to him.

The proposed section which is attached would reverse the law in this limited situation, where trusts had been irrevocably created prior to 1916, and would exclude trust funds from tax in the settlors' estates.

Amend H. R. 4473 by adding an additional section as follows:

SECTION—TRANSFERS PRIOR TO SEPTEMBER 8, 1916

Section 7 (b) of Public Law 378 of the Eighty-first Congress, first session, is hereby amended by striking therefrom the word "sentence" and inserting in lieu thereof "two sentences" and by inserting immediately prior to the last sentence thereof the following sentence: "In the case of a decedent dying after February 10, 1939, section 811 (c) (1) (C) of the Internal Revenue Code shall not apply to a transfer made prior to September 8, 1916."

C. B. RAGLAND CO.
Nashville, Tenn., July 24, 1951.

Senator WALTER F. GEORGE,
Chairman, Senate Committee on Finance,
Washington, D. C.

DEAR SENATOR: In reference to our conversation in your office on July 16, the following is a suggested amendment to section 445 of the Excess Profits Tax Act of 1950. Add to section 445 (b) (1) a paragraph:

"(C) Alternate method.—By multiplying the figure derived from (A) and (B) by 2 and then dividing by 3 this figure plus the actual net income for the last 12 months of the taxpayer's base period."

Such a paragraph will afford some relief to growing corporations organized during the base period. In the case of our Colonial Coffee Co., for instance, which was organized as a new corporation on July 1, 1948, and enjoyed a successful year during 1949, for its average base period net income the industry average formula would be used for 2 years and the actual net income for 1 year. There seems to be no particular well-thought-out reason for corporations organized after the beginning of the base period to suffer a disadvantage as compared to those previously organized by the disallowance of their actual experience and by the total absence of relief provisions which are contained in section 435. For the same reason, therefore, it would seem there is no logical reason to discriminate against corporations organized to purchase the assets of an existing business, and I believe it would be entirely equitable to amend the law so sections 435 (e) would read as follows:

"A taxpayer shall be entitled to the benefits of this subsection if the taxpayer commenced business before the beginning of its base period, or if it acquired by purchase substantially all of the assets of an operating company which commenced business before the beginning of its base period and the selling corporation thereafter ceased to operate and surrendered its charter, and if either * * *."

As a corollary to this, section 46 (a) should be amended so as to add a new subsection extending the definition of a component corporation, as follows:

"(5) A corporation which acquired by purchase during the years 1946–49, inclusive, substantially all of the properties and the business of another corporation, which corporation thereafter went out of business and surrendered its charter."

The suggested amendments would give some relief to new corporations which are less able to stand the impact of the Excess Profits Tax Act of 1950. The incompleteness of their base period would not penalize their growth resulting from capable and efficient management. Furthermore, growing corporations purchasing the assets rather than the stocks of older corporations would not be penalized and discriminated against.

These suggested changes would only operate to put new corporations on a plane of equality with their competitors. Their earnings are entirely unrelated to any excess profits caused by the effect of the Korean War on their business.

I am authorized to present the above suggestions by and in the name of the board of directors of the United States Wholesale Grocers' Association, as well as my own firm.

Sincerely yours,

C. B. Ragland Co.,
(Signed) C. S. Ragland,
(Typed) Charles S. Ragland.

Copies to Mr. Alfred Dorman and Mr. R. H. Rowe.

The Chairman. The committee will stand in recess until 3 o'clock, at which time we shall have an executive session.

(Whereupon, at 1:05 p. m., the committee recessed; to reconvene at 10 a. m. Tuesday, July 17, 1951.)

REVENUE ACT OF 1951

TUESDAY, JULY 17, 1951

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

The committee met, pursuant to recess, at 10 a. m., in room 312, Senate Office Building, Senator Harry F. Byrd, presiding.

Present: Senators Byrd, Hoey, Millikin, and Williams.

Also present: Elizabeth B. Springer, chief clerk. Colin F. Stam, chief of staff, Joint Committee on Internal Revenue Taxation.

Senator BYRD (presiding). The committee will come to order.

The first witness is Mr. Claris Adams, of the American Life Convention and the Life Insurance Association of America.

Will you identify yourself for the record?

STATEMENT OF CLARIS ADAMS, PRESIDENT OF THE OHIO STATE LIFE-INSURANCE CO., COLUMBUS, OHIO, CHAIRMAN OF THE JOINT COMMITTEE ON FEDERAL INCOME TAXATION OF LIFE-INSURANCE COMPANIES OF THE AMERICAN LIFE CONVENTION, OF CHICAGO, THE LIFE-INSURANCE ASSOCIATION OF AMERICA, OF NEW YORK, AND THE LIFE INSURERS CONFERENCE, OF RICHMOND

Mr. ADAMS. The taxation of life-insurance companies by the Federal Government has presented a recurring and vexatious problem ever since there has been an income-tax law. The Secretary of the Treasury, in his appearance before the House Ways and Means Committee in February of this year, characterized it as one involving difficult and complex issues.

The difficulties are inherent in the subject. Life insurance is unique in nature, complicated in character, and complex in structure. It cannot readily be fitted into either the pattern, or the philosophy, of the corporate income-tax law.

The corporate income tax is a profits tax, levied upon the annual operations of an enterprise. This concept is not applicable to life insurance. Many companies, indeed most of the large ones, make no profit at all in the generally accepted sense. All companies are engaged in what is fundamentally a long-term business, and their gains can be determined only by long-term measurements.

Life-insurance companies are in the business of assuming contingent liabilities. They enter into contracts as quasi trustees. These they may be called upon to perform within 24 hours. On the other hand the discharge of their obligations to policyholders and beneficiaries may extend literally over a hundred years.

Life insurance operates on the law of averages. It is the very nature of averages that large numbers and an extended period of time are essential to their validity. Annual statement figures, therefore, are not a valid criterion of actual realizable gains because they reflect but a small segment of experience with a long-continuing liability.

Prior to 1921, life-insurance companies were taxed upon an adaptation of the general corporate plan. Experience under this act makes a statement of the Treasury staff that—

Actuarial problems and uncertainties involved in the life-insurance business raise difficulties in measuring net income on a basis comparable to that of other corporations—

a conspicuous example of understatement.

This early law was satisfactory to no one, including the Government. The peculiarities of our business caused innumerable administrative difficulties. The statute resulted in wide controversy and much litigation but very little tax. It was finally repealed, to the relief of everyone, upon the joint recommendation of the Treasury and the life-insurance companies.

In 1921, a new form of law was proposed by the Treasury which taxed life-insurance companies upon their investment income over and above earnings required to meet interest liabilities to policyholders and beneficiaries. The principal liability which requires interest earnings to support it is that of policyholders' reserves. The necessity for reserves grows out of the level-premium plan of life insurance upon which all companies operate. Under this plan the same premium is charged each year, although obviously the probability of dying increases with advancing age. Thus the charge is greater than the risk in the early policy years and less in later ones. Therefore, an excess of funds is accumulated in the early period to meet the deficit which is bound to occur later. This excess must be held, or reserved, for that purpose. If a life-insurance company did not reserve such excess payments to meet the prospective deficiency it could not carry out the obligations of its contracts. It is required by law to hold such reserve because such practice is absolutely essential to solvency.

This reserve fund is invested. Interest is earned upon it. For this reason, the policyholder's premium is discounted by the amount that the management of the company feels they can expect to earn on such reserve during the life of the policy. This amounts to a guaranty that the estimated interest will be earned and added to the fund. The reserve and all accumulations thereof and accretions thereto must be compounded annually at the rate of interest guaranteed by the policy in order that it be sufficient to enable the company to carry out its obligation. Incidentally, the company must also account to the policyholder for the cash value of the policy, which approximates the reserve, at any time, upon surrender of his contract.

The law of 1921 and all subsequent enactments relating to the taxation of life-insurance companies have been based upon the theory that investment income over and above the earnings required to maintain reserves and other interest-bearing liabilities constitutes the true income of life-insurance companies.

Premiums are deposits by policyholders and not income. They consist of three elements. They are the cost of mortality, a charge

for expense, and a discount for anticipated interest. If mortality experience is more favorable than the death rate assumed, the actual charge against the premium is correspondingly less and the difference is returned to the policyholder. This payment is not a profit. It is a refund. If expenses are less than anticipated, that difference also is returned. Such refunds are called dividends. They are, in fact, the return of an overcharge. They represent the policyholder's own money coming back to him. He simply receives the unused portion of his own premium. No profit accrues to anyone on this transaction.

Furthermore, if some of such margins are put to surplus to guard against future fluctuations in mortality, a fall in interest rates, an increase of expenses, or a drop in the value of assets which secure the integrity of reserves, the funds represented by such margins and so applied are still the policyholders' own funds held for their benefit and protection.

Therefore, in theory and in fact, the only true income arising in the whole life-insurance transaction is the interest earned on assets over and above the amount necessary to maintain reserves. The reserve interest is not income to the company because it represents a liability to the policyholder. It is tantamount to interest paid upon indebtedness at a guaranteed rate. If you tax the interest required to maintain reserves in any significant degree, you invade the reserves themselves and, therefore, tax away solvency because the integrity of the reserves requires that they be increased year by year at the contract rate of interest. If the integrity of reserves is invaded, the solvency of the company is impaired.

Considerations which make excess interest the true measure of the corporate income of life-insurance companies apply with greater theoretical force to mutual life-insurance companies than to stock companies. Actually, however, there is little essential difference either in principle or practice in the two operations. Both types of companies sell basically the same product in the same market at a comparable price in one of the most strongly competitive fields in America.

Life insurance differs from all other enterprises in this respect: the mutuals dominate the business. The seven largest life insurance companies in the United States are mutuals. Approximately 80 percent of all insurance in force is on the mutual or participating plan. Obviously, therefore, the mutuals fix the competitive pattern for everyone. There are some sizable stock companies and some small mutuals but, as a generality, it is true that most of the large companies are mutuals and most of the small companies are stock. In many Western and Southern States you cannot start a mutual company.

A tax differential between stock and mutual companies would be an unbearable burden upon the young progressive stock companies, which are serving well both life insurance and the American public. So far as I know, no tax bill ever enacted by any legislative body in the United States has discriminated between the two classes of life insurance companies. With a single exception—a company appearing here today—no mutual company has ever asked for a tax advantage in this fiercely competitive market. The associations which I represent are clearly on record in favor of equal treatment. The result of such discrimination would be fatal to many small companies—serious to most

of them—and the net result would be to channel more and more of the business to the giants and less and less to their smaller competitors.

The act of 1921 taxes life-insurance companies at the going corporate rate upon net investment income, less interest paid to policyholders, and less a deduction of 4 percent upon reserve funds required by law. In 1932, the reserve deduction was decreased to 3¾ percent. Both of these figures were higher than the average reserve requirements of the companies but, on the other hand, substantial deductions granted other corporations as, for instance, the payment of heavy State taxes, were not accorded to life insurance companies. Initially, both of these acts yielded a satisfactory tax. However, the onset of the depression, accompanied by a severe decline in interest rates, caused the taxable margins of life insurance companies practically to disappear. Therefore, in 1942, when the urgent necessities of war required the canvassing of every possible source of revenue, the tax law relating to life insurance companies was again revised.

It will be noted that, under the foregoing acts, the reserve deduction granted all companies is the same, although the actual interest reserving rates of individual companies vary. This variation causes great difficulty in the practical and equitable application of the principle that the true income of life insurance companies is the excess of investment earnings over reserve requirements.

State laws which control reserves merely fix a minimum standard. Within statutory limits companies are free to determine their own reserve bases. Some companies assume that they can earn 3½ percent on invested funds, others estimate 3 percent, still others, 2½ percent. Most companies have changed their interest estimates and, therefore, their reserve bases, with changing conditions. Some have different segments of their business on different bases, others have all reserves on the same standard.

Obviously, the lower the interest assumption the higher the reserve will be and the higher the interest requirement the lower the reserve becomes, because it takes a greater sum compounded at 2½ percent interest to accumulate a given amount in a specified period than if such fund were compounded at 3½ percent. The difference is roughly an increase of 5 percent in the reserve fund for each one-half-percent deduction in the interest assumption; for instance, if reserves on a 2½-percent basis amounted to $1,000,000, they would be approximately $950,000 on a 3-percent basis and $900,000 on a 3½-percent basis.

It follows that a flat deduction of a given percentage of the reserve discriminates against one class of companies, and the use of the actual interest reserving rate of each individual company discriminates against another class. This clearly appears from the following illustration.

I have here a table. In the first part of that table, we have the flat interest deduction of 3 percent as under the old law. Now, three companies, the same in every other respect, $100,000,000 of assets, but one with a 3½-percent basis and one with a 3-percent basis and one with a 2½-percent basis, with the same assets and same interest incomes, Company A, because it is on 3½ percent, would pay $275,000 of tax; Company B, $200,000; and Company C, $125,000; whereas, if the actual reserving rate of each company is used, just the reverse is true.

Senator MILLIKIN. Will you hold up just 1 minute?

Mr. ADAMS. Yes.

Senator MILLIKIN. I should like to look this over.

Mr. ADAMS. You see, Company A gets 3 percent of $90,000,000; Company B, 3 percent of $95,000,000; and Company C, 3 percent of $100,000,000; whereas, if you used the actual reserving rate, then Company A gets an advantage under the same circumstances. Their interest deduction is 3½ percent of $90,000,000, which is more than 3 percent of $95,000,000, or more than 2½ percent of $100,000,000. Again, all companies are on the same assets and same interest income. Company A would pay $50,000; Company B, $200,000; and Company C, $375,000.

I shall have a little more to say about that later.

When the corporate tax rate was low and taxable margins were small, the inequity of the tax distribution was at least tolerable. With the imposition of war rates the discrimination was greatly accentuated. It became obvious that the application of the previous pattern would develop grotesque differences between companies out of all proportion to dissimilarity of circumstance. It was in an endeavor to find a pragmatic solution of this vexatious problem of an equitable distribution of income tax between companies that an averaging process, through a device known as the Secretary's ratio, was resorted to in the Act of 1942 and carried through into the so-called stop-gap law of 1950.

The procedure was roughly as follows—that was very technical, but roughly as follows: A fraction was developed by using the interest requirements of all companies as a numerator and their net investment income as a denominator. The result, which was proclaimed each year as the Secretary's ratio, was 93 percent in 1942. Thus, all companies received a deduction of 93 percent of net investment income for reserve requirements and were taxed at the going corporate rate on the remaining 7 percent of such income. Unfortunately a precipitate decline in the interest earnings of life insurance companies, resulting from conditions beyond our control, caused a rapid increase in the Secretary's ratio until, in 1947, it rose above 100 percent and no tax was payable.

This averaging process, arrived at by compromise to compose as far as possible the conflicting interests of companies of widely varying circumstances, in principle but with certain refinements, was carried over into the act of 1950. On 1951 operations under this law, if reenacted, such ratio would be approximately 88 percent, and all companies, therefore, would receive a deduction of 88 percent, and pay a tax at the going corporate rate on 12 percent of such income.

Senator BYRD. May I ask this? What is the device that is known as the "Secretary's ratio"? What does "Secretary" mean?

Mr. ADAMS. The Secretary of the Treasury.

Senator BYRD. The Secretary of the Treasury?

Mr. ADAMS. Yes.

Senator BYRD. In other words, the Secretary of the Treasury recommended this?

Mr. ADAMS. He calculates it. He calculates that all of the interest income of the companies be fixed as a proportion of all their interest requirements.

Now it will readily be seen that this amounts, in fact, to a flat tax at a varying rate upon net investment income. For instance, if the reserve deduction is 88 percent of investment income and, therefore, the tax base is 12 percent, at a 52-percent corporate rate, which I hope you will not enact, the tax upon each company would be approximately 6¼ percent of its net investment income.

This averaging process has not eliminated inequities but it did smooth out certain peaks and valleys of discrimination. It does eliminate the tax penalty upon conservatism inherent in any individual plan based upon the excess-interest principle where, if a company increases its reserves, it automatically pays more tax.

However, defects and difficulties have already appeared in connection with the stop-gap formula. In the first place, it is difficult to rationalize taxation according to industry averages instead of individual experience. Such procedure is repugnant to the Treasury, has its severe critics in the business itself, and seemed to be seriously questioned by members of this Senate Finance Committee at our hearing last year.

In the second place, it does have the unfortunate effect of taxing in substantial amount some companies which are actually not earning their interest requirements.

In the third place—and this is most important—as interest rates fell violently, a number of companies engaged in a major program of reserve strengthening. This had the effect of reducing their reserve-interest requirements. Since the tax deduction granted each company is dependent upon the average-interest requirement of the entire business, this action, particularly by the large companies, bore quite heavily upon those companies, many of them smaller ones, whose resources did not permit such an extensive program. Therefore, many small companies have had to pay higher taxes because a number of the large companies have done that which these smaller companies themselves could not afford to do.

In the fourth place, it is already apparent that the continuation of the present formula would develop an inordinate tax in the near future, one beyond the fair share of life insurance as a business, in our opinion, one which would constitute an unconscionable exaction upon policyholders for the mere privilege of saving their own money, and one which might well impair the usefulness of the institution itself as a disseminator of great social benefits.

The formula in the House bill would yield on 1951 operations almost four times the tax enacted by the war rate of 1943 although the investment income of life insurance has less than doubled. If the formula is continued the disparity will increase. I know of no business upon which the preparedness taxes of 1951 will exceed the war taxes of 1943 by such a disproportionate margin. I know of no informed man in our business who does not consider the present formula as a serious threat and who does not believe that if continued as a steeply progressive tax year by year it will ultimately blight an institution of great social significance which has served America exceedingly well.

In my appearance before the Ways and Means Committee of the House in February of this year, I stated that we were searching for a simplified method of taxation as a substitute for the highly technical

and somewhat complicated formula contained in the so-called stop-gap law.

Senator BYRD. May I ask whether most insurance companies recommended the so-called stop-gap law?

Mr. ADAMS. The majority of them.

Senator BYRD. Will you go into that?

Mr. ADAMS. I will come to that.

Senator MILLIKIN. Mr. Adams, you started right off with the text of your statement, and I do not believe you elaborated on the companies that you are representing here. I believe it would be well to get that into the record.

Mr. ADAMS. I shall be very glad to do that. May I do that at the end, because I do bring it in.

Senator MILLIKIN. You bring it in later? I see.

Mr. ADAMS. Yes.

(See roster at end of testimony.)

Mr. ADAMS. In an earnest effort to find a simple basis which would yield satisfactory income to the Government and distribute the tax burden fairly among the companies, we considered and tested a number of formulas suggested by some of the most eminent actuaries in our business. Several of such proposals had great theoretical merit, but most of them were quite complicated because of the great complexity of the life insurance structure and the highly technical character of our operations.

After much deliberation we have come to the conclusion that the most simple, practical, and equitable solution of the problem is the application of a flat percentage tax to net investment income, with a small company allowance comparable to that granted in the general corporate tax law and an adequate special deduction for those companies which are not earning interest requirements. Most of the latter are small companies so that total revenue will not be affected greatly and furthermore their dilemma is a transient one so that it will be a diminishing factor. We also propose that the accident and health business of life insurance companies be taxed at a level comparable to that provided in the current act, as it has been for many years.

This proposal, we believe, has the merit of great simplicity. It will provide a stable, substantial, and steadily increasing source of revenue. Unlike the stop-gap plan it is based solely upon individual company experience. It can readily be estimated in advance, which is a matter of significant importance in a business of essentially long-term nature, such as life insurance. It will distribute the tax burden basically among the companies according to size and among policyholders equally. One company will not be affected in its tax by the reserve assumptions or reserve changes of others. On the other hand, it will give needed relief to those companies who through special circumstances are not earning their minimum reserve requirements currently. It will give such relief to all companies if violent economic changes should place them temporarily in that category.

We suggest basically a rate of 6½ percent upon net investment income. It is estimated that this proposal would yield over $125 million in taxes in 1952 on 1951 operations. For 1949 operations under the stop-gap law, we paid $43 million at the then existing corporate rate of 38 percent. For 1950, we will pay about $75 million, based on an average rate of 42 percent. At a 52 percent rate the stop-gap law would yield in excess of $120 million on 1951 operations.

We have arrived at the rate of 6¼ percent because (1) it would produce about the same revenue as the stop-gap bill for the current year and, (2) it would produce the maximum amount which we believe the companies should be called upon to pay with due regard to their guaranteed long-term commitments to 83 million policyholders, many of which were contracted years ago.

In 1943, our war taxes were levied on a basis which equaled 3.14 percent of investment income. In 1949, the Treasury suggested as an alternative to the stop-gap bill a flat tax on net investment income at the rate of 3 percent. Our present proposal, which many in the business regard as too high, and is suggested only because of the great current necessity of the Nation, is double the rate that was levied during the last war and more than double the rate acceptable to the Treasury 2 years ago.

If it should be thought preferable to levy the going corporate rate on a fraction of investment income, as for example, a 52 percent rate on 12¼ percent of net investment income, that would be entirely acceptable to the life insurance business and, in fact, would be greatly preferred by some of our people.

In this connection, it must be remembered that life insurance companies are taxed very heavily by the various States. In the aggregate we will pay to States and municipalities taxes, exclusive of those on real estate, of more than $150,000,000 in 1952. This burden, the increase of which is a constant threat, added to the Federal imposition at the level suggested, would amount to an over-all levy of about $3.50 on every $100 of policyholders' net deposits. This is an onerous exaction upon an individual for the privilege of purchasing life insurance so that he and his dependents will not be a charge upon the State.

Senator MILLIKIN. Will you tell us the general nature of those State and municipal taxes other than real estate?

Mr. ADAMS. Premium taxes, primarily, franchise taxes in municipalities. By and large, we are taxed 2 percent of our premiums. If you pay your life insurance policy, the State tax gatherer gets 2 percent as you go in the door with your money.

There is an implication in some quarters that because life insurance companies are large they should be taxed heavily. As a matter of fact, these companies are big only because they owe so many people so much money. For instance, one life insurance company is one of the largest financial institutions in the world. It has about $10 billion of assets. However, this fund represents the aggregate savings of 33 million policyholders who are sharing with each other through the medium of this company, which they own, incidentally, the hazards of an untimely death or a dependent old age, and have invested, on an average, a little over $300 of their savings to purchase such protection for themselves and their families.

Life insurance funds do not represent in significant degree the large accumulations of the rich. Life insurance is an institution of the average man. Policyholders exceed income-tax payers by 50 percent. The savings of the average policyholder on deposit with the companies is about $700. The protection held by the average family insured is a little over 1 year of the breadwinner's earnings. When you tax life insurance companies you are not taxing the profits of trade, nor are you taxing rich corporations. You are taxing in fact the

orphan's pittance, the widow's mite, and the slender competence of the aged and the infirm.

All taxes levied will ultimately be borne by the policyholders. The load will fall upon the modest savings of plain people. They are the savers of the Nation, the bone and sinew of America. However, they bid fair to become the forgotten people at the bottom of the economic pyramid.

Neither are life insurance companies beneficiaries of the war boom. Inflation with its attendant increase of expenses, falls very heavily upon our business because our product is sold at a fixed price which can be adjusted to a very limited degree. Credit restrictions are bound to limit our investment opportunities and affect our levels of income. Furthermore, war has already increased our mortality losses and if all-out war should come in this atomic age, our mortality potential would be very serious.

We recognize that our proposal is a pragmatic approach to a recurring and vexatious problem. Had there been a pat solution it would have been arrived at long ago. Treasury technicians have been studying the question since 1947. They have yet to come up with a suggestion for a permanent solution. This is not said in criticism but rather to emphasize the intricacies and difficulties of the problem. We believe that our proposal is the best, the fairest, and the most equitable yet devised. Its enactment will not preclude consideration of a different plan if the Treasury comes forth with one in the fullness of time.

Our committee, which is composed, save for its chairman, of men eminent in life insurance, outstanding actuaries, leading lawyers, well-known investment men, and highly respected general executives, has labored long and hard upon this subject. The program here presented has the unanimous support of committee members. It was approved by unanimous vote of the governing bodies of the organizations composed of companies representing about 99 percent of all life insurance in the United States.

Senator MILLIKIN. In dollars, or in terms of numbers of policies?

Mr. ADAMS. In dollars. It is not very much different, sir.

It was submitted to a special meeting of the entire membership and was there endorsed by an overwhelming vote. It represents the best thought of life insurance as to the fairest manner of levying a tax upon the business at a level which seems to be necessary in view of the present situation of the Nation and the state of the world.

We earnestly request your acceptance of this proposal as a desirable way of ending the uncertainty regarding the Federal tax status of life insurance companies.

Thank you for your courtesy, gentlemen.

Senator BYRD. Are there questions?

Senator MILLIKIN. What are the objections of those who did not join in this plan?

Mr. ADAMS. There will be objection from one witness here this morning. I would much rather have him state it than myself. He believes, as I understand it, that the deduction should be geared to the individual reserving rate of each company, and our objection to that is this, that if my company, for instance, which started out on a 3½ percent basis, feels that that is not conservative enough, considering what may happen down the line, and if we have the resources

and as a matter of conservatism and precaution increase that reserve, we automatically increase our tax under this formula, regardless of anything else.

So if you put it on an individual basis, everybody being human, there is a strong incentive not to strengthen reserves because you pay a tax penalty for just putting up more security behind your policies.

That is the defect. When I was here before, Senator, the stop-gap was the best thing we had arranged. If you will excuse this, I am not quite like my old friend, Senator Jim Watson, when someone asked him, "What is the consistency of your statement?" and he said, "Sufficiency unto the day is the consistency thereof, sir."

Now, that is quite characteristic, because I, at least, am consistent on the record. I was for this flat tax a year ago, but we caucused, and the company had not yet seen the wisdom of my presentation. Now we have had 1 year, and they have seen the light, and I am very happy.

Senator BYRD. What percentage of the insurance companies recommended the stopgap plan?

Mr. ADAMS. A very large percentage of them. I cannot tell now. But it was a very large percentage of them in both organizations.

Senator BYRD. Are there as many that favor this plan as favored the stop-gap formula?

Mr. ADAMS. More.

Senator BYRD. You mean, more favor this plan?

Mr. ADAMS. More favor this plan. This is the nearest unanimity that we have ever had in our business.

Senator BYRD. This is based entirely on the question of reserves, is it?

Mr. ADAMS. As I say, it had its germ in part right here in this room a year ago. Senator Taft and Senator Millikin criticized this averaging process. I do not mean, they criticized it, but they questioned it. Why should two companies on different sides of the street both add their income together and be taxed that way?

Senator MILLIKIN. I both criticized it and questioned it.

Mr. ADAMS. Yes.

Senator MILLIKIN. And I was against it.

Mr. ADAMS. I understand so. Now the Treasury has been opposed to it in theory, and the criticism has grown in our business because it resulted in tax on some companies that were not making their interest requirements, as an integral part of this. But the main question is, sir—and I want to be frank with you—this stop-gap bill, if it goes on and on and on, is going to increase the tax because of this reserve strengthening, just by the reserve strengthening, so that including the taxes by the States, you will be taxing policyholders in 3 or 4 years $4.50 a thousand instead of $3.75 a thousand.

We think when we pay four times the tax when we have only grown twice, on preparedness taxes this year against war taxes in 1943, we are pretty good soldiers, even in this emergency.

I will tell you, sir. You may think when I talk about the widow's mite, it might be "corny" or whatever you want to say. But that is the business we are in. There are 50 percent more policyholders than there are income taxpayers. That is, one-third of the policyholders do not make enough to pay an income tax. And this is the traditional way for the American breadwinner to provide something

for his family. When the TNEC investigated this, and we came out with flying colors, and they said we did, Justice Douglas, who was the head of it at that time, said that it was obvious that the American public used life insurance more than all other savings institutions together for the protection of their families.

Senator HOEY. Mr. Adams, I believe you stated that about 90 percent, in volume, of the companies have recommended this plan. Do you know about what percentage in numbers?

Mr. ADAMS. No. What I am saying is this. I represent here a joint committee of two organizations. Those two organizations, by unanimous vote of this committee, of the board of directors of both organizations, recommended this, and that represents 99 percent of all life insurance in force. Now, we had a meeting in Chicago. It being July, I think we did pretty well. We got well over 100 there. And the vote in one organization was 94 to 8 in favor of this, and the vote in the other organization was 61 to 1.

As always happens in a thing of that kind, the people that are satisfied are not nearly as likely to come as the people who are critics of the plan.

Senator MILLIKIN. Did everyone receive adequate notice of the meeting?

Mr. ADAMS. Everybody in both organizations.

Senator MILLIKIN. I asked you that because when we had the retroactive question up here, there was some claim that some of the companies importantly affected did not know what was going on.

Mr. ADAMS. In the retroactivity matter, it was a question of general knowledge that was never brought home to anybody by formal notice. This was by formal notice of the meeting and the purpose of the meeting to every member of both organizations.

Senator MILLIKIN. Thank you very much.

Mr. ADAMS. There were many, many letters in addition.

Senator BYRD. Are there further questions?

Thank you very much, Mr. Adams.

Mr. ADAMS. Thank you very much.

(Mr. Adams submitted the following documents:)

ALC-LIAA membership roster, April 4, 1951 [1]

Acacia Mutual, Washington.
Aetna Life,[2] Hartford.
All States, Montgomery.
American General, Houston.
American Home, Topeka.
American Hospital, San Antonio.
American Life, Birmingham.
American Mutual, Des Moines.
American National, Galveston.
American Reserve, Omaha.
American Standard, Washington.
American United,[2] Indianapolis.
Amicable Life, Waco.
Atlantic Life, Richmond.
Atlas Life,[2] Tulsa.
Baltimore Life,[2] Baltimore.
Bankers Health & Life,[2] Macon.
Bankers Life Co.,[2] Des Moines.
Bankers Life,[2] Lincoln.
Bankers National, Montclair.
Beneficial Life, Salt Lake City.
Berkshire Life,[2] Pittsfield.
Boston Mutual,[2] Boston.
Business Men's Assurance,[2] Kansas City.
California-Western,[2] Sacramento.
Canada Life Assurance,[2] Toronto.
Capitol Life,[2] Denver.
Carolina Life,[2] Columbia, S. C.
Central Life Assurance,[2] Des Moines.
Central Life, Fort Scott.
Central Life,[2] Chicago.
Century Life, Fort Worth.
Colonial Life,[2] East Orange.
Columbian Mutual, Memphis
Columbian National,[2] Boston.
Columbus Mutual, Columbus.
Commercial Life, Phoenix.
Commonwealth,[2] Louisville.
Confederation Life,[2] Toronto.
Connecticut General,[2] Hartford.
Connecticut Mutual,[2] Hartford.

See footnotes at end of table, p. 1112.

ALC-LIAA membership roster, April 4, 1951 [1]—Continued

Constitution Life, Los Angeles.
Continental American,[2] Wilmington.
Continental Assurance, Chicago.
Country Life, Chicago.
Crown Life, Toronto.
Dominion Life, Waterloo, Ont.
Durham Life, Raleigh.
Eastern Life,[3] New York.
Empire Life & Accident, Indianapolis.
Empire State Mutual,[2] Jamestown.
Equitable Society,[2] New York.
Equitable Life,[2] Washington.
Equitable Life,[2] Des Moines.
Farm Bureau Life,[2] Columbus.
Farmers & Bankers, Wichita.
Farmers & Traders, Syracuse.
Farmers Life, Des Moines.
Federal Life & Casualty,[2] Detroit.
Federal Life,[2] Chicago.
Fidelity Mutual,[2] Philadelphia.
Fidelity Union, Dallas.
Franklin Life, Springfield.
General American, St. Louis.
George Washington, Charleston.
Great American Life, Hutchinson.
Great American Reserve,[2] Dallas.
Great National, Dallas.
Great Southern, Houston.
Great-West Life,[2] Winnipeg.
Guarantee Mutual, Omaha.
Guaranty Income,[2] Baton Rouge.
Guardian Life,[2] New York.
Gulf Life, Jacksonville.
Home Friendly,[2] Baltimore.
Home Life,[2] New York.
Home Life of America, Philadelphia.
Home Security, Durham.
Home State, Oklahoma City.
Homesteaders Life, Des Moines.
Hoosier Farm Bureau, Indianapolis.
Illinois Bankers,[2] Monmouth.
Imperial Life,[2] Toronto.
Indianapolis Life, Indianapolis.
Inter-Ocean, Cincinnati.
Interstate Life & Accident, Chattanooga.
Iowa Life, Des Moines.
Jefferson National Indianapolis.
Jefferson Standard,[2] Greensboro.
John Hancock Mutual,[2] Boston.
Kansas City Life, Kansas City.
Kentucky Central L. & A.,[2] Anchorage.
Kentucky Home Mutual, Louisville.
Knights Life, Pittsburgh.
LaFayette Life, LaFayette.
Lamar Life, Jackson.
Liberty Life, Greenville.
Liberty National,[2] Birmingham.
Life & Casualty, Nashville.
Life Insurance Co. of Georgia,[2] Atlanta.
Life Insurance Co. of Virginia,[2] Richmond.
Lincoln Liberty, Lincoln.
Lincoln Mutual, Lincoln.
Lincoln National,[2] Fort Wayne.
London Life,[2] London.
Loyal Protective, Boston.
Lutheran Mutual, Waverly.
Manhattan Life,[2] New York.
Manufacturers Life,[2] Toronto.
Massachusetts Mutual,[2] Springfield.
Metropolitan Life,[2] New York.
Michigan Life, Detroit.
Mid-Continent Life, Oklahoma City.
Midland Mutual, Columbus.
Midland National, Watertown, S. Dak.
Midwest Life, Lincoln.
Ministers Life & Casualty, Minneapolis.
Minnesota Mutual,[2] St. Paul.
Missouri Insurance Co., St. Louis.
Monarch Life, Springfield.
Monumental Life, Baltimore.
Mutual Benefit,[2] Newark.
Mutual Life Assurance,[2] Waterloo.
Mutual Life Insurance,[2] New York.
Mutual Savings, St. Louis.
Mutual Service Life, St. Paul.
Mutual Trust,[2] Chicago.
National Equity Life, Little Rock.
National Fidelity, Kansas City.
National Guardian, Madison.
National Life & Accident,[2] Nashville.
National Life Co., Des Moines.
National Life,[3] Montpelier.
National Life of America, Mitchell, S. Dak.
National Old Line, Little Rock.
National Reserve, Topeka.
New England Mutual,[2] Boston.
New World Life, Seattle.
New York Life,[2] New York.
North American Accident, Chicago.
North American Life Assurance, Toronto.
North American Life & Casualty,[2] Minneapolis.
North American Life, Chicago.
North American Reassurance,[2] New York.
Northern Life, Seattle.
Northwestern Life, Seattle.
Northwestern Mutual Life,[2] Milwaukee.
Northwestern National,[2] Minneapolis.
Occidental Life of California,[2] Los Angeles.
Occidental Life,[2] Raleigh.
Ohio National,[2] Cincinnati.
Ohio State,[2] Columbus.
Old American Life, Seattle.
Old Line Life,[2] Milwaukee.
Olympic National Life, Seattle.
Pacific Mutual,[2] Los Angeles.
Pacific National, Salt Lake City.
Pan-American, New Orleans.
Paul Revere,[2] Worcester.
Peninsular Life, Jacksonville.

See footnotes at end of table, p. 1112.

ALC-LIAA membership roster, April 4, 1951 [1]—Continued

Penn Mutual,[2] Philadelphia.
Pennsylvania Mutual, Philadelphia.
Peoples Life, Frankfort, Ind.
Peoples Life, Washington.
Philadelphia Life, Philadelphia.
Phoenix Mutual,[2] Hartford.
Pilot Life, Greensboro.
Pioneer Mutual, Fargo.
Policyholders' National, Sioux Falls.
Postal Life Casualty, Kansas City.
Presbyterian Minister's Fund, Philadelphia.
Protective Life,[2] Birmingham.
Provident L. & A.,[2] Chattanooga.
Provident Life, Bismarck.
Provident Mutual,[2] Philadelphia.
Prudential,[2] Newark.
Puritan Life,[2] Providence.
Pyramid Life, Kansas City.
Reliable Life, St. Louis.
Reliance Life,[2] Pittsburgh.
Republic National,[2] Dallas.
Rio Grande Life, Dallas.
Rockford Life, Rockford.
Rural Life, Dallas.
Security Benefit Life, Topeka.
Security Life & Accident, Denver.
Security Life & Trust, Winston-Salem.
Security Mutual,[2] Binghamton.
Security Mutual, Lincoln.
Service Life,[2] Omaha.
Shenandoah Life,[2] Roanoke 10.
Southern Life & Health, Birmingham.
Southland Life, Dallas.

Life insurers conference member companies

Southwestern Life, Dallas.
Standard Insurance Co., Portland.
Standard Life of America, Pittsburgh.
Standard Life of Indiana, Indianapolis.
Standard Life Insurance Co., Jackson.
State Capital, Raleigh.
State Farm Llife, Bloomington, Ill.
State Life, Indianapolis.
State Mutual,[2] Worcester.
State Reserve, Fort Worth.
Sun Life Assurance,[2] Montreal.
Sun Life of America,[2] Baltimore.
Texas Life, Waco.
Texas Prudential, Galveston.
Travelers,[2] Hartford.
Union Central,[2] Cincinnati.
Union Labor Life,[2] New York.
Union Life,[2] Little Rock.
Union Mutual,[2] Portland, Maine.
Union National, Lincoln.
United American, Denver.
United Benefit, Omaha.
United Fidelity, Dallas.
United Life & Accident, Concord.
United Services, Washington.
United States Life,[2] New York.
Unity Mutual, Los Angeles.
Universal Life & Accident, Dallas.
Victory Life, Topeka.
Volunteer State Life,[2] Chattanooga.
Washington National, Evanston.
West Coast Life, San Francisco.
Western & Southern,[2] Cincinnati.
Western Life,[2] Helena.
Western Reserve, Austin.
Western States, Fargo.
Wisconsin Life, Madison.
Wisconsin National, Oshkosh.
Woodmen Central, Lincoln.
World Insurance Co., Omaha.
Acme Life Insurance Co.
All States Life Insurance Co.
American Life & Accident Co. of Kentucky.
American Life & Accident Insurance Co. (Missouri).
American Life Insurance Co.
American National Insurance Co.
American United Life Insurance Co.
Atlantic Coast Life Insurance Co.
Atlatic Life Insurance Co.
Atlas Live Insurance Co.
Bankers Health & Life Insurance Co.
Capital Life & Health Insurance Co.
Carolina Life Insurance Co.
Central Standard Life Insurance Co. of Illinois.
Citizens Home Insurance Co.
Colonial Life Insurance Co.
Commonwealth Life Insurance Co.
Connecticut General Life Insurance Co.
Cosmopolitan Life Insurance Co.
Delta Life Insurance Co.
Dixie Life & Health Insurance Co.
Dixie Security Life Insurance Co.
Durham Life Insurance Co.
Empire Life & Accident Insurance Co.
Family Fund Life Insurance Co.
Family Security Life Insurance Co.
First National Life Insurance Co.
Franklin National Life Insurance Co
Gause-Ware Service Insurance Co.
Guarantee Reserve Life Insurance Co.
Guaranty Life Insurance Co.
Gulf Life Insurance Co.
Home Beneficial Life Insurance Co.
Home Friendly Insurance Co.
Home Seucrity Life Insurance Co.
Home State Life Insurance Co.
Imperial Life Insurance Co.
Independence Life & Accident Insurance Co.
Independent Life & Accident Insurance Co.
Inter-Ocean Insurance Co.
Interstate Life & Accident Insurance Co.

See footnotes at end of table, p. 1112.

Life insurers conference member companies—Continued

Kentucky Central Life & Accident Insurance Co.
Liberty National Life Insurance Co.
Life & Casualty Insurance Co. of Tennessee.
Life Insurance Co. of Georgia.
Lincoln Income Life Insurance Co.
Lincoln National Life Insurance Co.
Missouri Insurance Co.
National Accident & Health Insurance Co.
National Burial Insurance Co.
National Life & Accident Insurance Co.
North American Reassurance Co.
Old Dominion Life Insurance Co.
Palmetto State Life Insurance Co.
Peninsular Life Insurance Co.
Pennsylvania Mutual Life Insurance Co.
Philadelphia-United Life Insurance Co.
Pilot Life Insurance Co.
Professional Insurance Corp.
Progressive Life Insurance Co.
Provident Indemnity Life Insurance Co.
Public Savings Life Insurance Co.
Quaker City Life Insurance Co.
Reliable Life Insurance Co.
Republic National Life Insurance Co.
Rio Grande National Life Insurance Co.
Southern Life & Health Insurance Co.
Southland Life Insurance Co.
Standard Life Insurance Co. of the South
State Capital Life Insurance Co.
State Mutual Insurance Co.
Superior Life Insurance Co.
Suwannee Life Insurance Co.
Texas Prudential Insurance Co.
The Baltimore Life Insurance Co.
The Union Life Insurance Co., Inc.
Union Life Insurance Co.
Union National Life Insurance Co.
United Insurance Co.
United Life Insurance Co.
Unity Life Insurance Co.
Unity Mutual Life & Accident Insurance Co.
Universal Life & Accident Insurance Co.
Vulcan Life & Accident Insurance Co.
Washington National Insurance Co.
Wilson Life Insurance Co.

[1] ALC members: 229.
[2] Membership in both ALC and LIAA (92).
[3] Membership in LIAA only (4).

Company Federal Income Tax Program of the American Life Convention, the Life Insurance Association of America, and the Life Insurers Conference

The American Life Convention, the Life Insurance Association of America, and the Life Insurers Conference propose that the present stop-gap law for taxing life insurance companies be replaced by a flat tax on net investment income, as outlined in Mr. Adams letter of May 2 to Chairman Doughton of the Ways and Means Committee, modified, however, to give some relief to those companies which earn less than 105 percent of their reserve requirements. Implicit in the May 2 proposal is (1) a small company allowance to correspond with the $25,000 exemption from surtax now allowed all corporations and (2) the continuation of the method and level of taxing accident and health insurance.

The above proposal, which is expressed in general terms, may be set forth in more specific detail, as follows:

(1) The tax base for any company would be (a) the normal tax net income, as defined in the present law, plus (b) the adjustment for accident and health insurance reserves, if any, amended in accordance with paragraph (3) below, minus the reserve interest deficiency deduction, if any, specified in paragraph (4) below.

(2) The small company allowance, corresponding to the $25,000 surtax exemption permitted general corporations, would be effected by imposing a tax of 3¼ percent on the first $200,000 of the tax base and at 6½ percent on all of the tax base in excess of $200,000.

(3) Maintenance of the status quo in taxing accident and health insurance would be effected by changing the factor 3¼ percent, where it appears in section 202 (c), I. R. C., to 26 percent. The reason for this is that 6½ percent times 26 percent is exactly equal to the corporate rate of 52 percent times 3¼ percent.

(4) The reserve interest deficiency deduction would be computed as follows: Each company would calculate a ratio or fraction—A divided by B, where A and B are defined as follows:

A. (1) Net investment income without any deduction for tax-exempt interest and dividends, minus

(2) 3¼ percent of accident and health insurance reserves, as now defined in section 202 (c), I. R. C.

B. (1) Interest required, using actual valuation rates and reserves adjusted for preliminary term, as provided in section 201 (c) (3), I. R. C., plus

(2) Interest on deferred dividends, as provided in section 201 (c) (5), I. R. C., plus

(3) Interest paid as defined in section 201 (c) (6), I. R. C.

If this ratio is less than 100 percent, a special deduction of a maximum of X percent of the tax base (excluding any adjustment for accident and health insurance reserves) as otherwise computed would be allowed. If this ratio exceeded 105 percent, no such special deduction would be allowed. If this ratio fell between 100 and 105 percent, the deduction would be proportionately between the maximum percentage and 0.

Senator BYRD. Mr. Edward J. Schmuck.

Will you identify yourself, please?

STATEMENT OF EDWARD J. SCHMUCK, ACACIA MUTUAL LIFE INSURANCE CO.

Mr. SCHMUCK. I am Edward J. Schmuck, general counsel, Acacia Mutual Life Insurance Co.

Mr. Chairman, in the interests of conserving the time of the committee, I wonder if we might file for the record a formal memorandum that we have presented. I think that I can outline considerably more briefly at least the first three-quarters of this memorandum and perhaps refer to the memorandum for the last couple of pages.

Senator BYRD. It will be made a part of the record.

Mr. SCHMUCK. I appear representing only the Acacia Mutual Life Insurance Co. Our remarks are addressed solely to section 311 of the pending revenue bill providing that the 1950 stopgap legislation controlling the taxation of life-insurance companies——

Senator MILLIKIN. May I ask you, please, should we follow your statement, or are you talking off the statement?

Mr. SCHMUCK. Sir, I am talking off the statement for the moment. [Continuing:] Controlling the taxation of life-insurance companies shall be extended to cover the current taxable year 1951.

I think most life-insurance companies would prefer permanent legislation, but we must take cognizance of the fact that there are extremely heavy demands upon the Congress at this time, and particularly that the joint committee staff and the Treasury staff have not completed their studies of the question of permanent legislation. The House certainly has taken cognizance of that in its action.

As a practical matter, it seems realistic to suppose that whatever legislation is passed this year must of necessity be interim or stopgap, in its nature.

We appeared before your committee in 1950. At that time, we discussed in detail the basic problem of the taxation of life insurance companies and our proposal of principles looking to its solution. I think a very brief reference to the substance of this discussion is pertinent to the suggestion that we make here today, that even if stopgap legislation is to be extended, for the taxable year 1951, consideration should be given to an amendment to afford some measure of relief now to the companies that are prejudiced by the stopgap law.

Mr. Adams has very ably and quite comprehensibly covered the essential features of the laws governing the taxation of life-insurance companies since 1921. He has pointed out the averaging method that has crept into these laws since 1942.

We contend and have contended, and apparently we are now joined by the vast weight of the life-insurance companies in this business,

that any method of taxation, based on an averaging of a group of taxpayers, is essentially unsound, and will result in marked inequities and possibly intolerable tax burdens for some of the taxpayers involved. It is utterly inconsistent with any other provision of the income-tax laws.

No attention is paid under averaging formulas to the differences among the companies. Whether a company fails to earn enough interest to meet its policyholder requirements or whether it earns far in excess of those requirements, each company reports and pays taxes on the same percentage of investment income.

Obviously, as some companies are penalized by such a method, other companies gain marked tax preferences.

The Government, too, suffers from these arbitrary and artificial formulas. Since 1921, in no single year has the Government ever collected the full tax that would have been payable if each company had been paying taxes on its own free investment income over and above its policyholder interest requirements.

On the basis of the studies that we have made and our conviction as to the averaging method, we concluded and proposed for your consideration last year that a proper permanent method of taxation might be evolved from the following basic principles:

1. That free-investment income is the only sound and proper tax base for mutual life-insurance companies;

2. That the tax should be imposed on the basis of each mutual company's individual free investment income without averaging or any other arbitrary formula.

Senator BYRD. What do you mean by "free investment income"?

Mr. SCHMUCK. By "free investment income," sir, we mean that each company should take its own investment income, what it is able to earn on its investments; from that it should deduct, of course, its investment expenses and then take the deduction with which we have been most concerned in all the years since 1921, that is, the deduction of interest necessary to meet our contractual and statutory obligations to our policyholders. The primary element of that, of course, is the interest that must be added to the reserves in order to maintain them at the necessary levels.

Now, if a company's earned income exceeds these interest requirements, that balance we generally denominate as free interest or free investment income, and the theory of all the laws since 1921 is that that is properly taxable income, and with that theory we have no argument. Our sole contention is that the application of that theory should be on an individual company basis, with each company taking its own income and its own deductions and reporting its own balance and paying a tax on that balance.

Senator BYRD. The deductions are the expenses of the company?

Mr. SCHMUCK. The expenses, plus these requirements for reserve and other policyholder contracts.

Senator BYRD. You regard that as a part of the expense?

Mr. SCHMUCK. Yes, sir, as a proper deduction.

The third basic principle that we think might be taken into account——

Senator MILLIKIN. Just for the sake of clarity, what happens to the free income?

Mr. SCHMUCK. That goes into the pool, sir. It can be used for the payment of dividends to policyholders. It can be used for paying the

operating expenses of the company. It can be used in a stock company for paying dividends to stockholders. There is no limitation upon the use to which the free investment income can be put.

Senator MILLIKIN. In a mutual company, it is held in the company one way or another, is it not, for the benefit of the policyholders?

Mr. SCHMUCK. Yes, sir.

Senator MILLIKIN. In that kind of company, it obviously would not be paid to the stockholders?

Mr. SCHMUCK. No, sir; not in a mutual company.

That, of course, is the basis of the third consideration that we advanced, that it is a fact that there is this difference in our business, that stock life-insurance companies are owned and operated for the private profit of their stockholders, and that with respect to them, the Congress might desire to consider some form of total net income taxation which would take into account all of the profits of the company from any source.

Senator WILLIAMS. Is the reserve for deductions that you set aside any different for a mutual or a stock company?

Mr. SCHMUCK. They are not, sir.

Senator WILLIAMS. They are the same?

Mr. SCHMUCK. Yes, sir.

Senator MILLIKIN. I think it can be gathered from the testimony that preceded yours, but just so that we may have a connection with your own talk, what percentage in number of policies and value of policies is represented by mutual companies and by stock companies?

Mr. SCHMUCK. I can give it to you by insurance in force, sir.

Senator MILLIKIN. Take any base you want to.

Mr. SCHMUCK. According to our latest calculation, approximately 68 percent of the insurance in force in the United States has been issued by mutual companies and approximately 32 percent by stock companies.

Senator MILLIKIN. Is that in terms of dollars?

Mr. SCHMUCK. That is in terms of dollars of insurance in force: yes, sir.

Senator MILLIKIN. How abut numbers of policies?

Mr. SCHMUCK. I cannot tell you that, sir.

Senator MILLIKIN. Maybe someone in the room can supply that.

A VOICE. Mr. Adams in his testimony, I think, quoted 80 percent.

Senator MILLIKIN. Eighty percent mutual?

A VOICE. Yes, sir.

Senator MILLIKIN. All right.

Senator BYRD. Now, who fixes the reserves? The State agencies?

Mr. SCHMUCK. The State laws impose limitations upon the manner in which the guaranteed interest rate of the reserves may be fixed. Those allow for reasonable flexibility, so that the individual companies have a choice as to what rate of interest they guarantee to the policyholders. That is the reason why you have some companies that are 2-percent companies and other companies that are 3-percent companies. It is the determination by the management of what they are going to be able to earn and so guarantee to their policyholders.

Senator BYRD. That is fixed by the State insurance bureaus of the different States?

Mr. SCHMUCK. It is controlled by them, sir. It is not fixed by them except as these outside limits are fixed.

Senator BYRD. I mean, the total amount of reserves that company is required to have in proportion to the insurance outstanding, who fixes that?

Mr. SCHMUCK. That is fixed by the law, sir.

Senator BYRD. State laws?

Mr. SCHMUCK. State laws, yes, sir.

Senator BYRD. You have to have a permit in a State and comply with the laws of that State in order to sell insurance?

Mr. SCHMUCK. Yes, sir. And that applies to every state in which the company chooses to do business.

Senator BYRD. Are those laws uniform, as a rule?

Mr. SCHMUCK. The laws governing reserves are relatively uniform today, under the new laws that were put into effect in order to bring on the books, the so-called CSO tables that were worked out by the Commissioners in the 1940's.

Senator MILLIKIN. Do you have what you call a uniform State law on insurance?

Mr. SCHMUCK. No, sir.

Senator MILLIKIN. There is no such thing?

Mr. SCHMUCK. No, sir; there is no uniformity of the entire insurance codes of the various States.

With this brief background of our ultimate position, I would like to turn specifically to the matters which are before your committee.

The proposal in section 331 of the pending bill is to extend the 1950 stopgap law without change. As Mr. Adams pointed out, the formula under that law, due to the combination of a rapidly falling Secretary's ratio and increased corporate tax rates, has imposed an extremely heavy tax burden upon a substantial number of companies. The dissatisfaction with the stopgap formula has become fairly widespread in our business.

The representative of the companies' association who has just appeared before you, has disavowed the stop-law which last year they proposed here, not only as stopgap but as permanent legislation. It does not seem necessary here to labor the defects of that law.

At pages 4 to 6 of our memorandum, we have discussed some of the details of the resultant inequities of the stopgap formula which were projected last year as inherent——

Senator BYRD. What part of last year was that? When were these hearings held?

Mr. SCHMUCK. These were held, sir, in March of 1950.

Senator BYRD. And this change has come about. When did you reach the conclusion that this present law was not a just law?

Mr. SCHMUCK. We have opposed the averaging system from the outset, sir. We started opposing the stopgap formula in 1949.

Senator BYRD. We were told that a large majority of the insurance companies at that time advocated the stopgap proposition; that is right, is it not?

Mr. SCHMUCK. Yes, sir.

Senator BYRD. When did they change their minds? Last March they said it was a good law. Now, when did they reach the conclusion that it was such a bad law?

Mr. SCHMUCK. That has been a development, sir, since February of this year. In February of this year, Mr. Adams appeared before

the House Ways and Means Committee and they still supported the stopgap law. The change has come since that time.

Senator BYRD. The last 3 or 4 months?

Mr. SCHMUCK. Yes, sir.

Senator BYRD. Suppose another change comes; do you think a similar condition may occur, for which you are advocating a law now, and next year you might reach the conclusion that that is not a good law?

Mr. SCHMUCK. It certainly is foreseeable, Senator, that given a rapid shift in economic conditions, there would be as much dissatisfaction with this flat tax formula that is now proposed as there has been with respect to the stopgap law. I would like to develop that a little later in my statement, if I may.

Senator WILLIAMS. Have the advancing interest rates in general had anything to do with the changing of the opinions on this law?

Mr. SCHMUCK. Yes, sir; it has. It has had a very definite effect upon it. The result in the last few years in the life insurance has been a slightly increasing interest rate for the business, taken as a whole. That has been accompanied by a slightly but steadily decreasing required reserve interest rate for the business taken as a whole. When you get one line running up and another line running down, you get an increasing margin of free interest, or free investment income, between those two rates, and that is why the Secretary's ratio has been going down quite rapidly, and the resultant dissatisfaction has generated within the business.

Senator WILLIAMS. And advancing interest rates have reversed the formula so that taxes will increase under the old formula?

Mr. SCHMUCK. Taxes will increase markedly under the formula, yes, sir.

However, despite this trend within the business, as we have shown in our statement, there nevertheless is a substantial number of companies who either do not earn the amount of investment income that they require for their policyholder interest requirements or who earn it with but narrow margins which are not equal, on the whole, to what the average margins are for the business.

If you will refer, sir, to the table on page 5, for example, you would see that in the year 1950, of 156 companies that we were able to study, 27 had no free investment income. They failed to earn their requirements; 41 more had less than the average free investment income; 88 had more than the average free income. But the 27 and the 41, those 68 companies, still had to pay taxes as though they had the average of free investment income.

Senator BYRD. Is that the same as net investment income?

Mr. SCHMUCK. No, sir.

Senator BYRD. On page 7 you refer to net investment income.

Mr. SCHMUCK. No, sir. Net investment income under the law is defined as the gross investment income of the companies, minus the the investment expenses. And that, under the law, is net investment income.

Senator BYRD. Now, free investment income adds to it your reserves?

Mr. SCHMUCK. It takes from the net investment income the reserve interest that is required.

Senator BYRD. Is that the only factor that is different between the free investment income and the net investment income, the question of the reserves?

Mr. SCHMUCK. Reserves and the other interest that we must set aside for policyholders. We pay interest on dividends that are held, and we pay interest on contracts under which we undertake to pay out an insurance policy over a term of years.

Senator BYRD. In both of them, the factor of expenses is a factor?

Mr. SCHMUCK. Yes, sir.

Senator BYRD. The free income and the net income?

Mr. SCHMUCK. They are contract commitments to policyholders.

Senator MILLIKIN. Let me ask you this question, please. I am not asking you to accept in the assumption, but assuming that generally speaking, there is virtue in the proposal made by the preceding witness, would the inequities be taken care of by special exemption for companies that do not meet their interest requirements?

Mr. SCHMUCK. We do not believe so, Senator. We believe that so long as you have an arbitrary factor in the method of taxing life insurance companies, you are going to have inequities against somebody. Now, let us take their proposal. They propose that everybody pay a tax at the rate of 6½ percent of their net investment income with no deductions. Then they say, if a company does not earn the amount of interest that it requires for its policyholder reserves, we will give that company a credit, and under the action that was taken by the company association it was proposed that that credit be a maximum of 30 percent of the amount of the tax computed at the 6½ rate.

Now, if you took that 30 percent figure, or if you took a 50 percent figure, that company is still paying taxes on free investment income that it did not have.

Senator MILLIKIN. I am just "free-wheeling" here now. But supposing that there were a complete exemption in that kind of case.

Mr. SCHMUCK. A 100 percent exemption?

Senator MILLIKIN. Yes.

Mr. SCHMUCK. Certainly for those companies that did not earn their required interest, you would be giving relief. You would still, however, be imposing, in our opinion, a disproportionate tax burden upon the companies that had only narrow margins above the amount of interest that they require.

Let me illustrate that, if I may. Let us take a company today that is making its required policyholder interest, and let us say 6 percent above that required amount. Now, under this formula, that company would pay 6½ percent of its total net investment income as taxes. I am not a good mathematician, but I think that would work out at about pretty close to a 0.115 percent rate applied on the whole free investment income.

There is an amount that that company must get from some other source than its investment income, because it does not have enough free investment income to pay the 6½ percent tax rate out of that income. On the other hand, you will take another company, and there are companies actually today in this situation, another company that needs only 75 percent of its investment income to meet its requirements for policyholders. Now, if you taxed that company, let us say, on a 50 percent basis, that company should pay the Government

$12\frac{1}{2}$ percent of its net investment income, but under this formula they pay only $6\frac{1}{2}$ percent.

Senator MILLIKIN. You are concerning yourself now with a company that is not embarrassed by its inability, for whatever reason it may be, to meet its interest policy requirements. Is that not what you are talking about? But I am putting the emphasis on the company that is not able to meet its interest requirements, and therefore it occurs to me tentatively that perhaps some kind of exemption could be worked out to take care of that particular kind of company.

Mr. SCHMUCK. That would certainly solve the problem for those companies. In 1950, for example, it would have solved the problem for these 27 companies that did not earn their investment income. It would have resolved this tax problem. For the other 41, you would still be imposing upon them a tax that would be disproportionate because their spread of free interest would not be enough, so that the tax at $6\frac{1}{2}$ percent would not be a fair tax as to those companies. They would get some relief, Senator, but not in our opinion the relief to which they would be entitled.

Senator HOEY. What is your comment on the statement under the stop-gap law that we now have that it tends to be a burden on reserves and would deter the building up of reserves, because if you build them up, you would increase the taxes?

Mr. SCHMUCK. Sir, we are of the firm opinion that that argument is more theoretical than real. If a company is determined to follow the process of what is called strengthening reserves, we do not believe that that company would modify its sound business judgment simply on the basis of whether it would or would not pay a slightly higher tax, because the strengthening of the reserves necessarily supposes that that company has the assets to accomplish the strengthening.

Now, if it has those assets, it has to make a business judgment to do one of three things. It is going to let the money lie in the assets of the compay, in a surplus account or in a special reserve account, ot it is going to distribute the money in the form of dividends to policyholders, or it is going to distribute the money, if it is a stock company, in the form of dividends to stockholders.

Now, we have never been able to persuade ourselves that when a company had the assets and had the financial ability to do it, it would be deterred from a reserve strengthening process, simply because of a tax situation.

Senator HOEY. Is this tax very burdensome? For instance, as applied to the increasing of reserves, is it a consequential amount under the present stop-gap law?

Mr. SCHMUCK. It could be, sir, particularly in a larger company; yes.

Senator BYRD. What would the largest company pay in dollars? Do you have any figures on that?

Mr. SCHMUCK. Under what method, sir?

Senator BYRD. Under the stop-gap law.

Mr. SCHMUCK. Under the stop-gap formula?

Senator BYRD. The total is how much?

Mr. SCHMUCK. We did a little estimating on the basis of some 1950 figures. These are necessarily rough.

Senator BYRD. What would your company pay under that?

Mr. SCHMUCK. Under the stop-gap formula?

Senator BYRD. Yes.

Mr. SCHMUCK. If we would take what would be the rate for this year, the assumed 87½ percent, the Secretary's ratio for this year, our company's tax for 1951, based on our 1950 figures, would amount to about $457,000.

Senator BYRD. What would it amount to under this bill that you are now proposing?

Mr. SCHMUCK. Under which, sir?

Senator BYRD. Under the proposition that you now present, what would it amount to?

Mr. SCHMUCK. On free interest?

Senator BYRD. Yes.

Mr. SCHMUCK. About $265,000 or $266,000 on the basis of the modified stop-gap law which we propose for 1951, it would be $361,000.

Senator BYRD. Would the total bring in as much money?

Mr. SCHMUCK. Yes, sir, we think it would bring in more. We think we can demonstrate that, sir.

Senator BYRD. Your company pays just a little more than half?

Mr. SCHMUCK. But there are other companies that would pay considerably more than they are paying at the present time.

Senator BYRD. You think the total would bring in $125,000,000; is that what the present law is?

Mr. SCHMUCK. We think substantially more, sir.

Senator BYRD. How much more?

Mr. SCHMUCK. I have some figures here that are based on taking 50 percent of the average and 50 percent of the individual experience of the companies, and on that basis we figured out that for 1950 the flat tax proposal which the company associations have advanced today would have brought in about $112,200,000 from 125 companies. We could not get them for the whole business. The stop-gap would have brought in $114,350,000 for these 125 companies, and the 50–50 proposal, which I would like to discuss with you would have brought in about $114,330,000. Now, with the increased margin of free interest, that figure under the 50–50 proposal would go up, and we believe would exceed the amount under the flat tax or the stop-gap formula.

Senator BYRD. But for the first year it would be about the same?

Mr. SCHMUCK. For the first year, it would be roughly the same, yes, sir.

Senator BYRD. Very well.

Senator MILLIKIN. Pursuing that exemption business a little further, what would be the bad policy effects of such an exemption? I am talking about general policies for preserving the integrity of the insurance system. Would it encourage loose practices of any kind?

Mr. SCHMUCK. I doubt it, sir.

Senator MILLIKIN. What is the relation of an exemption of that kind to the self-determined rates of interest which the company imposes upon itself for reserve purposes?

Mr. SCHMUCK. I think theoretically you could do what has been done here. You could establish a relationship between the exemption and the company adjusting its guaranteed reserve interest rate to take advantage of the exemption.

Senator MILLIKIN. That is exactly what I am talking about.

Mr. SCHMUCK. In theory you could. In practice, sir, we think it is inconceivable that it would be done.

Senator MILLIKIN. Could some kind of limitation be put on that to accompany an exemption proposal?

Mr. SCHMUCK. Senator, that would impose a complication that I think would be almost worse than some of the formulas we have had in the past.

Senator MILLIKIN. That is the trouble with most of these things. You push in one place and you bulge out in another.

Mr. SCHMUCK. Yes, sir, and that is why we think that you can take out the push and the bulge if you just put us all on an individual basis and let us report and pay on that basis.

I would like to refer in a little more detail to this flat-tax formula that has been proposed here.

Senator MILLIKIN. May I ask you, if it is a proper question, and if it is not, forget it, what is the interest rate that your company determines for itself for the purpose of its reserves?

Mr. SCHMUCK. Our current interest rate, sir, is 2½ percent.

Senator MILLIKIN. Has that varied a great deal in, say, the last 5, 6, or 7 years?

Mr. SCHMUCK. Yes, sir.

Senator MILLIKIN. Within what range has it varied?

Mr. SCHMUCK. In the last 5 or 6 years?

Senator MILLIKIN. Yes.

Mr. SCHMUCK. In 1948, I believe it was, we reduced it from 3 percent to 2½ percent. I think it was in 1938 that we reduced it from 3½ percent to 3 percent.

Senator MILLIKIN. The lower rate that you impose on yourself, the higher your reserves?

Mr. SCHMUCK. The higher the amount of the reserves, yes, sir.

Senator MILLIKIN. Thank you.

Mr. SCHMUCK. This flat-tax formula is a rather interesting proposal. I think we have established here that for all practical purposes, for the year 1951, it probably would make little difference whether you had a tax imposed under the stopgap formula or under this flat-tax proposal. Roughly, that would come out the same, except as you might reduce the amount under the stopgap formula by reason of this proposed reduction of tax for some of the companies.

For future years, however, the situation is a very different one. This flat-tax formula is purely arbitrary. In effect, what it does is create a frozen Secretary's ratio. It takes no account for tax purposes of the experience of the life insurance companies, either individually or collectively. It takes no account of significant changes in general economic or other conditions affecting the income and other operating results of the life insurance companies. If these changes were such, for example, as to reduce markedly the earned interest rate of the life insurance companies, the tax burden under the flat-tax proposal might have serious adverse effects for individual companies.

Conversely, under currently foreseeable conditions, we believe the proposed method would work out to be unfair to the Government, since the free investment income of the life insurance companies is increasing, whereas this proposed formula will freeze the percentage of the net investment income which the Government would receive.

Senator MILLIKIN. Would that be true in a period of depression?

Mr. SCHMUCK. That the Government would receive more taxes than the life-insurance companies should properly pay.

Senator MILLIKIN. You say that under the present trend of things, perhaps the Government would not get enough out of the formula proposed.

Mr. SCHMUCK. Yes, sir.

Senator MILLIKIN. Would the converse be true in a depression period?

Mr. SCHMUCK. If the 6½-percent rate were maintained, the converse would be true, sir. But as I pointed out, in that situation you would possibly have serious consequences for individual companies by maintaining that 6½ percent. And I would be under no illusions that we would not be in here hollering for a reduction.

Senator MILLIKIN. Nor would I. That is what we are here for.

Mr. SCHMUCK. The other thing that concerns us with this formula is that in our opinion it is as unsound in principle as it is in result. It is a complete abandonment of the fundamental concept that in the determination of an income tax you set up your income, you set up your proper deductions, you strike a balance, and you pay a tax on that balance. The company associations have vigorously maintained that position for over 30 years. Every law we have had since 1921 has taken account of that position.

Now we abandon it for pragmatic purposes, as Mr. Adams has said.

What are those pragmatic purposes? In the first place, we think it is a quite patent effort to minimize taxes. In the second place, it is obviously a vehicle to execute the determined purpose of a number of the companies in this business that income taxes shall be paid according to the order of the size of the companies without respect to their relative ability to pay income taxes.

Mr. Adams, in his own statement today, pointed up that fact. To us, it is a position that has no reason except perhaps that it is a necessary one if the companies that gain by these averaging methods are to maintain their preferential tax positions.

The favorable aspects that we can point to on this 6½-percent proposal is that it does embody the recommendation that a reduction be afforded for the companies that need it under any averaging formula. That to us has been particularly interesting because it is the first recognition that these people have given to the burdens that the averaging methods are imposing upon a substantial number of companies, and it is the first concession that they have made that the operating results of the individual companies should be taken into account in determining the amount of taxes which each company must pay.

On the basis of the authority that they had when the company associations got through voting on this thing, that is, to recommend a 30-percent adjustment, we made a number of studies and calculations and have come up with an alternative that we think is somewhat fairer and will give more effective relief to a number of life insurance companies while providing what we consider an adequate base of revenue for the stop-gap period.

If I may, sir, I would like to go to page 10 of our statement and read in toto the discussion of this alternative proposal.

The proposed modification of the flat tax formula is an admission that the operating results of each individual company are a proper consideration in determining its tax liability. The modification pro-

posed is deficient, however, in that, first, it fails to give adequate relief to the companies that need relief, and, second, it fails to compensate for the resulting reduction in tax revenues by taxing additional free investment income of those companies which benefit from the averaging. The modification of the stop-gap formula which we propose will tend to minimise both of these deficiencies.

In making this suggestion, we wish to emphasize that it is proposed as a compromise for stop-gap legislation only and is in no way a withdrawal from our firm conviction that any averaging formula is inequitable to a substantial number of companies, is unsound in theory and result, and is not the proper basis for permanent legislation.

Our proposal is quite simple. We suggest that each individual company compute its tax, at the normal corporate income tax rate, first, according to the stop-gap formula, and, second, on its own free investment income for the taxable year 1951. The amount of tax payable by the company would be equal to one-half of the sum of these two taxes.

Senator MILLIKIN. State that again, will you?

Mr. SCHMUCK. We propose that each individual company shall compute its tax at the normal corporate income tax rate, first, according to the stop-gap formula, and, second, on its own free investment income for the taxable year 1951. The amount of tax payable by the company would be equal to one-half of the sum of these two taxes.

In other words, 50 percent would be on the average and 50 percent on the individual operating experience of the company for the year.

Even the technical and drafting work in connection with our proposed amendment of the stop-gap law would be minimal, since the essential details are covered by existing provisions of the Internal Revenue Code.

The stop-gap formula would continue as under the 1950 law, extended for 1 year. The computation by each company of its own free investment income would follow closely the provisions of the present law. From the net investment income, each company would take as a deduction the interest required for its reserves, using its own valuation rates and its reserves adjusted for preliminary term. It would also deduct interest on its deferred dividends and interest paid on supplementary contracts. These items are now defined in sections 201 (c) (3), (5), and (6) of the Internal Revenue Code.

This proposed modification gives 50 percent weight to the average experience of the industry and 50 percent weight to the individual experience of each company. It would result in distributing the tax more equitably among the companies on the basis of their ability to pay.

The distribution of tax under the several formulas can be illustrated if we consider their effect upon two companies, each of which is assumed to have $10,000,000 of net investment income. Company A is assumed to need only $8,000,000 for its policyholder interest requirements, while Company B needs more than its total net investment income. Company A thus has $2,000,000 of free interest over and above its required policyholder interest. Company B has none. Assuming a secretary's ratio under the stop-gap formula of 87½ percent and a corporate tax rate of 52 percent, the tax liability of these companies under the formulas would be as follows:

You will note that for Company A, under either the stop-gap formula or the flat tax formula, the tax would be identical. It would amount to $650,000. Under our proposal, however, Company A, with its $2,000,000 of free investment income would pay an increased tax in the amount of $845,000.

Now, Company B, on the other hand, under the present stop-gap formula, without modification, would also pay a $650,000 tax. Under the flat tax formula, with a 30-percent reduction, Company B would pay only $455,000 of tax.

Under our proposal, Company B's tax would be reduced to $325,000. However, the gross tax revenues that would be paid by these two companies would be slightly higher under our proposal than it would be under the flat tax formula, although in both cases the gross from these two companies would be less under the modified proposals than under the stop-gap formula.

Obviously, Company B needs the relief of its tax burden which is provided under the proposed flat tax formula, but it needs more and should be given the greater relief afforded by our proposed modification of the stop-gap formula. Equally obviously, Company A has the ability to pay additional tax under our proposal. It has no proper cause to complain of the reduction, under this formula, of the tax preference it enjoys because of the averaging method.

We tested the present stop-gap formula, the proposed flat tax formula and the proposed modified stop-gap formula which we are here suggesting on the basis of the data available to us for 125 companies for the year 1950. For the purpose of comparing the formulas on an identical basis, we assumed a secretary's ratio for 1950 of 87½ percent and a corporate tax rate of 52 percent. These calculations indicate that, on the assumed bases, the flat tax formula would have produced in 1950 approximately $112,220,000 tax revenues from the 125 companies; the stop-gap formula would have produced approximately $114,350,000 of taxes, and the modified stop-gap formula would have produced approximately $114,330,000 taxes.

Therefore, our studies satisfy us that under current conditions our proposed modification of the stopgap formula would produce adequate tax revenues for the year 1951, when compared with either the stopgap or the proposed flat-tax formula.

In fact, if the trend toward increased margins of free interest continues through 1951, as is expected, our proposal would produce greater tax revenues for this year than either of the other two formulas. Though a number of companies would pay less taxes under our proposal than under the other formulas, additional taxes would be collected from those companies having the greater margins of free interest, with the result that the revenues of the Government would not be adversely affected, and might even be increased in 1951, by our suggested change.

We, therefore, strongly urge consideration of our proposed modification of the stopgap formula for the purposes of stopgap legislation applicable to the taxable year 1951.

If I may, I would like to sum up the observations and conclusions that we presented here today.

1. The inherent unsoundness and innate inequities of the stopgap formula have been demonstrated by the results of its application to the 1949 and 1950 income-tax liability of the life-insurance

companies. The formula has been abandoned by its original advocates.

2. The proposed flat tax formula is more arbitrary than the stopgap formula and is at least equally unsound and inequitable in its result. However, the proposed modification under this formula for the benefit of the companies which do not earn or barely earn their required policyholder interest is a recognition by the averaging method advocates that at least some effect must be given under the tax law to the actual experience of individual companies in determining their tax liabilities.

Senator MILLIKIN. May I ask at that point, under your formula any company that is not meeting its interest requirements for reserve purposes could be compelled to pay taxes?

Mr. SCHMUCK. Yes, sir.

Senator MILLIKIN. Why should they?

Mr. SCHMUCK. We think in the final analysis they should not, sir. The proposal is made in the pending bill, though, as the House has passed it, that the stopgap formula be continued for the year 1951. That, roughly, would produce a tax burden upon those companies equivalent to the 6½-percent flat tax that the company associations proposed except that they, in turn, propose that it be reduced by some percentage.

Now we have made a proposal for a flat reduction of 50 percent of the amount that they would pay under the stopgap formula. We would like to see that a hundred percent and we think eventually we will see it a hundred percent.

Senator MILLIKIN. Thank you.

Mr. SCHMUCK. This proposed modification, while properly tending to reduce the inequities of the flat tax proposal, is inadequate and incomplete.

3. The proposed modification of the stopgap formula is a more reasonable and equitable formula for purposes of temporary legislation than either the stopgap formula in its present form or the proposed flat tax formula.

4. The only sound, fair, and reasonable basis for permanent taxation of life insurance companies, consistent with the general provisions of the income-tax laws, is to impose the tax upon each company upon the basis of its own individual operating experience, without averaging or any other artificialities

Unless there are more questions, I would like to express our appreciation for the privilege of appearing before your committee this morning.

Senator BYRD. Thank you, sir.

(The prepared statement submitted by Mr. Schmuck reads in full as follows:)

STATEMENT ON BEHALF OF ACACIA MUTUAL LIFE INSURANCE CO.

Acacia Mutual Life Insurance Co. appreciates the opportunity to present to your committee its views with respect to section 311 of H. R. 4473, adopted by the House of Representatives and now pending before the Senate. This section extends for another taxable year, 1951, the average valuation rate formula, generally termed the stopgap formula, which provides the method for computing the deduction for required policyholder interest which life insurance companies are permitted to take in establishing their taxable income for income-tax purposes.

We would prefer, as probably would most life insurance companies, that final action effecting a permanent solution of the problem of taxing life insurance companies might be taken now by the Congress. To that end, we presented to your committee last year a detailed and comprehensive analysis of the problem and our suggestions of appropriate bases for the permanent taxation of life nsurance companies.

However, in its discussion of section 311 of the pending revenue bill, the Committee on Ways and Means stated, at page 22 and 23 of the accompanying report, that progress has been made in the studies looking to the development of permanent legislation covering life insurance company income taxation, but that an extension of stopgap legislation for 1 year is necessary to provide additional time for the completion of the pending studies. During our appearance before your committee last year Senator Millikin initiated and Senators Hoey, Taft, Martin, Byrd, and Myers joined in the questioning of a representative of the Treasury Department concerning the averaging concept which is the basis of the stopgap law and was the basis of the 1942 law. It may be recalled that, under the questioning, the Treasury representative expressed his opinion that the averaging concept is essentially unsound but stated, in effect, that the Treasury then supported a stopgap solution (even though it was based on averaging) while the basic problem of permanent legislation is studied. The Treasury has not brought in a proposal for permanent legislation this year. In this situation, and considering the extremely burdensome demands upon the Congress at this time, it seems appropriate to accept without further discussion that any legislation covering life-insurance company taxation which is passed this year will be interim or stopgap.

However, we would like briefly to review the basic problem and to discuss the results and impact of the stop-gap formula and the alternative proposal which we understand will be submitted to your committee on behalf of the associations of life-insurance companies, which has been termed the flat tax formula. In addition, we would like to present for the consideration of your committee a third alternative for interim taxation which is a proposed modification of the stop-gap formula.

THE PROBLEM AND ACACIA'S BASIC POSITION

The basic position of this company was discussed with the Senate Finance Committee on March 29, 1950. Our formal statement, and the colloquy concerning it, appear in the record of hearings before the Committee on Finance on H. J. Res. 371 at pages 69 to 97.

In our presentation, we reviewed the successive laws covering the taxation of life-insurance companies since 1921, including the then pending stop-gap formula. Each of these laws was based on the theory that the only true taxable income of a life-insurance company is the excess of its investment income (interest, dividends, and rents) over its investment expenses and the amount of interest required to meet contractual and statutory obligations to policyholders. This theory is completely sound, at least as to mutual life-insurance companies. The laws since 1921 have applied, without regard to fundamental distinctions, to both stock and mutual life-insurance companies.

Each of these laws has contained arbitrary and artificial factors for the determination of the allowable deduction for required policyholder interest. These arbitrary artificialities have attained increased importance under the 1942 and the stop-gap laws, based on the so-called industry-wide method of taxation.

Under the stop-gap formula, the investment income of all life-insurance companies is lumped together. Next, the amount of interest needed by the life-insurance companies for policyholder reserves and other interest payments to policyholders is lumped together, except that if any company needs more interest than it earns, the excess over the earnings of that company is dropped. The ratio of the second total to the first establishes for the industry as a whole the percentage of the investment income (called the secretary's ratio) which theoretically is what is needed to satisfy policyholder interest requirements. Then, the stop-gap law requires that each company use that industry average percentage of its investment income in computing its deduction for required policyholder interest, as though that average percentage were its actual interest requirements. The balance is considered taxable income and tax is paid at the normal corporate rate.

No attention is paid, under this averaging formula, to the differences among the companies—the fact that some are very large and some are very small, some have made reasonably high interest guaranties to policyholders while others have made much smaller guaranties, some have high investment interest earnings

rates and others have low, some have large sums of investment income not needed for policyholder requirements while others have none. Nor does this formula recognize that some are mutual companies operating solely for the benefit of their policyholders while others are stock companies operating for the private profit of their stockholders.

In our 1950 presentation, we showed the unfair and inequitable impact that the averaging method has upon many companies in our business. In some companies, the net investment income is less than their policyholder required interest. In many other companies, the percentage of earned interest needed for policyholder requirements is far higher than the arbitrary industry-wide average. Yet all of these companies must report and pay tax on the same percentage of their investment income. Each of these companies, by reason of the averaging, is penalized and forced to pay an unjust and disproportionate tax. Of course, as is obvious, the method also gives an important tax preference to a substantial number of other companies, some of which earn free interest far in excess of their interest required for policyholders.

We also pointed out that, as a result of the arbitrary and artificial factor in the various laws since 1921, the Government has never realized in any year since 1921 the full tax that would have been payable if the individual companies had been paying taxes in each year based on the amount of free investment income of each company over and above its policyholder interest requirements.

Our studies have convinced us that much if not most of the difficulty for both the Government and the life-insurance companies over the matter of income taxation of these companies has resulted from the artificialities, the arbitrary factors and the averaging methods introduced into the various tax formulas since 1921. We believe that the problem can be minimized and perhaps eliminated and the Government will derive continuing revenue in a satisfactory amount if the Congress will impose the tax on each life-insurance company, as it does on all other taxpayers, on the direct basis of the actual income and the actual deductions of each company, eliminating the averaging and all other artificial formulas.

As a result of our analysis, we concluded, and therefore submitted to your committee for consideration that a proper permanent method of taxation, fair to each individual company and to the Government might be evolved from the following basic principles:

1. Free investment income is the only sound and proper tax base for mutual life-insurance companies.
2. The tax should be imposed on the basis of each mutual company's individual free investment income and without averaging or any other artificial or arbitrary formula.
3. The total net income basis is not a sound and proper basis for the taxation of mutual life insurance companies.
4. Some form of total net income basis would seem to be sound and appropriate for taxing stock life insurance companies, taking into consideration the fact that the stock life insurance companies are owned and operated for the private profit of their stockholders.

We are still committed to these principles and convinced of their fundamental soundness. We sincerely hope that they will form the basis of permanent legislation when it is before the Congress for consideration and that at that time all artificial and arbitrary formulas will be discarded once and for all from the tax laws affecting life insurance companies in favor of direct taxation based on the individual experience and results of each company.

STOPGAP FORMULA

The stopgap formula described in the preceding section was adopted in 1950 and made applicable to the taxable years 1949 and 1950. The Secretary's ratio or industry-wide percentage deduction for required policyholder interest was based on the operating results of the companies for the years 1948 and 1949 respectively.

The Secretary's ratio thus established for use in the tax returns covering the taxable year 1950 was 90.63 percent. This meant in effect that for the taxable year 1950 each company, without regard to its own requirements, took a deduction of 90.63 percent of its net investment income and paid a tax on 9.37 percent of that income at the regular corporate rate.

We do not have access to the confidential income tax information concerning each life insurance company, but we have been able to compile from various statistical sources the data necessary to compare for 156 companies the 1950

results under the stopgap formula with what they would have been had these companies been taxed directly on the basis of their net investment income and their own actual deductions for required policyholder interest. This study discloses that 27 of the 156 companies had less net investment income in 1950 than their required policyholder interest. Nevertheless, these companies were penalized under the averaging method of the stopgap formula by having to pay taxes on 9.37 percent of their net investment income. In addition, 41 more companies had more investment income than was required for their individual contractual and statutory obligations to policyholders but the margin between what they needed and what they earned was less than the 9.37 percent of their investment income upon which they had to pay tax. For these companies, the tax paid amounted to a substantially greater percentage of their actual free interest than the normal corporate tax rate. Eighty-eight companies required less than 90.63 percent of their investment income in 1950 for their interest obligations to their policyholders. These 88 companies gained a definite tax advantage as the result of the stop-gap formula since they were enabled, as a result of the averaging, to pay taxes at less than the normal corporate tax rate applied to their actual free interest and to shift a part of their proper tax burden to the other companies.

A breakdown of these companies by size is of interest and is shown in the following table:

Millions admitted assets, Dec. 31, 1950	Group 1 [1]	Group 2 [2]	Group 3 [3]	Total 1, 2, 3
Over $1,000	0	3	10	13
$500 to $1,000	1	1	4	6
$300 to $500	1	2	6	9
$100 to $300	4	4	17	25
$50 to $100	3	13	15	31
Under $50	18	18	36	72
Total	27	41	88	156

[1] Group 1: Investment income less than required interest in 1950.
[2] Group 2: Required interest less than investment income but greater than 90.63 percent of investment income in 1950.
[3] Group 3: Required interest less than 90.63 percent of investment income in 1950.

For the taxable year 1949, the secretary's ratio under the stop-gap formula was 93.55 percent. We were able to secure the comparative data for that year for 259 companies. This study discloses that 67 of these companies had less investment income in 1949 than their required policyholder interest. Thirty eight had more investment income in that year than their required policyholder interest but their requirements exceeded 93.55 percent of their investment income. One hundred and fifty four companies required less than 93.55 percent of their investment income in 1949 for their interest obligations to their policyholders and therefore benefited from the averaging formula. A breakdown of these companies by size is shown in the following table:

Millions admitted assets, Dec. 31, 1949	Group 1 [1]	Group 2 [2]	Group 3 [3]	Total 1, 2, 3
Over $1000	1	4	8	13
$500 to $1000	1	1	3	5
$300 to $500	0	2	6	8
$100 to $300	4	5	15	24
$50 to $100	7	6	12	25
Under $50	54	20	110	184
Total	67	38	154	259

[1] Group 1: Investment income less than required interest in 1949.
[2] Group 2: Required interest less than investment income but greater than 93.55 percent of investment income in 1949.
[3] Group 3: Required interest less than 93.55 percent of investment income in 1949.

These tables confirm previous studies concerning the effect of the averaging. They show again that a substantial number of companies are prejudiced by the averaging method and that, in general, the advantages of the averaging formula accrue most strongly to the larger companies, while proportionately more of the smaller companies suffer from the inequities and unfair discrimination of the averaging method.

The over-all trend within the life insurance business is toward increasing margins of free interest, reflecting in general slightly higher earned interest rates

accompanied by a steady decline in the guaranteed reserve interest rate on all insurance in force. Nevertheless, as is shown by the tables, a substantial number of the companies still do not earn the amount of their required policyholder interest and additional companies have less free interest than the average. For these companies, the general trend, coupled with the substantial increases in the corporate tax rate, emphasizes the burden which is imposed upon them by the averaging formula. The burden will be even greater for the taxable year 1951, since it is estimated that the secretary's ratio will fall to somewhere between 87 percent and 88 percent while the corporate tax rate is proposed to be increased to 52 percent.

We sincerely urge upon your committee that, even for stopgap purposes, recognition be given to the substantial unfairness of the stopgap formula in its present form and that your committee consider a change now in the tax law which will give some measure of relief to the companies that are prejudiced by the stopgap formula. We shall discuss later in this memorandum two possible means of affording such relief.

The dissatisfaction within the life insurance business over the past and projected results of the stopgap formula recently became obviously vocal and more widespread. Companies which had perhaps not considered, or at least had not participated in the discussion of the principles underlying the stopgap formula and the fundamental unsoundness of that formula, became impressed with the inequities of its application. Even the original sponsors of the stopgap legislation, the company associations within the life insurance business, have now withdrawn their support of that formula.

The stopgap law is unsound legislation which should be removed from the tax law at the earliest possible moment.

FLAT-TAX FORMULA

The representatives of the joint committee on company Federal income tax of the two associations of life insurance companies have been instructed to present to the Senate Finance Committee a proposed substitute for the stop-gap formula.

In essence, this proposal is that all life insurance companies shall pay a tax amounting to 6½ percent of their net investment income (interest, dividends, and rents less investment expenses). Under this method, the companies would not be allowed any deduction from net investment income for the interest required to be set aside or paid to policyholders out of the net investment income of the companies. The tax under this proposal would be subject to a small company allowance to correspond with the $25,000 exemption from surtax allowed all corporations and subject also to a modification or reduction of the amount of tax to afford some relief to those companies whose net investment income is less than 105 percent of their required policyholder interest.

The figure of 6½ percent was arrived at, as shown in a letter from the chairman of the joint committee to the chairman of the House Ways and Means Committee, dated May 2, 1951, by assuming that the percentage deduction for required policyholder interest for the year 1951 under the stopgap formula will be in the neighborhood of 87 percent of net investment income and applying an assumed corporate rate of 50 percent to the resulting 13 percent taxable income. (If the tax rate is 5 percent, the assumed percentage deduction would be 87½ percent. Given the reasonable accuracy of both the assumed percentage deduction for 1951 under the stop-gap formula and the corporate tax rate under the pending tax legislation, it would make little difference as to the current taxable year whether the tax on the life insurance companies was imposed under the stop-gap formula or under the proposed flat-tax formula, except for a proposed modification of the latter, which will be discussed later.

As to the future years, however, the situation would be very different. The proposed flat-tax formula is purely arbitrary. It takes no account for tax purposes of the experience of the life insurance companies, either individually or collectively. It takes no account for tax purposes of significant changes in general economic or other conditions affecting the income and other operating results of life insurance companies. If these changes were such, for example, as to markedly reduce the earned interest rate of the life insurance companies, the tax burden under the flat-tax proposal might have serious adverse effects for individual companies. Conversely, it is obvious that if current trends continue, the proposed method will be unfair to the Government, since the free investment income of the life insurance companies appears to be increasing, whereas the proposed formula would freeze the percentage of the net investment income which the Government would receive.

The proposal is essentially unsound. In addition, it is an amazing reversal by the company associations of a basic position consistently maintained and vigorously supported for over 30 years.

The interest earnings of life insurance companies are vital to the maintenance of the reserves upon life insurance policies which are necessary if the companies are going to accumulate the funds to make it possible to perform their contracts with their policyholders. If, for any reason, including the fact that the tax laws require the payment of too much taxes, any company is unable to add to its policy reserves in any year the amount of the interest guaranteed by its policy contracts, the solvency of that company is impaired. The chairman of the joint committee of the company associations summed up this basic concept in his statement to the Committee on Ways and Means as recently as February 28, 1951, in the following language:

"Therefore in theory and in fact, the only true income arising in the whole life insurance transaction is the interest earned on assets over and above the amount necessary to maintain reserves. The reserve interest is not income to the company because it represents a liability to the policyholder. It is tantamount to interest paid upon indebtedness at a guaranteed rate. If you tax the interest required to maintain reserves in any significant degree, you invade the reserves themselves and therefore tax away solvency because the integrity of the reserves requires that they be increased year by year at the contract rate of interest. If the integrity of reserves is invaded, the solvency of the company is impaired."

The flat tax proposal, abandoning the sound concept of a deduction for required interest, shockingly violates the fundamental principle so ably expressed in the foregoing quotation and which has been recognized in all income tax laws applicable to life insurance companies.

The entire proposal, in our opinion, is a patent attempt to minimize the taxes of some life insurance companies, under present and foreseeable conditions, while preserving the determined purpose of a number of companies in the business that income taxes shall be paid in order of size of the companies, rather than according to the ability of each company to pay such taxes on the basis of its individual operating results.

This position is necessary to preserve the preferential tax treatment of those companies which benefit from any averaging method. Under the flat tax formula, for example, some companies would pay taxes which would represent a 25 percent or even lower rate of tax on their actual free investment income. The disadvantages and inequities to the other companies, except perhaps for the minor modification of the flat tax which is proposed, and the unfairness of the proposal to the Government in future years, are completely disregarded. The dangerous possibilities of the flat tax formula for many companies in the event of a serious reversal of present economic conditions are ignored.

We are confident that the unsoundness of the flat tax formula is so clear that the plan would not commend itself to your committee, except perhaps as a substitute for the stopgap formula for the current taxable year. However, it is desirable to discuss that portion of the proposal which provides for reduction of the tax in the case of certain companies.

The proposed modification is that the amount of tax computed on the basis of 6½ percent of net investment income shall be reduced by 30 percent for those companies which fail to earn net investment income exceeding their policyholder required interest. The 30-percent deduction shall be graded down proportionately as the earnings of the individual company exceed its interest requirements until the deduction becomes zero when the earnings amount to 105 percent or more of the requirements.

This proposed modification is particularly interesting in that, to our knowledge, it is the first time that the proponents of the flat tax formula have given public recognition to the unfair and often harsh burden that their artificial averaging formulas have imposed upon many companies. It is also their first concession that the operating results of the individual company should be taken into account in the determination of the amount of taxes which the company must pay.

To the extent that the proposed modification or allowance would give relief to a number of companies who do not now earn their required policyholder interest or earn it with but a very small margin of free interest, the flat tax proposal, with the modification, would result in greater fairness to those companies for the current taxable year than would the stopgap formula. It would not remove the tax preferences now accorded to companies whose investment income substantially exceeds their required interest. Nor would it give full or in our opinion even adequate relief to those companies which most need it because of their

failure to earn their required interest. But it would give some relief to a number of companies and, as to those companies, would be less discriminatory in its impact than the present stopgap formula.

Senator BYRD. Senator Lucas, would you like to be heard? You have spent many hours in this room.

STATEMENT OF SCOTT W. LUCAS, APPEARING FOR THE ACACIA LIFE INSURANCE CO.

Mr. LUCAS. Yes, I have, sir.

Senator BYRD. You have rendered distinguished service on this committee. I have not seen you in the well before.

Mr. LUCAS. It is the first time I have been in the well. I can add nothing to what Mr. Schmuck has said except to say that in my opinion, as one who has been around this committee room for a long, long time, that he has presented a very illuminating, forcible, and constructive argument in the position that he takes, both from the standpoint of permanent legislation for life-insurance companies, as well as this temporary proposal that he is seeking to have the Congress adopt at this time.

It strikes me, Mr. Chairman, and gentlemen, that sooner or later, and the sooner the better, the Congress of the United States is going to have to recognize the principle that Mr. Schmuck is advocating here for the Acacia Life Insurance Co., taxing life-insurance companies on a company-by-company basis, and not on the averaging formula under which we have this stopgap legislation, which is utterly unsound, inequitable, and unfair to many, many small insurance companies in this country.

I should like to conclude by saying, as you all know, that the Acacia Life Insurance Co. is a small company. It has been advocating this principle for the last 25 years before committees and before insurance conventions. But because it is small, it has been outvoted nearly all the time.

But nevertheless a principle is involved here, in my opinion, which is exceedingly sound. The staff and the Treasury should take serious cognizance of it in their exhaustive study for the next year, if you are going to have permanent legislation in the near future. I sincerely hope that we will have such legislation soon because we have had the experience under the averaging laws of seeing life-insurance companies in 2 years pay no tax whatsoever.

Certainly, that cannot and should not happen again. There should be a permanent law on the books whereby these companies would pay in line with their ability to pay. That is the statement that Senator Taft made last year in that most interesting colloquy that was had here between Senator Millikin and Senator Hoey, Senator Taft and others, when Mr. Schmuck presented the position of the Acacia Life on permanent legislation for life-insurance companies.

I read it time and again, and it is to me one of the most interesting colloquies that was had before this Finance Committee.

Senator BYRD. Thank you very much, Senator. Are there any questions? Thank you.

Mr. SCHMUCK. Thank you.

Senator BYRD. Thank you, both of you gentlemen.

Mr. LUCAS. Thank you, Senator.

Senator BYRD. The next witness is Mr. John A. Lloyd. Please identify yourself, sir, to the reporter.

STATEMENT OF JOHN A. LLOYD, VICE PRESIDENT, THE UNION CENTRAL LIFE INSURANCE CO.

Mr. LLOYD. My name is John A. Lloyd. I am vice president of the Union Central Life Insurance Co., Cincinnati, Ohio.

I am speaking for that company.

In March 1950, when the subject of the taxation of life-insurance companies was before this committee, I appeared as a witness against the proposals in what then was known as House Joint Resolution 371. While that bill, as you will remember, included a provision which would have levied taxes retroactively for the years 1947 and 1948 it also contained the same provisions on a temporary or stopgap basis as are in the bill presently under consideration. Your committee wisely recommended against the retroactive features and they were stricken from the Revenue Act of 1950.

The wisdom of our opposition to the stopgap proposal has been confirmed with the passage of time and today I appear, representing the Union Central Life Insurance Co., to testify against the reenactment of the same old stopgap proposal, which now makes its appearance in H. R. 4473. Where, 16 months ago, there were comparatively few life-insurance companies which realized the dangers inherent in the stopgap proposal, today, after a year of its operation, all life-insurance companies—so far as I know, and I have made an effort to determine the facts—see this proposal in its true perspective, and all are vigorously opposed to it.

Our reasons for opposing the life-insurance taxation provision of H. R. 4473 may be summed up, in part, as follows:

1. Because it levies taxes upon the basis of an artificial, unrealistic, unfair, and discriminatory formula.

2. Because the tax it develops does not and cannot reflect the operational result of the company to be taxed.

3. Because if the theory upon which it is based were to be adopted as a permanent measure, it would, over the years, produce taxes so unconscionably high as to be confiscatory of the capital contributions of the policyholders of many and possibly of all companies.

4. Because this year it would develop such high taxes on some companies as to constitute a confiscation of portions of funds paid to those companies by policyholders in the form of premium deposits.

5. Because it is a temporary measure and does not meet the urgent need of the life-insurance business which is for a permanent form of taxation, ending the uncertainties which now make the problems of management so very difficult.

We strongly urge the adoption of the proposal presented by Mr. Adams who testified here today representing the practically unanimous views of the life-insurance companies. That plan provides for a tax at the rate of 6½ percent upon the net investment income of each life-insurance company, with reduction given in the instance of those companies which have not earned from investments or are having difficulties earning from investments the amount of interest necessary to meet policy reserve requirements.

Senator MILLIKIN. May I pursue my thoughts which are entirely tentative and do not at this time represent any fixed opinion on my part?

Why should a company that is not meeting its reserve requirements in the way of interest, pay any tax?

Mr. LLOYD. Well, the Senator asked me a question which goes to the heart of the theory which, if it were not for certain practical considerations, I should be glad to embrace.

From the standpoint of pure principle and pure reason, I must agree that that is the proper end to be reached.

The taxation of life-insurance companies has become such a difficult problem over the years, and the necessity for getting a permanent, well-reasoned and well-founded statute on the books is so important that we began to search for compromise formulae.

We came in here a year ago advocating exactly what we thought was, in principle, the thing to do, which was that company that had no net investment income should pay no taxes until it had net investment income after reserve requirements were taken care of. But we find ourselves faced with stopgap again. Stopgap is—I am almost tempted to use the word—a "wicked" form of taxation. We, therefore, having been in the camp of the opponents of the company organizations last time, began to seek some way out of the wilderness.

They came before the Ways and Means Committee of the House—Mr. Adams has testified that they were seeking a way out, that they would like to present a new proposal, that they were endeavoring to find one. If they could not find one they would recommend the stopgap for another year and they kept on seeking and finally they came up with the flat 6½-percent proposal.

We thought that the original 6½ proposal bore upon the companies who had not earned their interest requirements almost as heavily as the stopgap did.

We began to work with those two methods of taxation, the stopgap and the flat 6½-percent plan. Frankly, we felt that we had no chance to get an exemption for the company that was not earning its interest charges.

There have been a lot of loose statements made about life-insurance companies; they did not pay their taxes, and so on, by people who did not understand the situation.

So, we went to our company organizations and we proposed approximately what Mr. Schmuck has proposed this morning and in hammering that out on the anvil of discussion with other companies and with the technical staffs employed by the company organizations, we reached the conclusion that that was halfway as bad as stopgap for half of it it had the stopgap provisions.

When we got to the point of trying to adjust the thing, we came up with the conception that those companies that were having difficulties with interest requirement earnings could be given a proper credit that would enable them to build the surplus funds from which they can make their interest earnings, and so we are going to propose here in a little bit, another modification that we think is a little more practical than Mr. Schmuck's.

Just before the Ways and Means Committee got ready to act in the House the company organizations completed their studies, and they came up with the 6½-percent proposal. It was, I think, but a day

or two before the House committee acted; so that I do not think the House committee—and I am not criticizing them; I think they could properly have done as they did— had time to give this the consideration that it should have had.

But to get back to your question to which I may have spoken too long and perhaps I have not answered it to your satisfaction, the real answer is this: That we, in speaking on this subject of the credit for companies having difficulty with interest reserves—I am not just speaking for our company, I have been asked by a number of companies, some which make their interest requirements and some which do not, to discuss this matter with the committee.

As a purely practical matter, in the hope of getting a permanent tax bill, or at least of getting relief from the stopgap, we come in here and say that we would rather get the best credit that we can get and try to get some kind of a tax bill under which the companies can live. I do not know whether I have answered your question satisfactorily, but that is the real situation.

Our reasons for advocating this proposal include the following:

1. The proposal is applicable to the operation of each company and is simple to understand and easy to apply.

2. It eliminates industry-wide averaging and other so-called global treatment.

Each company will apply it to its own operations and its tax will no longer be affected by the policy reserve interest changes of other companies or by the investment policies of its competitors.

3. Each company will be in a position to estimate its tax liability in advance and to adjust its operations thereto.

4. It will produce slightly more revenue in 1951 than is provided for in H. R. 4473. In my opinion, the amount will increase automaticallx and steadily through the years as the business of life insurance develops under sound conditions.

5. It never can produce the unfortunate situation developed by the old law in 1947 and 1948, when no tax resulted.

Our proposal is not a perfect one. But it is a practicable one and a workable one and is the first such to be developed in recent years, upon which the life insurance business agrees almost with unanimity.

Stop-gap, makeshift legislation applied to permanent problems generally is bad legislation. This truth is particularly applicable to the business of life insurance. Life insurance is a long-time enterprise. The management of life insurance companies must plan not in terms of years but of generations. It must continually look as far into the future as it is possible to see clearly, and to provide for such contingencies as it can find in its long vision. It should have as definite knowledge of foreseeable factors as is possible, and taxation is one of those foreseeable factors which can be provided for permanently or at least for the foreseeable future.

Senator MILLIKIN. Theoretically, could it be argued—I think it has been argued theoretically—so far as mutual companies are concerned, there is no taxable income. There might be a capital gains question or capital loss questions, but there is really no income tax, as such, under a proper conception of capital gains and losses, as contrasted with regular income.

I mean, is the theory correct that in a mutual company the company is simply, in real effect, holding the capital of the policyholder?

Is that theory correct?

Mr. LLOYD. Yes; that is an exactly correct theory. I do believe that a mutual company which has income from investments net and above the interest income required to meet its reserve requirements should pay a tax on that net investment income.

Senator MILLIKIN. Yes, sir.

Mr. LLOYD. But that income differs from any other receipts the company has.

The policyholder in a mutual life insurance company puts up the capital with which the company operates when he makes his premium deposit.

Senator MILLIKIN. Well, I do not think that there is any chance of putting the insurance business on a capital gains and loss basis.

But just——

Mr. LLOYD. For a long-time business that would be very difficult.

Senator MILLIKIN. Yes; it would be very difficult and the matter of getting taxes is very practicable, and so I assume you continue to believe that some part of the income of some companies will be taxed as income.

But I was just wondering as a matter of theoretical interest whether an argument could be made that there should not be an income-tax problem in a purely mutual company, simply on the theory that the policyholders——

Mr. LLOYD. If you carry that theory clear out to its ultimate conclusion, the policyholder owning everything, including any increment on the investments on what he put in it, how it developed, that theory might go on to that point.

Senator MILLIKIN. Well, I would not carry it to that point.

Mr. LLOYD. I would not, either.

Senator MILLIKIN. But it is just to experiment with the pure logic of the situation.

Mr. LLOYD. I think something might be said at this juncture—you mentioned a mutual company, and the witnesses who preceded me, Mr. Schmuck in particular, mentioned the two different kinds of companies, and since we are a stock company in the process of mutualization, and no longer a stock company and not strictly a mutual, I am a perfectly impartial witness on that subject.

But I do think the committee should have this in mind, that stock companies write mutual-type insurance, too. In that instance the policyholder makes the same kind of a premium deposit he makes in a mutual company, so that it is not quite so easy to just say that the life insurance companies are all either sheep or goats.

The kind of business that is on the books and the policyholder's rights in that business make it a little difficult to just say that we can call one kind one kind, and one another.

Senator MILLIKIN. I understand.

Mr. LLOYD. I was talking about the long-term aspect of life insurance and the need for a long-term law.

That being true, we believe it should be so provided.

We urge you to put an end to the uncertainties of temporary legislation. Four years is too long for the unknown to be the normal in as important a matter as taxes.

It is just as easy to write a permanent law as it is to enact a stopgap measure. If a mistake is made, Congress can rectify it as simply if it is permanent as it can if it is stopgap.

It has been suggested that further congressional studies should be made. We will be glad to cooperate with anyone making such a study. If these efforts produce a better solution than our proposal we will embrace it; but whether we do so or not, Congress can adopt it.

May we suggest, however, that since 4 years of studies have not produced any other acceptable solution, it is but practicable to enact, without temporary status, our proposal and, if further studies develop a better plan, adopt it then.

Meantime, life insurance companies will not be left to wander in the wilderness of stopgap.

In the interest of good business and good government, we urge you to enact permanent legislation now.

I should like to direct the attention of the committee to the provision that credit on the tax be given to companies encountering difficulties in earning sufficient interest from investments to meet their policy-reserve-interest requirements.

The last figures I had, and they are quite current within a year, are that there are 87 such companies, out of the 200-and-some which we checked and, in the comment I shall make upon this phase of our tax proposal, I speak not only for myself but for a large number of companies both within and without that group. The two Nation-wide organizations of companies approve the principle underlying the suggestion which I shall make. That principle is an essential part of their proposal.

It seems to be in order here to discuss for a moment the situation in which these 87 companies find themselves. They are fine companies, strong, safe, and well managed. No proper criticism can or has been made of their position and none is implied. The reasons which underlie the situation whereby they are not currently earning from investments the interest to meet policy reserve requirements vary with the condition which prevails in each company.

In each instance upon which I have information, the gap between interest required to be earned and interest being earned is closing steadily and rapidly. The entire life-insurance business has suffered from low interest yield. A year or two ago the list of companies not earning policy-reserve-interest requirements would have been much larger than it is today.

If current trends in investment yield continue, in another year there will be a sharp decline in the number of companies encountering difficulty with interest earnings and the list will, in the near future, pass out of existence.

Senator MILLIKIN. Has that come about through rising interest rates?

Mr. LLOYD. Through rising interest rates.

Senator MILLIKIN. Is that substantial enough to be importantly felt at this time?

Mr. LLOYD. It is quite substantial, Senator; quite substantial throughout the entire business.

Senator MILLIKIN. In the type of investment that insurance companies are permitted to go into?

Mr. LLOYD. That is right. Mortgage and bond interest rates are going up. It is quite substantial.

Senator BYRD. How much have they gone up, would you say, in the last year, Mr. Lloyd?

Mr. LLOYD. Well, I am not an investment authority, although I have some responsibilities in the investments made by our company.

The rate on bonds has gone up 30 to 40 basis points, if my memory is correct.

We only buy the very top type of securities.

The interest on ordinary dwelling mortgages has gone up from either 4 to 4½ in what we would call AAA type, and from 4½ to 5 in the ordinary run-of-mine mortgage, and when you apply that much spread over the assets of a great corporation which is trying to earn money on it for the benefit of its policyholders, you get a considerable increment.

Senator MILLIKIN. Are good investments of the two types you mentioned available, readily available, to insurance companies?

Mr. LLOYD. Yes, sir.

Senator BYRD. On farm mortgages you said 4 to 4½ percent?

Mr. LLOYD. I said the type of property on which the rate was set is now 4½. The type of property on which it was 4½ is now 5.

Senator BYRD. Are those farm mortgages or land mortgages or buildings?

Mr. LLOYD. I am not too familiar with the farm mortgage problem now at all. There was a time when I was, because we had $150,000,000 of them, but I am not any more. We have not been in that market for some time. I could not answer that question.

Senator BYRD. What is your average rate from the Governments, do you know?

Mr. LLOYD. I do not believe I can answer that. I do not have that accurately and I would not want to guess at it, Senator.

Senator MILLIKIN. You have a mixture, I suppose, of short-terms and long-terms?

Mr. LLOYD. Oh, yes.

Senator BYRD. You have got 2½, I suppose?

Mr. LLOYD. I would not want to guess about it.

Senator MILLIKIN. Is there an average in the insurance business on Government securities in portfolios, does anyone know? Just roughly?

Mr. BRUCE SHEPHERD (general manager, Life Insurance Association of America). It is somewhere around 2.40, I guess, but most of the money is in the longer-term Governments.

Senator MILLIKIN. Thank you.

Senator BYRD. Go ahead.

Mr. LLOYD. The writing of new business on current interest assumptions should, barring unforeseen contingencies, ultimately eliminate the problem.

It is important that these companies have the proposed tax credit, for the impact of the full tax without this credit upon them will materially hamper the proper development of contingency reserves and needed surplus and the strengthening of policy reserves either directly or through the setting aside of funds for that purpose.

Taxes, by being too burdensome, can defeat the very purpose of taxation itself, if by their drain upon investable funds they prevent the normally expected increase of earnings. Our credit proposal will eliminate that danger.

The problem is a temporary one and, when the companies no longer encounter difficulties in earning their policy requirements, they should and gladly will pay the full tax provided for in the plan.

Senator MILLIKIN. It follows logically, does it not, from your suggestion that these companies that are in difficulty, due to the rising rate of interest, will get out of their trouble within a relatively short period of time. That being true, there will be no substantial loss of revenue insofar as those companies are concerned?

Mr. LLOYD. That is right.

Senator MILLIKIN. Yes.

Mr. LLOYD. Our recommendation is that the credit given by 50 percent of the tax, and that this be allowed where interest requirements are not earned from investments, with the reduction graduated downward until 105 percent of the interest requirement is earned. The graduating provision is necessary to provide stability and give opportunity for steady development.

We suggest, in the interest of simplicity, that the burden of asking for this credit and of proving a right to it be placed upon the companies. Such a plan of administration will relieve the Bureau of Internal Revenue of this chore.

While there are 87 companies which probably will receive the credit this year, the amount of tax revenue involved is quite small. This is true because most of the 87 companies are small. The 50-percent reserve interest credit proposal will only reduce the tax revenue from the 6½-percent plan by $2,500,000 in 1951.

In our judgment, the 50-percent credit we advocate is particularly necessary for small companies, for one of the many evils of the stopgap plan is that the tax will bear so heavily upon them as to retard and perhaps even prevent their growth. We believe these companies should grow and prosper, and we plead with you not to strangle them in their cribs with the stopgap tax plan.

The estimate of tax from life-insurance companies to be produced by H. R. 4473 is approximately $123,700,000 on 1951 business.

Our proposal, which includes the 50-percent reserve interest credit, will produce approximately $125,000,000 in revenue for the same period, more than $1,000,000 in excess of what the stopgap will develop.

To sum up, we believe that the stopgap proposal of H. R. 4473 contains uncontrollable and inherent features which bear upon life insurance in such a manner as to be confiscatory of the interest of policyholders. We urge you to end stopgap.

The 6½-percent flat tax, with reserve interest credit, is a workable, practicable, acceptable solution to what has long been a most troublesome problem for some 600 companies and more than 80 million policyholders. We urge you to adopt it.

Thank you very much.

Senator BYRD. Thank you very much, Mr. Lloyd.

Mr. LLOYD. Thank you, sir.

Senator BYRD. The acting chairman must go to the floor because of some legislation he is interested in and which is now coming up, and I will ask Senator Millikin to hear the two other witnesses.

Senator MILLIKIN. Mr. Woods, would you mind identifying yourself to the reporter?

STATEMENT OF CECIL WOODS, PRESIDENT, VOLUNTEER STATE LIFE INSURANCE CO.

Mr. WOODS. I am Cecil Woods, president of the Volunteer State Life Insurance Co. of Chattanooga, Tenn.

Senator MILLIKIN. Make yourself comfortable, Mr. Woods.

Mr. WOODS. Mr. Chairman, with respect to the statement of the former Senator from Illinois in regard to the size of his company, I want to say at the outset that in a company my size, we feel that his company, the Acacia Mutual, is a very large company.

We are not anywhere near ready for many years to talk in terms of a billion dollars, and I believe I more nearly represent the cross section of the smaller companies than anyone that will probably appear before the committee today. With that statement, I would like to open my remarks.

I am Cecil Woods, of Chattanooga, Tenn., president of the Volunteer State Life Insurance Co., a stock life insurance company organized in 1903 under the laws of Tennessee. The Volunteer State does busiin 11 States and has 182 million dollars of insurance in force and has 47 million dollars in assets. In its relation to the largest companies, my company may be classed as a small one. Numerically there are many times more of the small companies such as the Volunteer State than there are of the large companies Although I am currently president of the American Life Convention, I am appearing as president of the Volunteer State.

I appear in opposition to section 311 of H. R. 4473, the proposed Revenue Act of 1951, which would extend for the year 1951 the so-called stop-gap formula for the taxation of life insurance companies. In lieu of the extension of that provision, I strongly support the formula providing for a 6½-percent tax on the net investment income of life insurance companies with appropriate adjustments (1) to reflect the $25,000 surtax exemption applicable to corporations generally and (2) to grant a measure of relief to those companies encountering difficulty in earning the interest required on their policy reserves. I shall discuss the adjustments in some detail at a subsequent point in this statement.

The Treasury, the staff of the Joint Committee on Internal Revenue Taxation, the Ways and Means Committee, and the members of this committee last year regarded the 1950 stop-gap provision only as a temporary expedient, an expedient considered necessary, because the various parties who were interested in this subject had been unable to reach a solution which could be regarded by all of them as entirely satisfactory.

When the 1942 tax formula brought about a no-tax situation in 1947, there developed a conviction on the part of the lief insurance business generally that it should resume its proper position among the country's taxpayers and, notwithstanding the social purposes served by the life insurance business, it should contribute its fair share to the cost of the Government. Such differences of opinion as have developed among companies and between companies and governmental agencies have not been on the question as to whether life insurance companies should or should not pay taxes but rather as to the method of taxation. I am frank to say that there is probably more unity of feeling, with respect to this tax problem and the tax formula

now proposed, among the life insurance companies of the United States than one could expect to find in any business where taxation is the issue, and the amounts of money involved are very substantial indeed.

As an executive of one of the 229 companies for which Mr. Adams has appeared today, I am well aware of the enormous amount of study that has been given to this problem by his committee. The consolidation of opinion behind this proposal could not have come without a great deal of discussion. Many meetings of committees and organizations have been involved. Company executives in large numbers have participated in these meetings. As a result of these, I can say to you today that with the exception of a very few companies, the proposal made by Mr. Adams meets with the overwhelming support of the life insurance companies throughout the United States as a simple, practical, and sensible method of taxation of the life insurance business. The level of taxation proposed is as high as can be imposed on the business without serious damage to it. It is the most equitable plan that has been suggested in the distribution of the taxes among the several companies. In my opinion the adoption of this plan for the taxation of life insurance companies is a constructive step which will receive the support of the business generally.

I mentioned two features of the 6½-percent proposal which I wish to discuss in somewhat greater detail. These features are an essential part of the proposal. This inclusion assures the support for the plan of a large number of small life insurance companies.

One of these features is the incorporation of a surtax income credit comparable to the $25,000 credit applicable to corporations generally. Provision is made in the proposed Revenue Act of 1951, as passed by the House, for corporations subject to regular corporation income tax rates to pay normal taxes at the rate of 30 percent on their normal tax net incomes and surtaxes at the rate of 22 percent on their surtax net incomes. In calculating the surtax net incomes, a deduction of $25,000 is allowed. Except for certain minor items not important here, such corporations would be made subject to a tax of 30 percent on the first $25,000 of net income and 52 percent on the remainder. In the case of life insurance companies this adjustment could be made by imposing a tax of 3¾ percent upon the first $200,000 of net investment income and 6½ percent on any investment income in excess of that amount.

The other feature of the 6½-percent proposal is the provision which would grant tax credit to companies having difficulty in earning interest in an amount sufficient to cover their policy-reserve-interest requirements. This is a very serious matter to any life insurance company; yet it is a condition which prevails in the case of a number of well-managed companies.

As has been explained in other testimony before this committee, premiums upon life-insurance policies are calculated on the assumption that interest will be earned upon reserves at a definite rate. To make good on its policies, the company must earn interest at the rate so assumed on its investment of the policy reserve during the life of the policy. Otherwise, its ability to meet its obligations may be seriously impaired. A tax on investment income at a substantial rate, without some recognition of this situation, could be an intolerable imposition on companies in such a position.

The relief proposed is a substantial reduction in the amount of tax of any company which has difficulty in earning net investment income in excess of its reserve interest requirements. The reduction would reflect the extent of the difficulty. No reduction would be available to any company whose net investment income exceeded its reserve interest requirements by more than 5 percent. It is calculated that such adjustment might result in reducing the aggregate amount of tax otherwise collected only by 1 or 2 percent for the year 1951. After 1951 it is anticipated that the reduction would be much less.

There is one further point relative to the taxation of life insurance companies to which I would address myself. It is not involved in the pending bill nor in the 6½-percent proposal. It is involved in an alternative proposal previously made to the Ways and Means Committee of the House and again made to you today. It is the suggestion that it would be appropriate to apply different tax formulas to stock and mutual life insurance companies.

There is probably no phase of the tax problem on which there is more solidarity of opinion among the companies than on the continuance of the principle of identity of treatment. Only one company has ever suggested that a distinction be made in the tax treatment of these two types of companies. I feel quite safe in saying that all other companies, stock and mutual, large and small, North, South, East, or West, are firm in their conviction that the adoption of such a proposal would be a serious mistake.

The life insurance business is regarded by the public generally as a big business. In terms of aggregates it is large. It is large because the American people have entrusted large amounts of their savings to us. Probably 80 percent of the insurance in force in the United States is on the mutual or participating plan. The remainder is on the nonparticipating or guaranteed premium plan.

While there are differences in corporate organization and certain legal differences as to the relationship of the parties involved in the business of the two classes of companies, they operate side by side in intense competition, but in a legal and economic climate that has favored neither one over the other. This is a healthy situation which which our company and the business as a whole wish to preserve.

Mutual companies charge relatively high premiums and return unused margins to policyholders. Stock companies charge lower premiums, depending upon their forecasts of future experience to be realized sufficiently closely to permit them to meet their obligations. Cost of the policy in a mutual company, therefore, is the result of actual experience while the cost of a policy in a stock company is the result of anticipated experience. For all practical purposes, the companies operate side by side with a reflection of actual experience on the one hand and anticipated experience on the other. Historically, stock companies have been relatively accurate in their estimates of future experience and have thus been able to maintain an effective competitive position with mutual companies.

We think that the continuance of this balance is sound and in the interest of the American public. It gives free choice to any individual as to the particular type of organization he may prefer without his choice being affected by artificial influences resulting from preferences expressed in terms of discriminatory taxation. Except for the suggestion to which I refer, there has heretofore been no threat of tax

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imposition at either the State or Federal level which would place either of the two classes at a disadvantage.

As has been pointed out from time to time, preponderantly the large companies are mutual companies and preponderantly the small companies are stock companies. Practically all the companies organized in the last 30 or 40 years, and they have been many, are stock companies. These small stock companies are the lifeblood in the stream of life insurance organization at the present time. I think most of you will agree that it is good for the economy of the United States that we shall have new life insurance companies organized from time to time. You will probably agree that nothing should be done which would discourage the organization of new companies or which would stifle them at their very beginnings.

A competitive disadvantage taxwise to these companies would result in discouraging the formation of new companies, it would encourage the mutualization of existing stock companies, and would be a serious deterrent to the growth of small companies generally. It could sound the death knell of stock life insurance and lead to the concentration of the business in the hands of mutual companies.

While the larger part of the outstanding insurance is mutual, the number of stock companies exceeds by far the number of mutual companies. New companies have entered the life insurance field in substantial numbers during the last 50 years. They have found a field of fair competition. It has been accorded them by State governments and by the Federal Government. I do not believe that large mutual companies would favor a competitive advantage resulting from a tax law which would discriminate in their favor. On the other hand, the small stock companies are not seeking subsidy. They do, however, seek that they not be placed at a competitive disadvantage as against the large mutuals. In whatever tax formula that is devised, they ask that it be such that it will involve no competitive disadvantage to them.

In conclusion, I strongly oppose the extension of the 1950 stop-gap formula. I strongly support the continuance of the long-established principle of a nondiscriminatory tax upon stock and mutual companies alike. I also urge the adoption of the 6½-percent proposal.

Senator MILLIKIN. Thank you very much, Mr. Woods.

Mr. WOODS. Thank you.

Senator MILLIKIN. Mr. Linton?

It is a pleasure again to see you, Mr. Linton. Will you identify yourself, please?

STATEMENT OF M. ALBERT LINTON, PRESIDENT, PROVIDENT MUTUAL LIFE INSURANCE CO. OF PHILADELPHIA

Mr. LINTON. Thank you, sir.

My name is M. Albert Linton, and I am appearing as president of the Provident Mutual Life Insurance Co. of Philadelphia.

This year I am also president of the Life Insurance Association of America, and I very much appreciate your permission to testify on H. R. 4473.

My purpose in testifying is to give the reasons why we support the proposal to levy a flat tax on the investment income of a life insurance company, using illustrations based on our company's operations.

The Provident Mutual favors the proposal to determine its tax by applying a flat rate to its investment income as compared with the old plan which is continued in H. R. 4473. The use of the flat rate would do away with the industry-wide averaging process of the old plan, and our tax would no longer be affected by the reserve changes or investment results of other companies. I might say that what the large companies do in that regard does have a very large effect upon the smaller companies, especially.

It is perhaps unnecessary to emphasize here the unusual nature of the life insurance business which differentiates it from other lines of business. The receipts of a life insurance company consist chiefly of capital contributions from its policyholders. They carry with them liabilities that leave very little unencumbered margin. First of all, come the payments that must be made under policy contracts, such as death claims, matured endowments, surrendered policies, and guaranteed incomes to policyholders and beneficiaries whose funds have been left with the company. Second come the expenses of management. Finally, there are the reserves that must be set aside to assure beyond peradventure the payment of future claims as they fall due—many of them a generation or more hence.

It is this provision for future claims that presents unique problems. State laws prescribed the minimum provision that must be made to meet these liabilities. However, when conditions call for it, companies should take advantage of the provisions of the laws which enable them to add to their reserves beyond the minimum the laws require.

From the point of view of the policyholder, nothing is more important than the ultimate safety of his company and the assurance that his family and he will receive the protection of the promised benefits as they fall due. Many of us in this room, in common with tens of millions of others, want to be assured that our life insurance policies are sound and will be paid without fail when due.

A basic reason why a law taxing a company's individual so-called free or excess interest income, such as has been proposed by Mr. Schmuck, for example, would be dangerously unsound, is that it offers a tax concession to companies which fail to make adequate provision in reserves to safeguard their promises to policyholders. Making such provision has been exceedingly important in recent years as interest rates have declined drastically and make it necessary to make substantial additions to reserves, much in excess of statutory requirements.

This may be illustrated by the experience of the Provident Mutual. Prior to 1935 our policies provided for the earning of 3½ percent interest on all reserves and gave policyholders the right to elect income settlements when the policies were terminated by death or maturity, also involving a guaranty of 3½ percent interest. As interest rates declined below 3½ percent it became essential to use a greater proportion of the premium income from these policies to increase reserves so that the contracts would be carried out should the interest earned in the future remain below 3½ percent—as indeed it has for several years. As a consequence, about $15 million have been added to the reserves on our old 3½-percent business simply to offset the probable interest deficiency. Had the excess interest resulting from this reserve strengthening been taxable as such, as it would have been under any individual company excess-interest plan, it is clear that there would have been a strong incentive not to strengthen reserves.

Now Mr. Schmuck said that he felt that any company which had the funds would not hesitate to strengthen its reserves. That change of $15 million in the strengthening of our reserves under the excess interest theory of taxation would mean an extra tax to our company every year of at least $600,000 a year.

It is very clear that we would have thought many times before we increased our reserves by $15,000,000 voluntarily and thereby increased our tax $600,000 a year.

We would have been tempted, of course, to have paid that out in increased dividends and to have reduced the security behind our contracts, and we ought not to have that kind of a tax incentive to do the wrong thing.

After discontinuing in 1935 the issuance of new policies on a 3½ percent basis, the Provident Mutual adopted new forms of policies calling for the earning of lower rates of interest. Our present policies call for a 2¼ percent rate. These policies under present conditions show excess interest earnings. It is clear again that if our excess interest, as such, had been taxable there would have been a strong incentive to adopt rates of premiums calling for the earning of a higher rate of interest, say 3 percent. This would have meant adopting premiums with very small interest margins. In this way the taxation of excess interest as such would have provided an incentive to take a chance with the safety of our contracts.

It is considerations such as these which lead us to support the flat tax on investment income as against taxes on a company's so-called excess or free interest income.

Now, in saying this I include the modification for small companies and for companies not earning their required interest, which has been outlined to you already.

Senator MILLIKIN. Can you give me any good reason why a company that is not earning the type of interest which you describe should pay any taxes?

Mr. LINTON. Well, theoretically, I suppose, they should pay no tax. Psychologically, in the eyes of the public, it would be a very difficult situation because in all probability a mutual company would be paying dividends to its policyholders, and people would say, "Well, if they are able to pay any dividends to policyholders, they probably should pay some income tax."

Now, theoretically they probably should not pay any. I think it is the psychological situation that the companies would find themselves in if they paid no income tax that really makes them feel they should try to find the funds to pay some, even though they have not got the interest margin.

Senator MILLIKIN. It appears to me that outside of this special field where we have got to be especially careful not to disturb the integrity of what the policyholder has, outside of the insurance field, you do not pay any taxes on profits unless you have them.

Mr. LINTON. Well, that would lead to no tax on some companies.

Senator MILLIKIN. People comment sometimes on the fact that a man who is supposed to have a very large income does not pay any tax, but sometimes he cannot pay the tax because he has losses to offset the income.

Mr. LINTON. Yes, sir.

Senator MILLIKIN. And for psychological reasons, should we put a tax in other fields on people who are not making profits?

Mr. LINTON. Well, perhaps some of the companies that are not earning their interest rates should in the past have strengthened their reserves and they did not.

Now, then, it would put a premium on their not doing that, in a way—it is a complicated situation.

Senator MILLIKIN. Yes, I admit that. I am just probing around to try to satisfy several things that are in my mind.

Mr. LINTON. Yes.

Senator MILLIKIN. And, as I said before, I have no fixed notions on this thing. If we had some higher wisdom operating in our individual affairs, and were proper incentives applied, it might be possible for many people that do not pay income taxes to be paying them. But we do not apply the tax on that theory.

We apply the tax when there is a profit.

Mr. LINTON. I think it is mainly the psychological——

Senator MILLIKIN. Is it not true that in the insurance field, where we must be especially careful not to injure the policyholder, is there not a double reason for not taxing a profit which does not exist?

Mr. LINTON. Of course, to a certain extent whether or not there is an excess interest, if you go back over the history of the company, may depend on what the company has done with its funds.

Senator MILLIKIN. Yes; that is also true, Mr. Linton, in our private affairs.

Mr. LINTON. That is right.

Senator MILLIKIN. I could give you many reasons why certain people have not paid income taxes. We have lost that revenue because they did not handle their affairs properly; but, at the same time, we do not tax them unless they make a profit.

Mr. LINTON. Well, we do not want to have an incentive for them to not strengthen their reserves.

Senator MILLIKIN. No. I am just wondering how the principle of no profit, no tax could be incorporated with an incentive to get them out of that situation as rapidly as possible.

Mr. LINTON. Well, as was pointed out, approximately 87 companies would not earn their interest in 1951, but for two reasons; first, because interest rates seem to be going upward, and because the interest is going down as they issue new policies at lower rates of interest, it probably will be a short time relatively before most of those companies, perhaps all of them, in 2 or 3 years, will be earning all of their required interest.

So it is a temporary situation there.

Senator MILLIKIN. Suppose that we assume that interest rates will improve in the foreseeable future. Let us simply assume that. How would it be to exempt these companies, these 87 companies to which you refer, from any tax payments so long as they do not make what we term profits in this business, but put a time limit on that?

Mr. LINTON. That might be——

Senator MILLIKIN. Then, bring in the formula which has been proposed here.

Mr. LINTON. There might be some basis for that.

Senator MILLIKIN. That gives the incentive to get out of that situation. It gives temporary relief against a situation which they

probably cannot get out of immediately; it does not do any violence, as I see it, to the policyholders' interests.

Mr. LINTON. Well, it would be very interesting to make a tax concession which even those companies had not had the temerity to come and ask for, but it is a very interesting theory.

Senator MILLIKIN. I am thinking out loud, and probably not thinking very well on it.

Mr. LINTON. Well, there is a lot to be said for it.

I think I got to this point in my statement where I said the flat tax does not provide an incentive to avoid doing what should be done for the protection of policyholders and in the public interest. Although this form of tax is not perfect, it is the best solution of the tax problem we have been able to find.

As to the suggested 6½-percent tax rate, my personal opinion is that it is on the high side.

Now, at the height of the war in 1943, the tax of our company was 3.26 percent of investment income. Here we would pay twice that rate, 6½ percent, which seems like a pretty heavy tax to pay under peacetime conditions, twice the rate we paid at the height of World War II.

Senator MILLIKIN. What we are really paying on now are two wars. We are paying the costs of World War II, and now we are paying for world war III, and that means more revenue.

Mr. LINTON. All right.

Two years ago the Treasury suggested 3 percent, and I want to compliment them on the simple principle which finally the industry came to see.

We apparently looked for a very complicated plan and, as so often happens, we finally came around to a simple one, and the Treasury saw it 2 years ago, and we might have recognized it as an industry.

For the Provident Mutual a tax at the 6½ percent rate means a current tax of about $1,300,000 a year. When this is added to the taxes (other than the real estate taxes) we pay to the States, we find that the total is equivalent on the average to about five out of every hundred dollars of the net cost of our insurance to policyholders.

Now, Mr. Adams used a figure for the industry of $3.50. In our case we have a heavier tax because of the large funds that are left with us by our policyholders to provide income to their beneficiaries and also the large average reserve per thousand, so we pay a very heavy tax, relatively, under this plan, but we are willing to go along to provide harmony. I would prefer to have seen 5½ rather than 6½ percent. A 6½ percent tax would yield about $125 million from the entire life insurance business. This would be in addition to over $150 million paid to State and local governments. We believe this is a heavy tax to levy against policyholders on the money they are setting aside for the future protection of their families and themselves.

Senator MILLIKIN. May I ask, Mr. Linton, is the tendency to tax life insurance in the States up or down?

Mr. LINTON. On estates?

Senator MILLIKIN. The States. You are speaking of State taxation.

Mr. LINTON. Oh, the State taxation.

Senator MILLIKIN. Is there a tendency to run that up on insurance companies?

Mr. LINTON. Well, there is very seldom that the legislatures of the States meet that there are not proposals to increase the tax rates.

There are proposals continually in the various States to do that, I think almost without exception. Some get through but naturally we present the arguments, and we have been successful in many instances in keeping them from increasing.

The average rate is in the neighborhood of 2 percent, but there is a tendency to up them.

Senator MILLIKIN. That is 2 percent on premiums?

Mr. LINTON. Yes, sir; on premiums, that is right. We urge you, therefore to replace the stop gap law with the proposed 6½ percent flat tax. This is the limit beyond which life insurance should not be asked to go.

Senator MILLIKIN. Can you tell us, Mr. Linton, what the present Treasury attitude is toward the proposal we have here?

Mr. LINTON. Well, as I gather, the Treasury attitude is that they think, perhaps, they can find a better solution to the problem, and they would like to have the stop gap continued and continue study of it with the idea of a permanent solution, say, a year hence.

Well, we think this simple plan is the one that should be adopted. Then if somebody comes up with a better plan, O. K.

The disadvantages of the stop gap have been pointed out by presons who have preceded me, in every case, and we think it should be gotten rid of, and we should adopt this simple plan which people can understand. It is a good deal fairer to the small companies than the stop-gap, and it is the type of thing which we think should be adopted, and then if it is possible to find a better plan in this complicated situation, then it can be done.

Senator MILLIKIN. I think there is considerable delusion in the notion of permanent legislation. This world and the economy of this world are changing and do change so rapidly, that there is no wisdom in the world that can make sound permanent legislation on anything.

Mr. LINTON. Put it this way, we will not announce the fact that it is temporary.

Senator MILLIKIN. That is right.

The end point is to have the best legislation that we can evolve, to fit the circumstances we can foresee.

Mr. LINTON. Right.

Senator MILLIKIN. And we cannot see very far ahead.

Thank you, Mr. Linton. It is good to see you again.

Mr. LINTON. Thank you.

The CHAIRMAN. I submit for the record two memoranda submitted by Milo J. Warner dealing with the taxation of life insurance companies about which we have received oral testimony today.

DOYLE, LEWIS & WARNER,
Toledo, Ohio, July 16, 1951.

Re taxing formula for life insurance companies under the 1951 revenue act.

Hon. WALTER F. GEORGE,
Chairman, Senate Finance Committee,
Senate Office Building, Washington, D. C.

DEAR SENATOR GEORGE: On Tuesday, July 17, 1951, the Senate Finance Committee will hear representatives of the life insurance industry on the above matter.

The Prudential Life Insurance Co. of America, whom I represent and for whom I have done quite a bit of work during the past few years on the Hill, is naturally quite interested in having enacted a sounder and more stable formula of taxation

of life insurance companies than that provided by the so-called stop-gap formula which the House bill would continue for another year.

I have asked Mr. Louis R. Menagh, Jr., vice president and comptroller of the Prudential and also a member of the joint committee of the Life Insurance Association of America and the American Life Convention on this subject, to give me a letter presenting his personal views on this important subject.

Copy of Mr. Menagh's letter to me of July 13, 1951, is enclosed herewith. As supplementing the testimony of the representatives of the life insurance industry who testify on Tuesday, July 17, I feel it should be quite helpful to the Senate Finance Committee. I respectfully submit it herewith for that purpose and trust that it will receive favorable consideration.

Sincerely yours,

MILO J. WARNER.

THE PRUDENTIAL INSURANCE CO. OF AMERICA,
Newark, N. J., July 13, 1951.

Mr. MILO J. WARNER,
Toledo 4, Ohio.

DEAR MILO: In a mutual life insurance company the only income is the income from investments. So-called premiums are merely capital deposits made by the policyholders which are eventually returned to them or their beneficiaries. I think this point can be demonstrated most easily by imagining there were a company which did not invest its premiums but merely kept them in a vault from which the payments were withdrawn when the policyholders died. In that case, it would be clear that nothing has happened except a redistribution of capital contributions. This concept that investment income is the only true income has been the basic concept in the Federal taxation laws from 1921 to the present. To understand the present problem, I think it is necessary to go back to the original 1921 act which provided that the companies be taxed on the excess of their interest earnings over the interest required to maintain their reserves. This interest required was, however, not the true interest required, but was obtained by a somewhat arbitrary formula which, while denying the companies many valid deductions, gave the companies an allowance which was greater than the true interest required, namely 4 percent. The Revenue Act of 1942 reduced this allowance for interest requirement but still left it in excess of what would actually be required and it was not until the so-called stopgap legislation that the industry was taxed on the basis of the actual interest required to maintain reserves.

What has produced the difficulty in the discriminatory stopgap legislation is that, while still denying such valid deductions, it represents strictly the actual interest required. Consequently it imposes too heavy a discriminatory burden on the life insurance industry, so heavy a burden that its continuance into the future would, in my opinion, endanger the financial solvency of many life insurance companies. The reason for this is that the stopgap legislation does not take into account in any way other deductions from income which are allowed all other types of corporations. For example:

1. We should receive full credit for tax-free interest and the 85 percent dividend credit.
2. We should receive a deduction for taxes paid to States and municipalities.
3. We should be allowed a deduction for maintenance of the accounts of pure indebtedness funds such as supplementary contracts and dividend deposits as it should be recognized that the cost of maintaining the accounts of such borrowed funds must be met from the income arising from the investment of the funds.
4. To the extent a group annuity trust meets the requirements of section 165, interest earnings should be exempt entirely from tax. Bank trusts which qualify under section 165 are entirely exempt from tax under section 511.
5. All investment expenses and taxes should be allowed.

If these discriminations which appear in the stopgap legislation were eliminated, we would find that in a mutual life insurance company there is no taxable income according to the concepts applied to corporations in general, with the result that, if the life insurance industry is to pay a tax, and it has signified its willingness to do so, such a tax must be on a somewhat arbitrary basis. The 6½-percent tax on investment income is such a tax.

This 6½-percent tax can be rationalized in two ways:

1. If the adjustments cited above were limited arbitrarily to 87 percent of the net investment income, a 50-percent tax rate would be the equivalent of a 6½ percent tax on investment income.

2. Under the tax law of 1942 to the present time, the Secretary of the Treasury yearly promulgates the so-called secretary's ratio representing the relationship between the actual interest earnings and the interest required to maintain reserves and this ratio applies to all insurance companies' taxes during the subsequent year. This ratio fluctuates widely and it would seem more in the interest of all concerned were it to be stabilized at an arbitrary figure. On the basis of a 50-percent tax rate to produce the equivalent of a 6½-percent tax on investment income would require a statutory frozen requirement ratio of 87 percent.

I think without exception all of the large eastern companies would dislike to have the law call for a flat tax of 6½ percent on investment income. It was, however, the thought of the committee that to attempt to put forth the law in a technical form as of this late date and under the conditions prevailing at the present time in Washington would make our cause hopeless. Our thought was that although it would be presented in its initial stages as a flat 6½-percent tax, when it came time to draw up the law, every effort would be made to tie it on the corporate tax rate by one of the devices I have mentioned. You will remember that at the time of the last Senate Finance Committee hearing the point was brought out that under the stopgap law, a company which was not earning its required interest would still have to pay the same rate of tax as a company with ample margins. In an effort to overcome this, it is our suggestion that a special deduction be allowed for such companies. A company which does not have interest earnings sufficient to provide their interest required will have their income-tax payments reduced. This will help about 87 companies, most of them small, and will be exceptionally helpful to the Union Central. As most of these companies are small companies, the loss of revenue to the Government will be comparatively minor. Our objections to the stopgap legislation beyond those already expressed above are:

1. If any company changes the interest basis used in calculating its policy reserves, the action affects the taxes of all companies. Similarly, any changes in investment practices of a company affect the taxes of all companies. This would not happen under the suggested plan.

2. Life insurance is a long-range business and the stopgap basis can fluctuate so widely that companies find it difficult to plot their long range financial future.

3. The basis of the tax is only partially a valid one and it seems probable that its invalid features will be sufficiently important in the future to result in calling for payments from the companies far in excess of their ability to pay.

4. It is important to the public that the life insurance companies continue the conservative practices which have characterized the institution. If, however, the discriminatory stopgap law continues, there will be several temptations on the part of companies to relax the standards of their policy reserve requirements in order to avoid substantial increases in taxes.

A Federal income tax which calls for a payment which is the equivalent of 6½ percent of net investment income represents in itself a large imposition on the policyholders. Taken in conjunction with State and municipal taxes, exclusive of real estate amounting to $150 million, it would mean that out of every dollar set aside by people to take care of their dependents, 5 cents would go to pay these two types of taxes. This is a severe burden to put on thrift. I have never heard of any suggestion to levy taxes as severe as this on bank deposits and yet there are many reasons why such a tax might be considered more applicable to bank deposits than life insurance deposits. In the case of bank deposits, the money deposited may be used for a great variety of purposes, but in the case of life insurance deposits, most of it is used to take care of people who otherwise would be unable to support themselves and would become wards of the state.

Sincerely yours,

Louis R. Menagh, Jr.,
Vice President and Comptroller.

Doyle, Lewis & Warner,
Toledo 4, Ohio, July 16, 1951.

Hon. Walter F. George,
Chairman, Senate Finance Committee,
Senate Office Building, Washington, D. C.

Dear Senator George: It would seem that the withholding of interest and dividend provisions of the 1951 revenue bill as passed by the House are not feasible or desirable in that there is serious question as to whether or not the cost of administration and the cost to the taxpayers, together with the undue hardships which are bound to be placed upon many taxpayers who can ill afford

it, including many charitable endowment funds, are justified by the speculative and questionable benefits.

There is enclosed a memorandum setting forth some of the effects and impacts of such provisions upon life insurance companies. On July 11, 1951, the Senate Finance Committee heard some very able representatives of the life insurance industry on this matter. The enclosure is mainly to supplement the statements of these witnesses. It was prepared by and under the supervision of the comptroller of the Prudential Insurance Co. of America in conjunction with other department heads, including the legal department of that company.

I feel that this memorandum should be helpful to the committee, and I am respectfully submitting it herewith for your careful, and I hope favorable consideration.

Sincerely yours,

MILO J. WARNER.

MEMORANDUM RE EFFECT UPON LIFE INSURANCE COMPANIES OF WITHHOLDING PROVISIONS IN 1951 REVENUE BILL AS PASSED BY THE HOUSE

1. *Withholding of 20 percent on corporate interest and dividends received by a life-insurance company.*—This is a most peculiar provision because the Revenue Act of 1950 contained an acceleration program for payment of corporate income tax. Under this program, by stages the payment dates would be advanced until in 1954 and thereafter, the tax liability would be paid in two installments. In the case of life-insurance companies, this feature would not only nullify the entire acceleration program but more than the tax obligation would be collected on the average more than 9 months ahead of the due date.

This will result in a very substantial interest loss to policyholders and require rearrangement of investment commitments.

Exempt corporations may recoup such withholding currently from their liability for payroll taxes, with any excess refundable quarterly.

The obvious solution is to exclude corporation holders of such securities from the withholding provisions.

For example, let us suppose that the income-tax liability for 1952 of an insurance company would be $20,000,000, and conservatively let's say the withholding on corporate interest and dividends received in 1952 would be the same figure. Thus roughly the entire 1952 obligation would have been collected and turned over to the Treasury as of July 1, 1952. Actually the acceleration program in the 1950 Revenue Act provided for payments as follows:

Due Mar. 15, 1953 (40 percent)	$8, 000, 000
Due June 15, 1953 (40 percent)	8, 000, 000
Due Sept. 15, 1953 (10 percent)	2, 000, 000
Due Dec. 15, 1953 (10 percent)	2, 000, 000
Total	20, 000, 000

As this liability was on the average liquidated as of July 1, 1952, the interest loss is as follows:

			Rough proportion of year collected in advance					Interest loss to policyholder
First installment,	$8,000,000	×	¾	=	$6,000,000	×	3¼ percent	$195, 000
Second installment,	$8,000,000	×	1	=	$8,000,000	×	3¼ percent	260, 000
Third installment,	$2,000,000	×	1¼	=	$2,500,000	×	3¼ percent	81, 250
Fourth installment,	$2,000,000	×	1½	=	$3,000,000	×	3¼ percent	97, 500
								633, 750

(We understand the Life Insurance Association of America feels withholdings would not be applicable to corporate mortgages; we are not so sure.)

Subject to certain interpretations of the statute, for instance if corporate mortgages are subject to withholding, the withholding could exceed the ultimate liability.

It must be remembered in 1952, that in addition to the loss of 20 percent of interest and dividends withheld at source, the Prudential will be currently liquidating its liability for 1951 tax under the 1950 acceleration program as follows:

	Percent
Mar. 15, 1952	35
June 15, 1952	35
Sept 15, 1952	15
Dec. 15, 1952	15

We are confident that when the Senate Finance Committee becomes aware of the impact of this provision on the financial operations of selected financial corporations, including life companies, they will not permit the 1950 acceleration program to be nullified through the back door.

Another unusual point is that the 20-percent withholding on the total dividends received by corporations, is inconsistent with the 85-percent exemption of such dividends from corporate taxes.

Exempt corporations, including exempt savings institutions such as savings banks, can recoup such withholding tax from the payroll taxes. If such payroll taxes are not sufficient, a refund may be secured quarterly. Also as to regulated investment companies, such withholdings can be recouped from the 20-percent withholdings on dividends paid to shareholders.

It is somewhat surprising that the commercial banks have not objected to this withholding as corporate bonds held by them would be involved. However, because of the proportion of their portfolio in governments and loans, as distinct from corporate securities in registered or coupon form, they may feel they are not seriously involved.

They are, however, attacking the provision because of the additional work involved as the paying agent for such corporate interest.

2. *Withholding of 20 percent on interest credited to dividend deposits and on interest paid on policy proceeds.*—Under "Dividends deposits" there is a contractual requirement to compound interest at not less than a guaranteed rate. The effect of the 20 percent withholding is to abrogate the contract and require compounding at a 20 percent lower rate. For example, where the contract provided for compounding at 3.5 percent, the rate would in effect be changed to 2.8 percent.

Legality of this procedure will undoubtedly be questioned as it will abrogate this provision and in many cases disturb the insurance program as arranged for the policyholder.

Many policyholders may insist on repaying the tax withholding to maintain their insurance program, which together with the withholding procedure could lead to untold administrative expense.

The maximum amount of withholding tax would be about $700,000 for Prudential. Under claim settlements, the same result would obtain. Insurance programing of such payments would be disturbed, the contractual rate would be reduced 20 percent and the amount of tax raised would be nominal in light of the administrative expense involved and the wholesale wrecking of planned insurance estates which to many beneficiaries represent bread in the bread box, coal in the coal bin and, in the preponderance of cases, the barest of family comforts. Governments should tread carefully when seeking to diminish these funds of self-reliance. The effect of this withholding provision is to discourage the self-reliance practiced by the thrifty when they seek to provide for the bare necessities of life for their beneficiaries through life-insurance premiums.

This withholding applicable to life-insurance companies is discriminatory and unsound and as such should be eliminated by the Senate Finance Committee.

Senator MILLIKIN. We will recess until 10 o'clock tomorrow morning.

(Whereupon, at 12:35 p. m., the committee recessed to reconvene on Wednesday, July 18, 1951, at 10 a. m.)

REVENUE ACT OF 1951

WEDNESDAY, JULY 18, 1951

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

The committee met, pursuant to recess, at 10 a. m., in room 312, Senate Office Building, Senator Harry F. Byrd presiding.

Present: Senators Byrd, Hoey, Frear, Millikin, Taft, Butler of Nebraska, Martin, Williams, and Flanders.

Also present: Elizabeth B. Springer, chief clerk. Colin F Stam, chief of staff, Joint Committee on Internal Revenue Taxation.

Senator BYRD (presiding). The acting chairman is informed by Senator Dirksen that there is present a delegation from the Bavarian Legislature, Germany. Mr. Getzer, I understand, is the chairman. So, we desire to welcome you gentlemen here to America, and we hope that your visit will be profitable, and that you will enjoy it. We will ask the delegation to stand so that they can be presented to us. [Applause.]

The meeting will come to order.

The first witness is Mr. Newsom. Take a seat, please, sir, and identify yourself.

STATEMENT OF HERSCHEL D. NEWSOM, MASTER, THE NATIONAL GRANGE, ACCOMPANIED BY J. T. SANDERS, LEGISLATIVE REPRESENTATIVE, AND LLOYD C. HALVORSON

Mr. NEWSON. I am Herschel D. Newsom, farmer from Indiana, and present in the capacity as master of the National Grange.

Senator BYRD. Proceed.

Mr. NEWSON. The National Grange believes that farmers of America are anxious to give their utmost in productive effort and to accept the full measure of their fair share of the bill to pay the cost of Government, including our mobilization effort to preserve freedom. American democracy is built upon acceptance of individual responsibility, and although our form of government and our type economy provides a maximum of freedom and opportunity, as well as material advancement, it likewise demands more of the individual than any other type government or economy. If we are to prove ourselves worthy of the inheritance of the American system, we must prove our willingness to accept that individual responsibility and to discipline ourselves. If we do not have that capacity, who is to prevent us from living beyond our means, robbing our children, and destroying ourselves through inflation? We must, insofar as is economically possible for us to do it, pay our way as we go.

There are two possible exceptions—the first is war. If total war comes, survival may be the only issue. Paying the bill may then necessarily be left in part to the future We should, however, willingly make substantially increased personal effort both in the field of production and in the field of meeting our individual tax liability. When peace comes, however, or when opportunity presents itself we must set out immediately to retire the debt within a reasonable period.

The second exception lies in self-liquidating projects which can well be undertaken in periods of depression. In such a period of time, we should not confuse economy with sound investment. The present situation does not call for either of these exceptions, however.

America's role as the major champion of the cause of constitutional government and of the dignity and liberty of the individual is a complex one. We must therefore dedicate ourselves primarily to the extension as well as the preservation of individual liberty and responsibility.

To that end, Grange members accept as a reality the necessity of full mobilization of the Nation's finances, as well as the partial mobilization of our material resources and manpower. We must utilize the high level of national income to strengthen our fiscal position and lessen or remove any apparent need for direct price controls, which are at best only partially effective for limited periods of time, rather than to permit that high level of national income to compete in the market for an inadequate supply of consumer goods and thereby create an inflation that might disrupt our economy.

Unless we have the courage to adopt a pay-as-we-go program, the Nation's mobilization effort will inevitably result in a substantially higher national debt with the corresponding rise in the cost of living as a result of the added inflationary pressure arising from that debt, no matter what measures are used to disguise this increase. The idea that we can all consume more goods and services at a time when a growing portion of our national production is being taken off the market to fill mobilization requirements is false. There is no easy way to wage war against the Communist forces of the world and there is no easy way to combat inflation. It is our judgment that we shall have to take a reduction in our level of living as a result of the mobilization program. The people have not generally been told this but it is inescapably true. There is no way that we can shift the burden of this rearmament effort to another generation honorably or morally.

Senator MILLIKIN. May I ask the witness a question, Mr. Chairman?

Senator BYRD. Yes, sir.

Senator MILLIKIN. The evidence here indicates that in fiscal year 1953, which starts in less than a year from now—assuming the passage of the House bill or assuming the passage of any bill that will raise from 7 to 10 billion or 6 to 10 billion; pick your own figure—we will have a deficit of from 20 to 30 billion dollars. Can we cover that by taxes?

Mr. NEWSOM. I have grave doubts as to whether there is any possibility of covering that kind of item with taxes. I think I will answer that question a little more fully as we proceed a little further in the testimony, sir.

What I am trying to say is that we have to take several of these things into account. I think that we should adopt as our major goal a determined policy of paying our way through this effort insofar as it is possible to do so, without imposing an individual tax liability that may prevent the individuals from consuming the prospective supply of consumer goods, on the one hand, or without imposing a tax liability on the business of the country, either through corporate or excess-profits rates, that will stifle incentive and hamper the very productive effort that we must have.

We have tried to say that a little bit later on. I will be glad to answer the question in further detail now, but I think perhaps, if you will permit me to read another page of this, it will in part be answered; and, if it is not fully answered, we will be glad to try.

Senator MILLIKIN. Go ahead.

Mr. NEWSOM. To attempt to shift the burden to a future generation, as we did in our previous war effort, might well wreck our whole economy and rob that generation of the freedom that it is our duty to hand to them. The real cost of this effort in terms of fewer goods and services must be borne currently.

On the basis of the figures presented to this committee about 2 weeks ago by the Director of Mobilization and on the basis of the estimated tax revenues under existing provisions, we feel that the administration was justified in requesting an increase of $10 billion in Government revenue. We further feel that it was entirely sound to call for a major portion of that increase through increased personal income-tax liability.

Greater reliance on individual tax liability, rather than on hidden taxes derived through the suppliers of goods and services, by taxing income in the hands of the individual at a highly graduated personal income-tax rate, can both increase the revenue of the Treasury and safeguard purchasing power where purchasing power is needed most. It is the individual's responsibility to support the Government and not the responsibility of the Government to support or even subsidize the individual.

Tax liability must be based upon "ability to pay" and "benefits received." In tending to overemphasize "ability to pay," we have come to almost actually ignore it. The placing of greater portions of the gross tax liability on corporate businesses of the Nation has actually been a method of passing that tax liability on, in the form of hidden taxes, to the ultimate consumer. The family of low-income and large needs pays the tax liability of utility corporations or other suppliers of necessities, out of all proportion to its ability to pay.

By the same token, the family receiving high income and often with less food and fewer pairs of shoes to purchase is not taxed according to ability to pay in this method of raising governmental revenue.

What I am trying to say, gentlemen, is that the family head with an income of, let us say, $2,000—and we have a lot of them in rural America with an income of less than that and perhaps a dozen children to buy shoes for, or at least let us say a dozen pairs of shoes to buy per year—is, in our judgment, paying the income-tax liability of the corporation that manufactures those pairs of shoes out of all proportion to his ability to pay it, compared with the high-income person who, perhaps, has no children to buy shoes for, and there is grave injustice in this heavy load of hidden taxes.

Senator MILLIKIN. One aspect of what you are saying was developed here the other day. One of the witnesses—I think he picked the $2,500 income as his bracket with which to illustrate—said that the taxes of a family of the type that he was describing amounted to about $750 a year, and over $400 were concealed taxes.

The concealed taxes passed down from the taxes that were on the middle- and upper-income brackets; so, if you increase your taxes on the middle- or upper-income bracket, it means that they are passed to the lower brackets where you have your most dynamic consumption.

Mr. NEWSOM. That is right.

Senator MILLIKIN. How are you going to stop that?

Mr. NEWSOM. I am not sure that we have the political courage, if you please; that sounds like a harsh accusation, but I do not know of any other term—I do not think we have the political courage to assess the portion that I think we should assess of this cost of government against individuals on a highly graduated income rate.

Senator MILLIKIN. But, assuming that you assess it, all tax costs are ultimately passed on, and they increase their burden the further down the scale they go. How are you going to stop that?

Mr. NEWSOM. Well, in my opinion, the way to stop it is to make up our minds that it is the individual that must pay the bill in the final analysis. So, let us assess it against him in the first place rather than against the businesses and the corporations of the country, so that we will have a chance—assuming that we do have the courage to do it—so that we would have a chance to apportion that tax liability on the individual justly and fairly.

Senator MILLIKIN. Put it on the individual, put it on the corporation. The corporation is simply a conduit for the individual——

Mr. NEWSOM. That is right.

Senator MILLIKIN (continuing). Put it on the corporation; put it on the individual, if you will, but it is a cost of his business; it is a cost of a corporate business; it is a cost of individual business and, therefore, it is going to be passed on. To whom is it going to be passed? It is bound to be passed to the fellow who consumes the goods, to the fellow who rents, to the fellow who buys consumer goods.

How are you going to keep that burden from being passed on to the bracket which is the least able to pay for it?

Mr. NEWSOM. I am simply saying that, if you put it on the individual in the first place, the individual who is finally receiving either the wages or the dividends or the profits, his share of the profits out of a given business, assessed not on his business but on him as an individual, there is no place for it to be passed on.

Senator HOEY. Under the present law, as passed by the House, the individual is assessed up to a maximum of 94½ percent.

Mr. NEWSOM. Frankly, as we will say in a few seconds, we think the administration's proposal for a horizontal four-point increase in individual income-tax liability had a great deal more justice and equity and was a great deal more realistic in the present high-income and inflationary situation than the House action was.

Senator HOEY. I was just wondering; you say put it on the individual directly.

I was wondering if the taxes now do not go pretty heavily on the individual when under this bill it would reach up to 94½ percent?

Mr. NEWSOM. We have a very small staff in our National Grange office. We have a couple of gentlemen with me here, in whom I have a lot of confidence, but there is a limit to how far they can go. We do not profess to have made a complete study as to how this rate should be graduated to assess the load equitably, but I am saying to you now that I think, had we accepted the administration's proposal to increase the individual-income rate by a horizontal four-point increase down the line, rather than to juggle that one and increase each individual's present liability by 12½ percent, which, in our opinion, creates further disparity than the administration proposal would have created—there is just a limit as to how much we can get out of the higher incomes, and by the same token I am trying to say that those of us in the lower-income brackets have a responsibility to support the Government, at least in a time like this, that I think we are not sharing to our full measure.

Senator MILLIKIN. Assuming that a $2,500 family—assume it—is paying $750 a year in taxes, does not that strike you as a pretty heavy burden for that kind of family which has to buy the shoes that you are talking about?

Mr. NEWSOM. Yes, sir. But, by your own statement a moment ago, 50 percent or more—I do not recall your figures, but 50 percent or more—of that tax load that that individual is carrying is in the form of hidden taxes.

I am saying to you that if we have the courage to assess tax liability on him individually, and keep it off of the pairs of shoes he is buying, we will lower the cost of his consumer goods and services by taking the hidden tax out of them.

Senator MILLIKIN. How are you going to do that? That is what I am trying to get at. Let us make it very specific: How are you going to take the hidden tax out of a pair of shoes? The hidden tax out of a pair of shoes carries the taxes on the farmer who raises the livestock that provides the hide; it carries the hidden taxes and all other taxes on the fellow who raises the grain to put into the cattle; it carries over to and passes on from every processor—the profits and the mark-ups of every person who touches the hide until it becomes a pair of shoes, and afterward until it reaches the retail shelves.

How are you going to take it out?

Mr. NEWSOM. Perhaps, it would not be possible to take all of the hidden tax out, if you are assuming that that portion of hidden tax, as you call it——

Senator MILLIKIN. As you call it.

Mr. NEWSOM (continuing). Which goes into the production of the hide out on the farm and is a legitimate cost of production, if you call that a hidden tax—the hidden tax that I am talking about is this terrific and increasing corporation tax that we have been assessing against the company that is manufacturing the shoes.

Senator MILLIKIN. Yes.

Mr. NEWSOM. They, in turn, let us say, pay a million dollars in corporation taxes. There is just one place for them to get that—at least there is just one place that they are going to get it—and that is through tacking it onto the product of that corporation or the pair of shoes.

Senator MILLIKIN. That is right. That also applies to all of the economic processes in that part of the economy that is sustained by individual effort, as distinguished from corporate effort.

Mr. NEWSOM. What I am trying to say to you is just this: From a theoretical point of view—now, understand, under the present emergency, I do not think we can remove all of the corporation taxes. We are not advocating that, as you will see in just a moment. But, if we can keep our goal steadily before us, if our goal is as sound as I think it is, then we should move in the direction of relieving that shoe corporation, since that is the one we are talking about for illustration here, of as great a portion of its corporation-income tax as we possibly can.

Now, it may be when we do that we will have to invoke some sort of high-level excess-profits tax with sound definition where the profit becomes excess, to enforce a distribution of the earnings of that company back to the individuals who are stockholders or partners, or owners of the company, so that it will become available to assess an individual tax liability.

What I am saying is that if we take the direct corporation tax off of that shoe company, then they immediately can take that amount out of the price of their pair of shoes or their profits are going to go up, one or the other, and we attack it from that end.

Senator MILLIKIN. Let us take a look at that.

Mr. NEWSOM. All right.

Senator MILLIKIN. Let us assume you did that, the latter. And then what does the individual damand? He demands higher wages, and he demands higher dividends, and how are you going to stop the operation of those two forces?

Mr. NEWSOM. Well, I said a moment ago that we have gone too far down this road of trying to fool the people into thinking that they are not paying their cost of government. We have gone too far in trying to assess our tax liability on a political basis against the businesses which have no votes, if you please, and spare the individual, or soften the effect on the individual, because we do not want to antagonize the voters, frankly.

It has been going on for a long time in this country. There is nobody who is individually to blame. I am saying that it is time for us to look the situation over and chart our course.

Senator MILLIKIN. What I am getting at is, all through this hearing I have been trying to get at, and touching the same subject you are touching, and that is to emphasize the hidden tax that affects the people in the lower income brackets, and measure it and see what its impact is, if anything can be added to it, see what, if anything, that has been one of the purposes of this inquiry. We have been at it with witness after witness, but no one has yet come up with a plan whereby you can add it either to the middle or upper individual income brackets or add it to the corporations without its being passed down to the mass consumer.

Mr. NEWSOM. I think we have such a plan.

Senator MILLIKIN. I would like to hear it.

Mr. NEWSOM. But I ask you to recognize that in this time when we are talking about spending 78 billion dollars in 1953, and nearly that much in 1952, we probably will have to recognize that we cannot relieve tax liability any place, but I simply am trying to say in these next few words of ours here that if and when we come to a time when we are getting substantially in the black, or if and when we come to a time when the tax liability of this country is a deterrent on

the productive capacity of this country, then I think is the time that we want to give earnest attention to relieving the businesses of this country of that kind of tax liability that is passed on to the consumer and try diligently to assess the liability on the individuals themselves, according to a fair and just formula.

Senator MILLIKIN. Well, you are really talking to the inequity of double taxation that is represented in the profits of a corporation.

Mr. NEWSOM. I think so.

Senator MILLIKIN. That is what you are really talking about.

Mr. NEWSOM. Yes, I think so.

Senator MILLIKIN. And there is obviously a lot of room for debate on it, and I would not now take a debating stand againist it. You present a great practical problem when you have got an existing source of revenue that may have certain inequities in it, and there may be certain philosophical objections to it. It is very difficult to wipe it out and start all over again.

The corporations would be tremendously pleased to be excused from all taxes to have those taxes passed on to the dividends of the stockholder.

But the corporation executive who advocated taking it off of the corporation would be the first one in here to holler about putting it on his personal income taxes.

Mr. NEWSOM. I am aware of that fact. Frankly I feel that those of us in agriculture, being in the middle, so to speak, are, perhaps, in as good a place as anybody in the country to assume some measure of leadership in this direction because we can do it without perhaps as much fear of being charged with selfishness as either the laboring group or the business group could be. We are trying to approach it on a basis——

Senator MILLIKIN. I agree entirely that in logic, assuming you had devices to prevent unfair and unjust and tax-evasion accumulation of capital of a corporation; assuming you had those devices, and assuming that they were workable, assuming those things, you could run the finances of this Government on a personal income tax basis. It all comes to the personal tax, anyhow, one way or the other.

Mr. NEWSOM. That is right.

Senator MILLIKIN. But that is a big fancy theory in which I will join with you in logic, but we are trying to make a tax bill for this year.

Mr. NEWSOM. I know it.

Senator MILLIKIN. I am just wondering what we could do about it this year.

Mr. NEWSOM. We are going to try to tell you what we think ought to be done this year, but we want you to do that with a realization of what your best opinion—and we hope it is in agreement with our best opinion—as to what the ultimate, long-time objective in a tax program is.

It is too big a job to solve it at any one time.

Senator MILLIKIN. I will give you an objective that does not quite meet everything you are talking about and that is to balance your budget and reduce taxes, which we demonstrated could be done back in the Eightieth Congress and which I hope, the Lord sparing, I shall participate in doing after this war is over.

That is one way to relieve your tax burden.

Mr. NEWSOM. I do not think we will take vigorous disagreement with that. I think we may disagree in part with what you have just said in that I frankly believe, as I think I will say in perhaps just the next paragraph, that rather than to try to reduce taxes and thereafter reduce Government expenditures - -

Senator MILLIKIN. It would all be done the same time. We did it at the same time.

Mr. NEWSOM. All right. Let me read this next paragraph.

Senator MILLIKIN. We brought about a balanced budget, reduced the expenditures, and reduced taxes and it can all be done at the same time. Go ahead.

Mr. NEWSOM. I doubt if I am qualified to go into that discussion too deeply with you any further than the rest of this statement does.

Senator MILLIKIN. Well, I am sorry I interrupted you.

Mr. NEWSOM. A major factor in the cost of living of every American today is the cost of Government. The surest way to reduce that excessive cost of Government wherever possible is to be sure that 150 million American pay their just share of the cost of Government directly, and are aware of its amount. We will then have 150 million Americans definitely interested in governmental as well as personal austerity—and we'll get it.

General economy in Government as well as courageous curtailment of all governmental expenditures, not essential in the present emergency, must be our goal. Let us all be vigilant, however, that we do not provide justification for two common present-day charges. There may be real grounds for the charge that "the more you spend, the more you're likely to get," or that "the better job you do in Government, the more you get nicked." These indictments of a horizontal percentage cut may be justifiable. In some cases, however, horizontal cuts in appropriations on the percentage basis must be made, but in those cases, administrative authority to apportion reductions in expenditures may be the logical answer to these charges.

In making a proposal that the Grange made some time ago for a horizontal cut within the Department of Agriculture, we immediately were faced with evidences, in some measure, I think pretty satisfactory evidences, that this or that division had been wasteful, or perhaps another division had really tried to do a good job, and now then they were taking a horizontal cut, which is not equitable.

I say there is no substitute in the final analysis for a certain amount of authority to adjust that kind of inequity.

Senator MILLIKIN. Let me ask you this: Have the farm organizations ever combined to make a thorough functional study of the Department of Agriculture with the end point of making recommendations as to which functions could be done away with so far as the farmer is concerned?

Mr. NEWSOM. Well, that is a question that is a little bit embarrassing to me because I recognize that it is a desirable function that we should have provided to the country; but, frankly, our own organization—I will not attempt to speak for the others now—is not adequately financed to carry out such a study. I do not know, maybe we do not manage our affairs as well as we could, but we operate in Washington terminology at least, on a financial shoestring, and that is one of the assignments that we would like to get to, but I do not know how we can get to it, and I want to say further that we do have some

fundamental differences in the farm organizations that might make that one both difficult, on the one hand, and very constructive on the other, if we could just do it.

Senator MILLIKIN. I would like to make this observation: This is a political institution and it should be a political institution. As long as any time any one proposes here in the Congress to take off some function of the Department of Agriculture, and immediately an enormous propaganda comes up as though you were stopping the moon and stars and the rain from falling, as long as the farmers themselves will not aid in combating that kind of thing, you are going to have the continuance of the very thing you are complaining about.

Mr. NEWSOM. I recognize that fact, sir, fully, and it is just one of the several things that worries us.

I do not pretend at all that agriculture is free from blame in this situation. As a matter of fact, it may be a little bit out of the province of this committee, but I think that we must analyze pretty thoroughly and completely the whole basic foundation of our present farm programs. I think they have been conceived in conditions of chaos and despair, low income, and I think we had better rebuild a farm program that is predicated on a high level of income.

Senator MILLIKIN. If you gentlemen—you have magnificent organizations, and if you gentlemen could get yourselves together and take the Department of Agriculture, which receives the largest contributions of any agency, does it not, Senator Byrd? If you should take that agency, function by function, and not decide these things at the high level, but decide in meetings and at round tables with your farmers, and say, "Are you willing that this function be abandoned?" and finally come up with collated and unified demands on that, you will get the relief that you are talking about. Until something of that kind is done, you are not going to get much relief.

Mr. NEWSOM. Well, if I may be personal for a moment, I should like to say that having been on this national scene only about 6 months, I still hope that maybe we can get into that sort of an assignment one of these days. I recognize its need and I pledge to you that we are going to try to get to a study of that kind. But I must confess that we have had some basic differences even within our own membership on that very discussion.

Senator MILLIKIN. It will be an enormously constructive thing if it can be done.

Mr. NEWSOM. I agree.

Senator MILLIKIN. Maybe you have your political differences within your own organizations.

Mr. NEWSOM. Well, I think that perhaps we should have, and maybe we will get the best answer if we face them.

Senator MILLIKIN. That is right.

Senator BYRD. Along that view, the Congress has submitted a plan for the agricultural appropriations.

Mr. NEWSOM. We did, too. Frankly, we have a great many farmers—I am trying to remind myself that I am not permitted to speak as an individual now that I carry the title of "Master of the National Grange"—we have a great many farmers who are in disagreement, and, to some extent, I think the basis of their disagreement is pretty good, with either the statement that we have submitted, or the statement that the Farm Bureau submitted or either of us.

Senator BYRD. Do you deal in your statement with the proposed reductions?

Mr. NEWSOM. Not in this statement.

Senator BYRD. Give the committee some further idea of what the Grange does advocate in the present existing Agricultural Appropriations Act. What do they propose as reductions?

Mr. NEWSOM. We made that assignment to our legislative representative here in the national office, Dr. Sanders, who is here with me. I expect that he can answer that question, if you will permit that sort of thing, a little more accurately than I might.

Basically, I gave you the answer just a moment ago when I said what we proposed, but I would like to introduce J. T. Sanders, our legislative representative.

Senator BYRD. If you prefer to submit a memorandum to the committee, that will be all right. Would you make a brief statement?

Mr. SANDERS. Briefly, our proposal, as Mr. Newsom has just said, was that we did not have the time and did not feel capable of going into the Department's budget, item by item, because we knew that if we undertook such a study with no more force and no more time, that we would make grievous errors, and we suggested an over-all cut, or a selective cut, if the committee preferred.

Senator MILLIKIN. I may suggest that your cut was an over-all cut.

Mr. SANDERS. Yes, sir.

Senator MILLIKIN. Any approach of that kind results in this: You have to delegate the cutting power to someone in the executive agency, and it is then turned into a political lever, to produce the most political discontent that can be worked out.

In other words, the cut always will be intended to arouse the most opposition to the cut, and it works that way; we have seen it work that way. That is why I was suggesting that the thing be approached functionally, and if we had a recommendation from the farm organizations on the functions that could be abandoned, we would have something to go to town on.

Mr. SANDERS. Well, I think that there is a great deal to the thing that you are saying. But in our testimony we had to face the reality of a resolution that told us to favor cutting Federal expenditures, and in order to do that with a feeling of assurance that we were not ignorantly cutting where we should not be cutting, we suggested to the committee that we thought that the committee had more resources, and we suggested that they cut either selectively or—that they could selectively but allow flexibility of administration afterward.

Now, the objection to that I fully realize is that you may not get conscientious and real meritorious allocations of the cuts.

Senator MILLIKIN. That is right.

Senator BYRD How much of a cut did you recommend?

Mr. SANDERS. About 10 percent we suggested, and we felt that that would probably be reasonable.

Senator BRYD. Ten percent of the total appropriation?

Mr. SANDERS. Yes; of the over-all budget of the Department.

Senator BYRD. Is that in official form? This bill will come up in the Senate within the next 10 days.

Mr. SANDERS. Yes, sir. Our testimony is on record. We testified before——

Senator BYRD. We would like you to give this committee, which is charged with raising the funds——

Mr. SANDERS. We could give you a copy of the testimony.

Senator BYRD. We would like a statement as to what the grange recommends in the way of reductions, in as much detail as possible.

Mr. SANDERS. We will be glad to do that.

(The following information was subsequently furnished for the record.)

NATIONAL GRANGE,
Washington D. C., July 25, 1951.

Hon. HARRY FLOOD BYRD,
Washington, D. C.

DEAR SENATOR BYRD: On July 18 when National Master Herschel D. Newsom was testifying before the Senate Finance Committee you requested us to file with the committee a statement on our recommendations of reductions in the appropriations of the Department of Agriculture "in as much detail as possible, as to what the Grange recommends in the way of reductions."

In response to this request I am filing herewith a portion of my testimony of July 11 before the subcommittee of the Senate Appropriations Committee that considered appropriations for the Department of Agriculture.

You will note that in this statement we deal with specific cuts for the following items:

1. Reductions in the appropriations for the Bureau of Agricultural Economics exclusive of appropriations for crop and livestock estimates.
2. Reductions in research funds for cooperative marketing for the Farm Credit Administration.

In addition to these two items we believe for the reasons given below in connection with each listed cut, that cuts can well be made as follows:

1. PMA payments, possibly, in view of the present emergency, could be cut to about a half of the appropriations for these payments during the past year.
2. Since allotment or quota programs are in operation for only two crops this year and this work will probably not be increased next year, allotment and quota administrative expenses can and should be reduced. We believe the reduction should be from the $30 million recommended to at least $10 or $12 million.
3. We also believe that since the price support purchases of the Commodity Credit Corporation for the coming year will be on a much smaller scale than normal, a cut of $3 million from the administrative funds of this agency is possible. However, this recommendation is conditional on any additional appropriation needed to take care of any additional duties that may be placed on the Commodity Credit Corporation by the Defense Production Act now in conference.

We believe that appropriations for Rural Electrification Administration loans for next year should not exceed a total of the loans made during the past year, as it is doubtful if supplies and other emergency limitations will permit a judicious loan program in excess of that of the past year.

It is important, however, to permit the shift of the $25 million from the $100 million additional loan fund for Rural Electrification Administration to additional possible loan funds for telephones, thus reducing the Rural Electrification Administration additional loans from $100 million to $75 million and increasing additional loans for telephones by $25 million.

Very sincerely yours,

J. T. SANDERS, *Legislative Counsel.*

STATEMENT BY J. T. SANDERS, LEGISLATIVE COUNSEL, THE NATIONAL GRANGE, BEFORE THE SENATE COMMITTEE ON APPROPRIATIONS SUBCOMMITTEE ON U. S. DEPARTMENT OF AGRICULTURE.

The position of the National Grange for all possible reductions in nondefense expenditures of all kinds places us in a very difficult position so far as the Department of Agriculture is concerned. Regardless of this difficult position we say that the Department should take its share of these cuts. At our last annual session in November 1950 at Minneapolis we passed a resolution as follows: "No democracy which lacks the courage to tax its people sufficiently to live within its income can long survive. But economy in Government, as well as courageous curtailment of all governmental expenditures not essential in the present emergency, must be our goal."

As much as our organization cherishes and appreciates the work of the Department of Agriculture, and as valuable as its work is to the Nation, we do not believe it should be exempt from the sorely needed cuts in Federal expenditures. We are not, however, able to tell this committee where specific cuts should be made and how much the cuts should be. If it is to be the policy of the Congress to reduce nondefense expenditures of the Government around 10 percent, then in all probability Congress should make a 10-percent cut in the Department. If such an over-all cut is made across the board, or even if an aggregate of 10 percent is selectively cut from the Department's appropriation with the greatest care possible by the Congress, we believe grave mistakes will be made. We doubt that the Congress can by any amount of possible effort avoid making such errors.

I would first like to point out a few such mistakes made by the House committee in the bill they sent to the Senate and then later suggest a possible means of providing for corrections of these probable errors that are likely to result from any action the Congress may take on these cuts.

The House, we believe, made an error in its proposed cuts in research for the Department. Let me preface these remarks on research funds by stating that doubtless wasteful and sometimes foolish use of research funds have been made by the Department. Research is always an elusive and often an indefinable effort. It is highly personal and as such it is often colored by individuality. Especially is this true in Agriculture. I was in Government research work for 20 years and can now see that much of the detail work that I came in contact with did not seemingly yield benefits in excess of cost. But this was decidedly not the case for the work in the aggregate.

The National Grange fought hard for the passage of the 1946 act expanding the research of the Department. We are disappointed that the appropriations have almost completely ignored the accelerated authorizations for research carried in this act. Indeed it is doubtful if proposed appropriations by the House have as much research purchasing power as the appropriations made immediately after the passage of the act. We trust that the Senate committee will recommend a much more liberal appropriation than the House recommendations carry. We doubt the wisdom of cutting these appropriations under last year's. If the committee will examine the annual report of the ARA or will examine the speech of Deputy Administrator Byron T. Shaw before the Western Society of Soil Science at Salt Lake City June 21, 1950, they will find numerous examples of how this type of research is entirely justified as a defense activity.

Another error made by the House, we believe, was its recommended cut of the Bureau of Agricultural Economics. This cut, we understand, although it aggregated about a proportional cut for the BAE as a whole, was all placed on the work of the Bureau that does not pertain to crop and livestock estimates. Doubtless it was not wise to cut crop and livestock estimates during the present emergency; but it was unsound to ask the remainder of the Bureau to carry the entire cut amounting to around 21 percent of the balance of the Bureau's work outside of its crop and livestock estimates activities. We believe the Bureau should carry only its proportionate cut based on its non-crop-and-livestock-estimates appropriation. Such cuts are very destructive in any essential research organization and the BAE is one of the most essential and important jobs done by the Department. This importance is magnified by defense.

There is one other item that we think is very important—the proposed cut of the House Committee for the Cooperative Research and Service Division of the Farm Credit Administration. This Division is largely engaged in research on Cooperatives. Presently only this item of $580,000 comes from appropriations out of the total funds of $2.9 million used to carry on the Federal work of the Farm Credit Administration. The proposed cut in the Cooperative research funds amounts to 48 percent cut of the total appropriated funds—a cut that would practically destroy any research organization as it will most surely do in this case.

The National Grange has always been an unfailing advocate of cooperative efforts among farmers. We consider this item of cooperative research indispensable. We can see reason for a cut of around $60,000 or around 10 percent of this item of $580,000 but can see no logic to the proposed House cut unless the purpose is to destroy this research work. We can't believe that the House committee had this in mind; yet such a cut would practically compel a complete abandonment of currently operated projects.

I stated above that I am firmly convinced that no Congress can undertake an over-all cut of considerable proportions of nondefense activities of the Government without doing unknowing but grave damage to some of the thousands and thousands of complex activities of each department. We believe that this will hold true for either selective or for across-the-board flat cuts.

We believe, however, that such probability of damage could be greatly reduced, and mitigated, if each department were appropriated a supplemental "free-use funds," amounting to, let us say, 10 percent of the aggregate of all cuts made. The purpose and use of this fund would be to relieve the most serious areas of damage done by cuts in appropriations. The Secretary should have freedom to use this fund to relieve the most damaging cuts. Such a fund would be a very effective insurance against most serious areas of damage and could be the basis of the Congress making cuts, without the serious qualms which every Congressman or Senator must have, when he votes for these cuts, and if he appreciates honest, conscientious Government service. Any rigid cuts will do highly variable amounts of damage to different parts of our present extremely complex Government structure, and any sound flexibility that can be written into reduction of appropriations will increase the over-all gains from cuts and reduce greatly the losses from areas where acute damage is done by error.

Senator BYRD. I understand that roughly it is 10 percent of the appropriations bill.

Mr. SANDERS. Yes, sir.

Senator BYRD. You may proceed.

Mr. NEWSOM. Thank you, Senator. If I may, I should like to comment on one of the questions that was asked of Brother Sanders.

We believe that, perhaps, the most satisfactory out—I am simply trying to say that we are not very proud of our own inability to do the type thing which the Senator has just indicated be done. That is what we would have liked to have done, but recognizing that we could not do it, we feel that it is sound politically to hold the individual administrators in the executive departments responsible for getting the job done, and that is the only——

Senator MILLIKIN. You have no alternative.

Mr. NEWSOM. That is the only satisfaction we have.

Senator MILLIKIN. You have no alternative.

Mr. NEWSOM. That is right.

Senator BYRD. Let me interrupt you right there. What Senator Millikin was referring to, as I understand it, were the functions. If you are going to have any substantial reduction in these appropriation, you have got to go into the functions; you have got to abandon some certain functions which have been undertaken, not to cut the administrative force, because there comes a time when you can't cut it any more. We have got to determine whether or not this function or that function should be continued, and I agree with Senator Millikin that if the Farm Bureau, Farm Grange—and I am a member of the grange and am proud of it, and have been for very many years——

Mr. NEWSOM. We are proud to have you.

Senator BYRD. If you could get together and make recommendations to the Congress as to what real substantial reductions should be made in functions—that is where the savings are going to come from—and then carry that message back to the farmers, so they will not deluge the Congress with protests against the cuts, then I think we may get somewhere.

Mr. NEWSOM. I certainly do not want to impose upon the committee from the standpoint of time, but I would like to say one thing to illustrate the position in which we find ourselves.

At out last national convention in Minneapolis, we failed by a margin of one vote to call for a cancellation of all PMA payments.

Now, one of the legitimate arguments against detroying or removing all PMA payments now, in my own opinion, was this fact, that the PMA set-up within the Department of Agriculture is a very necessary part of the present farm program which, as I said a moment ago, was

predicated in my opinion on conditions of depression, of despair, and bankruptcy in agriculture.

It is our own personal feeling that perhaps it is not too constructive to wipe out all PMA payments and thus destroy the mechanism for our present program until or unless we have some decent conception of what a broad over-all program for agriculture ought to be that will not depend on something like PMA crutches.

In other words, I do not think the Grange wants to be a party to tearing apart the administration's farm program piece by piece. I would rather attack it broadside and say that here in our judgment is a sound broad program predicated on a high level of employment, high level of national income, that we think will help to keep America at such a level.

I mention that only as an example of how we find difficulty even within our own ranks of saying that here, specifically right here, is where we can cut so many million dollars out of the Department's budget.

Senator BYRD. Let me say that I do not think anyone wants to attack any special program, but you advocate, and properly so, a pay-as-you-go plan.

Senator Millikin has pointed out that in the next fiscal year we are going to spend $85 billion that will only be so, we hope for a temporary period. We will then go to probably 75 billion or 70 billion as long as this crisis exists in the foreign field.

Now even to balance that budget of 70 billion is going to strain the economy of this Nation to the very utmost and, we have got to reduce every possible expenditure that is not absolutely essential. They may be desirable, they may be all right, if you have enough money to pay for it, but we are in a situation now that if we have a deficit spending for any period of years we may crack the solvency of this country—we can easily do it.

Mr. NEWSOM. I agree with you.

Senator BYRD. We have $260,000,000,000 to start with. But the point I make is when you advocate pay as you go it is incumbent upon you—and I mean the Grange and the Farm Bureau—to make an earnest effort to help Congress to reduce these expenditures.

Mr. NEWSOM. I agree with you thoroughly, and we accept the assignment to the very best of our ability. We are simply trying to say that we do not have the answer. We are just hoping that, perhaps your committee has a staff that can help it get the answer.

Senator BYRD. Will you give the committee assurance that you will get in touch with Mr. Kline and these two organizations forming the major farm organizations, and try to work out some plan and give it a real backing with the farmers, to reduce these expenditures, at least next year, if it cannot be done this year?

Mr. NEWSOM. I will give you that assurance. As a matter of fact, we have talked about it a great deal, just the two of us individually, and our respective organizations' representatives have talked about it. I do not think we have done enough work on it.

Senator TAFT. PMA payments—you refer to the payments, the PMA payments which are the subsidy payments? They do not relate to the support of prices, do they?

Mr. NEWSOM. That is right.

Senator TAFT. They refer to fertilizer and that program?

Mr. NEWSOM. That is right. Basically, they are the payments that are made in very modest amounts, if you please, so far as individual farmers are concerned, to encourage the application of lime when soil is sour, to encourage the application of phosphate where that plant food is sorely needed, largely in the increase of grassland production.

Senator TAFT. I only wanted to have it clear in the record what it was.

Mr. NEWSOM. Thank you, sir.

Senator WILLIAMS. The Farm Bureau has gone on record in endorsing a cut in that particular program, have they not?

Mr. NEWSOM. As I understand it, they have advocated the complete wiping-out——

Senator WILLIAMS. That is what I was thinking about.

Mr. NEWSOM. I beg your pardon; their final position I think, was that they be cut just about half, as I recall it.

Senator TAFT. Half.

Mr. NEWSOM. As I understand it the result of that is that the amount that they have recommended to have left, will just about pay administration costs, pay the bill of keeping the committees in existence, and probably not leave anything for actual PMA payments to the farmers. [Laughter.]

Senator FLANDERS. Pay the overhead, but nothing beneath it.

Mr. NEWSOM. Well, I think that is about the way it is.

Senator WILLIAMS. Was not that particular phase of the program set up as a depression only——

Mr. NEWSOM. That is exactly what I tried to say a moment ago.

Senator WILLIAMS. It was intended to be suspended when we came out of the depression.

Mr. NEWSOM. I personally believe there is no justification for that sort of thing; payment to individual farmers under present income positions, but I am not sure that as master of the National Grange, I should have said that.

Senator BYRD. You may proceed, Mr. Newsom.

Mr. NEWSOM. Under present circumstances, it is highly essential that we consider taxation in connection with, and as a very effective control of, inflation. Inflation robs the thrifty. It decreases purchasing power ruthlessly. It increases the financial burden of supporting Government and tends to destroy all semblance of stability.

Senator MILLIKIN. Mr. Chairman, I do not want to interrupt the witness any more because we have gotten him off on several sidetracks here, but we have in this committee room, a delegation of Germans. It is a tragedy that it is not appropriate to call them to the witness stand. They can tell us about inflation. They know more about inflation than all of us together. They could point out the same symptoms in our system today that led to the final economic destruction of Germany.

Mr. NEWSOM. I suspect that is exactly right. I do not pretend to know the answer to that, but I would be glad to hear their statements, if that were possible. I assume it is not.

The Grange is earnestly concerned about inflation, but we insist that to treat the symptoms of inflation and fail to attack the causes is futile and shows a lack of courage. Accumulation of Government debt is a major cause of inflation. A part of the present inflationary

gap is a result of the $4½ billion subsidy payments to farmers and consumers in our World War II effort. An adequate tax structure coupled with sound credit and monetary controls, combined with a vigorous program of personal savings, are the real weapons against inflation.

In times of emergencies such as this, in times of extraordinary governmental expenditures such as we have today, the level of personal income tax liability should be limited only by the prospect of deflation and unemployment as a result of a level of tax liability so high that people would not have enough money left to buy the prospective production of civilian goods at prices which would be adequate. Such a level of personal income tax liability will not reduce the standard of living unless those taxes should greatly discourage production, because the standard of living is determined by the volume of national products left for civilian use after the mobilization needs have been met.

To the extent that a realistic high income tax program would be effective in preventing inflationary price increases, even those people with fixed incomes would gain in the long run by the prevention of the rising prices.

We believe the administration's proposal for a 4-point increase in individual income-tax liability rate was more realistic than the provisions of the House action.

Last February, the Grange called for substantial increase in the excess-profits tax revenue. If the level of profits above which all profits become subject to excess-tax liability is determined with due regard to—

(1) The historic level of income or a reasonable return on invested capital.

(2) The volume and efficiency of output compared with the historic or base period.

(3) Maximum utilization of plant and employment capacity, then we thoroughly believe that the excess profits liability rate in this emergency can justifiably be increased.

I think, gentlemen, I should like to digress for just a moment to say to you that under this kind of emergency, and in the face of the threat of inflation that we have, in the face of all the other conditions, some of which we have tried to enumerate, we do not believe that American business will find or should find—I had maybe better say—too much fault with a very high rate of excess-profits tax liability, assuming the base period above which that tax liability is assessed is soundly determined.

I do not believe that a historic level is a sound basis for determining the limit above which income becomes excess.

For example, we have a very thriving industry in my own county-seat town that has been on an extended production effort for 2 years. In talking with one of my good friends who is an official in that company, frankly, I made some attack on the high level of profits during the last year. I think that level of industrial profits is, perhaps, vulnerable to some attack.

But I quickly came to realize in conversation with him that a major factor in that high level of industrial profit was the tremendously full utilization of plant capacity and the terrific amount of overtime that went into that production, and I do not think that it

would be sound for us to expect that industry to completely disrupt its price mechanism in the face of those circumstances of fullest production to bring profits down to some point that those of us on the outside might think was reasonable.

I am simply trying to say in that particular instance I think we should not only give recognition to the historic level of profits, but we should give recognition to a fair return on investment, and we should give recognition to the utilization of plant capacity and the level of employment.

We must guard against any possibility that the imposition of excess-profits tax liability will be a reason or excuse, even for chopping off employment and chopping off production at some given level.

Now, having arrived at—and we have tried to set down in general terms, three essentials or four essentials actually, because the first one is compounded, of a determination of a level above which profits become "excess," then we are trying to say that under these circumstances I believe that a very high rate of excess-profits tax would certainly be sound.

Senator TAFT. Do you see any reason for reducing the 85 percent to 75 percent? That seems to me on its face not excess profits at all. I can't see that. I can see your argument for a higher rate, but I can't see any reason for reducing 85 to 75.

Mr. NEWSOM. I think that is an unsound approach. That is just what I have been trying to say, Senator, that approach is based almost entirely, as I understand it, on historic level, and I do not think that is a completely sound approach to the determination of where profits become "excess."

Does that answer your question?

Senator TAFT. Yes; that answers it.

Mr. NEWSOM. We recognize that corporation incomes tend to fluctuate widely. For this reason, corporation incomes after taxes may need to be very high at times to offset low periods. Our information, however, indicates that corporation incomes have been at extremely high levels even after allowance for the increased price level and added investment for a number of years. Even though this high level of profit may at least in part be justified by the high level of plant utilization and high level of output, we believe that under the emergency conditions now existing a corporate income tax increase in the amount provided by the House action is justifiable.

Senator FLANDERS. May I just call attention to what I suppose is the fact here, sir, that you are referring to averages in this paragraph.

Mr. NEWSOM. Yes, sir.

Senator FLANDERS. And you presumably would be willing to concede that an average may cover very great discrepancies?

Mr. NEWSOM. That is right.

Senator FLANDERS. And that, I think, relates in part to that historic level of income because there are types of industries which thrive only during a war period, and which are pretty well down during the proposed historic base periods.

Mr. NEWSOM. We agree.

Senator FLANDERS. And we always want to be sure that when we are talking about averages, we recognize the possibility that it may conceal some very great discrepancies.

Mr. NEWSOM. I am sure that we agree with that fully, and I think we do recognize that.

Senator FLANDERS. Yes.

Mr. NEWSOM. A 12½-percent increase in capital gains seems reasonable, but we strongly urge that the length of time which property or assets must be held before income from their sale can be treated as capital gains should be increased to 12 months.

Senator MILLIKIN. Is that a matter of philosophy or for revenue?

Mr. NEWSOM. Well, it is a matter for both.

Frankly, maybe if I stay on this national scene longer than I presently expect to, I will get to mixing philosophy and results more than I am disposed to want to do now; but I still believe, and I think I will always believe, that if you set your goal soundly, then there ought to be enough intelligence somewhere in this country to get there.

Senator HOEY. Does not the record show that you get more revenue if you have a quicker turn-over? In other words, if that were changed to 6 months, the revenue would increase from this source? If you put it back to 12 months, do you not think that it would result in drying up a good deal of this revenue?

Mr. NEWSOM. Well, I have heard that argument. I suspect there is a great deal of soundness, a sound basis for it. Frankly, I confess that that statement was prompted, to some extent, by my feeling that we should try to set out basic general rules for all of us to go by, and we are thinking in terms largely of agriculture, and I do not believe that agriculture should be entitled to treat any livestock holdings, for example, the sale of which may result in any given tax period—I do not at this time think they should be treated as capital gains unless we have held that livestock for at least 12 months.

Senator MILLIKIN. How about timber?

Mr. NEWSOM. I do not see why the same rule should not be applicable to timber. As far as we can, I would like for us to make rules that everybody can live by, and not to make too many special rules. But I recognize that we probably will have to make some kind of exemption, even in this case, to account for the fact that you mentioned.

Senator MILLIKIN. Philosophically the period for holding before you can claim a capital gain should be such as to avoid a narrow band where the capital transaction is, in fact and reality, an income transaction.

That is what you have got to guard against so far as your period is concerned.

Mr. NEWSOM. I agree.

Senator MILLIKIN. But if you fall short of that, where you really and truly engage in capital transactions, as Senator Hoey has pointed out, the evidence indicates, the shorter the period, the greater the revenue.

Mr. NEWSOM. It is true, of course, but I would immediately want to point out that the shorter the period, the greater contribution that type transaction will make to inflation, and it seems to me that that may be a substantial offsetting factor to the point that you raised, Senator. I am talking about speculative operations, of course.

Selective excise taxes to absorb surplus purchasing and therefore combat inflation, as well as raise revenue, are entirely justified in the present emergency on goods that become scarce and therefore tend

to get themselves pricewise into a luxury category. Normally, however, excise taxes should be limited largely, if not entirely, to luxuries and amusements. The Grange believes that this mechanism can be effectively applied as a method of helping to shift productive effort to the necessities of life and our national effort, and from those items which we can best afford to restrict in volume.

Unless we confine excise tax mechanisms to the category of amusements and luxuries, we are again tending to penalize those who have the least purchasing power and need it the most, without any regard to their ability to pay.

Senator BYRD. You would oppose a sales tax, I assume?

Mr. NEWSOM. We do, because we oppose the increase in Federal tax on gasoline used in necessary production, either industrial or agricultural. Such an increase of tax on gasoline would serve no useful economic function but would increase the cost of production and actually be inflationary.

We believe the proposed excise tax on automotive parts and tires as well as that on trucks is unsound and we oppose it.

We believe that there are still legalized escape provisions from just tax liability. We do not believe there is any justification for failure to impose Federal income tax on earnings from State and local bonds, and favor the imposition of such tax liability.

We believe that the depletion allowances presently provided are, in some cases at least, excessive and we urge their review. It does not seem that depletion allowances should exceed a reasonable relationship to the investment cost and the probable life of the producing resource.

Senator MILLIKIN. I suggest to you that if you take the exemption off of the interest on municipal bonds, for example, you will increase the cost of running your municipal government. The same goes for State governments.

Mr. NEWSOM. That to some extent, I grant you, would inevitably be true, but I have seen evidence that seems to prove to me that that result would in no manner coincide with the increased revenues that would be available to the Federal Government. But the major thing about it is that I just do not believe it is economically just and sound to permit some people to hide behind that sort of mechanism and keep from paying their fair share of the cost of maintaining our Government.

Senator MILLIKIN. Would you be in favor of the States having the power to tax Federal securities?

Mr. NEWSOM. Well, not the securities themselves, not to impose a property tax on the securities themselves, but in those States where there is an income tax as a part of their revenue mechanism, I would be inclined to be in favor of it. Perhaps we would have to look it over pretty hard.

Senator MILLIKIN. At the present time there are very few—I do not recall of any, unless there are some small Liberty's, Federal securities, that are tax-exempt. But assuming there were, would you give the States power to tax that exempt interest?

Mr. NEWSOM. I would want to examine it, but my present disposition is that I would.

Senator MILLIKIN. I think you will find a close point of balance there if you start pursuing it through all of its ramifications.

Mr. NEWSOM. Then the answer should be found in the matter of where equity lies.

Senator MILLIKIN. You would be against the tax if it is that close?

Mr. NEWSOM. No, I do not think I would. I think I would still be for it.

Senator WILLIAMS. Do you endorse the changing of tax exemption as relating to farm cooperatives? I notice you are discussing the other things.

Mr. NEWSOM. Well, frankly, our position on that—I do not know at this time what the change is, to be perfectly honest with you, but I can tell you what our position is, if that is what you want. You had better tell me if you want a specific answer to the question, just exactly——

Senator WILLIAMS. I would like to know your position.

Mr. NEWSOM. Well, as a matter of fact, Dr. Halvorson is prepared to make a statement, later on this week some place on that particular subject, but basically our position is just this: We believe there is some inequity in the provision that permits cooperatives to retain certain unallocated reserves in some cases which are not subject to Federal income tax either in the hands of the cooperative or in the hands of the patrons.

Senator TAFT. Or in the hands of what?

Mr. NEWSOM. Patrons. The patrons of cooperatives.

Senator TAFT. I never understood that anybody objected to taxing them.

Senator WILLIAMS. They are not being taxed.

Mr. NEWSOM. I say there is an inequity, in the provision that permits the cooperatives to retain certain sums that do not become subject to Federal income tax liability in either place.

Now, our position is that those funds of the cooperativ which are paid to the patrons as patronage dividends actually never were the property of the cooperative because they have been the property of the patron all the time; they are simply in the same category as my dime would be if I were to give you a dollar bill and tell you to go downtown and get me 90 cents' worth of merchandise and you came back and gave me the change. These 10 cents were never yours. Neither was that patronage dividend ever actually the property of the cooperative.

Senator TAFT. I agree with that, but of course, when it does go back to the farmer it is taxed in his hands because it reduces his cost. I mean, it is not completely exempt.

Mr. NEWSOM. That is right. The inequity exists only on that money which is never paid back to the farmer in patronage dividends, either in cash or in the form of certificates of equity or in any other instrument which does become evidence of his interest therein so that it is susceptible to income tax liability in the individual member's hands.

Now, in other words, that portion of the so-called income of the cooperative which is kept by the cooperative without sufficient certification or allocation to the patron as to make it taxable in his hands, we think should be subject to the regular corporation tax in the hands of the cooperative. That would eliminate the only inequity that exists. Does that answer your question?

Senator WILLIAMS. Yes, you do recognize that there is some need of a revision, and I understand that you have a representative speaking directly on the subject later this week, is that correct?

Mr. NEWSOM. That is correct.

Senator WILLIAMS. So, I will withhold it.

Senator BUTLER. Will that representative, Mr. Newsom, probably make a suggestion as to a proposed change in the bill to accomplish the purpose?

Mr. NEWSOM. Halvorson is our National Grange economist. I cannot even keep up with everything that goes on in our own office there. I'll have to ask Lloyd to answer the question.

Mr. HALVORSON. Well, those savings which a cooperative retains and are not allocated in cash or in certificates, so as to make them taxable in the hands of the patron, we feel should be taxable as income of the cooperative.

Mr. NEWSOM. The Senator's question was: When are you going to make such a statement? I do not know the answer to that one.

Mr. HALVORSON. I have not as yet been scheduled.

Mr. NEWSOM. Before what group?

Mr. HALVORSON. This committee is going to hold hearings.

Senator BYRD. Thursday and Friday are the nights set aside for holding hearings on the cooperative question. I suggest that we go ahead. We have gone an hour with this witness and there are quite a number of witnesses to go yet. We have to be on the floor at 12 o'clock.

Mr. NEWSOM. Shall I proceed?

Senator BYRD. Yes, sir.

Mr. NEWSOM. We must recognize that, in this struggle with the enemies of freedom, terrific financial liabilities are imposed upon us and we must meet the problem by eliminating or reducing to an absolute minimum Government borrowing. The key to a successful mobilization effort is more production and adequate tax and fiscal policies rather than what we should maneuver for preferred position among ourselves. We believe that the above principles will make America financially strong while we are engaged in the mobilization effort. A strong America is freedom's greatest potential asset.

Senator BYRD. Thank you, Mr. Newsom, for your contribution.

Mr. NEWSOM. Thank you, sir.

(The following letter was subsequently supplies for the record:)

NATIONAL GRANGE,
Washington 6, D. C., July 19, 1951.

Hon. JOHN J. WILLIAMS,
Senate Office Building, Washington, D. C.

DEAR SENATOR WILLIAMS: We have reviewed that portion of our testimony dealing with taxation of cooperatives which I gave on July 18 before the Senate Finance Committee and find that in our judgment it presents our views adequately on the subject.

We, therefore, have not requested the clerk to schedule us for appearance as was suggested at the hearing.

Sincerely yours,

HERSCHEL D. NEWSOM, *Master.*

Copies to Mrs. Elizabeth Springer.

Senator BYRD. Mr. Henry B. Fernald?

Mr. Fernald, identify yourself to the reporter. We have gotten behind in our schedule, and I will ask you to be as concise as possible because we will have to adjourn at 12 o'clock promptly.

STATEMENT OF HENRY B. FERNALD, CHAIRMAN, TAX COMMITTEE, AMERICAN MINING CONGRESS

Mr. FERNALD. I will try to be, sir. I am Henry B. Fernald.

Senator BYRD. Could a part of your statement be put in the record?

Mr. FERNALD. Yes, sir. It is a very long statement.

Senator BYRD. I do not want to prevent you from making a full statement, but it looks to me like it would take half an hour to read it.

Mr. FERNALD. I am afraid it will, sir.

I will condense it as much as I can, sir.

I am Henry B. Fernald, Montclair, N. J., chairman of the tax committee of the American Mining Congress.

I am appearing to present to you certain matters of deep concern to the mining industry with respect to the pending revenue bill.

First, as to the general nature of the bill, this bill has been urged for two major purposes, to raise revenues and curtail inflation. Taxes which leave no fair incentive to create and maintain incomes cannot be counted on to yield revenues. Taxes which curtail incentives for production do not curb, but feed, inflation.. Income taxes only yield revenue as there are incomes to be subject to the tax. Yet this bill imposes bitter taxation on incomes of individuals in the upper brackets and will deal very harshly with the incomes of corporations. We shall point out here how serious this is. Taxes at best are a faulty means of curbing inflation. I will condense some of this.

Senator MILLIKIN. May I make a friendly suggestion to you?

Mr. FERNALD. Yes, sir.

Senator MILLIKIN. The suggestion would be that you get to the mining part of your statement.

Mr. FERNALD. Very good, sir.

I do want to call attention briefly to the exhibits I present herewith, and their showing as to what the proposed taxes will do in regard to the higher individual incomes and to corporate incomes, and the impossibility of trying to maintain investments out of what will remain to the investor after income taxes.

For instance, we have under this bill, taxes which in the $80,000 to $90,000 bracket will have taxes taking $9,450 out of $10,000 income, and leave only $550 to the taxpayer. That is not any margin from which he can make investments.

As to our particular mining questions, we speak first of prospecting, exploration, and development of mines.

The present emergency has found our country sadly deficient in the metals and minerals essential for our civilian economy and the rearmament effort. One of the major contributing causes of that deficiency has been a tax climate which removed all incentives for the discovery and development of new mineral deposits. Until and unless that condition is changed we can look forward to little improvement in the situation.

Our stockpiles are deficient. We are not able to go ahead as we should with much of our defense production because we lack the needed metals and minerals. We need to find and develop additional sources of supply. The present laws leave little incentive for the risk and effort required. The Government is eager for its large share of any success from the discovery and development of minerals, but it is hesitant to make allowances for the risk expenditures from which, if

successful, the Government will so largely benefit. It benefits from its taxes on profits of the successful mines; from the mineral supplies for its defense; from the activities created and revenues arising as the minerals and their products flow through our entire industrial life.

The minerals are in short supply and we need them badly. We need to stimulate the search for and the development and production of them. The Congress has not been unmindful of the needs of the mineral industry but more must be done if we are to meet present needs.

Section 302 of the bill would permit development expenditures for mines to be deductible as expense, which is their proper treatment. Present Bureau regulations require such development expenditures before the mine enters the production stage to be capitalized and recovered through depletion. The committee report on the bill points out that such expenditures should have the same general status as similar expenditures for a producing mine. Otherwise, there is an unfair discrimination against mines which must do substantial work before entering the production stage as compared with those which more promptly begin production.

We are further pointing out that when percentage depletion was granted to mines at the rates established, the allowable rates granted did not contemplate that depletion thus allowed should include amounts which in their nature were costs of operation.

This principle is recognized in the amendments proposed in section 302 of the bill. These amendments fairly and satisfactorily cover the general situation as to certain mines or types of mines which were under particular consideration in working out the wording of those amendments. There are somewhat different circumstances and conditions as to other mines which are not satisfactorily met under the present wording and we urge that certain changes be made so that this section will cover this problem for all mines.

Section 302 deals solely with the question of development expenditures after a commercially valuable deposit is disclosed. We believe it should also be extended to cover prospecting, exploration, and development expenditures before disclosure of the commercially valuable deposit. This matter we shall later discuss.

We first point out certain provisions which should be made even within the scope of the present amendment.

(A) There should be inserted a provision for a taxpayer's election to take the deductions either as deferred expenses "or at the taxpayer's election, in the year paid or incurred."

This is desirable for the stimulus it will give to development if that is permitted.

The present margin which remains after taxes, corporate or individual, or the two combined, is so narrow that in many cases it will be impossible to try to make expenditures of this kind from the residue which remains to the taxpayer after income taxes have been paid. The taxpayer will not be able to make such expenditures from the income unless the tax deduction is allowed. Sometimes, however, the individual or the corporation will not have the current income from which the deduction might be taken and would wish for deferment. Accordingly, a taxpayer should be permitted in any year or as to any expenditures either to write off the amount currently, or to defer it for future deduction.

Moreover, there are difficulties in determining just what is meant by the word "development," and such an amendment would avoid that question.

Senator MILLIKIN. Let me get a little further into this deferment. How far do you recommend that deferment be permitted?

Mr. FERNALD. Under this bill the amount is to be allowed ratably over ore benefited. There is a great deal of difficulty in trying to determine just what is "ore benefited" by particular expenditures. We find it a hard problem. I do not think you can cover it satisfactorily by any wording in the law. It will have to be met under Bureau rulings, and I am afraid we cannot bring that readily down under fixed rules.

Senator MILLIKIN. At the same time, could you allow the miner, without following any rule, on his own to defer until some year of high profits, and then reduce those by indefinitely deferred depletions?

Mr. FERNALD. That is as to the development expenditures referred to?

Senator MILLIKIN. Yes.

Mr. FERNALD. I do not think that will follow, Senator. In general, the years of high income will be the years of maximum production. They would naturally carry under this benefit rule a higher write-off in that year than they would when times were bad and production was very low. I think we will probably meet that problem by what we are suggesting as to the expenditure; permit a taxpayer either to write it off in the year he has to take his money and put it into this venture—from which the Government is going to be the largest beneficiary, after all—or to defer it if he has to defer it. I think the best we can do is hope to determine with the Bureau reasonable rules as to any deferment.

Conditions in different mines vary so greatly it is very difficult to give one broad general rule that will apply equally to the vein mine, and to the disseminated deposit; surface, underground, and all the other conditions. I think those will have to be administratively determined largely.

A second point we urge is that there should be inserted a provision that—

before the mine has reached the production stage net receipts from any minerals produced shall be applied to reduce any then remaining balance of development expenditures.

I believe there is no question that it is intended to follow that long-existing rule but I think it would be better if it could be included as a specific provision in the law to avoid any question. You understand that, as we are proceeding with exploratory and development work, in the course of those workings, we may remove some ore. It is a well-established rule that any net receipts from such ore reduce the remaining balance that you have to consider as your net cost of development. I do not believe that there is any question about it, but we make that suggestion.

A third point is that there should also be recognition of a long-established rule that—

Expenditures to maintain production of an operating mine shall not be considered as expenditures for development within the meaning of this paragraph but shall be deductible as ordinary cost of operation in the year such expenditures are made.

That has been a long-established policy, which has been recognized, and I am quite sure there was no intention to do other than that under the wording of this amendment, but I believe it would be important to have mention of that so as to avoid possible controversy.

The next amendment we ask is that something be said to this effect:

To the extent that such expenditures have not been previously so deducted by the taxpayer, they may be deducted in the year in which it is determined that there is no reasonable expectation of such production thereafter.

We have had considerable controversy as to when a loss from the abandonment of a mine or mining property can be written off. It is very difficult to give the negative proof that there is no possibility of ever finding any further mineral in a property. Instead of being put to a difficult test like that, we feel that it should be enough to show that there is no reasonable ground to expect further production, and then be permitted to have the write-off.

The foregoing are points which arise within the scope of the present amendment. However, we feel that the amendment should go further, and should cover prospecting, exploration, and development before the commercial nature of the deposit is disclosed, and we so recommend.

We point out that, as our tax laws are at present, they are drying up the sources of possible venture capital. A man whose income falls in the $80,000 or $90,000 class will, under the bill, have left to him only $550 out of $10,000 which he may earn. To accumulate income enough to make a $10,000 expenditure for prospecting, exploration, and development in any year, he would have to earn $182,000 additional so as to pay the Government $172,000 in taxes, and leave him with the $10,000 he might invest. It simply leaves no margin unless this risk expenditure he is making—which, if it is successful, is going to benefit the Government far more than it benefits him—can be allowed as a current deduction.

We therefore urge a broad amendment, such as we have presented previously, to cover prospecting, exploration, and development, as well as the more limited development referred to in the present section.

To hurry through the remainder of this, Senator——

Senator BYRD. We would appreciate it if you would.

Mr. FERNALD (continuing). We approve the changes made in percentage depletion, which has been fully discussed by your committee before. This depletion is one of the essential allowances for mining.

As to excess output of mines under section 453 (b) (2), and (4), we urge that those provisions should be extended to nonmetallic as well as metallics. I would be glad to discuss that at length, but we submit our recommendation on that. We believe it is only fair, and it is really essential, if we are going to avoid great injustice to them——

Senator MILLIKIN. You are talking about the excess profits?

Mr. FERNALD. I am speaking of the excess-profits tax, the allowance for excess output.

The bill contains a provision as to coal royalties, to accord to them the same capital treatment when received by a lessor that is now available to timber. There have been certain suggestions already made before your committee as to the wording of that provision,

which I will not stop to discuss. We do feel that to avoid any possible question a statement should be included that—

In determining the gross income, the adjusted gross income, or the net income of a lessee, the deductions allowable with respect to rents and royalties shall be determined without regard to the provisions of this paragraph.

We are satisfied that is the intent of that provision, but we believe that should be clearly stated.

We present to you the matter of the foreign tax credit with respect to foreign subsidiaries, which is quite an important matter in regard to our minerals. The present majority requirement of section 131 (f) (1), should be eliminated and the (f) (2) requirement should be reduced from 100 percent to not more than 50 percent. I believe that is well understood by your committee.

We also mention the matter of income earned abroad under section 116, where, because of a technicality in the law, it is necessary for a citizen to have been a resident abroad for the entire calendar year That will not cover one who goes abroad in January or any subsequent month; so he will not have the allowance for the remainder of that year. That should be granted. There should also be an amendment to make clear what is meant by foreign residence, and the withholding provisions of section 1621 (a) (8) should be modified accordingly.

We renew our prior recommendation that net operating loss deductions should not entail a disallowance of percentage-depletion deductions.

We ask that the penalty on consolidated returns of 2 percent should be eliminated.

As to the proposed change in excess-profits credit based on income from the present inadequate 85 percent to an even less adequate 75 percent of the base-period income, we strongly urge that, instead of such reduction, the amounts should be raised to 100-percent allowance. To do otherwise is to subject normal income to excess-profits tax, which is grossly unfair and is contrary to the principle of excess-profits taxation.

The bill includes an extremely difficult series of provisions intended to limit corporations to a single $25,000 surtax exemption and to a single $25,000 minimum excess-profits credit. We believe the problem involved does not merit all the confusion and difficulty which would arise in endeavoring to apply these tests. As to what I mean by that, all I can do is to ask you to read section 123. We believe the provisions presently in the law, such as section 45 and section 129, are adequate to deal with any cases where a right to file separate returns might otherwise lead to abuses. We urge that section 123 be eliminated.

As to corporation-tax rates, we strongly urge that normal and surtax should in no event exceed an aggregate of 50 percent. The Government should not take more than one-half of the normal income of a corporation.

The bill proposes an increase in the ceiling rate for corporate-income and excess-profits tax to 70 percent instead of the present 62-percent limitation. We urge this should not be raised by more than the amount of increase in normal and surtax.

As to capital gains, we urge that its rate should not be increased beyond the present 25-percent rate.

I appreciate your courtesy.

Senator BYRD. Thank you very much. Would you like your complete statement put into the record?

Mr. FERNALD. I wish it would be, sir.

Senator BYRD. Very well.

Mr. FERNALD. Thank you, sir.

(The prepared statement of Mr. Fernald is as follows:)

STATEMENT ON BEHALF OF THE MINING INDUSTRY, BY HENRY B. FERNALD, CHAIRMAN, TAX COMMITTEE, AMERICAN MINING CONGRESS, RE REVENUE BILL OF 1951 (H. R. 4473)

Mr. Chairman and members of the committee, I am Henry B. Fernald, of Montclair, N. J., chairman of the tax committee of the American Mining Congress.

I am appearing to present to you certain matters of deep concern to the mining industry with respect to the pending revenue bill.

AS TO THE GENERAL NATURE OF THE BILL

This bill has been urged for two major purposes: To raise revenues and to curtail inflation. Taxes which leave no fair incentive to create and maintain incomes cannot be counted on to yield revenues. Taxes which curtail incentives for production do not curb but feed inflation.

Income taxes only yield revenues as there are incomes to be subject to the tax. Yet this bill imposes bitter taxation on incomes of individuals in the upper brackets and will deal very harshly with the incomes of corporations. We shall point out briefly how serious is this taxation and how it leaves little or no incentive for creation of taxable incomes.

Taxes at best are a faulty means of curbing inflation. They can be expected to curb inflation only if they serve as deterrents to causes of inflation. The inflation we now face is primarily a shortage of production as compared with funds available for expenditure. The large amounts of production which we are diverting and expect to divert from consumers' demands at the same time we are maintaining and even increasing the funds available for expenditure inevitably have an inflationary tendency. To the extent that we can increase production we can counteract that tendency. We do not encourage the production we need by imposing taxes which curtail incentives for production and penalize productive and creative efforts.

Taxes forthwith spent by the Government do not curtail inflation.

We must meet needed defense requirments, but we should see that unnecessary expenditures are eliminated. Expenditures by the Government for nondefense purposes should be reduced to the minimum which will meet essential needs. Waste or extravagance should so far as possible be avoided in defense expenditures. As this is done we shall find our revenue requirements minimized.

But whatever may be our need for revenues, we do not derive revenues nor do we curtail inflation by curtailing incentives for maintaining and increasing incomes and for production of goods and services. Let me point out briefly something of what this bill does to curtail incentives.

First, as to individual income taxes, a tabulation is submitted (exhibit A) which shows the individual income-tax rates by brackets and cumulatively. Tax rates under this bill will rise until at $80,000 the tax rate becomes 94.5 percent. On $10,000 of income falling into the $80,000–$90,000 bracket the tax will take $9,450, the taxpayer will have left to him only $550. We further note that, for a single man with $80,000 of taxable income, the tax will be approximately $56,500, leaving to the taxpayer only $23,500 after tax.

Again we may note that income in the $14,000 to $16,000 bracket will be taxable at approximately 53 percent. In the $50,000 to $60,000 bracket the tax rate will be over 84 percent.

Exhibit B herewith shows what these tax rates will mean with respect to investments, considering at this point only the net yield to the investor after his individual-income taxes thereon. If an investment pays 10 percent to the investor, the net remaining to him if that income falls in the $50,000–$60,000 bracket will only be slightly over 1½ percent. If it falls in the $80,000–$90,000 bracket, the yield will only be slightly over one-half of 1 percent. If the income fell into the $50,000–$60,000 bracket, the investor would have to receive 20 percent on his investment to have a net to him of 3 percent. But such 20-percent yield, if it

fell in the $80,000–$90,000 bracket, would only yield 1.1 percent net to the investor. Such rates as these certainly give no incentive for investment.

But let us go further and consider the result of a combination of corporate and individual taxes as illustrated in exhibit C. This illustrates the result of investment of $1,000,000 in a corporation which has its excess-profits credit based on invested capital, and the results to stockholders in various income brackets if the corporation earns 10 percent, 20 percent, or 30 percent on its invested capital. If the corporation earns 10 percent—$100,000—it would have no excess-profits tax to pay, but if its dividends fell in the $80,000–$90,000 bracket for its stockholders, to whom the corporation distributed the entire balance of its earnings after payments of its taxes, the combined taxes would amount to $97,058, leaving to the stockholders only $2,942, a net to the stockholders of three-tenths of 1 percent on their investment.

If the corporation earned 30 percent, or $300,000, it would be subject to excess-profits tax as well as income tax. The combined corporate and individual taxes, again assuming all income distributable to stockholders in the $80,000–$90,000 bracket, would amount to $294,748, leaving to the stockholders only $5,250, or slightly over one-half of 1 percent on their investment.

Even if its stockholders were only in the $20,000–$22,000 bracket, if the corporation earned $100,000, taxes would take over $80,000, leaving to the stockholders only $20,000 or 2 percent on the investment. If the corporation earned $300,000, even for the stockholders in the $20,000–$22,000 bracket, taxes would take $265,000 and leave to the stockholders $35,000, or 3½ percent on the investment.

Certainly there is no incentive to the stockholders in the higher tax brackets to make any such investments or to endeavor to create additional incomes which may be subject to tax. Furthermore, it is hardly necessary to point out that when taxes are taking 75, 80, or 90 percent and more of income the taxpayer does not have remaining income for investment.

We urge your careful study of what these rates will mean in their effect on incentives, on Government revenues and on inflation.

We may further point out that the proposal in this bill to increase present taxes by a uniform 12½ percent has a very bitter effect on the upper-bracket incomes, as it will so greatly reduce the amounts now remaining under the present law to the taxpayer after present taxes. For income in the first $2,000 bracket under present law, the tax rate of 20 percent would leave 80 percent of such income to the taxpayer (in addition to the nontaxable income represented by exemptions). The 12½-percent addition under the bill would only reduce by 3⅛ percent the present 80 percent remaining to make it 77½ percent. This percentage of present remaining income which would be taken by the increased tax rises rapidly until in the $80,000–$90,000 bracket it becomes 65.6 percent, so that the presently remaining 16 percent after an 84-percent tax becomes only 5½ percent after a 94½ present tax. Or, stated otherwise, out of $10,000 of income in the $80,000–$90,000 bracket the present tax would take $8,400 and leave $1,600 to the taxpayer. Under the bill, taxes would take $9,450 and leave only $550 to the investor. We urge that such taxation is neither equitable nor desirable and will hurt rather than help Government revenues and our general economy.

Much more might be said on the general nature and impact of the taxation which this bill would impose, but we pass to certain special features to which we ask your attention.

PROSPECTING, EXPLORATION, AND DEVELOPMENT OF MINES

The present emergency has found our country sadly deficient in the metals and minerals essential for our civilian economy and the rearmament effort. One of the major contributing causes of that deficiency has been a tax climax which removed all incentives for the discovery and development of new mineral deposits. Until and unless that condition is changed, we can look forward to little improvement in the situation.

Our stockpiles are deficient, we are not able to go ahead as rapidly as we should with much of our defense production because we lack the needed metals and minerals.

The mining industry has in the past pointed out that the present situation was almost inevitable under our tax rules. Only an immediate improvement can relieve the present shortages in the near future.

We need to find and to develop additional sources of supply. Present tax law leaves little incentive for the risk and the effort required.

The chances of disappointment and failure in the search for and endeavor to disclose valuable mineral deposits are very great. The incentive comes from the hope for the occasional success which will yield profits adequate to compensate for many failures. Under our tax laws the Government will take, in corporate and individual taxes, most of the profits of the successful venture. Taxes may even take more than the total profits of a venture because present allowances in annual income computations are often inadequate for capital recoupment.

The Government is eager for its large share of any success but very hesitant to make allowances for the risk expenditures, from which, if successful, the Government will so largely benefit. It benefits from its taxes on profits of the successful mine; from the mineral supplies for its defense; from the activities created and revenues arising as the minerals and their products flow through our entire industrial life.

The minerals are in short supply and we need them badly. We need to stimulate the search for and the development and production of them.

The Congress has not been unmindful of the needs of the mineral industry but more must be done if we are to meet present needs

Section 302 of the bill would permit development expenditures for mines to be deductible as expense, which is their proper treatment. Present Bureau regulations require such development expenditures before the mine enters the production stage to be capitalized and recovered through depletion. The committee report on the bill points out that such expenditures should have the same general status as similar expenditures for a producing mine Otherwise, there is an unfair discrimination against mines which must do substantial development work before entering the production stage, as compared with those which can more promptly begin production.

We would further point out that when percentage depletion was granted to mines and the rates established, the allowable rates granted did not contemplate that the depletion thus allowed should include amounts which in their nature were costs of operation.

This principle is recognized in the amendments proposed in section 302 of the bill. These amendments fairly and satisfactorily cover the general situation as to certain mines or types of mines which were under particular consideration in working out the wording of those amendments. There are somewhat different circumstances and conditions as to other mines which would not be satisfactorily met under the present wording, and we urge that certain changes be made so this section will better cover this problem for all mines.

Section 302 deals solely with the question of development expenditures after a commercially valuable deposit is disclosed. We believe it should also be extended to cover prospecting, exploration, and development expenditures before disclosure of the commercially valuable deposit. This matter we shall later discuss.

First we would point out certain provisions which should be made even within the scope of the present amendment. These are as follows:

(A) Page 74, line 24, after the word "sold" insert the following: "or, at the taxpayer's election, in the year paid or incurred."

This is desirable, first, for the stimulus it will give to such development if the privilege of current deduction in computing taxable income is granted. The present margin which remains after taxes—corporate or individual, or the two combined—is so narrow that in many cases it will be impossible to try to make expenditures of this kind from the residue which remains to the taxpayer after income taxes have been paid. The taxpayer will not be able to make such expenditures from income unless the tax deduction is allowed. Sometimes, however, the individual or the corporation will not have the current income from which to make the deduction and would wish for deferment. Accordingly a taxpayer should be permitted in any year or as to any expenditures either to write off the amount currently or to defer it for future deduction.

Second, there is no clear definition of exactly what expenditures should be embraced within the meaning of the word "development." If the taxpayer has the right as to any such expenditures, either to charge them off currently or to defer them, it will avoid question as to classification and will simplify the procedure.

For such reasons it is desirable that the taxpayer should be permitted such election.

(B) As to receipts from minerals produced before the mine has reached the production stage, on page 74, line 24, insert after the amendment above proposed the following: "Before the mine has reached the production stage net receipts

from any minerals produced shall be applied to reduce any then remaining balance of development expenditures."

In many cases exploratory and development work in an ore body will yield some valuable mineral. It is the natural and long-established procedure to consider any net amounts thus realized as a credit against the expenditures which have given rise to it. Perhaps this is sufficiently understood so that specific provision of the law is not required, but the proposed amendment would eliminate any possible doubt regarding it.

(C) As to expenditures to maintain production, on page 75, line 9, insert after the end of paragraph (D) the following sentence: "Expenditures to maintain production of an operating mine shall not be considered as expenditures for development within the meaning of this paragraph, but shall be deductible as ordinary costs of operation in the year such expenditures are made."

This principle has long been recognized in Bureau procedure both as customary mining practice and as supported by various court decisions. After the mine has entered the production stage there are many expenditures which must be currently made merely to maintain production, as mining proceeds in the ore body, working faces recede, etc. It has not been customary to consider these as part of the expenditures made for development of the mine. In fact, it becomes difficult, if not impossible, to distinguish exactly which of the expenditures being currently made as mining proceeds might be classed as the direct cost of mining ore already exposed as distinguished from expenditures to block out and uncover the ore for future mining. We believe that it should be made clear that there is no intention to change the long-established procedure of permitting such expenditures to be considered as ordinary mining costs after the mine has reached the production stage.

(D) As to loss when there is no reasonable expectation of further production, include after amendment (B) referred to above the following: "To the extent that such expenditures have not previously been so deducted by the taxpayer they may be deducted in the year in which it is determined that there is no reasonable expectation of such production thereafter."

There has been in the past and is at present much question as to when expenditures not otherwise deductible may be written off as losses. It is difficult, and in many cases impossible, for a taxpayer to establish that there will be no future possibility of encountering ore against which the balance of development expenditures might be deducted. The negative proof is most difficult. We believe the rule should be that when it can be shown there is no reasonable expectation of further production any balance which has not previously been allowable should be permitted to be charged off as a loss. We accordingly urge this provision.

The foregoing amendments relate to the section 302 as it is now limited to development expenditures after ore in commercially marketable quantities has been disclosed.

However, the amendment with the foregoing additions will not cover the question of initial prospecting, exploration, and development before the commercial nature of a deposit is established. If we wish to encourage the prospecting and exploration for and development of additional deposits of minerals, provision must be made as to those expenditures.

We must here note how different the present tax situation is from that which existed in the early days of our income tax when many of our present rules were formulated. When we started our income tax with the 1 percent tax on corporations, the 1 percent normal tax on individuals, with a possible maximum surtax of 6 percent, the exact treatment of prospecting, exploration, and development of mines—even their depletion—was not a very important question. Even when our corporate taxes had increased to 10 or 15 percent and our individual income taxes had substantially increased from initial rates, it could still be urged that sufficient income remained to the taxpayer from which risk expenditures could be made and it was perhaps more a question of theory than practical necessity to work out appropriate treatment for such expenditures. Moreover, we then recognized to the stockholder on distributions received by him substantial allowance for the taxes already paid by the corporation. Under such tax rates there was still incentive for taxpayers to endeavor to find and develop new mineral resources. Our tax laws have completely changed that today. Our normal and surtax will take at least 50 percent of a corporation's income, rising to 82 percent in the excess-profits class. It is true we allow depletion on the cost or percentage basis to allow for the disposal of capital assets in mine operations, but the intricacies and technicalities are such that it often fails to make adequate allowance.

While percentage depletion may be allowable to the corporation it is not passed over as an allowance to the stockholder against distributions received by him.

Individual tax rates now reach to 86 percent which it is proposed to raise to 94 percent. Such rates leave no incentive for investment in mining enterprises—for the risk, the effort and the disappointments involved in endeavor to find and develop new deposits. Most of the endeavors to do this will be failures and the money will be lost. It is only the occasional venture which offers hope of sufficient profit to cover the loss of many failures. As we minimize through present high tax rates the possible profit to come from the successful ventures we minimize incentive for undertaking the risk of new ventures.

But these tax laws have another effect. They dry up at the source the possible venture capital. The man whose income falls into the $80,000–$90,000 class will, under the bill, have left to him only $550 out of $10,000 which he may earn. To accumulate from income enough to make a $10,000 expenditure for prospecting, exploration, and development he would have to earn $182,000 additional, of which the Government would take $172,000 and leave to him for possible investment $10,000. Even for a man in the $20,000 bracket, his earnings would have to be $8,000 in order to leave to him $2,000 he could put into such a venture. Similarly with a corporation—if it must pay an 80 percent tax rate, the 20 percent remaining to it leaves little margin from which to make any such risk investment. We pile this on top of the difficulty of trying to find any incentive for such risks when we have so greatly minimized the profits which will remain to the venturer if he is fortunate enough to find and develop a valuable deposit.

Under present rules the venturer is supposed to be able to charge off and get deduction for his losses from unsuccessful ventures but the technicalities of our rules for determining when and to what extent such losses can be deductible make great uncertainty as to when, if ever, the deductions can be effectively taken.

What we urge is that as such risk expenditures are made, the taxpayer should be permitted to make current deductions therefor from his taxable income. Under our present taxation this seems the only way to give any incentive therefor or to make the funds therefor available. We believe you realize the need for development of further mineral resources to meet both defense and civilian demands. We accordingly urge inclusion in the present law of a provision which will give possibility and incentive for such endeavors through a broad amendment which we have heretofore urged and again urge for your adoption. It would cover the ground already covered by section 302 but would extend the allowances to cover the further expenditures which need to be made if we are to meet our mineral needs.

We hardly need to urge that any such provision for allowances with respect to expenditures for prospecting, exploration and development should in no way curtail or abridge the present allowances for depletion. Those are needed. The rates established did not allow for recoveries of these expenditures and there is no reason or occasion for any abridgement of depletion because of the allowances here requested.

We therefore urge an amendment to cover all expenditures for prospecting, exploration, and development, as follows:

Add to section 23 (a) (1), Internal Revenue Code, a new paragraph (D) as follows:

"(D) *In the case of mines and other natural deposits (except oil and gas wells)*—

> "All expenditures (in excess of net receipts from any minerals produced before the mine has reached the production stage) incurred in prospecting, exploration, and development may be deducted as expense, either in the year incurred, or, at the election of the taxpayer, deferred and ratably apportioned to the production directly related to such expenditures, and to the extent not previously so deducted by the taxpayer may be deducted in the year in which it is determined that there is no reasonable expectation of such production thereafter."

This provision is recommended as a substitute for the first sentence (p. 74, lines 16 to 24) of the amendment proposed by section 302 (a) of the bill. It would then be followed by the present provisions of section 302 as to adjustment of basis, depreciable property, etc.

The technical amendment provision of section 302 (c) would then be conformed by having it refer (p. 75, line 24) to "prospecting, exploration and development" instead of merely to "development."

We strongly urge adoption of the broad amendment above set forth which would cover prospecting and exploration as well as development.

PERCENTAGE DEPLETION (SEC. 301)

The bill retains the necessary provision for percentage depletion—increasing the percentage in case of coal and adding certain other minerals—all of which has our approval.

This question has been so fully discussed before your committee on various occasions, that we feel there is no need to enlarge upon it now. It is one of the essential allowances for mining and should be in no way weakened.

EXCESS OUTPUT OF MINES (SEC. 453 (B) (2) AND (4))

The Excess Profits Act in section 453 recognizes the principle that if a mine is making no more than a reasonable profit per unit of output, this is not excess profit which should be subjected to the excess profits tax.

The law has recognized difficulties in working out its standards of measurements in every case. Therefore, in addition to its general standards for determination of normal profit per unit, it has included such provisions in section 453 (b) (2) and (4) which in the prior law had applied only to coal and iron, but which in the present Excess Profits Tax Act have been extended to all metals.

When the present law was under consideration last year we had urged that these two provisions should be extended to all minerals. In the haste of enactment of this legislation last year it was deemed impossible to give full consideration to such extension and the allowances were made only with respect to metals and coal.

We renew our urge that it should be extended to all minerals.

The World War II act included a provision whereby relief could be given under section 722 by setting up a constructive base period computation for mines which had subnormal base-period profit, or for those not in production in the base period. A similar provision does not exist under the present law and the only relief apparently must come through such provisions as those of subsection (b) (2) and (b) (4).

We accordingly urge that nonmetallics as well as metallics and coal should be included within these provisions.

COAL ROYALTIES (SEC. 307)

Section 307 of the bill would extend to recipients of coal royalties the capital gain treatment now available to timber under section 117 (k) (2).

Certain suggested changes in the provisions of the bill have already been presented to you on behalf of the coal lessors. These included the wording to specify that "The date of disposal of such timber or coal shall be deemed to be the date on which such timber is cut or such coal is mined", which we believe is the reasonable and proper standard to be applied. It was also urged that there should be elimination or modification of the sentence "In the case of coal, this paragraph shall not apply if such owner is personally obligated to pay a share of the cost of mining operations." This sentence in its present form would seem to raise unnecessary difficulties and confusion.

The treatment by the lessor of payments received by him as capital gains from sale of his coal should in no way change the tax treatment otherwise accorded to the lessee with respect to such payments. From the lessee's standpoint the rents or royalties paid are simply an operating expense deductible in the normal course of operations. The law is specific that such rents or royalties shall be deducted from gross income in computing percentage depletion to the lessee. We believe that the amendment under section 307 is not intended to change the present treatment of such rents or royalties from the standpoint of the lessee. But to avoid any possible question in this regard, we believe specific statements to that effect should be made in the law in wording somewhat as follows: "In determining the gross income, the adjusted gross income, or the net income of a lessee, the deductions allowable with respect to rents and royalties shall be determined without regard to the provisions of this paragraph."

As we have stated, we believe this is the clear intent of this amendment, but we urge appropriate specification thereof in the law.

FOREIGN TAX CREDIT WITH RESPECT TO FOREIGN SUBSIDIARIES (SEC. 131 (F))

Present law grants the foreign tax credit under section 131 (f) (l) with respect to takes paid by a majority owned foreign subsidiary. The treasury has recommended that this majority requirement should be eliminated. We so urge.

If it is not deemed practicable to eliminate wholly the percentage requirement as to stock ownership, we urge that it should be reduced to not more than a 10 percent ownership at most.

Similar credit is granted by section 131 (f) (2) with respect to a wholly owned subsidiary of a subsidiary which qualifies under subparagraph (1). This 100 percent ownership should be reduced to not more than a 50 percent ownership requirement.

A particular reason for these recommendations is increasing insistence either by the laws of foreign countries or by their established policies that there should be some local ownership in enterprises. Another reason is that ownership of the stock of a foreign corporation may be divided between two or more domestic corporations. It is not always possible to have the subsidiaries meet stock ownership requirements as these have been adopted under our earlier laws.

We accordingly urge that these changes should be made in section 131 (f).

INCOME EARNED ABROAD (SECS. 116 (A), 1621 (A) (8))

The Treasury has recognized that in accord with the point 4 program the present provisions exempting income earned abroad by United States citizens should be modified to avoid a technical difficulty in the present law.

At present the principle of such an exemption is recognized, but it is made applicable only to citizens who have been resident abroad for the entire calendar year. Hence, one who goes abroad in January or any subsequent month will not have the benefit of this provision for the remainder of that year. The law should be amended so that the exemption will apply for the entire period of foreign residence.

An amendment is also highly desirable to prevent the requirement of foreign residence from being construed as necessitating the equivalent of legal domicile in a foreign country.

Correspondingly, section 1621 (a) (8) should be amended so that wages and salary withholding will not be required for the period that the exemption is allowed.

NET OPERATING LOSS DEDUCTIONS (SEC. 122)

Percentage depletion allowances should not be curtailed in computing and applying net losses. The taxpayer, unfortunate enough to sustain net losses in one year, should not be placed in a more disadvantageous position than the taxpayer having uniform profits from year to year. There should not be discrimination against percentage depletion in computing net operating losses to be carried forward.

We accordingly submit as exhibit D herewith the amendments we urge to section 122 to eliminate this unfair discrimination.

PENALTY TAX ON CONSOLIDATED RETURNS (SEC. 141 (C))

The 2 percent penalty tax on consolidated returns should be eliminated.

EXCESS PROFIT CREDIT (SEC. 502 OF BILL)

Section 502 of the bill proposes to change the excess profit credit based on income from the present inadequate 85 percent to an even less adequate 75 percent of the base period income.

The entire amount of the base period income should be allowed 100 percent as the excess profit credit. To do otherwise is to subject normal income to excess profits tax. This is grossly unfair and is contrary to the principles of excess profit taxation.

We strongly oppose any such reduction and urge in its place that the allowance should be made 100 percent.

SURTAX EXEMPTION AND EXCESS PROFITS CREDIT TO RELATED CORPORATIONS (SEC. 123)

The bill contains in section 123 a series of amendments intended to limit related corporations to a single $25,000 surtax exemption and a single $25,000 minimum excess profit credit, to be divided between them instead of making separate allowance to each corporation. To do this the bill presents a series of most difficult and involved tests as to what corporations should be considered related.

The problem involved seems not to merit all the confusion and difficulty which would arise in endeavoring to apply these tests. More important, however, is the fact that it seems grossly inequitable as well as unnecessary to make any such provision. Each separate corporation should receive its own full allowance.

We believe present provisions of the law, such as section 45 and section 129, are adequate to deal with any cases where the right to file separate returns might otherwise lead to abuses.

Accordingly we urge that you eliminate section 123 from the bill.

CORPORATION TAX RATES

The bill proposes to increase the combined normal and surtax rates for corporations to a total of 52 percent, even as to income which is not in the excess profits class. We urge most strongly that such taxes should in no event exceed an aggregate of 50 percent. The Government should not take more than one-half of the normal income of the corporation.

It also proposes to raise the "ceiling rate" to 70 percent instead of the present 62 percent limitation. The limination should not be raised by more than the amount of the increase in normal and surtax.

CAPITAL GAINS TAX

The rate of capital gains tax should not be increased beyond the present 25 percent rate.

We urge these matters for your consideration and favorable action, and express our appreciation of the opportunity to present them to you.

EXHIBIT A

INDIVIDUAL COMBINED NORMAL TAX AND SURTAX (H. R. 4473)

Taxable years beginning after Aug. 31, 1951, effective rates and cumulative amounts[1]

Taxable net income	By brackets		Cumulative	
	Net rate	Amount	Amount	On
	Percent			
Not over $2,000	22.5	$450.00	$450.00	$2,000
$2,000 to $4,000	24.75	495.00	945.00	4,000
$4,000 to $6,000	29.25	585.00	1,530.00	6,000
$6,000 to $8,000	33.75	675.00	2,205.00	8,000
$8,000 to $10,000	38.25	765.00	2,970.00	10,000
$10,000 to $12,000	42.75	855.00	3,825.00	12,000
$12,000 to $14,000	48.375	967.50	4,792.50	14,000
$14,000 to $16,000	52.875	1,057.50	5,850.00	16,000
$16,000 to $18,000	56.25	1,125.00	6,975.00	18,000
$18,000 to $20,000	59.625	1,192.50	8,167.50	20,000
$20,000 to $22,000	63.0	1,260.00	9,427.50	22,000
$22,000 to $26,000	66.375	2,655.00	12,082.50	26,000
$26,000 to $32,000	69.75	4,185.00	16,267.50	32,000
$32,000 to $38,000	73.125	4,387.50	20,655.00	38,000
$38,000 to $44,000	77.625	4,657.50	25,312.50	44,000
$44,000 to $50,000	81.0	4,860.00	30,172.50	50,000
$50,000 to $60,000	84.375	8,437.50	38,610.00	60,000
$60,000 to $70,000	87.75	8,775.00	47,385.00	70,000
$70,000 to $80,000	91.125	9,112.50	56,497.50	80,000
$80,000	94.5		65,947.50	90,000
			75,397.50	100,000
			122,647.50	150,000
			169,897.50	200,000

[1] Amounts of taxable net income are after deduction of exemptions at $600 each.
For joint return of husband and wife the total tax will be twice the tax on ½ the combined taxable net income.
Net income (before exemptions) above which combined tax is limited to 90 percent of net income: for exemption, $437,100.

EXHIBIT B

Net remaining to investor on investment at tax rates of H. R. 4473

In income bracket—	If investment pays—		In income bracket—	If investment pays—	
	10 percent	20 percent		10 percent	20 percent
	Percent	*Percent*		*Percent*	*Percent*
Up to $2,000	7.75	15.50	$14,000 to $16,000	4.7125	9.425
$2,000 to $4,000	7.525	15.05	$16,000 to $18,000	4.375	8.75
$4,000 to $6,000	7.075	14.15	$18,000 to $20,000	4.0375	8.075
$6,000 to $8,000	6.625	13.25	$26,000 to $32,000	3.025	6.05
$8,000 to $10,000	6.175	12.35	$50,000 to $60,000	1.5625	3.125
$10,000 to $12,000	5.725	11.45	$80,000 to $90,000	.55	1.100
$12,000 to $14,000	5.1625	10.325	Over $137,100	1.000	2.000

EXHIBIT C

Net remaining to stockholder from corporate earnings (before tax) of 10-20-30 percent on $1,000,000 investment under H. R. 4473

[Investment $1,000,000. EP credit based on invested capital]

Corporation earns (before Federal income tax)		$100,000	$200,000	$300,000
Tax at 52 percent		$52,000	$104,000	$156,000
Less $25,000, at 22 percent		5,500	5,500	5,500
Normal and surtax		46,500	98,500	150,500
Excess-profits tax (credit $120,000):				
$80,000 taxable at 30 percent			24,000	
$180,000 taxable at 30 percent				54,000
Total corporate tax		46,500	122,500	204,500
Balance distributed dividends		53,500	77,500	95,500
Stockholder's tax:	*Percent tax*			
A. In $10,000-$12,000 bracket	42.75	22,871	33,131	40,826
B. In $20,000-$22,000 bracket	63.00	33,705	48,825	60,165
C. In $50,000-$60,000 bracket	84.375	45,141	65,391	80,578
D. In $80,000-$90,000 bracket	94.500	50,558	73,238	90,248
Balance to stockholders:	*Percent to taxpayer*			
A. In $10,000-$12,000 bracket	57.25	30,629	44,369	54,674
B. In $20,000-$22,000 bracket	37.00	19,795	28,675	35,335
C. In $50,000-$60,000 bracket	15.625	8,359	12,109	14,922
D. In $80,000-$90,000 bracket	5.500	2,942	4,262	5,252

EXHIBIT D

NET OPERATING LOSS DEDUCTION

(To correct inequitable adjustments relating to percentage and discovery depletion)

SEC. 122. NET OPERATING LOSS DEDUCTION.

(a) Section 122 (b) of the Internal Revenue Code is amended by striking out the words "subsection (d) (1), (2), (4), and (6)" wherever the same may appear therein and inserting in lieu thereof the words "subsection (d) (1), (3), and (5)".

(b) Section 122 (c) of the Internal Revenue Code is amended by striking out the words "subsection (d) (1), (2), (3), and (4)" and inserting in lieu thereof the words "subsection (d) (1), (2), and (3)".

(c) Section 122 (d) of the Internal Revenue Code is amended by striking out paragraph (1) and by changing the numbers of paragraph (2), (3), (4), (5), and (6) to (1), (2), (3), (4), and (5), respectively.

(d) The amendments made by subsections (a), (b), and (c) shall be applicable to taxable years beginning after December 31, 1941.

Senator BYRD. The next witness is Mr. Lee P. Miller. Identify yourself, please, sir, to the reporter.

STATEMENT OF LEE P. MILLER, PRESIDENT, CITIZENS FIDELITY BANK & TRUST CO., LOUISVILLE, KY.

Mr. MILLER. Senator, I am Lee Miller. I am president of the Citizens Fidelity Bank & Trust Co., Louisville, Ky.

I am chairman of the committee on taxation of the American Bankers Association. I will be brief.

Senator BYRD. Mr. Miller, we have 20 minutes, and Mr. Cooley, of the Virginia Bankers Association, has 5 minutes.

Mr. MILLER. He is with me.

Senator BYRD. Unfortunately we have to be on the floor promptly because there is a very important bill coming up.

Mr. MILLER. I am appearing for the American Bankers Association primarily in connection with withholding and other provisions of the proposed tax legislation directly affecting the banks.

However, I feel that I would be derelict in my duty if I did not mention certain points relating to the general application of the tax bill as the banks see it.

We have, as an association, and many of us as individual bankers, emphasized our agreement with the fundamental necessity of balancing the budget and of keeping ourselves on a pay-as-we-go basis. It is not my purpose to expand this point but merely to point out our deep conviction that this is a vital necessity, including the elimination of all unnecessary expenditures and the providing of adequate tax revenue soundly conceived to meet the necessary total of expense.

H. R. 4473 proposes to require a tax of 20 percent to be withheld at the source from dividends and interest on corporate bonds.

Since such withholding will be made without regard to whether the recipient is liable for income tax or not, taxes will be withheld from many people who are not liable for income tax. Thus many persons will have their income reduced by a fifth although no tax is due and will be unable to secure a refund until sometime after March 15 of the following year.

The Ways and Means Committee originally proposed to require that a tax of 20 percent also be withheld from interest on savings accounts and on interest on United States savings bonds. However, H. R. 4473 as reported out by the Ways and Means Committee, and as passed by the House, did not contain those provisions. We heartily approve of that action since in many cases the tax withheld with respect to interest on savings accounts would have been nominal and no tax actually would have been due from the recipients.

In that same connection, if I may, I would like to file several schedules of selected localities just at random, Dallas, Tex.; Wellsboro, Pa.; Cincinnati, Ohio; and Louisville, Ky.—and also Nebraska, which shows the smallness of the amount of interest and withholding that takes place.

Senator BYRD. It will be inserted in the record.

(The documents referred to are as follows:)

EXHIBIT 1. *Analysis of savings accounts in various localities*

Locality	Banks	Total savings deposits	Total number savings accounts	Average size of savings accounts	Average annual interest	20 percent withholding
Dallas, Tex	3	$42,151,211.00	80,507	$524.50	5.78	1.16
Wellsboro, Pa	2	3,984,275.00	4,071	979.00	5.97	1.70
Cincinnati, Ohio	8	174,700,317.00	220,001	884.04	7.49	1.50
Louisville, Ky	5	49,262,104.04	71,744	686.49	4.17	.84

EXHIBIT 2. *25 Nebraska banks Cross section of State, including Omaha and Lincoln*

Bank	Total savings deposits June 30, 1951	Total number accounts	Average balance per account	Total interest paid per year	20 percent withholding tax
1	$1,524,116.61	1,300	$1,174.00	$10.64	$2.13
6	397,010.04	1,304	304.54	1.00	.18
12	972,400.37	2,104	311.82	1.38	.27
17	5,677,221.75	16,019	351.05	3.38	.67
20	8,017,530.21	14,851	541.13	2.02	.40
27	10,105,800.81	25,100	407.00	3.85	.77
28	8,972,074.07	19,001	472.16	1.74	.35
16	2,811,012.27	6,312	449.00	4.20	.84
7	1,917,864.35	2,778	700.00	4.70	.94
8	1,521,788.00	2,057	741.00	4.12	.85
19	358,350.21	1,012	344.00	3.27	.64
11	1,321,895.71	3,204	412.00	1.54	.31
22	2,251,870.00	2,851	790.00	7.00	1.40
21	3,204,810.04	3,078	887.30	7.40	1.48
24	1,397,851.30	1,125	1,212.20	10.52	2.10
25	7,703,051.20	9,004	802.00	14.35	2.87
18	3,501,920.22	7,313	478.87	4.54	.91
5	400,000.00	1,210	328.00	1.88	.35
15	950,971.50	1,100	800.00	13.84	2.77
4	500,451.04	700	708.50	5.94	1.19
14	1,900,751.07	3,001	634.30	6.10	1.22
9	1,103,490.70	1,704	640.00	5.50	1.10
2	550,818.21	624	925.45	6.84	1.37
10	3,400,019.58	4,800	707.95	7.30	1.46
3	1,300,070.00	1,400	907.00	8.26	1.65
Total	63,215,097.37	134,845	16,121.19	142.44	28.45
Average for 25 banks	2,520,819.80	5,393	644.93	5.66	1.14

Mr. MILLER. Such excessive withholding would require filing of claims for refund by small taxpayers, many of whom would be bewildered by the procedure involved. Under those conditions many just claims would not be filed and the Treasury would have money to which it would not be entitled. More important, withholding on savings interest and on United States savings bonds would tend to discourage such accounts and discourage the purchase of savings bonds at a time when it is highly important that saving be encouraged to check inflation.

Under the bill, withholding also would be required with respect to dividends in kind although the paying agent would have no money to satisfy the tax. As a result, the paying agent would have to attempt to secure a ruling as to the value to be attributed to the dividend, advise the stockholder as to the amount of tax he would have to remit, and secure the remittance before the dividend could be re-released. In practice, some stockholders probably would request the paying agent to sell enough of the dividend to satisfy the tax and to remit the balance. Also, exempt organizations would be required

to raise money to pay the tax on such a dividend in kind, although the tax would be refundable shortly thereafter.

The bill also proposes to require payors to file information returns under conditions which can be most troublesome and costly to payors or their paying agents.

At the present time no information returns are required to be filed with respect to interest paid on bonds except tax-free covenant bonds and registered bonds where the interest exceeds $600 per annum. Information returns with respect to other types of interest need be filed only where the interest paid to an individual exceeds $600 per annum.

Registered bonds constitute only a small portion of the interest-bearing bonds outstanding, so that the work involved in filing such returns is small. The tax-free covenant bonds are not a major factor and grow less important each year.

Most bonds now outstanding are coupon bonds. Under present conditions such coupons come to the payor without any identification of the owners whatsoever, and no information returns are required to be filed. In actual practice a bond owner will bring his coupon to his local bank and request collection. The local bank will forward the coupon to its correspondent bank in a larger city. Each correspondent will pass on its accumulation of similar coupons to its correspondent. It is not at all unusual for a coupon to pass through the hands of five or six banks before it is presented to the bank which acts as paying agent for the obligor. If information returns are to be required with respect to payments of interest on coupon bonds, it is obvious that the paying agent must be given the necessary information. The only possible method is to require an ownership certificate to be furnished by the owner to the first bank to whom the coupon is presented and to have such certificate accompany the coupon up the chain of correspondent banks.

In practice, it has been found that such ownership certificates are often illegible or incomplete. Section 204 (a) requires the filing of information returns with respect to interest of $100 or more per annum if there is no withholding and on the interest of $300 or more per annum if there is withholding. Section 204 (b) further authorizes the Commissioner to require information returns as to interest on coupon bonds, regardless of amount, if there is no withholding.

If this information system is to be workable, the statute must give the paying agent clear protection in refusing to pay a coupon, which is a negotiable instrument payable to bearer, because not accompanied by a proper ownership certificate. In no event should the paying agent be required to do any more than file the ownership certificate with the Commissioner. It should not be required to list all payments made to the same owner during the year, since that would necessitate the creation of a complex accounting system with its attendant cost.

Ownership certificates formerly were required to be filed on all coupon bonds, but have not been required for about 8 years in the case of residents except with respect to tax-free covenant bonds because of the burdens imposed upon payors and the practical impossibility of adequately processing them in the Bureau. There is no reason to believe that the Bureau could utilize such certificates any more effectively today in view of the enormous volume involved.

At the present time banks handle most of the redemptions of United States savings bonds. In that connection the redeeming bank furnishes full information to the Federal Reserve Bank as fiscal agent of the Treasury, and the redeemed bonds themselves eventually go to the Treasury. Under those conditions, no further duty to report the payment of the increment [interest] should be imposed upon the bank which handles the redemption.

Sir, I am trying to hurry through.

I would like to ask whether it would be permissible for us to file a statement in the record on excess-profits taxes and its effect on banks?

Senator BYRD. It will be included in the record.

Mr. MILLER. Thank you, sir.

(The document referred to is as follows:)

SUPPLEMENTAL STATEMENT OF LEE P. MILLER ON BEHALF OF THE AMERICAN BANKERS ASSOCIATION WITH RESPECT TO EXCESS-PROFITS TAX

Presently most banks compute their excess-profits tax credit upon the basis of invested capital. Under section 437 of the Internal Revenue Code the invested capital credit is 12 percent of the first $5,000,000 of invested capital, plus 10 percent of the invested capital between $5,000,000 and $10,000,000, and 8 percent of the invested capital in excess of $10,000,000. If income taxes are imposed at the rate of 50 percent, those allowable rates of return will permit a bank to earn after taxes 6 percent on the first $5,000,000 of capital, only 5 percent on the next $5,000,000 of capital, and only 4 percent on all capital in excess of $10,000,000.

Banks are required to utilize a part of their earnings to set up adequate reserves. If the return on capital is only 4 percent after taxes, the balance is insufficient to permit any addition to surplus and the payment of reasonable dividends, which is necessary to attract new capital. Such a low rate of return thus will impair the ability of banks to meet the increasing credit needs of business both large and small and thus will adversely affect the national economy.

The law now provides a minimum excess-profits tax credit for certain regulated industries which permits them to earn a 6-percent return after taxes. Since banks are also regulated by both State and Federal authorities, consideration might well be given by Congress so as to provide similar treatment for banks in order that they will be better able to take care of the necessary credit needs of our economy.

Mr. MILLER. With that permission being granted, I would be glad to turn the floor over to Mr. Cooley, who will get you through in time for your 12 o'clock appointment.

Senator BYRD. You made a very clear statement.

Mr. MILLER. Thank you.

Senator BYRD. Mr. H. H. Cooley, the president of the Virginia Bankers Association.

STATEMENT OF H. H. COOLEY, VICE PRESIDENT AND CASHIER, ROUND HILL NATIONAL BANK, ROUND HILL, VA.

Mr. COOLEY. Mr. Chairman and gentlemen, my name is H. H. Cooley. I appear before your committee as the chairman of the Federal legislative committee of the Virginia Bankers Association. Our association has a membership of more than 300 banks, and I appear as a witness to testify in their behalf against the plan as proposed in the tax bill to withhold 20 percent from interest and dividends at the source.

We fully realize that in times of national emergency, such as the present, when our Federal expenditures have been greatly increased largely because of our military needs, that it is extremely important to have our national budget balanced as nearly as possible. We

further realize that this calls for increased taxes, and to this we subscribe so long as the fixing of tax levies and the method of collecting them is fair and just.

It is our opinion and the opinion of bankers generally that the proposed plan to withhold 20 percent from interest and dividends at the source is one of the most far-reaching tax legislation proposals that has ever been proposed in the history of our Nation.

It truly approaches that form of government that we have all been fighting to prevent in this country. We refer to the confiscation of private property for the enrichment of the State or National Treasury. This withholding-tax plan, if enacted into law, would reach into the pockets and take a tax from millions of children, widows, elderly people, church organizations from whom no income tax would be due.

A number of banks, including our own, have made a study of their savings accounts and find that at least 70 percent of them belong to persons who are not subject to an income tax, and many of them are not sufficiently familiar with tax laws to know about making a claim for refund; so the Treasury Department would be unjustly enriched.

The matter of arbitrarily taking a portion of the interest on savings accounts and series E bonds, as well as all other Government bonds and corporate bonds, thereby making series E bonds payable at maturity at the rate of 95 cents on the dollar, does not seem to bear out the principles of our American way of life. Especially is this true when the bonds were sold with the guaranty to pay them on maturity at face value.

Although I have been speaking primarily of the effect of the 20-percent withholding tax on the savings depositors in our banks and the holders of Government bonds—and I fully realize that this particular provision of the tax bill was deleted by the House Ways and Means Committee in its final consideration—I firmly believe the same objections to a withholding tax are true so far as they apply to dividends and other income.

We do not believe that a withholding tax on interest and dividends at the source is the answer to the claim by the Treasury Department that a large amount of revenue is now lost through the failure of individuals to report all of their income. Neither do we believe that a withholding tax would produce the amount of revenue claimed. When you take into consideration what it would cost the Government to make the millions of refunds to individuals who would not be subject to an income tax, it would undoubtedly necessitate a further increase in the number of Federal employees; therefore, the net intake from this source could be very small.

The plan for withholding as proposed by the House Ways and Means Committee will cause a great amount of ill feeling between investors, paying corporations, banks, and others, and it should be remembered in this connection that a great amount of this work would fall on the same banks that now have no "essential" or otherwise preferred manpower rating.

It would also have a tendency to discourage thrift, and the habit of saving which is already at a very low ebb. We are heartily in favor of collecting taxes from everyone who owes a tax but the proposed plan is not practicable and is certainly contrary to the principles of American justice. It would be the only law of which we

have ever heard that imposed a penalty on the innocent in order to catch the guilty.

In conclusion, may we suggest that your committee give serious consideration to the matter of fully taxing the business income of all presently exempt businesses such as cooperatives and mutual institutions such as savings and loan associations, mutual savings banks, production credit associations, credit unions, farm cooperatives and many other cooperative and mutual associations who now pay no Federal income taxes because of the exemption provisions provided by Federal law, and this tax exemption deprives the Federal Government of substantial amounts of needed revenue.

And, we further suggest that a large amount of additional revenue in the form of taxes would be produced if the Bureau of Internal Revenue would increase their field workers to check more returns. Although we are against the general practice of increasing the number of Federal employees, we do believe money spent for this purpose would pay large dividends.

We earnestly request your committee to make no provision whatsoever in the tax bill for the withholding tax on interest and dividends at the source.

Senator BYRD. Thank you very much, Mr. Cooley. Are there any questions?

Senator MILLIKIN. I would like to ask the witness whether he has made any study of the actual cases as to the increase in the cost of operating the bank if this sort of a scheme were made into law?

Mr. COOLEY. If the withholding——

Senator MILLIKIN. Yes.

Mr. COOLEY. According to the committee's report, they set it up as being very simple. But we, in the banking business, do not believe that you can withhold from a customer's account a certain amount of interest without properly reporting to him the amount withheld which would entail a great amount of work and expense.

We have purposely said very little about the amount of work and expense involved, but that does enter into it in a very large measure.

Senator MILLIKIN. It would reflect in your normal bookkeeping?

Mr. COOLEY. Undoubtedly so, sir.

Senator MILLIKIN. In all of the records that pertain to deposits they would be reflected in your normal bookkeeping, would they not?

Mr. COOLEY. Absolutely, sir.

Senator MILLIKIN. If you increased the expense of the bank you make that good by decreasing the rate of interest on savings or by increasing the loan rate to your borrowers.

Mr. COOLEY. Well, if you increase the expense of your bank, you either are going to have smaller earnings or you are going to have to offset it by increasing your loan rate.

Senator MILLIKIN. Increase your loan rate or reduce your interest?

Mr. COOLEY. Reducing interest on savings accounts, that is true, sir.

Mr. MILLER. May I say that the main part of our problem is one of the bank's difficulties today, and that is——

Senator MILLIKIN. So, what you are doing also is in effect, imposing a tax on the bank or any institution which is affected by these withholding taxes when it does not owe any taxes?

Mr. COOLEY. Right.

Senator MILLIKIN. Is that correct?

Mr. COOLEY. Senator, we lay great stress on the fact that this tax would fall upon, as I said, 70 percent of our depositors in the savings department, which are small accounts that owe no tax.

It would have a disastrous effect on the psychology—on the psychological effect of savings.

We have instilled into these people from their childhood up—I have been in the banking business and country banking 35 years, and we urge them to start savings accounts for their children so that when they go to college they will have a fund.

If you are going to start arbitrarily taking 20 percent of that child's interest, well, I just do not see how we could explain it to them, and I think you would be destroying, as I said, the incentive to save, which is already at a very, very low ebb.

We are destroying the thing that we have been encouraging all these years, and I do not believe we would ever live long enough to live it down.

Senator MILLIKIN. As I recall your testimony, you said that out of a study made in your own bank, a certain percentage of your depositors did not owe any income tax. What was that?

Mr. COOLEY. I said in the statement that a number of banks—and that is the very figure as a whole—70 percent of the depositors in the savings department are not subject to a tax.

In our own bank we made an analysis of the accounts, and I am very familiar with it, having been there a great number of years and 79 percent of the depositors in our savings department would not be subject to an income tax.

Senator MILLIKIN. Did you make a pretty careful study on that?

Mr. COOLEY. We thought we did, yes.

Senator MILLIKIN. Can you give me the mechanics whereby you determined that?

Mr. COOLEY. Well, we went through it and took the accounts—as I say, having been there so long, I know nearly every family and every depositor personally, and I know just about who makes income-tax returns and whose income would be sufficient to make them liable for a return.

I could tell you why that percentage probably runs higher than you would realize.

Senator MILLIKIN. Is it a relatively small bank?

Mr. COOLEY. It is a small bank.

Senator MILLIKIN. You have close knowledge of your depositors and their financial affairs and your borrowers, so that without a lot of elaborate hocus-pocus you could tell pretty well——

Mr. COOLEY. That is right, sir.

Senator MILLIKIN (continuing). Whether they are subject to an income tax, is that what you are telling me?

Mr. COOLEY. Yes, sir; that is what I am trying to tell you, sir. Having lived there a great many years, I know practically every one of them personally.

Here is another thing that enters into it. A family may have four or five children and start an account for each one of them of maybe $50 or $100, and gradually try to get it up when the child goes off to school, to get it up to help them along. I have done it myself.

That child is not subject to an income tax, and you go in there and take a part of their interest; you start them off in the world wrong. They say, "Why, here the Government is taking my interest. What kind of a country is this I am living in?"

Senator BYRD. Mr. Cooley is a very accurate man, I can say to the committee. He runs a bank in a beautiful little village called Round Hill, about 40 miles from here. I would depend on his figures.

Senator BUTLER. Mr. Chairman, there are two or three exhibits attached to the statement made by Mr. Miller.

Mr. MILLER. Yes.

Senator BUTLER. We do not need to refer to them in detail, but I would like to refer to one of them that was made up covering 25 banks in Nebraska, where the total savings as of June 30 last totaled over $63,000,000, covering almost 135,000 individual accounts, and now that averaged up for the 25 banks a withholding tax of $1.14 per customer.

Mr. MILLER. That is right, sir.

Senator BUTLER. It shows the impractical way in which this thing works out.

Senator BYRD. Mr. Cooley was merely testifying that as a precaution that should be done, I assume, because it is not in the bill.

Mr. MILLER. That is right.

Mr. COOLEY. We do not want it in there.

Mr. MILLER. Can I file copies of the various bank resolutions?

Senator BYRD. Yes.

(The documents referred to are as follows:)

NORTH DAKOTA RESOLUTION, MAY 25 AND 26, 1951

That the proposal of the Federal Government to withhold taxes on interest payment on savings accounts at the source would impose upon the banks of the country an unfair, expensive, and heavy burden, both in dollars and man-hours, and collection of taxes in this manner is opposed.

OREGON RESOLUTION, JUNE 12, 1951

Whereas we are informed that the House Ways and Means Committee in Congress has voted to include in a new tax bill a provision for a 20-percent withholding tax on dividends and interest; and

Whereas such withholding tax would apparently apply to interest on bank deposits and United States savings bonds, regarless of amount; and

Whereas such withholding tax would tend to discourage savings and thrift and would run directly counter to efforts being made to control inflation; and

Whereas such withholding tax would apply to countless thousands of savings accounts and savings bond redemption transactions on which no tax would otherwise be payable: Now, therefore, be it

Resolved, That the Oregon Bankers Association go on record as being unalterably opposed to the imposition of any such withholding tax; and be it further

Resolved, That a copy of this resolution be duly transmitted to the Oregon delegation in Congress.

SOUTH CAROLINA RESOLUTION, MAY 19, 1951

Whereas it is proposed in the revenue bill now under consideration in the Congress of the United States to impose a withholding tax on dividend and interest payments; and

Whereas such legislation, if enacted, would:

1. Tend to discourage savings and thrift which are the key to the future prosperity of this country. This would run directly counter to efforts being made to control inflation which includes encouraging people to save through savings accounts and purchase of savings bonds.

2. Apply to countless thousands of savings accounts and savings bonds redemption transactions on which no tax would otherwise be payable. Thus the individuals from whom the tax would be withheld would be forced to seek refunds of the tax which would place an inequitable burden on these individuals or if they failed to apply for the refund, would unjustly enrich the Government.

3. Such refunds would require the employment of a large army of Government workers to handle the details, the cost of which, it is believed, would to a large extent offset the estimated $400 million in new taxes which would be collected by this method.

4. Result in considerable additional work for all banking institutions at a time when operating expenses are increasing and manpower difficulties are being experienced: Now, therefore, be it

Resolved by South Carolina Bankers Association, That it protest to the Congress the enactment of such legislation, and that each of its member banks urge upon its representatives in Congress the advisability and necessity of defeating the same for the above-mentioned reasons.

TENNESSEE RESOLUTION, MAY 15 AND 16, 1951

The Tennessee Bankers Association wishes to go on record as being opposed to the deduction of taxes at the source on interest disbursed by banks, on the interest on savings bonds, and dividends of corporations. It is the opinion of the association that the amount of income received from an operation of this character will not compensate for the expense involved and that it will burden all banks with a complicated and almost impossible operation. It is impossible to compute the possibility of the extent of driving savings out of banks and the influence of defeat which such a program might have on the sale of savings bonds.

VERMONT RESOLUTION, JUNE 16, 1951

Whereas the proposed 20-percent withholding tax on interest and dividends paid individuals imposes a levy upon individuals and requires banks to participate in seizing a portion of the interest upon all deposits, including the interest upon meager thrift savings of individauls, without first ascertaining that they are taxable, and thereby deliberately throws upon the individual the burden of getting back from the Government any unjust levy, and

Whereas to seize the income of a citizen upon the establishment of the mere fact that he has even a small bank deposit or a small holding of United States savings bonds discourages saving at the very time when the whole equilibrium of the national economy depends upon the encouragement of saving, as an antidote to inflationary spending, and

Whereas institutions to which the public entrust their savings ought not to be required to participate in what may be an unjust seizure of the money of their depositors;

Be it resolved by the Vermont Bankers Association in convention assembled:

That such legislation strikes at the very principles of free government, most vital to every citizen at all times and especially at a time when we are engaged in a struggle to uphold freedom against statism and totalitarian aggression:

That the damage done to our economy by such legislation would far outdistance the financial benefits derived therefrom, and

That this association opposes such legislation on principle and calls upon our people and our representatives in Congress to do everything in their power to prevent its passage.

VIRGINIA RESOLUTION, JUNE 13, 1951

Whereas the Congress of the United States is considering the enactment of a tax law providing that 20 percent of all dividends and interest payable to investors and thrifty citizens with savings accounts be withheld and remitted to the Secretary of the Treasury as a withholding tax to be credited to the taxpayer, and

Whereas the enactment of such a law will be inimical to the interests of the public generallv, especially the small investors and thrifty citizens, and

Whereas whatever amount of additional taxes may be collected by such withholding tax the same amount can readily be secured by other means compatible with sound tax laws, and

Whereas this association has heretofore endorsed, and hereby renews its endorsement of the sale of United States savings bonds, believes that the imposition of such a tax will unduly and unnecessarily impede the sale of E bonds and all other investments issued by the Federal Government: Now, therefore, be it

Resolved, That this association go on record as opposing the enactment of any law providing for the withholding of any amount of interest and dividends which may be payable to the citizens of this country on their savings accounts and investments, and that a copy of this resolution be forwarded to the Members of Congress from the State of Virginia and to such other person or persons as the secretary of the association may determine.

RESOLUTIONS OF THE WISCONSIN BANKERS ASSOCIATION, 1951

WITHHOLDING TAX PRINCIPLE

Whereas the withholding-tax principle is the long and perhaps final step toward the socialistic state, and

Whereas the vigorous opposition of Wisconsin banks to the withholding tax on savings-bond interest and savings-account interest caused, at least in part, the reversal of the Ways and Means Committee so that bank-savings interest is is now exempt from the withholding principle, and

Whereas the withholding principle is equally wrong for all other invested capital returns, and

Whereas the strength of this Nation rests on the responsibility and independence of individual citizens who ought to be paid earnings of their own capital and in turn to pay their own taxes directly: Now, therefore, be it

Resolved, That the Wisconsin Bankers Association in convention assembled instruct its officers to continue vigorous opposition, directly, and in cooperation with other State associations and the American Bankers Association to the application to any tax legislation.

TAX EQUALITY

Whereas small banks are now paying a direct Federal income tax of 25 percent of their earnings and under the pending revenue bill will pay direct Federal tax of 30 percent of their earnings, and

Whereas larger banks are paying a direct Federal tax of 47 percent of their earnings above $25,000 and under the pending revenue bill will pay 52 percent, and

Whereas many banks will pay an excess profits tax of 77 percent of their top earnings under the present law and 82 percent under the pending legislation, and

Whereas our principle competitors for savings money, including savings and loan associations, mutual savings banks, credit unions, etc., are completely exempt from these confiscatory levels of taxes and pay no Federal tax, and

Whereas the American Bankers Association which represents us in Federal tax matters has the responsibility for and should provide a Federal tax on banks at the same rates as similar competitive financial institutions are taxed: Now, therefore, be it

Resolved, That the Wisconsin Bankers Association in convention assembled instruct its officers to actively work for tax equality, to cooperate with other responsible agencies working for tax equality and respectfully request the American Bankers Association to aggressively work for tax equality.

Senator BYRD. The committee will adjourn until 3 o'clock this afternoon, to reconvene in this same room.

(Whereupon, at 12 noon the committee adjourned to reconvene at 3 p. m. of the same day.)

AFTERNOON SESSION

Senator HOEY (presiding). We will be in order, please.

The members of the Finance Committee presently are engaged over on the Senate floor, because they have important amendments pending but, since the witnesses are here and since we depend upon the record anyway in this matter, I am going to call the witnesses and give them a chance to testify so that their statements may go into the record, and save them the trouble and inconvenience of coming back again tomorrow morning.

The first witness is Horace Russell.

I may say to the witnesses that they may exercise their pleasure by reading their statements or putting them all into the record and just making supplemental comments as they desire to make.

STATEMENT OF HORACE RUSSELL, GENERAL COUNSEL, UNITED STATES SAVINGS AND LOAN LEAGUE

Mr. RUSSELL. Senator, if I may, I would like to read this three-and-a-half-page statement I have here.

Senator HOEY. Go right ahead.

Mr. RUSSELL. Thank you, sir.

Mr. Chairman and gentlemen of the committee we have no objection to the tax bill H. R. 4473 but make this statement because of the requests to you of a minority of our competitors and certain so-called tax-equality propagandists.

It is very well known that the members of the Finance Committee of the Senate and the committee staff and Treasury officials are very well acquainted with the situation with which we are dealing. I will, therefore, endeavor to confine this statement to what appears to me to be the fundamentals of the question. If additional information is wanted, I will be glad to supply it. Of course, we all know that the committe staff is able to supply the committee with accurate and complete information on all of the questions raised in this statement.

The position of the savings and loan business is that it now produces more revenue for the Federal Treasury than is produced by competing financial institutions, and, therefore, that no additional tax should be levied:

The Federal Internal Revenue Code levies taxes in various ways. In the case of savings and loan associations, mutual investment trusts, and partnerships, the tax is levied on the owners. In the case of commercial banks and trust companies the tax is levied upon the bank—after payment of interest—and upon interest in the hands of the savers and upon the dividends in the hands of the stockholders. In the case of life insurance there is no tax upon the owner of cash values, but all of the tax is upon the company. If this situation is examined, it is found that the Federal tax revenue produced by savings and loan associations is about $5,000 per million dollars of assets against about $3,250 per million of bank assets and less than that of insurance-company assets. Savings and loan associations, insurance companies, and banks lend their money in direct competition, and therefore receive about the same gross earnings upon their loans and their net earnings on loans are comparable.

The reason why the Federal revenue produced by savings and loan associations exceeds that produced by commercial banks and trust companies is (1) that savings and loan associations employ substantially all of their capital, and (2) pay out all net earnings semiannually or annually where it is taxable, whereas banks and trust companies carry substantial idle funds and invest somewhat more substantially in low-yield Government bonds, have higher expenses, and retain a substantial part of net earnings.

The Government levies only one tax on the interest paid by banks on savings exactly as it is with savings and loan associations. It would get no tax on the earnings of privately held bank capital on the profits banks make on demand deposits and service charges, unless a tax were

levied on the bank or the stockholders, or both. Mutual savings and loan associations have no private stockholders and pay out all their earnings at least annually to their savers where it is subject to full taxation. This is doubtless the fundamental reason for the present method of levying the tax burden.

Prior to 1932 savings and loan associations were exempt and their members were exempt on dividends to $300. In 1932 the Congress removed the exemption of savings and loan dividends, and in the Public Debt Act of 1942, the normal tax exemption which had been allowed on Federal savings and loan association dividends, was removed. For some years, therefore, the members of savings and loan associations and similar institutions have been subject to full normal income tax and surtax upon all earnings of such associations as received by the members.

In view of the fact that the average savings and loan account is about $1,000 and the average dividend is about $25 per annum, and the minimum tax at 20 percent is therefore, $5 per annum, and in view of the fact that the Federal income-tax burden is now greater on these small savings than the total income-tax burden on the same amount of money in banks—against the bank and its savers and its stockholders added together—it does not seem reasonable that the Congress would increase the present tax burden on savings and loan associations and their savers.

The cost of money: Most savings and loan associations refer to their distribution of earnings semiannually or annually as "dividends" as the mutual savings banks did originally. However, in both fields of business, the average saver considers his saving account a "deposit" and calls the earnings "interest." In substance, the yield on a saving and loan account is interest paid for the money. It is a cost of money to the association. Such cost of money is a part of the cost of doing business, and indeed is the major cost. We assume that this question has been settled and, therefore, leave the question here except we refer to the report of the committee staff to the Ways and Means Committee in 1950 and 1951 and the report of the Ways and Means Committee to the House of Representatives in 1950 and 1951, which have recommended that such yield be treated as cost of money whether called interest or dividend, as is done in the case of commercial banks and trust companies with respect to their savings accounts.

Retained earnings are loss reserves: The question is raised from time to time as to whether savings and loan associations should be taxed upon their so-called "retained earnings." If such associations were retaining earnings unduly from the tax stream, there would be some basis for this suggestion. The position of the savings and loan business is that all their earnings except "necessary loss reserves" are paid out periodically, usually semiannually to their members who in turn are subject to full normal tax and surtax upon such earnings. We take the position that about 15 percent is a reasonable loss reserve.

It appears that the only question here is whether such "retained earnings" constitute necessary loss reserves or whether such "retained earnings" are in excess of necessary loss reserves. The Internal Revenue Code, section 23 (k) (1), authorizes the deduction of losses from current earnings or before payment of income tax an allocation to a loss reserve approved by the Commissioner. Federal savings and loan associations are subject to Federal law, regulation, examination,

and supervision, and are required to build up their loss reserves to 10 percent of their total share capital. They now have about 7 percent. State savings and loan associations are subject to state law, regulations, examinations, and supervision, and the insured institutions are also subject to Federal regulation, examination, and supervision, and they are required to allocate from earnings after expense and before dividends funds to loss reserves in varying amounts up to 5 percent, 10 percent, and even 20 percent of share capital or assets. Their present retention amount to about 7 percent of share capital. I might point out that percentage has not materially changed in the past 10 years, that is, these institutions during the past 10 years have not changed their course of business and continue merely to withhold a reasonable loss reserve. Both Federal and State supervisors have been very insistent in recent years upon greater allocation to loss reserves before dividends. Finally in this connection it is pointed out that it is the legal duty of these mutual institutions to pay out all "net earnings." They have no legal right to retain earnings not resaonably required for loss or contingent reserves. Their members have the right to compel the payment of all "net earnings" after reasonable loss reserves.

It has always been customary in Federal income taxation to allow for losses for bad debts to be deducted from current income or for an allocation to a loss reserve before payment of income tax. See Internal Revenue Code, section 23 (k) (1). It is in the interest of the whole economy, as well as a particular group of savings institutions and their savers, to permit the accumulation of a reasonable loss reserve before the event, in order to avoid losses to the Federal Savings and Loan Insurance Corporation, loss of Federal revenue, and chaos at the bottom of a depression.

The published statements of the Home Owners' Loan Corporation, a Government corporation, indicate that the original mortgagees took a write-down and loss of 7 percent and that it took an additional loss of approximately 10 percent or a total of 17 percent on a $3½ billion portfolio. Dr. John Lintner of Harvard University in his book Mutual Savings Banks and the Savings and Mortgage Market, page 304, says that the Massachusetts savings banks for the period 1931 through 1945 took losses on their mortgage portfolio which average 16 percent of the portfolio at the beginning of the period. There are other studies which indicate that in a depression period mortgage losses may be 15 percent or higher. These facts are substantial evidence that our "retained earnings" presently about 7 percent are not net earnings but are bona fide loss reserves. Indeed it appears that if we were paying out more we would be paying out a part of the capital and that in substance is exactly the position that our supervisors from time to time take when associations pay too much for savings and allocate too little to loss reserves.

It is significant, and casts light upon the necessity for a loss reserve, that the United States of America, in addition to initial, appraisal, and other charges, makes an annual charge at the rate of one-half of 1 percent per annum on contractual unpaid balances—and is authorized by Congress to charge 1 percent—of FHA insured mortgages, which

extend up to 20 years and 25 years, to provide a similar loss reserve against such mortgages. It should be pointed out in this connection that if one institution insured all its mortgages, it could deduct said mortgage insurance premium before determination of net income, and would be compelled to provide other loss reserves for the losses which it may take on FHA loans, such as foreclosure cost and rehabilitation, and for other contingencies. It looks as though it follows that a similar institution not insuring its mortgages would be entitled to deduct similar loss reserves before arrival at net income.

In spite of the fact that we pay out all of our net earnings at least annually into the tax stream and produce Federal tax revenue greater than the commercial banks and certain other financial competitors, we regret that a few of our competitors and certain propagandists have urged the Ways and Means Committee and the Senate Finance Committee to levy additional taxes upon this type of savings, and have complained at our effective and successful savings and home ownership advertising and the improvement in our office quarters as a ground for restricting our savings and home ownership program by additional Federal income taxation in excess of the tax burden levied on other types of finance.

We believe that they misunderstand the situation. After all, the present bill as it passed the House will increase our tax burden 12½ percent as it increases the tax burden on other taxpayers. We try to give you the fundamentals of our situation taxwise, and will supply additional information if you desire it. We very much appreciate the consideration the Ways and Means Committee has given to this question and the time and consideration the Finance Committee of the Senate is giving to it.

Our position is then (1) that the Federal income-tax burden on the savings and loan business is now greater than that on the commercial banking and trust company business, and, therefore, that the tax burden should not be increased; (2) that our cost of money, whether called interest or dividend, is similar to the cost of money to commercial banks in savings accounts and is, therefore, a part of our overhead expense and should be recognized as such; and (3) that the only earnings retained or retainable by mutual savings and loan associations are "necessary loss reserves" which are retainable by all corporations before payment of tax; and (4) finally such associations are organized and operated both Federal and State under the strictest kind of law, regulation, public examination, and supervision which should give the Congress assurance that these things are true.

Mr. Chairman, if there are any questions, I will be glad to try to answer them.

Senator HOEY. That is all right, Mr. Russell. They have been covered very fully, and we thank you for your appearance.

Mr. RUSSELL. May I put a statement by Mr. Morton Bodfish in the record, showing the study with respect to this question?

Senator HOEY. Yes.

Mr. RUSSELL. Thank you very much.

(The document referred to is as follows:)

Savings and Loan Associations and Cooperative Banks: Their Federal Tax Status [1]

(By Morton Bodfish)

FOREWORD

For some time, there has been an increasing amount of provocative comment with regard to the Federal tax status of savings and loan associations and cooperative banks. The substance of some of these comments has been that, as a result of this tax status, the savings and loan association today enjoys a "competitive edge" over the savings department of commercial banks.

In any discussion tinged with the air of competition, there is apt to be more heat than light. It is a matter of regret that some misstatements of fact have been issued in connection with this discussion. A major inaccuracy frequently repeated has been that the savings and loan association and cooperative bank business today does not bear any burden of taxation.

The purpose of this booklet, with no feeling of rancour, is to examine the financial structure of both savings and loan associations and commercial banks, and determine the points of difference that have led to traditional congressional designation of a separate tax status for each. It will show also where and how savings and loan associations now contribute to the tax revenues of the United States.

Morton Bodfish.

April 1951.

Savings and loan associations and cooperative banks for decades have been fostered and encouraged in their growth by the United States Congress because their fundamental purpose is to serve two highly important social objectives—first, to offer a real incentive for thrift on the part of small savers and—second, to provide credit for small home ownership. The entire operation of these organizations is devoted to these objectives.

Men in all walks of life, public and private, have always agreed that carrying out the dual objectives of savings and loan associations and cooperative banks constitutes a highly worth-while public service regarded basically as a civic activity. Because of their objectives and since—by their mutual character—they operate solely for the welfare of all who participate in them, these institutions have always properly been regarded by the Congress as basically different from those money-making corporations whose measure of success is ever-increasing dividends and higher market prices for their securities rather than expanded community service.

SERVICE TO THE COMMUNITY

Savings and loan associations and cooperative banks are organized solely to promote thrift and home ownership.

With few exceptions there are no funds in these institutions except those placed there by the member savers. Savings accounts in most of these institutions typically amount to from $500 to $600 and usually represent all of the account holders' savings for emergencies, for the education of their children, for family burial expenses, and for their backlog of family security. Some 11,000,000 people currently have savings accounts in these institutions which are located in every State of the Union and in most cities with a population of 10,000 or more and in many cities of smaller size. The average association is owned by about 2,000 individuals whose savings funds in the institution are loaned to about 600 home owner-borrowers in the immediate vicinity. It requires the average savings funds of three to four people to equal the loan requirements of one typical home owner-borrower.

Savers' funds in savings and loan associations and cooperative banks are invested primarily in first-mortgage loans on residential property. Law and good business practice require certain percentages to be held in cash and Government bonds for liquidity purposes but the remainder of their funds is available for lending to homeowners. Savings and loan associations devised and pioneered the home mortgage loan repaid in rentlike monthly installments and have always been the place where a family of modest income could get a long-term amortized loan up to 80 percent of the purchase price or construction cost of a home. From 1940 through 1950 savings and loan associations financed home ownership for more than

[1] Prepared by the United States Savings and Loan League for the information of its member savings and loan associations and cooperative banks.

4,000,000 families. More than 665,000 veterans of World War II were able with their help to buy homes with GI loans at interest rates of only 4 percent through the years 1945 to 1950.

The fact that some commercial banks and individually operated private companies make home mortgage loans when it is to their advantage to do so should not in the least obscure the special purpose of these savings and loan associations in the community services they render. At the end of June in 1950, commercial banks had only 5.2 percent of their total assets invested in mortgage loans on homes and small residential property whereas savings and loan associations and cooperative banks devoted 80.6 percent of their assets to this purpose.

COOPERATIVE CHARACTER OF SAVINGS AND LOAN ASSOCIATIONS

What happens to the income which the association receives from the interest on mortgages and Government bonds? It is divided in just three ways. First, it is used to pay the expenses of operating the institution. Second, it is used to set up valuation reserves to absorb the losses which inevitably occur in making long-term, high-percentage mortgage loans. Third, the remainder, every cent of it, is distributed on a pro rata basis to its member savers. All earnings paid to savers are fully taxable as income. Since loss reserves are an expense and are recognized as such in every business for accounting and tax purposes, this description of what happens to the income could be simplified to just two items—expenses and distributed earnings. There is no other income, no other payment, no other retention.

In order to encourage thrift, the operating plan of these mutual savings institutions was devised to provide a maximum return to small savers since the institution was organized and operates to pay out all of the earnings of the institution to the savers. They currently pay from 2 to 3 percent and in a few instances more, depending upon earnings, to the savings account holders who own the institutions.

On the other hand, a bank operates for the profit of a few stockholders who own the bank rather than the depositors who provide the bank with the money it lends. Its operating efficiency is measured by the amount of net profit which accrues to the benefit of the stockholders, and profits are increased by paying as low a return as possible to the savings depositors. Thus, the saver in a savings and loan association usually receives two to three times as much as he would receive if his funds were placed in a savings account in a commercial bank.

The 1,850,000 stockholders of insured commercial banks, owning bank stock valued at $3.4 billion, received $354,144,000 in dividends in 1949. To their 27,-600,000 savings depositors of the $36 billion in their keeping, the same banks that year paid $328,010,000 interest. In other words, less than 2,000,000 holders of bank stock received more investment income than the savings depositors, who outnumbered them 15 to 1. Since there is no small group of capital stockholders in mutual savings and loan associations, all current earnings are paid to their 11,000,000 savers. (See chart I on p. 6.)

This is a clear-cut illustration of the major difference between banks and savings and loan associations. As mutual institutions, savings and loan associations distribute all income (after expenses and necessary valuation reserve allocations) to all savings account holders who are the owners of the associations. On the contrary, as a corporate operation, the profits of banks are distributed among a limited number of stockholders. To put it another way, while the return to the savings account holder is the primary purpose of the managers of these mutual or cooperative organizations, it must be a secondary purpose of the managers of banks whose first obligation is to their stockholders. Because of this key difference between a maximum distribution of earnings to savers in a savings and loan association and a minimum distribution to the savings depositors in banks, savings and loan associations properly have not been regarded as the same type of institutions as banks and as a result have had a different tax status.

To illustrate further the difference between a mutual or cooperative financial institution and an ordinary corporation, there is reproduced a typical financial statement of a commercial bank showing its assets and liabilities and a typical financial statement of a savings and loan association showing its assets and liabilities. Note that the savers are the real owners of the savings and loan association, while a few stockholders and not the savers or depositors own the bank.

Commercial banks derive their money from three sources:

1. The checking or commercial depositors to whom banks pay no interest.
2. The savings depositors to whom banks pay only a low rate of interest.

In 1949 the interest payments averaged less than 1 percent.

Typical statements of condition: A $10,000,000 commercial bank and a savings and loan association of same size

	Commercial bank	Savings and loan association
Assets:		
Government bonds	$4,239,000	$1,025,000
Other bonds	642,000	
Cash and balance with other banks	2,268,000	599,000
Loans and discounts	2,037,000	
Home mortgage loans	467,000	8,045,000
Other real estate loans	268,000	
All other assets	79,000	331,000
Total	10,000,000	10,000,000
Liabilities:		
Commercial deposits	[1] 6,852,000	
Savings accounts	[2] 2,369,000	[3] 8,582,000
Borrowed money		351,000
All other liabilities	84,000	[4] 331,000
Reserves for losses, surplus, etc	476,000	730,000
Proprietary stock	[5] 219,000	
Total	10,000,000	10,000,000

[1] Owned by 1,500 people.
[2] Owned by 1,825 people.
[3] Owned by 6,600 people.
[4] Chiefly "loans in process" representing liability for funds promised borrowers building new homes.
[5] Owned by 120 people.

Source: Based upon data for insured commercial banks, Annual Report (1949) of the Federal Deposit Insurance Corporation, pp. 164-165, and data for members of the Federal Home Loan Bank System, Annual Report (1949) of the Home Loan Bank Board covering association members of the Bank System, pp. 48 and 49. In these hypothetical institutions the percentage distribution of assets is the same as for the total of all insured banks and all association members of the Bank System as of December 31, 1951.

3. The owners of the underlying capital stock to whom all profits of the bank accrue in the form of dividends or appreciation of the book value of their investment.

There is no profit-making or capital appreciation ownership stock in a mutual savings and loan association. The member savers own the institution. They share in its profits in simple and direct relation to the amount of money they have invested in the enterprise. They also participate in any losses which cannot be absorbed by the loss reserves built up from earnings. Distribution of earnings to savers in all associations in 1949 averaged more than 2¼ percent.

How the distribution of earnings in a mutual financial institution differs from the distribution in a typical corporate enterprise is illustrated by the comparison below of a typical bank having $10,000,000 in assets with a typical savings and loan association having the same amount of assets. Note that all the earnings of the association are paid to the savers, where they become taxable income in the hands of individuals; in the case of the bank, stockholders hold back for themselves as dividends and capital appreciation two and one-half times as much as they pay their savings depositors.

Distribution of earnings to savers and stockholders

	Cents
Savings and loan association or cooperative bank: To 11,000,000 savers	100
Commercial bank:	
To 1,850,000 bank stock owners	52
To 27,600,000 bank savings depositors	48

Income statements: Typical $10,000,000 commercial bank and a savings and loan association of same size

	Commercial bank		Savings and loan association	
	Income account	Taxes received by Treasury	Income account	Taxes received by Treasury
Total income	$238,000		$421,000	
This income is paid out as follows:				
To meet operating expenses	129,000		123,000	
To meet losses and necessary transfers to reserves for future losses	11,000		96,000	
Payments to holders of savings accounts	22,000	[1] $4,400	202,000	[1] $40,400
(Rate of payments on savings accounts)	[2] 2.9		[2] 2.3	
This leaves net income of	76,000			
This net income is distributed as follows:				
Federal income taxes (based as in any corporation on net income remaining after expenses, transfers to reserves and payments to savers)	20,000	20,000		
Dividends to stockholders	24,000	[1] 4,800		
(Rate of dividends)	[2] 10.9			
Transfers to surplus accruing to benefit of stockholders	32,000			
(Transfers to surplus as percent of capital stock)	[2] 14.6			

[1] As interest or dividends are received by individuals, they are taxed on that income. Estimates of personal income taxes paid on these earnings as they enter the "tax stream" are based on 20 percent, the lowest income tax bracket. . Note that the earnings of the savings and loan association are fully taxed in the hands of the savers.
[2] Percent.

Source: Same as preceding table. The percentage distribution of gross income in these hypothetical institutions is the same as for all insured banks and all association members of the Federal Home Loan Bank System for the year 1949.

EARNINGS ALREADY IN THE TAX STREAM

Just as the savings depositor in the commercial bank pays a Federal income tax on the interest income he receives from the bank, and the capital stockholder of a corporation on the dividends he receives on his capital stock, so does the saver in a savings and loan association or cooperative bank pay taxes on the return he receives on his money entrusted to an association. There is a constant flow of all of the earnings of a mutual financial institution into the tax stream where they are fully taxed as earnings received by individuals in accordance with their individual capacity to pay. There are no earnings of the mutual institution retained in the organization to be taxed.

Secretary of the Treasury John Snyder, testifying before the House committee said the whole question of the earnings of cooperative institutions, when declared in reference to their earnings, "The tax is paid by the members * * * that is an equitable distribution." That money is already in the tax stream.

LOSS OR VALUATION RESERVES

Questions sometimes arise concerning the allocation of funds to valuation reserves of savings and loan associations, indicating that this aspect of the savings and loan business is not clearly understood.

Specifically, the question is raised as to whether reserves are too large. It is difficult to understand why such questions arise in light of the fact that minimum reserves are required by law and the reserves of the savings and loan business are under the constant scrutiny of Federal and State supervisory authorities.

In accordance with Federal and State laws and regulations, the savings and loan business must make periodic allocations to loss reserves. Commercial banks, trust companies, and life insurance companies are likewise required to maintain valuation reserves, and such appropriations to reserves are a lawful deduction before taxes.

Such reserve allocations are required because it is a known fact that losses can and do occur, and that they should be borne by all individuals whose money has been saved in the institution over a period of time. Otherwise, those fortunate enough to have their money in the institution during "good times" would receive

an unusually high return, whereas, those whose money was invested during "bad times" would actually suffer a capital loss. The building up of loss reserves is simply a device to "average out" the losses taken and earnings paid to the saver-owners through good times and bad.

In an expanding economy, when people add to their savings funds, this very growth imposes extra demands on that portion of the gross earnings of the savings institutions earmarked for reserves. The reserve fund must receive not only its regular periodic addition, but the growth of the savings in the institution must be reflected in a corresponding growth of the reserves to maintain a proper balance percentagewise.

These funds constitute a safeguard for the assets, in part or in whole. If at any time the value of any or all the assets for any reason is impaired, the reserves are required to offset the impairment.

The law as it pertains to the valuation or loss reserves of savings and loan associations and cooperative banks forbids the investment of these funds in other enterprises.

No one can competently predict the vagaries of the real estate cycle. As in all attempts at prediction, experience is the best guide. The point is well established in a book by Dr. John Lintner, of Harvard University's Graduate School of Business, entitled, "Mutual Savings Banks in the Savings and Mortgage Market." Discussing the loss experience in the mortgage market, Dr. Lintner notes that the mutual savings banks of Massachusetts in the period from 1931 to 1945 foreclosed mortgages aggregating $562,000,000, equivalent to 44.5 percent of the mortgages held by them at the beginning of that period, and lost 27.2 percent on the total principal amount foreclosed. That was a loss of 17 percent on the average mortgage portfolio outstanding during the period.

Originally, savings and loan associations paid out all earnings every year. They were, as a matter of fact, paying out more than their real earnings, since the interest received on a loan is not fully earned until the loan is completely paid off. The folly of this—of not retaining reasonable reserves—was clearly shown during the depression years.

The sudden and substantial losses which associations may be called upon to meet are seen in the fact that losses sustained in the 2 years of 1931 and 1932 amounted to more than those of the entire decade of the 1920's. An analysis of losses and reserves covering a large cross section of the savings and loan business during the decade of the 1930's shows that the losses sustained by associations from 1930 through 1936 equaled the total of all of their reserves accumulated throughout the years up to the depression.

In building reserves for future losses savings and loan associations must follow a radically different course from that of other commercial enterprises where losses are known from year to year. Most business organizations extend credit for from 30 days to 18 months only—relatively short periods. Consequently, losses on loans can be determined accurately by these organizations from year to year. But savings and loan associations, handling loans for periods of from 15 to 25 years, are wholly at the mercy of the severe real estate cycles. To be protected from the hazards of the unforeseeable future, they must build up reserves over a 20-to-30-year period to absorb those losses which occur in a 2-to-3 year depression period.

Remembering the bitter lesson of past depressions, particularly the great depression of the 1930's, Federal and State supervisory authorities have repeatedly urged, in recent prosperous years, a more rapid and more adequate accumulation of reserves. They have sponsored legislation to that end.

The Annual Report of the Home Loan Bank Board for 1949 shows the aggregate total of valuation or loss reserves (variations of the term are sometimes used) of member institutions to be 7.3 percent of assets. While this ratio is slightly above that of 3 or 4 years ago, it is actually less than the percentages of 1942 and 1943. The Federal associations are required to build to 10 percent, with accumulation of additional reserves expressly authorized. New Jersey sets the reserves minimum at 15 percent and the maximum at 20 percent.

Most supervisory authorities agree that valuation reserves should be built up to from 10 percent to 15 percent of assets although there is no truly workable criterion for adequate reserves. State laws differ, mortgage loans are more safely made in some cities than in others, and the reserves needed in a depression depend upon the severity of that depression in each community. It is fallacious even to try to set maximums or reasonable goals. When a particular association reaches what its management considers an adequate loss reserve position to protect its savers' funds, it ceases to make additional allocations since there is no conceivable

incentive in any institution to build excessive reserves. There is no appreciation of the savers' investment through capital gain such as results from the retention of earnings in the surplus account by an ordinary corporation or a commercial bank.

METHODS OF TAXING VARIOUS TYPES OF ENTERPRISES

The thought that mutual financial institutions like savings and loan associations and cooperative banks have a "preferred" tax treatment probably stems from the fundamental error of attempting to compare them with other totally different types of business organizations.

The Federal Government has chosen to levy taxes in different ways on different classes of business enterprises. The purposes of the differing formulas devised by the Congress are to achieve an equitable distribution of the total tax burden and to further the broad social and economic objectives of each type of enterprise.

This is how the Federal Government derives revenue from several different types of business enterprises:

(1) Partnerships: There are hundreds of thousands of business firms in the United States which are owned in partnership. These may be owned and operated by professional men or businessmen pooling their knowledge, know-how, and capital. These partnerships are not taxed as concerns. From the gross earnings of the firms are deducted all costs of operation and charge-offs for potential bad debts. All remaining net profit is payable to the partners, who individually pay income taxes on this income.

(2) Commercial banks: Here the Government has chosen a tax formula which levies a tax against the bank as a corporation and the stockholders and customers as individuals. From the earnings on its investments are deducted out-of-pocket operating expenses. The bank does not pay a tax on the return paid to its saver-customers.

Banks are required to charge off current losses and build up valuation reserves for future losses. These, too, are deductions from income before payment of taxes.

After the afore-mentioned deductions, this type of corporation, as an "artificial person," is taxed on its income. Then, after taxes are allowed for, the profits are distributed among corporate stockholders or are retained as surplus which enhances the value of the corporate stock.

(3) Mutual financial institutions: These include savings and loan associations, cooperative banks, mutual savings banks, credit unions, and national farm loan associations. The tax formula applied to these types of financial institutions is similar to that applied to partnerships, which, as cooperative organizations, they basically resemble. Savings and loan associations, credit unions, and mutual savings banks are organized to attract savings from individuals, who then become, in effect, part owners of the business.

Operating expenses are deducted from the income received from their investments. The mortgage loan investments of savings and loan associations are made on a long-term basis, entailing risks unknown in the present but certain to be met in the future; thus a portion of the gross income is also set aside to build up a valuation reserve to meet the losses of the future to assure the future solvency of the savers' funds.

After providing for operating expenses and the allocation to build up the valuation or loss reserve the entire income is distributed among the saver-owners of the enterprise. This income is then fully taxable in their hands.

SUMMARY

Briefly, the foregoing may be summarized as follows:

1. Savings and loan associations and cooperative banks for years have been fostered and encouraged in their growth by the Congress because they restrict their activities to the promotion of individual thrift and the financing of small-home ownership.

2. Savings and loan associations—like credit unions, mutual savings banks, national farm loan associations, and other mutual and cooperative organizations—are organized not for the profit of a few stockholders but for the mutual benefit of all who participate in their operation and their communities.

3. Savings and loan associations and cooperative banks, after provision for necessary loss reserves, pay out all their earnings and these earnings are fully taxed as the income of individuals. They differ from privately owned capital stock companies in that they have no retained income.

In view of these facts, it is evident that savings and loan associations' income is at present fully taxed, and that there is nothing in the structure or operation of these institutions that in the least warrants the imposition of any further taxes upon their operation. The imposition of unfair new tax legislation on this business, as has been advocated by some small special interest groups, would only serve to reduce the reward these mutual institutions pay for thrift and increase the cost of home ownership in the United States.

Senator HOEY. Mr. Samuel J. Foosaner? Mr. Foosaner, you may give your name and your connection to the reporter.

STATEMENT OF SAMUEL J. FOOSANER, TAX ATTORNEY, NEWARK, N. J.

Mr. FOOSANER. Mr. Chairman, my name is Samuel J. Foosaner. I am a practicing attorney, specializing in Federal tax law. Having previously appeared before this esteemed committee, and having had the privilege of cooperating with it with respect to earlier tax legislation, I know of the open mind with which it scrutinizes new tax proposals.

Senator HOEY. Mr. Foosaner, I may say to you that you may exercise your pleasure with reference to whether you wish to read at all. Since the committee is not here, we are going to print it in the record, print the entire statement, and you can either read it all or make a brief summary, and the full statement will go in the record so that all members of the committee will have an opportunity to read it, just as you prefer.

Mr. FOOSANER. I would like to devote about 10 or 12 minutes with reference to the statement.

Senator HOEY. All right.

Mr. FOOSANER. I do not come before you in behalf of any client or group, or any segment of our taxpayers, but, rather, in the interest of the American taxpayers as a whole. In this light, I respectfully urge that you reject those proposals in H. R. 4473 which would increase individual-income, corporation, and excise taxes at this time. Substitutionarily, I humbly submit certain alternative suggestions.

The House bill H. R. 4473 seeks, in one fell swoop, to increase the collection of taxes from the American people by an amount which far exceeds any sum ever encompassed in a single bill in our entire history. It does this, notwithstanding the back-breaking tax burden already prevailing. It does this in spite of the fact that the American taxpayer, as yet, has neither felt the impact nor had time to comprehend the full severity of the two 1950 Revenue Acts. And, as if all this is not enough, as if the Government has detected that the American taxpayer may still have some breath left in his body which it feels should be choked out, further proposals are already in the making. Even before Congress can act on the unprecedented demands before it, the Secretary of the Treasury is panting down its back and vehemently insisting that taxes must be increased 3 billions more.

Greatly increased individual and corporation taxes are advocated to counter further inflation. But would they have this result? Experience proves to the contrary. Tax away the individual profits of the businessman, be he a sole proprietor or a partner, and what happens? He finds new ways for keeping those profits down. He seeks out new business expenditures or undertakes those which could other-

wise be deferred. He spends to get deductions where he would not otherwise spend, and thus he feeds the fires of inflation.

What is true of the individual taxpayer in higher brackets is even more pronounced with corporations. In periods of exceedingly high taxation, they are primarily motivated into undertaking many business expenditures by the knowledge that the net cost to them will only be a fraction of the dollar. Our experience in the last war period proved this beyond a doubt. There wasn't a corporation in the country in the excess-profits tax bracket which did not spend money which it would not have otherwise spent, except for the fact that it was putting out 14½-cent dollars.

No more convincing proof of the above argument can be offered than the information presented to this committee by the Secretary of the Treasury himself. When he appeared before you on June 28, 1951, he presented a very interesting table, table 13, along with his statement. Reference to that table shows that corporation profits averaged a new high of $34 billion a year for the period 1948 through 1950. But this is not the whole story.

The Secretary's table shows that corporate profits in 1945, a war year, amounted to only 19.7 percent before taxes. During this year, it will be recalled, the 95-percent excess-profits-tax law was in effect. With the repeal of this law, corporate profits, before taxes, jumped to 23.5 percent in 1946; 30.5 percent in 1947, and 33.9 percent in 1948. Thus, it is quite apparent that the percentage of corporate profits, before taxes, are unquestionably controlled by the rates of taxation to which those profits are to be subjected. When the rates are lower, percentagewise, higher profits before taxes will be earned. When taxes are high, percentagewise, the profits earned before taxes are kept down. This is accomplished through the simple device of undertaking more expenditures and establishing increased deductions for Federal income-tax purposes.

Increased corporation taxes are passed on to the consumer. This raises the cost of living, which is just another way of saying the dollar becomes worth less. That this is so is shown by the Government report of last week that food prices alone rose 12 percent in the last year. Consider this augmented living cost with the proposal to increase all individual-income taxes by a flat 12½ percent across the board, and it becomes immediately obvious that new wage demands must logically follow. Thus the vicious cycle is on again.

Price and wage controls can help supply the answer. But price and wage controls cannot cure the havoc that can be wrought by excessive taxation. "Cheap" dollars are spent fast.

Increased taxes are recommended on the theory that our taxpayers will have enough income to pay them. But is it a sure assupmption? Contrarily, is it not reasonable to conclude that further taxes in the amounts sought may go a long way toward obliterating such incentive as yet remains. Ours is a free-enterprise system. Supporting such a system is the underlying opportunity to earn profits, to grow and prosper. Deny those of our taxpayers who supply the employment for others the right to keep a fair share of those profits and you destroy the will to achieve. Continue to saddle these taxpayers with restrictions, along with the increasing production and management responsibilities which they are compelled to shoulder, and your further dis-

courage the desire for men to say in business, not during our emergency period but over the long pull.

All too many of our taxpayers have already adopted the philosophy of "It's later than you think," They ask: "What's the point in expanding my business? If I earn more money, I'll pay it out in taxes. I'd rather produce less and not work as hard. It might be better if I planned to retire as soon as conditions will permit and spend more time playing golf and fishing." This fast-growing attitude on the part of those who make the wheels of industry turn is dangerous to the continuing strength of our Nation. The businessmen of America constitute the backbone of our economy. For the very preservation of our democracy, nothing must be permitted to occur which might break that backbone.

The American taxpayers have reached the point where they may properly inquire: "In what direction are we headed?" They have every right to insist upon our Federal budget being restudied with a view to decreasing it wherever possible. Congress must take the lead in minimizing waste, inefficiency, and nonessential spending.

The Federal budget can be pared, and should be pared. Four of the most eminent men in our Government, members of this honorable committee, have shown the way. Senator Taft has made specific recommendations for tax economies. Senator Byrd has indicated where in excess of $9 billion could be cut from the Federal budget. Senator Martin has convincingly urged the elimination of duplicated and triplicated Government activities on the Federal, State, and local levels. Your own illustrious chairman, Senator George, has made one constructive proposal after another, all of which have been blissfully ignored.

Tax credits: Our minimum Federal needs for the fiscal year ending June 30, 1952, must be ascertained in light of a pared budget. Once, this is done, with due consideration being given to a longer-range tax program, Congress can then decide just how much additional revenue will be required for the current fiscal year. Instead of imposing new individual, corporation, and excise taxes, however, levies can be made on a non-interest-bearing "tax credit" basis.

Such additional sums as taxpayers are required to pay under any new enactment should be credited to their respective accounts.

The full amount of such credits should then be usable by them in any taxable year, beginning after December 31, 1953, against any Federal income, estate, or gift taxes which they may owe during the ensuing 10-year period. Thus, assume Congress decided to increase corporate-income taxes by 5 percentage points, it could impose this additional amount, not as a further tax but rather as a sum payable by a corporation, to be credited to tax payments of that corporation, or its successor, limited, however, to tax liabilities for 10 taxable years after December 31, 1953.

The "tax credit" plan would enable the Treasury to collect the additional income it required. At the same time, inflationary spending would be curbed.

Since tax rates themselves would not be increased, taxpayers would be less inclined to undertake expenditures not otherwise contemplated. They would be spending their own money, and this makes a difference. Moreover, surplus sums of taxpayers would be drawn off by the Government.

The "tax credit" plan is not offered as a substitute for future taxation. Rather, it is proposed with a view to meeting additional current Federal revenue needs, while simultaneously pursuing a study aimed at longer-range tax planning.

Ten-year tax plan: The 1950 Revenue Act, passed on September 23, 1950, increased taxes by $6,100,000,000. The new Excess Profits Tax Act, enacted on January 3, 1951, added another $3,900,000,000. Both of these acts require extended study. The excess-profits tax constitutes one of the most complicated pieces of tax legislation ever enacted. It is extremely difficult to digest and master. Yet, on the heels of these two acts comes another which, if passed, the Treasury Department would have immediately followed by still another.

Where are we to stop? What is our tax pattern to be? Does not far-visioned tax planning unequivocally demand that our Government take immediate steps to provide a financial blueprint?

Those who know have clearly indicated that the security program which we have cut out for ourselves will cover a period of at least 10 years. If this is so, then our tax planning must also be approached on this basis. With this thought in view, I have prepared a "10-year tax plan" which was presented to the Committee on Ways and Means on February 16, 1951, It is attached to this statement, for review by this committee.

The time has come for businesslike tax planning. Americans can no longer afford the luxury of the hodgepodge approach. The future continued success of our great Nation and of a free world rests largely on an invulnerable American economy. Our tax laws and tax system constitute the very foundation of that economy. They must be carefully studied and intelligently designed; not as so much tax legislation but rather as the very vehicle which shall be capable of transporting one American generation to another through good times and bad, toward a goal of greater human happiness and achievement for both ourselves and our posterity.

Mr. CHAIRMAN. The 10-year tax plan attached to this statement——

Senator HOEY. Yes; that will be included with your statement in the record.

Mr. FOOSANER. With a couple of accompanying charts.

Senator HOEY. Yes.

Mr. FOOSANER. It merely projects budgetarily our requirement for 10 years with conjectural suggestions that we endeavor to anticipate our national income and have each taxable year pay taxes in accordance with its ability to pay. On that basis we can travel on a pay-as-you-go plan and simultaneously, in all probability, make some repayments on the national debt.

Senator HOEY. Thank you very much. The tables and all will be included in the statement.

Mr. FOOSANER. Thank you for the opportunity to appear here, Mr. Chairman.

(The documents referred to are as follows:)

TEN-YEAR TAX PLAN

(The pertinent portions of the 10-year tax plan presented before the Committee on Ways and Means, on February 16, 1951, constituting a part of the statement presented to that committee by Samuel J. Foosaner, Newark, N. J., former chairman, Federal Tax Lawyers Committee; chairman, Federal Tax Committee,

New Jersey State Bar Association; Federal tax editor, Trusts and Estates; special tax lecturer (number of universities); author, book, many articles on Federal tax subjects.)

Congress must decide upon a budgetary program In spite of the compulsory conjecture, it is recommended that Congress endeavor to anticipate and project the Government's revenue requirements. While, as a practical matter, it will not be expected to enact tax legislation to stand indefinitely without change, modification, or adjustment, nevertheless Congress is capable of charting a general course.

The essential steps which would be entailed in the proposed 10-year tax program are as follows:

1. Estimate the Federal expenditures for the period from July 1, 1951, to June 30, 1961.
2. Estimate tne probable national income for the same period.
3. Equitably apportion the tax load over the period from July 1, 1951, to June 30, 1961.

Within the purview of the above tax plan, the deficit of 1 year would be offset by the surplus revenue collections of another.

Here is how the plan would work. Assume, after full pruning of all expense items except the "absolute essentials," our budgetary requirements for the 10-year period from July 1, 1951, to June 30, 1961, were estimated at $600 billion. If the history of the last 10 years repeats itself the national income will increase from year to year, with the possible exception of small drop-back in 2 or 3 years. (See table A.) With this pattern in mind, let us assume that the national income is $280 billion for the fiscal year ending June 30, 1952 and thereafter there is an average increase of $20 billion a year to 1961. Conjecturing a drop-back of $10 billion in each of 3 years (say 1955–56 and 1959), the total estimated national income for the 10-year period will amount to $3,310,000,000,000. (See table B.)

Instead of piling taxes in one year to meet the defense costs of other years between now and June 30, 1961, the $600 billion required by the Government would be met by taxes in accordance with the "taxable year's ability to pay." Illustratively, since the estimated national income for the fiscal year ending June 30, 1953, is $300 billion, and this represents approximately 9 percent of the total anticipated national income for the entire 10-year period, the total tax requirement for that year would be 9 percent of $600 billion or $54 billion.

The national income for the fiscal year ending June 30, 1954, having been conjectured at $320 billion, or somewhat less than 10 percent of the conjectured total income for the 10-year period, the taxes to be collected for that year would be approximately $58 billion.

If the above assumption of $600 billion is determined to be too low for the 10-year period from July 1, 1951, to June 30, 1961, it can be increased. It is merely necessary to apply the same formula to the higher figure. Thus if after preliminary study, or upon subsequent modification, it appears that $700 billion, for example, will be necessary, then, in such event, each taxable year will be required to produce its percentage of taxes on the $700 billion figure.

The new tax plan would enable the Government to keep current without long-term deficit financing. In any year in which the tax collections exceeded the actual outlays there would be a surplus to carry forward to the remaining taxable years. While the Treasury would not be on a "pay as you go" basis from year to year, it would not be behind at the end of the 10-year period. Through sound economic Government administration, with 10 high tax years, not only can current Federal needs be met, but a substantial reduction might be simultaneously made in the present national debt.

The 10-year tax plan is not intended as a panacea. It is proposed that our security costs be met by spreading our payments over a longer stretch. It is humbly submitted that this would be less shocking to the Nation's economy and the American people than a series of back-breaking tax loads shot at individual and corporate taxpayers in machine gun succession. It is only in this way that our country can remain capable of resisting financial bankruptcy from within and the challenges of foreign ideologies from without.

TABLE A.—*National income and taxes paid, 1939–50*

[In billions]

	National income [1]	Amount of taxes paid [2]		National income [1]	Amount of taxes paid [2]
1939	$72.5	$5.5	1945	$182.7	$44.4
1940	81.3	5.7	1946	180.3	40.9
1941	103.8	7.8	1947	198.7	40.0
1942	137.1	13.5	1948	223.5	42.4
1943	169.7	22.6	1949	216.8	40.5
1944	183.8	42.2	1950	[3] 236.2	39.0

[1] Based on calendar years. (Source: U. S. Deptment of Commerce, Bureau of Foreign and Domestic Commerce).
[2] Based on fiscal years ending June 30. (Source: U. S. Treasury Dept.)
[3] Estimates based upon incomplete data as submitted by Council of Economic Advisers. National ncome for fourth quarter reached annual rate of 254.7 billions.

TABLE B.—*Projected-10 year national income and taxes*

[In billions]

Fiscal year ending June 30	National income (conjectured)	Approximate percentage of over-all tax to be collected [1]	Approqimate amount of taxes to be collected [1]	Fiscal year ending June 30	National income (conjectured)	Approximate percentage of over-all tax to be collected [1]	Approximate amount of taxes to be collected [1]
1952	$280	8.46	$50.76	1958	$340	$10.27	$61.62
1953	300	9.06	54.36	1959	360	10.88	65.28
1954	320	9.67	58.02	1960	350	10.57	63.42
1955	340	10.27	61.62	1961	370	11.18	67.08
1956	330	9.97	59.82				
1957	320	9.67	58.02	Total	3,310	100.00	600.00

[1] Based upon estimated 10-year budget of $600 billion.

Senator HOEY. Mr. John W. Douglas.

STATEMENT OF JOHN W. DOUGLAS, PRESIDENT, REPUBLIC FOIL & METAL MILLS, INC., DANBURY, CONN.

Mr. DOUGLAS. Mr. Chairman, I would like to read my statement, if I might, sir. I will make it short.

Senator HOEY. Give your name.

Mr. DOUGLAS. My name is John W. Douglas, and I live in Brookfield Center, Conn., and I am president of the Republic Foil & Metal Mills, Inc., producers of aluminum foil, which is used for protective packaging, electrical condensers, insulation and other functional and decorative purposes. Cigarettes are a very good example of foil packaging..

The first page of the statement which I have points up what our problem is and, incidentally, it deals in facts and not generalities.

During the first year of our operation, which was 1947, we incurred a loss of $145,000, followed by losses in 1948 and 1949 of approximately $49,000; and in 1950 it turned about and made a profit of $138,000.

You will note that the net deficit for 4 years was $5,000 but that our Federal income tax for 1950 was $55,000, thereby bringing our deficit to $60,000.

What we want to impress is that after 4 years of operation and a deficit of $55,000, we had to pay $55,000 in Federal taxes, which was not from income but from invested capital and, gentlemen, that is confiscation.

Our company was incorporated in 1945; after 9 months of intensive study and investigation. We knew we would be dependent upon three producers the only three producers, of primary aluminum who our source of supply and also are our competition.

In addition, there were two well-established producers of aluminum foil who were independent producers. However, we felt that all things being equal we could compete along with these companies and make a fair amount of money by investing risk capital.

Our original thought was that we would require $750,000 of capital. However, later we were required to add about $200,000 so that our present capitalization is somewhat under $950,000. We need every penny of that. I want to emphasize again that that is risk capital, all private capital, and no loans from the Government or any similar source.

We raised our capital in 1946, and during that year we built our plant, and started to buy and install equipment. It was early in 1947, March, before we started our completely modern foil mill, which was the most up to date in the country, and it cost us $500,000.

Needless to say, during that year we lost considerable amounts of money because of ironing out the bugs in production.

In 1948 and 1949 we encountered a very serious raw-material shortage over which we had no control. That was due to the drought that cut power production and, therefore, cut down the production of aluminum. Being dependent upon the primary producers, and having no background, we virtually were faced with very difficult times.

However, we expected when we started out to have our share of obstacles, and we continued to exert our fullest efforts toward improving our processes, and increasing our production.

However, when you lose $243,000 in 3 years, or more than one-quarter of your capital, it certainly represents a pretty serious drain on your resources.

However, our confidence was justified in 1950 when we made approximately $238,000 before Federal taxes; and I want to emphasize that those profits were not due to defense work. We entered into defense work, but that replaces rather than supplements more profitable civilian business.

Now, when we started out originally, those of us who were to invest in this company, determined that after going through several hard years, we should make $250,000 a year, which we did in order to permit us to build up reserves, keep our plant going, and also pay a small dividend. That, of course, was based upon the taxes in effect at that time.

Unfortunately, now if we make $250,000 after taxes, we will actually be taxed 62 percent and, I may say, that starting last April we started to be taxed at 77 percent on every dollar we earned.

The source of our problem is the fact that we are unable to offset our 1947 losses against our income. This represents to us a serious inequality of treatment for two good reasons: First of all, established

companies are more favorably treated than we are and, secondly, corporations starting after 1949 have more favorable treatment.

First of all, before 1950, losses could be carried forward for 2 years and then carried back for 2 years. Obviously, if a corporation was established and had losses in 1947 it could offset those losses with profits in 1946 or even during the war year of 1945 and I understand through credit carry-back provisions of the excess-profits tax, they could even carry them back as far as 1943.

Therefore, established corporations had entirely different treatment. Not being in operation before 1947, we had no way to carry back our losses. We could merely carry them forward, and that certainly does seem to us to be discriminatory.

We had to compete with established companies. Of the eight companies with which we compete today, five were well established by the end of World War II, and those five companies do more than 75 percent of all the foil business. Three of them do all of the primary production of aluminum.

Second, last year Congress revised the loss carry-back and the carry-forward provision to provide a one-year carry-back and five-year carry-forward.

The purpose of this change, as this committee said, was, and I quote:

> to reduce the tax disadvantages which occur to businesses with fluctuating incomes.

The committee further said that—

> such incomes are associated with unusual business risks and occur relatively frequently among small and new businesses—

and we certainly are a small and a new business.

This provision does not apply to our losses since we incurred them before 1950.

However, if a competitor of ours started in business in or after 1950, they have the opportunity to carry losses forward to 1955; in other words, we will be at a distinct disadvantage as against them.

Now, unfortunately that statement is not fanciful. It is actually real. One of our competitors started in business in 1950 and another in 1951. As I say, we will be at a disadvantage, distinct disadvantage, against those companies.

Now, we are a little business, and we frankly are very proud of what we have accomplished.

We, perhaps, could call ourselves the Frank Merriwell Co. the way we have grown.

We now employ 120 people in Danbury, which heretofore suffered from the seasonal nature of its business, and our pay roll is over $500,000 a year.

We have proved that a small, independent company can succeed and can compete successfully and can assume leadership in an industry, but we cannot succeed if the tax burdens are unequal.

In that respect, I want to point out that at the present time to even maintain our position in the industry we should spend at least $150,000 on new plant and equipment and, gentlemen, we have not any money to spend for anything because we are being taxed out of even our capital.

Now, we do not want any special tax favors, and we want nothing but equal treatment, but as it is we are caught in the middle and we cannot move.

I am confident that Congress did not intend any discrimination such as I have described, and it does amount to discrimination against those who venture their capital and create employment.

The injustice of the law can be largely eliminated by a simple amendment, granting to new businesses established since World War II, the privilege of carrying over their 1946–49 losses for 4 years instead of 2, and we trust you will approve such an amendment.

I want to submit for the record and for the examination of your experts a draft of an amendment which, I am told, would be suitable, and that is attached to the statement.

Finally, I want to make a statement on the excess-profits tax, which you have probably heard a great deal about already.

As the tax is framed, it bears most heavily and unfairly on new, small and growing corporations. The relief formulas of the law afford no relief because they take no realistic account of the problems of small businesses.

For example, in our case our investment was made, as I told you before, on the basis of a profit of $250,000. Other companies which have been in operation for years, the companies we compete with, have had a base period in which to establish their earnings ability But we have no recourse except the arbitrary formulas in the present law which do not fit us, and they provide a credit less than half of what we regard as our normal earning record.

As I said before, we got into the 77-percent bracket in the latter part of March of this year. I think it is only fair that every new business have an opportunity to establish its normal earnings level. If no formula or method can be devised under which this can be done, we feel that the excess-profits tax should be scrapped, and the needed revenue obtained otherwise.

I wish to thank you, sir.

Senator HOEY. It is very good to have had you make this presentation.

Mr. Stam, of our staff will consider the amendment that you have proposed.

Mr. DOUGLAS. Thank you.

(The amendment referred to is as follows:)

AMENDMENT TO H. R. 4473

At the appropriate place in the bill, insert the following new section:

"SEC. —. NET OPERATING LOSS DEDUCTIONS.

"(a) ALLOWANCE OF FOUR-YEAR CARRY-OVER FOR NEW BUSINESSES.—Section 122 (b) (relating to the amount of carry-backs and carry-overs) is hereby amended by adding at the end thereof the following new subparagraph:

" '(c) NEW BUSINESSES—LOSS FOR TAXABLE YEAR BEGINNING AFTER 1945 AND BEFORE 1950.—In the case of any taxpayer not engaged in the active conduct of any trade or business before January 1, 1946, subsection (b) (2) (A) shall not apply, but if, for any taxable year beginning after December 31, 1945, and before January 1, 1950, such taxpayer has a net operating loss, such net operating loss shall be a net operating loss carry-over for each of the four succeeding taxable years, except that the carry-over in the case of each succeeding taxable year (other than the first succeeding taxable year) shall be the excess, if any, of the amount of such net operating loss over the sum of the net income for each of the interveing years computed—

" '(i) with the exceptions, additions, and limitations provided in subsection (d) (1), (2), (4), and (6), and

" '(ii) by determining the net operating loss deduction for each interveining taxable year, without rgeard to such net operating loss or to the net operating

loss for any succeeding taxable year and without regard to any reduction specified in subsection (c).

For the purposes of the preceding sentence, the net operating loss for any taxable year beginning after December 31, 1945, shall be reduced by the sum of the net income for each of the two preceding taxable years computed—

"'(iii) with the exceptions, additions, and limitations provided in subsection (d) (1), (2), (4), and (6), and

"'(iv) by determining the net operating loss deduction without regard to such net operating loss or to the net operating loss for the succeeding taxable year, and without regard to any reduction specified in subsection (c).'

"(b) EFFECTIVE DATE OF SUBSECTION (a).—The amendment made by subsection (a) shall be applicable in computing the net operating loss deduction for taxable years beginning after December 31, 1948."

EXPLANATION

This amendment adds a new subparagraph to section 122 (b) of the Internal Revenue Code to provide that taxpayers who established new businesses, that is, first engaged in the active conduct of a trade or business, in a taxable year beginning after December 31, 1945, and sustained a net operating loss for any taxable year beginning after December 31, 1945, and before January 1, 1950, may carry forward such loss (to the extent not absorbed as a carry-back) for four taxable years, in lieu of two taxable years, as provided by existing law. The amendment is applicable to taxable years beginning after December 31, 1948.

No change is made in the 2-year carry-back and 2-year carry-over available to taxpayers generally for losses of taxable years beginning before January 1, 1950; nor in the 1-year carry-back and 5-year carry-over available to all taxpayers for losses of taxable years beginning after December 31, 1949.

Senator HOEY. Mr. Hubert Rhodes. Have a seat, Mr. Rhodes, and identify yourself for the record.

STATEMENT OF HUBERT M. RHODES, CREDIT UNION NATIONAL ASSOCIATION

Mr. RHODES. My name is Hubert M. Rhodes, and I am appearing before you as a representative of the Credit Union National Association, with which approximately 8,000 of the 11,000 credit unions in the United States are affiliated.

Credit unions, but not the members thereof, have been granted exemption from the payment of Federal income tax under section 101 of the Internal Revenue Code. These organizations function under either State credit union laws or the Federal Credit Union Act. The latter provides that credit unions formed under it are subject to taxes only on real and tangible personal property. This is true in some of the States. Generally, credit unions are exempt from other taxation. It has been an encouragement in the formation and operation of credit unions for them to have exemption from the Federal income tax and we hope this tax status may be maintained.

A credit union may be defined as a cooperative association organized within well-defined groups of people for the twofold purpose of promoting thrift among its members and supplying them with needed loans for useful purposes at reasonable cost. Each credit union is confined in its sphere of operation to members of a specific group having a mutual bond of interest, such as occupation, association or residence. Members may save in modest amounts of 25 cents a month or more. Their pooling of savings creates a fund from which loans can be made to members at low rates of interest. The maximum interest rate may not exceed 1 percent per month on unpaid balances. Loans are made only to members.

The credit union is a service organization to promote systematic savings even when such may be in very modest amounts, and to help eliminate usurious charges for short-term personal loans. Out of the income derived from its low-cost loan service, the credit union pays expenses of operation and sets aside a portion of earnings each year as a reserve against possible bad loans. The remainder is available for the members to pay themselves interest on their savings accounts.

Each credit union is self-managed by directors and committees selected by and from members. None of these may be compensated for their services. They contribute time and effort for the welfare of their members. Credit unions may and do employ clerical assistance when that becomes necessary.

The credit union is not formed to make profits, it does not do business with the general public, and any financial return from its operation on a mutual basis is distributed to members. It is a self-help organization and one which Government, industry, churches, labor and others recognize for its value and benefit to people of small means.

We feel very strongly that the present tax position of the credit union should be maintained and, therefore, we wish to register opposition to any proposal which would make any change in this position.

Thank you, Mr. Chairman.

Senator HOEY. You want the law to remain the way it is as already provided?

Mr. RHODES. I beg your pardon?

Senator HOEY. You wish the law to remain as it is?

Mr. RHODES. Yes, sir. Thank you.

Senator HOEY. Robert B. Dresser.

Identify yourself for the record, please.

STATEMENT OF ROBERT B. DRESSER, ATTORNEY AT LAW

Mr. DRESSER. Mr. Chairman, my name is Robert B. Dresser. I am a member of a law firm with offices at 15 Westminster Street, Providence, R. I. I appear individually, in my own behalf, and not as a representative of anyone else.

In these days when our very existence as a free people is being threatened by Communist attack from without, it is doubly important for us to make certain that we are not destroyed by Communist influence from within.

One hundred years ago Karl Marx published his Communist Manifesto attacking the capitalistic or private enterprise system with its right of private ownership. His plan of attack was outlined in a platform of 10 planks, two of which related to taxation. They are as follows: 1, "A heavy progressive or graduated income tax;" 2, "Abolition of all right of inheritance"—in other words, a 100-percent inheritance tax.

By this means Marx knew that he could dry up the sources of capital and ultimately destroy the capitalistic system and establish communism in its stead.

In our present hodgepodge system of taxation the three taxes which serve these purposes best are: (1) The income tax, (2) the estate or death tax, and (3) the capital-gains tax.

The first of these, the income tax, if levied at sufficiently high and heavily progressive or graduated rates, will reduce one of the principal sources of capital on which industrial and economic progress depends. The death tax and the capital-gains tax are levies on capital, and likewise reduce the supply.

I am going to comment just briefly on the individual income tax, and then skip to the subject of estate and gift taxes, in order to comply with the 10-minute rule.

In the first place, I think it must be agreed that individual income taxes, under the present law, which are graduated from a rate of 20 percent on incomes of not over $2,000 to a high of 91 percent on incomes of over $200,000 are heavily progressive and that they answer the requirement of Marx's platform.

Secretary Snyder presented to the Ways and Means Committee on February 5 of this year a very revealing statement estimating the distribution of surtax net income in the calendar year 1951. From this it appears that the surtax net income—which is the net income after deducting the personal exemptions and credits for dependents—in the brackets over $10,000 amounted to only about $8,000,000,000, and that the taxes on this particular income amounted to $4,500,000,000, something over 50 percent, leaving a balance of $3,500,000,000.

It, therefore, appears that even if we should take every penny of the income in the brackets over $10,000, we would add only $3,500,000,000 to our present revenue, and, mind you, this is the group that has in the past supplied a large part of the capital needed for industrial expansion and for the maintenance of our industries.

Without this group, the Government must, of necessity, have supplied the funds, and that is a very far step toward the completely socialized state.

Now, coming to the matter of Federal estate and gift taxes, I submit that the levying of estate and gift taxes by the Federal Government should be abandoned and this field of taxation should be left exclusively to the States.

Under existing laws the tax on the estates of decedents runs to a high of 77 percent, and the tax on gifts to 57¾ percent. These rates are manifestly confiscatory, and they have very harmful economic effects. They not only seriously impair the incentive to work, produce, and save, but they are extremely destructive of capital and will in the long run destroy the accumulations of capital that are so necessary for industrial activity and expansion with the resultant beneficial effects on our economy and the people as a whole.

Moreover, the heavy taxation of large estates compels the rich to seek comparatively safe, liquid investments in order to provide for the heavy taxes that will be imposed upon their estates at death, thus further reducing the capital available for hazardous business ventures which have done so much to improve the lot of the American people.

There should be no fear that the absence of a heavy Federal estate tax would lead to an undue concentration of wealth in the hands of a few. The rule against perpetuities, inherited by us from the common law of England, forbids tying up the ownership of property for a longer period than a life or lives in being and 21 years. In other words, an estate must be divided among the heirs or beneficiaries in the second succeeding generation. From that time on the estate will be subject to a further subdivision with each generation, if it should

happen that there is any of it left to be divided. If the large estates are to be broken up, it is obviously better that this should be done by natural forces than by taxation. In the first case the capital continues in the hands of individuals. In the second it is taken by the Government.

Assuredly, the harm done to the economy by the present high rates is out of all proportion to the revenue produced, and cannot be justified by any argument based on fiscal needs. Even with the very high rates now in force, the revenue from these taxes is but a trivial part of the total budget—less than 1 percent, I understand, at the present time. According to my information, the revenue from estate and gift taxes in the calendar year 1950 was $610,000,000, and in the fiscal year 1950, $657,000,000, which is less than 1 percent of our total budget.

The imposition of death taxes, as you know, is not confined to the Federal Government. The individual States as well impose either estate or legacy taxes on death. The duplication of taxes by the State and Federal Governments has become a matter of grave concern, and it is important that steps be taken to end it. The field of taxation should be divided among Federal, State, and local governments in such manner as to eliminate duplication as far as possible. The field of death taxes should, I submit, be assigned to the States, the laws of which determine the right to dispose of property on death and the rights of inheritance.

The gift tax is, of course, merely auxiliary to the death tax, and they should both be dealt with alike.

I submit, therefore, that the levying of such taxes by the Federal Government should be abandoned and this means of taxation left exclusively to the States. Competition among the States would tend to keep the rates within reasonable bounds—rates which would be more in conformity with the excises imposed by our Federal and State Governments on other transfers of property.

I come next and lastly to the subject of capital gains and losses. In the first place, the gain resulting from a sale of a capital asset is in the eyes of the law capital, and, except for the purpose of taxation, it is commonly so treated under our laws. Accordingly, unless the legal concept of capital gains is ignored, a tax on capital gains must be regarded as a capital levy.

If, however, capital gains are to be treated as income for tax purposes, I submit that every consideration of equity and justice requires that capital losses shall be treated as the direct negative of income and that their deduction from income, of whatever character it may be, shall be permitted.

If capital gains are taxed as income and capital losses are allowed as deductions from income, in the light of past experience it is not unreasonable to expect that the net revenue over a period of years would be nil.

Secondly, the economic effects of a high capital-gains tax are decidedly harmful.

The capital-gains tax operates as a serious deterrent to the investment of capital in the equities of business enterprises, and its effect is to reduce steadily the fund of venture capital available for that purpose. It lessens the incentive to invest capital in existing and in

new enterprises, with the resulting ill effects on employment and wages.

A capital-gains tax lessens the stability and liquidity of markets, and by so doing seriously deters new capital issues which are so essential to business expansion and employment. The tax creates frozen positions in securities and real estate, and thereby restricts business activity and the taxable income normally resulting from such activity.

In the third place, a capital-gains tax, if imposed at high rates, produces but little revenue. On the other hand, if the rate is low greater revenue will be produced.

This is due to the fact that the taking of capital gains is discretionary. When the tax rates are high the owner elects not to sell, unless the sale will result in a loss, or at least in no substantial gain.

I might add that in the year 1940, the revenue from the capital-gains tax was $12,868,000; in 1941, it declined to $2,011,000, to practically nothing; in 1942, the law was changed, reducing the holding period from 24 and 18 months, respectively, to 6 months. The result was an immediate increase in revenue, and the revenue has been increasing, I believe, quite steadily since then, so that in the year 1945, which I believe is the last year for which the final figures are available, the revenue was $721,000,000. I am advised that for 1951, the Treasury has estimated that the revenue will amount to about $660,000,000 from individuals and fiduciaries, and $200,000,000 from corporations.

I might also add that the $721,000,000 for the year 1945 represents the revenue only from individuals and fiduciaries.

My recommendations in regard to the capital-gains tax are these:

While a very good argument may be made for not taxing capital gains at all, nevertheless, I believe that for the present at least the tax should be retained at a moderate rate and a short holding period prescribed to distinguish between short-term and long-term capital gains and losses. For this purpose, the 6-month period provided in the present law would seem to be reasonably satisfactory, although I believe that a shorter period would produce greater revenue. Six months happens to be the period provided in the Securities Exchange Act as the measure of a speculative turn. In no circumstances, I submit, should the holding period be lengthened.

Regarding the rate of the tax, I favor a flat rate of not more than 12½ percent, which is one-half of the present rate. I have no doubt that the lower rate, through removing in part at least the barrier to sales, would greatly increase the sales, and, coincidentally, the gains and the revenue from the tax.

Thank you very much, sir.

Senator HOEY. Thank you, Mr. Dresser.

Mr. DRESSER. May I have the privilege of filing a more complete statement?

Senator HOEY. That will be agreeable if you wish to file it.

Mr. DRESSER. May I send it from Providence or must I file it today?

Senator HOEY. No; send it to Senator George.

Mr. DRESSER. Thank you.

(The complete statement referred to is as follows:)

STATEMENT OF ROBERT B. DRESSER, REGARDING H. R. 4473, THE REVENUE ACT OF 1951

I. INTRODUCTORY STATEMENT

My name is Robert B. Dresser. I am a member of a law firm with offices at 15 Westminster Street, Providence, R. I. I appear individually, in my own behalf, and not as a representative of anyone else.

In these days when our very existence as a free people is being threatened by Communist attack from without, it is doubly important for us to make certain that we are not destroyed by Communist influence from within.

One hundred years ago Karl Marx published his Communist manifesto attacking the capitalistic or private enterprise system with its right of private ownership. His plan of attack was outlined in a platform of 10 planks, 2 of which related to taxation. They are as follows:

1. "A heavy progressive or graduated income tax."
2. "Abolition of all right of inheritance,"—in other words, a 100-percent inheritance tax.

By this means Marx knew that he could dry up the sources of capital and ultimately destroy the capitalistic system and establish communism in its stead.

The taxing power, which as aptly stated by Chief Justice Marshall "involves the power to destroy," was correctly recognized by Marx as the most potent weapon at his disposal to accomplish his objective. Any tax that would dry up the sources of capital would in the end destroy the capitalistic system.

In our present hodgepodge system of taxation the three taxes which serve this purpose best are (1) the income tax, (2) the estate or death tax, and (3) the capital-gains tax.

The first of these, the income tax, if levied at sufficiently high and heavily progressive or graduated rates, will reduce one of the principal sources of capital on which industrial and economic progress depends.

The death tax and the capital-gains tax are levies on capital, and likewise reduce the supply.

II. INDIVIDUAL INCOME TAX

Let us look first at the tax on individual incomes. Such taxes, under the present law, are graduated from a rate of 20 percent on incomes of not over $2,000 to a high of 91 percent on incomes of over $200,000. Assuredly, these rates are heavily progressive and will of themselves, I submit, if continued for a long enough period of time, destroy our system of private enterprise and our American form of Government, and force us into some form of socialism or communism. This process is greatly accelerated by coupling with these high rates on individual incomes, heavy taxes on the incomes of corporations.

The process by which this is accomplished is simple:

1. By increasing to an excessively high rate the taxes on industry and on those who invest capital in industry, the supply of capital for industry is reduced.
2. Less capital for industry means less business and incidentally less demand for labor and lower wages. Continued reduction in the capital supply leads to business stagnation and ultimately to the Government's supplying the capital.
3. If the Government supplies the capital, it eventually acquires ownership or control and we have socialism or communism.

Accordingly, if communism or socialism is to be avoided, it should be our objective to increase rather than decrease the capital supply.

In this country it has been sought to justify the graduation of tax rates on the ground of the ability of the taxpayer to pay. "Taxation according to ability to pay" is a political slogan, and not an economic concept having any defined limits or based upon any scientific principle. Carried to its logical conclusion, it would mean the reduction of all incomes after taxes to the same level—the goal of the Communists. Those who support the graduation of tax rates, whether they realize it or not, are following the Marxian doctrine.

Without a constantly increasing supply of capital for investment in productive enterprise no nation can be prosperous. For example, from $8 billion to $10 billion of new capital is needed each year merely to give employment to the net annual additions to the labor force, to say nothing of other needs.

It is the so-called venture or risk capital, of course, that is the most important—capital required by new and hazardous enterprises, such as the railroads, the automobile industry, the aircraft industry, and many others, which have provided jobs and good wages for millions.

Such enterprises, however, are risky. Many of them fail and the investor loses his investment. If high taxes take the great bulk of profits where the enterprise is successful, the incentive to invest is destroyed.

The average American produces more and earns more than the citizen of any other nation because he is assisted by a larger investment in plant, equipment, and other assets. For example, aided by an investment of $25,000 per employee in the railroad industry, an American railroad worker earns and is paid wages 100 times those paid a Chinese coolie who performs the same service without the aid of any equipment. Take from the American worker the railroad equipment and leave him with nothing but his bare hands, and his high wages would disappear.

Likewise, a primitive Hindu textile worker earns a few pennies a day with her cheap, inefficient hand loom on which she can make but a few yards of cloth in a day. Aided by an investment per employee of $6,000 in modern machinery and equipment and other assets, the American textile worker produces hundreds of yards of cloth daily and earns an average of over $10 a day.

In the United States 90 percent of the work today is done by machinery. It is this machinery that has made the high wages and high standard of living possible.

The capital required to provide the machinery and equipment that have so greatly improved the lot of the American worker comes from the savings of corporations and individuals. Only a small percentage of the people, probably not over 10 percent, however, save money for investment in productive enterprise. The great bulk of the capital supplied by individuals comes from those having the larger incomes. Excessive taxation not only discourages the investment of capital in industry, but it greatly reduces these savings which constitute the source of supply.

On February 5, 1951, Secretary of the Treasury Snyder submitted to the House Ways and Means Committee a most important statement, from which the following appears:

1. Out of a total of $90 billion of surtax net income over $62 billion (or more than two-thirds) is in the bracket under $2,000, $82 billion is in the brackets of $10,000 and under, and only $8 billion is in the brackets over $10,000.
2. The amount of the present taxes on this $8 billion of income is $4,500,000,000.
3. By confiscating the entire balance of this $8 billion of income, only $3,500,000,000 would be added to the Government revenue.

This last group has in the past, however, furnished a large part of the capital needed to maintain and expand industry. The maintenance of this source of capital supply is of vital importance.

Moreover, it is a fact, I believe, that a moderate rate of tax on income will, in the long run, produce more revenue than a high rate.

The principle involved is the same as that governing the operation of a successful business, namely, that within certain limits the greatest profits come from charging a low rather than a high price for goods sold. As high prices lessen the ability and incentive to buy, so high tax rates lessen the ability and incentive to produce.

In this connection, I wish to call your attention to the testimony of Dr. Willford I. King before this committee on July 5. In the course of his testimony he submitted the results of a study which revealed the fact "that the levying of confiscatory rates destroys the income from which the fiscal authorities have expected to gain revenue. Surprisingly enough," he states, "this destruction occurs to such an extent that income-tax rates taking more than 26 percent of the incomes of individuals have succeeded in raising no more revenue than could have been obtained by a 26-percent rate," and that "the thing which the levying of rates higher than that level has actually accomplished is to prevent the possibility of saving by the wealthy, and thus to dry up what formerly was the chief source of venture capital for founding new enterprises and for expanding old enterprises."

At the present time about 80 percent of the total revenue of the Federal Government is being derived from taxes on the income of individuals and corporations. I submit that this is unsound.

There can be no doubt, I think, that a sales or excise tax is a much sounder way of raising revenue. It does not have the damaging effect on the capital supply and the incentive to produce that is present in the case of the income tax, and it is a much more stable source of revenue, since it is less affected by current business conditions. It should, therefore, be used by the Federal Government to supply a much larger proportion of its revenue.

Accordingly, I submit that there should be no further increase in the taxes on the incomes of those persons who have been supplying a large part of the capital for industry. On the contrary, I submit that these taxes should be reduced.

III. FEDERAL ESTATE AND GIFT TAXES

The levying of estate and gift taxes by the Federal Government should be abandoned and this field of taxation should be left exclusively to the States

Under existing laws the tax on the estates of decedents runs to a high of 77 percent, and the tax on gifts to 57¾ percent. These rates are manifestly confiscatory, and they have very harmful economic effects. They not only seriously impair the incentive to work, produce, and save, but they are extremely destructive of capital and will in the long run destroy the accumulations of capital that are so necessary for industrial activity and expansion with the resultant beneficial effects on our economy and the people as a whole.

Moreover, the heavy taxation of large estates compels the rich to seek comparatively safe, liquid investments in order to provide for the heavy taxes that will be imposed upon their estates at death, thus further reducing the capital available for hazardous business ventures which have done so much to improve the lot of the American people.

It should be realized that rich men, such, for example, as the late Henry Ford, play a very important part in our economy. They and their families can personally consume and enjoy but a trivial part of their wealth. The balance is in effect held by them as trustees for the public. It is this wealth that has supplied in the past much of the venture or risk capital required by new and hazardous enterprises, such as the railroads, the automobile industry, the aircraft industry, and many others, as well as for the expansion of existing enterprises. By this means jobs and good wages have been provided for millions of workers. The automobile industry furnishes an excellent illustration. Based upon 1949 reports, the number of jobs created directly and indirectly by the automobile industry, which is only about 50 years old, is over 9,000,000. This is 1 out of every 7 persons now employed in all classes of employment in the United States.

Such enterprises, however, are risky. Many of them fail and the investor loses his investment. Hence, he must have funds that he can afford to risk. Most people do not have such funds, and banks, insurance companies, and trust estates are not permitted to make such hazardous investments. High death as well as high income taxes destroy the incentive and the ability to incur such risks.

Does anyone doubt that the wealth of Mr. Henry Ford was of far greater benefit to the people of this country in his hands than it would have been in the hands of the Federal Government? He used it to develop a great industry which has given employment at good wages, directly and indirectly, to hundreds of thousands of people. In the hands of the Federal Government the money would soon have been dissipated in the construction of nonproductive post offices and other Government buildings and in paying the costs of an unduly expanded bureaucracy.

It is indeed significant that the Communist platform of Karl Marx, as previously stated, contains the following plank: "Abolition of all right of inheritance."

There should be no fear that the absence of a heavy Federal estate tax would lead to an undue concentration of wealth in the hands of a few. The rule against perpetuities, inherited by us from the common law of England, forbids tying up the ownership of property for a longer period than a life or lives in being and 21 years. In other words, an estate must be divided among the heirs or beneficiaries in the second succeeding generation. From that time on the estate will be subject to a further subdivision with each generation, if it should happen that there is any of it left to be divided. If the large estates are to be broken up, it is obviously better that this should be done by natural forces than by taxation. In the first case the capital continues in the hands of individuals. In the second it is taken by the Government.

Assuredly, the harm done to the economy by the present high rates is out of all proportion to the revenue produced, and cannot be justified by any argument based on fiscal needs. Even with the very high rates now in force, the revenue from these taxes is but a trivial part of the total budget—less than 1 percent, I understand, at the present time. I am advised that the revenue collected from these taxes was $657 million in the fiscal year 1950, and $610 million in the calendar year 1950.

The imposition of death taxes, as you know, is not confined to the Federal Government. The individual States as well impose either estate or legacy taxes on death. The duplication of taxes by the State and Federal Governments has become a matter of grave concern, and it is important that steps be taken to end it. The field of taxation should be divided among Federal, State, and local governments in such manner as to eliminate duplication as far as possible. The field of death taxes should, I submit, be assigned to the States, the laws of which determine the right to dispose of property on death and the rights of inheritance.

The gift tax is, of course, merely auxiliary to the death tax, and they should both be dealt with alike.

I submit, therefore, that the levying of such taxes by the Federal Government should be abandoned and this means of taxation left exclusively to the States. Competition among the States would tend to keep the rates within reasonable bounds—rates which would be more in conformity with the excises imposed by our Federal and State Governments on other transfers of property.

IV. TAXATION OF CAPITAL GAINS AND LOSSES

A. Capital gains are not income in the legal sense of the term, but capital

The gain resulting from a sale of a capital asset is in the eyes of the law capital, and, except for the purpose of taxation, it is commonly so treated under our laws. Take, for example, the case of a trustee who sells property belonging to the trust estate at a gain. The gain is not treated as income and paid to the life beneficiary, but is added to the capital of the trust estate. Conversely, capital losses suffered by a trust estate are charged against capital and not against income. Accordingly, unless the legal concept of capital gains is ignored, a tax on capital gains must be regarded as a capital levy.

If capital gains are to be treated as income for tax purposes, it is submitted that every consideration of equity and justice requires that capital losses shall be treated as the direct negative of income and that their deduction from income, of whatever character it may be, shall be permitted.

Our income-tax laws, in order to arrive at the net income to be taxed, permit the taxpayer to deduct from gross income of all sorts such items as interest paid, taxes paid (with certain exceptions), depreciation, and various other items. What would be said if it should be proposed that interest paid should be deductible only from interest received, that taxes paid should be deductible only from income from the property on which the taxes are paid, that depreciation should be ductible only from income from the property depreciated? The taxpayer might have no interest receivable or income from the property taxed or depreciated. Certainly, any one of these proposals would be summarily rejected. And yet, why should capital losses be treated differently? If short-term capital gains are to be taxed as ordinary income, what possible justification is there for not permitting short-term capital losses to be deducted from ordinary income? Manifestly, there is none.

In short, capital gains are either income or they are not income. If for tax purposes they are regarded as income, capital losses, which are the direct converse of capital gains, should be deductible from income. If capital gains are not income, they should not be taxed as income, and, conversely, capital losses should not be deducted from income.

If capital gains are taxed as income and capital losses are allowed as deductions from income, in the light of past experience it is not unreasonable to expect that the net revenue over a period of years would be nil.

B. The economic effects of a high capital-gains tax are decidedly harmful

The capital-gains tax operates as a serious deterrent to the investment of capital in the equities of business enterprises, and its effect is to reduce steadily the fund of venture capital available for that purpose. It lessens the incentive to invest capital in existing and in new enterprises, with the resulting ill effects on employment and wages.

In a statement filed with the House Ways and Means Committee on March 20, 1942, by the tax committee of the executive council of the American Federation of Labor it is said:

"One tax which has an important effect in slowing up investment in new venture enterprises is the present capital-gains tax. If this is not repealed by the new 1942 Revenue Act, it should be sharply modified to tax capital gains at lower rates, and to liberalize the provision for the deduction of capital losses. Failure to take such action in earlier laws has led to a sharp reduction in capital available for new venture enterprises, because of the heavy taxes involved if the business venture is successful, and because of the denial of reasonable credits against other profits if the new venture is not successful."

A capital-gains tax lessens the stability and liquidity of markets, and by so doing seriously deters new capital issues which are so essential to business expansion and employment. The tax creates frozen positions in securities and real estate, and thereby restricts business activity and the taxable income normally resulting from such activity.

Writing in the Tax magazine for September 1937, the late Morris S. Tremaine, Comptroller of the State of New York, referring to the capital-gains tax, said:

"The law dams up the normal ebb and flow of trade. It affects commodity markets, especially real estate. Because of this, many real estate owners have refused attractive offers of purchase, with the result that, in addition to sellers missing a sale, brokers miss commissions, the buyer is prevented from buying and improving property, contractors miss a job, a materialman misses the market, building construction labor and building service labor remain unemployed, the city misses and increased tax on proposed new building, and, lastly, fantastically enough, the Government collects no capital-gains tax."

On March 20, 1942, at a hearing before the House Ways and Means Committee on the capital-gains tax, André Istel testified about the experience of France. Mr. Istel, who was technical adviser to the French Ministry of Finance under Paul Reynaud, stated that prior to the German invasion, France had no capital-gains tax. In March 1941, he said, the Vichy government introduced a tax on capital gains from stocks at a rate of 33 percent, and without limit as to the period of holding. In the words of Mr. Istel:

"The effect of the law was exactly contrary to expectation. The buyers of shares became more reluctant than ever to sell, as they wished to avoid paying the tax. Owing to the scarcity of offerings, the market thereupon rose even more sharply. In fact, owing to the complete absence of shares offered for sale, some stocks were not quoted at all, for days at a time.

"As a result, the Vichy government was compelled to relax the provisions of the law. In July 1941 the rate was reduced from 33 to 20 percent, and the holding period which was unlimited was reduced to 1 year from the date of purchase. After 1 year, capital gains were free of tax.

"In February 1942 the law was relaxed further in order to accomplish its original purpose. The rate was reduced to 10 percent. The time limit was reduced to 3 months. No tax was payable on gains realized after the 3 months' holding period."

C. A capital gains tax, if imposed at high rates, produces but little revenue. On the other hand, if the rate is low greater revenue will be produced

This is due to the fact that the taking of capital gains is discretionary. When the tax rates are high the owner elects not to sell, unless the sale will result in a loss, or at least in no substantial gain. Senator Connally brought out this point very clearly when he said at the hearings before the Senate Finance Committee on the Revenue Act of 1938:

"It seems to me there is a differentiation between ordinary income and income from capital gains. In the case of ordinary income the taxpayer has to pay it (the tax); he has no choice. But in the case of capital gains he has a choice; he does not have to realize unless he wants to. * * * If the holder does not sell, you do not get any tax. * * * I am coming around to the view that as to capital gains and losses we should make it more attractive to a man to sell instead of offering him a premium to hold."

Our experience under the various revenue acts in effect since 1913 amply supports the conclusion that the lower rate produces the larger revenue. From the Treasury Department's own figures, it appears that if the 5-year boom, 1925–29, is excluded, the taxpayers of the United States had no net capital gains, but huge net capital losses, amounting to over $8 billion, during the period from 1917 to 1940. For the calendar year 1940 the revenue produced by the capital gains tax, according to the Treasury figures, was $12,868,000, and for the calendar year 1941, $2,011,000. The shortening of the holding period from 18 and 24 months to 6 months by the 1942 act, and the consequent reduction of rates on certain gains previously classed as short-term, resulted in a substantial increase in the revenue from the capital gains tax, which had about reached the vanishing point. It is my understanding that the revenue from this tax for the fiscal year 1945 (the latest year for which, I am advised, the final figures are available) was $721,000,000.

D. Recommendations

While a very good argument may be made for not taxing capital gains at all, nevertheless, I believe that for the present at least the tax should be retained at a moderate rate and a short holding period prescribed to distinguish between short-term and long-term capital gains and losses. For this purpose, the 6-month period provided in the present law would seem to be reasonably satifsactory, although I believe that a shorter period would produce greater revenue. Six months happens to be the period provided in the Securities Exchange Act as the

measure of a speculative turn. In no circumstances should the holding period be lengthened.

Regarding the rate of the tax I favor a flat rate of not more than $12\frac{1}{2}$ percent, which is one-half of the present rate. It happens also to be the rate under the 1921 and later acts prior to the Revenue Act of 1934. I have no doubt that the lower rate through removing in part at least the barrier to sales would greatly increase the sales, and, coincidentally, the gains and the revenue from the tax.

I further suggest that some measure of relief be granted to the present inequitable treatment of capital losses. This would be accomplished by restoring the rule in force under the Revenue Act of 1924 and subsequent acts up to the act of 1934, which permitted a percentage of the actual net long-term loss equal to the rate of tax on long-term gains (which was $12\frac{1}{2}$ percent) to be taken as a credit against the tax on ordinary income for the current year.

V. CONCLUSION

The time has come for the question to be squarely faced and answered, "Do the American people want free enterprise and constitutional government, or do they want socialism?" Let there be an end to the mistaken idea that we can for long have free enterprise and at the same time confiscatory taxes. We cannot have both. If the people, or a majority of them, want socialism, let the Government take over without further ado, and let us give the experiment a try.

If, on the other hand, the people want free enterprise and our present constitutional form of government, let us stop doing the things that make it impossible for that system permanently to survive, and that means, among other things, to stop the confiscation of capital and the sources of capital by the Government.

Let more attention be given to the cutting of unnecessary expenditures and less to the raising of revenue to pay for the billions that are being wasted. It is of great importance, of course, that the budget be balanced, but the first step is to reduce expenditures by eliminating every unnecessary item.

The experience of England should be a warning to us. For many years England has had a heavy graduated income tax on individuals and a heavy tax upon inheritances. These taxes have so reduced the supply of capital that there is not enough now to provide her industries with the capital needed for modern machinery and equipment. At the same time, England has definitely accepted socialism and a part of her industries have already been nationalized. The effect has been to decrease production and efficiency.

Meanwhile, since the close of World War II, England has been receiving billions of dollars of aid from this country to prevent the collapse of her experiment in socialism.

It is instructive in this connection to read the following statement made by Dr. Carl Snyder in his book, Capitalism the Creator, published in 1940 (at p. 345):

"The purpose of progressive-income taxation is to strike hardest at these large incomes, the chief source of new capital supply. The State now expropriates a considerable portion of the income of the rich, the heavy saving class. With what result? The danger of extinguishing the larger part of the capital supply. *This seems what has happened in England in recent years. Not merely an impression. It is the conclusion of a competent student of the distribution of income in Great Britain, Colin Clark. And the outcome has been just that which might be predicted, a steady retardation of growth in British industry.*" [Italics mine.]

APPENDIX

1. The harmful effects of the excessive taxation of income is well pointed out by Dr. Irving Fisher and Mr. Herbert W. Fisher, in chapter 9 of their book on constructive income taxation. It is said that in 40 years the fortune of Henry Ford increased from $1,000 to $1,000,000,000, which is at the average annual rate of 41.42 percent compounded. In the hypothetical case, using round figures for simplicity, it is supposed that an automobile business was started in 1900 with an investment of $1,000, and that, with no income tax, its net worth increased at the compound rate of 40 percent a year. This would give it a value at the end of 40 years of $700,500,000. Then, by contrast, it is supposed that there was a 100 percent tax, and that despite this the business continued to produce income before taxes of 40 percent a year, or $400. This is admittedly an impossible case, since no one would operate without a chance of profit. It is chosen merely for simplicity of exposition.

At the end of 40 years, instead of having a net worth of $700,500,000, the business would have its original net worth of $1,000 and the Government would have collected in taxes $16,000 at the rate of $400 per year. Had the Government not collected these taxes, it would have had to obtain the money elsewhere. Assuming that it borrowed the money and paid as high a rate of interest as 5 percent, the $16,000 with compound interest at this rate would have amounted to but $48,320 at the end of 40 years. Compare this with the revenue which might have been obtained from an estate or inheritance tax of, say, 10 or 20 percent on $700,500,000, the net worth of the business at the end of 40 years with no income tax.

With an 80 percent income tax, instead of a 100 percent tax, the net worth of the business at the end of 40 years would have been $21,700 and the Government would have collected $82,600 in taxes. With a 50 percent tax the net worth at the end of 40 years would have been $1,470,000, and the taxes collected $1,470,000. With a 20 percent tax the net worth at the end of 40 years would have been $66,500,000, and the taxes collected $16,600,000. In other words, as the tax rate decreases, both the revenue and the net worth of the business increase.

In all of these cases, in addition to the revenue from the income tax, there would, of course, be the revenue from the estate or inheritance tax upon the death of the owner.

2. In his book, Taxation: The People's Business, published in 1924, Mr. Andrew W. Mellon, then Secretary of the Treasury of the United States, in discussing this question said (p. 16):

"It seems difficult for some to understand that high rates of taxation do not necessarily mean large revenue to the Government, and that more revenue may often be obtained by lower rates. There was an old saying that a railroad freight rate should be 'what the traffic will bear'; that is, the highest rate at which the largest quantity of freight would move. The same rule applies to all private business. If a price is fixed too high, sales drop off and with them profits; if a price is fixed too low, sales may increase, but again profits decline. The most outstanding recent example of this principle is the sales policy of the Ford Motor Car Co. Does anyone question that Mr. Ford has made more money by reducing the price of his car and increasing his sales than he would have made by maintaining a high price and a greater profit per car, but selling less cars? The Government is just a business, and can and should be run on business principles."

The committee will recess until 10 o'clock in the morning.

(Whereupon, at 4:10 p. m., a recess was taken until 10 a. m. Thursday, July 19, 1951.)

REVENUE ACT OF 1951

THURSDAY, JULY 19, 1951

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

The committee met pursuant to recess at 10 a. m. in room 312, Senate Office Building, Senator Harry F. Byrd presiding.

Present: Senators Byrd, Kerr, Millikin, Taft, Martin, Williams, and Flanders.

Also present: Elizabeth B. Springer, chief clerk, Colin F. Stam, chief of staff, Joint Committee on Internal Revenue Taxation.

Senator BYRD. We will come to order. The first witness is Mr. Booth. Will you please identify yourself and proceed.

STATEMENT OF R. C. BOOTH, VICE PRESIDENT, GRAIN AND FEED DEALERS NATIONAL ASSOCIATION; ACCOMPANIED BY RAY B. BOWDEN, EXECUTIVE VICE PRESIDENT, GRAIN AND FEED DEALERS NATIONAL ASSOCIATION

Mr. BOOTH. Thank you, sir.

Mr. Chairman, and members of the committee, my name is R. C. Booth, and my home is in Cedar Rapids, Iowa, in an area where I operate a small grain and feed business.

I am appearing here today as vice president of the Grain and Feed Dealers National Association, which has its principal office in St. Louis, Mo. The national association of the grain and feed trade was organized in 1896, and always has considered its first interest to be that of the country grain elevator and the local feed distributor and retailer. The national association has about 1,300 direct members and 43 affiliated associations in States and regions.

Our request to you today is that Congress give us relief from the unjust Federal tax discrimination between competing members of our industry. In short, that Congress equalize Federal corporation income taxes between the cooperatives and the proprietary firms with which they compete.

Since preparing this statement I have reread the text of an amendment to the bill before you, offered by Senator Williams of Delaware. May I interject here a comment that I believe our policy statement would follow and support Senator Williams' amendment.

Senator KERR. You believe what?

Mr. BOOTH. I believe our association's poilcy statement would follow and support Senator Williams' statement as far as it goes toward equalization of this tax disadvantage. While our policy resolution calls for complete equalization of taxes, we would welcome each and every step made in that direction.

The policy of our national association in matters of this kind is set forth in resolutions adopted by our membership at each annual meeting. A policy asking for equal taxation between corporations competing in our industry, has been restated for a number of years. At the annual meeting of 1950 the members adopted the following resolution: May I simply state this: The resolution is a simple demand for fair play and equal rules for all.

It is as follows:

> The long-standing position of this association in favor of equalization of taxation is hereby affirmed. There is no good reason why two firms doing the same kind of business with the same kind of facilities should not pay Federal income taxes on the same basis, upon all their profits, regardless of method of distribution. Yet some cooperative corporations admittedly enjoy a unique tax-exemption privilege which, in a field as highly competitive as is the grain business, is translated into a tremendous business advantage. But higher taxes will again widen the disadvantage between these two classes of business, which is very serious to the small grain and feed firms in our industry, and is proving to be ruinous competition. The fact that many cooperative leaders, including some of our own menbers, advocate the equalization of this advantage is sufficient evidence of the essential fairness of our request, that the tax inequities be eliminated once and for all. It is certainly not an unreasonable or an unfair request to ask that cooperatives pay taxes upon all of their profits. Cooperatives enjoy the benefits of our Government and our national defense and should contribute to the cost in the same manner as do their private competitors. Any interpretation of this as an 'anti-co-op' stand must be regarded as an effort to convert the issue into something more than it is—simply a demand for fair play and equal rules for all.

Gentlemen, I happen to be one of those small grain and feed dealers who has seen cooperative competition at first hand. Cooperative members are also frequently customers of my firm; they are my neighbors and my friends. I know them as good farmers, and they are businesslike in the management of the cooperative corporations which do business in exactly the same manner as others in our trade. If you were to visit one of the towns in my area of Iowa, you could scarcely see any physical differences in the plants or in the management practices between cooperatives and proprietary grain elevators. But there are wide differences, which is understood by the cooperatives as well as by their competitors. The difference lies in the fact that a proprietary firm is under a heavy Federal corporate tax burden, while a great many cooperatives are exempt. The difference between us in competition is not something that grew up in Iowa—it is something that the national Congress has done in setting up a trade advantage for the cooperative.

Senator KERR. You say that the cooperative is exempt. What do you mean by that?

Mr. BOOTH. I am not an expert, sir, in the details of the Federal law, except that under the corporate structure of the average cooperative, they are not required to pay taxes before any allocation of their funds.

That is how I understand it.

Senator KERR. Because of what?

Mr. BOOTH. They are not required to pay taxes before any allocation of any of their earnings.

Senator KERR. Well, are not partnerships as such, exempt from taxation?

Mr. BOOTH. As I understand partnerships; yes, sir. Not corporations.

Senator KERR. Sir?

Mr. BOOTH. Not corporations.

Senator KERR. Well, is not the cooperative an organization of men working together more or less as a partnership?

Mr. BOOTH. You are getting into some technicalities which I will cover later in my statement.

Senator KERR. Would you rather not have the question?

Mr. BOOTH. I believe you will find that part of the questions——

Senator KERR. I say, would you rather not have the question?

Mr. BOOTH. Yes.

Senator WILLIAMS. Mr. Chairman, I think I can clear up what the Senator from Oklahoma has in mind.

The Treasury Department confirms it and it is also confirmed and it was by the witness yesterday on behalf of the National Grange, the Master, that in a cooperative organization, there is a certain portion of the earnings that can be set aside as a reserve for future expansion or for prospective needs, and which they do not have to allocate to their members nor does the corporation pay any taxes, or the members pay any taxes. I mean, that is an admitted fact now, there is no dispute about it.

Now, in a partnership there is no such allocation of earnings. You cannot compare the corporate structure to partners. The partnership cannot write up a future expansion and deduct it from this year's earnings—deduct from this year's earnings the cost of a building or plant that they are going to build next year or 2 years from now. The Treasury Department through an interpretation of the existing law, has been allowing these cooperative corporations to write off the cost of buildings and expansion prior to their construction without allocating that to the members, and there is no tax paid either by the members or by the corporation.

Senator BYRD. In a partnership the profits are arbitrarily taxed—the profits of each partner, regardless of whether or not he receives the cash or anything else.

Senator WILLIAMS. Yes, sir.

Senator BYRD. Whatever the profits are, they are taxed directly to the partners.

Senator KERR. Well, the witness has said that this cooperative is exempt, and I am aware of the fact that part of the earnings of a cooperative, so long as they are held in reserve and not distributed, are not presently subject to taxation, but I did not know it was ipso facto exempt from taxation.

I was under the impression that there were many requirements and that some of what they did was exempt and some of what they did was not exempt, and some of them are exempt and some are not.

I just do not believe that the statements that the cooperative as such is exempt; that is what I was trying to bring out.

Senator WILLIAMS. I think, Mr. Chairman, if I might add, there are two different classifications of cooperative: One which the Treasury Department lists as being in the tax-exempt status, and the other which is in the non-tax-exempt.

Those non-tax-exempt. Those non-tax-exempt do pay a substantial part of the taxes, perhaps, but they do have a classification in the Department where certain cooperatives are classified as being wholly tax-exempt.

I think that phrase is correct.

Senator BYRD. You may proceed.

Mr. BOOTH. Mr. Chairman, I would like to correct a statement here. I would like to correct a statement that I made to Senator Kerr. I do not object to questions. I was referring to questions during the reading of the text of my statement.

I believe that part of the questions that might be asked will be answered during the balance of the reading.

Senator KERR. Well, the other day there was a Senator on the floor who asked me if he knew what I was going to ask him, he would know what answer to make to the question that I would ask.

So, if I knew I was going to find the answer to the questions I was going to ask, in your paper, I was going to say perhaps I had better leave the room because I would rather not be in a position where my mind was being read. [Laughter.]

Mr. BOOTH. Such situations as this I have been afraid of.

The money we may earn in a year, which is going in an ever-increasing proportion to federal taxes, may be retained by the cooperative for expansion of their plant. In brief, they can build and expand on the same portion of their earnings that we must pay for taxes.

Senator KERR. You say the money you earn is being retained by the cooperative?

Mr. BOOTH. No, sir. I do not believe I said that the money we may earn in a year, which is going in an ever-increasing proportion to the payment of Federal taxes may be retained by the cooperatives for the expansion of their plant, the same earnings, the type that we make.

In brief, they can build and expand on the same portion of their earnings that we must pay for taxes.

May I offer a personal experience.

In Iowa in 1948 a small grain elevator that I owned in a small town was burned. It was an old plant and I had only $11,000 in insurance, all the insurance I could obtain, because of its age, but not enough to even begin to finance rebuilding.

For a year and a half I studied the problem of rebuilding, but found the financing difficult for my small firm if I were to build a suitable new elevator.

Then the cooperative came in with more funds and credit than I could obtain, and built a modern new storage facility.

Had I been able previously to set aside in reserves, on the same business as the cooperative was able to do, the amounts that I had paid in Federal taxes, I would have been better able to rebuild and maintain a facility in the town where I long had been in business.

For a number of years our national association has tried to point out to the Congress that proprietary business cannot survive against this privileged competition. If the Congress refuses to equalize this taxation, and increases the discrimination by increasing the tax rate, proprietary business as we smaller fellows in the grain and feed business know it, must weaken and eventually pass out of the picture. That already is happening—it has been happening for some years. The smaller independent merchants gradually have been selling out to the growing cooperative competitor, or to one of the large integrated proprietary businesses which can better meet the pressure from Government and co-ops.

It does not require any fine splitting of legal terms to see and to understand what actually is happening in the country. Like you, we have read many of the involved arguments about the legal aspects of the proposed taxation of cooperatives. I am not competent to argue these legal questions, nor to interpret the tax tables of the statisticians. But I do know what is happening in competitive practice in the grain and feed business, and I can tell you from experience that this exemption of cooperatives from Federal corporation taxation is seriously weakening the small- to middle-size proprietary taxpayer in our business.

We come to you gentlemen with the very urgent request that you avoid technicalities and dig down to the fundamental question involved—that you face squarely the evident fact that your discrimination has set up two classes of competitors in our business. One class, long financially favored by you, is growing rapidly under tax exemption favors; the other group is rated second-class by your action and must pay heavy taxes merely because it consists of proprietary corporations.

If Congress maintains the theory that it must actively favor these cooperatives in business, then we urge you to face squarely now, the plain fact that you favor the gradual drying up of present sources of Federal revenue from our corporations. If, in the minds of you men in Congress, the cooperative idea and system are so good that they merit a very important competitive advantage under law, then the corollary is that you believe that American business should go cooperative, or perish under legal discrimination. If this latter is the position that you take, either by your action or your inaction, then you owe it to the businessmen of America that you state it at once in clear terms so all may be on guard.

If the Congress should bravely and honestly announce a policy that for our grain and feed business, or for any similar business, it is the considered judgment of the Nation's legislators that the proprietary taxpaying type of business is inferior, unwanted, and to continue under tax discrimination, then at least it would be a straightforward policy that we would know how to meet in the country.

But we have come to a blank wall of inaction. We are told that you definitely are not trying to drive business into the cooperative form, but that instead you respect and want to encourage Americans to risk their funds and their labor in a proprietary type of business, a business from which you draw an important part of your Federal funds. You seem even to agree with us that the untaxed cooperative has a distinct competitive advantage, but that you do not believe in this discrimination between forms of taxpaying business.

In our opinion, and this is not said with any inference of discourtesy—some Members of Congress hesitate to take up this cooperative tax problem because they know that in their area they can count proprietary grain firms by tens, while they can count cooperative member voters by hundreds. We maintain that this is one of the delusions of our whole present confusion. It is our honest opinion that individual farmers are willing to see their cooperatives operate on the same tax basis as their competitors. In our own experience, the farmers who are themselves in a proprietary business called farming, generally prefer to trade with an established proprietary firm off

the farm just so long as that firm gives them fair and equal treatment, and provides the facilities they need.

We do not find any conviction among the majority of farmers that they should have some peculiar legal advantage enabling them to take over the grain business, the oil business, the lumber yards, or other forms of off-farm business. On the contrary, farmers have often complained when proprietary corporations have set up farming enterprises within a State and have often and vigorously supported State laws against corporation farming. One Member of Congress recently has said that although he openly favored the equal taxation of cooperatives, the farmers of his district did not resent it but continued to vote for him.

May I repeat that I am not competent to discuss with you the technical, legal, or tax questions surrounding this question. Our grain and feed dealers are neither lawyers nor tax experts. But what they do understand, and understand without a shadow of doubt when they look at their books, is that they are being hurt by untaxed cooperative competition. They don't need a lawyer to explain causes to them when they find it difficult to save or borrow funds for the maintenance or expansion of their business enterprises.

On this point of necessary continued growth of enterprises, may I refer to the often-quoted statement that it takes between $8,000 and $10,000 of machinery and plant investment for each employee hired. Our business is under continual evolution, where modern machinery must often be installed before the machinery replaced is really obsolescent.

In recent years the Government itself often has asked our industry to increase its storage and handling facilities rapidly to provide for grain surpluses built by Government action. But additional facilities mean heavy investments, and if our business is to meet the demands for additional space it must have either good cash reserves, or a favorable business prospect that will make bank loans readily available.

The cooperatives are able to expand on the same portion of their earnings that, in our hands, would go to Federal taxes. Additionally they have easy Federal credit. The cooperatives are in better position to expand to meet Government needs for space, and then use this increasing Government patronage to pile up further untaxed earnings.

Obviously, under such a situation, the cooperative is able to do its part in the employment of that additional million men who come into the American labor force each year, while the proprietary firm can not easily build up reserves for the necessary investment, nor offer to his banker the favorable business outlook that would encourage bank loans.

Our national association has no controversies with cooperatives and there are many of them in our industry who do not enjoy this tax advantage. Some of our national association members are cooperative firms and have remained members even while we have been urging Congress to equalize taxes between us.

More than a few cooperative members over the country have frankly told us that they realize their unfair tax advantage, and none of them has denied that this discrimination exists. Many cooperatives have argued with us in friendly manner that we should join forces for the elimination of the Federal income tax on all corporations, rather than work for the additional taxation of cooperatives.

Our members usually have been favorable to this, but when we have talked to you men of Congress we have been told that the elimination of Federal corporation taxes is too far distant even to consider seriously, at this time. So we always come back to the knowledge that, for many of our people, time is running out on them in this unfair competition and that equalization of the burden of taxation is the only solution, now, to their pressing problem.

In closing, Mr. Chairman, we are simply asking equality under law, not any advantage or preferred position for any group. We respectfully urge that, in its action or absence of action on this tax matter, your committee frankly state in its report to the Senate its policy as between cooperatives and the firms with which they compete; whether one is to remain a business preferred by Congress, while the other is to be considered inferior business. We have pleaded this matter before you for some years; we believe we deserve a frank statement of your policy. Of course we sincerely urge that you provide for the equal taxation, in your tax bill, of all corporate business firms in competition in an industry.

Senator BYRD. Are there any questions?

Senator MILLIKIN. Mr. Chairman, in order to get the thing down on a case basis, let us make this assumption: In your own town there is a feed business which we will say during any given year makes a profit of $10,000, a proprietary business.

In the same town there is a cooperative feed business which makes a similar profit. Now, explain to us what happens in the one case and what also happens in the other as far as Federal taxes are concerned?

Mr. BOOTH. I wish I were competent to give you the detailed part of it, but from the practical angle, the cooperative across the street from my place of business is able at the end of the year to determine what portion of his earnings, profits, or what have you he can give back to his patrons or customers; at the end of my tax year I do not have that privilege. I understand that I can make a statement at the beginning of my tax year that I am going to give a patronage dividend and it can be deducted, but I must make that statement at the beginning of the year.

Again, I am getting into some details that I am not too familiar with, but the advantage that the cooperative has against me is that the patrons who go there know they are going to get a patronage refund, rebate, gratuity of some sort because of having done business there instead of with me.

That is a deductible expense to the cooperative, and he does not pay tax on it.

Senator MILLIKIN. I was trying to get away from the technicalities by asking what I thought was a simple question. You make a profit of $10,000; the cooperative in the same business makes a profit of $10,000.

Now, right at that point, what does the Federal Government take out of you by way of taxes?

Mr. BOOTH. It depends on my tax base, of course, but a minimum would be 20-some percent.

Senator MILLIKIN. Well, it takes a tax out of that, and I am assuming that you have a corporate form of business?

Mr. BOOTH. That is right.

Senator MILLIKIN. It takes a corporate tax away from you on that $10,000 profit.

Mr. BOOTH. That is right.

Senator MILLIKIN. Let us move over now to the cooperative.

What does the Federal Government do in the way of taking taxes from that incorporated cooperative.

Mr. BOOTH. At that immediate time, nothing. That cooperative may take a portion of it and set it aside for purposes of expansion.

Senator MILLIKIN. To the extent that it makes that election, the cooperative does not pay a Federal tax on the profit so used and a similar election is not open to you; is that the point?

Mr. BOOTH. That is true, sir.

Senator MILLIKIN. All right.

Senator BYRD. Are there any further questions?

Senator WILLIAMS. If I understand it correctly, to use the illustration that the Senator from Colorado used, two corporations making $10,000, when you file your tax return you must pay the tax from the beginning on the $10,000 at whatever rate it might be?

Mr. BOOTH. Correct.

Senator WILLIAMS. While the cooperative puts that aside—decide they need a warehouse, an additional expansion on a warehouse, that is going to cost them something, and they are going to build it the next year or the year after, and they could deduct three, four, or five thousand dollars, whatever it might be from that $10,000 as a flat deduction for future expansion, and they could deduct their patronage dividends without paying them out, by issuing certificates of tax indebtedness to the farmers, before they paid any tax, and they could reduce theirs in that manner and you would have to pay it in the beginning.

Mr. BOOTH. That is correct.

Senator WILLIAMS. In other words, a cooperative can, under the existing law, write off the cost of a plant they are going to build or the year after out of this year's earnings rather than wait until they built a plant and depreciated it in the normal manner?

Mr. BOOTH. In that particular situation there are two advantages to the cooperative He has the money to expand that is tax-free, and he has attracted to him additional patrons because of the issuance of scrip or statements of indebtedness that they can or may at some future time receive a refund for the business done.

Senator MILLIKIN. When the cooperative sets aside that $10,000—let us assume that it sets it aside in pursuance of a plan of expansion—I understand that there would be no tax on the corporation.

Let us assume that it just decided to keep the $10,000 for whatever corporate purpose it might want to use it, not reflecting distribution to stockholders, just kept it in the till. Would it then have to pay a tax?

Mr. BOOTH. That is a technical question that I cannot answer, sir. If it is put into surplus, I understand that they are taxed on that portion put into their surplus, but with the election of not putting it any place, I do not know. I do not know that they have that choice.

Senator MILLIKIN. It has been suggested that if it is exempt under 101 it would not pay any tax, even though it did not set the money aside for the specific purpose of plant expansion.

Senator BYRD. Thank you very much, Mr. Booth.

Senator TAFT. Mr. Booth, I have one question. You introduced a thing I have not heard about with respect to patronage dividends. You say you have to announce in advance that you are going to do it?

Mr. BOOTH. That is a matter of interpretation, as I understand, Senator Taft. I have been told that by making an announcement or stating a position at the beginning of my year I may make allocations.

Senator TAFT. If you were going to do it you would announce it at the beginning of your year, would you not? I mean, if you wanted to bring in business, you could—that would be the purpose of it. There is nothing to prevent you, as far as patronage dividends are concerned, from announcing that if you make a net profit this year of so much you are going to devote 25 percent of that profit to crediting your customers in accordance with that.

Mr. BOOTH. I see nothing wrong with it.

Senator TAFT. Rebates, or whatever it may be; or additional payments—you could do that, could you not?

Mr. BOOTH. I could see nothing wrong with it if I had the same privilege that my competitors have.

Senator TAFT. It would be deductible, would it not?

Mr. BOOTH. As I understand, or as I have been told, that is true. My point is that under the circumstances in which I find myself, I make the declaration first. My competitor across the street does not have to make that declaration unless it is so stated.

Senator TAFT. Well, in effect, he made the declaration because that is the whole basis of his being a cooperative.

Mr. BOOTH. That is right, in general.

Senator TAFT. And you are not required—are you required to make any more definite statement? It is a new idea of its having to make a statement at all. But assuming you do, it could be a very general statement, could it not?

Mr. BOOTH. Can you answer that, Senator? I am not familiar with the details?

Senator WILLIAMS. I think, if I understand it correctly, he can make the statement but he must make the statements specifically; for instance, 25 percent, 50 percent, or whatever it might be, he must make that statement at the beginning of the year, and then he can deduct that particular percentage that he has announced.

Senator KERR. And he can deduct the percentage that he has announced and wishes to follow through by distributing it.

Senator WILLIAMS. He must distribute it and follow through before he can deduct it.

Senator KERR. He must have announced it and distributed it.

Senator TAFT. Is there any regulation to that effect, or can there be a general statement pretty much like that which the cooperative makes?

Of course, cooperatives say "we will do it," and then they reserve all sorts of rights and say over and above what they need in reserve, for reserve purposes.

Mr. BOOTH. Yes; there is still a difference, though. When I make declaration I have to pay it out.

Senator TAFT. They have to pay out, too, over and above——

Mr. BOOTH. Not in cash.

Senator TAFT. But there is not some sort of a reason for—I mean, I agree it is pretty general.

Senator WILLIAMS. If I understand it, he has to make a declaration in specific percentages. Then he must pay it out in cash to the customers in order to get the credit, while the cooperative—it is an interpretation that is placed on it, by the definition of a cooperative, it is automatically announced, and they can determine at the end of the year whether it is 25 percent, 10 percent or a hundred percent, and determine their percentage at the end of the year, and they will not be held and are not being held to paying it out in cash. They can give certificates of indebtedness.

Senator TAFT. I do not think that is an important difference because they certainly would not object to having that statement required of them in advance.

But I do not think that there is any regulation requiring you to do it in advance. If so, I would like to have a reference to it, if there is such a ruling.

Mr. BOOTH. We have a letter in our association headquarters from the Revenue Department relative to that.

Senator KERR. A little louder, please.

Mr. BOOTH. Our association has a letter from the Revenue Department to that effect in the declaration of a statement.

Senator TAFT. It must be a declaration? It must be of a particular percentage of profits, or how definitely must it be, really?

Mr. BOOTH. Can you remember what that is?

Mr. BOWDEN. It has, as I remember it, indistinctly—they must make an announcement, which will be given at the beginning of the year, and it states the percentage that will be given, and it has to be an action passed by the board of directors of the corporation appearing on the minutes.

Senator KERR. It has to be a binding declaration.

Senator TAFT. How specific does it have to be, that is what I mean? Could it not just be that you intend to return over and above whatever certain returns you obtain, or over and above a certain amount for reserves, or something of the sort?

Mr. BOWDEN. Not being certain, Senator Taft, which it is, would you like to have us file that letter with you?

(The letter referred to follows:)

TREASURY DEPARTMENT,
Washington, March 1, 1949.

THE HALE GRAIN CO.,
Royal, Iowa.

GENTLEMEN: Reference is made to your letter of January 17, 1948, addressed to the collector of internal revenue, Des Moines, Iowa, requesting advice with respect to the income-tax consequences to your company of an outlined procedure whereby you would declare a dividend at the end of the year to your customers on a patronage basis the same as a cooperative association does.

True patronage dividends have long been recognized by the Bureau to be rebates on purchases made in the case of a cooperative purchasing organization or as additional cost of goods sold in the case of a cooperative marketing organization when paid with respect to purchases made by, or sales for the account of, the patron distributees. While there is no statutory provision permitting the deduction of so-called patronage dividends by corporations subject to tax, the administrative practice has been to permit a cooperative association to deduct such distributions from its gross income when paid to its patrons, whether members or nonmembers, in proportion to the volume of business transacted with them, provided the bylaws of the association or a prior agreement between it

and its patrons makes provision for such payments. This practice is based upon the theory that a cooperative association is organized for the purpose of furnishing its patrons goods at cost or for obtaining the highest market price for the produce furnished. However, the amounts are not allowed as a deduction unless they are actually paid to the members or set apart for them.

While the above-outlined practice may, at first glance, appear to be strictly peculiar to cooperative associations, it is to be noted that rebates made to nonstockholders by any corporation are obviously not dividends and are a deductible expense, but rebates given to customer-stockholders warrant close scrutiny of all the facts to determine whether the rebates are merely a method of distributing dividends under the name of a deductible expense. Payments made to customer-stockholders of refunds based upon the volume of business transacted with the customers and in no way dependent upon stock ownership are considered refunds and not dividends. Thus, where the bylaws of a corporation (not a cooperative) provided that the surplus earnings should be returned to stockholders in the ratio which the business furnished by each stockholder was to the total business, the payment was not a dividend (*Uniform Printing & Supply Co., Inc.* v. *Commissioner* (88 F. (2d) 75)), but the obligation to make the rebates or refunds must be in existence before the profits are earned. If the stockholders agree to distribute the profits on the basis of the respective business furnished by each after the earnings have been made, the payments are considered to be dividends and not rebates (*Peoples Gin Co.* v. *Commissioner* (118 F. (2d) 72)).

In this connection, it is to be noted that even in the case of a cooperative association if so-called patronage dividends are payable only to members or stockholders (or the members receive larger so-called patronage dividends than nonmember patrons on identical transactions), the excess of the payments over the amounts due them on a patronage basis represents ordinary income to the cooperative from business carried on by it for the joint profit of the members, and, consequently, distributions thereof to the members are essentially ordinary dividend payments. Such distributions are not true patronage dividends and are taxable to the cooperative. (See I. T. 3208, C. B. 1938-2, 127.)

It is the view of this office that, subject to the conditions and circumstances set forth in the second preceding paragraph, the payment of refunds or rebates to your customers based on the amount of business done with such customers would be an allowable deduction in computing your company's taxable income for the year in which such refunds or rebates were paid.

Very truly yours,

E. D. McLarney,
Deputy Commissioner.

Senator Taft. Yes, I would like to know. I am not talking now about reserves really at all. That is a different question. I am talking about this whole question of simply the question of patronage dividends, and whether there is really any substantial distinction, and if so, certainly it could be taken care of by statute, so that there would not be any, so far as they are concerned. Now, the reserve question, that is another thing.

Senator Millikin. Mr. Chairman, may I ask a question of Mr. Stam? Mr. Stam, what is the law or regulation that works on a private proprietary business in respect to what the witness has described?

Mr. Stam. I am not familiar with that particular ruling to which they refer from the Internal Revenue agents' office. Of course, where a corporation pays rebates or makes discounts why, naturally, they are deductible items and come out of income, but I am not aware of any particular ruling which says that you can declare a certain percentage of your profits and get a deduction if they are going back to the customer, I mean.

Senator Kerr. Would you inquire of the Treasury what their announced or unannounced——

Senator Taft. Pardon?

Senator Kerr (continuing). Policy is in that respect, Mr. Stam?

Mr. STAM. I will be glad to do that.

(See testimony of Vance Kirby on July 20, 1951.)

Senator BYRD. Thank you very much.

Mr. BOOTH. Thank you, sir.

Senator BYRD. Mr. Saxon?

Dr. O. Glenn Saxon, National Tax Equality Association.

STATEMENT OF O. GLENN SAXON, PROFESSOR OF ECONOMICS, YALE UNIVERSITY, REPRESENTATIVE OF NATIONAL TAX EQUALITY ASSOCIATION

Mr. SAXON. I am professor of economics, Yale University. Mr. Chairman and members of the committee, I am here on behalf of the National Tax Equality Association.

I have taught in the field of corporate finance, tax, and fiscal policies for 20 years. In the course of that work, I have naturally come into the problem of tax exemption not only of cooperatives but of a great many other institutions, such as the local government agencies and properties, the Federal Government, and I am firmly convinced that under the circumstances as they are today, when the tax rates on corporations have gone up to 77 percent, and the individual rate ranges from 20 to 90 percent, the problem of revenues for the Federal Government requires the elimination of all tax exemption of business.

The problem of exemption of mutual corporations and cooperatives raises the question of the ultimate results on our economy. It could mean socialization of our economy.

In Europe generally today the cooperatives have a total membership of approximately 150,000,000 people. Those cooperatives in those countries today control from 20 to as much as 80 percent of the retail and wholesale trade in many fields of activity.

The development of the cooperatives in this country has been relatively slow, but the rate of increase has been amazing in periods of high taxation.

The number of cooperatives expanded rapidly under the high tax rates of World War I and again under the high tax rates of World War II, and they are continuing to expand year by year since the end of World War II at a phenomenal rate.

Today the percentage of business which they do is relatively small but it is increasing very, very rapidly.

Senator KERR. Is the statement directed to the percentage of the total business being done in the country or the increase in business being done by the cooperatives?

Mr. SAXON. It is both, sir. The percentage that is being——

Senator KERR. Could you give us those figures?

Mr. SAXON. That the cooperatives of the country and the mutual organizations, what they do today is relatively small—the percentage of the total, but the percentage is increasing more rapidly than the total increase in the volume of business.

Senator KERR. Do you have the tabulation for the last 5 years?

Mr. SAXON. I have that, sir, based upon figures of the Department of Agriculture and other agencies. Those official figures are inaccurate in many respects in the sense that they are not comprehensive. They do not cover a great many of the cooperatives. They are not required by law to report, but even the figures put out by the

departments do show conclusively this very sharp expansion in volume and in the percentage of the total business done by the cooperatives. Does that answer your question?

Senator TAFT. There have been figures presented showing the percentage of total business done in the country by cooperatives as being less than it was 10, 15, or 20 years ago, and that is an over-all figure, and would not relate necessarily to the particular industries—that might be different, but some over-all figure was presented.

Mr. SAXON. I have incorporated in this manuscript for your convenience figures by the Department of Agriculture as of 1949, which I think, will conclusively overcome that position that you just stated, and will give you the facts going back as far as 1915.

Senator KERR. I asked you if you had tabulations for the last 5 years?

Mr. SAXON. The figures of the Department of Agriculture cover through 1949 and they show a very sharp increase, both in dollar volume and in percentage, since the end of World War II.

Senator KERR. That is included in your manuscript?

Mr. SAXON. That is; yes, sir.

Senator KERR. At what page?

Mr. SAXON. That is the one, sir—it is rather a bulky document. On page 51 and the following pages, the business volume—it begins actually, sir, on page 50, with respect to the expansion of farm cooperatives. I go into the expansion of the numbers of the cooperatives, the volume of business done, and the rate of pay.

If you will notice on page 52, there is a table there showing the number of cooperatives, the membership and the business volume for the marketing associations and the purchasing associations, and the total combined.

Senator BYRD. This is only the farm cooperatives?

Mr. SAXON. This is only the purchasing and marketing in the farm group, yes. It does not cover consumer cooperatives, and, as I said, this is not comprehensive in the sense that many of the cooperatives are not required to report at all, but these statistics are based on a consistent base, so that you get a comparison from year to year or from period to period.

Senator WILLIAMS. Mr. Saxon, what percentzge of the business is done by a small group? Is it not a fact that the small group of cooperatives do a large percentage of the business that is done over the Nation as a whole?

Mr. SAXON. We cannot document that, sir, but that is the general conclusion and conviction of all who have studied the problem. It cannot be documented until the Congress requires full reports from all these organizations, whether they are tax-exempt or non-tax-exempt.

Senator WILLIAMS. I do not have it with me this morning, but the Treasury Department did put out a book recently on that subject in which, I think, they pointed out that about 60 percent of the business is done by 7 percent of the organizations.

Mr. SAXON. I think that is quite true, but I have not seen the bulletin you mention.

Senator BYRD. Proceed, Mr. Saxon.

Mr. SAXON. The next point I would like to make, Mr. Chairman, is that the Congress over the past year and a half, after studying the problem, has already eliminated the exemption of business income of

labor organizations and charitable and educational institutions, but you leave still tax-exempt the business cooperatives, the mutual savings banks, some of the mutual insurance companies, and the farm cooperatives, both the marketing and the purchasing cooperatives, which are actually engaged in profit-making operations, and by statutory law of Congress, and by Treasury ruling, the great majority of them are exempt from all Federal taxes—some of them by Federal law exempted even from State and local taxes in the field of the mutual savings banks, and the other credit institutions of that type.

Senator KERR. Explain briefly how the mutual savings bank works.

Mr. SAXON. The mutual banks instead of stockholders simply have memberships. Each depositor automatically becomes a member. Instead of stockholders they have members but the business of mutual corporations operates exactly in the same sense that a stock corporation in the same field operates, the only difference being that they escape the income tax paid by the stock corporations.

As a consequence, they can pay higher dividends on their deposit accounts than the competitive stock corporation can do. This puts the stock company at a competitive disadvantage, which is evidenced by the very sharp growth in the deposits of the mutual companies, at the expense of the stock companies. Of course, savings have increased sharply over the last 15 or 20 years, particularly since 1940, but the statistics in this memorandum will give you the growth, the rate of growth of the mutual banks, compared with the stock banks, and you will find that it is as much as two or three times as rapidly in certain periods, particularly in a period of high tax rates.

Senator MILLIKIN. May I ask, sometime during your testimony you will make perfectly clear the exact points and the exact nature of the discriminations which you claim exist.

Mr. SAXON. Well, Senator, if I may, I will do that right now.

Senator MILLIKIN. Please do it right now, Mr. Saxon.

Mr. SAXON. The last witness was somewhat confused on the situation, and I think that I can help clarify it.

Senator MILLIKIN. It is very important. This is the heart of the thing. As to the discrimination, how does it operate, where does it operate, and when does it operate?

Let us get at that.

Mr. SAXON. Congress has granted total exemption to farm marketing and purchasing cooperatives provided they comply with certain qualifications specified by Congress such as limiting their membership to actual farmers, and doing business—not more than 50 percent of their business can be done with nonmembers—and restrictions of that sort.

I suppose that perhaps 50 percent of the farm cooperatives are totally tax exempt. They pay no Federal tax under any circumstances.

Now, any cooperative, however, that does not comply actually gets practically total tax exemption by Treasury ruling, for which there is no statutory authority whatsoever. But the Treasury has, by ruling, permitted the qualifying cooperatives to set aside allocated reserves for necessary purposes, and the word "necessary" has been interpreted so broadly that it is necessary for a cooperative to establish reserves to own oil wells, refining companies, tar manufacturing companies, and tractors, things of that sort.

They are allowed to set aside allocated reserves, and those reserves become nontaxable under Treasury ruling.

In other words, you have two classes of farm cooperatives that are tax-exempt—the so-called tax-exempt under section 101, and then a great number of them that pay only token taxes, under the Treasury rulings. Allowing them to allocate these reserves, with the Treasury ruling them as being rebates, makes them nontaxable.

Senator MILLIKIN. Are you attacking both types of cooperatives?

Mr. SAXON. Both.

Senator MILLIKIN. Both? All right.

Mr. SAXON. Because the escape under the Treasury ruling is almost total.

Senator TAFT. Getting away from the cooperatives which simply deal with farmers, and pyramid on top of others, are they able to qualify or are they all in this second class, these large——

Mr. SAXON. The consumer-cooperative, for instance?

Senator TAFT. I did not mean consumer cooperatives. I meant cooperatives that deal with cooperatives, these people who deal in grain nationally, and that sort of thing, do they fall in the second classification?

Mr. SAXON. They can fall under either so long as they are either purchasing or selling products that the farmer produces or requires in the course of his operations as a farm.

Senator TAFT. I thought you said half of the business had to do with farmers or something of that sort?

Mr. SAXON. I say they have the option of one or the other, but if they want to do more business than 50 percent with nonmembers, they could not qualify.

Senator TAFT. If they do business with cooperatives, is that——

Mr. SAXON. If they do business with cooperatives, the cooperative itself may be exempt and, consequently, ruled out. It is part of the——

Senator TAFT. They are considered farmers for the purpose of the——

Mr. SAXON. I think that is right; and you have the situation where a farm-marketing cooperative starts in business, then it becomes a purchasing cooperative as well; then from there it goes into the development of the materials which they are purchasing, oil, oil-well ownership, refining operations, and the manufacturing of all sorts of farm implements, and the minute the cooperative touches and buys control of such an operation, that operation itself may become in effect tax-exempt.

Senator MILLIKIN. Now, pardon me. Have you reached a good stopping place?

Mr. SAXON. Surely.

Senator MILLIKIN. Let us consider only for the moment the field of those cooperatives which do not qualify——

Mr. SAXON. Yes.

Senator MILLIKIN. Under the statute.

Mr. SAXON. The so-called nonexempt.

Senator MILLIKIN. So we do not get confused between the two groups.

Mr. SAXON. That is right.

Senator MILLIKIN. Let us take those who do not qualify for total exemption.

Mr. SAXON. All right.

Senator MILLIKIN. Let us come down to the homely case that I put to the preceding witness. There is the Joe Doe private proprietary corporation in the feed business in this town of Squedunk. Across the street is a corporation, a corporate cooperative in the same business, both of them making a profit of $10,000 in a given year. Now what happens so far as Federal taxes are concerned as to the profits of both of those institutions?

Mr. SAXON. Well, this year the cooperative would—well, let us take the proprietary corporation first. The privately owned corporation, under stock form, would pay under your present bill a large percent of the $10,000, and have a take-home pay, so to speak, of what is left.

Senator MILLIKIN. Which it could or could not distribute by way of dividends?

Mr. SAXON. That is right, at its own option.

Senator MILLIKIN. Yes.

Mr. SAXON. The cooperative, on the other hand, could simply take the $10,000 and allocate it, keeping the cash and issuing certificates or what not. Even though called necessary reserve, this would mean building up a fund to buy an oil refinery not related at all to the original function of the cooperative. The form of scrip and notes may be payable 5 years from now or 10 years from now or may have no definite termination date at all.

Senator MILLIKIN. I could not hear that.

Mr. SAXON. It could issue bonds and distribute those to its members and, by any one of those devices, the entire $10,000 become tax-exempt under Treasury ruling without any authority for such rulings from the Congress.

Senator MILLIKIN. And the scrip under those circumstances—the person who receives the scrip or the promise to pay, or whatever it may be, does he or does he not pay taxes on what he gets?

Mr. SAXON. He is supposed to pay taxes on what he gets. Some corporations have stock dividends, and under United States Tax Court rulings, under certain circumstances, the stock dividend is not considered as income.

Senator MILLIKIN. There is no discrimination——

Mr. SAXON. All those other scrips are payable——

Senator MILLIKIN. As far as the stock dividend is concerned, there is no discriminatory element. I mean that applies to all corporations.

Mr. SAXON. That is right.

Senator MILLIKIN. Yes, sir.

Mr. SAXON. But all these other forms of scrip result in the cooperative being able to retain all of its earnings tax-free for expansion purposes and, at the same time, satisfy the Treasury rulings. It can pass them out in theory though in fact it keeps the cash from its members.

Senator BYRD. Now, does a member pay a tax on the scrip before he gets the cash?

Mr. SAXON. He is supposed to, sir; but the fact that cooperatives are not required to report and disclose means that there is a very substantial tax escape, and the farmer, according to the ideology which they have been taught, is taught to believe in any case that that is not income since it is a return of his money.

Senator BYRD. The law requires——

Mr. SAXON. But if it is income, it is treated as income in every respect in the courts of this country, except taxwise.

Senator WILLIAMS. Mr. Saxon, is it not possible under the existing interpretation to use the example that the Senator from Colorado has given for this cooperative to allocate these earnings to the farmers in the form of scrip, we will say, after deductions, and they allocated $5,000 a year to the farmers in the area, which were a tax liability to the farmers, and this went over a period, we will say, of 10 years, and then this cooperative failed, and it would be possible in that situation that you would have a situation where the farmers had paid taxes on something that they had never had an opportunity to have demanded payment on; they never had the money and they never had use of it, nor would they ever get the use of it, nor could they get a refund on their taxes.

Mr. SAXON. The same is true, sir, of certificates of any other corporation. In other words, if General Motors Corp. paid a dividend in bonds and 10-year notes and in the meantime if General Motors Corp. failed before those notes matured, you would have the identical problem.

Senator WILLIAMS. Except, would there not be this difference? If General Motors distributed bonds, they usually are negotiable, where it is possible for the cooperative to distribute stock certificates which are redeemable only at the discretion of the board of directors of the company.

Mr. SAXON. Well, either form of corporation could make the bonds nontransferable, but the cooperatives, by and large, as a rule, do make their certificates nontransferable.

Senator TAFT. Mr. Saxon, a lot of the larger cooperatives, pay some taxes, I do not know what.

Mr. SAXON. They are the non-exempt.

Senator TAFT. You emphasize what they do not pay. What do they pay?

Mr. SAXON. Only in case the Treasury refuses to recognize the amount of reserve as an allocated reserve would they be forced to pay taxes, so if they allocated the reserve——

Senator TAFT. I could see some basis for the Treasury rulings if they allocated it to these taxpayers, that it was not taxable. But I do not see any basis for saying that their funds are tax-exempt when they say, "We need the money."

Mr. SAXON. The Treasury could say, "There is no reason why you have to buy an oil well down in Texas," but they have let tax-exempt co-ops do that, and set funds aside and called them allocated reserves because of book credits or certificates to member patrons.

Senator TAFT. You take this biggest cooperative in the East, whatever it is called.

Mr. SAXON. Eastern States?

Senator TAFT. No, it is up in New York—GLF, they pay a tax. What tax do they pay?

Mr. SAXON. Well, they practically determine the tax themselves, depending——

Senator TAFT. I know, but what tax do they pay?

Senator KERR. Every taxpayer figures out his tax and sends it in, does he not, subject to the Treasury reexamination?

Senator TAFT. I mean, I wanted to know exactly on what they pay, and on what they do not pay?

Mr. SAXON. Mr. Lester has just handed me a memorandum on that very point. Another example of this type of organization is the cooperative Grange League Federation Exchange which, in its 1949–50 fiscal year, distributed over a million dollars in patronage dividends, nearly a million dollars in dividends to stockholders, paid an estimated income tax of $1,099,000, and added $847,000 to surplus. If it had been taxed on its full earnings it would have paid at the 38-percent rate——

Senator TAFT. If you are including patronage dividends, suppose you leave out patronage dividends.

Mr. SAXON. Sir, I cannot do that, because that is merely a distribution of profits.

Senator TAFT. I do not agree to that at all.

Mr. SAXON. Could we divorce that for just a moment and get to the question of the taxation? You want to know what they paid?

Senator TAFT. Yes, sir.

Mr. SAXON. They did pay actually $1,099,000. If they had paid at the full corporate rate at 38 percent on the entire earned income, they would have paid an income tax of $1,534,000 to the Federal Government, and would still have been able to add $412,000 to its surplus.

Senator TAFT. I still do not know whether they pay it on everything outside of the patronage dividends. That is what I want to find out.

Mr. SAXON. That I cannot say without having the statement of the cooperative before me. I have not got that, sir.

Senator MILLIKIN. May I ask that the witness give us the reference to law or to the regulations which permit the nonexempt cooperative to set aside reserves without paying taxes on the reserves? I am not talking about the allocation to the stockholder, but what they retain as reserve. I would like to have the authority for the gentleman's statement that they do not have to pay taxes on that, as a corporation does.

Mr. SAXON. Well, those rulings are made in individual cases, and there are hundreds and hundreds of them, sir, and they go back as early as 1913.

Senator MILLIKIN. We are talking now about the nonexempt cooperatives.

Mr. SAXON. That is right.

Senator MILLIKIN. Well, there must be some basis for the exercise of the discretion, there must be some regulation, there must be some provision of law. Could we have a citation of that?

Mr. SAXON. Well, I can get it for you but I do not have it available with me.

Senator MILLIKIN. Will you supply it to the committee?

Senator WILLIAMS. I have the regulation right here. It is in a letter signed by John S. Graham, the Assistant of the Treasury, and I will read it:

Section 101 (12) of the International Revenue Code which governs the exemption of farmers' cooperatives, farmers' marketing and purchasing cooperatives permits the retention of a reserve required by State law or "a reasonable reserve."

And this is the regulation I am quoting from.

Senator MILLIKIN. Senator Williams, you are talking about the exempt and nonexempt group.

I am talking about the nonexempt.

Senator WILLIAMS. I am not so sure.

Senator MILLIKIN. Your letter says that it is the exempt group.

Senator TAFT. It is the 101 corporation.

Senator WILLIAMS. Maybe that is correct, but this letter deals with both of the situations.

Senator MILLIKIN. What you read does not deal with both; it deals with the exempt.

I am now probing solely the nonexempt cooperative, and I want to know by what authority they do not pay taxes on reserves that they set aside.

Mr. SAXON. Well, all I can say, sir, is that the Treasury rulings in the entire field are simply assumed authority which Congress from time to time has failed to either confirm or deny.

Senator MILLIKIN. Will you give us a full memorandum?

Mr. SAXON. Yes; I will see that you get a memorandum on that subject.

Senator MILLIKIN. Or a full statement, either substantiating or not substantiating what you read. That goes to a very important question in this hearing.

Mr. SAXON. Yes, sir; if it is not otherwise supplied before the conclusion of these hearings.

(See testimony of Vance Kirby on Friday, July 20, 1951.)

Senator TAFT. Mr. Saxon, just offhand on these figures that you gave, as I got them roughly, this GLF paid a million dollars in taxes; they distributed, leaving out patronage dividends, a million dollars in dividends and set aside $800,000 for reserves.

In other words, on $2,800,000 net income they paid $1,000,000 in taxes, which is not so very different from what any corporation would do after various kinds of deductions.

What I want to find out is whether they are paying—leaving out the patronage dividend question—the same tax as somebody else. That is what I am interested in finding out.

Mr. SAXON. Well, I have available, sir, a record which will show you not only this particular corporation, but a great many others, and you will see that I am not exaggerating when I say that the tax they pay is pretty largely determined by themselves, based upon what they allocate——

Senator MILLIKIN. Mr. Chairman, may I ask whether there is any representative of the Treasury here? State your name, please.

Mr. JULIUS M. GREISMAN. My name is Greisman.

Senator MILLIKIN. What is your job?

Mr. GREISMAN. I am an attorney with the Tax Legislation Counsel's office.

Senator MILLIKIN. Does the Treasury permit tax exemption in the case of a nonexempt cooperative when it makes a declaration of reserves for any purpose?

Senator KERR. Or for no purpose?

Senator MILLIKIN. Or for no purpose.

Mr. GREISMAN. I am not familiar with that field at all, sir, so I am afraid I cannot answer.

Senator MILLIKIN. I have asked the witness to supply us with a memorandum.

I will ask the Treasury to supply us with a memorandum. Is the problem clear?

Mr. GREISMAN. Yes. You want the basis for tax exemption of recognized nonexempt cooperatives which do not qualify under section 101 (12), what the basis for the tax exemption——

Senator MILLIKIN. I want the basis for any tax exemption they have on reserves that they set aside.

Senator TAFT. While you are about it, it seems to me you might as well cover the 101 corporation as well.

Mr. SAXON. Subsection (12).

Senator TAFT. That is in the law.

Mr. GREISMAN. You mean section——

Senator TAFT. Any regulations that have been issued under it.

Senator MILLIKIN. I want no confusion between the two types of corporations. I want this limited entirely for my purposes—I do not care whether you put it in one paper, but I want that one paper so divided that if it covers other subjects, that as to the nonexempt type of cooperative there is no question as to the authority for any tax exemption in setting up reserves.

Mr. SAXON. They call the group you are speaking of the non-tax-exempt group.

Senator MILLIKIN. That is right.

Senator WILLIAMS. Mr. Chairman, I understand a gentleman by the name of Mr. Copeland over in the Treasury Department is their expert on cooperative taxes. I wonder if we can have him over here?

Senator KERR. I second that request.

Senator WILLIAMS. Or whether they wish to assign someone else, it is all right; but he was named as an expert on cooperatives.

Senator BYRD. I think it would be a good idea to call him on the phone.

Senator MILLIKIN. While we are talking about cooperatives.

Senator BYRD. It would be a good idea to call him on the phone and ask him to come down immediately.

Senator KERR. As I understood you, Doctor, you said that if and when the cooperative sets aside any amount of money and calls it a necessary reserve by that act, it makes that amount of money tax exempt, even though it is not an exempt cooperative.

Mr. SAXON. Subject to this qualification, sir, that that must be allocated to patrons in a manner recognized by the Treasury.

Senator KERR. Well, that is quite a little qualification.

Mr. SAXON. It is, but the record shows that the Treasury has been so loose and broad in——

Senator KERR. Let us have that record.

Mr. SAXON. The record?

Senator KERR. Let us have that record. You say there are hundreds and hundreds that you know about.

Mr. SAXON. Thousands.

Senator KERR. Have you got one?

Mr. SAXON. Not with me, sir. I did not expect it to be questioned in detail.

Senator KERR. You did not expect to be questioned here?

Mr. SAXON. Not in that detail, sir, not to document it. I will read part of this manuscript if you like.

Senator KERR. I asked you a question if you have anything to substantiate what you said.

Mr. SAXON. You asked me to document it. I cannot document it.

Senator KERR. I asked you if you had a single illustration.

Mr. SAXON. I have not.

Senator BYRD. You may proceed.

Mr. SAXON. The next point that I wanted to talk about was the competitive disadvantage——

Senator KERR. Let me ask just one more question. As I understood the Senator from Delaware, he asked you a question a while ago, and I understood you to answer, "yes"; that when a cooperative issues a certificate of participation or an evidence of profit made and ownership by the member in the form of an indebtedness or a promise to pay at a specific time or unspecified time, the receiver of it pays taxes on that as though he had received it in cash.

Mr. SAXON. It is his income, and it is subject to a tax, with this one qualification, and that is, if it is a stock dividend, it is not taxable until he sells the stock.

Senator KERR. Yes, but when he receives a note or a bond or a certificate of participation whereby he has $10 earned, and the cooperative has kept it, but he is the owner of the $10 interest, he pays taxes on that when he receives it.

Mr. SAXON. No, unless he is forced to.

Senator KERR. Unless it is——

Mr. SAXON. Again, it is subject to the question of whether it is a liquidated thing to him.

If it is a promise to pay him 50 years from today or 10 years from today, naturally he may not declare that until he receives payment.

If, on the other hand, he discounts it by selling it for cash, then it becomes cash income, and he probably declares it.

Senator KERR. That is not what you said a while ago, or that is not what I understood you to say, and I frankly thought your answer in that regard was correct.

Mr. SAXON. I said the Treasury permits that to be treated as not part of the income of the corporation.

Senator KERR. I understand that.

Mr. SAXON. But once that is done——

Senator KERR. I understand that. But I am talking about the individual. You said when the individual receives that evidence of indebtedness, or that evidence of having had an interest in an amount of money earned, but which is kept by the cooperative, that one who receives it pays taxes on it when he receives it.

Mr. SAXON. Only if under his arrangement it is treated as cash.

Senator BYRD. Can you answer my question? If he received the scrip, he paid taxes on it?

Mr. SAXON. Well, the scrip itself is not cash, and it is not, ordinarily, income until he actually——

Senator BYRD. Did you not make that answer?

Mr. SAXON. I have to qualify that if I said that, sir. I am not a tax lawyer.

Senator BYRD. I certainly understood you to say that if the scrip was issued to a member the member would pay a tax on that scrip; it was the same as if it was cash.

Mr. SAXON. He probably would not. I think Mr. Stam has a statement.

Mr. STAM. I might say on that, it is our understanding that if this scrip is issued, that by virtue of the agreement between the patrons and the cooperative itself, the patron agrees to take up in income the face value of that scrip. In other words, if the face value of that scrip was $100, even though its actual market value might be much less than $100 because of the fact that there was no fixed date for that maturity, nevertheless, under the cooperative's arrangement, the patron would be required to put that $100 into his income tax return.

Mr. SAXON. If there is an agreement to that effect; yes, sir.

Mr. STAM. That is practically the case with all bylaws; they agree to take that.

Senator BYRD. Whether it is cash or scrip?

Mr. STAM. That is right.

Mr. SAXON. I did not get into that, but if the agreement were not there——

Senator TAFT. They are afraid of its being taxed to themselves unless they do that. They want the patron to assume the job.

Mr. SAXON. If that were not clear——

Mr. STAM. The patron assumes the responsibility of reporting that at face value, not market value.

Now, in the case of an ordinary corporation, if the ordinary corporation gets a dividend in stock, that is only includible in the ordinary—I mean, in the stockholder's—income at its fair market value at the date the dividend was received. But in the case of one of these refunds, by virtue of this agreement, you do not pay any attention to the market value at the time the amount is allocated. You take the face amount of the specific certificate, and he is required to include that in his income return.

Senator BYRD. But a stock dividend from a corporation—a tax is not paid on that by the stockholder until he sells the stock.

Mr. STAM. If it is nontaxable stock dividend, but if it is a taxable stock dividend——

Senator BYRD. I mean as to an ordinary stock dividend; that is my understanding.

Mr. SAXON. If it is a true stock dividend, the same stock which is being paid, is not taxable.

Senator BYRD. Until you sell it.

Mr. SAXON. That is right.

Mr. STAM. You have two types. You have what you call the taxable, and you have what you call the nontaxable stock dividend.

Now, in the case of the taxable stock dividend, the dividend may still be in stock, but you include that in your income at the fair market value at the date you received it. If it is a taxable stock dividend, that is what you do.

Senator KERR. Which most of them are.

Mr. STAM. Which most of them may be. It might be stock in another corporation, or something of that sort.

Mr. SAXON. It all depends.

Senator KERR. I want to ask one more question because, following that statement, I understood the Senator from Delaware to say to you, then at a later time that if the cooperative goes broke, the owner of that scrip would then never receive—it would never be redeemed

to him, and he is not entitled to take that loss as a tax-deductible item. I understood the Senator from Delaware to ask that question, and I understood you to answer that in the affirmative.

Mr. SAXON. What the situation would be is this, sir. That he—the owner of the scrip—would usually come in as a creditor, but usually is subordinate to any other creditor of the bankrupt corporation, and he might get a dividend on that scrip and he might not. He might get partial payment or it might be a total loss.

Senator KERR. Is it not a fact that any loss he took on it, the difference between what he accepted it at and what it was eventually redeemed at, would be taken by him as a loss?

Mr. SAXON. It may be deductible for tax purposes.

Senator KERR. Are you sure about that?

Mr. SAXON. I should think so, at least under some circumstances.

Senator KERR. Are you sure, sir?

Mr. SAXON. I am not sure of anything in the tax field. [Laughter.]

Senator KERR. I want to say that is one statement from the witness that I am going to accept.

Mr. SAXON. That is your privilege, sir.

Senator MILLIKIN. Mr. Chairman, I would like to ask the witness to listen attentively to an excerpt from a study made by the staff of the Joint Committee on Internal Revenue Taxation of April 1951, and I am reading from pages 8 and 9, and I am going to ask him whether it is correct, and if it is not correct, in what respects it is incorrect.

Cooperatives are taxable as corporations and are subject to the regular corporate income and regular excess-profits tax rate. The difference in their treatment under the corporate-income tax and the treatment of ordinary business corporations arises from their practice of allocating their net margins as patronage dividends and computing their tax only on that amount of their net margins which is not so allocated. To be permitted this privilege, the cooperative association must have agreed at the time of the original transaction with the patrons to return any net proceeds to him in proportion to patronage. Moreover, if only members may receive patronage dividends, the cooperative may not exclude from its gross income the portion of any distribution to members which represents profits from dealings with nonmembers. This principle was announced by the Bureau of Internal Revenue as long ago as 1918 when Treasury decision 2737 stated "where such refund payments are made in accordance with bylaws or published rules regularly adhered to, they are to be regarded as discounts or rebates tending to reduce the taxable net income of the organization. Like discounts generally they should appear as an added item of cost in the detailed schedule of cost items submitted with the organization's return of income."

In determining the amount of patronage dividends whh reduicced the net margins of the cooperatives, no distinction has been drawn between patronage dividends paid in cash and such dividends in the form of stock, revolving fund certificates, certificates of indebtedness, or letters of advice as to net amounts retained or credited to the patron's accounts on the books of the cooperative. All such forms of distribution or allocation are regarded as the equivalent of cash distributions in the hands of the patrons, the theory being that they are cash payments which have been automatically reinvested in the association under provisions of the charter, bylaws, or other contracts previously agreed to by the patrons.

Is that correct?

Mr. SAXON. I should say every word of it is correct, as I understand it.

I think, sir, that I could help a bit——

Senator TAFT. May I ask, sir, the distinction again—is that with respect to 101 cooperatives, or is that a general statement?

Mr. SAXON. That is with reference to cooperatives outside of section 101 subsection (12), I believe.

Senator MILLIKIN. Is that a 101 corporation you are talking about or nonexempt cooperatives?

Mr. STAM. I am sorry. I was out of the room when that question was asked.

Senator MILLIKIN. I am reading from pages 8 and 9 under the subject of taxable cooperatives and present tax treatment. Are you referring to exempt corporations, nonexempt corporations, or both?

Mr. STAM. That particular paragraph you are reading from refers only to the taxable cooperatives, that is, those not exempt under 101, because if they are exempt under 101 they do not have the problem except as far as the patron is concerned, and the individual patron, he would be subject to the same requirement about including that patronage refund in his income.

Senator MILLIKIN. Under the interpretation of Mr. Stam that that is talking about nonexempt cooperatives, do you agree it is a correct statement?

Mr. SAXON. Yes, I think, sir, that I could help just a little bit to clear up some of the confusion in this whole terminology of words used by the cooperatives.

The question of what is income and what is capital and the difference between capital and property, if you would give me just a moment or two on that, I could help clarify some of the confusion.

Capital may be in many forms, in land or in the form of money, of property, of physical things; anything that is tangible and useful to man, an economist considers to be capital.

Capital produces certain benefits which we call income and an economist divides that income into four classifications: The income from land is called rent; the income from money is called interest; the income from labor is called wages; and then there is the fourth factor, which is called profit. Profit is compensation for risk.

Now, if we did not have either man-made or natural risks in the world we would have only three kinds of income, riskless rent, which is the return on land; riskless interest which is the return on money; and riskless wages, which is the return for labor; but since we do have risks, profits to the economist, are the compensations for risks absorbed, and the capital or the property that absorbs the risks earns the profit.

Now, when we talk in terms of income and profit generally of corporations, we use the terms loosely and what we call corporate income is a composite of rent, interest, wages of management, and the compensation for risk.

When you organize a corporation, whether it is a cooperative corporation or whether it is a proprietary corporation, the stockholder has limited liability, liability limited to the investment which he puts into the corporation, whether it is a cooperative or a proprietary corporation.

Now, the minute you put your money into a corporation by either stocks or bonds, the capital which you owned the minute before is no longer your capital, it is now the capital of the corporation.

The corporation now has a contract with you in the form of a stock or bond, which we call property, a property right. You have a contract or a claim against the corporation, but your capital has

now become the capital of the corporation, and if the corporation fails you are not liable for debts of the corporation, and if you fail, the corporation is not liable for your debts.

Now, that makes your difference whether you invest in bonds or stocks. The minute you put your cash into the corporation, it is no longer your capital.

Now, a formed cooperative, therefore, is absolutely unsound in logic or reason or justice when they claim that they do not have any income. The cooperative is organized and it is capitalized by its members, some of it in the form of stock, some in the form of property which is given them for disposal, sale, or holding for higher markets, and some in the form of so-called patronage dividends which are retained and held in the form of various kinds of scrip.

All of that is capital to the corporation. That capital then goes to work to earn profits, and they can only earn profits by absorbing risks, and the cooperative corporation is the legal entity that earns the profits, because it is the only capital holder—it has the only capital which is risked in the business and, consequently, to say that patronage dividends should be deducted from the profit of the corporation before it accounts for any income is not looking at realities of logic or law or equity.

If the cooperative fails, the capital of the member of the cooperative is not at stake. And if the member fails the capital of the cooperative is not at stake.

The risk is what produces the profit, and to the owner of the risk goes the profit, and no matter what you call it, patronage dividends, rebates or what not, it is merely a distribution of profit that is earned solely because the capital of the corporation has absorbed risks, and has been successfully managed, and is efficiently managed and, as a consequence, there is a net gain on the operation.

Now, the difference between patronage dividends, Senator Taft and rebates, in my opinion, is this, sir: There are two major kinds of rebates in commercial business. If you want to get your cash in more rapidly than the trade terms would permit, say, if you were selling ordinarily on 30-day terms, and you offer your customers cash less 1 percent or net in 60 days, you do it for the purpose of increasing your capital turn-over and making more money, and the recipient of that discount knows at the time when he pays it exactly what he has to pay.

If it is not determined a year later—furthermore, it is payable regardless of whether the corporation makes a profit or not at the end of the year.

Now, the second type of commercial rebate is one based upon volume of business done. I will give you these thousand articles for $10,000 but if you buy 10,000, I will give you a 30-percent discount for volume.

Again, the purpose that the corporation has in mind is to make additional profit by a lower-unit cost on a larger volume of business, and that discount is known at the time the deal is made, and it is not determined at some indeterminate date in the future.

Senator TAFT. What difference does that make? I do not see what difference it makes? Sure, there are different kinds of discounts, and there is another kind of discount, one that will give it back to you if they find that they have overcharged you, if they find that they made more profit than they needed, and they will give it back.

I do not see any difference at all.

Mr. SAXON. Just permit me to carry it out, if you will, please. The individual who gets that quantity discount is paid that discount or is entitled to it, regardless of whether the corporation makes a profit that year.

Now, let us take patronage dividends on the contrary. The patronage dividends are not determined until the end of the year when the cooperative determines that it has got a profit, and then and they only—and furthermore——

Senator TAFT. I do not see what difference it makes. For all practical purposes, because you are a member, you bought your stuff cheaper because they are not taking the profit; they are not taking the profit; they are giving it back to the people who deal with them.

Mr. SAXON. Well, Senator, suppose——

Senator TAFT. I cannot see any basis for claiming that is really in substance, whatever it may be technically or legally, anything except a reduction in the price of the goods that you are selling or buying for your members.

Mr. SAXON. Let us suppose I am a cooperative manager, and you come to me with 10,000 bushels of wheat, and you say, "Sell this on the market." I sell that on the market, or I take it in and hold it. It may be that actually we suffer a loss on that compared with your cost of production, or I may give you $20,000 for the wheat.

Yet at the end of the year, because this same cooperative owns oil wells, owns a tractor manufacturing company, and they make $10,-000,000, and you are going to get a dividend not because your wheat was sold at a profit, but because the oil wells—even the gold mines, possibly—under the Treasury rulings have shown a profit on a transaction that was not related to anything that you did, sir.

Senator TAFT. Do you not think that many private dealers do the same thing? They sell some things at less than cost because they are making a profit on a lot of other things? I do not see any difference.

Mr. SAXON. There is certainly the sale of loss leaders, sir, but we are talking of the question of tax exemption.

Now, take the Ford Motor Co.——

Senator TAFT. I am talking about the question of whether this is, in fact, a profit or whether, in fact, they are not letting their members buy things cheaper because of the form of organization, or not letting them pay more for their goods. That is why the farmers get together to do it.

Mr. SAXON. If it is not a profit, why do they have to wait until the end of the year to determine whether they have a loss or profit, and do not distribute it if there is a loss?

Senator TAFT. Because they are not operating for purposes of profit and they say, in effect, "we do not want to make a profit more than reserves and, therefore, we will see that you get the full price."

They say, "We cannot do it safely now; we are not sure, but we can do it and figure it up at the end of the year."

I do not see any argument against patronage dividends and I think, as a matter of fact, you are barking up an impossible tree because I do not think there is the slightest chance that Congress is going to tax patronage dividends.

Mr. SAXON. I was going to say that I do not think that the Congress understands the problems.

Senator TAFT. I think they do understand it, because they understand what the cooperative movement is. That is what it is for, so that its members——

Mr. SAXON. Let me pose you this question, sir.

Senator TAFT. So that its members get things cheaper because of the fact that they are all linked together and nobody is making a profit on it.

Mr. SAXON. Do you think—I am talking of the question of the fairness of it—do you think it is fair for a group of, say, Iowa farmers who go to speculating and prospecting for oil and drilling oil and refining oil and selling it at a profit in competition with oil companies and refining companies that pay taxes to the Government?

Senator TAFT. That is entirely another question. If they get it back that year in proportion to what they sell the company, the company is going to have to make that deduction with some reference to their purchase of those commodities. You cannot take a tremendous loss, and will not probably on any particular feature of their business.

Mr. SAXON. Well, sir, what is the relationship between producing oil in Texas and growing corn in Kansas?

Senator TAFT. If they then sell it to their members cheaper by reason of the fact that they produced it, if they sell that oil to their members cheaper, that seems to me a result of their form of organization. But they are not keeping it for themselves, but keeping it for their members.

Mr. SAXON. What becomes of the argument that there is no profit? Assume you do not make a profit on your grain operations, and make a profit on your oil. I just do not see how you can relate the two.

Senator TAFT. Everybody relates the two; every business corporation relates tham. That is the way people run their businesses. They make a profit on one thing, and there may be a loss on another, and they think they are sensible men if they are a cooperative, they see that they do not lose on any feature of their business.

Mr. SAXON. The Supreme Court would not let a proprietary corporation do that.

Senator TAFT. Let a proprietary corporation do what?

Mr. SAXON. Make an announcement in advance that they will pay a dividend.

Senator TAFT. You give me that opinion and we will look it up, but I cannot see the slightest difference between what a private corporation can do in the same field if they do not want to keep a profit for themselves—they are willing to distribute money in relation to the people with whom they deal not as members but as——

Senator KERR. Patrons.

Senator TAFT. Patrons of their business; it seems to me that is part of the cost of the patron. It affects retroactively perhaps a very short distance, the price that they pay or the price that they charge their patrons, but that is what it affects, not the profits that they make.

Senator BYRD. What you mean is that they could give a rebate?

Senator TAFT. What?

Senator BYRD. You mean that they could give a rebate to the customers?

Senator TAFT. I can say to you, "I will pay you so much for your wheat but if I find, as a matter of fact, I did not need that much in order to make that profit return on that as I thought, I will give it

back to you at the end of the year, which will increase the price that I paid you."

It seems to me a perfectly reasonable thing, having no relation to profits made by that company. That company is doing business at a better price for its members or its customers, as long as the distribution is in accord with the total business done with that fellow and not with relation to his investment or anything of that kind.

Mr. SAXON. Let me pose this situation to you. Let us suppose that General Motors declared at the end of this year a $100 refund, a patronage dividend, we will call it, to every customer that bought a car this year. How long do you think the board of directors and the officers of General Motors would be in office? The stockholders would say that, "You have violated your duty to the stockholders."

Senator TAFT. I do not think the stockholders would say anything of the kind. They would say, "If you think that is the way to run this business and get a better patronage and sell more cars," they would approve it.

Take this question, Mr. Saxon: Here is a fellow, here is a landowner. He rents a store to a company and he charges him so much rent, but if they do so much business or if they make so much profit they must pay an additional rent at the end of the year, based on that profit.

Mr. SAXON. I think that is perfectly proper.

Senator TAFT. Why, certainly.

And that fellow deducts the rent that he pays; the owner pays an income tax on the whole rent that he received.

Mr. SAXON. But you cut me off in midstream. I said it was perfectly proper but the corporation might still have to pay a tax to the Treasury on it.

Senator TAFT. They would not pay at all. The additional supplemental bonus they have to pay on that rent is deductible as to them.

Mr. SAXON. I will give you a reference to a decision on that. See *Hightower* v. *Comm.* (8 T. C. M. 1003, affirmed C. C. A. 5 on March 19, 1951).

Senator TAFT. Why, certainly. There is no question on that. If you figure up—most of these store rents today are based on percentage of gross, and a good many on a percentage of net, and no matter how you figure it if you pay that rent it is deductible from your taxes as part of your expense.

Mr. SAXON. Under certain qualifications. If it is paid to the equitable owners, it may be disallowed as a deduction.

Senator MILLIKIN. I think there is a distinction at this point. A corporation can allow a discount or it can allow bonuses which are all a part of its pricing mechanism, but when it gets through——

Mr. SAXON. That is right.

Senator MILLIKIN. When it gets through with those discounts and those bonuses, or whatever device it sets up in order to establish price on its goods——

Mr. SAXON. Provided that is determined——

Senator MILLIKIN. If it has a corporate profit it pays a tax on the corporate profits.

Mr. SAXON. That is right, and I agree with everything you said provided the deal is made at the time and the amount is determined at the time the deal is made.

Senator WILLIAMS. Mr. Chairman, I think——

Senator TAFT. Mr. Stam has pointed out here the return of patronage dividends must be set out in the bylaws, the basis on which it is done.

Senator KERR. In the agreement.

Senator TAFT. The basis on which it is done. It leaves certain leeway.

Mr. SAXON. There is nothing to prevent a proprietary corporation from reorganizing as a cooperative and doing that, but it would not dare to do that without organizing as a cooperative.

Senator TAFT. I do not see why not.

Senator MILLIKIN. A private corporation can maintain its prices by rebate or discount.

Mr. SAXON. That is right.

Senator MILLIKIN. It is just a way of setting a price on its goods.

Mr. SAXON. That is right, but a bargain sale to members may be a dividend in disguise.

Senator MILLIKIN. But if, when it gets through with all that, it has a profit, it has to pay Government taxes.

Mr. SAXON. That is right.

Senator TAFT. No; it does not have to pay taxes—Government taxes, if it proposes to redistribute some part of that profit to people it dealt with during the year, and if it does so and says so in advance, as a cooperative says in advance, then it——

Senator MILLIKIN. If it does so, and after it is through doing so, it has a profit, it pays a tax?

Senator TAFT. Oh, yes. That is not the question. I am not talking about that.

Senator MILLIKIN. And that point is the whole distinction in this discussion here.

Senator TAFT. That is on the reserve.

Senator BYRD. Senator Flanders?

Senator FLANDERS. I think it would help me at least if Mr. Saxon could in a few well-chosen words tell us what the nature of the Supreme Court decision is. There is one, we have been informed, but it might help if you could tell us what it determined.

Mr. SAXON. I am not at all sure, but I think there was a situation, sir. I cannot give you any citation. It may have been about 1916.

In that situation the Ford Motor Co. declared in advance that it would, if it sold so many cars that year, pay a $50 rebate to every customer who bought a car that year. It did so, and it deducted the amount from its income.

Senator FLANDERS. Thank you. That seems to be pertinent to this business.

Mr. SAXON. Yes, and there is a Ford case holding that a corporate entity cannot be disregarded taxwise.

Senator TAFT. I would like to see the opinion.

Mr. SAXON. I will see that you get a copy of it.

Senator MARTIN. Mr. Chairman, would it not be a good idea to put the gist of that opinion in the record, because I think it is a pretty important thing.

(The opinion referred to is as follows:)

In *Ford Motor Co.* v. *United States* ((1935) 9 F. Supp. 590, cert. den. 296 U. S. 636), the Ford Motor Co. (Michigan) was the wholly-owned subsidiary of Ford Motor Co. (Delaware). The former owed the Government $9,023,708.67 in corporation income taxes while the latter had overpaid $7,787,696.26. Because of their close relationship, the Commissioner treated them as one corporation for tax purposes. The court, however, pointed out that the Ford Motor Co. of Michigan was the owner of its assets and exercised complete and unrestricted control over them; furthermore, although Ford Motor Co. of Delaware was the parent company, it did not own or control the subsidiaries' assets. It held that these separate entities could not be disregarded and that each corporation should be taxed as a separate entity.

Senator WILLIAMS. Mr. Chairman, I think it would be well to point out for the record that while I agree with the witness that there is a tax inequality, and to a certain extent agree with his statement, as Senator Taft has said, there has been no proposal before this committee to tax the dividends in their entirety.

I know that I am the sponsor of the amendment that we have, and on which these hearings are being held now, and that amendment does provide for an exemption for the cooperative—they can pay these refunds out in cash to their customers at the end of the year, and to that extent I cannot subscribe to your theory.

Mr. SAXON. Well, Senator, you are merely codifying the Treasury rulings that have been in existence since 1913; you are not going to change the situation one iota. You are just simply saying by law what the Treasury has said for thirty-odd years.

Senator WILLIAMS. I agree to that extent, but I say that because, as Senator Taft pointed out, many of us feel that the cooperatives do have an essential part in our economy, and we are extending them, and Congress did extend to them advantages, and I will go along to a certain extent on these advantages, although on these tax-exempt reserves that they have been setting up, I think that is in there and I think that these patronage dividends that are paid out should be paid in cash or something similar to these farmers so that they will not have to be put in the position of merely getting a piece of scrip which is, in itself a tax liability upon something that they never can get cashed because——

Mr. SAXON. I agree to that, sir. But you are not going to change the competitive disadvantages that you are putting the competitor of the cooperative to at all.

Senator WILLIAMS. It might not change it.

Mr. SAXON. You are not going to increase your tax revenue.

Senator WILLIAMS. It might not change it entirely as you and I see it, but it would correct, to a certain extent, the inequity that exists, and would collect some revenue.

Senator BYRD. Let the Chair make a statement.

A suggestion has been made that the Supreme Court decision——

Mr. SAXON. I think it is the Ford case.

Senator BYRD. What is the name of it?

Mr. SAXON. I think it is *Treasury* v. *Ford*.

Senator BYRD. Let me say this: It is suggested that that be summarized and put in the record. That will be done.

Senator MARTIN. At least the syllabus of the case.

Senator BYRD. It will be summarized.

Mr. SAXON. I shall be happy to look into it. My information is hearsay. If I can find the case I shall supply it.

The Chair further states that there are two experts on their way down from the Treasury Department to clear some of these things up for us.

The more experts you get sometimes the more confusion you get. [Laughter.]

Mr. SAXON. Mr. Chairman, I would like to say just one or two other things make one or two other points, and those are these: That the cooperatives have served a very useful function in this country.

There are many of them that have performed very vital and necessary functions, particularly in the past where you had a situation where you did not have adequate marketing and purchasing facilities in the years past.

But today the United States has the most efficient marketing economy of any nation in the world. The local grist mill and the local corner store monopoly has been eliminated, and there is simply no justification for one corporation on one side of the street paying 50 percent or more of its profits to the Government, and one across the street being totally tax-exempted.

I would like, if you will permit me, to ask Mr. Lester, who is the president of the Tax Equality Association, to give you one or two brief illustrations of the competitive advantages that the cooperatives have over their tax-paying competitors.

Senator BYRD. We will be glad to hear Mr. Lester, but we have three witnesses here of the National Tax Equality Association, and we are limited for time.

Mr. LESTER. It will not take but just a minute, Senator.

My name is Garner M. Lester.

Senator BYRD. You have concluded, Doctor?

Mr. SAXON. Yes; thank you very much.

Senator BYRD. Is there anything you desire to insert in the record in addition to what you have said?

Senator KERR. I would presume you wanted this statement in the record, Mr. Saxon?

Mr. SAXON. I may say that was presented and printed in the hearings of the Ways and Means Committee, but I will give each of you a copy of the larger document.

This shorter statement is a supplementary statement I would like to have incorporated in the record, if I may.

Senator BYRD. Without objection, that will be done. The larger statement is for the information of the committee.

Mr. SAXON. Thank you.

(The documents referred to are as follows:)

STATEMENT OF O. GLENN SAXON, PROFESSOR OF ECONOMICS, YALE UNIVERSITY, FOR THE NATIONAL TAX EQUALITY ASSOCIATION

Capital stock fire and casualty insurance companies are vitally affected by the income tax treatment of their mutual fire and casualty insurance corporation competitors. As corporate tax rates increase, the tax advantage of the mutual corporations becomes greater. With an excess profits tax in operation, the tax advantage enjoyed by the mutual corporations is almost great enough to offset their payment of policyholder dividends. Stock companies cannot continue to meet mutual competition when the mutual corporation can use the tax they don't pay to pay a substanital part of their policyholder dividends.

The House made a very commendable attempt to remove the tax advantage of the mutual corporations in the 1942 Revenue Act. Your committee did not

see fit to go along with the House version of the 1942 act, and the issue was finally compromised by the Congress. It departed from our traditional concepts of net income to levy, what, in effect, is a gross-income tax on the mutual corporations. At the time, however, the mutual insurance corporations insisted that the gross-income formula would yield substantially the same amount of tax as the capital-stock-company formula. No one could disprove that contention, although representatives of the capital-stock companies insisted that it would not produce tax equality. Now, 8 years later, we have sufficient experience to prove that the mutual formula does not begin to impose the same income tax burden on the mutual corporations as the capital-stock formula imposes on the stock companies. This disparity will be further aggravated by the imposition of excess,-profits taxes which are inoperative on companies which are generally taxed on receipts rather than profits. It is a well known fact that few mutual fire and casualty insurance corporations paid any excess profits taxes during World War II.

There is no legal or economic justification for taxing mutual fire and casualty insurance corporations on a gross receipts basis while taxing their capital-stock competitors on net income as all other corporations are taxed. This situation can only be corrected by requiring both types of corporations to pay Federal income taxes on the same statutory basis. We can see no need for two sets of tax laws to measure the relative ability of the mutual and stock fire and casualty insurance corporations to pay taxes. Both types of corporations operate in a profit and loss economy. The mutual companies' contention that they have no profits from their underwriting business will not stand the test of legal or economic examination, nor will present methods of operation prove this theory. In their appearance before this committee on July 17, the spokesmen for the capital stock and mutual life insurance companies stated, "A tax differential between stock and mutual companies would be an unbearable burden upon the young progressive stock companies * * *." The witness added, "So far as I know no tax bill ever enacted by any legislative body in the United States has discriminated between the two classes of life insurance companies." He continued, "The associations which I represent are clearly on record in favor of equal treatment. The result of such discriminations would be fatal to many small companies—serious to most of them—and the net result would be to channel more and more of the business to the giants (mutuals) and less and less to their smaller (stock) competitors."

In the life insurance field, the mutuals dominate the business. Over 80 percent of all life insurance in force is placed with the mutuals. If present tax inequities in the fields of fire and casualty insurance are permitted to continue in favor of mutual companies it will be only a matter of time, and a very short period of time indeed, until the mutuals will dominate this field of insurance also.

Once the mutuals get in that place of domination they will no doubt be appearing before your committee, not as today, seeking a continuation of special privilege over their stock company competitors who have been fortunate enough to survive, but rather to seek the formula that will tax the industry as a whole to the smallest extent possible, and probably equally as mutual life insurance companies have requested here just 2 days ago.

In a broad sense, all insurance contracts are "mutual" in that the premiums of many pay the losses of the few. It is only incidental that in the case of stock companies the original or subsequently issued capital is subscribed by shareholders, while the original capital of mutual insurers is subscribed by shareholder-members. Subsequent accretions to assets in both cases inure to the benefit and profit of the suppliers of the original capital as well as to the policyholders. The capital and reserves of both types of corporations are the legal property of the corporation. The corporate assets in both cases are liable for the debts of the company and are disposable in the discretion of the directors or managers and not of any individual shareholder or policyholder. Of course, as in the case of a stock company, the surplus of a mutual would be distributable to someone if the corporation should dissolve or liquidate. But for Federal tax purposes the corporation is a taxable entity so long as it exists, and should be required to account taxwise for its profits irrespective of when or how such profits are subsequently distributed to the participants in the corporate venture.

The income-tax laws contemplate the imposition of a tax upon the taxpayer which earns the profits. If mutual corporations so conduct their business that they distribute earnings back to policyholders as dividends, then under existing corporate tax laws they should not be entitled to deduct such distributions of profits for tax purposes. Our courts have reiterated, time after time, that a taxpayer is free to conduct its business as it sees fit, but in so doing incurs the

tax liability which goes with such form of profit-making ventures. Taxpayers, whether stock or mutual or otherwise, should not be entitled to cloak their activities under the guise of "organizations not for profit," in order to gain tax exemption or more favorable tax treatment at the expense of other taxpayers.

Spokesmen for the mutual fire and casualty insurance corporations argue that they should be tax-free on their insurance operation because they in effect underwrite "at bare cost." This line of argument is fallacious. It is a fundamental of insurance that averaging of losses can be effected through the combining of individual risks. The combination of coverages increases and broadens the intermingling of such individual risks, so that the "bare cost" of each individual underwriting cannot be determined. When a company writes every conceivable type of coverage, from boiler explosion to personal accident, from fire to fidelity bonds and intermingles the results of this underwriting and of these various and sundry cash transactions, it cannot be argued that, as to any single risk, the insurance is written "at bare cost." The term "bare cost," in the case of any insurer can be ascertained only with respect to its total business over a fixed period of time; and, an insurer can only arrive at such a conclusion by totaling the losses and expenses over a fixed period of time and calculating the net earned underwriting income for the period and setting the one against the other. If they are equal, then on the average the premiums were precisely estimated. It would be putting coincidence to too great a test to expect any such degree of precision in each and every branch of the business written, whether it be fire, automobile, marine, casualty, or surety. There is not sufficient actuarial science in the field of fire and casualty insurance upon which to predict with accuracy the underwriting losses that may be experienced. Judgment plays a very important part in the make-up of rates. Unusual events such as the removal of gas restrictions following the last war can send losses sky high. It is impossible in such circumstances to anticipate bare cost of insurance underwriting.

Consideration of the time element in insurance contracts likewise confirms the impossibility of ascertaining the underwriting bare cost. Policies are written every day in the year and losses occur daily. Not only are policies written that expire any day of the year, but they are written for varying periods, usually from 1 to 5 years. Furthermore, there may be cancellations with different return premium rates, depending upon whether the insured or the company cancels.

An even more pertinent situation is brought to light when the management of a mutual corporation decides to enter a new field, such as bonding or boiler insurance. To do so means recruiting a highly technical home office and field staff, buying new equipment and generally incurring various expenses. It also means assuming all the business risks of a new venture which management now decides to take. The automobile policyholder, the plateglass policyholder, the fire policyholder, all must involuntarily contribute to the new venture, which can have no effect except to raise their costs because of this managerial action over which they have not the slightest control. The new capital necessary is not raised in the capital market—but comes out of the current operations or surplus. The losses of the new department are intermingled with the profit or loss on current business. Dividends are declared and distributed on the new accounts, as well as the old, even though the new business is temporarily underwritten at a loss. Thus, the expenses of the new department and resulting temporary losses are involuntarily paid for from profits realized from other profitable underwritings.

It is also true that for some risks more is charged than is necessary to carry the class as such, while for other risks less is charged. Thus the surplus paid in by some policyholders is offset by a deficiency in payments by others.

It should also be noted that it is common practice for mutuals to cede and accept reinsurance to and from other insurers. These are clearly commercial transactions with nonmembers from which gain or loss results. The gain, if any, will appear in its surplus, part of which may be distributed to policyholders, or held for ultimate distribution or used for other business purposes. All such distributions represent an arbitary allotment of profits from a business venture.

The creation of a yearly surplus by a complicated operation of the insurance business is accomplished in the same way by both stock and mutual insurers. The fact that it is distributed in one case to stockholders and in another case to policyholders does not in any way alter the essence of its creation. To view it otherwise is to place the emphasis of tax liability on the manner of distribution of the profit rather than the manner in which it was created which, under tax law, is the proper test. For these reasons, both the mutual fire and casualty insurance corporations and the capital stock fire and casualty insurance corporations should be taxed under the same tax formula.

In general, stock companies are taxed on investment income plus underwriting profits at regular corporate rates.

Mutual fire and casualty insurance corporations either pay regular corporate rates on investment income only, or 1 percent of gross income including rents, dividends and interest, less policyholder dividends—whichever produces the greater tax. In practically all cases, the mutual companies' tax bill is determined by the 1 percent of gross formula, so that the mutual corporations' tax liability becomes dependent upon gross income and not upon the net income as is the case with the stock company.

The degree of advantage enjoyed by the mutual insurance corporations under the 1942 law is summarized in the following table which details the business volume and the underwriting and investment profits as compared with Federal income taxes paid for the years 1943 to 1949, inclusive.

Operations of insurance corporations in the fire and casualty fields compared to Federal income taxes paid

[In thousands of dollars]

Year	Number of companies	Earned premiums	Underwriting profit	Investment profit	Total profit	Federal income tax paid	Tax as percent of earned premiums	Tax as percent of total profit
		Mutual fire						
1949	207	$343,319	$117,485	$26,183	$143,668	$4,267	1.24	3.0
1948	197	306,382	85,747	10,564	96,311	3,755	1.22	3.9
1947	193	290,014	68,401	9,102	77,503	3,067	1.17	4.0
1946	197	214,318	52,741	4,703	57,444	2,612	1.22	4.5
1945	195	189,563	51,059	25,597	76,656	2,719	1.43	3.5
1944	193	176,705	50,538	17,054	67,592	2,579	1.46	3.8
1943	192	162,588	55,154	16,936	72,090	2,593	1.59	3.6
Total	....	1,653,519	481,125	110,139	591,264	21,582	1.31	3.6
		Stock fire						
1949	370	$2,225,088	$283,951	$361,875	$645,826	$128,039	5.75	19.8
1948	367	1,996,179	117,140	88,397	205,537	54,320	2.72	26.4
1947	363	1,721,155	[1]74,930	68,911	[1]6,019	9,848	.57	([2])
1946	355	1,324,225	[1]114,970	[1]28,677	[1]143,647	6,650	.50	([2])
1945	357	1,128,333	[1]34,377	362,466	328,089	16,313	1.45	5.0
1944	352	1,046,467	[1]22,131	232,002	209,871	13,143	1.25	6.3
1943	352	1,012,629	47,017	239,534	286,551	27,727	2.74	9.7
Total	....	10,454,676	201,700	1,324,508	1,526,208	256,040	2.45	16.8
		Mutual casualty						
1949	155	$896,474	$129,623	$33,065	$162,688	$8,547	0.95	5.3
1948	155	814,722	124,669	17,522	142,191	7,460	.91	5.2
1947	155	685,384	85,875	16,109	101,984	6,746	.98	6.6
1946	156	531,324	45,377	14,562	59,939	5,982	1.13	10.0
1945	151	443,103	53,487	24,416	77,903	4,901	1.11	6.3
1944	145	408,172	63,603	16,339	79,942	3,814	.93	4.8
1943	136	383,700	69,358	14,777	84,135	3,205	.85	3.9
Total	....	4,162,879	571,992	136,790	708,782	40,715	.98	5.7
		Stock casualty						
1949	246	$2,198,649	$137,182	$165,723	$302,905	$60,658	2.76	20.0
1948	229	1,996,751	82,456	63,272	145,728	34,057	1.70	23.4
1947	217	1,665,773	26,085	39,985	66,070	15,801	.95	23.9
1946	210	1,295,977	[1]36,667	17,129	[1]19,538	3,470	.27	([2])
1945	191	1,127,881	67,711	154,440	222,151	21,472	1.90	9.7
1944	181	1,081,635	93,856	98,951	192,807	47,093	4.35	24.4
1943	173	1,015,015	105,700	92,012	197,712	55,601	5.32	28.1
Total	....	10,411,684	476,323	631,512	1,107,835	238,155	2.29	21.5

[1] Deficit.
[2] Loss.

Source: Best's Fire and Casualty Aggregates and Averages.

The foregoing study shows that stock companies in both the fire and casualty fields generally pay greater taxes per dollar of earned premiums or of total investment and underwriting profits than the mutuals. However, in this abnormal period since 1942 stock fire companies experienced underwriting losses in 4 of the 7 years, and stock casualty companies, over-all, experienced underwriting losses in 1 of the 7 years, although many individual companies had a 2 or 3-year cycle of underwriting losses during this periop. The mutual corporations showed over-all profits in each of the 7 years. The period was characterized by heavy inflationary claims and excessive withdrawals of surplus due to statutory requirements in setting up unearned premium reserves. These resulted in greatly curtailed earnings for both the stock and mutual corporations. Therefore, tax payments of the stock corporations, based on earnings, were low due to low earnings, while tax payments of the mutual corporations based on gross income, necessarily remained constant, and did not reflect the low earnings of the period.

The abnormality of the earnings records of various companies in this period, 1942–49, has permitted widespread statistical manipulation by both capital stock and mutual analysts to prove that their respective tax formulas resulted in higher tax payments. In all cases these studies have been based on the tax payments of a carefully selected group of companies, whose earnings records supported the point of view of the analyst. This is an intellectually dishonest approach, frequently employed by the statistician, to reach a predetermined conclusion. The true facts can be obtained only by the use of aggregate figures for the industry as a whole. This has been done in the accompanying table and analysis. We compare taxes paid with earned premiums, which reflect business volume, and with total profits which reflect earnings ability.

Despite the abnormal losses experienced by stock fire and casualty companies during the 7 years that the 1942 tax provisions have been operative, both stock fire and stock casualty companies paid more Federal income tax per earned premium dollar than did the mutual fire and casualty insurance corporations. While stock fire companies paid an annual average of 2.45 percent of their earned premiums in Federal income taxes, the mutual fire corporations paid an annual average of 1.31 percent of their earned premiums in Federal income taxes. Stock casualty companies, on the other hand, paid an average each year of 2.29 percent of their earned premiums in Federal income taxes compared to 0.98 of 1 percent paid by their mutual competitors. Comparison of what appear to be normal years reveals a more startling disparity. For instance, in 1949 stock fire companies paid 5.75 percent of their earned premiums in Federal income taxes while the mutual fire corporations paid only 1.24 percent.

Although premiums earned may serve as a basis for comparison of underwriting results and for tax burdens based thereon, the fact remains that those items do not necessarily measure the tax advantage granted mutual insurance corporations under the Federal income tax laws.

The Federal income tax is levied against a corporation's earning results and not against its business volume. Mutual corporations normally enjoy better earnings; therefore, their true ability to pay Federal income taxes is better reflected by a comparison of taxes paid by them in terms of their total underwriting and investment income. Although the tax measurement in terms of premiums earned establishes mutual insurance corporations as having a definite tax advantage, the use of net earnings as a test show even greater disparities in their tax advantage.

When income tax payments are related to the total of underwriting and investment profits or income, it becomes readily apparent that both stock fire companies and stock casualty companies pay far more income tax per dollar of earnings than do the mutual corporations.

For the 7-year period surveyed, stock fire companies paid an average of 16.8 percent of their profits in Federal income taxes while their mutual competitors paid only 3.6 percent. The only year in the 7-year period studied in which the fire business was close to normal was the year 1949. In that year stock fire companies paid 19.8 percent of their profits in Federal income taxes while the mutual fire companies paid only 3.0 percent.

Stock casualty companies paid 21.5 percent of their profits in Federal income taxes during the years 1943 to 1949, while their mutual competitors paid only 5.7 percent. During the years which might be classes as representative of normal operations (1943–44 and 1947–49), the stock casualty companies paid about 24 percent of their income in income taxes and the mutuals about 5 percent.

Thus, on a comparison of taxes paid per dollar of profit, stock fire corporations pair four times as much in Federal income taxes as did the mutual fire corporations. A similar ratio prevails for the stock and mutual casualty corporations.

This indicates that on the basis of 7 years' experience during which the stock companies suffered severe reverses, the present rates on mutual insurance corporations would have to be quadrupled to produce any degree of competitive tax equality. As the insurance business reaches normalcy again, this ration would become greater, especially in the case of the fire companies.

The figures previously given, showing the relation of net income and tax payments made by mutual and stock corporations operating in the fire and casualty fields, provide the basis for estimating the amount of revenue lost to the Treasury through failure of the Congress to tax mutual insurance corporations on the same basis as stock corporations.

For the purpose of estimating the loss in revenue resulting from the favored tax treatment of the mutual insurance corporations, it has been assumed that the mutuals' tax burden should be equivalent to that of the stock corporations in terms of underwriting and investment profits.

It has already been shown that mutual fire corporations paid 3.6 percent of their total profits in Federal income taxes during the 7-year period 1943 to 1949, inclusive, whereas the stock fire corporations paid 16.8 percent. On this basis tax equality would increase the mutual tax bill approximately 13.2 percent of investment and underwriting profits. Application of the 13.2 percent figure to their total profits of $143,668,000 in 1949, would produce an additional tax of $18,964,000 at the 38 percent rate or about $25,000,000 at present rates and $28,000,000 at the House bill rates.

Mutual casualty corporations during the same 7 years paid 5.7 percent of their total underwriting and investment profits in Federal income taxes on the average, while their stock competitors paid 21.5 percent, a difference of 15.8 percent. The total profits of the mutual casualty corporations in 1949 totaled $162,688,000 indicating that an increased tax bill of $25,704,000 would be necessary to place them upon substantially the same basis at the 38 percent rate of about $35,000,000 at present rates and $40,000,000 at the rate included in the House bill.

It appears therefore that equal taxation of mutual and stock insurance companies would bring a minimum of $60,000,000 annually into the Federal Treasury at present rates and $68,000,000 at House bill rates. During periods of normal underwriting results, however, the revenue gain to the Treasury would be much greater.

The mutual corporations will continue to enjoy a substantial Federal income tax advantage over the stock companies so long as the present formula for taxing them under section 207 of the Internal Revenue Code remains unchanged. This tax disparity becomes most pronounced during periods of normal profitable operations, inasmuch as the stock tax is measured by net profit, whereas the mutual corporations pay on a gross-receipts basis at a 1 percent rate.

The principle of taxation measured by net profits should apply to all corporate taxpayers, including mutuals. There should be no hybrid statutory scheme of taxation enabling a selected class of competing taxpayers to be unjustifiedly favored over another class. Section 207 should be amended to conform to section 204 of the Internal Revenue Code with appropriate amendments thereto clearly stipulating that, as in the case of dividends paid to shareholders, dividends paid to policyholders are not deductible as a business expense.

Do this and you will help lighten the burden that must be borne by present taxpayers and you will greatly contribute to the revenues of the Treasury.

We must tax all income before we increase the taxes of present income taxpayers; otherwise, we may be faced with a complete breakdown in the incentives that have driven many to work longer hours even though the Federal Treasury is the principle recipient of their increased compensation.

We urge competitive tax equality in the fire and casualty insurance fields as it already exists in the field of life insurance.

Representative Cooperative Corporations

(1) Tax-exempt cooperatives

The Farmers Union Grain Terminal Association is a good example of a cooperative association that qualifies for full tax exemption under section 101 (12) of the Internal Revenue Code. This association markets grain in 39 States for more than 150,000 members, handling more than 100,000,000 bushels of country-delivered grain a year. In 1946 it owned 150 country elevators. Through an affiliate, the Great Plains Supply Co., it operates 108 lumber yards throughout a

six-State area. From 1946 to 1950 its net worth increased 87 percent or $9,328,-173, bringing its net worth to $18,878,745.

This expansion is almost entirely capitalized out of tax-exempt earnings, the corporation distributing patronage dividends in the form of stock and certificates of equity.

Net earnings in 1946 were $3,560,000. In 1950 they were $1,801,755 upon which an ordinary corporation would pay Federal income taxes of nearly $846,824 at present rates of taxation.

Another wholly tax exempt cooperative is the Southern States Cooperative of Richmond, Va, which has seven subsidiary corporations, 117 cooperative retail service stores, 10 cooperative freezer plants, and 26 cooperative service stations. It also sells supplies through 46 local cooperative associations and 550 retail stores acting as its agents.

Among the assets of this corporation are 30 wholesale purchasing, processing, manufacturing, distributing, and marketing facilities. It owns seven seed and farm supply warehouses, five feed mills, four fertilizer plants, four egg-marketing terminals, a seed-processing plant, and a river petroleum terminal, as well as two oil-blending plants, a paint factory, and an oil refinery in Texas.

The net worth of this cooperative rose from $646,391 in 1937 to $11,430,945 in 1946, to $18,061,000 in 1950. In 1950 the profits of this cooperative exclusive of the profits of affiliated corporations, amounted to $2,411,000. This income was, of course, tax-free. An ordinary corporation would have paid approximately $1,133,000 to the Government in Federal income taxes at present rates.

The Eastern States Farmers' Exchange, with headquarters in West Springfield, Mass., in 1946 had a total annual business volume of over $56.5 million with declared "savings," or profits, of $499,296 plus $953,207 which was retained for capital expenditures out of current income. In 1948 the total business volume rose to $80,431,000 with declared earnings of $2,128,000 plus $1,273,000 which was retained for capital expenditures.

National Cooperatives, Inc., is a national service organization owned and operated by 24 regional cooperatives in the United States and Canada. The 24 regional cooperatives in 1948 were owned by 5,529 local cooperatives which operated 7,223 retail outlets with 1,747,000 patrons.

The retail business of the local co-ops affiliated with the National exceeded $922 million in 1947, an increase of 32 percent over the previous year.

The California Fruit Growers Exchange and its subsidiaries had an annual business volume estimated at well over $300 million. This cooperative ships more than 85 percent of all lemons and more than 33 percent of all oranges going to market in the United States.

Typical of cooperative operations in heavy industry is the National Farm Machinery Cooperative, which manufactures corn planters, tractors, and numerous farm implements. Its fiscal year ending June 30, 1949, reported a business volume of $19 million with net earnings of $215,000.

(2) Taxable cooperatives

The Consumers Cooperative Association of Kansas City, Mo., is an example of this type of cooperative. In 1948 it reported earnings of $8,320,206 but indicated that its total Federal and State income tax bill would amount to only $415,105. An ordinary corporation making the same profit would have been required to pay $2,000,000 more than the $415,000 that this big cooperative paid to both Federal and State governments. The basis for this $2,000,000 tax advantage was the patronage-dividend device referred to above. The oil business of this cooperative is operated through a wholly owned subsidiary which, in turn, owns the four petroleum refineries, a thousand miles of pipeline, 911 oil wells, 161,000 acres of undeveloped leases, and other similar assets.

Through its retail operations in 10 States, it sells not only petroleum products but also tires, tubes, accessories, paint, twine, spray, feed, machinery, wire and steel, lumber, roofing, groceries, household appliances, and farm supplies, many of which are produced in its own factories.

For example, its facilities include grease, paint, and printing plants; a soybean mill; a cannery; a bottling plant; a lumber mill; a feed mill, and several fertilizer plants.

Another example of this type of corporate organization is the cooperative Grange League Federation Exchange, which, in its 1949–50 fiscal year distributed over a million dollars in patronage dividends, nearly a million dollars in dividends to stockholders, paid an estimated income tax of $1,099,000 and added $847,000 to surplus. If it had been taxed on its full earnings it would have paid

at the 38 percent rate an income tax of $1,534,000 to the Federal Government and so would still have had $412,000 to add to surplus. It seems clear that paying income taxes would not destroy this cooperative. The Grange League Federation Exchange at the close of its 1948–49 fiscal year sold supplies to its members through 282 GLF owned service stores, 365 agency stores, 61 bulk petroleum plants, 14 egg stations, and 45 local cooperative associations.

The Illinois Farm Supply Co. for its 1948 fiscal year reported earnings of $1,998,000. A private corporation would have paid $759,138 in income taxes on these profits. The Illinois Farm Supply Co., however, reported that it paid $414,308 in Federal income taxes.

PAYING TAXES WOULD NOT DESTROY COOPERATIVES

Requiring cooperative corporations to pay income taxes would not destroy them any more than it would destroy any other business corporation. Bearing their fair share of the tax burden might not permit them to expand as fast as they are presently doing but a decrease in the rate of expansion is a far cry from destruction. The Federal income tax only taxes profits. When profits are small, the income tax is small and when there are no profits, there is no income tax.

The Merrimack Farmers' Exchange of Concord, N. H., is a cooperative corporation that has paid Federal income taxes since its inception in 1921. It has stores at 22 country points serving 10,000 patrons. Sales passed the $1 million mark in 1946—reached $5 million in 1942—$10 million in 1944—and in recent years have ranged from $11 million to more than $13 million. From 1943 to 1949 they paid more than 51 percent of their profits, which amounted to $711,674 in Federal income and excess-profits taxes.

The full payment of Federal income taxes by this cooperative merely curtailed its expansion—but it had no effect upon its successful operation. Income tax is exacted in direct proportion to the success enjoyed.

The effect of the application of the Federal income tax to the reported net earnings of cooperative corporations is well illustrated by the following examples:

The Union Equity Cooperative Exchange which operates primarily in Oklahoma, had a ratio of reported net income to invested capital of 40 percent for 1949. This means that the net worth of this cooperative would double every 2½ years that its success continued. After the application of a 50 percent Federal income tax, the ratio of net income to net worth would drop to 20 percent. In other words, if this cooperative were required to pay Federal income taxes at the rate of 50 percent it would still double its net worth every 5 years.

Incidentally, this cooperative elected to pay some Federal income tax in the year 1950 and it has reported that its income and excess-profits taxes would exceed $800,000 for the 1951 fiscal year. During this brief period of income-tax payment the cooperative was still able to expand its business.

In 1949 the ratio of net income to invested capital for the Southern States Cooperative, Inc., was 13.5 percent. After a 50 percent tax the ratio would be 6.7 percent.

For the Eastern States Farmers' Exchange the ratio of net income to capital in 1949 was 28 percent. After paying a 50 percent tax, the ratio would still be 14 percent which would allow the cooperative to double its net worth after every 7 years.

The ratio of net income to capital for the Farmers Union Central Exchange for 1949 was 19.5 percent. After payment of a 50 percent tax, the ratio would be nearly 10 percent.

The above examples clearly indicate the fact that cooperative corporations are well able to pay Federal income taxes without being destroyed. By paying their fair share of the tax burden they would not have their present advantages over their fully taxed competitors but they still would be able to operate successfully and double and redouble their net worth over a period of years.

Senator TAFT. Mr. Saxon, let me ask you one other question on this mutual and stock fire and casualty corporation matter. I see you file a whole statement on it, and I remember the fight in 1942, in which all I remember was that a compromise was reached, which seemed to me to be somewhat mild on the mutual fire and casualty companies.

What change do you want in it? They pay a tax of 1 percent on gross income?

Mr. SAXON. They pay a tax, sir, on the gross income, although it is an optional tax, but 99 percent of them pay it on the gross ncіome. You have had some years of experience now and the record shows that the tax paid by the mutuals is one-quarter of the tax paid by the stock companies.

Senator TAFT. By the stock companies?

Mr. SAXON. Yes; and all that they are asking for is fair treatment and equality of treatment. You will recall, sir, that there is no discrimination against the stock life companies on behalf of the mutual life companies, and——

Senator TAFT. They are practically all mutual now.

Mr. SAXON. Well, 80 percent of them are.

Senator TAFT. In fire and casualty there are more stock.

Mr. SAXON. If you continue the present inequity and inequality pretty soon there will be no stock casualty companies, the same as you have very few stock life companies. That is exactly the point I am proving, sir, they cannot continue to exist under those conditions.

Senator BYRD. Thank you very much.

Mr. SAXON. Thank you, sir.

STATEMENT OF GARNER M. LESTER, PRESIDENT, NATIONAL TAX EQUALITY ASSOCIATION

Senator BYRD. Please identify yourself.

Mr. LESTER. I am Garner Lester. I live in Jackson, Miss., and I am a farmer, cotton ginner, seed and fertilizer business.

I am also president of the National Tax Equality Association.

Mr. Chairman, just one or two little points: As a practical competitor, and working in the same community with the cooperatives, I run into it every day and I would just like to bring out one or two points for the committee here.

First is this illustration of just how and what it does to me personally. In one of our locations the county agent called a meeting of the farmers and wanted to organize a cooperative cotton gin. I attended the meeting and I told them that I would sell them my plant there, and they said, "No, we do not want to buy a plant." They wanted to build a new one. One farmer said, "I want to be in business just like you are." So they did build a plant, and they go out here—I want to illustrate just how it works with doing business with mostly their own members.

They have to do no more business with outside people than they do with their own members. Well, they do business, say, with a hundred farmers. Fifty-one percent of them are members, and forty-nine percent are not.

Well, the next year they issue stock to these 49 percent patrons who were not members in payment of their patronage dividend, and so the next year they have 100 members, and the next year they get 199. It just multiplies itself right on up, so that is the competition that I face as a private businessman down there, showing that this doing business with 51 percent of the members only is meaningless because they usually issue stock in payment of this patronage dividend, and then they are all members.

In fact, I am a member of the cooperative myself, and that is how I got in, don't you see?

Senator BYRD. You are still a member?

Mr. LESTER. Sir?

Senator BYRD. You are still a member?

Mr. LESTER. When I got into this fight, I do not know whether I am a member or not. I know I have not got any dividends for a long time.

Senator BYRD. Let me ask you this.

Mr. LESTER. Yes.

Senator BYRD. Is this stock dividend taxable then to the recipients, or not?

Mr. LESTER. I heard a lot of discussion about it just now, including a lot of Supreme Court rulings.

I want to say this to the Treasury Department: I never have paid any taxes on it. I told my own tax collector that.

Senator BYRD. That is a stock dividend, not scrip?

Mr. LESTER. Yes, sir. I never did see the stock. All I got was a letter, a mimeographed letter, saying such-and-such happened, and it was held by the treasurer of the cooperative, and I could not sell it until the board of directors had determined it.

Senator BYRD. Is that very generally recognized as a subject of taxation, the scrip that is given?

Mr. LESTER. Well, in my territory it is not. I do not know ever of anyone who paid any taxes on any scrip from a cooperative.

Senator BYRD. Do you think it is legally liable for taxation?

Mr. LESTER. My interpretation would be that it was.

Senator BYRD. All right.

Mr. LESTER. Now, what happened after they built this gin, when they had finished it, they went into the seed and fertilizer business, like I did, and now they have one quarter-million-dollar plant there in this same town where I sell seed and fertilizers.

One of the members of the firm came to me and said "I want to thank you." I said, "What for?"

He said, "You stirred up such a row about not paying taxes and not paying dividends." This year there were paid out some dividends in cash, the first time in 13 years.

What happened to me is that they have got modern equipment and everything else. They have a definite advantage in the ordinary fields of doing business, Senator.

Senator MILLIKIN. May I ask a question, please?

Mr. LESTER. Yes.

Senator MILLIKIN. You say they have got modern equipment, which I assume, you are not able to supply in ordinary competition. Let us see how that comes about. I would like to know. I have no theory on that at all. I would just like to get some facts.

Here is your gin over here; here is their gin over there. You each make $10,000 profit. All right. What is the process whereby they can do things that you cannot do that puts you in a hole competitively?

Mr. LESTER. I am glad you asked that, Senator. Let me start.

Senator MILLIKIN. Let us keep it simple.

Mr. LESTER. Let me start with myself.

Senator MILLIKIN. Yes.

Mr. LESTER. All right.

If I make $10,000 I have got to pay the individual tax rate on that $10,060 no matter what I do with the money.

Senator MILLIKIN. Are you a corporation or an individual?

Mr. LESTER. I am talking about the individual.

Senator BYRD. You are speaking individually?

Mr. LESTER. I am speaking individually, but I am also a partnership. I will get to that in a minute.

If I make $10,000 I have got to pay the individual tax on that $10,000, all right. I have got to pay the tax whether I take the money out of the business or not.

All right, now. Let us get on to a partnership. I am also a partner in another business, too. We make $10,000. If we do, then I have to pay on $5,000 and my partner has to pay on $5,000, whether we take 1 penny out of the business or not.

Not only that, as a partner, I am liable for any debt or losses the partnership incurs. I have no legal protection; if he runs off with the money I must put it up because I am a partner.

Senator MILLIKIN. As an individual you are also liable.

Mr. LESTER. Yes.

Senator TAFT. Roughly speaking, if you had an income of $25,000 or $30,000 you would pay half of that in taxes?

Mr. LESTER. Yes, sir.

Senator TAFT. If you had $10,000 you would file on half of that, or $5,000.

Mr. LESTER. Yes, sir.

Getting over to the corporation, if the corporation makes $10,000, of course it pays at the corporate level.

Now, getting over to the cooperative, which is a competitor across the street from me, if they make $10,000, in the first place they say they are a partnership but they are not at all. They have got a charter, they got have laws that protect them.

Senator MILLIKIN. May I interrupt you?

Never mind about what they say or what others say. What happens taxwise?

Mr. LESTER. Well, I just wanted to bring out the fact that there was a little difference there, Senator, between the partnership and the other.

Senator MILLIKIN. All right. Let us see what happens taxwise.

Mr. LESTER. Taxwise they make $10,000. Here is what actually happens. They say, "Well, listen, we want to build a plant here to mix this fertilizer, so we are going to set up here $2,000 as a reserve, and then we are going to pay out $8,000 but we are not going to pay it in cash, we are going to pay it in scrip or issue stock."

What they did was to issue stock, and so they kept the $2,000 reserve, did not pay taxes on it, and then they kept the $8,000 in cash, although they issued scrip to their members, so they had $10,000 to build a fertilizer plant with, and I did not have but whatever was left after I paid the taxes.

Senator MILLIKIN. Keep your mind now on the tax. What do they pay in the way of tax on that profit?

Mr. LESTER. Nothing.

Senator MILLIKIN. Nothing?

Mr. LESTER. Nothing.

Senator MILLIKIN. Now then, your complaint comes down to this, does it not, that regardless—let us pass a lot of complications here, regardless—of whether or not that cooperative in putting this money in for expansion has multiplied its obligations to its members—pass that, whether it has or has not—that cooperative at that level, you claim is in a position to expand because it has not paid taxes, whereas you, as an individual, and as a partnership have to pay the taxes?

Mr. LESTER. Yes, sir.

Senator MILLIKIN. Now, the future obligations as between the cooperative members and the cooperative do not alter the fact that as of today they are able to expand and you are not able to expand; is that the point?

Mr. LESTER. Correct, sir.

Senator MILLIKIN. That is the real point that people are complaining about; is it not?

Mr. LESTER. Correct. May I follow that just a little further, though, Senator? I know more about my own business than I do about someone else's, you see—and I do not know much about it, but in the gin business, we sell seed to the oil mill, that is a crushing mill, that takes the seed and crushes it. You will recall last year, or maybe year before last, 2 years ago, the Commodity Credit Corporation had a cottonseed purchasing program. All right, they bought this seed from the farmer because the price was so low and they wanted him to get a fairer price.

The seeds that the Commodity Credit Corporation bought, many of them were crushed by a cooperative oil mill. Not a pound of those seeds belonged to the farmers, they all belonged to the Government, and in crushing those seeds, they made thousands of dollars.

So, they went back to these cooperative gins and other gins and said, "Now, look here, we got a lot of money. If you do business with us you will get some of that money."

Not a penny of that money was made in dealing with the farmers at all. It was on the contract with the Commodity Credit Corporation for crushing those seeds, and they made lots of money and did not pay any taxes on it.

Now, there was a grain elevator in Enid, Okla., that had the same thing with reference to the storage of Commodity Credit wheat, and they did pay some taxes, because they said it was not their money, but they did not pay at a rate that an individual or a corporation would have to pay, but that is what we are running up against, Senator.

Senator MILLIKIN. Before we get through here, we are going to follow the hair on the hide; we are going to follow all those points, but the main point that you are talking about is that through not having to pay taxes on the profits which the cooperative makes, it is able to expand and thereby give a quality of competition which the fellow who does not have that privilege is unable to withstand, is that the point?

Mr. LESTER. That is correct, sir.

Senator MILLIKIN. Now, then, this whole question of what are the relations of the cooperative member to the cooperative, when it does that, and what is the relation of a stockholder to the company in a normal corporation—we will get to all of that—but that which we

have discussed is the essential point that you are driving at, is that correct?

Mr. LESTER. That is correct.

There is one other point I want to make before I leave. It has been said that we are out to put these people—to put them out of business. We could not do it if we wanted to.

The only thing that we are asking is: They have a special treatment and we do not have it and we are asking equality. We are not asking for any favors. We are not asking for any special treatment; we are just asking for equal treatment.

I have a few figures here which show just how powerful they are, how much money they make and paying taxes would not hurt them.

We had illustrations here just a while ago as to how some of them do business, but we think they should pay the same taxes that we do, and that is the whole story.

Now, so far as the technicalities and all of that, we have thousands of little-business men, just like I am, who are facing that every day, and that is the only way we can face it, is to appear before the Congress. That is what I am doing here today.

In order to tell you our story, I will tell you how I got to do something on it.

I went down to a bank in New Orleans, La., and I told my story to the president, and he said, "I cannot do anything about it." He said, "The laws and rules and regulations are written in Washington." He said, "The place for you to go is to Washington," and so I am here. So you can see just how unjust and how unequal it is.

Now, you have already taxed the business earnings of labor unions, churches, charities, and universities, and we are hoping you will do something about this unfair treatment on the business competitors that we have.

We thank you very much. If there are any questions I will be glad to answer them.

Senator BYRD. Mr. Stam has handed me Income Tax Information Release No. 2, April 13, 1950, from the Treasury Department, which is as follows:

The earnings (savings) of farmers' cooperative marketing and purchasing associations, distributable to their patrons on the basis of the amount or value of produce furnished by them to the cooperatives or the value of supplies and equipment purchased by them from the cooperatives, generally are distributed to the patrons as patronage dividends in the form of cash or in one or more of the following forms:

Capital stock of the cooperative.
Revolving fund certificates.
Retain certificates.
Certificates of indebtedness.
Letters of advice as to net amount retained.

For Federal income tax purposes, the amounts which are includible in the gross income of the patrons to whom such distributions are made are not restricted to amounts distributed in cash. Distributions by cooperatives in the form of capital stock, or in any form other than cash, should be included in the gross income of the patrons to the same extent that such distributions would be included if paid in cash. This rule is applicable to patrons who file their Federal income tax returns on the basis of cash receipts and disbursements as well as those who file their returns on the accrual basis.

What is the pleasure of the committee? We have got three more witnesses, and we will have to be on the floor, I imagine, at a little after 12.

Would it be the pleasure of the committee to reconvene at 3 o'clock?

(Discussion was continued off the record.)

Senator BYRD. We will adjourn until 10 o'clock tomorrow morning, when we will hear the three witnesses who have not been heard, Mr. O'Connell, Mr. Burgess, and Mr. Glander, to be followed by the others when they are reached.

(At 12 m. the committee recessed to reconvene at 10 a. m. Friday, July 20, 1951.)

REVENUE ACT OF 1951

FRIDAY, JULY 20, 1951

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

The committee met pursuant to recess at 10 o'clock a. m. in Room 312, Senate Office Building, Senator Harry F. Byrd, presiding.

Present: Senators Byrd (presiding), Kerr, Frear, Millikin, Taft, Williams, and Flanders.

Also present: Elizabeth B. Springer, chief clerk, Colin F Stam, chief of staff, Joint Committee on Internal Revenue Taxation.

Senator BYRD. We will come to order. The first witness is Mr. Wilfrid E. Rumble.

Will you identify yourself, please, for the record?

STATEMENT OF WILFRID E. RUMBLE, ATTORNEY, NATIONAL FEDERATION OF GRAIN COOPERATIVES, LAND O'LAKES CREAMERIES, INC., AND FARMERS UNION CENTRAL EXCHANGE, INC.

Mr. RUMBLE. Mr. Chairman, and members of the committee, I am Wilfrid E. Rumble, a lawyer practicing in St. Paul, Minn. I have represented a number of cooperatives for a great many years, and appear here on behalf of the National Federation Grain Cooperatives, which is the National Association of Cooperative Grain Organizations, Land O'Lakes Creameries, Inc., which is a regional dairy cooperative, and the Farmers Union Central Exchange, Inc., which is a regional farmers' purchasing organization.

I have a prepared statement which has been handed to the committee and which I requested be made a part of the record. Because of the limitations, however, on the committee's time, I propose to bypass a substantial part of that statement in my testimony here this morning.

Senator BYRD. You want it made a part of the record?

Mr. RUMBLE. Yes, sir.

Senator BYRD. Very well. You may proceed, Mr. Rumble.

Mr. RUMBLE. Thank you very much.

I would like first to cover a few factual matters and then devote my time principally to a discussion of some of the legal questions that have been raised.

The essence of the cooperative is that the members get the service of the organization at cost. A cooperative is not designed to make profits for itself. In order to reduce costs to their patrons, some marketing cooperatives engage in the first processing, warehousing,

and transportation of farm products, and some purchasing cooperatives, for the same purpose and also in order to secure these supplies, engage in manufacturing operations, and own and operate oil wells, refineries, fertilizer plants, and feed processing plants.

Because of some comment that was made at the hearing yesterday, I would like to say here that there is no grain marketing cooperative that I know of that owns oil wells or any other facilities except those directly related to the marketing of grain.

Senator WILLIAMS. May I interrupt there? If I am not mistaken, I saw a notice some time back that the Southern States, which is a grain marketing cooperative, had bought some tankers and was operating the tankers.

Mr. RUMBLE. Senator, I suppose that maybe I should have begun by stating that my familiarity with cooperatives grows out of my work in the northwest section of this country, and also with the National Federation of Grain Cooperatives. Southern States is not a member of that organization.

Senator WILLIAMS. You were speaking only of those that you were familiar with and not making it as a broad coverage in general?

Mr. RUMBLE. That is right.

Senator WILLIAMS. I see.

Senator MILLIKIN. Mr. Chairman, might I interrupt long enough to remind the committee that yesterday one of the witnesses mentioned a Supreme Court decision called the Ford case.

The inquiries of the staff indicate that there never was any such Supreme Court decision. There was a Treasury ruling in a Ford case which permitted the deduction of rebates as expense where the plan had been announced in advance.

Mr. RUMBLE. That is right, Senator. And do you mind if I just give a little of the detail right now on that Ford situation?

Senator MILLIKIN. Take your own time. But I thought there should not be any delay in getting that straight in the record.

Mr. RUMBLE. I can clear that up right now.

On August 1, 1914, which was the first day of the fiscal year of the Ford Motor Co., that company announced to the public through newspapers and otherwise that it would refund from $40 to $60 on every Ford car sold during that fiscal year if 300,000 or more cars were sold.

They did sell 330,000 cars, and on August 15, 1915, 15 days after the close of their fiscal year, they refunded to every purchaser of a Ford automobile $50 per car, and the Treasury Department permitted them to exclude those payments from their income for that fiscal year.

Senator MILLIKIN. It was a part of the Ford pricing mechanism and represented an expense of doing business?

Mr. RUMBLE. That is right.

Senator MILLIKIN. And therefore it was deductible?

Mr. RUMBLE. Yes, sir.

Capital is essential to cooperatives. Some marketing cooperatives need even more capital than private business corporations with which they compete because of their obligation to accept all products tendered by their members, regardless of market conditions.

Such cooperatives cannot buy when market conditions are favorable and refuse to buy at other times. The carrying of large inventories and consequent unusual exposure are inevitable during certain periods and seasons.

It is practically impossible for a cooperative to offer a security which is attractive to the ordinary investor, because of provisions customarily found in the State cooperative statutes limiting dividends upon capital stock, prohibiting payment of cumulative dividends, requiring that control of the corporation shall always be in the members or producer-members in a farmer cooperative, limiting the class from which directors and officers may be chosen, and other less important restrictions.

Senator MILLIKIN. Has anyone ever made a digest of the State laws as they affect cooperatives?

Mr. RUMBLE. I think that the Department of Agriculture at some time during the past few years has made such a digest.

Senator MILLIKIN. Mr. Chairman, I would like to ask Mr. Stam to see if information of that kind is available.

Mr. STAM. Very well. I shall obtain such publications and bring them to the attention of the Committee in Executive Session.

Senator WILLIAMS. Mr. Chairman, I might add that there is, I think, a bulletin put out by the Treasury Department, No. S. 520, which is the most complete digest of cooperatives that I have seen in some time.

Senator MILLIKIN. Does it contain the provisions of the State laws?

Senator WILLIAMS. It makes reference to them. It does not contain all the provisions, but it makes reference to them.

Senator MILLIKIN. I was hoping that there might be a complete digest so that by reading them we could at least get the general nature of the State laws on the subject of cooperatives, State by State.

Mr. RUMBLE. I would be very glad to attempt to find such a digest.

Senator MILLIKIN. If you find it, would it be all right to send it to the chairman?

Mr. STAM. I think there is one available. I am pretty sure that I have seen one. I will look it up for you.

Mr. RUMBLE. And we will also try to find it.

Thus cooperatives are practically compelled to secure their capital from their own patrons and members.

The result is that this capital has been secured to a considerable extent from the reinvestment in capital securities of the cooperative by patrons of their share of the receipts of the cooperative.

All the State statutes that I know of require cooperatives to distribute savings, after dividends on capital stock and after small required reserves, to patrons annually or oftener, and most of them expressly permit distributions to be made in capital securities.

It is principally the methods used by cooperatives to finance their activities which give rise to the present attacks upon the income-tax treatment of cooperatives.

In the course of the many congressional hearings which have been held upon this subject, there have been suggestions advanced from time to time which, in my judgment, may result in some confusion as to the real operations of the cooperatives.

For instance, many State statutes and by the bylaws of a number of cooperatives authorize the cooperative to forfeit the membership stock of a member who ceases to do business with the cooperative for a period of a year or some longer period.

Senator KERR. It authorizes them to forfeit?

Mr. RUMBLE. Yes, sir.

Senator KERR. That means that they reimburse them, does it not?

Mr. RUMBLE. Yes, sir.

I will cover that, Senator, in a moment.

Senator KERR. Very well.

Mr. RUMBLE. In such cases, the cooperative is obligated to pay the member the par value of his stock or the book value, if that is lower than par.

Senator KERR. Suppose it were larger?

Mr. RUMBLE. It cannot be larger in a true cooperative, because there can be no surplus in such a cooperative.

Senator KERR. Would not the fact that you have been accumulating reserves affect that?

Mr. RUMBLE. No, sir, because they do not belong to the cooperative. They belong to the patrons.

Senator WILLIAMS. Might I suggest this: Suppose there are unallocated reserves.

Mr. RUMBLE. Any kind of reserves, allocated or unallocated.

Senator KERR. But this fellow being put out of the cooperative, does he get his part of that accumulation, too?

Mr. RUMBLE. I will meet that, too, in just a moment.

Senator KERR. Very well, sir.

Mr. RUMBLE. This forfeiture provision is essential to a tax-exempt cooperative if it is to retain its exemption, for the revenue code requires that substantially all of the voting stock of such a cooperative be owned by producers who market their products or purchase their supplies through or from the association.

The payment provisions are fair, for the cooperative can have no surplus, and its stock can never have a book value higher than par.

Any interest of the members in reserves of the cooperative is not forfeited and continues to be owned by the stockholders.

Senator MILLIKIN. You are talking about entirely exempt cooperatives, is that correct?

Mr. RUMBLE. At the moment.

Senator MILLIKIN. Yes.

Mr. RUMBLE. Yes, sir.

Senator TAFT. You say it continues to be owned by the stockholder. But he has just sold his stock, or you have paid it off.

Mr. RUMBLE. He has acquired this interest in the reserve because he was a patron.

Senator TAFT. A patron or a member?

Mr. RUMBLE. Either.

Senator WILLIAMS. Both.

Senator TAFT. They sell to nonmembers, do they not, sometimes?

Mr. RUMBLE. Yes, sir.

And he has the same interest in an exempt cooperative in the reserves as a member.

Senator TAFT. You mean if they closed up, he would get something out of that?

Mr. RUMBLE. That is my belief.

Senator TAFT. Even after the stock had been sold?

Mr. RUMBLE. Yes, sir.

Senator WILLIAMS. Now, just suppose that a member has lost his membership by not dealing with the cooperative, we will say for the 2-year period. How can you assign to that member if you liquidate

5 years later, his proportionate part of the earnings which have accrued to him which were not allocated to him? They are unallocated earnings, and he has lost his membership, we will say, 3 years prior to the dissolution of the corporation, and you have $1,000,000

Mr. RUMBLE. I am talking about cooperatives with which I am familiar, those who operate in the northwest area.

Senator WILLIAMS. We will talk about those, sir, in the northwest area.

Mr. RUMBLE. I beg your pardon?

Senator WILLIAMS. Just assume that this cooperative was in the northwest area.

Mr. RUMBLE. Right. We have not a single cooperative operating in Minnesota, North and South Dakota, and Montana and probably in Wisconsin, that I have ever heard of that does not keep accurate patronage records from which it could be determined at any time what interest a particular patron had in any reserve, whether or not the reserve was allocated. But I would go even farther than that, and say to you that in our area, all reserves are allocated, so far as I know.

With my own clients, I know they are all allocated. These organizations that I represent here today, every one of them allocates its reserves.

Senator TAFT. They allocate it year by year so that a man who quit doing business gets his share of the reserve in a year that he did do business; is that your theory?

Mr. RUMBLE. That is right.

Senator TAFT. But he gets no part of the reserves in the year that he does no business?

Mr. RUMBLE. That is right.

Senator WILLIAMS. Would you be willing to furnish this committee with the financial statements of those organizations that you have represented over the past several years as broken down as to the allocated earnings, and if there were any unallocated earnings, designate them in your statement?

Mr. RUMBLE. Senator, I am sure that I can secure for you, and willingly will do so, the financial statements of the organizations that I represent here.

Whether or not I can secure the additional information you want, I do not know, but if I can, I certainly will.

(The information referred to was not received by the committee at the time the hearings were printed.)

Senator WILLIAMS. Assuming that none of the members of your organizations have been taking advantage of this provision where there could be such a thing as unallocated tax-exempt earnings all around, and as you say, assuming that your members have not taken advantage of that, you have no objection to Congress repealing that section which you have not taken advantage of prior to that, would you?

Mr. RUMBLE. Yes, I have. I have very substantial objection to it.

Senator WILLIAMS. What would the objection be to it?

Mr. RUMBLE. Do you want me to discuss that now?

Senator WILLIAMS. I just wondered what would be the objection to repealing a section of the law that neither you nor your members have ever taken advantage of.

Mr. RUMBLE. My particular members have not, but there are cooperatives all over this country who need the protection given them by 101 (12) insofar as unallocated reserves are concerned.

There is in my mind just no doubt about that matter. Furthermore, it is my opinion that in many farmer cooperatives—I am speaking now of the larger ones—the cost of allocating reserves in many situations would amount to more than the total amount of the unallocated reserves.

I say I believe that.

Senator WILLIAMS. Yes. But you say you have been doing that. You should not believe it. You should know. You say your companies have been keeping track of all those unallocated earnings?

Mr. RUMBLE. That is right.

Senator WILLIAMS. Has the cost been prohibitive?

Mr. RUMBLE. I would say that for the two organizations I represent, the cost of allocating roughly 40 percent of the reserves—maybe less than that—is substantially equal to the amount of that 40 percent. I am referring now to livestock organizations and liquid milk, dairy organizations where frequently the unallocated reserves are contributed by patrons whose interest in the reserves is less than $1 in the course of a year.

Senator WILLIAMS. Those farmers who deal with these cooperatives—and by dealing with them it is part of their money that goes to make up this reserve fund—why are not they entitled to that allocation in all instances?

Mr. RUMBLE. I think that if at the time when that cooperative liquidates or at some earlier time their interest in those unallocated reserves can be ascertained and paid off they are protected.

Senator WILLIAMS. If they are protected, that gets back to my original question.

If they are protected, and if the committee is in error, there is no harm in writing and spelling it out in the law that they must be protected if they are already getting that protection. Let us assume that they are, for a moment.

Mr. RUMBLE. Except for this expense item, Senator. And I think that probably raises a pretty serious question with some organizations.

Senator WILLIAMS. But I thought they were already getting that. I thought your argument was that they are being protected, that they are getting what we are suggesting that they get, that is, that each each member gets his proportionate share of the earnings of that cooperative which is earned as a result of his business.

Mr. RUMBLE. At the time of liquidation?

Senator WILLIAMS. At the time of liquidation, or whenever——

Mr. RUMBLE. I think that in any well-managed cooperative, his interest in those reserves, if at that time any of them were left, could be determined, and that he would be protected.

Senator WILLIAMS. I agree with you that it should be.

Mr. RUMBLE. But I do not believe that they should be required to allocate those reserves from year to year on account of the cost involved.

Senator WILLIAMS. If they do not allocate it from year to year and keep their records as they do, how can they do it 10 years or 20 years later?

Mr. RUBLE. Allocating them and keeping records from which that fact can be determined, at two mighty different things. The allocating year by year of these patronage refunds and distributions to reserves in cooperatives which have 20,000 to 25,000 members, is a pretty costly mechanical job.

Senator WILLIAMS. Do you think that they should remain unallocated and that the cooperative should also remain tax-exempt?

Mr. RUMBLE. I think that the position of some of these cooperatives who very seriously argue that they should not be required to allocate their contingent reserves and other similar reserves has a great deal of mierit.

I wonder if I cluld leave my position that way.

Senator TAFT. Do you think that they should be required to keep the records so that they could make that allocation as it becomes necessary?

Mr. RUMBLE. Absolutely. And that is the law, Senator Taft, incidentally.

Senator WILLIAMS. And do you think that one or the other should pay tax, or do you think that a portion of the earnings should be set aside in a special fund upon which neither the farmers nor the cooperative would pay any tax?

Mr. RUMBLE. I would like, Senator, to make the position of my clients absolutely clear on that point. We are unalterably opposed to any change in section 101 (12). Insofar as the nonexempt cooperatives are concerned, they do now pay taxes on such reserves.

Senator WILLIAMS. On unallocated earnings?

Mr. RUMBLE. Yes, sir.

Senator TAFT. Would you say that again?

Mr. RUMBLE. Insofar as nonexempt cooperatives are concerned.

Senator WILLIAMS. You are speaking about nonexempt? How about your exempt?

Mr. RUMBLE. It just happens that these organizations that I appear for here are exempt cooperatives.

Senator WILLIAMS. We are speaking about the unallocated earnings of the nonexempt cooperatives. We are speaking about those now, but a moment ago we were speaking about the exempt.

Mr. RUMBLE. That is what I am talking about now.

I say that those are taxed. The unallocated reserves of a nonexempt cooperative are taxed today.

Senator WILLIAMS. How about the unallocated earnings of a so-called exempt cooperative?

Mr. RUMBLE. No part of the earnings of these cooperatives is taxed today.

Senator WILLIAMS. And you are not taking any position on that, whether they should be taxed?

Mr. RUMBLE. I am certainly taking the position that we do not think that section of the code should be altered in any respect.

Senator WILLIAMS. And do you think that that portion of the earnings should remain to go untaxed to anyone?

Mr. RUMBLE Yes, sir; in those exempt cooperatives. Now, wait a minute. You added "to anyone."

Senator WILLIAMS. They are not taxed either to the cooperative or the farmer.

Mr. RUMBLE. The unallocated reserves are not taxed to the farmer as I understand it.

Senator WILLIAMS. That is right.

And they are not taxed to the cooperative.

Mr. RUMBLE. That is right.

Senator WILLIAMS. And do you think that that should be continued along, that they should not be taxed to either?

Mr. RUMBLE. Yes, sir.

The amount involved is a pittance. But the importance of it to the cooperative is very real in some cases.

Senator TAFT. My impression was that the cooperatives that I talked with were willing to have the unallocated reserves taxed. That was a concession they were willing to make, but that they would object very strenuously to any taxing of the allocated reserves, as evidenced by scrip or by any other manner, but they did not object to taxation of unallocated. Maybe I misunderstood their position.

Mr. RUMBLE. No; I do not think that you have misunderstood that at all. There are some cooperatives in this country, farmer cooperatives, who do believe it would be proper either to require that all reserves be allocated or to tax the unallocated reserves.

But there are a great many cooperatives who do not agree.

I would say from my meetings with national cooperative organizations that at least half of the cooperatives of this country, the farmer cooperatives, are violently opposed to any taxation of the reserves of the exempt cooperatives.

Senator TAFT. Would it not be perfectly easy for any small cooperative to allocate reserves? Is it not just the large ones that have the difficulties you speak of in allocating reserves?

Mr. RUMBLE. I think that largely the difficulty does appear in the bigger organizations, but it should also, I think, be observed that many of our small cooperatives do not have adequate accounting employees or bookkeeping employees, and I would think, that in those cases there might be some difficulties presented.

However, that subject will be much more fully treated than I have attempted to do here by one of our following witnesses.

Senator WILLIAMS. For the record, I might point out that the day before yesterday, I think, when the master of the Grange was testifying, he recognized the inequity of that. And many of the cooperatives are recognizing now that it perhaps could be used to the disadvantage of the farmers, and they are getting complaints from the members of their organization about the fact that they deal with this cooperative over a period of years and the reserve is built up out of the earnings from these farmers; then when they lose their membership and step aside, they do not get the benefit of this money of theirs which has been reinvested and which lies in the cooperative upon which, it is true, they have not paid any taxes.

But it is their money and they feel that they should have a right to take it out of the cooperative or have some claim to it. And there is quite a complaint on that.

I have noticed that many cooperatives in the East are endorsing this proposal, on that particular phase of this.

Mr. RUMBLE. Of course, I will accept as true any factual statement that you make here. But so far as I am concerned, I do not know

anything about that, because of all these cooperatives that I have ever known out there, I have never known of a single farmer to complain to the cooperative about the treatment accorded him in connection with the distribution of the patronage refunds or in connection with the handling of reserves.

So I probably cannot be of much help to the committee on that question.

Senator MILLIKIN. Mr. Rumble, yesterday we were talking about nonexempt cooperatives

Mr. RUMBLE. Yes, sir.

Senator MILLIKIN. A statement was made by a witness to the effect that a nonexempt cooperative can avoid payment of taxes on its profits by some kind of allocation devices.

Mr. Kirby of the Treasury is here and if you do not mind, I would like to back up enough now to get that single phase of this problem straight.

Mr. Kirby, I would like to ask you under what, if any, circumstances may a non-tax-exempt cooperative avoid the payment of taxes on its profits?

STATEMENT OF VANCE KIRBY, LEGISLATIVE COUNSEL, TREASURY DEPARTMENT

Mr. KIRBY. By paying out patronage dividends to their patrons.

A patronage dividend is a payment out in proportion to the business of the patron with the cooperative in cash, in kind, or in their——

Senator KERR. Scrip?

Mr. KIRBY. Scrip, stock, certificates of indebtedness or even a credit memorandum indicating that the cooperative has set aside to the account of the patron certain amounts as the dividend that really is going to him eventually.

Senator TAFT. Under what law is that?

Mr. KIRBY. That is under the rulings of the Department which have really been in existence for many, many years and which have been confirmed by Court decision. It goes back, really to 1918, to the—to a Treasury decision from which I will quote, where refund payments are made——

Senator MILLIKIN. You are talking about nonexempt, now?

Mr. KIRBY. Yes, sir; I am talking about nonexempt.

Senator TAFT. May I ask this question to get it straight? Are you talking about a nonexempt cooperative or are you talking about a cooperative which becomes exempt by doing these things?

Mr. KIRBY. No; I am talking about a nonexempt cooperative because those are the cooperatives that are interested in the deduction for patronage dividends.

Now, with respect to the exempt cooperatives, they are not concerned about a deduction from their net income because they are exempt completely from tax.

Senator TAFT. Is there anything in the statutes dealing with nonexempt cooperatives?

Mr. KIRBY. Nothing specific with respect to nonexempt cooperatives.

Senator TAFT. Why is a nonexempt cooperative different from any other corporation?

Mr. KIRBY. Since they are corporations, they are not essentially different. Insofar as this deduction for refund payments is concerned, any corporation or any department store can, if it makes arrangements with its patrons prior to the purchase similar to those made by a cooperative, make rebates to purchasers and get the same type of deduction that is accorded to the nonexempt cooperative.

Senator TAFT. Can they do that if they make that distribution to patrons in stock?

Mr. KIRBY. Yes.

Senator TAFT. I can see where they might do it in the case of cash. But it would seem to me that it would go pretty far in letting them do it by handing something to someone that is not marketable.

Mr. KIRBY. It is something of value.

Senator TAFT. I just do not see the basis for the Treasury ruling at all. As I understand it, that ruling would apply, not only to a cooperative, but would apply to anyone; is that right?

Mr. KIRBY. Yes.

Senator TAFT. I certainly do not see the basis for that.

Mr. KIRBY. That is, made under these circumstances. And if I could just quote these two sentences from this early Treasury decision, they are:

> Where such refund payments are made in accordance with the bylaws or published rules regularly adhered to, they are to be regarded as discounts or rebates tending to reduce the taxable net income of the organization. Like discounts generally, they should appear as an added item of cost in the detailed schedule of cost items submitted with the organization's returns of income.

Senator WILLIAMS. These exemptions are largely as a result of interpretations that have been placed on this law by the Treasury Department down through the years; is that not correct?

Mr. KIRBY. This deduction; yes.

Senator WILLIAMS. Yes; that is what I mean, these deductions.

Senator MILLIKIN. Would you say that——

Mr. KIRBY. Pardon me, Senator.

I would like on this to point out the court decisions have followed the Department's original rulings and supported them completely.

Senator MILLIKIN. Now, except as to these items that you have mentioned, which I assume can be viewed as expenses of that type of cooperative, are there any other exemptions arising by virtue of a nonexempt cooperative setting aside a portion of its profits into reserves for, let us say, general purposes?

Mr. KIRBY. None whatsoever.

Senator MILLIKIN. None whatsoever.

Mr. KIRBY. So that the mere setting aside of reserves for expansion of their business or for like purposes, there is no deduction in computing the income tax.

Senator KERR. You mean, there is no exemption of that from taxation?

Mr. KIRBY. Not in itself.

Senator KERR. What do you mean by "not in itself"?

Mr. KIRBY. You would have to have the further fact that we were referring to a little while ago, that those reserves arose as a result of patronage dividends.

Senator MILLIKIN. Again we are talking about nonexempt cooperatives.

Mr. KIRBY. Again, speaking of nonexempt cooperatives.

Senator MILLIKIN. There is no exemption for setting aside reserves, except what you mentioned?

Mr. RUMBLE. That is right.

Senator MILLIKIN. There is no exemption for setting aside general reserve?

Mr. RUMBLE. That is right.

Senator MILLIKIN. Or a specific reserve for any purpose? There is no exemption?

Mr. KIRBY. There are— —

Senator KERR. Let me see if I can state it, Senator.

Senator MILLIKIN. All right.

Senator KERR. What he has told us is that there is no exemption of any money by reason of its being set aside in any kind of reserve unless, at the same time, participation certificates of one kind or another have been issued to the extent of the amount set aside in such reserves.

Senator MILLIKIN. Is that correct, Mr. Kirby?

Mr. KIRBY. That is correct, if I may make another qualification.

Senator KERR. All right.

Mr. KIRBY. There are certain reserves which provide deductions available to all corporations, such as reserves for bad debts, and reserves for depreciation. But I assume that we are not talking about that type of reserve.

Senator KERR. Then let me see if I can state it this way: What you have said is this: That a nonexempt cooperative gets no preferred treatment in comparison to a competitive corporation with respect to any money which it sets aside except as to that money for which it has issued participating certificates to its members which in their hands are taxable to them when received?

Mr. KIRBY. That is correct.

Senator MILLIKIN. Now, let me carry this one step further. Will you state again those items which may be deducted as expenses and for which there is an exemption for the nonexempt corporation?

Mr. KIRBY. It is generally the patronage dividend.

Senator MILLIKIN. The patronage dividend.

Mr. KIRBY. And the patronage dividends can be paid and issued in either cash, scrip, stock, or credit memoranda.

Senator MILLIKIN. And as to those cases you say that those must be made in accordance with bylaws or published rules regularly adhered to: is that right?

Mr. KIRBY. That is correct of the corporation; yes.

Senator KERR. Of the cooperative.

Mr. KIRBY. Of the cooperative.

Senator MILLIKIN. Now, what control thereafter is exercised over the reserves so created?

May they be held indefinitely?

Mr. KIRBY. It would be subject to the cooperative's own bylaws and subject to whatever statements were made, I assume on the script, if that was the case.

Senator MILLIKIN. But there would have to be a valid claim against it in the hands of the scrip holder?

Mr. KIRBY. Yes; I would think so.

Senator KERR. And such a claim as he, the holder, the member, has taken into account, and paid taxes on in the year of his receiving it, the same as though he had received it in cash?

Mr. KIRBY. That is true with respect to the marketing co-ops.

Senator KERR. That is true with reference to the nontax-exempt cooperative: is that correct?

Mr. KIRBY. Yes, sir. But that rule also applies in the case of exempt cooperatives.

Senator MILLIKIN. Let us not go into the exempt now. Let us hew to the nonexempt line now. Restricting our thought to the nonexempt cooperative, the patronage dividend received in any of these forms is taxable to the patron when he receives it, if he receives it.

Mr. KIRBY. Nonexempt?

Senator MILLIKIN. Nonexempt. Nonexempt consumer cooperatives.

Mr. KIRBY. In this nonexempt area, with respect to the consumer cooperative, the patron may receive a refund from a transaction such as the purchase of clothes or home equipment or things like that.

Now, such a refund, or rebate, or patronage dividend would not be taxable.

But with respect to the marketing cooperative, which we assume is taxable, not the purchasing cooperative, refunds paid by those organizations would be taxable in the hands of the patron.

Senator MILLIKIN. Now, the reserves set up for those purposes, can they be used for other purposes, or must they be definitely earmarked, set aside and preserved exclusively for that purpose?

Mr. KIRBY. There is no requirement that with respect to these nonexempt cooperatives——

Senator MILLIKIN. That is what I am talking about.

Mr. KIRBY. That they set aside reserves for any particular purpose.

Senator KERR. The test comes when they set them aside and issue the participating scrip against them?

Mr. KIRBY. That is right. The test is really that they have allocated or distributed the money to the patron.

There is not test relating to the reserve or the purpose for which it has been set up.

Senator KERR. Or what it is used for?

Mr. KIRBY. That is right.

Senator MILLIKIN. Prior to the time that it is so actually distributed, are they tax exempt on the amount of money which they may reserve or set aside for that purpose?

Mr. KIRBY. Prior to either the distribution or the allocation?

Senator MILLIKIN. Yes.

Mr. KIRBY. The profits would be taxable. In other words, if the profits accrued in one taxable year and they made no allocation or distribution in that year, then there would be no deduction for patronage dividends and the profits would be taxable.

Senator MILLIKIN. So that to protect themselves against that tax, they have to make a current allocation to the stockholders; is that correct?

Mr. KIRBY. Yes, sir.

Senator MILLIKIN. That is correct.

Mr. KIRBY. To the patrons, or the members?

Senator MILLIKIN. Patrons.

Now, coming back again to what the non-tax-exempt corporation does actually with that which has been allocated by means of scrip or other methods to the patron, may it use that money represented by those scrip certificates or whatever the method might be, for purposes other than to make good those certificates?

Mr. KIRBY. I would think so. There is no restriction so far as the Department is concerned.

Senator MILLIKIN. In other words, that is exclusively an obligation between the co-op and the patron?

Mr. KIRBY. Yes, or exclusively the obligation or duty of the person actually running the cooperative.

Senator MILLIKIN. If the nonexempt co-op uses those funds and impairs its ability to make good on those certificates or allocations that it has made, that is considered to be a matter between the patron and the corporation?

Mr. KIRBY. Yes, I would think so.

Senator MILLIKIN. So that, in practical effect, that reserve could be used, passing any breach of obligation that might exist between the patron and the cooperative as such, for general expansion; is that correct?

Mr. KIRBY. Oh, yes, indeed.

Senator KERR. Used for any purpose?

Senator MILLIKIN. Used for any purpose.

Senator KERR. In the course of business?

Mr. KIRBY. That is correct.

And I think that the funds that are represented by scrip or stock are pretty generally used for the expansion of business of the cooperative.

Senator MILLIKIN. Thank you.

Senator TAFT. Mr. Kirby, what I do not quite understand is the basis on which that cooperative in that respect is treated differently from other corporations without any law about it at all, but entirely on regulation of the Treasury.

An ordinary corporation could not deliver its stock to its patrons as a rebate, it seems to me, unless that stock had a market value equal, and if it is not redeemable, nobody can do anything with it. You could not count that as a deduction to the corporation, it seems to me.

Mr. KIRBY. I think this would be true, that an ordinary corporation could decide to issue, say, either scrip or preferred stock to purchasers of its goods in accordance with the profit attributable to that past patronage.

Senator TAFT. And that stock would not be salable, of course, nor any of these certificates salable nor any of these scrip certificates salable; so you certainly would not permit that corporation to deduct that from its earnings.

Mr. KIRBY. I think probably that if you had to determine the ultimate value——

Senator TAFT. I can see how you can reach that result in a cash payment or even in the payment of something of value that you could sell tomorrow. But for something that is wholly nonsalable and represents only a stock interest of the company, I do not see how you can reach that conclusion under the existing law.

Senator KERR. Senator, why do you assume that a stock certificate issued in that kind of situation would be without value?

Senator TAFT. I do not say it would be without value. But whatever its value is, the actual market value at the time you give it is all that represents anything in the way of a rebate, it seems to me, and obviously if it cannot be sold—and it cannot be, it has no market, and it has no way in which you can cash in on it—I do not see how you can make that ruling as to an ordinary corporation. I do not see how you can do it on a nonexempt cooperative which has no statutory standard whatever except as an ordinary corporation.

Mr. KIRBY. I think with respect to the deduction in the case of taxable cooperatives, the scrip is considered as representing cash which is being reinvested by the member. This is also true in determining the tax in the case of any recipient of a patronage dividend.

Senator TAFT. Yes, sir.

But you do not give them any right to say that they will not reinvest it.

Mr. KIRBY. Of course, it can be considered that the patronage, the very transaction of their becoming a member, involves the consent of that member.

Senator KERR. He has already agreed to that.

Senator MILLIKIN. I would like to get that nailed down. The relationship between the patron and the corporation is such, the legal relationship established by the corporation or the bylaws or by specific contracts between the corporation and the patron—that relationship is such that if the corporation spends the money which would otherwise cover these allocations, let us say, for an expansion, there is in that relationship a waiver or some sort of legal situation which permits the corporation to do that, so far as its relations with the patron are concerned; is that correct?

Mr. KIRBY. I would think so. And I think that when the cooperative issues this scrip, it is treated as though the cash were received by the member and then turned back to the cooperative in accordance with its rules and bylaws.

Senator MILLIKIN. Let us take the next step.

Assuming that rightfully under the existence of contractual relationship or whatever the legal relationship may be, that the corporation rightfully uses a part of its profits or all of its profits, let us say, for expansion; then let us say that the corporation goes broke and is unable to make good on those outstanding scrips; is the contractual relationship or other relationship between the patron and the corporation such that there is no liability from the corporation to the patron if that should come about?

Mr. KIRBY. I would think that the holder of the scrip would be entitled to some sort of priority as far as any of the assets.

Senator MILLIKIN. The liquidating priority?

Mr. KIRBY. That process.

But that would be the only obligation.

Senator MILLIKIN. But barring that, under the legal relationship between the patron and the corporation, he has no complaint on the ground that a part of those profits were used for expansion instead of holding them intact and earmarking them to make good the scrip, or whatever it may be?

Mr. KIRBY. I think that is correct.

Senator TAFT. Mr. Kirby, what is the status, then, of a nonexempt cooperative dealing with patrons who are not members?

Mr. KIRBY. The status — —

Senator TAFT. In the first place, do they give this rebate to those patrons who are entitled to scrip?

Mr. KIRBY. They can, or they need not.

Senator TAFT. Do you permit the deduction there of scrip certificates given to nonmembers who are mere patrons?

Mr. KIRBY. Yes.

Senator TAFT. There is no contractual relationship, of course, at all.

Mr. KIRBY. It would be allowed only if the bylaws of the regulations of the cooperative so provide that there is a rebate to the patrons, whether members or not.

Senator TAFT. I understand.

Mr. KIRBY. Pardon me. Whether members or nonmembers. But if they make the rebate on the basis of the business that the patron has with the cooperative — —

Senator WILLIAMS. But they do not have to do that.

Senator TAFT. If they make the rebate in cash, I can see that. But suppose they make the rebate in something that is wholly nonsalable, noncollectible, and does not represent a thing except an interest in a reserve which is never going to be distributed. How can you figure that nonmember is getting anything of value which can be deducted or charged to him in this business?

Mr. KIRBY. This scrip in the cases that I am familiar with has a positive obligation. In the case of a revolving fund certificate, it is going to be paid in 3 or 5 years, or in accordance with some schedule.

Senator TAFT. This statement of Mr. Stam says, "Or letters of advice as to net amounts retained and credited to the patron's accounts on the books of the cooperative."

Mr. KIRBY. In other words, it is basically the underlying thought that the patron whether member, or nonmember, is going to get the property represented by the scrip.

Senator TAFT. Does he ever get it?

Mr. KIRBY. I think in the usual case, they have revolving funds and the scrip is payable in 3 or 5 years, or whatever the time limit is that is specified.

Senator TAFT. A letter of advice as to interest credited to his account is not an obligation to pay.

Mr. KIRBY. That may be more indefinite in the time of payment than some cases involving revolving fund certificates.

Senator WILLIAMS. Some of those are marked payable at the discretion of the board of directors, at 10, 20, or some indefinite period in the future; is not that correct?

Mr. KIRBY. I am not exactly familiar with that, Senator Williams. But we can check on that.

Senator WILLIAMS. You do not even require a specific termination date upon which they get the money?

Mr. KIRBY. I would like to check on that, Senator Williams, although I do not believe any such date is required. We will let you know, as to that particular point if there is any such time limitation.

Senator KERR. I would like to ask a question right here, Mr. Chairman, if I may.

Whatever it is, it may have the dignity or the status of that which, in the first place the patron accepts in lieu of cash?

Mr. KIRBY. Yes; that is right.

Senator KERR. And when he does accept it, it becomes a tax item in his hands?

Mr. KIRBY. That is correct.

Senator WILLIAMS. Could I ask you this? Are there any restrictions on these nonexempt cooperatives which we are speaking of now, as to the percentage of business that they must do with their members?

Mr. KIRBY. Pardon me, Senator.

Senator WILLIAMS. Are there any restrictions on these nonexempt cooperatives on the percentage of business that they must do with their own members?

Mr. KIRBY. No, there are no restrictions——

Senator WILLIAMS. No restrictions whatever?

Mr. KIRBY. For tax purposes, with respect to nonexempt cooperatives.

There are with respect to the others.

Senator WILLIAMS. Yes. But we are speaking of nonexempt.

Mr. KIRBY. That is right.

Senator WILLIAMS. Now, as far as the Treasury Department is concerned, or otherwise, are there any rules that they must allocate to each customer, whether he is a member or nonmember, his proportionate part of the earnings during that year? Or is that optional with the board of directors?

Mr. KIRBY. That is optional with the nonexempt cooperative.

Senator WILLIAMS. That is what I am speaking about.

Mr. KIRBY. But the deduction for patronage dividends depends upon the refund with respect to the profit being attributable to the business of that particular patron. So the cooperative cannot distribute profits from, say, nonmembers to members and get a deduction.

Senator TAFT. Yes; that is what I wanted to know.

Senator BYRD. May the Chair make this statement?

We have 12 witnesses this morning, and we have not heard 1 yet. It seems to me that some of these legal matters could be taken up in executive session, and not take the time of the public here.

Senator TAFT. May I ask one general question here, Mr. Kirby? What proportion of the cooperatives are exempt and what proportion are nonexempt?

Mr. KIRBY. According to the latest information we have, the exempt farm cooperatives number somewhat more than half of all farm cooperatives.

Senator TAFT. Now, why do any choose to be nonexempt? What is the difficulty of being exempt?

What practical difficulty do they find in being exempt?

Mr. KIRBY. For one thing, they have to make distributions in accordance with the transactions of not only members, but nonmembers as well.

In other words, they must make a fair distribution to all their patrons, whether they are members or nonmembers.

Now, with respect to the nonexempt——

Senator TAFT. With respect to some of the large cooperatives that Mr. Rumble represents, some of those large cooperatives are wholly exempt.

Now, why are they nonexempt? That is what I am trying to get at.

Mr. KIRBY. You get away from some of the restrictions that appear in 101 (12) of the law, one of which is the percentage of business that has to be done with producing members and the amount of business to be done with nonproducing or nonproducing farming members.

Senator WILLIAMS. Has it not been the experience of the Treasury that they start out on an exempt basis, and after they get built up to their projected size through unallocated earnings, or these tax exemptions, then they give up their exemptions in order that they might sell in unrestricted competition with private industry, or the fellows across the street?

In other words, they do not have to confine their business to their own members then, when they get beyond a certain point.

Mr. KIRBY. I could not really say whether that is the general pattern or not, Senator Williams.

Senator BYRD. Mr. Rumble, will you proceed, sir? We interrupted you a good deal. Will you proceed as rapidly as you can?

Senator WILLIAMS. Mr. Chairman, I might say that Senator Millikin requested the background of some of these cooperatives, and I have those here if he wants them.

Mr. KIRBY. I would like to say that there is no time limit with respect to the payment of scrip or credit memoranda.

Senator BYRD. These matters can be gone into in executive session. These people have come here from all over the country, and we have 12 of them, but we have not heard 1 yet.

Mr. RUMBLE. Mr. Chairman, I was talking about these forfeitures, I think, when this question was raised.

Any interest of the member in the reserves of the cooperative is not forfeited.

Senator TAFT. Now you are back on exempt cooperatives; right?

Mr. RUMBLE. Yes, sir.

And that continues to be owned by the stockholder and may be assigned or transmitted by him, and, if the association is revolving its reserves, will be paid to him.

Some cooperatives pay out this interest when the forfeited stock is retired. The cooperative never acquires the member's interest in the reserves. Many cooperatives retire members' stock and pay out interest in reserves if the member ceases to be a farmer, or if he dies, or if he leaves the area in which the cooperative operates.

These bylaw provisions and those which permit the payment of patronage refunds in securities and the creation of reserves have been made or approved by the members of the cooperative.

They express their desires in the matter. This is not an exaggerated statement. I think I can honestly say to this committee that in our area, in the local cooperatives, from 50 to 75 percent of the members always attend the annual meetings of the cooperative unless there is abnormal weather.

In the Land O'Lakes Creameries, Inc., one of the cooperatives I am representing here, we have at our annual meeting from 4,000 to 6,000 members and their representatives. In the Farmers' Union Grain Terminal Association and in the Farmers' Union Central Exchange, we have from 2,500 to 4,000 members and representatives of members in attendance at those annual meetings.

These provisions are passed upon by those stockholders and many of them, it has been my experience, are quite vocal at the annual meetings.

Now, there have been suggestions made from time to time that patronage refunds should be excluded only in those cooperatives which do business only with their members.

If any such principle were adopted, there would be very few cooperatives whose patronage refunds would not be subject to tax, for few if any cooperatives can as a practical matter limit their business to members.

For instance, the livestock cooperatives which operate on terminal and other market places subject to regulations under the Federal Packers and Stockyards Act are required to accept the livestock of any producer who desires to do business with them. The grain marketing cooperatives are compelled by the commission merchants' statutes and the warehouse laws of the various States in which they are organized or operate, to accept all grain tendered to them.

Many dairy cooperatives are subject to the commission merchants' statutes and in any event are handling perishable products such as milk and cream, could not, as a matter of common decency, refuse to accept such products.

The purchasing cooperatives in their refinery operations and in their soybean processing plants, have residuals which cannot be used by or sold to farmers.

We understand that a memorandum has been submitted by the joint staff to the House Ways and Means Committee in which certain legal principles are discussed and a position taken. I may not have accurate reference to that statement, because my information concerning it comes principally from quotations in the Chicago Tribune.

Senator KERR. Now, just a moment. What did you say about the Chicago Tribune?

Mr. RUMBLE. Senator Kerr——

Senator KERR. Let me ask it another way. I am not to understand that anything you have said is in any way an endorsement of it?

Mr. RUMBLE. No, sir; I could even say that I do not endorse what the Tribune says, nor do I in any degree endorse what Mr. Stam and his associates say, and I say that with all due respect to Mr. Stam, with whom I have dealt for a number of years.

Senator KERR. I will tell you right now, you are going to lose a lot of friends among the members of the committee if you put Mr. Stam and the Tribune in the same category.

Mr. RUMBLE. I do not want to do that to you, Mr. Stam.

Senator WILLIAMS. Perhaps what you lose in one direction you might pick up in another, Mr. Rumble.

Senator TAFT. You were saying that you had read it and you did not agree with it. What was it that you were going to criticize?

Mr. RUMBLE. No, Senator, I said that my information concerning it had come from the Tribune, and that the positions taken by Mr. Stam, are what I thoroughly disagree with, and if you desire, I will go right to those points.

Senator TAFT. Yes, I think so, because we have this memorandum before us.

Mr. RUMBLE. In my statement which has been furnished to the committee, I discuss some other legal questions and I support them with the authorities. But I will omit those at this time.

Now, in that Chicago Tribune article, the joint staff is said to have stated that Congress can constitutionally tax net margins of cooperatives.

We believe otherwise.

It is our position that net margins which at the inception of the transactions out of which they grow, the cooperative is obligated by statute, by its articles of incorporation or bylaws, or by express individual contracts to return to its patrons as a patronage refund, are not income to the cooperative and that, therefore, Congress cannot constitutionally tax them as income of the cooperative.

A brief explanation of net margins may be helpful. A cooperative engaged in marketing farm products customarily pays the farmer a dollar amount when he delivers the products to the cooperative.

It sells the products in the markets, usually for a greater amount than it gave the farmer-patron, a gross margin. At the end of the year or the accounting period, it has received a total gross margin on all business done, and has had certain expenses of doing business, usually less then the total gross margins. The difference is commonly called net margin. This net margin, or the greater part of it, is then distributed back to the patrons of the cooperative in proportion to the business that each patron has done with the cooperative. The distribution may be in cash or in securities or the cooperative.

The same principle is involved in the net margin of a purchasing cooperative. The purchasing cooperative typically buys manufactured goods and sells them to the patrons.

It receives an initial dollar amount from the patron which is greater than its cost, the difference being its gross margin.

After expenses have been determined and deducted from gross margin, the remainder is the net margin, which is distributed back to the patrons in proportion to their patronage.

If net margins are not income of the cooperative, then Congress cannot constitutionally impose an income tax on them.

Income is the gain from capital or labor, or both. May I say that in my statement I cite the authorities for these various propositions, but I will not bother to refer to them here.

If there is no gain, there can be no income tax. To the extent that the cooperative is obligated to make distribution of net margins to the patrons there is no gain to the cooperative.

Net margins are substantially similar to many adjustments commonly made at the end of business transactions, such as a discount given after a particular volume has been reached— the Ford case or the adjustment made at the end of a cost-plus contract, or the refund paid to the Government by a Government contractor after he has been renegotiated.

In such cases, income is based on the final outcome not on initial or tentative payments.

Senator TAFT. Mr. Chairman, I do not know this. There are arguments on both sides of these legal questions. We may never get to the legal question, anyway.

I think if we are going to have the other side now present a long legal argument on this question, it is going to take a long time. I think the witness has his statement here, or brief. We cannot decide a legal question without examining the brief anyway, very well.

While I think it is perfectly proper to argue it, I think that you can save time by skipping the constitutional question as to whether or not you can tax patronage dividends.

Mr. RUMBLE. I think, Senator, you are exactly right. I am sure our opponents will submit briefs which will express their views on the law.

Certainly my statement does so.

Senator BYRD. I hope that we can abbreviate these hearings somewhat. As I repeat again, we have 11 more witnesses that should be heard. They have come here from all over the country. Mr. Rumble has been interrupted so much but I hope very much that he can condense it to the things that are pertinent, and the legal question I imagine will have to be decided by the legal staff, in any event.

Mr. RUMBLE. You mean, your legal staff?

Senator BYRD. No. I say they will have to be heard on all these legal questions.

If you submit your brief and put it in the record, it will be before the committee.

I do not want to cut you off.

Mr. RUMBLE. No, that makes good sense to me, Senator.

Senator BYRD. We have to do something to shorten these hearings. Otherwise there are people who are not going to be heard.

Mr. RUMBLE. I agree with that.

Senator TAFT. There is an elaborate legal brief on the other side, as I remember it, referring to some recent decision somewhere.

Mr. RUMBLE. Yes, sir.

Senator TAFT. I have not read it. But we are not going to decide that question on oral argument, anyway.

Mr. RUMBLE. I think that you are right.

May I give you my summary?

Senator TAFT. Surely.

Mr. RUMBLE. Despite the thousands of words that have been placed before Congress in the many hearings held upon this subject during recent years, and despite the articles written by former officials of the Treasury Department, and despite the intemperate propaganda of the National Tax Equality Association, these conclusions seem to me inescapable:

1. Exempt farmers' cooperatives have been given by Congress privileges not extended to other cooperatives or private business corporations, that is, the limited dividends they are permitted to pay stockholders are not subject to tax, nor are reasonable and proper amounts placed in unallocated reserves. Otherwise their status is the same as that of all nonexempt corporations.

2. Nonexempt cooperatives and private business corporations are treated alike for income tax purposes. The cooperatives, however, pay less income tax than their comparable private business corporation competitors. This is not due to the fact that one corporation is a cooperative and the other a privately owned business corporation, but is due solely to a fundamental difference in the objectives of the two types of corporation. The cooperative is in business only for the purpose of benefiting its customers. The private business corporation is in business only for the purpose of benefiting its stockholders. The cooperative returns its net margins to the customers who produced the net margins. The private business corporation returns its net

margins to its stockholders, who had nothing whatever to do with earning the net margins or with the transactions which created them.

3. Every court which has ever considered the question has squarely held that net margins of a corporation, whether a cooperative or private business corporation, which are returned to customers pursuant to a legally binding contract in effect at the time the margins are earned, are not taxable income of the corporation.

4. Although there is no decision squarely in point on the questions whether net margins of a cooperative are income to it within the sixteenth amendment to the Constitution of the United States, the cases holding that margins are not income of the corporation and the decisions of the Supreme Court of the United States in the Eisner and Wilcox cases require the conclusion that Congress cannot tax to the cooperative the distributed net margins because they are not profit income of the cooperative.

Thank you very much.

Senator BYRD. Mr. Rumble, the committee appreciates very much your contribution. We agree to inserting in the record anything that you desire in regard to the legal questions.

Mr. RUMBLE. Thank you.

(The prepared statement of Mr. Rumble is as follows:)

STATEMENT OF WILFRID E. RUMBLE

My name is Wilfrid E. Rumble. I am an attorney practicing in St. Paul, Minn., have been counsel for a number of cooperatives since the 1920's and am appearing here on behalf of the National Federation of Grain Cooperatives, Land O' Lakes Creameries, Inc., and Farmers Union Central Exchange, Inc.

I wish first to outline the basic facts of cooperatives' operations, and then to take up some of the arguments which have been made in favor of proposed legislation taxing cooperatives.

In order to view fairly the taxation proposals which are being made, one must understand the general nature of cooperatives. The cooperative corporation is essentially a group of individuals or corporations, or both, organized into corporate form for the purpose of acting collectively in the marketing of their products or the acquisition of their supplies. Although most states have statutes expressly providing for the organization of cooperative corporations, and although Congress has provided for the organization in the District of Columbia of cooperative associations, of consumers,[1] a cooperative may be organized under the ordinary business corporation statutes of most States. There are some advantages in organization under the usual cooperative statutes, but there are also definite restrictions and disadvantages. The Minnesota General Cooperative Act[2] is fairly typical. Cooperatives organized under these statutes differ from business corporations in several important respects, among which are the following:

1. There is a limit on the amount of voting stock a member may own, a common limitation being "not more than one-twentieth of the stock outstanding";
2. Dividends on capital stock may not exceed a stated rate, such as 6 percent per annum, and are not cumulative;
3. Each member has one vote only, regardless of the number of shares of stock he owns; and
4. All earnings or savings or net margins remaining after payment of expenses of operation, dividends on capital stock, and provision for required reserves must be distributed to patrons annually or oftener.

There are in general two types of cooperatives. One engages in marketing or selling the products or property of its members and patrons (customers), and is commonly known as a marketing cooperative. Most all cooperatives of this type are owned and controlled by farmers, and market only farm products A notable exception is the Railway Express Agency. The other engages in pur-

[1] District of Columbia Cooperative Association Act, Public Law 642, 76th Cong., 3d sess., ch. 397, approved June 19, 1940.

[2] Minnesota Statutes, 1949, secs. 308.05 to 308.18.

chasing or buying supplies and goods for its members and patrons, and is commonly known as a purchasing cooperative. Destpite the growth in recent years of urban purchasing cooperatives it is still true that most of the purchasing cooperatives are principally owned and controlled by farmers. Urban cooperatives of this type are frequently referred to as consumer cooperatives. Some farmer-owned cooperatives engage in both marketing and purchasing activities. The principal purpose of any cooperative association is to sell, buy, or furnish products, merchandise, or services, as the case may be, for its patrons at cost. The essence of the cooperative is that the members get the services of the organization at cost The organization is not designed to make profits for itself (except to pay limited dividends on what amounts to preferred stock). In order to reduce costs to their patrons, some marketing cooperatives engage in the first processing, warehousing, and transporting of farm products, and some purchasing cooperatives, for the same purpose and also in order to secure necessary supplies, engage in manufacturing operations and own and operate oil wells, refineries, fertilizer plants, and feed-processing plants.

Cooperative associations vary in their actual methods of operation. Generally, however, the marketing cooperative agrees to market all the agricultural products of the type handled by it produced and delivered to it by its patrons, and to pay to each patron the entire marketing proceeds after deduction of expenses. When a patron delivers products to the cooperative for sale, the amount to which he will finally be entitled cannot be known, so the cooperative pays to the patron a substantial part of the estimated sales price. At the end of the year, when the products have been sold and the costs determined, the cooperative distributes the remainder of the proceeds to its patrons in proportion to the products marketed for them. This distribution is called a patronage refund, but in reality it is further payment of the sales price. In addition to their selling, processing, warehousing, and other activities incident to the marketing of products to the best possible advantage, most farmers' marketing cooperatives employ laboratory and other experts for the purpose of improving the quality of their patrons' products, increasing efficiency in production, and informing members of current developments in production methods, types of product, and equipment.

A purchasing cooperative agrees to buy and deliver to its patrons farm supplies and other goods at cost. Since the actual cost of each purchase cannot be determined in advance, the cooperative usually charges and collects from the patron an amount more than sufficient to cover the expected cost price plus estimated operating expense. At the end of the accounting period the actual cost of goods purchased plus cost of operation is determined, and any excess amount collected from the patrons is returned to them in proportion to their purchases. The amount so returned to the patrons is a true patronage refund in that it is a refund of part of the purchase price paid initially.

When I hereafter refer to a cooperative, I intend a farmers' cooperative which is legally obligated by written agreement or by appropriate provisions of its articles of incorporation or bylaws, or by the statute under which it is organized, (1) to distribute to its members or patrons, or both, in proportion to their patronage, all of its income in excess of its costs of operation, except such as it is authorized to pay in limited dividends upon capital stock and to place in statutory or other necessary reserves, and (2) to allocate or credit all reserves (except consumable reserves) to the patrons who contributed to them upon the same patronage basis.[3]

Cooperatives are organized either on a capital stock or on a membership basis. In the capital stock cooperatives, exclusive voting control is in the common or membership stock, and all eligible patrons must acquire at least one share, which may be paid for upon an ordinary subscription basis or by the application of patronage refunds. In most membership cooperatives the patron, if eligible, is required to pay for a membership (usually the fee is nominal) when he first patronizes the cooperative.

Capital is essential to cooperatives. Some marketing cooperatives need even more capital than private business corporations with which they compete because of their obligation to accept all products tendered by their members, regardless of market conditions. Such cooperatives cannot buy when market conditions are favorable and refuse to buy at other times. Carrying of large inventories and consequent unusual exposure are inevitable during certain periods and seasons.

Cooperatives generally finance themselves through the issuance of preference stock, bonds, notes, certificates of indebtedness, and bank borrowings, and the use of revolving and other reserves. A large part of the securities of cooperatives is sold to members and patrons in the usual fashion, except that sales are direct

[3] See *American Box Shook Export Assn.* v. *Commissioner*, 156 Fed. (2d) 629 (C. C. A. 9th, 1946).

from the cooperative to the individual purchaser. It is practically impossible for a cooperative to offer a security which is attractive to the ordinary investor, because of provisions customarily in State cooperative statutes, limiting dividends upon capital stock, prohibiting payment of cumulative dividends, requiring that control of the corporation shall always be in members (producer-members in farmer cooperatives), limiting the class from which directors and officers may be chosen, and other less important restrictions. Thus cooperatives are practically compelled to secure their capital from their own patrons and members. The result is that this capital has been secured to a considerable extent from the reinvestment in capital securities of the cooperative, by patrons, of their share of the receipts of the cooperative. All the State statutes require cooperatives to distribute savings (after dividends on capital stock and after small required reserves) to patrons annually or oftener, and most of them expressly permit distributions to be made in capital securities. It is principally the methods used by cooperatives to finance their activities which give rise to the present attacks upon the income-tax treatment of cooperatives.

I PRESENT LAW AS TO THE TAXATION OF COOPERATIVES UNDER THE UNITED STATES REVENUE CODE

Since 1916 the Internal Revenue Code has provided an exemption[4] for farmer cooperatives fulfilling certain stated conditions. The code contains no other provision specifically applicable to cooperatives, so that for income-tax purposes there are only two classes of cooperatives, one class consisting of those wholly exempt from the payment of income taxes, and the other of those which are not exempt and which are subject to the same rules, regulations, and laws as private business corporations. Section 101 (13) is not particularly important. Section 101 (12) is set forth in a footnote.[5]

The courts and the Treasury Department have unanimously adopted the view that obligatory patronage distributions of a cooperative are not profits of the cooperative, and are not part of its gross receipts. (Decisions and rulings setting out that view are discussed later.) Conversely, earnings of a cooperative on the business of patrons to whom there is no contractual obligation to make refunds are profits of the corporation and taxable as such. So are amounts paid to stockholders as dividends upon capital stock. The heart of the difference between amounts paid or set aside for stockholders of ordinary business corporations and those paid or set aside for patrons of cooperatives is that each patron receives credit based on volume of business with him alone, and without regard to the amount of stock owned.

Patronage distributions are excludable if paid in money or its equivalent (capital stock, certificates of indebtedness, or notes).[6] This is similar to the rule followed by the Treasury Department in respect to ordinary business corporations, which have always been permitted to deduct bonuses, salaries or other operating expenses paid in corporate securities,[7] and dividends upon capital stock paid in notes, are treated as cash payments for the purposes of section 102 of the Revenue Code. For tax purposes there would seem to be little doubt as to either the propriety or the fairness of the rule.

The Treasury Department holds that net margins distributed to capital reserves and credited or allocated to patrons are excludable, provided a certificate of interest

[4] 53 Stat. 876, 26 U. S. C., sec. 101 (12) (13) (1940).

[5] Farmers', fruit growers', or like associations organized and operated on a cooperative basis (a) for the purpose of marketing the products of members or other producers, and turning back to them the proceeds of sales, less the necessary marketing expenses, on the basis of either the quantity or the value of the products furnished by them, or (b) for the purpose of purchasing supplies and equipment for the use of members or other persons, and turning over such supplies and equipment to them at actual cost, plus necessary expenses. Exemption shall not be denied any such association because it has capital stock, if the dividend rate of such stock is fixed at not to exceed the legal rate of interest in the State of incorporation or 8 percent per annum, whichever is greater, on the value of the consideration for which the stock was issued, and if substantially all such stock (other than nonvoting preferred stock, the owners of which are not entitled or permitted to participate, directly or indirectly, in the profits of the association, upon dissolution or otherwise, beyond the fixed dividends) is owned by producers who market their products or purchase their supplies and equipment through the association; nor shall exemption be denied any such association because there is accumulated and maintained by it a reserve required by State law or a reasonable reserve for any necessary purpose. Such an association may market the products of nonmembers in an amount the value of which does not exceed the value of the supplies and equipment purchased for members: provided the value of the purchases made for persons who are neither members nor producers does not exceed 15 percent of the value of its purchases. Business done for the United States or any of its agencies shall be disregarded in determining the right to exemption under this paragraph. Id., sec. 101 (12).

[6] *San Joaquin Valley Poultry Producers Assn. v. Commissioner*, 136 F. 2d, 382 (C. C. A. 9th, 1943; Midland Cooperative Wholesale 44 B. T. A. 824 (1941); United Cooperatives, Inc., 4 T. C. 93 (1944); G. C. M. 17895 Cum. Bull. 1937-1, 56 I. T. 3208, Cum. Bull. 1938-2, 127.

[7] Package Machinery Co., 28 B. T. A. 980; J. J. Hart, Inc., 9 T. C. 135.

or prompt notice of such distribution is given to the patron.[8] Until rather recently the position of the Internal Revenue Department in respect to the taxation of patronge distributions to patrons or recipients thereof was not entirely clear. However, in April 1950, the Department held that all such distributions were taxable to the patrons or recipients:[9]

"The earnings (savings) of farmer cooperatives marketing and purchasing associations distributable to their patrons on the basis of the amount or value of products furnished by them to the cooperatives or the value of supplies and equipment purchased by them from the cooperatives generally are distributed to the patrons as patronage dividends in the form of cash or in one or more of the following forms:

Capital stock of the cooperative
Revolving fund certificates
Retained certificates
Certificates of indebtedness
Letters of advise as to net amount retained.

"For Federal income tax purposes the amounts which are includible in the gross income of the patrons to whom such distributions are made are not restricted to amounts distributed in cash. Distributions by cooperatives in the form of capital stock or in any form other than cash should be included in the gross income of the patrons to the same extent that such distributions would be included if paid in cash. This rule is applicable to patrons who file their Federal income tax returns on the basis of cash receipts and disbursements, as well as those who file their returns on the accrual basis."

I think the existing law as to the right of cooperatives to exclude patronage distributions in determining their taxable income is thoroughly well settled. The general counsel of the Treasury has testified similarly.[10] The efforts of those persons who believe that patronage distributions should be included as taxable income of cooperatives are directed to attacks upon the law and to attempting to persuade Congress to change the law as established by the courts and the Treasury Department. Strangely enough, some of the articles written to support these efforts have been written by men who were connected with the Treasury Department during the years when that Department was applying the rules set forth above, so that it is fair to assume they did not then differ with the rules. What has happended to change their views is problematical.

II. CONGRESS CANNOT CONSTITUTIONALLY TAX NET MARGINS WHICH ARE SUBJECT TO AN OBLIGATION OF THE COOPERATIVE TO DISTRIBUTE THEM TO PATRONS

It has been stated that Congress can constitutionally tax net margins.[11] We believe otherwise. It is our position that net margins which at the inception of the transactions out of which they grow, the cooperative is obligated by statute, by its articles of incorporation or bylaws, or by express individual contract to return to its patrons as a patronage refund, are not income to the cooperative and that therefore Congress cannot constitutionally tax them as income of the cooperative.

A brief explanation of net margins may be helpful. A cooperative engaged in marketing farm products customarily pays the farmer a dollar amount when he delivers the products to the cooperative. It sells the products in the markets, usually for a greater amount than it gave the farmer-patron—a "gross margin". At the end of the year (or the accounting period) it has received a total gross margin on all business done, and has had certain expenses of doing business, usually less than the total gross margins. The difference is commonly called net margin. This net margin, or the greater part of it, is then distributed back to the patrons of the cooperative in proportion to the business that each patron has done with the cooperative. The distribution may be in cash or in securities of the cooperative.

The same principle is involved in the net margin of a purchasing cooperative. The purchasing cooperative typically buys manufactured goods and sells them to

[8] See letters from Commissioner to National Council of Farmer Cooperatives in hearings before Committee on Ways and Means on proposed revisions of the Internal Revenue Code, 80th Cong., 1st sess. 2619, 2620 (1947).

[9] Income Tax Information Release No. 2, dated April 13, 1950, by E. I. McLarney, Deputy Commissioner of Income Tax Unit, Bureau of Internal Revenue.

[10] See testimony of Thomas J. Lynch, general counsel of the Treasury Department, in record of public hearing before House Ways and Means Committee on revenue revision of 1951, on April 2, 1951, and memorandum submitted by Mr. Lynch pursuant thereto and inserted in the record.

[11] See Chicago Tribune, April 20, 1950, quoting a "report prepared by the staffs of the Treasury and the Joint Committee on Internal Revenue Taxation", but apparently not officially released.

the patrons. It receives an initial dollar amount from the patron which is greater than its cost, the difference being its gross margin. After expenses have been determined and deducted from gross margin, the remainder is the net margin which is distributed back to the patrons in proportion to their patronage.

If net margins are not income of the cooperative, then Congress cannot constitutionally impose an income tax on them.[12] The sixteenth amendment to the Constitution reads:

"The Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration."

Income is the gain from capital or labor, or both.[13] If there is no gain, there can be no income tax. To the extent that the cooperative is obligated to make distribution of net margins to the patrons, there is no gain to the cooperative.[14]

Whether the cooperative acts as agent for its patrons, or in a fiduciary capacity, or whether it has some of the attributes of a partnership, is not particularly important in a consideration of the strict legal question. It should be borne in mind, however, that the cooperative is organized by farmers as an instrumentality through which to get their products to the market place or supplies to their farms.

Net margins are substantially similar to many adjustments commonly made at the end of business transactions, such as a discount given after a particular volume has been reached, or the adjustment made at the end of a cost-plus contract, or the refund paid to the Government by a Government contractor after he has been renegotiated. In such cases income is based on the final outcome, not on initial or tentative payments.

The opponents of cooperatives do not walk squarely up to that fact. They talk about the power of Congress to determine to whom income should be taxed (which I discuss later), and about the case of *Penn Mutual Life Insurance Co.* v. *Lederer*,[15] in which a Federal statute taxing premium income of mutual insurance companies was construed. The Supreme Court in that case did not pass on the validity of the statute, however, but only its interpretation. The Court said at the beginning of the opinion:[16]

"Whether the plaintiff is entitled to recover depends wholly upon the *construction* to be given certain provisions" of the Revenue Act of October 3, 1913. [Italics added.]

In other words, the Court did not consider whether the statute, if construed to tax to the company dividends paid to mutual insurance policyholders, was taxing something other than income. The Court did, however, and I think this is the importance of the case insofar as the question under consideration is concerned, endorse the principle of another section of the same statute applied to mutual fire and marine insurance companies, and which provided for the exclusion from income of premium deposits returned to policyholders, saying in language entirely apt for the operations of the typical cooperative (252 U. S. at 533):

"But in respect to the service performed fire and marine companies differ fundamentally, as above pointed out, from legal reserve life companies. The thing for which a fire or marine insurance premium is paid is protection, which ceases at the end of the term. If after the end of the term a part of the premium is returned to the policyholder, it is not returned as something purchased with the premium, but as a part of the premium which was not required to pay for the protection; that is, the expense was less than estimated."

The case is authority for our position. It is not authority for the position of our adversaries, and so far as I know there is no decision supporting their position.

The Treasury memorandum, as quoted in the Chicago Tribune, says "The cooperatives' net margins are income to them regardless of patronage dividend contracts." On that we disagree. Our position can be best stated under a number of headings:

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[12] *Helvering* v. *Edison Bros. Stores*, 133 F. 2d 575, 579 (C. A. S, 1943).
[13] *Eisner* v. *Macomber*, 252 U. S. 189 (1920).
[14] *Commissioner* v. *Wilcox*, 327 U. S. 404 (1946). This is generally overlooked when the statement is made that there is no specific statutory exclusion of cooperatives' margins and that it is a matter of administrative grace. If the Constitution limits a statute, it makes no difference that the statute omits to mention the limitation.
[15] 252 U. S. 523 (1920).
[16] Id. at p. 524.

1. Amounts received by a cooperative and held subject to a prior obligation to pay them over to the patron are not income of the cooperative

It is our position that net margins are not taxable, not because a corporation has the magic word "cooperative" before it, but because of the way in which the typical cooperative does business. The ordinary business corporation can do business in the same way, also, and if it does it is not taxable on its net margins.

Our position is that "income" is not produced by this transaction: A marketing organization buys goods from the farmer-producer, and agrees at that time that after resale of the same goods any margin left over after costs of doing business will be paid over to the producer.

Nor is "income" produced by this transaction: A buying or manufacturing organization undertakes to buy or manufacture goods and resell them to its customers. Included in the undertaking is a promise that if the initial sales price includes more than the organization's total costs, the margin or excess will be returned to the customers.

In both cases the costs cannot be determined until the end of the year, so the margins cannot be returned to the producer or customer until that time. They are, nevertheless, not the property or the "income" of the organization.

We have used the word "organization" here to emphasize that it need not be a cooperative corporation. There are many cases in which private business corporations were involved in which the propositions above stated were upheld.

One of the leading cases establishing that point is *Uniform Printing and Supply Company* v. *Commissioner*.[17] The company was an Illinois corporation whose stockholders were insurance companies, and for whom it engaged in its principal occupation of printing insurance forms. The bylaws required distribution to the stockholders of the net amount in excess of cost, in proportion to the gross amount of business done for each stockholder. The court stated the question as follows:

"Both the Commissioner and the Board found the so-called refund was a dividend. The precise and only question before us is the soundness of this finding or conclusion. Perhaps it would be better to call it a mixed finding of fact and conclusion of law. If the payment of this sum is a dividend, it should have been included in petitioner's taxable income for 1930. If it was a refund or rebate to customer, it was not part of petitioner's taxable income, for the sum should have been included in the stockholders' taxable income."

After stating its reluctance to differ with the board of tax appeals, the court said: [18]

"Had the taxpayer given a customer (whether stockholder or outsider) a discount promptly after filling the order, no one would call it a dividend. If a rebate were given promptly upon the customer's business reaching a certain volume, the same conclusion as to its character would follow. To make cost estimates and adjust them at or near the end of each year, returning the excess payment to the customer, should not change the reasoning which leads to this conclusion. Nor should the fact that the customer is a stockholder materially affect the result."

To the same effect are Paducah and Illinois Railroad Company,[19] involving a railroad bridge company whose stock was owned by and services performed for three railroads which operated trains over the bridge and which made rebates of toll charges at the end of the year, Mobile Delivery Co.,[20] Cooperative Power Plant,[21] In re General Film Corporation,[22] and Broadcast Measurement Bureau Inc.[23] All of these cases except the last involved corporations formed under the ordinary business laws of the various States. All of them involve to some degree the fact that there was an obligation existing at the time of the transaction to pay over the net margin at the end of the year, which made it not the income of the corporation. It is the absence of such obligation which usually accounts for a contrary holding, as in Druggists Supply Corp.[24] and *Cleveland Shopping News Co.* v. *Routzahn*.[25] Other decisions to the same effect involving cooperatives are cited in a footnote.[26]

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[17] 88 F. (2d) 75 (C. A. 7, 1937) reversing 33 BTA 1073.
[18] Id., at page 76.
[19] 2 B. T. A. 1001.
[20] 8 B. T. A. 1224.
[21] 41 B. T. A. 1143.
[22] 274 F. 903 (C. A. 2, 1926).
[23] 16 T. C. No. 122, decided May 10, 1951.
[24] 8 T. C. 1343 (1947).
[25] 89 F. (2d) 902 (C. A. 6, 1937).
[26] *Farmers Union Co-op Co.* v. *Commissioner* (90 F. (2d) 488 (C. A. 8, 1937)); *Juneau Dairies, Inc.* (44 B. T. A. 759, 762 (1941)), and *Fountain City Co-op Creamery Assn.* v. *Commissioner* (172 F. (2d) 666 (C. A. 7, 1949)).

A leading case involving a cooperative is *San Joaquin Valley Poultry Producers Association* v. *Commissioner*.[27] The association there was incorporated under the agricultural cooperative association laws of California. The Court of Appeals for the Ninth Circuit held that the bylaws of the association made all net proceeds of the association beyond its expenses the property of the patrons, and that therefore none of them could be included in the gross income of the cooperative. To the same effect are *Midland Cooperative Wholesale* v. *Commissioner*,[28] *Home Builders Shipping Assn.* v. *Commissioner*,[29] *United Cooperatives* v. *Commissioner*,[30] and *Farmers Cooperative Co.* v. *Birmingham*.[31] The reasoning upon which those cases is based is aptly summarized in an article by Randolph Paul, former general counsel of the Treasury, as follows:[32]

"The administrative practice has been to exclude patronage dividends from a cooperative organization's income even where the organization is not exempted from tax. This is the correct view in the case of true cooperatives, not because these patronage dividends are deductible expenses, as is sometimes contended, but because they are amounts to which the cooperative has no claim and takes as agent only. The marketing cooperative is only a conduit through which flows income from the purchaser to the farmer. The conduit retains nothing but its own expenses, including depreciation reserves, and has, accordingly, no taxable income."

It should be noted that this has been the view of the Treasury Department itself during a long course of rulings on the subject. In *I. T. 1499*,[33] the Department said, in part:

"This office has consistently held that, under the Treasury decision and articles of the regulations referred to (art. 75, regulations 33 (T. D.) 2737), cooperative associations, even though not exempt from taxation, may deduct from gross income for the years 1917, 1918, 1919, and 1920 the amounts returned to their patrons, whether members or nonmembers, upon the basis of the purchases or sales, or both, made by or for them. This is upon the theory that a cooperative association is organized for the purpose of furnishing its patrons *goods at cost* or *obtaining the highest market price* for the produce furnished by them. In the case of purchases, *instead of allowing a discount at the time of purchase*, the full price is collected and the discount is allowed by way of rebate. In the case of sales of produce furnished by patrons, the refunds based upon the quantity of produce furnished are in reality only part payment of the produce furnished. If the association is organized in accordance with the laws governing *farmers'* and *other* cooperative associations in the State in which it operates and if its constitution or bylaws provides for refunds or rebates to its patrons, whether members or nonmembers, *upon the basis of goods purchased or produced furnished*, or if it actually conducts its business upon such basis, the *refunds* or *rebates* so made may be deducted by the association in computing net income under the Revenue Acts of 1917 and 1918. * * *"

And in GCM 17895,[34] the Department said:

"* * * So-called patronage dividends have long been recognized by the Bureau *to be rebates* on purchases made in the case of a cooperative purchasing organization, or *an additional cost of goods sold* in case of a cooperative marketing organization, when paid with respect to purchases made by, or sales made on account of, the distributees. For purposes of administration of the Federal income-tax laws, such distributions have been treated as *deductions* in determining the taxable net income of the distributing cooperative organization. Such distributions, however, *when made pursuant to a prior agreement* between the cooperative organization and its patrons are more properly to be treated as *exclusions* from gross income of the cooperative organization. (I. T. 1499; S. M. 2595; G. C. M. 12393.) It follows, therefore, that such patronage dividends, rebates, or refund due patrons of a cooperative organization *are not profits of the cooperative organization* notwithstanding the amount due such patrons cannot be determined until after the closing of the books of the cooperative organization for a particular taxable period." [Italics supplied.]

All of the foregoing cases conclude that amounts which the cooperative is obligated to turn over to the patron are not income to the cooperative. This is consistent with the judicial definitions of the word "income" as used in the sixteenth

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[27] 136 F. (2d) 382.
[28] 44 B. T. A. 824.
[29] 8 B. T. A. 903.
[30] 4 T. C. 93.
[31] 8 F. Supp. 201 (D. C. Iowa 1949).
[32] 29 Minn. Law Review, pp. 343, 369.
[33] CB I-2, pp. 189-191.
[34] CB 1937-1, p. 56.

amendment in *Eisner* v. *Macomber*, supra, and *Commissioner* v. *Wilcox*, supra In the latter case the Supreme Court said:[35]

"For present purposes, however, it is enough to note that a taxable gain is conditioned upon (1) the presence of a *claim of right* to the alleged gain and (2) the *absence of a definite, unconditional obligation to repay or return* that which would otherwise constitute a gain." [Italics added.]

The result must be that if amounts do not meet those tests they cannot be taxed under the sixteenth amendment, which permits only the taxing of "income." Cooperatives' margins do not meet those tests and are not "income" because they are held, not under claim of right by the cooperative, but instead under acknowledgment of the superior right of the patrons, and they are held subject to a definite, unconditional obligation to repay or return them to the patrons.

2. Cases holding that assigned income is nevertheless taxable as income of the assignor are not applicable

Opponents of cooperatives have relied[36] on United States Supreme Court cases holding that income assigned in advance of receipt by a parent to a subsidiary or a subsidiary to a parent, or by one member of a family to another, was nevertheless income of the assignor.[37]

Of these cases, *Lucas* v. *Earl*, the Horst case, the Harmon case, and the Tower and Lusthaus cases all involve efforts by one member of a family to get a portion of what would otherwise come to him, as income, into some other member of the family. The husband or father either made a contract without consideration, gave away interest coupons before they matured, or entered into a partnership to which the wife or children contributed nothing substantial. In each case the Court said that the income is nevertheless taxable to the person who really earned it. We have no quarrel with those cases, but they are not applicable to cooperatives, as we will show below.

The Moline Properties and National Carbide cases are of a different kind and involve corporations and their stockholders. In each the corporation was arguing that income (or gain) received by it was not its income for tax purposes. In both cases the Court rejected the contention. The two cases are somewhat different as to detail, and neither is applicable to the cooperative situation, as shown below.

In the Moline Properties case an individual held all of the stock of a corporation which his creditors had caused him to set up. The corporation held title to real estate and engaged in little activity beyond the bare holding of title. When some of the real estate was sold, the corporation asserted that the capital gain should not be taxed to it, but to its sole stockholder. The Court rejected that contention and said the corporate entity could not be ignored. It also said that there was no evidence that the corporation received the gain as agent for the stockholder, and that therefore the income was that of the corporation.

In the National Carbide case (and similarly in the Fontana Power case) a subsidiary agreed to pay its parent all its "profits" above a fixed amount. The subsidiary then contended that all amounts so paid over to the parent were not income to it, because when they were received they were subject to the obligation to pay them over. The argument is superficially like ours here, but on second look it will be seen that it is really more the argument of the assignors of income in the *Lucas* v. *Earl* line of cases. The subsidiary knew it was going to receive income, so it assigned it in advance to its parent, without consideration. That is not the cooperatives' case. The subsidiary in National Carbide made profits from dealings with outsiders and then turned those profits over to its parent, which had nothing to do with the transactions out of which the profits grew. In the cooperative situation, the cooperative makes sales to or for its patrons and then refunds to them the amount by which it has overcharged them, or has underpaid them, in the first instance. Those distributions of net margins were part of the original transactions. They went back to the original customer, not on up to a parent corporation. That this distinction is sound is demonstrated by another decision of the same court which decided the Railway Express case.[38]

Thus, all the cases cited by the Treasury memorandum which are discussed here involve attempts to assign income over which the assignor has "command."

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[35] 327 U. S. at p. 408.

[36] See brief filed by Joseph T. O'Connell with House Ways and Means Committee, April 1951.

[37] *Lucas* v. *Earl* (281 U. S. 111 (1930)); *Helvering* v. *Horst* (311 U. S. 112 (1940)); *Moline Properties* v. *Commissioner* (319 U. S. 436 (1943)); *Commissioner* v. *Harmon* (323 U. S. 112 (1940)); *Commissioner* v. *Tower* (327 U. S. 280 (1946)); *Commissioner* v. *Lusthaus* (327 U. S. 293 (1946)) *National Carbide Corp.* v. *Commissioner* (336 U. S. 422 (1949)). See also *Fontana Power Co.* v. *Commissioner* (127 F. (2d) 193 (C. A. 9, 1942)).

[38] *In re General Film Corp.*, (274 F. 903 (C. A. 2, 1921)).

They do not come to grips with the situation of cooperatives, who engage in conditional transactions as a result of which there is no income. At the time of the transaction there exists the obligation to distribute net margins to the patron in proportion to his patronage, including the transaction in question. As said in *Uniform Printing & Supply Co.* v. *Commissioner:*[39]

"Had the taxpayer given a customer (whether stockholder or outsider) a discount promptly after filling the order, no one would call it a dividend. If a rebate were given promptly upon the customer's business reaching a certain volume, the same conclusion as to its character would follow. To make cost estimates and adjust them at or near the end of each year, returning the excess payment to the customer, should not change the reasoning which leads to this conclusion. Nor should the fact that the customer is a stockholder materially affect the result.

"Perhaps a single refund coming at the end of each year would lessen the irresistibility of the inferences, but the conclusion would still fit the facts better than one founded on a dividend assumption. It is true the taxpayer is not a nonprofit corporation in a legal sense. It is subject to a tax upon the profits by it made. Nevertheless, net profits in its case must depend upon the facts. Payment to the customers, who are also taxpayers, of sums called refunds based upon the volume of business transacted and in no way dependent upon stock ownership is the determinative factor."

The same reasoning was used in *Midland Cooperative Wholesale* v. *Ickes,*[40] in holding that the cooperative could not handle coal under the Bituminous Coal Act's licensing provisions because by its method of operation it would amount to "price cutting." The Court said in part:

"The patronage dividend is as much a part of the transaction as the Price itself. If petitioner did not distribute patronage dividends or hold out they would do so—as under Minnesota law and its bylaws it must—there would doubtless be no sales of coal by it. Petitioner admits this. It is its promise and obligation to pay patronage dividends on this coal business that provides the incentive for the purchase of coal from petitioner, and it is not denied that petitioner's purchases of coal are purchases in interstate commerce.

"The payment of such dividend has the effect of decreasing the sale price below the established prices. It thus has an effect upon the price structure which sets the price for most of the bituminous-coal production, all of which moves in or has been held directly to affect interstate commerce. * * *"

3 Statutes and cases taxing trusts and associations as corporations are not applicable

Those advocating harsher tax treatment for cooperatives have referred[41] to the long-existing rule that an association or trust doing business in a corporate way may be taxed as a corporation.[42] That proposition is apparently brought in to support the argument that calling cooperatives agents, partners, or trustees does not prevent taxing them as corporations.

Those cases are not really applicable, but we have no quarrel with the proposition that nonexempt cooperatives are taxable insofar as they have income. The question is whether their net margins are income.

The fact is that some courts have described the relation of patron and cooperative as that of principal and agent.[43] It has also been stated that the relationship was one of beneficiary and trustee.[44] It has been stated that the relationship was one of creditor and debtor.[45] It has been suggested that the patrons are in effect partners with each other, and the cooperatives analogous to the partnership.[46] While those differences in analysis are to some extent based on differences of fact in the case involved, those statements are mainly of analogy. In our view it makes little difference which analogy is used, so long as the point (made by all of them) is inderstood—that money received by the cooperative and distributed at the end of the year is received and held by the cooperative pursuant to binding obligation to hand it over to the patrons as soon as the exact amount

[39] 88 F. (2d) 75 (C. A. 7, 1937), supra, at p. 76.
[40] 125 F. (2d) 618, 635 (C. A. 8, 1942).
[41] O'Connell, op. cit.
[42] *Burk-Weggoner Oil Association* v. *Hopkins*, 269 U. S. 110 (1923); *Morrissey* v. *Commissioner*, 296 U. S. 344 (1935).
[43] *State* v. *Morgan Gin Co.*, 189 So. 817 (Miss. 1939); *Texas Certified Cottonseed Breeders Association* v. *Aldridge*, 61 S. W. (2d) 79, 82 (Tex. Supp., 1933); *Bowles* v. *Inland Empire Dairy Association*, 53 F. Supp. 210 (D. C. Wash., 1943).
[44] Californian & Hawaiian Sugar Refining Corp., 163 F. (2d) 531 (C. A. 9, 1947).
[45] Valley Waste Disposal Co., 38 BTA 452 (1938); Growers Cold Storage Co., 17 BTA 1279 (1929).
[46] *Farmers Cooperative Co.* v. *Birmingham*, 86 F. Supp. 201, 218 (D. C. Iowa, 1949).

has been determined. It is that obligation which, from the moment of its receipt, impresses that money with a trust, agency, bailment, or indebtedness relationship, thus making it neither the property nor the income of the cooperative.

4. Facts of ownership of property, determination of price, etc., do not alter the character of cooperative net margins

The Treasury memorandum, as quoted in the Chicago Tribune, attacks the analogy of cooperatives to agents, and says:

"The legal title to the property of the cooperative is ordinarily vested in the cooperative"; and

"Moreover, the cooperative sells for its own account and not for the account of the member"; and

"The member does not set the price for which his particular products must be sold, and the sums returned to him are not attributable to profits on sales of his products but to profits on sales on all members' products"; and

"That a cooperative itself earns income seems difficult to dispute. It has assets and employees; it buys, sells, and performs services"; and

"Moreover, dividends paid by a cooperative on its capital stock, and amounts placed by it in reserves, stem from earnings resulting from its activities and are taxed at the present time to the cooperative as its income."

From these statements (with most but not all of which we can agree), the Treasury memorandum apparently concludes that the cooperative cannot really be the agent of the patrons. There are several answers to that:

(*a*) Each of these statements except the last fits a partnership, and strengthens the analogy of a cooperative to a partnership. Yet a partnership is not taxed as an entity. Thus: "The legal title to the property of a partnership is ordinarily vested in the partnership." "The partnership sells for its own account, and not that of a partner." "The partner does not set the price for which his particular products must be sold, and the sums returned to him are not attributable to products on sales of his products, but to profits on sales of all partners' products." "The partnership can have assets and employees, and buy, sell, and perform services."

In each of the foregoing statements the word "partnership" was substituted for "cooperative," and "partner" for "member." The statements are true, but the partnership is not taxable as such. Its partners are taxable, but the partnership as such has no taxable income. That concept is equally sensible in the case of cooperatives, which, like partnerships, are operated for their members' benefits.

(*b*) In spite of the cooperative's taking title, and selling on its own account, a number of courts have said that the cooperative was nevertheless the agent, and only took title for expediency in closing sales.[47]

(*c*) A number of arguments commonly made along the line of these statements are dealt with below:

(i) The argument that a "patronage refund" made to a particular patron "has no relation to the gain or loss on individual transactions in which he is involved, but depends on the success of the total enterprise. The actual profit realized on his goods may be much more than the patronage dividend distributed to him, and, conversely, he may receive a patronage dividend although the actual result of dealing with him was a loss."[48]

The short answer is that the obligation of the cooperative is not to pay to the patron the margin on the specific transaction but to pay to him his share (based on patronage) of the average margin of all transactions during the year. This is perfectly sensible and reasonable, as the margin can be expected to average out among transactions and patrons over the years, and as a reasonable way to eliminate an impossible quantity of book work that would result if rebates were related to individual transactions. Further, many cooperatives use a "multiple pool" system, which operates to make different rebates on different commodities, and effectively and equitably averages the margins.[49]

(ii) The argument that the cooperative realizes income based on Treasury Regulation 22 (a).

"Thus, if a corporation purports to make sales to shareholders at less than market, the transaction is ordinarily to be treated for tax purposes as a sale at

[47] *Texas Certified Cotton Breeders Association* v. *Aldridge*, 61 S. W. (2d) 79, 82 (Tex. Supp. 1933); *Rhodes* v. *Little Falls Dairy Co.*, 245 N. Y. S. 432 (App. Div.) affirmed 177 N. E. 140 (N. Y. 1930); *Johnson* v. *Staple Cotton Co-Op Association*, 107 So. 2 (Miss. 1926); *Bowles* v. *Inland Empire Dairy Association*, 53 F. Supp. 210 (D. C., Wash., 1943); see also *Farmers Cooperative Co.* v. *Birmingham*, 86 F. Supp. 201, 216 (D. C. Iowa, 1949).

[48] Magill, 49 Mich. Law Review, 167, 186.

[49] See 35 Minn. Law Review, 549 (May, 1951).

market, the difference being made up by a dividend constructively received by the shareholder."[50]

The same passage quotes Treasury Regulations 41, section 22 (a)–1, as follows:

"If property is transferred by a corporation to a shareholder, for an amount less than its fair market value, regardless of whether the transfer is in the form of a sale or exchange, such shareholder shall include in gross income the difference between the amount paid for the property and the amount of its fair market value to the extent that such difference is in the nature of a distribution of earnings or profits taxable as a dividend. * * *"

The argument made, based on that regulation, overlooks a number of things:

First, the corporate situation Mr. Magill is talking about typically involves a corporation which has in the past made substantial profits. It sells to a stockholder a piece of property, usually for as much as it cost the corporation, but less than its present market value. The courts and the Treasury both say the corporation has paid the stockholder a dividend, to the extent of the difference between the selling price and the real market value. Result, the stockholder pays a tax on the "constructive" dividend.

In the case of the cooperative, however, it has not made profits in the past which it can pass on to the stockholders by way of dividend, actual, or constructive. Further, its purpose is to sell to all patrons at cost. It is not paying them a dividend out of prior earnings, it is performing its principal function. The Treasury regulation was not intended to create a dividend where none existed, but to catch a dividend being paid in the guise of an ordinary sale. That that is the case is indicated by the fact that the regulation has stood from 1923 on, and the Treasury has not attempted to apply it to cooperative refunds, even during the period when Mr. Magill was Under Secretary of the Treasury.

Second, the Treasury regulation does not provide for taxing a fictitious income against the corporation anyway, which is what the proponents of cooperative taxation are urging. In other words, the remedy provided by the Treasury regulation leaves the corporation alone but requires the shareholder to include the constructive dividends in his income. It seems apparent, therefore, that even if the regulation were applicable it would not create income in the cooperative. It may be noted in passing that a result in line with the regulation's philosophy does occur at the patron's end of the typical cooperative transaction. The patron of a purchasing cooperative is required to include in income (or deduct from expense) patronage refunds received. The Treasury has so stated.[51]

(iii) It should be noted here that what we have said relates to the net margins of a cooperative which have been distributed to the patrons. In fact, it is those which our opposition suggests be taxed. Some cooperatives may have net margins which are not distributed to the patrons. Some of those may be taxable and some may not. I do not intend to discuss that question, but as a matter of information the general opinion in respect to it can be summarized as follows:

Net margins to the extent used or usable to pay dividends on stock are taxable to the cooperative.[52]

Net margins to the extent that they are retained in "unallocated reserves" of the cooperative are usually taxable to the cooperative.[53]

Net margins to the extent they are retained in "allocated reserves," in which each patron has a readily identifiable share, are not taxable.[54]

The status of patronage refunds paid out in various ways has been indicated by the Treasury Department in a letter of November 23, 1943, to the National Council of Farmer Cooperatives,[55] as follows:

"(1) When patronage refunds are paid in cash they reflect taxable income to the recipient either as a reduction of operating costs in the case of purchases made by the patron distributee or as an item of income in the case of goods sold for the account of the patron distributee and constitute income in the year received to a taxpayer on either a cash or accrual basis, unless the latter had previously received authentic advice upon which to accrue it in advance of its receipt.

"(2) When the patronage refunds are paid in capital stock of the association receipt of such stock constitutes, for income-tax purposes, constructive receip of income to the recipient in the case of goods sold for the account of the patron distributee, or as a reduction of operating costs in the case of purchases made by

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[50] Magill, 49 Mich. Law Review, 167, 187.

[51] Income-Tax Information Release No. 2, April 13, 1950; Current "Instructions for Preparation of Returns".

[52] United Cooperatives, Inc., 4 T. C. 93.

[53] See *Fountain City Co-op Creamery Association v. Commissioner*, 9 T. C. 1077, affirmed 172 F. (2d) 666 (C. A. 7, 1949); cf. *Midland Cooperative Wholesale*, 44 B. T. A. 824.

[54] *Midland Cooperative Wholesale*. 44 B. T. A. 824.

[55] Published as part of the record in the hearings of the House Committee on Small Business, 79th Cong.

the patron distributee, to the extent of the cash value of the refunds. This is true whether or not the capital stock has a readily realizable market value, and the cash value of the refunds represents the cost basis of the stock for the purpose of determining capital gain or loss upon the sale or exchange of the stock.

"(3) When patronage refunds are paid in certificates of indebtedness or equity issued by the association with or without interest but having a definite due date, receipt of such certificates constitutes, for income-tax purposes, constructive receipt of income to the recipient in the case of goods sold for the account of the patron distributee, or as a reduction of operating costs in the case of purchases made by the patron distributee, to the extent of the cash value of the refunds. This is true whether or not the certificates have a realizable market value and the cash value of the refunds represents the cost basis of the certificates for the purpose of determining capital gain or loss upon the sale or exchange of the certificates.

"(4) The answer to question (3) is also applicable when patronage refunds are paid in certificates of indebtedness or certificates of equity issued by the association with or without interest but having no definite due date.

"(5) When patronage refunds are paid in merchandise or other property, receipt of such payment constitutes, for income-tax purposes, constructive receipt of income to the recipient in the case of goods sold for the account of the patron distributee, or as a reduction of operating costs in the case of purchases made by the patron distributee, to the extent of the cash value of the refunds which represents the value of the property received."

(iv) It has sometimes been suggested that cooperatives can be taxed in any event because Congress can tax gross income if it so desires. It may be agreed that Congress can tax gross income. But margins which cooperatives are bound to return to the patrons are not gross income any more than they are net income. They are not income at all.[56] They are no more income than rebates or discounts which the seller credits to the buyer. On the Federal corporation income-tax return form the accounting principle is recognized in the first three lines, where the form calls first for "gross sales," then "less returns and allowances," and "less cost of goods sold" to determine "gross profits," as a part of "gross income."

SUMMARY

Despite the thousands of words that have been placed before Congress in the many hearings held upon this subject during recent years, and despite the articles written by former officials of the Treasury Department, and despite the intemperate propaganda of the National Tax Equality Association, these conclusions seem to me inescapable:

1. Exempt farmers' cooperatives have been given by Congress privileges not extended to other cooperatives or private business corporations, i. e., the limited dividends they are permitted to pay stockholders are not subject to tax, nor are reasonable and proper amounts placed in unallocated reserves. Otherwise their status is the same as that of all other nonexempt corporations.

2. Nonexempt cooperatives and private business corporations are treated alike for income-tax purposes. The cooperatives, however, pay less income tax than their comparable private business corporation competitors. This is not due to the fact that one corporation is a cooperative and the other a privately owned business corporation, but is due solely to a fundamental difference in the objectives of the two types of corporation. The cooperative is in business only for the purpose of benefiting its customers. The private business corporation is in business only for the purpose of benefiting its stockholders. The cooperative returns its net margins to the customers who produced the net margins. The private business corporation returns its net margins to its stockholders, who had nothing whatever to do with earning the net margins or with the transactions which created them.

3. Every court which has ever considered the question has squarely held that net margins of a corporation (whether a cooperative or private business corporation) which are returned to customers pursuant to a legally binding contract in effect at the time the margins are earned, are not taxable income of the corporation.

4. Although there is no decision squarely in point on the question whether net margins of a cooperative are income to it within the sixteenth amendment to the Constitution of the United States, the cases holding that margins are not income of the corporation and the decisions of the Supreme Court of the United States in

[56] They are "excluded" from gross income. See *Farmers Cooperative Co. v. Birmingham*, 86 F. Supp. 201, 217 (D. C. Iowa, 1949).

the Eisner and Wilcox cases require the conclusion that Congress cannot tax to the cooperative the distributed net margins because they are not profit income of the cooperative.

Senator BYRD. Mr. Fred V. Heinkel. He is representing the Missouri Farmers Association, Inc.

STATEMENT OF FRED V. HEINKEL, MISSOURI FARMERS ASSOCIATION

Mr. HEINKEL. Mr. Chairman and gentlemen of the committee, my name is Fred V. Heinkel. My address is Columbia, Mo. I grew up on a farm in Franklin County, Mo., which I now own and operate. I am president of the Missouri Farmers Association, a farmer cooperative association composed of some 300 farmer cooperatives, which are owned by more than 133,000 individual member farmers.

I would like to interrupt here just to say that I shall be glad to answer any questions I can. I am appearing here not as a lawyer or a tax accountant, but as a farmer giving you my and our observations as a farmer.

Senator TAFT. Is the Missouri Farmers Association connected with the Farm Bureau or Grange or anybody else, or is it entirely independent?

Mr. HEINKEL. It is not connected with either the Grange, the Farm Bureau, or the Farmers Union. It is affiliated with the National Council of Farmer Cooperatives.

Senator KERR. And its members may be members of the other organizations?

Mr. HEINKEL. That is right.

Senator MILLIKIN. Are you speaking in your talk about exempt cooperatives or nonexempt cooperatives?

Mr. HEINKEL. We have both kinds, but my statement is confined to the exempt.

Senator MILLIKIN. To the exempt. All right.

Mr. HEINKEL. In considering the matter of the tax status of farmer cooperatives, this committee and the Congress should, and I am sure will, give the greatest attention to the reasons why the Congress has for years past, under both Democratic and Republican administrations, fostered and promoted farmer cooperative associations.

Historically it has been well recognized that the public interest demanded an economically sound and stable agriculture. A great amount of wise legislation has been directed at the problems of this segment of our economy, and as a result many benefits have, in the national interest, been conferred upon agriculture. But years ago Congress well recognized that the most lasting program for farmers was one in which the farmer by himself would be able to maintain his place in the national economy.

One of the congressional encouragements to farmers is section 101 (12), providing for exemption from Federal income taxes for certain farmer cooperative associations.

Senator KERR. Let me ask the witness right here, now, and I will not interrupt you further, is there a single State that you know of that imposes a tax upon any farmer cooperative which is exempt from Federal tax under 101 (12)?

Mr. HEINKEL. I could not answer that question.

Senator KERR. That you know of. Does Missouri impose any tax on your exempt cooperatives in Missouri?

Mr. HEINKEL. No income tax.

Senator KERR. You do not know of any State that does?

Mr. HEINKEL. That is right.

Senator KERR. You have never heard of any State that does?

Mr. HEINKEL. No.

Senator KERR. Very well.

Mr. HEINKEL. This exemption statute, first enacted in 1916 under President Wilson, reenacted in substantially its present form in 1926 under President Coolidge, and reenacted in the administration of President Roosevelt, recognizes that farmer cooperatives are in the public interest and should be encouraged, developed, and expanded as a means whereby the farmer can help himself. However, the Congress has said in this exemption statute, and wisely so, to the farmers: "In order to qualify for this exemption your association must be a true farmer cooperative." So Congress placed strict limitations upon the activities of these farmer cooperative associations to insure that in order to qualify for this exemption the association must always be and remain truly a farmer cooperative, promoting our agricultural economy.

The exemption statute provides:

First, that the cooperative association must be owned and controlled by farmers; and if it issues capital stock, substantially all of the voting stock must be owned by farmers who are currently patronizing the association.

Second, that if it issues capital stock, the dividends paid thereon may not exceed 8 percent or the legal rate of interest permitted by the State in which it is organized.

Third, that it limit and restrict its business and activities to marketing farm products and furnishing farm supplies.

Fourth, that it market no farm products for anyone but the producer thereof.

Fifth, that it not market more farm products or furnish more farm supplies to nonmember farmers than it markets for or furnishes to its own member farmers.

Sixth, that it not furnish farm supplies to persons who are neither members nor farmers in an amount which exceeds 15 percent of all the farm supplies it furnishes.

Seventh, that if it does market any farm products or furnish any farm supplies to persons who are not its members, it must treat those nonmembers exactly as it does its own members with reference to prices paid or charged and with reference to patronage refunds credited or paid.

Senator TAFT. Is this all in section 101 (12)?

Mr. HEINKEL. Yes, sir.

Senator WILLIAMS. And you are speaking of exempt cooperatives, and not the nonexempt?

Mr. HEINKEL. That is right.

Eighth, that it can maintain only reasonable reserves for necessary purposes. In other words, it cannot maintain reserves to expand to do any business other than the furnishing of farm supplies or the marketing of farm products, and it cannot maintain reserves beyond that which is needed for the operation of its permitted activities.

Ninth, that if it does maintain any reserves, those reserves must be allocated and credited to all patrons, members and nonmembers alike, on the basis of their patronage, or records maintained from which such allocations and credits may be made.

Tenth, that it must keep records of business done with all patrons and allocate and credit all savings on the basis of patronage.

The sound wisdom of this legislation, as well as other legislation designed to foster and encourage farmers to organize and operate their own cooperative associations, has been recognized through 6 administrations and 17 congresses, and is a principal plank in the platforms of both the Democratic and Republican Parties.

Bearing in mind that one of the principal purposes for the enactment of the tax-exemption statute was to permit the farmers themselves to improve their economic position by cooperatively marketing their own farm products and cooperatively obtaining their own farm supplies, does the economic position of us farmers today justify the complete reversal of the position of Congress and the repeal of the tax-exemption statute? In 1947 net income received by farm operators was almost $18 billion. The farm net income dropped to about $16½ billion in 1948, and to about $14 billion in 1949. In 1950, even with the aid of a period of increasing farm prices in the last half of the year, net farm income took a further drop to $13 billion. Meanwhile, corporate profits have risen from $18½ billion in 1947 to a record peak of $22.1 billion in 1950, after taxes. In the last quarter of 1950 corporate profits were running at an annual rate of about $28½ billion, after taxes. Comparing the last quarter of 1950 with the prewar period of 1935-39, you will see that food prices had slightly more than doubled, but consumers' disposable income per capita was more than 2½ times the prewar level. Also, in 1950 income from agriculture was running slightly below 2.7 times the 1935-39 average, while nonagricultural income was almost 3⅓ times the 1935-39 average; and corporate profits more than 7 times the 1935-39 period. We say emphatically that the economic position of farmers is not now such that the Congress should revoke one of the principal acts of legislation designed to permit farmers to improve and stabilize their economic position. All the statistics quoted are from United States Government publications.

Senator WILLIAMS. May I interrupt the witness at this time and point out that one of the proposals before the committee would not increase the tax as far as the farmer is concerned. In fact, it would lessen the tax to the farmer because it would shift the burden from the farmer paying tax on his scrip over to the cooperative which is holding the funds.

So I think the net result from the individual farmer's standpoint would be an advantage. Now, that is a debatable point. You might disagree as to the long-range advantage. But the net immediate advantage would be in the farmer's favor, because he would not have to pay the tax on the money that he got.

Mr. HEINKEL. Our farmers do not happen to agree with your viewpoint on that, Senator.

Senator WILLIAMS. I say, there may be a difference of opinion on it, but the net result would be that.

Mr. HEINKEL. Another important reason for the encouragement given by Congress to farmers to organize and operate their coopera-

tives is the realization that farmer cooperatives permit the operation of the farm as a family-size production unit, yet with the benefits of efficient and effective marketing and purchasing. By and large, American agriculture is family-type agriculture. The continued existence of American family-type agriculture was and still is threatened by the great industrial and mechanical age in which we live. Instead of promoting American family-type agriculture to produce food and fiber, the industrial and mechanical age breeds corporate-type agriculture or collectivist agriculture. Neither corporate agriculture nor agriculture of collectivism is in keeping with the spirit of the American way of life. The answer to both systems is for farmers operating family-type farms to join together in their own cooperative associations to market their own products efficiently and effectively to obtain a greater share of the consumer's dollar and to join together to obtain their farm supplies in order to reduce the cost of their production of farm products.

Another reason for the encouragement of farmer cooperatives is the recognition that local monopolies were and continue to be a major factor in depressing farm incomes. I am speaking of the monopolies where the egg or poultry dealers in a local farm community join together to hold down the local price which farmers are paid for eggs and poultry.

Senator KERR. Let me interrupt you right there. Is that not the reason that the law was passed in the first place?

Mr. HEINKEL. That is my understanding, Senator.

Senator WILLIAMS. Is it not also true that any such monopoly as indicated here would be a violation of the Sherman Antitrust Law?

Mr. HEINKEL. That is my understanding. But I also point out a little further down here that it would be an insurmountable job for the Justice Department to try to track down all of these violations in the thousands of farm communities across the country.

Senator WILLIAMS. But there is a law against it?

Mr. HEINKEL. Yes; I understand that there is.

Senator KERR. Is it not a fact that most of those who suffered by it would be dead and buried before the Justice Department got around to correcting the situation?

Mr. HEINKEL. Exactly right. And that is why we dealt with it in another manner, and that is by farmer cooperatives.

I am talking of the local monopoly where local grain elevators join together in a community to depress the price of wheat paid to farmers in that community as much as 50 cents a bushel. I am talking of the local monopolies of feed and fertilizer dealers who hold up the price of feed and fertilizer to farmers in that trade territory by illegal conspiracy. While we have antitrust laws which make this illegal, the impossibility and impracticability of enforcing such laws in every farming community in this Nation is insurmountable. But we farmers who have joined together and invested our hard-earned money out of our own pockets for organizing and maintaining our own cooperative in that community have effectively broken up these local monopolies. In those places, no longer can local monopolies exist, because the farmers, through their own cooperative, see to it that they receive the fair market price for their eggs, poultry, cream, corn, cotton, wheat, and other farm products. Also, we farmers, through our cooperative, see to it that feed, fertilizer, petroleum

products, and other items of farm supply are furnished to us farmers at a fair price and that the price is not dictated by local conspiracies and monopolies.

Thus we see that the encouragement given by Congress to farmers to organize, own, and operate their own marketing and purchasing cooperatives has resulted in the maintenance of the American way of agriculture and in increased incomes to the farmers of the Nation, which helps everyone.

Farmer cooperative associations have been criticized for being in competition with ordinary businesses, and it has been strenuously argued that the provisions of section 101 (12) have somehow endowed farmer cooperative associations with a competitive advantage.

First of all, farmers did not organize and do not operate their cooperative associations for the purpose of entering into competition with anyone. A farmers marketing or purchasing cooperative is merely an extension of the farming operation—allowing the farmers to do as a group that which they cannot do efficiently and effectively as individuals. Those in the business of marketing farm products for their own profit or in the business of furnishing farm supplies for their own profit have no right to intrude and demand that farmers not market their farm products jointly with other farmers or not obtain their farm supplies jointly with other farmers.

Senator KERR. Let me ask you a question there. You are taking the basic position there that farmers do not exist for the benefit of the local businessman. Do you think that you can sustain that position?

Mr. HEINKEL. I do not think I am taking that position, Senator.

Senator KERR. I believe you are taking the position that the farmer is entitled to be in the position of kind of being in business for himself.

Mr. HEINKEL. Yes, I do. He is in business for himself.

Senator KERR. Then that means that he does not exist primarily for the benefit of some other business operator.

Mr. HEINKEL. His first responsibility is that of producing food and fiber for the people of the Nation, and that in itself is a business.

Senator KERR. Then you take the position that he is entitled to exist to as great a degree as he can in America for the development of his own economic welfare?

Mr. HEINKEL. Yes, sir.

Senator KERR. You believe that?

Mr. HEINKEL. Yes, sir, I do.

Senator KERR. You do not have anything against anybody else?

Mr. HEINKEL. No, sir.

Senator KERR. You think that they can do the same thing?

Mr. HEINKEL. Certainly. But historically, Senator, the marketing and processing of farm products has always been done by the farmers They used to sell their products direct to the consumer.

Senator KERR. Do you think they have a right under the Constitution to market the products which they create?

Mr. HEINKEL. Yes, I do. And I think the laws permit that.

Senator KERR. Do you think that is a kind of a basic right?

Mr. HEINKEL. Yes, sir.

Senator KERR. I just wanted to know.

Senator WILLIAMS. Has there ever been a proposal made, or has anyone ever suggested a proposal, that they do not have that right?

Mr. HEINKEL. There are some people in this country that are waging a campaign against us that gives us every reason to believe that they are, Senator.

Senator WILLIAMS. I am speaking about the proposals that you know of before this committee. Have there been any such proposals? If so, I would like to know it because I have not heard of any proposals that would prohibit farmers from doing what you say they have the right to do, which the whole committee recognizes that they have.

Mr. HEINKEL. I think that some of the proposals, Senator, would be very crippling and damaging to the successful operation of these farmer cooperatives.

Senator BYRD. Proceed.

Mr. HEINKEL. It is inevitable, however, that there will be conflict between farmers operating their own marketing and purchasing cooperative and those who buy farm products from the farmer and seek to make a profit for themselves off the marketing operation or who sell farm supplies to farmers and seek to make a profit for themselves from such sale.

If there is any so-called competitive advantage which farmer cooperatives may have over other types of business organizations such competitive advantage stems from the very nature, character, and purpose of the farmer cooperative association. With or without any tax-exemption statute, a cooperative association organized and operated to serve its patrons at cost and without profit to itself will always have a so-called competitive advantage over a business organization which, by its very nature and character, seeks to make a profit off of its patrons or customers. Thus, in reality what the enemies of farmer cooperatives want is the ultimate destruction of the very right of farmers to organize and operate their cooperative associations.

There has also been a tremendous amount of loose talk about the phenomenal growth of farmer cooperative associations. Yet it is common knowledge that the Nation itself has been in a period of expanding economy. Farmer cooperative associations have tried, sometimes successfully and sometimes unsuccessfully, to keep the pace. In many instances they have been far out-distanced. For example, a recent edition of the Wall Street Journal noted the fact that plant investment of one single business corporation, the Du Pont Co., at the end of 1949 was $866 million. This was an increase of $358 million in 4 years.

Right here I would like to say that I am not making reference to the du Pont Co. in any disparaging manner. I think they have a right to expand. But I am just citing the facts.

The growth of all the farmer cooperatives in the Nation during the same period could not favorably compare with the growth of this one business concern. According to the statistics of the Bureau of Internal Revenue, presented before the House Ways and Means Committee in 1947, the total assets of all the tax-exempt cooperative marketing and purchasing associations totaled only $489 million.

It has been repeatedly charged by our enemies that farmer cooperatives have grown and expanded at a rapid rate on so-called tax-free reserves. It should be borne in mind, however, that this provision of the tax-exemption statute on reserves is in actuality a restriction.

By its terms, cooperatives are prohibited from accumulating or maintaining any reserves other than those necessary in its activities and reasonable in amount. If the amount of a reserve becomes unreasonably high, then the exemption is forfeited. If the reserve is maintained for any purpose other than marketing farm products or furnishing farm supplies, the exemption is forfeited. Furthermore, these reserves are fundamentally different in character and nature from the surplus of an ordinary profit-making business corporation. Reserves or surplus in an ordinary profit-making corporation may be used to acquire new buildings, machinery, equipment, or facilities, thereby increasing the volume of business and the ultimate net income or profits of the corporation. In such a case those additional profits attributable to the maintenance of the surplus of the corporation inure to the benefit of the stockholders whose proportionate share of the profits were retained in surplus. The accumulation of reserves by an exempt farmer cooperative may also permit the association to expand and increase its ability to make greater savings for its patrons, but no part of the increased savings made by the cooperative, attributable to the accumulated reserve, inures to the benefit of the patron whose proportionate share of the cooperative was held in reserves.

Senator MILLIKIN. Mr. Chairman, in pursuing the distinction between the exempt cooperative and the normal corporation, if the corporation uses its profits for expansion, it has to pay a tax on the profits, does it not?

Mr. HEINKEL. You are talking about the exempt cooperative?

Senator MILLIKIN. I am talking about a normal corporation. If it makes a profit, it may distribute part of it by way of dividends, or it may keep all of it and put it into expansion. But whether it does one or the other, it pays a tax on its total profit, does it not?

Mr. HEINKEL. As I stated in the beginning, Senator, I am not here as a tax expert or an attorney.

Senator MILLIKIN. You just made a statement there—

Mr. HEINKEL. It is my understanding that profit-making corporations are entitled to some reserves.

Senator MILLIKIN. They are entitled to reserves. But the point I am making is that they have to pay taxes as a corporation on that which they reserve.

Mr. HEINKEL. They pay taxes. I am familiar with that.

Senator MILLIKIN. And the cooperative, for instance, as you have stated, the exempt cooperative, does not; is that correct?

Mr. HEINKEL. Yes, sir.

Senator MILLIKIN. Yes. And your point as far as the cooperative is concerned, as I get it, is that the social purpose of the cooperative is sufficient so that it is entitled to that exemption which is not given to the corporation?

Mr. HEINKEL. I am making the point here, Senator, that there is a distinct difference between these reserves in an ordinary profit-making corporation and a farm cooperative. I have not yet completed it, but there is this distinct difference.

Senator MILLIKIN. It is that distinction that gives rise to the social questions which you say are sufficient to warrant an exemption in the case of a cooperative and not warrant it in the case of a corporation. If you do not have a special social status here to warrant an exemption, I suggest you have no basis for an exemption.

Mr. HEINKEL. Senator, you may refer to it as a social status. It is a practical business proposition with us farmers.

Senator MILLIKIN. But I thought you developed at considerable length—and I have been very much interested in your testimony—the reasons why we came into cooperatives, the reasons why they have been continued, for example, to destroy monopolies. That is a distinct social purpose, and the Congress in the past has recognized it and has granted exemptions so that that social purpose might be pursued.

All that I am trying to point out here is something that I should think would be a helpful argument for the exempt cooperative, that it is pursuing a useful social purpose.

Mr. HEINKEL. It is, very definitely, pursuing a useful purpose, Senator.

Senator WILLIAMS. Might I ask you this question along the lines of your statement, that the purpose of the farm cooperative was to destroy a monopoly, and you referred to a Treasury Department report which was put out in 1947 in which they gave the value of all the assets of the cooperatives as $488 million. Are you familiar with that report that they put out in which the Treasury Department pointed out that they included in that estimate 2,909 cooperatives that were surveyed, that had a net valuation of assets of $488 million, but they pointed out that 67 cooperatives out of the 2,909 had 54 percent of all the assets, and that 7 of them had 20 percent of all the assets. And they pointed out that 53 cooperatives in this country out of 4,000 and something, in another survey, were doing 40 percent of all the business of the country, that is, of all the cooperative business.

So the fact that cooperatives were started to break up monopolies—and I am inclined to agree with you that there was a need for something, and I am not saying that there is not a need today for cooperatives, but I think there is nevertheless, there is a possibility that we are going to get into the field where we are going to be eaten up by the very thing we try to destroy if we are not careful. We are building up monopolies. The cooperative associations themselves are building up monopolies.

Mr. HEINKEL. No, Senator, we could not agree with you on that statement. I see nothing bad or detrimental in the fact that a few cooperatives have attained some size. The only reason the farmers permitted them to attain that size is that it was necessary in order for them to do the things the farmers wanted those cooperatives to do.

Bear in mind this, that there are restraining factors on the expansion of these cooperatives. There are two important ones. First, the Internal Revenue Department requires an information return at the end of each operating period, and if it appears from that information that this exempt cooperative is getting off base, they then require a new exemption application to be filed, and that requires a lot of detailed information. And I would say that the Internal Revenue Department is doing a good job of enforcing the law.

Then there is the further restraining factor that because of the farmer's economic plight, he organized these cooperatives as an extension of his farming operations so that he could effectively and efficiently market his farm products, and they have been in search of more cash. And they go to these annual meetings. In our State, they go to the annual meetings of local cooperatives, in attendance,

in terms of 100 to 500. And in one of our larger cooperatives, it had an attendance of 2,200. They are inclined, I would say, to take out too much of the money and prevent expansion and growth, because they have been in search of more cash, Senator.

So I would say there are plenty of restraining factors. If there are some that have gotten large, it was only because the farmers, after thorough consideration, deemed it advisable to build them that way to do the job that needed to be done.

Senator WILLIAMS. I was pointing out the fact that there are large industries in the cooperatives themselves, and we are not altogether dealing with small business when we speak of a cooperative. I mean, the picture is ofttimes painted as just a small group of individual farmers. Ofttimes it is big business that we are speaking of today.

It has gone away from the field just involving a group of small farmers.

Mr. HEINKEL. Yes, Senator. We have some large ones, and we found by experience that we needed some large ones. But in our case, the Missouri Farmers Association is 37 years old, and there are still plenty of private produce dealers and grain dealers and feed dealers and fertilizer dealers in the State of Missouri.

They may have had some casualties in that time, and so have we, but there are still plenty of them around, even though we have built some rather large cooperatives.

Senator MILLIKIN. May I ask you this? Does the case come to this, first, that what might be termed the profits of the exempt cooperative due to the relationship that exists between the members and the corporation, are not in fact profits; and that opens the whole scope of your legal argument.

Mr. HEINKEL. Yes.

Senator MILLIKIN. That is No. 1. But to the extent that they may be true profits, that the useful service that you perform in the interest of the farmer and the public welfare warrants the exemption, is that not what the case comes to?

Mr. HEINKEL. Yes, sir; it does.

Senator MILLIKIN. Thank you very much.

Mr. HEINKEL. I will move along as rapidly as possible, gentlemen.

Instead, those increased savings must go to and belong to the patrons who subsequently deal with the cooperative and who furnish the additional volume of business on which such additional savings were realized. The patron whose proportionate share of the savings was retained to make up the reserve will receive only the proportionate share originally withheld in reserve. Thus, there is a fundamental distinction between reserves in a farmer cooperative association operating under section 101 (12) and the surplus of an ordinary profit-making corporation.

On this question of expansion by farmer cooperative associations, we farmers in Missouri have recently constructed two new ferilizer plants, in order to take care of our need for fertilizer and plant foods, which in the last 4 years have increased far beyond the capacity of all production facilities, including our own. We have built a soybean-processing plant and a seed-processing plant, where none existed before, in order to serve our own needs. We have constructed three new milk plants in order to effectively market for ourselves the increased volume of milk we are producing in southwest Missouri. In

so expanding our operations, it was necessary that we farmers ourselves invest out of our pockets more than $2½ million for these operations, and we were unable to expand them merely with the use of accumulated reserves.

Senator TAFT. May I ask how you do that? You say some of your associations were nontaxable and others were taxable.

Mr. HEINKEL. The overwhelming majority are exempt, Senator.

Senator TAFT. You said some were taxable?

Mr. HEINKEL. Yes.

Senator TAFT. In the first place, why do they choose to be taxable? What restrictions are they unable to comply with in the section 101 (12)?

Mr. HEINKEL. There are these restrictions—here, Senator

Senator TAFT. Doing business with members 50 percent, is that one of the things that forces them to take a nonexempt status?

Mr. HEINKEL. No. There are some of them that do this business with people that are not eligible for membership, and they prefer to be on a taxable basis and operate as other businesses and be free to do that business.

Senator TAFT. Now, you say, when you bill for those plants, do you form a separate cooperative to build a fertilizer plant, or is there one big cooperative that does the whole works in Missouri? What is the corporate organization, in general?

Mr. HEINKEL. We have, Senator, local cooperatives. Then we have some that are called district, or regional, cooperatives, and we have one that is State-wide.

Senator TAFT. Now, who are the members of those?

Mr. HEINKEL. These 133,000 member farmers that I referred to in the beginning are members of these local cooperatives, and they also hold a membership, a direct membership, in the State-wide Missouri Farmers Association, Inc.

Senator TAFT. And also in the regional one that you spoke of?

Mr. HEINKEL. Not a direct membership in the regional ones.

Senator TAFT. Who are the members of the regional ones?

Mr. HEINKEL. The local cooperatives.

Senator TAFT. The local cooperatives are members of the regional cooperatives?

Mr. HEINKEL. That is right.

Senator TAFT. And you arrange it so that any member who joins any of them is a member of the big one?

Mr. HEINKEL. That is right, Senator.

Senator BYRD. What is the minimum number of farmers in a cooperative?

Mr. HEINKEL. Well, sir, that is a legal question. I believe it is 11 that can form a corporation.

Senator TAFT. Does the big company own these manufacturing facilities?

Mr. HEINKEL. Going through here, Senator, these two fertilizer plants and the seed plant are in the Missouri Farmers Association, Inc.

Senator KERR. That is a State-wide association?

Mr. HEINKEL. That is right. The soybean plant is in one of the regionals known as the MFA Cooperative Grain & Feed Co.

The milk plants are in the Producers Creamery Co., located at Springfield, Mo., in southwest Missouri, again, in which the farmers hold a direct membership because it does business, naturally, directly with the members in the case of the marketing.

Senator WILLIAMS. Are your earnings distributed on the basis of accumulated earnings in the State-wide organization, or to each individual?

Mr. HEINKEL. In the case of the local cooperative, it is on the basis of the business that the farmer does with his local cooperative. In the case of these regional cooperatives, it is on the basis of the volume that the local cooperative does with the regional.

Senator KERR. In other words, if the regional cooperative makes a profit, it immediately distributes it, or that which represents it, to the member cooperatives, who then distribute it to their individual members?

Mr. HEINKEL. Yes, sir.

Senator MILLIKIN. I believe you have already answered this question, but I would like to ask you again, so far as the regional cooperative is concerned, the membership of the regional cooperative consists, does it not, of the representatives of the local cooperatives, or do the members of the local cooperatives also belong, as such, to the regional?

Mr. HEINKEL. No, sir. They hold a direct membership in the State-wide Missouri Farmers Association, but they do not hold a direct membership in the regional, or manufacturing, cooperatives, in the case of two of our companies that manufacture feed.

Senator MILLIKIN. What does the membership of the regional consist of?

Mr. HEINKEL. The local cooperatives.

Senator MILLIKIN. You mean, the representatives, the officers of the local cooperatives?

Mr. HEINKEL. They are the ones who will represent the local cooperative in the meetings of these regional cooperatives and who serve as members of the boards of directors.

Senator MILLIKIN. Yes.

Senator KERR. I will illustrate that, Senator. In Oklahoma, we have quite a number of local rural electric cooperatives. They are corporate entities. A number of them went together to form what they called the Western Electric Cooperative, in which the local REA is a member, and of which the local REA owns a portion.

But the Western Electric Co-op is an entity, a corporate entity, owned by the local cooperatives.

Senator MILLIKIN. Yes.

Senator KERR. But in the Western Electric Cooperative, there are no individual memberships.

Senator MILLIKIN. But the individual membership is reflected through representation in that organization of the officers, I assume, of the local?

Senator KERR. The representatives, whoever they want to send.

Senator MILLIKIN. The representatives, whoever they may be.

Mr. HEINKEL. Usually the president of that local.

Senator WILLIAMS. Usually the members of the REA's cooperatives obtain their exemption in another section of the law from the one to which you are referring at this time.

Mr. HEINKEL. Yes; in Missouri we have tried to expand and grow, and we will continue to do so, because we believe that the benefits flowing to Missouri farmers and to the entire economy of our State make our efforts worthy of the highest praise.

There has been much loose talk to the effect that unless some kind of discriminatory tax is placed upon cooperatives, then all forms of business will convert to the cooperative method of doing business in order to escape the payment of Federal income taxes. Such a charge is fantastic. General Motors, United States Steel, or Du Pont Co. would not give a second thought to accruing and paying all of their net profits over to the people who ultimately buy and use their products. They are in business, and rightfully so, for the purpose of making a profit for the owners of those businesses, namely, the stockholders. Farmer cooperatives, on the other hand, are in business for the purpose of enabling their patrons, the farmers, to increase their income out of their own farming business.

I well recognize that we are faced with a period of international tension, a period which will no doubt provide a severe test of our military, political, and economic strength. American agriculture is ready and willing to play its part in our Nation's struggle to preserve its free institutions, its traditional democracy, and its hope for justice and decency throughout the world. The need for increased revenues for the Federal Government arising from the national emergency should not result in a hasty and ill-advised overthrow of the well-established policy of Congress of "helping the farmer help himself." I am confident that neither this committee nor the Congress will use this time of international upset to deal such a telling and discouraging blow to the farmer. I might add that the enemies of farmer cooperatives have certainly used the present world calamity to press their insidious campaign of deceit and hate. These enemies well recognize that the power to tax includes the power to destroy. Therefore, as the first step in their attempt to destroy farmer cooperatives, these adversaries of American farmers have waged an unrelenting campaign to induce the Congress to impose taxes upon their cooperatives without regard to their true purpose, nature, functions, and operations.

The repeal or any modification of the income-tax-exemption statute relating to farmer cooperatives or the enactment of special tax laws on nonexempt cooperatives would, in our opinion, be a declaration on the part of the Congress that farmer cooperative associations should no longer be encouraged. It would put the stamp of congressional approval upon the vicious attacks which have been made by those who have been waging a pressure campaign to destroy farmer cooperatives. Such an action would be disheartening to the millions of farmers who own and operate and are served by their cooperatives. Such action should not be taken at a time when the American farmer is being called upon to work longer hours in order, with less manpower, to produce the food and fiber needed in the defense of our country. Especially is this true when Congress has passed laws authorizing the Government to loan Federal money to industry for expansion; when it has provided rapid amortization for tax purposes for new facilities; when it has raised the minimum wage for labor. Is that the time when Congress should pick on farmer cooperative associations which have so ably demonstrated that they are vital and necessary to maintaining American agriculture? Certainly, the few millions of dollars

that would be exacted from farmers by changing the tax status of their cooperative associations would not justify such a congressional rebuke to the farmers of America.

Remember this—that farmer cooperative associations are private enterprise. The farmers of this Nation have more invested in our free, competitive, capitalistic economy than any other group of people in America. Therefore, the farmers of America have more reason for maintaining our free, capitalistic economy, because they have a greater stake in it. All that we farmers are trying to do with our cooperative associations is to make our business of farming show a profit and to hang onto our stake in our American economy and our American way of life.

Senator BYRD. The next witness is Mr. Karl D. Loos, of the National Council of Farmer Cooperatives.

Proceed, Mr. Loos.

STATEMENT OF KARL D. LOOS, NATIONAL COUNCIL OF FARMER COOPERATIVES

Mr. LOOS. Mr. Chairman, my name is Karl D. Loos, and I am a practicing lawyer in Chicago and Washington, and have been practicing since 1914.

During that time, I have worked for quite a number of cooperatives, and for two or three of them during all that time.

First I would like to discuss very briefly the matter of business volume. There is being placed before you a statement which I have prepared comparing the business volume of the cooperatives, both marketing and purchasing, with the total receipts from farm marketings.

There have been quite a number of statements made to which Mr. Heinkel has already adverted regarding the phenomenal growth of cooperatives and their large size. And if we look at the figures alone of the cooperative growth from year to year, it does look like quite a considerable growth. But we must remember that these are figures measured by dollars, dollar volume, and, of course, it takes two or three times as many dollars now to represent the same quantity in tons or bushels of farm commodities or farm supplies.

I have used the cash receipts from farm marketings as the basis for comparison to indicate the relative proportion of the farm purchasing power that is dealt in through the cooperatives, and by comparing the farm marketing cooperative volume shown in the second column of dollar figures with the total farm marketing receipts, we can get a percentage that shows the proportion of the total farm commodities that are marketed through the cooperatives.

Likewise, by comparing the volume of purchases through the purchasing cooperatives with the farm marketings, we get a percentage of the total farm receipts that the farmer spends through his cooperatives, and when we combine the two in the percentage in the last column and relate that to twice the cash receipts, what he receives and what he spends, assuming that he spends it all, we get the percentage of total transactions that is represented through the cooperatives.

When we examine these percentages, the growth does not appear to be at all startling. In fact, it appears that in some of these years

we have been declining, particularly during the early war years, and since the war we have had a small gain, but we are still below the maximum that was reached on this relative basis, which maximum was reached way back in 1932.

Senator KERR. I would like to ask you a question right there.

Mr. Heinkel, who just preceded you, gave us a very clear and effective presentation, and told us that the farm net income was $16,500,000,000 in 1948. Your column in cash receipts, farm marketings, in 1947–48 was $30 billion, and in 1948–49 was $29 billion.

Would you explain the difference to us?

Mr. LOOS. I am not sure just what Mr. Heinkel's figures were, but I think they were net income.

Senator KERR. Farm net income.

Mr. LOOS. And my figures are the gross receipts for farm marketings – the cash received for all farm commodities marketed.

Senator KERR. And the figures that he gave us were the net?

Senator TAFT. Net income; yes.

Mr. LOOS. Probably after expenses. I am not sure whether they deduct expenses of production or not in that particular figure that he was giving.

Senator KERR. Mr. Heinkel is still in the room.

Mr. LOOS. Yes, Mr. Heinkel is still here.

Senator KERR. The figures you gave us for the income for the various years, Mr. Heinkel, you referred to as net income, and that was calculated after the payment of the expense in connection with the income?

Mr. HEINKEL. Right.

Senator KERR. All right.

In other words, the figures you have given us now, Mr. Loos, represent the gross income?

Mr. LOOS. Gross income; yes, sir. And, of course, the cooperative volume figures are also in gross figures.

Senator KERR. All right.

There would be one result or one thing to be drawn from your paper, which is this: That while the farm marketing cooperatives in total dollar volume increased—we will look at the 1929–30, because that is almost an identical percentage to 1949–50—in other words, in 1929–30, 22.7 percent of the farmers' gross income was spent with farm marketing cooperatives. That is the inference to be drawn from that?

Mr. LOOS. Yes, that he marketed that percentage——

Senator KERR. And the total in dollars was $2,310,000,000?

Mr. LOOS. Yes, sir.

Senator KERR. Now, in 1949–50, the percentage was 22.9, which is almost the same, and his total dollar volume with the cooperatives was $6,500,000,000.

Mr. LOOS. That is correct, Senator.

Senator KERR. That would mean, then, that 77.5 percent, or approximately that, which he spent with competitors, so-called, of the farm marketing cooperatives, increased in proportion in terms of dollars on the same basis as his own, except that in terms of dollars it represented a far greater sum for noncooperative spending as compared to cooperative spending?

Mr. LOOS. That is exactly correct, Senator. And you will note that in 1948–49, the year before last, shown on the table, the percent-

age had gone up to 24.9 percent, with a total of $7,298,000,000 in farm marketing through the cooperatives. And this year, the last year, 1949–50, it declined almost $800 million in total volume and the percentage declined to 22.9 percent, which, as you pointed out, Senator, is almost exactly what it was way back in 1929–30

Senator WILLIAMS. Do these figures include just farm commodities alone, or your total volume of business, regardless of where the sales might come from?

Mr. LOOS. It includes the total cash received by the farmer for all commodities he sells.

Senator WILLIAMS. That is correct.

Mr. LOOS. Livestock, grains— everything.

Senator WILLIAMS. But now the percentage that is marketed through the farm cooperatives, and your volume of business, that includes only your volume of business on farm crops; is that correct?

Mr. LOOS. It includes everything that the marketing cooperative sells, which, of course, is only farm crops livestock or anything else.

Senator WILLIAMS. What I was wondering was this. For instance, if some cooperative has an interest in some oils or some other nonrelated business, is that included in the volume?

Mr. LOOS. Not in the marketing volume, Senator, but it is included in the volume of the purchasing cooperative.

Senator KERR. In the next column?

Mr. LOOS. In the next column.

Senator WILLIAMS. That is what I wanted to know—which one it was included in.

Mr. LOOS. Yes.

Now the marketing volume, of course, would not show petroleum in its marketing. These marketing figures and purchasing figures are the actual marketing activities and purchasing activities regardless of whether they are done by a marketing cooperative or by a purchasing cooperative.

As you probably know, Senator, there are quite a number of cooperatives that perform both functions.

Senator WILLIAMS. I know they do.

Mr. LOOS. And the functions have been separated.

And in Southern States Cooperative, which you mentioned in connection with the testimony of Mr. Rumble, it does both marketing and purchasing. Now, its marketings are in the marketing column here and its purchases are in the purchasing column.

Senator WILLIAMS. That is what I wanted to point out; yes, sir.

Mr. LOOS. The purchasing volume has increased rather steadily, but it still is less than 8 percent of the total money that the farmer has to spend.

Senator KERR. Now, let me interrupt you right there. For the percentage of his income he has spent with his own cooperative, the total amount has reached only $2.250,000,000 in 1949–50.

Now then let us go back to 1930–31. His total income for that year was $7,700,000,000.

Mr. LOOS. Yes, sir.

Senator KERR. Of which he spent $215,000,000 with his own cooperative, which means that he spent $7,500,000,000 of his income with others than his own cooperative.

Mr. LOOS. Approximately that, Senator.

Senator KERR. Well, approximately $7,500,000,000.
Mr. LOOS. Approximately $7,500,000,000.
Senator KERR. $7,480,000,000, or something like that.
Mr. LOOS. That is right.
Senator KERR. Now, in 1949-50, while his spendings with his own cooperative had gone up close to $2,000,000,000, his spending with noncooperative sources had gone up from, let us say, $5,000,000,000 in 1931-32, where he spent a net of about $5,250,000,000 outside, and in 1949 he had $26,000,000,000 to spend on the outside.
Mr. LOOS. That is right, Senator. That is exactly the point of all these figures.
Senator TAFT. Of course, when you were talking about those spending figures, however, that includes his taxes and everything else?
Mr. LOOS. Surely, it does not mean that he spent them just for that.
Senator TAFT. Yes, sir. It is not all marketing.
Mr. LOOS. It does not mean that he spent it all for farm supplies.
Senator KERR. You can take it for granted that a lot of money he spent in 1949-50 was for taxes, but we think it was a worthy purpose.
Mr. LOOS. I think these figures are pretty clear. Next I would like to make some comparisons about size.
There has been a great deal of talk about the size of these cooperatives, and some of them individually, as Senator Williams points out, are big, and we are proud of the fact that they are big, because we need big cooperatives. But most of these big cooperatives are regional or national cooperatives that are owned by a whole lot of smaller local cooperatives.
Furthermore, if we compare these cooperatives, no matter how big they are, with some of our really big corporations of this country, we get very quickly a clear idea of the very small relative size and the very small part in our national economy that the cooperatives themselves play.
For example, let us take——
Senator KERR. Before he goes to that, Mr. Chairman, I would like to know if this chart that he is giving us will be in the record.
Senator BYRD. It will be in the record.
Mr. LOOS. Thank you, Senator.
(The table referred to is as follows:)

Farmer cooperative business volume compared with total agricultural cash receipts

[In millions]

Year	Cash receipts farm marketings	Farmer marketing cooperatives	Percent	Farmer purchasing cooperatives	Percent	Total transactions, percent
(1)	(2)	(3)	(4)	(5)	(6)	(7)
1913	$6,248	$304	4.9	$6	0.1	2.5
1915	6,403	624	9.8	12	.2	5.0
1921	8,150	1,199	14.7	58	.7	7.6
1925–26	10,780	2,265	21.0	135	1.3	11.2
1927–28		2,172		128		
1929–30	10,158	2,310	22.7	190	1.9	12.3
1930–31	7,696	2,185	28.4	215	2.8	15.6
1931–32	5,557	1,744	31.4	181	3.3	17.4
1932–33	5,028	1,200	23.9	141	2.8	13.4
1933–34	5,824	1,213	20.8	152	2.6	11.7
1934–35	6,710	1,343	20.0	187	2.8	11.4
1935–36	7,726	1,525	19.7	315	4.1	11.9
1936–37	8,608	1,883	21.9	313	3.6	12.3
1937–38	8,268	1,960	23.7	440	5.3	14.5
1938–39	7,782	1,684	21.6	416	5.3	13.5
1939–40	8,122	1,639	20.2	448	5.5	12.9
1940–41	9,778	1,830	18.7	450	4.6	11.7
1941–42	13,290	2,240	16.9	600	4.5	10.7
1942–43	17,424	3,030	17.4	750	4.3	10.9
1943–44	19,915	4,150	20.8	1,010	5.1	13.0
1944–45	20,944	4,550	21.7	1,095	5.2	13.5
1945–46	23,190	4,850	20.9	1,220	5.3	13.1
1946–47	27,525	5,664	20.6	1,452	5.3	13.0
1947–48	30,279	6,813	22.3	1,822	6.0	14.3
1948–49	29,278	7,298	24.9	2,022	6.9	15.9
1949–50 [1]	28,396	6,492	22.9	2,233	7.9	15.4

[1] All figures for 1949–50 are preliminary and not yet published.

Source: Column 2—Bureau of Agricultural Economics, Farm Income Situation, July-August 1949, p. 11; for 1925–26 and subsequent years, simple average of two calendar years. Columns 3 and 5—As reported by Farm Credit Administration; see Statistics of Farmers Marketing and Purchasing Cooperatives, 1945–46, p. 5; for 1935–36 and subsequent years, adjustments have been made for the purchasing business of the marketing associations and the marketing business of the purchasing associations; and supplemental annual reports. Column 4—Computed percent of column 3 to column 2. Column 6—Computed percent of column 5 to column 2. Column 7—Computed percent of columns 3 and 5 to twice column 2.

Senator BYRD. Proceed.

Mr. LOOS. Let us compare the farmer purchasing cooperative volume in 1950 of $2,250,000,000 in round numbers, with what four single retail organizations had as their volume in 1950: Sears, Roebuck; Montgomery Ward; the A. & P.; and Woolworth. I picked these four because they are in a compilation issued by the National City Bank, and the figures were readily available. Those four organizations alone had a total volume of $7,281,000,000 in 1950 as compared with something over 3,000 purchasing cooperatives which had a total volume of only $2,225,000,000.

Now, Sears, Roebuck alone—and Sears, Roebuck sells a lot of supplies to farmers—had a total volume in 1950 of $2,500,000,000 which was a quarter of a billion dollars more than the total volume of all purchasing cooperatives, the 3,000 of them.

Senator BYRD. What year was that?

Mr. LOOS. 1950.

Senator KERR. I wonder if it is not a fact that Sears, Roebuck alone has had a greater expansion through the years than all of the cooperatives put together?

Mr. LOOS. Senator, that is exactly the case. In 1940 the total volume of Sears was $704,000,000. In 1950 it was $2,556,000,000. That is an increase of $1,852,000,000 in those 10 years.

Taking the same 10 years for the purchasing cooperatives, which in 1940 were something like 2,500 or less in number and are now some 3,000 in number, in 1940 they had a total volume of $448,000,000; in 1950, $2,233,000,000, an increase of $1,785,000,000, which is just about $70,000,000 less than the total increase of Sears, Roebuck alone in sales volume.

Senator WILLIAMS. You spoke of that amount as being with 3,000 cooperatives. I might say that, while I am not objecting to the size of them, it is a question of whether or not they should pay tax. That is the question.

But I do not have the figures in 1948. However, in 1944, 67 of those 3,000 were doing 54 percent of the business, and I am wondering if that percentage is carried up or whether it has increased or decreased.

Mr. LOOS. I would not be able to say, Senator, because these figures for 1950 are preliminary figures, and the analysis has not been carried that far as yet. But it will be. Furthermore, I do not have those tables with me. But it is quite true that a relatively small number of the large national cooperatives do a large percentage of the total volume of business, both with respect to purchasing and marketing. However, that is also true with respect to other corporations in this country.

Senator WILLIAMS. It is true with Sears, Roebuck and the other retailers throughout the country, too, to the same extent.

Mr. LOOS. I would like also to make some comparisons between the marketing cooperatives and the corporations which sell food products or farm products in manufactured form.

Here I have taken three food marketers, Armour, Swift, and National Dairy Products; and three tobacco marketers, American, Liggett & Myers, and Reynolds; and the combined volume of those six corporations in 1950 was $7,153,000,000, which is $750,000,000 more than the total marketings of all the nearly 7,000 farm marketing associations.

Senator KERR. Let me go back to that second column. Can you tell us the increase in the purchases that have been made in this country generally from establishments comparable to farmer purchasing cooperatives? While their purchases have grown from $450,000,000 in 1940 to $2,250,000,000 in 1950, can you tell us what the purchases of the country generally from private corporations have grown from and to?

Mr. LOOS. Of the corresponding farm supplies, Senator?

Senator KERR. No; the total of the country. What I would like to put into the record, if we can, is the figures which show the insignificant percentage of the total business in the country which these cooperatives do.

Mr. LOOS. Senator, I am sorry, I do not have these figures with me, but, as I say, it is a very, very small percentage of the total. If you use national income or any other figure representing gross volume of all business, it is a very small percentage.

Senator KERR. Could you not furnish us with a tabulation of these figures?

Mr. LOOS. I could probably do so. I do have some comparisons along that line of total assets, which also indicate——

Senator TAFT. The gross product is about $300,000,000,000 compared to $28,000,000,000 for farms. It is a little more now. The farm receipts are less than 10 percent.

Mr. LOOS. Yes; and the farmer cooperative volume would be something less than $10,000,000,000 aggregate, and that compared to $300,000,000,000 would be about 3 percent.

Senator KERR. I would like for you to give us those figures if you can put that into the record later.

Mr. LOOS. I will try to do so, sir.

(The information referred to, later submitted, follows:)

POPE, BALLARD & LOOS,
Washington, D. C., July 25, 1951.

Hon. HARRY F. BYRD,
Senate Finance Committee, Washington, D. C.

DEAR SENATOR BYRD: During my testimony before your committee on Friday, July 20, Senator Kerr asked whether figures could be obtained comparing farmer cooperative business volume with total national volume. I requested opportunity to present such figures if they could be obtained, and you gave permission to do so.

The attached table is submitted for that purpose. It compares cooperative business volume with "gross national product," the figure annually compiled by the Department of Commerce as representing the total national volume, eliminating all duplications.

It should be noted that the cooperative volume as published by the Farm Credit Administration eliminates duplication in transactions between federated cooperatives and their subsidiaries where title does not pass. However, other duplications are not known and therefore cannot be eliminated.

It is stated by the Department of Commerce that, while it compiles no statistics of such character, it is estimated by sources outside the Department that total national volume, if duplications were not eliminated, would exceed $600,000,000,000.

We thank you very much for this opportunity to submit this additional statement and hope that it may be incorporated in the record.

Very truly yours,

KARL D. LOOS.

Ratio of business volume of farmer cooperatives to gross national product

Calendar year	Gross national product	Crop year	Sales volume of farmer cooperatives	Percent
	Billions of dollars		*Billions of dollars*	
1930	90.9	1930-31	2.4	2.6
1931	75.9	1931-32	1.9	2.5
1932	58.3	1932-33	1.3	2.2
1933	55.8	1933-34	1.4	2.5
1934	64.9	1934-35	1.5	2.3
1935	72.2	1935-36	1.8	2.5
1936	82.5	1936-37	2.2	2.7
1937	90.2	1937-38	2.4	2.7
1938	84.7	1938-39	2.1	2.5
1939	91.3	1939-40	2.1	2.3
1940	101.4	1940-41	2.3	2.2
1941	126.4	1941-42	2.8	2.2
1942	161.6	1942-43	3.8	2.3
1943	194.3	1943-44	5.2	2.7
1944	213.7	1944-45	5.6	2.6
1945	215.2	1945-46	6.1	2.8
1946	211.1	1946-47	7.1	3.4
1947	233.3	1947-48	8.6	3.7
1948	259.1	1948-49	9.3	3.6
1949	255.6	1949-50	[1] 8.7	3.4

[1] Preliminary.

NOTE.—Cooperative sales volume as reported above by the Farm Credit Administration covers both farmers' marketing and purchasing cooperatives and has been reduced to eliminate sales between central organizations and their affiliated locals where title to products did not pass. No other duplicated sales between cooperatives have been eliminated as volume thereof is not known.

The gross national product above reported by the Department of Commerce in its Survey of Current Business for July 1950, p. 9, is said not to include any duplication of sales. Therefore the ratio shown above for cooperative volume to gross national product is on the high side.

The Department of Commerce states that no record is kept of total sales by all business concerns but that this figure has been unofficially estimated outside of the Department as currently in excess of $600,000,000,000 annually.

Senator KERR. Pardon me. Go ahead.

Senator BYRD. I notice that you express the farmer purchasing cooperative receipts as a percentage of the cash receipts of marketing?

Mr. LOOS. Yes, sir.

Senator BYRD. Should not that be expressed as a percentage of farm expenditures?

Mr. LOOS. That should be, Senator, if we had any such figure available. But I have been unable to locate any such figure, and I used that, recognizing its infirmity in some respects, but as indicating the percentage he spent with his cooperatives of all the money he had to spend, assuming that he was entitled to spend all the money he received from his farm marketings.

Of course, Senator Taft, as you pointed out, that does include a whole lot of things other than farm supplies.

I do have one or two comparisons, however, of farm supplies by commodities. Take petroleum, for example, of which there has been a great deal said. There happens to be a series of statistics here that are published regularly by the National City Bank showing 30 major oil companies, and there is a similar corresponding series published by the Farm Credit Administration showing 30 regicnal cooperatives which deal with petroleum products and which do 95 percent of all the business done by all the purchasing cooperatives in petroleum products.

But in 1946—I am sorry that that is the most recent year for which I have been able to get such figures—the 30 cooperatives marketed 955,000,000 gallons. The 30 major oil companies marketed 42,000,000,000 gallons. The farm purchasing cooperative marketings or sales of petroleum products were only 1.7 percent of the gallonage marketed by the 30 major oil companies.

Senator KERR. Can you tell us what percentage of that was procured by the cooperatives from the oil companies themselves?

Mr. LOOS. A very large percentage, Senator.

Senator KERR. Most of it?

Mr. LOOS. There are only a few of the cooperatives which do have their refining facilities. There is only one that I can think of that has its oil wells, and that is a result of the fact that, in the territory where they do have refineries and where they do have oil wells out there in Kansas, they were forced into that because the major companies would not sell them gasoline and other petroleum products to distribute. They had to go and get their own refineries.

Senator KERR. But, with the exception of that very limited quantity which they produced for themselves, they are in reality customers of the oil companies with respect to everything that they do market?

Mr. LOOS. Yes, sir; that is exactly correct.

Now, with reference to the comparison of assets, I have a lot of figures here, but I think that only one or two will be necessary to make the point.

It must be self-evident that the cooperatives, measured by their assets, are very, very small compared with the whole enterprise of the country. We have to go back to 1943 to make any satisfactory comparison here because that was the year for which the Treasury tabulated the Form 990 returns, and those returns showed total assets.

There were 3,547 exempt cooperatives which reported total assets of $728 million.

In that same year, according to a compilation prepared by the Department of Commerce, there were 1,000 so-called largest manufacturing corporations, and in addition there were 34 other corporations each of which had assets of $1 billion or more, and those 1,034 corporations—I do not mean that the 1,000 manufacturing corporations had $1,000,000,000 each, but those 1,034 corporations together had total assets of $140,000,000,000 as against less than $1 billion for the 3,547 cooperatives.

Senator KERR. Which was the total of the tax-exempt cooperatives?

Mr. LOOS. That is the total of the tax-exempt cooperatives that reported, Senator, their balance sheets on these Form 990 returns. Many of these smaller cooperatives were not required to report their balance sheets, and some of the cooperatives that were supposed to report them failed to do so. But there were 3,547 who did report, and that is the result of the comparison.

Now, as Mr. Heinkel said, I am not making these comparisons in any spirit of disparagement. I agree with him that it is very important to the economy of this country that we have these corporate giants. I think that we are lucky to have a General Motors and a Pennsylvania Railroad and a du Pont Co. because all of them and all of these large corporations add tremendously to our economic strength and our military might.

Senator KERR. Let me ask you this question. Does not every farm cooperative in this country increase the possibility that we have to maintain and develop the giant corporation?

Mr. LOOS. Absolutely, Senator, because they are among his best customers.

Senator TAFT. If you are answering a particular argument to me, I think you have made your point. But it does not really have much effect on the question.

Mr. LOOS. It does not, Senator.

Senator TAFT. I mean, to a fellow who has a big store and has a small elevator in one town, the cooperative is a concern twice as big as he is, perhaps. So in that particular town they have two-thirds and he has one-third. So, in considering the tax question, we have to consider the question of competition to some extent.

They do not compete with General Motors or anything like that.

Mr. LOOS. No. But you may have the cooperative purchasing organization down here at Salisbury, Md., a block or two away from a branch of Sears, Roebuck.

Senator TAFT. I agree that the whole thing has been misrepresented as something greatly more dangerous for the country, and all that, than it is. But I think that you have made your point completely.

Mr. LOOS. My point is sufficiently made.

Senator TAFT. Of course, that is only one of the arguments.

Mr. LOOS. As you say, Senator, it has very little bearing on the merits of the case, but it has been so much emphasized and so much talked about that we thought it should be answered.

I think we probably have adequately answered it for the purpose of this hearing, anyway. It has also been answered in other hearings.

The next point I want to make is with respect to the amount of taxes that would be available if you did repeal the cooperative tax exemption in section 101 (12), or even if you undertook to tax patronage refunds.

On that there have been a lot of estimates. The Under Secretary of the Treasury, Mr. Wiggins, when he testified in the 1947 hearings, estimated that all that there was involved in the repeal of the exemption was between $10 million and $20 million.

Senator WILLIAMS. He was not referring, though, to repealing the exemption on the tax of the patronage dividends?

Mr. LOOS. He was not referring, Senator, to taxing the patronage refunds of the cooperatives.

Senator WILLIAMS. That is what I am referring to.

Mr. LOOS. That would not be involved in any repeal, because there is not any statute that gives such an exemption.

Senator WILLIAMS. That is the point surely.

Mr. LOOS. But I am making the distinction, and I will cover both points.

Now, in the hearings before the House Ways and Means Committee, the National Tax Equality Association has made a number of estimates and Mr. Parker made an estimate, and Mr. Burgess made an estimate, and I understand that Mr. Burgess is going to make an estimate here before you, probably today. I am assuming that it will be much the same as the one he made before the House Ways and Means Committee.

I think it can be said with respect to all of those estimates that they proceed on this basis: First, they take the official figures as published by the Farm Credit Administration on volume of marketing and purchasing cooperatives. Then they blow that up on various assumptions to bring it up to what they call the business done at the retail level, or at the local level. They do it on various bases.

Anyway, they blow it up. Mr. Burgess blew it up 30 percent. I think the original estimate of the National Tax Equality Association blew it up considerably more.

Now, those are more or less debatable assumptions and they are not very important, anyway. So I am not going to take the time to discuss them.

But after blowing up these volume figures, then what do they do to estimate the income that should be taxed? They determine what the average rate of net income earned by other corporations is to their total volume of business, their total sales, as, for example, 7 percent retail, 10 percent for manufacturing. Those were the figures that were used by the NTEA; 5.4 percent for wholesale. And then they apply those percentages to the business volume of farmer cooperatives which are in business at cost to serve the farmer at cost, without any profit at all.

Senator KERR. Which are in business to keep from making money?

Mr. LOOS. Exactly, Senator. And that is the very absurdity of all these estimates that have been made.

Senator WILLIAMS. I am not going to get into any argument with you as to the estimates, because I do not claim to be nearly authority enough to pass judgment on these estimates.

But I am wondering is there available anywhere figures that are put out by your organization to show the total amount of patronage dividends that are paid in cash and then the total amount of patronage dividends that are being paid in scrip or some other form of certificate?

Mr. LOOS. There is not any tabulation, Senator, that is very accurately divided between the two forms, but there are two tabula-

tions, the 1943 and the 1946 tabulations of the Internal Revenue Bureau, prepared from the Form 990 returns and the 1946 tabulation includes some 2,000 nonexempt cooperatives whose returns were filed on the regular Form 1120.

I have here a computation which I have made and which I have used before showing the computation of taxes on the amounts that are indicated in those compilations as income: First, income of exempt cooperatives; and, second, patronage refunds of both the exempt and nonexempt. And I have blown those up by percentages to come out so that the fact that all of the cooperatives are not shown in these tabulations of the Treasury—I have increased it to make allowance for the cooperatives that are not shown in the report.

Senator WILLIAMS. If I might interrupt there the reason I asked the question is that the House had before it there at the time that they were putting their estimate before the House, the proposal, if I am not mistaken, by Congressman Mason, which proposed to tax all patronage dividends prior to the distribution, both cash and scrip. We were considering here one just as scrip, and I was wondering if there was a breakdown to show the differential, and how much it would be.

Mr. LOOS. I am sorry to say there is not.

Senator WILLIAMS. There is no such breakdown?

Mr. LOOS. There is no such breakdown in these two tabulations. And I do not know of any comprehensive statistical compilation that will give that. There are, however, compilations of a few cooperatives from which some conclusions or inferences might be drawn.

Senator WILLIAMS. But in the absence of such a breakdown, is it not a fact that almost any estimate is just a guess, more or less, on the basis of the blown-up figures and averages?

Mr. LOOS. No; this one I am talking about is not, Senator.

Senator WILLIAMS. I did not mean yours necessarily. I was speaking of any of them.

Mr. LOOS. You mean between those issued in script and those issued in cash?

Senator WILLIAMS. Yes.

Mr. LOOS. I am afraid it would be pretty much of a guess as to how much is one and how much is the other. But a study could be made——

Senator TAFT. The figures on the nonexempt corporation must show the increase in reserves.

Mr. LOOS. The total, Senator, is readily available, and is readily ascertainable.

And I have them in these figures, when you combine the scrip and the cash together.

Senator TAFT. Yes. But what I mean is, the scrip will show up in the increase in reserves, and the cash will not?

Mr. LOOS. That is true; yes.

Senator WILLIAMS. Mr. Chairman, could we ask the Treasury Department's representative if they have some estimate?

On the amount of scrip that is passed out, do you have a breakdown of that in the Treasury Department?

Mr. KIRBY. It would be only an estimate. I do not have that with me. But we did make a total revenue estimate with respect to the House plan.

Senator WILLIAMS. I thought so.

Mr. Loos. Of course, Senator, you must keep in mind that much of this scrip is on revolving funds, and revolved out every 3 to 4 years to as much as 10 or 12 years.

Senator KERR. You mean, it has a complete revolve-out in those periods?

Mr. Loos. It is completely revolved out yes, sir.

Senator KERR. So much each year?

Mr. Loos. Yes, sir.

Senator KERR. You were about to give an estimate?

Mr. Loos. I was about to give you an estimate on the taxes that were lost by reason of the——

Senator KERR. I thought you were about to give us your estimate of the percentage that is paid out in cash and the percentage that is paid out——

Mr. Loos. No I was not, Senator. I could only give you a guess on that.

Senator KERR. You would not be prepared to give a "guesstimate" on that?

Mr. Loos. No. If I made a guess, I would say it was somewhere around 50–50.

Senator KERR. Yes.

Mr. Loos. What are the taxes that are lost by virtue of the exemption, and if the exemption were repealed, what would you add to the tax? On the basis of the 1943 tabulation, it would be $10,000,000; on the basis of the 1946 tabulation, $6,000,000.

Senator WILLIAMS. Now, you are speaking only on the exemption of the unallocated reserves?

Mr. Loos. No, sir. That is the repeal of the exemption. That is all the income tax that would be gotten if you repealed the exemption.

Senator TAFT. What you mean is that that is all the tax that you would get if you made every exempt cooperative in it a nonexempt cooperative?

Mr. Loos. Exactly.

Senator TAFT. And they still received the benefits that the nonexempt cooperative receives?

Mr. Loos. Yes, sir.

Senator WILLIAMS. That is what I was getting at.

Mr. Loos. Now, then, if you took away the privilege of making refunds and excluding them from the income that was taxable, your total tax on the basis of the 1946 tabulation—and I make that because that is the only year of which we have any data with respect to nonexempt cooperatives—the total tax would be $40,000,000, in addition to the $10,000,000 or $6,000,000.

Senator BYRD. The total figure would be what?

Senator KERR. Something under $50,000,000.

Mr. Loos. The whole thing would not be more than $50,000,000.

Senator WILLIAMS. And how much did you say the volume of business of the cooperatives was during those years?

Mr. Loos. In 1946? From this table the cooperative marketing volume was $4,850,000,000, and the purchasing $1,220,000,000.

Senator WILLIAMS. In other words, it was a little over $6,000,000,000?

Mr. Loos. As against $8,700,000,000.

Senator WILLIAMS. And according to your estimate, repealing the tax exemption in its entirety all across the board would be only $40,000,000?

So, what I was pointing out is, assuming you are correct in your estimate, it could not very well be said that $40,000,000 in taxes on a $6,000,000,000 business would necessarily put them all out of business.

Mr. LOOS. Oh, no; nobody has ever said that taxing the cooperatives would put them all out of business.

Senator BYRD. Are you speaking of farm cooperatives only, or all cooperatives?

Mr. LOOS. I am speaking of farm cooperatives only.

Senator WILLIAMS. You say that you do not have any estimate.

Senator TAFT. Is that a 1946 estimate, or have you increased that by the increase in volume since 1946?

Mr. LOOS. It is for 1946 only, Senator Taft.

Senator TAFT. Of course, this would be 20 percent above—this would amount to a 20-percent increase?

Mr. LOOS. About that.

Senator TAFT. So it would be around $50,000,000?

Mr. LOOS. Yes, sir.

Senator BYRD. You have no estimate on the other cooperatives?

Mr. LOOS. No, sir; I have made no estimate on the other cooperatives.

Senator KERR. I would presume that your estimate there on the 1946 tax was based on the 1946 rate?

Mr. LOOS. Yes, sir.

Senator WILLIAMS. Are there any figures as to the over-all patronage dividends, or what you call benefits, that the farmers receive annually from the cooperatives, all of them combined?

Mr. LOOS. These Treasury statistics give those.

Senator WILLIAMS. How much is that?

Mr. LOOS. The total patronage refunds shown by the Form 990 returns were $106,000,000, and I have increased that to allow for those not included in the tabulation, and added for cooperatives filing Form 1120 returns, making a total of $124,000,000 in 1946.

Now, that is the only year for which we have any comprehensive tabulation, because the Treasury does not regularly compile these statistics on the basis of Form 990 returns.

Senator WILLIAMS. That included all patronage dividends regardless of size?

Mr. LOOS. That included all, regardless of size, and it included both scrip and cash.

Senator FREAR. Mr. Chairman, may I ask one question of Mr. Loos?

Senator BYRD. Yes.

Senator FREAR. What percentage of the total cooperative associations are the farmer cooperatives?

Mr. LOOS. I would not like to make any estimate on that, Senator, because I am not very familiar with the figures on consumer cooperatives and the purchasing cooperatives, the retail stores, the groceries, drygoods, and all of those. Of course, there are also other cooperatives like the Associated Press, ASCAP, and the Railway Express Agency. Those are organized as cooperatives.

There are not many of those, but there are a tremendous number of these purchasing cooperatives, drugstores, grocery stores, and the like. There are such figures available, probably, but I have made no study of them, and I would not like to make any estimate of them.

Senator FREAR. The estimated revenue for 1950 from the Library of Congress from all cooperative associations if they had not been exempt, was $190,000,000.

Of course, I realize that the farm cooperatives may be only a small percentage of that.

Senator TAFT. $190,000,000?

Senator FREAR. That is all cooperative associations.

Senator TAFT. In farm co-ops, the total volume of business is $9,000,000,000 by themselves.

Senator FREAR. I am not familiar with that.

Senator BYRD. Senator Frear, are you speaking of receipts?

Senator FREAR. If the tax-exemption part of the code in 1950 was not in there on cooperatives, the additional revenue of 1950 would have been $190,000,000.

Senator TAFT. That may well include insurance companies, banks, mutual insurance companies, and savings and loan associations.

Senator FREAR. I think that includes all cooperatives.

Senator WILLIAMS. I think that includes all of them. That is what I was saying. I have seen 8 or 10 estimates on that.

Mr. LOOS. Senator Frear, I am sure that is a greatly exaggerated estimate. That sounds like the National Tax Equality Association's estimate.

Senator FREAR. I am sorry. That came from the Library of Congress. It did not come from the NETA.

Mr. LOOS. $190,000,000 of income taxes?

Senator FREAR. Yes, sir.

Mr. LOOS. I would like to have an opportunity to analyze that estimate, because I am sure it is incorrect.

Seantor FREAR. I do not think the man who made this up will vouch for its correctness because it was an estimate, he said. But I think he gives a pretty substantial basis for it.

Mr. LOOS. There just cannot be any such net income as that in the cooperatives, in my opinion.

Senator FREAR. Of course, he differentiated the cooperatives into three classes; and, assuming those figures on all three, I think he arrived at a figure that was somewhere between the top and the bottom.

Mr. LOOS. Now, if he used the same method that was used by these other estimators to whom I have referred, of assuming a percentage of net income to sales based on the percentage that was earned by other corporations, and applied that to a nonprofit cooperative operating at cost, of course, that is a highly erroneous procedure.

Senator FREAR. Of course, now, that did not include the mutual savings banks or savings and loan associations or the mutual fire- and casualty-insurance companies.

I think that someone told me about some of the insurance companies. I thought he meant those like the Ohio Farm Bureau Insurance Co., or the other Farm Bureau insurance companies were included, but not the others.

Senator WILLIAMS. I might point out that is just about the average between adding the National Tax Equality Association's estimate and your estimate together, provided it gives the Library of Congress a figure that comes out somewhere in the middle, at least.

Mr. LOOS. Maybe that is the way they did it.

Senator FREAR. They have gone into much more detail than that.

Mr. LOOS. Mr. Chairman, I would like to file as a part of the record this calculation of taxes to which I have been referring.

Senator BYRD. That may be done.

Senator TAFT. Mr. Chairman, I think that the reporter should put that into the record because we do not have copies of it. That should be right in the record.

Senator BYRD. Very well. That will be incorporated in the record.

(The tabulation referred to follows:)

ESTIMATED INCOME NOT TAXED BY REASON OF COOPERATIVE-TAX EXEMPTION

[Based on Treasury statistics for 1943 and 1946]

Farmer cooperatives' returns showing 50,000 or more of gross receipts

1943—Dividends and other distributions to patrons and members (other than patronage refunds)		$11, 424, 000
Other disbursements or charges	$8, 575, 000	
Difference between total receipts and total disbursements	35, 701, 000	
Sum	44, 276, 000	
One-half of above sum which might be income		22, 138, 000
Total income which was not taxed by reason of exemption		33, 562, 000
Tax at 30 percent		10, 068, 600
1946—Dividends and other distributions to members, shareholders, or depositors (other than patronage dividends)		6, 060, 000
Benefit payments to members		91, 000
Excess of receipts over disbursements	$28, 140, 000	
One-half of above amount		14, 070, 000
Total income which was not taxed by reason of exemption		20, 211, 000
Tax at 30 percent		6, 063, 300

Average rate of 30 percent calculated as follows: Income calculated above represents less than 1 percent of gross receipts:

1943 gross receipts	$3, 000, 462
1946 gross receipts	5, 601, 366

Therefore, cooperatives with less than $5,000,000 gross receipts would have net of less than $50,000; those with 1 to 5 million gross receipts average less than $37,500; those with less than $1,000,000 gross receipts average less than $20,000.

1943 returns classified by income groups.

(NOTE.—1946 returns show number of returns by income groups but not amount of income in each group; therefore, necessary to use 1943 tabulations in arriving at average tax rate.)

Gross receipts	Number returns	Amount	Percent
Less than $1,000,000	4, 075	$787, 337, 000	35. 2
1 to 5 million [1]	269	539, 395, 000	24. 2
Over 5 million	53	907, 175, 000	40. 6
Total	4, 397	2, 233, 907, 000	100. 0

[1] Assumed that one half (12.1 percent) 2.5 million and less, and other half more than 2.5 million.

Weighted-average rate

Gross-receipts group	Average net income	Tax rate (percent) [1]	Percent weight	Average rate
Less than 2.5 million	$20,000	22.5	47.3	10.643
2.5 to 5 million	37,500	33.0	12.1	3.993
Over 5 million	[2] 50,000	38.0	40 6	15 428
Average rax rate				30 064

[1] See next table.
[2] Over.

Present corporate rates

	Normal	Surtax
	Percent	*Percent*
First $5,000	15	6
Next $15,000	17	6
Next $5,000	19	6
Next $25,000	31	22
Over $50,000	24	14

Computed rates for different brackets of income

Assumed income	Computed rate		Combined
	Normal	Surtax	
	Percent	*Percent*	*Percent*
$5,000	15.0	6.0	21 0
$20,000	16 5	6 0	22 5
$25,000	16.9	6.0	22 9
$35,000	21.0	7.4	28 4
$37,500	21.7	11.3	33 0
$40,000	22.3	12.0	34 3
$45,000	23.2	13.1	36 3
$50,000 and over	24.0	14.0	38 0

[1] Average rate for farmer cooperatives showing gross receipts of $50,000 or more.

AMOUNT OF TAX ADDED IF PATRONAGE REFUNDS COULD BE TAXED AS INCOME

Since patronage refunds distributed pursuant to a preexisting obligation do not constitute income, they could not be subjected to income tax. But, assuming that this constitutional point could be overcome, the amount of tax may be estimated as follows:

[Based on 1946 Treasury statistics]

		Number	Receipts (000 omitted)
1. Form 990 returns	6,009		
Group	94		
		6,103	$5,620,127
2. Form 990 returns showing $50 million or more gross receipts (5,620=100.34 percent of 5,601)		4,703	5,601,366
3. Form 1120 returns	2,344		
(890,780=16.9 percent of 5,601,366)		2,344	890,780
4. Total lines 1 and 3		8,447	6,510,907
5. Total farmer cooperatives reported by FCA		10,125	7,116,000
Percent line 5 to line 4		119.9	109 3

	Amount
Patronage refunds shown by Form 990 returns showing $50,000 or more gross receipts	$106, 109, 000
Add for those cooperatives having gross receipts of less than $50,000 (0.34 percent)	360, 000
Add for cooperatives filing Form 1120 returns (16.9 percent)	17, 932, 000
Subtotal	124, 401, 000
Add for missing cooperatives (compared with FCA report) (9.3 percent)	11, 569, 000
Total	135, 970, 000
Tax at 30 percent	40, 791, 000

Mr. Loos. I would like to say that I had intended to discuss at some length the reserves. However, that has been pretty well covered in the discussion with Mr. Rumble and Mr. Kirby.

I would like to mention two or three cases, however, to which reference has been so frequently made, and about which there is considerable misunderstanding.

One of those is the case of *Lucas* v. *Earl* (281 U. S. 111 (1930)).

Now, Mr. O'Connell said, in talking to the House Ways and Means Committee, that there was not much difference between a patronage refund and an anticipatory assignment of income. He cited *Lucas* v. *Earl*, which is a United States Supreme Court case, and various others on that point. He did say there was a difference but he said it was not much of a difference.

Now, in some ways you might say that there is not much of a difference between interest and dividends, and yet interest, because it is pursuant to an obligation to pay, is deductible from income; a dividend is not.

Here we have the same thing, in this difference between a patronage refund and an anticipatory assignment. In *Lucas* v. *Earl*, Mr. Earl made an assignment of half of his salary to his wife, who was an utter stranger to the transactions out of which the salary was earned, and the Court said rightfully, "You cannot do that and get away with it. Mr. Earl, you have to pay the tax on that."

In the case of the coöperative patronage refund, we do not have an assignment from the patron to somebody else; it goes right back to the patron from whom the interest arose. If Mr. Earl had made an agreement with his employer that at the end of the year on certain conditions his salary would be reduced 20 percent and he would pay back 20 percent, and it went back to the source from which it came, nobody would ever doubt that that was a proper reduction or adjustment of salary.

So that is the big distinction between the anticipatory assignment and the patronage refund. In the patron refund, the margin comes out of the transactions with the patron and it goes back to that same patron, and therefore is not income. In the anticipatory assignment, it goes to somebody who is an utter stranger to the transaction out of which it arose.

The case of *Penn Mutual Life Insurance Company* v. *Lederer* (252 U. S. 523 (1920)) has frequently been cited as authority for the proposition that the Congress can tax patronage refunds. The use of that case for that purpose completely overlooks what refunds there were that were being taxed.

All of the refunds that were used to reduce premium payments were allowed as exclusions from income. There was not any question

about it. The Treasury had not taken any occasion to disallow it. The only thing that was disallowed as an exclusion was the sum of about $800,000 which represented the dividends paid on matured contracts, and that was thus merely a payment of investment income on the matured contracts, and dividends arising out of tontine forfeitures where the policyholder had not carried the policy to expiration, and he forefited his reserves, and those were distributed among the others who continued it to a certain date. That is similar to our distribution of margins on nonmember business to members, margins on somebody else's business. And in the cooperative field, we always recognize that that is taxable in the case of the nonexempt cooperative and you cannot have any such thing in the case of an exempt cooperative, because you have to distribute to nonmembers as well as members, to be exempt.

So that case should be looked at with great suspicion whenever it is cited in support of the proposition that the Congress has the authority to tax patronage refunds.

Senator Byrd. You are not referring to the patronage refunds of an exempt cooperative?

Mr. Loos. Patronage refunds of a nonexempt cooperative, I was referring to.

I had intended to say something about reserves, and I had intended to say something about Senator Williams' proposed amendment; but the general subjects have been pretty well covered, and I have already greatly overstayed my time. So I will conclude at this point.

Senator Byrd. Very well, Mr. Loos. Thank you very much indeed, sir.

Mr. Calhoun is representing Mr. Joseph J. O'Connell, of the National Tax Equality Association.

STATEMENT OF LEONARD J. CALHOUN, APPEARING FOR JOSEPH J. O'CONNELL, NATIONAL TAX EQUALITY ASSOCIATION

Mr. Calhoun. Senator, I should like to present Mr. O'Connell's regrets that it was impossible for him to be here, and to request on his behalf that his statement be filed with the committee, I also request that the brief referred to in his statement be considered filed with the committee. It is already before the committee.

Senator Byrd. You mean to put it in the record?

Mr. Calhoun. We would like to have it in the printed record, sir. But if you feel that that would be inappropriate, we would like to have it filed with the committee.

Senator Byrd. The statement of Mr. O'Connell is not long. I see no reason why it should not be put in the record at this point.

(The statement of Joseph J. O'Connell is as follows:)

Statement of Joseph J. O'Connell

My name is Joseph J. O'Connell, Jr. I was a staff member of the Treasury Department for many years and was general counsel for the Department from 1944 to 1947. I have spent many years studying the laws and decisions relating to the administration of the Federal income-tax law.

At the present time I am a practicing attorney. My firm was retained by the National Tax Equality Association to examine the question of whether the net margins of cooperative corporations represented their taxable net income regardless of patronage dividend contracts. In order to cover fully this question, an opinion of some length was prepared which was addressed to both the legal and

economic aspects of the matter. Since time will clearly not permit a detailed discussion of this all-important question, I hereby ask leave of the committee to have this opinion incorporated into the record of the present hearings.

Summarizing the contents of this opinion, I would say that it demonstrates beyond all question that the so-called savings or net margins of cooperative corporations represent corporate profits that are taxable to the corporation earning them, regardless of the existence of a preexisting agreement which the members or stockholders have made with their corporation controlling the distribution of those profits. It shows that there is no legal obstacle to the enactment of legislation which would subject the earnings of cooperative corporations to Federal income taxes exactly in the same manner and to the same extent as the earnings of other corporate businesses. The opinion concludes that at the present time there is no sound policy basis for continuing the present preferential treatment accorded cooperatives and other tax-exempt commercial corporations.

About half of the farmers cooperative corporations pay no income taxes whatsoever because they qualify for complete income tax exemption under section 101 (12) of the Internal Revenue Code. The other half of the farmer cooperatives and all other cooperatives pay little or no income taxes because the administrative rulings of the Treasury Department allow them to exclude from their taxable income the dividends which are distributed or allocated to patrons on a patronage basis.

By allocated, I mean that the profits are plowed back into the business and book entries are made to the capital accounts of members. Or perhaps some kind of stock or equity certificate may be issued the members. From the viewpoint of the competitor across the street, it makes no difference at all whether these retained profits are or are not evidenced by book entries or certificates. At the tremendously high corporate tax rates that we are experiencing today, the tax privileges accorded this type of corporation has in it such an element of discrimination and undue competitive advantage as to make remedial legislation absolutely necessary not only to restore competitive equality to the economic system but also to bring in substantial revenues to the Government.

Cooperative corporations are true corporations. Their charters are filed with the Secretary of State and the membership votes for the board of directors who, in turn, elect the officers. They have limited liability and exist in perpetuity. Under our tax laws, the net earnings of this type of business is taxed once to the corporation and a second time in the hands of the individuals receiving it.

Cooperative corporations escape nearly all of the corporate income tax. The large regional cooperative associations have obtained great size by distributing their profits to the local associations, which are their members, in the form of common stock. This method of distributing permits the cooperative to expand on income which has not been taxed to it. In theory, the tax should be paid by the local association or if it in turn distributes it as a patronage dividend, it should be paid by the patron.

The April 15, 1951, issue of Cooperative Digest contains an article by Warren LeBourveau of the Texas A. &. M. College department of agricultural economics. Mr. LeBourveau points out that among local agricultural cooperatives the tendency is "to look upon regional refunds in stock or book credits as something worth not much more than wallpaper." He notes that in many cases stock refunds "cannot be found entered anywhere in the cooperative's financial statement." He says:

"Aside from the fact that this would seem to be poor business and accounting procedure, what is more important are the possible illegal and unethical aspects of the situation. Briefly, it amounts to hiding assets, and could lead to serious repercussions. Furthermore, with the Federal income-tax situation regarding taxability of patronage refunds other than cash to individual members in its present muddle, it might boomerang as money, revenues, or assets escaping taxation."

It would appear from the above that very frequently the income of these large regional corporations instead of being subjected to double taxation, escapes taxation completely.

The patron of the local cooperative is supposed to pay income taxes on his patronage dividends, but how many farmers on a cash basis are paying income taxes on patronage dividends that are merely allocated on the books of the cooperative or distributed in revolving fund certificates that may not be redeemed for many years? Several witnesses before the House Ways and Means Committee have testified that they paid no income taxes on noncash patronage dividends and one farmer stated that, furthermore, he didn't know of anyone who

had. A corporation income tax is necessary to enable the Government to make the profits earned by cooperative corporations bear their fair share of the tax burden.

Remedial legislation should not only repeal the specific exemption but also reverse the present administrative practice of the Treasury Department by making it crystal clear that corporate profits distributed as patronage dividends are to be taxed to the corporation earning them. This latter step is necessary since as long as patronage dividends are not treated as corporate income, it makes little difference whether a cooperative qualifies under section 101 of the Internal Revenue Code or not. The effect of the exclusion of patronage dividends from income minimizes and all but eliminates taxable income. Any legislation which fails to recognize this point would be meaningless.

At one time there seemed to be considerable confusion about the taxable income of cooperative corporations. At the present time, however, that confusion has largely disappeared. The most recent studies that have been made of the problem by experts both inside and outside of the Government have generally reached the common conclusion that the so-called savings or net margins of cooperative corporations represent corporate income which can be taxed. In justice, it should be taxed. Cooperative spokesmen, of course, continue to argue in favor of their special treatment but I believe that few people would now dispute the right, if not the duty, of Congress to tax cooperative corporations like other corporations.

The Treasury Department, over a long period of years, has allowed the exclusion of patronage dividends from cooperative gross income upon the theory that a dividend on patronage represents a rebate in the case of a purchasing cooperative, and an addition to price in the case of a marketing cooperative.

Discounts, rebates, and refunds, however, are trade practices designed to accomplish specific things, such as obtaining prompt cash payments for quantity sales. They are used in an effort to increase over-all net profits. Patronage dividends, on the other hand, are used to wipe out corporate earnings by distributing them to the owners of the corporation.

The trade discounts, rebates, price adjustments, etc., used in ordinary business practices, differ from patronage dividends in that they are not contingent upon the existence of net profits. They are not used to siphon net profits out of the corporation and deliver them to the owners of the corporation. The ordinary rebate relates only to the transaction that gives rise to it, while a patronage dividend, since it is a distribution of profits, depends upon the debits and credits from all the operations of the business during the year.

The agreement to distribute patronage dividends represents little more than an anticipatory assignment of income from a cooperative corporation to its owners. Such arrangements are without effect in the field of taxation because it represents a form of self-dealing for tax purposes.

My original examination of this problem on behalf of my client pre-supposed that there might exist some constitutional or other legal obstacle of moment. Hence, a great deal of our opinion is addressed to a consideration of these so-called problems, although, in all honesty, it has seemed to me from the beginning that no such problems really exist. Fortunately, the thinking of people who have studied the problem, both within and without the Government, is, according to my understanding, pretty much in agreement on that point. Few people would now dispute the power of the Congress validly to do what I have proposed. The only consideration of moment left is one of policy. And on that score I submit the balance is clearly on the side of subjecting cooperatives to their fair share of our common burden.

In this connection, it will be recalled that last year the Congress saw fit to subject the business income of charitable organizations to Federal income taxes even though the ultimate beneficiaries of such income were admittedly of a class always thought worthy of solicitude on the part of the Government.

If you feel that the farmers need special consideration, give it to them equitably. The tax advantage granted cooperative corporations benefits at most the farmers who are patrons of such corporations. Possibly as many as half the farmers are not patrons of such associations and so receive no benefit from this policy regardless of their need. I submit, therefore, that even though you should believe farmers should receive special benefits, the haphazard distribution of those benefits as obtained from the present income tax laws relating to cooperatives does not recommend itself from the view of equity.

In conclusion, I submit that there is no justification for not subjecting the net margins of cooperative corporations to corporate income taxes either in law or as a matter of public policy.

Furthermore, corrective legislation is necessary if fully taxed business is to survive. The point was well stated by the Fourth Circuit Court of Appeals in a case handed down 2 months ago (*U. S.* v. *Community Services, Inc.*, C. C. A. 4, May 5, 1951, reversing E. D. S. C.) as follows:

"Manifestly, a corporation engaged in commercial activities, if exempt from Federal taxes, would have a tremendous economic advantage over competitors in the same field. Such a corporation could effectively eliminate competitors, actual and potential, since it could undersell corporations, whose earnings are subject to diminution by Federal taxation. It is difficult to believe that Congress intended to countenance such a situation."

It is our sincere hope that Congress will see fit to remedy the situation.

Mr. CALHOUN. I would like to make a very few observations respecting tax policy. I shall not belabor the point as to taxability of cooperatives for the question that has been raised from time to time as to the constitutionality of taxing patronage dividends appears to have practically disappeared.

You will find from the rather laborious research that has been done, not only by Mr. McGill, and not only by Mr. O'Connell, but by the Treasury, and your joint committee staff that there seems to be a uniform agreement that the tax treatment of cooperatives is purely a matter of tax policy.

I should like to make observations on two or three points that have appeared from this morning's discussion to be of some considerable interest. Preliminary to those comments, I would like to say that the cooperative attorneys have done a brilliant job from the viewpoint of creating a maze of contrasts and bylaws so that earnings of the cooperative can be passed to reserves through contractual devices, with a net effect that the cooperative itself pays no taxes, and the still more brilliant achievement in the case of the consumer co-ops, so-called, that neither the cooperative nor the receiver of the patronage dividend, or the person to whose capital account it is credited, pays any taxes.

A question that has been raised from time to time, and that fortunately was settled this morning, was the significance of taxation of unallocated reserves. As was mentioned this morning, and not subject to any apparent dispute at this time, unallocated reserves, except to the extent stated in the 101 (12) exemption, are already subject to tax.

The important and brilliant solution that has been arrived at by the cooperative attorneys, however, is that without increasing the cooperative's indebtedness, the money which it has earned though in fact retained is not to be treated as retained, but through a contractual arrangement that gives a member no claim greater than a mere stockholder would have is deemed to have been paid out as a price adjustment. By virtue of the so-called constructive payment doctrine, earnings are transferred to capital without the distress of increasing the debt of the corporation or of paying taxes.

Now, that is of basic importance, and rulings apply even if a particular transaction is between a cooperative and an utter stranger, It may credit to that stranger on its capital account, a credit which may have little or no value, and get a 100-percent tax credit for that book entry.

There has been a general theory which is rather harsh on the cooperative members that when they are caught in the tangles of the contracts or bylaws, regardless of the value of what they receive, they have agreed that it is to be counted taxwise as worth 100 percent face value, and members are supposed to pay tax on this basis. That, of course,

does not apply to the consumer cooperative dividend recipient, since they are considered taxwise as receiving a rebate on their purchase of clothes or groceries.

The important question that I do not believe has been judicially settled is whether an utter stranger, who receives a patronage dividend certificate, is bound by the artificial stated value of that certificate.

It is highly important that every corporation receive risk capital that it is free to use. Today this is largely plowed back earnings. We do not apologize for the profit system, because the profit system is the summation of the risks that you take with your capital and what you come out with after taking those risks.

The cooperative member doubles in brass, to use an old circus expression, inasmuch as he is vitally interested in his cooperative corporation as owner as well as patron. He must be pleased as an investor, and for that reason, there is a reluctance, of course, to create a diversion of funds to a person who is not an investor.

So the ruling that they can create investors by sending out a patronage equity certificate, or something like that, is in effect a beautiful method of creating members and eliminating any question of members or nonmembers. And as long as the cash is kept untaxed, then the question of whether you make book entries or do not make book entries, which is the only difference between allocation and nonallocation, is of comparative small importance to the cooperative as an entity, or to the man who does business across the street as a competitor.

The brilliant job has been to translate a simple fact into legal tax fiction. What are nothing more nor less than retained earnings are converted by a series of contractual manipulations into a payment out in cash and a return of that cash to capital investment.

I will not take the time of the committee to go into other points, but I do think that that is a key point and that it is the most brilliant tax avoiding device in the entire web of contracts which have allowed a translation of corporate earnings without taxation into the reserves of the corporation.

Thank you.

Senator BYRD. Thank you, Mr. Calhoun.

The committee will now recess to reconvene at 2:30.

(Thereupon, at 12:50 p. m., the committee recessed, to reconvene at 2:30 p. m., the same day.)

AFTERNOON SESSION

Senator BYRD (presiding). The committee will come to order.

Mr. Ralph E. Burgess, National Tax Equality Association.

STATEMENT OF RALPH E. BURGESS, PRESIDENT, COMMODITY MARKETING CORP., REPRESENTING NATIONAL TAX EQUALITY ASSOCIATION

Mr. BURGESS. Mr. Chairman and members of the committee, to conserve time, I should like to file my complete statement for the record, and present only the high lights from it orally.

Senator BYRD. The committee would appreciate that very much. I would like to say that we have eight witnesses, and we hope that all

of them will use their discretion to hear everything that should be heard, but I hope it will not take longer than necessary.

Mr. BURGESS. I shall take a few minutes longer than I originally intended, to point out several errors of fact and methodology testified to by an attorney appearing for the cooperatives this morning.

I am Ralph E. Burgess, president of the Commodity Marketing Corp., 500 Fifth Avenue, New York 18, N. Y. My firm serves as industrial consultants to trade associations and companies in various lines of business. We have given particular attention to the economic and statistical analysis of problems relating to taxation.

Members of this committee will recall that a few years back I served as actuary for the Joint Committee on Internal Revenue Taxation, when I was responsible for the estimates of tax revenue presented to your committee, and that earlier I performed a similar function for the Treasury Department.

Senator BYRD. Were your estimates accurate?

Mr. BURGESS. I think I had as good a record as any other estimators, Senator.

I am appearing here in behalf of the National Tax Equality Association, which has asked me to give you my estimate of the tax loss to the Federal Government arising from special treatment accorded to mutual, cooperative and Government business of various kinds.

The total loss to the Federal Government from the loopholes in the present tax laws and regulations that favor mutual or cooperative business corporations and Government corporations competitive with private business, is estimated at approximately $1,180 million annually, at existing rates of taxation. Under the rates of the House bill the estimated loss would, of course, be moderately larger. This loss approximates one-twentieth of either the total corporate or individual income tax bill. This total estimated tax escapement is divided approximately among the principal lines of mutual, cooperative and Government businesses as shown in the table in my prepared statement.

Senator TAFT. Of the mutual financial institutions, do they include life-insurance companies, or do you leave them out altogether?

Mr. BURGESS. It does not include them. The mutual financial institutions include the mutual savings banks, savings and loan associations, credit unions, production credit associations, and national farm loan associations.

Senator BYRD. What does the category of Government corporations include?

Mr. BURGESS. All of them, Senator Byrd, the RFC, TVA, and all the others.

These estimates were prepared, in general, by taking the reported or estimated earnings of the specified types of organization, adjusting them where necessary to a basis similar to that employed by private corporations for tax purposes, and then applying to this net income an "effective" corporate tax rate of 42 percent.

The adjusted earnings figures for the mutual and governmental (but not cooperative) organizations I have taken from tabulations of the National Tax Equality Association. These were from official sources, and cannot be questioned without a detailed examination of reporting requirements which I have not had time to make. However, recent official Treasury estimates (prepared for Congressman Mason) are in

close agreement. With respect to the mutual organizations other than cooperatives, and the Government business activities, the following specific sources were used to obtain figures representing in each case the business income: for mutual savings banks, annual reports of the Federal Deposit Insurance Corporation; for savings and loan associations, annual reports of the Federal Home Loan Bank Board; for credit unions, reports of the Bureau of Labor Statistics; for Production Credit Associations and for National Farm Loan Associations, reports of the Farm Credit Administration; for mutual insurance companies, Best's Insurance Reports; for the Federal Government, annual reports of the Secretary of the Treasury; for State and local governments, reports of the Census Bureau. In general, operating results for the calendar years 1949 and 1950 are employed.

Because there seems to be relatively less agreement among the experts as to the amount of revenue involved in taxing cooperatives, the major part of my statement is devoted to an explanation of estimates of the tax escapement of cooperatives, as given in the table. These estimates are based on materials from a number of sources. No ready-made data on the net income of the various types of cooperatives are available. Here a few words need to be said concerning the data compiled and published by the United States Treasury Department from the informational returns on Form 990 required to be filed by the exempt type of cooperative. As you know, it was the 1943 Revenue Act which provided for such reports. Information compiled from these returns has been published so far only for 1943 and 1946, and this represents the only "official" data available on receipts and disbursements of cooperatives. Unfortunately, there are many persons who interpret the designation "official" to mean "reliable." This assumption frequently is in error because of incorrect reporting, tabulation or interpretation of facts.

It is clear that the data compiled from the informational returns filed by cooperatives are unreliable, without major adjustments, for use in determining statutory net income of such organizations. This is apparent for the following reasons:

(1) Revenue agents do not exercise the same zeal which they show in ferreting out taxable revenue; consequently, many cooperatives fail to file informational returns while others follow loose accounting principles in their returns.

(2) It would appear that many cooperatives report non-cash-patronage dividends as other expenses or as part of the cost of goods sold.

(3) Local cooperatives frequently fail to report as income non-cash-patronage dividends received from regional associations.

The estimates of possible revenue to be derived from taxing cooperatives heretofore attributed to the Treasury Department or to the Joint Committee Staff appear to have been based upon these incomplete and inaccurate statistics compiled from reports on Form 990. Because the Treasury Department refuses to discuss with outsiders its method of estimating possible revenue from cooperatives, no one can be sure just how their estimates were made. It appears, however, that in estimating $113 million as the yield—under Congressman Mason's bill—that the Treasury was in error in at least three respects, namely:

(1) No allowance was made for the increase in general business, shared by cooperatives, from 1946—the latest year for which informational returns were compiled—to date.

Incidentally, the attorney's estimates presented this morning also failed to allow for the increase in business since 1946. This, of course, explains a major part of the discrepancy between his figures and mine.

Senator TAFT. What do you mean by that? These figures were $40 million. We added $10 million for the increase in business for the years 1946 to 1950, between those years, and that made $50 million. How do you mean? How does that reconcile with yours?

Mr. BURGESS. That was done, I believe, Senator, in the discussion between the witness and yourself.

Senator TAFT. That is right.

Mr. BURGESS. The witness presented a figure of $40 million, I believe. My allowance varies with the type of cooperative. I go into that later in my statement; that is, into the amount that I allow for the increase in business between 1949 and 1950.

Senator TAFT. I do not quite see how you could say it was the same as yours.

Mr. BURGESS. He made no allowance, as I understood it, Senator, in his presentation. It was only in the discussion between you and the witness that that allowance of $10 million was brought out. I am, perhaps, mistaken.

2. The total number of cooperatives reporting to the Treasury in 1946 on both Forms 990 and 1120 was nearly 2,000 less than were reported to be in operation by the Farm Credit Administration.

Inasmuch as the total number reporting to the Treasury was about 8,400 an adjustment for those not reporting would be nearer 20 percent than the mere 5 percent employed by the witness this morning.

3. No allowance was made for understatement of cooperative profits owing to expensing of capital expenditures, establishment of contingent reserves, expensing patronage dividends, and depreciating at abnormal rates.

Finally, as proof of my point, it is necessary only to quote from the text accompanying the Treasury's 1943 tabulation from these cooperative returns:

> It is important to note that the data on receipts and disbursements contained in this report are not comparable with the income and deduction data contained in corporation income-tax returns. Therefore, it is not possible to determine from these data amounts which would be comparable with the net taxable income of taxable corporations.

This lack of comparability is evident from even a cursory examination of Form 990, a copy of which I offer for the record, if the committee wishes to include it, as a supplement to my statement.

Senator BYRD. It will be included.

(The document referred to follows:)

Form 990
TREASURY DEPARTMENT
Internal Revenue Service
(Revised May 1944)

UNITED STATES

ANNUAL RETURN OF ORGANIZATION EXEMPT FROM INCOME TAX UNDER SECTION 101 OF THE INTERNAL REVENUE CODE, OR UNDER CORRESPONDING PROVISIONS OF PRIOR REVENUE ACTS

(Required under Section 54(f) of the Internal Revenue Code, as added by Section 117 of the Revenue Act of 1943[1])

For Calendar Year ....

or Fiscal Year Begun ...., **and Ended** ....

This return must be filed on or before the 15th day of the 5th month following the close of the annual accounting period. Return must be filed with the Collector of Internal Revenue for the district in which is located the principal place of business or principal office of the organization.

PRINT PLAINLY NAME AND ADDRESS OF THE ORGANIZATION

....
(Name)

....
(Street and number)

....
(Post office) (County) (State)

Have you been advised by Bureau letter of your exemption? .... If "Yes"
(Yes or no)
state date of letter .... If "No," application for exemption must accompany this return. Consult collector for your district for information.

State nature of your activities ....

....

Subsection of section 101 under which you are exempt ....

File Code ....

Serial No. ....

District ....

1. Have you engaged in any activities which have not previously been reported to the Bureau? .... If so, attach detailed statement. (Yes or no)

2. Have any changes not previously reported to the Bureau been made in your articles of incorporation or bylaws or other instruments of similar import? .... If so, attach a copy of the amendments. (Yes or no)

3. State the names and addresses of the officers or other persons having care of the books of account, minutes, correspondence, and other documents and records of the organization.

....
(Name and title) (Address)

....
(Name and title) (Address)

4. Check whether this return was prepared on the cash ☐ or accrual basis ☐.

5. This form shall be prepared in accordance with the method of accounting regularly employed in keeping the books of your organization.

6. Fill in the items on the reverse side of this form, to the extent that they apply to your organization.

We, the undersigned, president (or vice president, or other principal officer) and treasurer (or assistant treasurer, or chief accounting officer) of the organization for or by which this return is made, each for himself declares under the penalties of perjury that this return has been examined by him and is to the best of his knowledge and belief a true, correct, and complete return.

[CORPORATE SEAL] ....
(President or other principal officer) (State title) (Date) (Treasurer, Assistant Treasurer, or Chief Accounting Officer) (State title) (Date)

The following additional declaration shall be executed by the person other than an officer or employee of the organization actually preparing this return:

I declare under the penalties of perjury that I prepared this return for the organization(s) named herein and that this return is to the best of my knowledge and belief a true, correct, and complete return.

....
(Name of firm or employer, if any) (Signature of person preparing this return) (Date)

[1] The filing of a return is not required of any organization exempt from taxation under the provisions of section 101 which is a (1) religious organization exempt under section 101 (6); (2) educational organization exempt under section 101 (6), if it normally maintains a regular faculty and curriculum and normally has a regularly organized body of pupils or students in attendance at the place where its educational activities are regularly carried on; (3) charitable organization, or an organization for the prevention of cruelty to children or animals, exempt under section 101 (6), if supported, in whole or in part, by funds contributed by the United States or any State or political subdivision thereof, or primarily supported by contributions of the general public; (4) organization exempt under section 101 (6), if operated, supervised, or controlled by or in connection with a religious organization exempt under section 101 (6); (5) fraternal beneficiary society, order, or association solely exempt under section 101 (3); or (6) corporation exempt under section 101 (15), if wholly owned by the United States or any agency or instrumentality thereof, or a wholly owned subsidiary of such corporation.

GROSS INCOME AND RECEIPTS

Item No.

Item	Description		Amount
*1.	Receipts from members:		
	(a) Dues		$
	(b) Fees, fines, assessments, and similar receipts		
*2.	Dues, assessments, per capita taxes, etc., received from affiliated organizations		
*3.	Grants, gifts, contributions, etc., received		
4.	Dividends and interest		
†5	Rents		
†6.	Gross receipts from business activities (state nature).		
	(a)	$	
	(b)		
	(c)		
	(d)		
*7.	Other gross income and receipts		
8.	Total gross income and receipts (total of items 1 to 7, inclusive)		$

DISBURSEMENTS, ETC.

Item	Description		Amount
9.	Benefits paid to members or their dependents:		
	(a) Death, sickness, disability, or pension benefits		$
	(b) Other benefits		
10.	Dues, assessments, per capita taxes, etc., paid to affiliated organizations		
11.	Cost of goods sold (or, in the case of farmers' cooperatives, purchases for or advances to patrons)		
12.	Wages, salaries, and commissions (other than compensation paid to officers, directors, trustees, etc.)		
13	Compensation paid to officers, directors, trustees, etc.		
14.	Interest		
15.	Taxes (such as property, income, social security, unemployment taxes, etc.)		
16.	Other operating, administrative, and overhead expenses		
17.	Grants, gifts, contributions, etc., paid (state nature):		
	(a)	$	
	(b)		
	(c)		
	(d)		
18.	Dividends (other than patronage dividends) and other distributions to members, shareholders, or depositors		
19.	Patronage dividends or patronage refunds paid or credited (For farmers' cooperatives only)		
20.	Other disbursements or charges (state nature):		
	(a)	$	
	(b)		
	(c)		
	(d)		
21.	Total disbursements, etc. (total of items 9 to 20, inclusive)		$

Farmers' cooperative marketing and purchasing organizations shall also state—

VOLUME OF BUSINESS DONE WITH.	*Marketing*	*Purchasing*
(a) Members	$	$
(b) Nonmember producers		
(c) Nonmember nonproducers		
(d) United States Government		

*In all cases where the total of either Items 1, 2, 3 or 7 includes money or property amounting to $3,000 or more, or to 10 percent or more of Item 8, which was received directly or indirectly from one person, in one or more transactions during the year, itemized schedules showing the total amount received from and the name and address of each such person shall be attached to this return (The term "person" includes individuals, fiduciaries, partnerships corporations associations and other organizations) Receipts by a "central" organization from organizations included in a group return need not be itemized in the "central" organization's separate return.

†If any amounts are reported in Items 5 or 6 a classified balance sheet of the organization(s) receiving such amounts, showing the entire assets and liabilities as of the end of the accounting period, should be attached.

A group return on this form may be filed by a central parent, or like organization for two or more of its chartered, affiliated, or associated local organizations which (a) are subject to its general supervision and examination, (b) are exempt from tax under the same provision of revenue law as the central organization (c) have authorized it in writing to include them in such return, and (d) have filed with it statements, verified under oath or affirmation of the information required to be included in this return. Such group return shall be in addition to the separate return of the central organization but in lieu of separate returns by the local organizations included in the group return There shall be attached to such group return a schedule showing separately (a) the total number, names and addresses of the local organizations included, and (b) the same information for those not included therein. For further information see regulations under sections 54(f) and 101 of the Internal Revenue Code.

U. S. GOVERNMENT PRINTING OFFICE 1944 O - [illegible]

Mr. BURGESS. It was necessary, therefore, for me to go one step back to sales volume as a basis for estimating net income or tax escapement. Even the sales volume of cooperatives, however, is difficult to estimate. Several different approaches may be used. The National Tax Equality Association, in a report submitted to the Committee on Ways and Means of the House in February 1950, tried two approaches, one based on Treasury Department figures and the other on Farm Credit Administration data. Various adjustments were made in the data to allow for underestimation of the number of cooperatives, to convert business receipts to business volume, and to allow for operations performed by associations at various levels of marketing.

Anyone wishing to take issue with the association's estimates of cooperative sales volume may find a number of points in its analysis to criticize. It is my opinion, however, that most analysts are likely, using the available official figures, to come up with estimates of total volume not radically different from those made by the association. I believe it would be possible to get all the different estimators together around the conference table and reach conclusions substantially agreeable to all. However, the association asked us not to rely on their own estimates with respect to cooperatives but to go at the problem independently.

A second possible source of materials for these estimates is to be found in the data presented in tax hearings in 1947 by Mr. Lovell H. Parker, a distinguished tax consultant of Washington, who was formerly chief of staff for the Joint Committee on Internal Revenue Taxation, and is well and favorably known to you gentlemen. In preparation for my testimony before the Committee on Ways and Means I wrote to Mr. Parker for permission to use his former estimates as one check against my own estimates, and believe that my letter to him and his reply may be of interest to your committee in connection with the matter now under advisement. My letter to Mr Parker, and his reply appear in my prepared statement.

Examination of Mr. Parker's testimony in 1947 in relation to this letter indicates that as of now his volume estimates would not be greatly different than would be a projection of the estimates of the National Tax Equality Association previously described.

But estimation of the sales volume is only one part of a two-pronged problem. The other, and more difficult, requirement is to estimate the imputed tax liability attaching to such volume of business if the profits on it were taxed. This may be done on an over-all basis, as did the association and Mr. Parker, under the assumption that the income or tax-to-sales ratios will average out about the same as in private business. The association did attempt to break the over-all volume down into several different major groups, applying the most comparable tax-sales ratios of private business to the sales volume for each group.

I have attempted to approach the problem by a different method: namely, to break the total cooperative volume down into commodity groups, and in some cases into subgroups, and impute net income dollar sales ratios separately for each one, based on whatever information is available regarding the profitablity of each type of cooperative enterprise. I am sure that in principle this is the best approach to the problem, and believe that anyone familiar with the wide varia-

tion in profits per dollar of sales in various lines of cooperative business will agree with me. For example, a livestock commission firm handles a tremendous dollar volume of business, but its commissions amount roughly to only 1 percent of dollar sales, and its net profit, of course, to a much smaller percentage. To apply to dollar sales volume of this kind the average earnings or tax to sales ratio of private corporations is obviously unwarranted. The National Tax Equality Association recognized this in its separation of commission business from other cooperative business and, in effect, application to it of a much lower tax-sales ratio. I have done this not on an over-all basis but by commodity groups.

The difficulty with my approach is the lack of adequate quantitative data regarding earnings rates not only in various lines of cooperative business but even for all such business in total.

For the purpose of estimating earnings rates in various lines of cooperative business, therefore, I have been compelled largely to rely on judgment estimates based so far as practicable on rates for somewhat comparable lines of private business, which, frankly, I might have difficulty in supporting individually. But, allowing for compensating errors, I sincerely believe that this approach at least offers a good check on other methods of estimating and on the whole has distinct advantages. Given time, it would be possible to work out highly satisfactory estimates along these lines.

First I removed from the sales volume data of the Farm Credit Administration for 1948–49—the most recent available—the figures for livestock and tobacco and 40 percent of the dairy-products figure, the latter approximately representing that proportion of such sales which was fluid milk sold through bargaining associations. These sales were considered as commission sales on which only very small handling charges were earned. A total of only about $1½ million profit was imputed to the total sales of these items, amounting to $2,344 million. This may be leaning over backward to avoid overestimating the cooperatives' tax escapement but at least should exempt my estimates of these most vulnerable items from any criticism by cooperative interests.

To the total sales of such cooperatives was added the "sales" of cotton cooperatives, which I understand consist largely of charges for ginning and other services. The resulting total of $2,795 million was subtracted from the FCA's total reported cooperative volume of $9,320 million, and the remainder was raised by 30 percent of the total figure, representing an estimated allowance for handling at successive stages of marketing which is not included in the FCA figure. This allowance was prorated among the commodity groups other than livestock, cotton, tobacco, and fluid milk, which apparently are not involved in such successive-stage handling to any material extent. The 30-percent blow-up is a conservative interpretation of data in a letter from an FCA statistician in the Cooperative Research and Service Division to the Cooperative Digest, and I doubt that anyone familiar with the official cooperative statistics will disagree with this percentage as a reasonable allowance for cooperative operations at successive stages of marketing, such as fruit handled by local cooperatives and cooperative central sales agencies.

The attorney who appeared for the cooperatives this morning referred to this 30-percent figure as a "more or less debatable assumption."

First, I should like to point out that this is no assumption at all; that it is based upon official Farm Credit Administration figures published in the Cooperative Digest.

Second, if the committee members consider this figure to be debatable, they may wish to verify it in the Farm Credit Administration.

Senator TAFT. I do not understand it. You are trying to prove—I mean, this is all assumption. You are trying to show that, if you handle a certain dollar-volume goods, besides the profits you might make on handling those goods, you also make a profit on some other services.

Mr. BURGESS. No, Senator Taft. The orange is sold twice, so to speak. It is handled at the farm level, and it is handled at the wholesale and retail levels

Senator TAFT. But, if you had an integrated individual company, would they not handle it all together?

Mr. BURGESS. That is correct, and they would, in effect, pay Federal income tax on the profits earned at each stage.

Senator TAFT. You mean two cooperatives handling it, first one and then the other?

Mr. BURGESS. That is it exactly.

Senator TAFT. Does that happen to a considerable amount of business?

Mr. BURGESS. To the extent of the 30-percent blow-up, if you consider all of it.

The Farm Credit Administration, Senator Taft, attempts to measure only the amount of business done at the farm level and does not include in its figures business done at other levels of distribution

Following this adjustment of the dollar sales volume of the commodity groups other than cotton, tobacco, livestock, and fluid milk, varying imputed profit rates were applied to each to obtain profit estimates. For this purpose the profit rates determined from published tax-return data for industries as nearly comparable as possible were used. I believe the profit rates are reasonable, but undoubtedly they could be substantially improved by research. As it is, anyone differing with me could only set his judgment up against mine, with no way of proving whose was the best.

Senator KERR. What you are saying is that neither you nor he would have any way of proving what you said. [Laughter.]

Mr. BURGESS. We would both have difficulty proving it.

Senator TAFT. You say there is the profit. You assume that, if the cooperative were not a cooperative but were something else, it would make this profit; is that it?

Mr. BURGESS. We have assumed profit rates for cooperatives in various lines of business, which appear to be reasonable in the light of the rates earned by private business.

Senator TAFT. But is not what I say correct? You say this is a profit a cooperative would make if it were operated as an individual company?

Mr. BURGESS. That is right; and the witness this morning referred to——

Senator TAFT. I do not mean individual; I mean a private company.

Mr. BURGESS. A private company.

In questioning the profit rates that were used in my estimate, the witness this morning claimed that the cooperatives were operating at cost.

I think we all know that they are not operating at cost. If they were, and if the cooperatives could prove it, we would not be sitting here considering this problem, because the problem would then not exist.

Senator TAFT. Well, I do not admit for the moment that a cooperative makes the same profit as the individual when they give it back to their members; I do not think they make that profit. I mean your whole thing is based on an assumption with respect to something we are not going to do. That is the whole thing. I think if you want to estimate—I do not think for a moment I would consider taxing patronage cash dividends. I think there is a question, of course, on this reserve thing, so far as assuming that all patronage cash dividends would be taxed; and I think that is the difference between a cooperative and somebody else, that those cash dividends do go back and they are a discount to the farmers who are running the cooperative.

Mr. BURGESS. Taxation of all patronage dividends is what is proposed by the National Tax Equality Association, Senator Taft.

In making my estimates, I am addressing myself to that proposal.

Senator TAFT. I so understood. That is all I really meant to point out; that is the assumption I go on.

Mr. BURGESS. I realize you do not accept the principle.

Senator KERR. Mr. Burgess, have you told the committee who the National Tax Equality Association is?

Mr. BURGESS. I would prefer for one of the officers of the National Tax Equality Association to answer that question or to put the information in the record for your use.

Senator TAFT. One of the officers appeared here yesterday.

Mr. BURGESS. I am representing——

Senator KERR. You say here that you are representing them.

Mr. BURGESS. I am. My firm performs research work for associations, individuals, and concerns in all lines of business, and the NTEA happens to be one client of ours, Senator Kerr. However, I am not familiar with all the operations, nor am I acquainted with all the officers of each of our clients.

Senator KERR. You represent them but you do not know who they are. Well, that is not necessary, I presume—it is not necessary that the relationship require that.

Mr. BURGESS. That is correct.

Senator KERR. They are not anonymous, though.

Mr. BURGESS. I think they are not anonymous.

From this procedure I obtained a total in round numbers of $514 million of profits, for the agricultural marketing and purchasing cooperatives, as of 1948–49 and without allowance for the increase in volume of business since then or for the officially admitted lack of completeness of the FCA data on cooperatives. Since nobody really knows how incomplete the data are, I am making an arbitrary allowance of 3 percent for this factor I believe the associations not reporting to the FCA represent a larger percentage of the total, but

that their average volume of business is substantially below the average for reporting associations.

Senator TAFT. I might say about the increase of business since 1948–49, that 1949–50 business seems to be considerably smaller, according to this table submitted, if that is correct. The 1948–49 business is not an increase.

Mr. BURGESS. That latest figure, as the witness mentioned this morning, is not official yet. The witness referred to a preliminary figure.

Senator TAFT. That is right.

All figures are preliminary, not yet published.

Mr. BURGESS. What I have seen, Senator Taft, does indicate some decline in business in 1950, but preliminary data show that it has come back in 1951 to approximately the level of 1949.

Senator TAFT. 1949. Then there would not be an increase.

Mr. BURGESS. No, there would not in that event, but later data may change the picture.

An additional increase of 5 percent is made to allow for the increase in volume of business and profits since 1948–49, bringing the figure to $556 million.

In addition to the agricultural marketing and purchasing cooperatives, there must be included the consumer cooperatives and retailer-owned cooperatives.

For the former I have taken the Bureau of Labor Statistics official sales volume estimates for 1948, for local associations only, and deducted petroleum associations, insurance associations, credit unions, and one-half of the "stores and buying clubs." This seems to me to be a very reasonable allowance for duplication with the mutual organizations, and the FCA purchasing cooperatives, already accounted for, since most of the remaining categories seem definitely nonagricultural. The total sales volume so obtained is approximately $607 million, and allowance for the increase in dollar sales since 1948 raises it to $680 million. Applying a 7 percent rate of return as for private retail business, these sales yield a net profit of $48 million. For the retailer-owned cooperatives, I used the 1939 census of wholesale trade figure of $223 million, increased by 200 percent to allow for the increase in wholesale trade since then, as reported by the Department of Commerce, but without any allowance whatever for the marked trend from private to cooperative types of wholesale establishments since 1939. Probably further research would raise this estimate considerably. On these $669 million of sales I estimated $31 million of net profit at rates of private business.

This gives a total estimated sales volume for nonagricultural cooperatives, as of 1950, of $1.349 million and estimated net income of $79 million.

The sum total of imputed profits of all these types of cooperative enterprises combined is $635 million and the estimated Federal tax on this sum is $267 million. From this is deducted the $3 million now paid in Federal taxes, leaving $264 million net tax escapement by cooperative business.

Considering the differences in approaches followed, this completely independent estimate seems to be in much more close agreement with other estimates than I had expected at the beginning. Although this estimate could be improved with more research, I believe that it is sufficiently accurate for reliable use in formulating tax policy.

Senator KERR. You say this is an independent estimate?

Mr. BURGESS. Entirely independent, sir. All of our work is done independently.

Senator KERR. Independent of what?

Mr. BURGESS. Independent of our client's wishes, desires, or hopes as to results. No estimate, no research we do, is influenced by the client's hopes as to the results. We give the truth, whether it helps or hurts.

Senator KERR. Well, which part of this hurts your client?

Mr. BURGESS. I do not believe any of it does, inasmuch as it confirms estimates previously made by the client.

Senator KERR. Would there be any relationship between that fact and the fact of your presence here?

Mr. BURGESS. None whatever.

Senator BYRD. You have submitted your statement?

Mr. BURGESS. Yes, sir.

Senator BYRD. Thank you, sir.

Senator WILLIAMS. These estimates were based upon the assumption that they were cash tax patronage dividends; is that correct?

Mr. BURGESS. All patronage dividends would be taxed, Senator Williams.

Senator WILLIAMS. You did not have it broken down, isn't that right, if the cash payments were exempted?

Mr. BURGESS. I do not have my estimate broken down. From information I believe to be reliable, the amount of cash patronage dividends, rather than 50 percent of the total as "guesstimated" by the witness this morning, is probably less than 20 percent of the total.

Senator WILLIAMS. To your knowledge, has there ever been an official publication of a breakdown of those figures?

Mr. BURGESS. No, sir; there has not to my knowledge. The information is available in the Bureau of Internal Revenue, certainly on a sample basis, if not for all informational returns that have been filed. I believe that you could get a reliable figure from the Bureau.

Senator WILLIAMS. Thank you.

Senator BYRD. Thank you, Mr. Burgess.

Senator TAFT. Mr. Chairman, the Treasury this morning made some estimates. I wonder if the Treasury representative is here and can give us those estimates? The Secretary of the Treasury testified, as I remember it, that from $20,000,000 to $40,000,000 was the sum.

Senator BYRD. We have a Treasury representative here. Will you identify yourself to the stenographer, please?

STATEMENT OF THOMAS LEAHEY, ASSISTANT DIRECTOR, TECHNICAL STAFF, TREASURY DEPARTMENT, ACCOMPANIED BY RAPHAEL SHERFY, ASSISTANT TAX LEGISLATIVE COUNSEL, TREASURY DEPARTMENT

Mr. LEAHEY. My name is Thomas Leahey. I am an Assistant Director of the Technical Staff of the Treasury Department.

Senator KERR. You are what?

Mr. LEAHEY. An Assistant Director of the Technical Staff of the Treasury Department.

Senator KERR. You do research?

Mr. LEAHEY. Yes, sir.

The estimates we have made in connection with cooperatives are those we made in answer to a question in connection with H. R. 240 which was introduced by Mr. Mason. We have made estimates on two bases which apply to mutual savings banks and building and loan associations, depending upon whether the dividends or the interest paid by those organizations would be deductible in the net income subject to tax. If those interests or dividends, whichever they may be termed, paid by mutual savings banks to their depositors or building and loan associations to their shareholders, are not allowed as deductions in computing net income——

Senator KERR. By whom?

Mr. LEAHEY. By the organization.

Senator KERR. Yes, those particular organizations?

Mr. LEAHEY. Yes, sir.

Senator KERR. Yes.

Mr. LEAHEY. We estimate that H. R. 240 would yield $650 million. If the payments by the mutual savings banks to their depositors, and by the building and loan associations to their shareholders are allowed as a deduction in computing the net income of those organizations subject to tax, the estimated yield would be $325,000,000.

Senator KERR. Do you mean that estimate was made on the basis of what you think would be produced from building and loan associations and mutual savings associations?

Mr. LEAHEY. No. This is the entire revenue yield of H. R. 240. I have a breakdown which I can give you.

Senator KERR. Are you about to give it to us?

Mr. LEAHEY. Yes, sir.

Senator KERR. In reference to farm cooperatives?

Senator TAFT. He has not gotten to that yet.

Mr. LEAHEY. The farm cooperatives are included in this total.

Senator KERR. They are included?

Mr. LEAHEY. Mutual savings banks, $215,000,000, with no deduction for interest or $60 million if the interest is allowed as a deduction. Building and loan associations, $230 million, if payments to their shareholders are not allowed; $65 million if such are allowed as deductions.

Credit unions, $7 million with no deductions for interest; $2 million deduction for interest.

And now for the remaining figures, there is no difference in the two estimates. Farm cooperatives and cooperative financial institutions, $70 million.

Senator KERR. Do you break that down as between the two?

Mr. LEAHEY. I do not have that here, sir.

Senator KERR. Would you give your best judgment?

Senator TAFT. Farm cooperatives and what?

Mr. LEAHEY. Financial institutions—cooperative financial institutions.

Senator TAFT. That is under 101 (13)?

Mr. LEAHEY. I am not familiar with the specific section.

Senator TAFT. It does not amount to much; I think it can be disregarded.

Mr. LEAHEY. I do not think the cooperative financial institutions are important.

Senator KERR. All right, now; that is $70 million?

Mr. LEAHEY. Yes.

Senator TAFT. Upon what assumption is the Mason bill, then? I missed that. What is the Mason bill on cooperatives?

Mr. LEAHEY. Essentially it taxes cooperatives just the same as most corporations would be taxable, and dividends are defined the same way as you would define a dividend of a regular corporation and are not deductible in computing——

Senator KERR. What you say is that this source would yield that if they were taxed on all that they made before they make their disbursements, in whatever form it takes to their patrons or shareholders?

Mr. LEAHEY. That is correct.

Senator KERR. Have you an estimate of what would be secured if they were taxed on what was retained after the disbursement of the participating profit to the shareholders or patrons?

Mr. LEAHEY. $25 million on the farm cooperatives.

Senator WILLIAMS. The Mason bill proposal to which you refer, upon which this estimate was based, goes upon the assumption that they would be taxed before there was any distribution either in cash, scrip, or interest.

Mr. LEAHEY. That is correct, sir.

Senator WILLIAMS. Does the Treasury have a breakdown anywhere or an estimate as to the percentage of these patronage dividends paid in cash and the percentage paid in scrip or some other form?

Mr. LEAHEY. I do not know whether we have that or not, sir. I can look it up.

Senator WILLIAMS. If you do have that, will you furnish it?

Senator TAFT. How did you get this $25 million?

Mr. LEAHEY. That assumed that all dividends paid would be deducted. It is retained income.

Senator TAFT. And you only get $70 million from the whole thing even if this patronage dividend is taxed without deducting?

Mr. LEAHEY. Yes, sir.

Senator WILLIAMS. Do you have an estimate anywhere on the amount of patronage dividends paid in——

Senator TAFT. Have you read Mr. Burgess' statement?

Mr. LEAHEY. We have based our estimate on the 1946 tabulation prepared by the Treasury Department from returns filed by tax-exempt organizations.

Senator KERR. Would that take into effect the known expansion?

Mr. LEAHEY. Yes, sir.

Senator TAFT. You have made allowance for those that did not answer?

Mr. LEAHEY. Yes, sir; we made about a one-third increase for that.

Senator KERR. One-third increase?

Senator TAFT. One-third?

Mr. LEAHEY. Yes, sir.

Senator TAFT. Offhand, the difference of $70 million and the $260 million estimated by Mr. Burgess is quite substantial.

Mr. LEAHEY. Well, Mr. Burgess, of course, used the rate of return of commercial enterprises as a percent of sales in computing the net income. We just took the net income shown by the Treasury survey.

Senator KERR. In other words, he took a rate of return which would have been made by the average private enterprise in the same business, and you took the actual facts?

Mr. LEAHEY. We took the net income as shown in the Treasury tabulation of the 1946 cooperative organizations.

Senator KERR. If I can say it another way as I read his statement, he based his estimate on what he said was the imputed profit.

Mr. LEAHEY. Yes, sir.

Senator KERR. I have been looking that word up here. He based his estimate on what he described as the imputed profit, and you base your estimate upon actual profit as ascertained by the reports that you had from them.

Mr. LEAHEY. Yes, sir.

Senator WILLIAMS. You say you based yours upon the actual facts that were presented to the Treasury?

Mr. LEAHEY. Yes, sir.

Senator WILLIAMS. Well, in the light of that statement, then you have got the breakdown and can furnish the committee definitely with a breakdown of the amount of patronage dividends in cash and otherwise.

Senator TAFT. It is not separate.

Mr. LEAHEY. I am not positive, sir, that the survey covered those two separately.

Senator WILLIAMS. You have it in the aggregate anyway, do you not?

Mr. LEAHEY. I believe we have, sir.

Senator TAFT. You must, to make the difference between $70 million and $25 million.

Mr. LEAHEY. Yes, sir.

Senator WILLIAMS. You would have to have it if it is, as you say, based upon facts.

Mr. LEAHEY. Yes, sir.

Senator WILLIAMS. And you also would be willing to—you would be able to furnish a definite figure to us of the amount of unallocated income that is accumulating in the so-called exempt profits.

Mr. LEAHEY. The retained——

Senator WILLIAMS. The retained unallocated profits.

Mr. LEAHEY. I am not sure whether we can.

Senator WILLIAMS. Well, you have to, if it is based upon facts, because you cannot base it on facts if you do not have that.

Mr. LEAHEY. We know what the total retained is.

Senator WILLIAMS. That is what I mean, but you will have the total unallocated earnings in all of the cooperatives in the past year.

Senator TAFT. You will have all of the earnings.

Senator WILLIAMS. You have all of those figures, and you can furnish us with the exact figures.

Mr. LEAHEY. I will give you whatever we have.

(The information is as follows:)

Of the 6,009 exempt farmers' cooperatives which filed information returns for 1946, a breakdown of net margins is available for the 4,703 with gross receipts of $50,000 or more. These 4,703 organizations appear to have had net margins (before payment of patronage dividends, ordinary dividends, or other distributions to members) of $140.3 million. From this total, $6 million was paid as dividends on capital stock or similar distributions to members. Patronage dividends were reported as being $106.1 million, of which $16.5 million was paid in cash and $89.6 million in noncash form. After all dividends and costs, these cooperatives had left a balancing item of $28.1 million. This is presumed to represent amounts retained as reserves but it was not possible to ascertain from the information returns to what extent this assumption is correct.

Senator TAFT. You must have all the earnings, and then you must have all the patronage dividends which are or are not deducted from the earnings.

Mr. LEAHEY. Yes, sir.

Senator WILLIAMS. The figures which you supply us, as I said before, will be actual figures, and not estimates.

Mr. LEAHEY. Well, we can give you the 1946 figures. We then, in order to take into consideration the change in the business volume done——

Senator WILLIAMS. Couldn't you give us a later date figure on that, if you have it actually? You have it, have you not?

Mr. LEAHEY. We will give you the figures for 1946; we will give you that.

Senator TAFT. They have not gotten any returns since 1946.

Senator WILLIAMS. Have they not got returns since then?

Mr. LEAHEY. No, sir. That was a special survey.

Senator WILLIAMS. They are not filing returns at the present time?

Mr. LEAHEY. No, sir.

Senator WILLIAMS. Is there not a law that they are supposed to file returns?

Mr. LEAHEY. They have not been tabulated since then.

Senator WILLIAMS. You mean you have not just looked at them?

Mr. LEAHEY. Well, I do not——

Senator WILLIAMS. I mean, they are filing them.

Mr. LEAHEY. Yes, sir.

Senator WILLIAMS. That is what I thought. There was a law which required them to file, so that you must have these figures that you are giving if they are based upon facts, and then you can give us exact figures, so that we can break them down here if you do not have them here.

Mr. LEAHEY. The only tabulated and readily available data would be for 1946. It would take some time I presume to get the latest returns together in the fashion that you would want them.

Senator WILLIAMS. Well, you bring up to—could you get us the 1946 returns up here by the first of the week, and if you have got those readily available, you can go ahead and tabulate them for 1949 or 1950.

Mr. LEAHEY. I cannot answer for the tabulation, sir. That would be a Bureau of Internal Revenue matter.

Senator WILLIAMS. I mean, you can get us the 1946 figures because those are just a matter of drawing them off, those figures.

Senator TAFT. Do you know whether the House committee asked you to make a new compilation for a later year?

Mr. SHERFY. No, sir.

Senator TAFT. They did not?

Mr. SHERFY. I am going to check myself on that, but I am pretty certain that is true.

Senator TAFT. I thought they decided to postpone the whole thing.

Mr. SHERFY. I will find out.

Senator WILLIAMS. I think last year when we were holding hearings, I was under the impression that they asked for that. I know I had asked a time or two for it.

Senator TAFT. Thank you very much.

Senator KERR. I wonder if Mr. Burgess is still here?

Are you at all familiar with the structure of the National Tax Equality Association?

Mr. BURGESS. No, sir; I am not.

Senator KERR. Is it a cooperative?

Mr. BURGESS. I have no knowledge of its business operations, Senator Kerr.

Senator WILLIAMS. If it is, it ought to be taxed?

Mr. BURGESS. If it is, it should be taxed.

Senator KERR. Is it tax-exempt?

Mr. BURGESS. I know nothing about its taxable status, I am sorry, Senator Kerr.

Senator KERR. All right.

Senator BYRD. Mr. Burgess' complete prepared statement will be inserted at this point in the record.

(The prepared statement submitted by Mr. Burgess is as follows:)

STATEMENT OF RALPH E. BURGESS, PRESIDENT, COMMODITY MARKETING CORP., NEW YORK, N. Y., REPRESENTING THE NATIONAL TAX EQUALITY ASSOCIATION

I am Ralph E. Burgess, president of the Commodity Marketing Corp., 500 Fifth Avenue, New York, N. Y. My firm serves as industrial consultants to trade associations and companies in various lines of business. We have given particular attention to the economic and statistical analysis of problems relating to taxation. Many of you gentlemen will recall that a few years back I served as actuary for the Joint Committee on Internal Revenue Taxation, when I was responsible for the estimates of tax revenue presented to your committee, and that earlier I performed a similar function for the Treasury Department. I am appearing here in behalf of the National Tax Equality Association, which has asked me to give you my estimate of the tax loss to the Federal Government arising from special treatment accorded to mutual, cooperative, and Government business of various kinds.

The total loss to the Federal Government from the loopholes in the present tax laws and regulations that favor mutual or cooperative business corporations and Government corporations competitive with private business, is estimated at approximately $1,180 million annually, at existing rates of taxation. Under the rates of the House bill the estimated loss would, of course, be moderately larger. This loss approximates one-twentieth of either the total corporate or individual income-tax bill. This total estimated tax escapement is divided approximately among the principal lines of mutual, cooperative, and Government businesses as shown in the accompanying table.

Mutual, cooperative, and Governmental organizations—Estimated net income from business activities and estimated Federal tax escaped

[In millions of dollars]

Type of organization	Estimated net income from business activities [1]	Estimated Federal tax escaped [2]
Mutual financial institutions [3]	$1,057	$444
Mutual fire and casualty insurance companies [4]	[5] 307	[6] 60
Cooperative marketing and purchasing [7]	635	264
Government corporations	982	412
Total	2,981	1,180

[1] Income received in form of dues, contributions, grants, and gifts is excluded.

[2] Effective rate of 42 percent applied to estimated net income.

[3] Mutual savings banks, savings and loan associations, credit unions, production credit associations, and national farm loan associations.

[4] Includes companies presently taxable under a special formula.

[5] Total of underwriting and investment income.

[6] Obtained by applying to reported underwriting and investment income the same ratio of taxes paid to such income as reported by stock companies, and then deducting taxes presently paid.

[7] Includes agricultural cooperative marketing and purchasing organizations, consumer cooperatives, and retailer-owned cooperatives.

These estimates were prepared, in general, by taking the reported or estimated earnings of the specified types of organization, adjusting them where necessary to a basis similar to that employed by private corporations for tax purposes, and then applying to this net income an "effective" corporate tax rate of 42 percent.

The adjusted earnings figures for the mutual and governmental (but not cooperative) organizations I have taken from tabulations of the National Tax Equality Association. These were from official sources, and cannot be questioned without a detailed examination of reporting requirements which I have not had time to make. However, recent official Treasury estimates (prepared for Congressman Mason) are in close agreement. With respect to the mutual organizations other than cooperatives, and the Government business activities, the following specific sources were used to obtain figures representing in each case the business income: For mutual savings banks, annual reports of the Federal Deposit Insurance Corporation; for savings and loan associations, annual reports of the Federal Home Loan Bank Board; for credit unions, reports of the Bureau of Labor Statistics; for production credit associations and for national farm loan associations, reports of the Farm Credit Administration; for mutual insurance companies, Best's Insurance Reports for the Federal Government, annual reports of the Secretary of the Treasury; for State and local governments, reports of the Census Bureau. In general, operating results for the calendar years 1949 and 1950 are employed.

Because there seems to be relatively less agreement among the experts as to the amount of revenue involved in taxing cooperatives, the major part of my statement is devoted to an explanation of estimates of the tax escapement of cooperatives, as given in the table. These estimates are based on materials from a number of sources. No ready-made data on the net income of the various types of cooperatives are available. Here a few words need to be said concerning the data compiled and published by the United States Treasury Department from the informational returns (Form 990) required to be filed by the exempt type of cooperative. As you know, it was the 1943 Revenue Act which provided for such reports. Information compiled from these returns has been published so far only for 1943 and 1946 and this represents the only official data available on receipts and disbursements of cooperatives. Unfortunately, there are many persons who interpret the designation "official" to mean "reliable." This assumption frequently is in error because of incorrect reporting, tabulation, or interpretation of facts.

It is clear that the data compiled from the informational returns filed by cooperatives are unreliable, without major adjustments, for use in determining statutory net income of such organizations. This is apparent for the following reasons: (1) Revenue agents do not exercise the same zeal which they show in ferreting out taxable revenue; consequently many cooperatives fail to file informational returns while others follow loose accounting principles. (2) It would appear that many cooperatives report noncash patronage dividends as other expenses or as part of the cost of goods sold. (3) Local cooperatives frequently fail to report as income noncash patronage dividends received from regional associations.

The estimates of possible revenue to be derived from taxing cooperatives heretofore attributed to the Treasury Department or to the joint committee staff appear to have been based upon these incomplete and inaccurate statistics compiled from reports on Form 990. Because the Treasury Department refuses to discuss with outsiders its method of estimating possible revenue from cooperatives, no one can be sure just how their estimates were made. It appears, however, that, in estimating $113 million as the yield (under Congressman Mason's bill), the Treasury was in error in at least three respects; namely, (1) No allowance was made for the increase in general business shared by cooperatives from 1946 (the latest year for which informational returns were compiled) to date. (2) The total number of cooperatives reporting to the Treasury in 1946 was nearly 2,000 less than were reported to be in operation by the Farm Credit Administration. (3) No allowance was made for understatement of cooperative profits owing to expensing of capital expenditures, establishment of contingent reserves, expensing patronage dividends, and depreciating at abnormal rates.

Finally, as proof of my point it is necessary only to quote from the text accompanying the Treasury's 1943 tabulation from these cooperative returns: "It is important to note that the data on receipts and disbursements contained in this report are not comparable with the income and deduction data contained in corporation income tax returns. Therefore it is not possible to determine from these

data amounts which would be comparable with the net taxable income of taxable corporations."

It was necessary therefore for me to go one step back, to sales volume, as a basis for estimating net income or tax escapement. Even the sales volume of cooperatives, however, is difficult to estimate. Several different approaches may be used. The National Tax Equality Association, in a report submitted to the Committee on Ways and Means of the House in February 1950, tried two approaches, one based on Treasury Department figures and the other on Farm Credit Administration data. Various adjustments were made in the data, to allow for underestimation of the number of cooperatives, to convert business receipts to business volume, and to allow for operations performed by associations at various levels of marketing.

Anyone wishing to take issue with the association's estimates of cooperative sales volume may find a number of points in its analysis to criticize. It is my opinion, however, that most analysts are likely, using the available official figures, to come up with estimates of total volume not radically different from those made by the association. I believe it would be possible to get all the different estimators together around the conference table and reach conclusions substantially agreeable to all. However, the association asked us not to rely on their own estimates with respect to cooperatives but to go at the problem independently.

A second possible source of materials for these estimates is to be found in the data presented in tax hearings in 1947 by Mr. Lovell H. Parker, a distinguished tax consultant of Washington, who was formerly chief of staff for the Joint Committee on Internal Revenue Taxation and is well and favorably known to you gentlemen. In preparation for my testimony before the Committee on Ways and Means, I wrote to Mr. Parker for permission to use his former estimates as one check against my own estimates and believe that my letter to him and his reply may be of interest to your committee in connection with the matter now under advisement. My letter to Mr. Parker and his reply were as follows:

FEBRUARY 21, 1951.

Mr. LOVELL H. PARKER,
Washington, D. C.

DEAR MR. PARKER: The National Tax Equality Association has asked me to revise the tax estimates that you presented to the Ways and Means Committee in 1947 to include certain groups which you had excluded from your estimates and to reflect the recent increases in business activity and in corporate tax rates. I informed them that I would be glad to take on this task, and with your permission would like to use your estimates as one of several sources on which to build my own estimates. For this purpose I would like to have your opinion on whether or not developments in the field of tax-exempt organizations have followed your predictions. In other words, Do you feel that the present volume of tax-exempt business bears out your predictions of more than 3 years ago?

It is my understanding that your estimates did not include possible revenue from mutial savings banks, savings and loan associations, credit unions, production credit associations, national farm loan associations, or Federal, State, and local government-owned enterprises. On the other hand, your estimates included some small amounts of revenue which could be derived from the taxation of the business income of educational, religious, and charitable organizations, labor unions, and other group-interest organizations. Since these were taxed in the Revenue Act of 1950, the revenue to be derived from them should be removed from your data. In addition to making these adjustments, I wish also to make allowance for recent increases in business activity and the increase in the corporate tax rate from 38 to 47 percent.

In view of the search for additional revenue now being conducted by the Congress, would you be willing to review the testimony you gave to the Ways and Means Committee in 1947 (page 2710 of the official report of hearings) and, out of your continuing interest in the problem of tax equality, give me your opinion as to the present validity of your estimates in the light of the advances made by tax-exempt business since that date. Thank you.

Sincerely yours,

RALPH E. BURGESS, *President.*

FEBRUARY 26, 1951.

Mr. RALPH E. BURGESS,
President, Commodity Marketing Corp.,
New York, N. Y.

DEAR MR. BURGESS: Reference is made to your letter to me dated February 21, 1951. You ask me certain questions with respect to my estimates of tax-exempt income presented to the Ways and Means Committee under date of November 18, 1947. I am glad to answer your questions, as I have a moderate pride in the accuracy of my estimates You have, of course, my permission to use my estimates presented at that time in any way you see fit. They are a matter of public record.

1. You ask, "Do you feel the present volume of tax-exempt business bears out your predictions of more than 3 years ago?"

My answer is "Yes." On this point please note that in my testimony in 1947 I based my predictions on the facts as far as known for the year 1945. The principal basic fact for the year was a figure of $5,645,000,000 published by the Farm Credit Administration of the United States as being the gross income of the farmers' marketing and purchasing cooperative associations of the United States. Now, recently a similar figure has been published by the Farm Credit Administration for the year 1949. This figure is $9.320,000,000. Thus in 4 years with respect to this figure the percentage increase has been 65 percent, or about 16 percent per year. I expect for 1950 the trend will continue and that the 1950 volume will be at least 80 percent above the 1945 volume.

You will be interested to note that, for all the tax-exempt volume of business I took into account, my estimate for 1950 was $20,018,000,000, based on fairly accurate figures for 1945 of $11,571,000,000. The $20,018,000,000 figure is only 73 percent above the 1945 figure, which I believe indicates my estimate was conservative.

2. You are correct in all respects with regard to the statements made in paragraph 2 of your letter.

I believe the above covers the subject matter of your letter, and I repeat that I still think my estimate of 1947 has been well justified by subsequent events.

Very truly yours,

LOVELL H. PARKER.

Examination of Mr. Parker's testimony in 1947 in relation to this letter indicates that as of now his volume estimates would not be greatly different than would be a projection of the estimates of the National Tax Equality Association previously described.

But estimation of the sales volume is only one part of a two-pronged problem. The other, and more difficult, requirement is to estimate the imputed tax liability attaching to such volume of business if the profits on it were taxed. This may be done on an over-all basis, as did the association and Mr. Parker, under the assumption that the income or tax-to-sales ratios will average out about the same as in private business. The association did attempt to break the over-all volume down into several different major groups, applying the most comparable tax-sales ratios of private business to the sales volume for each group.

I have attempted to approach the problem by a different method; namely, to break the total cooperative volume down into commodity groups, and in some cases into subgroups, and impute net income-dollar sales ratios separately for each one, based on whatever information is available regarding the profitability of each type of cooperative enterprise. I am sure that in principle this is the best approach to the problem and believe that anyone familiar with the wide variation in profits per dollar of sales in various lines of cooperative business will agree with me. For example, a livestock commission firm handles a tremendous dollar volume of business, but its commissions amount roughly to only 1 percent of dollar sales, and its net profit, of course, to a much smaller percentage. To apply to dollar sales volume of this kind the average earnings or tax-to-sales ratios of private corporations is obviously unwarranted. The National Tax Equality Association recognized this in its separation of commission business from other cooperative business and, in effect, application to it of a much lower tax-sales ratio. I have done this, not on an over-all basis, but by commodity groups.

The difficulty with my approach is the lack of adequate quantitative data regarding earnings rates not only in various lines of cooperative business but even for all such business in total.

For the purpose of estimating earnings rates in various lines of cooperative business, therefore, I have been compelled largely to rely on judgment estimates,

based so far as practicable on rates for somewhat comparable lines of private business, which I might have difficulty in supporting individually. But, allowing for compensating errors, I sincerely believe that this approach at least offers a good check on other methods of estimating, and on the whole has distinct advantages. Given time, it would be possible to work out highly satisfactory estimates along these lines.

First, I removed from the sales volume data of the Farm Credit Administration for 1948–49 (the most recent available) the figures for livestock and tobacco and 40 percent of the dairy products figure, the latter approximately representing that proportion of such sales which was fluid milk sold through bargaining associations. These sales were considered as commission sales on which only very small handling charges were earned. A total of only about $1½ million profit was imputed to the total sales of these items, amounting to $2,344 million. This may be leaning over backward to avoid overestimating the cooperatives' tax escapement, but at least should exempt my estimates of these most vulnerable items from any criticism by cooperative interests.

To the total sales of such cooperatives was added the "sales" of cotton cooperatives, which I understand consist largely of charges for ginning and other services. The resulting total of $2,795 million was subtracted from the FCA's total reported cooperative volume of $9,320 million, and the remainder was raised by 30 percent of the total figure, representing an estimated allowance for handling at successive stages of marketing which is not included in the FCA figure. This allowance was prorated among the commodity groups other than livestock, cotton, tobacco, and fluid milk, which apparently are not involved in such successive-stage handling to any material extent. The 30-percent blow-up is a conservative interpretation of data in a letter from an FCA statistician to the Cooperative Digest, and I doubt that anyone familiar with the official cooperative statistics will disagree with this percentage as a reasonable allowance for cooperative operations at successive stages of marketing, such as fruit handled by local cooperatives and cooperative central sales agencies.

Following this adjustment of the dollar sales volume of the commodity groups other than cotton, tobacco, livestock, and fluid milk, varying imputed profit rates were applied to each to obtain profit estimates. For this purpose the profit rates determined from published tax-return data for industries as nearly comparable as possible were used. I believe the profit rates are reasonable, but undoubtedly they could be substantially improved by research. As it is, anyone differing with me could only set his judgment up against mine, with no way of proving whose was the best.

From this procedure I obtained a total in round numbers of $514 million of profits for the agricultural marketing and purchasing cooperatives as of 1948–49 and without allowance for the increase in volume of business since then or for the officially admitted lack of completeness of the FCA data on cooperatives. Since nobody really knows how incomplete the data are, I am making an arbitrary allowance of 3 percent for this factor. I believe the associations not reporting to the FCA represent a larger percentage of the total but that their average volume of business is substantially below the average for reporting associations. An additional increase of 5 percent is made to allow for the increase in volume of business and profits since 1948–49, bringing the figure to $556 million.

In addition to the agricultural marketing and purchasing cooperatives, there must be included the consumer cooperatives and retailer-owned cooperatives. For the former I have taken the Bureau of Labor Statistics official sales volume estimates for 1948 for local associations only and deducted petroleum associations, insurance associations, credit unions, and one-half of the stores and buying clubs. This seems to me to be a very reasonable allowance for duplication with the mutual organizations and the FCA purchasing cooperatives already accounted for, since most of the remaining categories seem definitely nonagricultural. The total sales volume so obtained is approximately $607 million, and allowance for the increase in dollar sales since 1948 raises it to $680 million. Applying a 7-percent rate of return as for private retail business, these sales yield a net profit of $48 million. For the retailer-owned cooperatives, I used the 1939 census of wholesale trade figure of $223 million, increased by 200 percent to allow for the increase in wholesale trade since then, as reported by the Department of Commerce, but without any allowance whatever for the market trend from private to cooperative types of wholesale establishments since 1939. Probably further research would raise this estimate considerably. On these $669 million of sales I estimated $31 million of net profit at rates of private business.

This gives a total estimated sales volume for nonagricultural types of cooperatives as of 1950 of $1,349 million and estimated net income of $79 million. The sum total of imputed profits of all these types of cooperative enterprises combined is $635 million, and the estimated Federal tax on this sum is $267 million. From this is deducted the $3 million now paid in Federal taxes, leaving $264 million net tax escapement by cooperative business. Considering the differences in approaches followed, this completely independent estimate seems to be in much more close agreement with other estimates than I had expected at the beginning. Although this estimate could be improved with more research, I believe that it is sufficiently accurate for reliable use in formulating tax policy.

Senator BYRD. The next witness is C. Emory Glander.

STATEMENT OF C. EMORY GLANDER, ATTORNEY AT LAW, REPRESENTING NATIONAL TAX EQUALITY ASSOCIATION

Mr. GLANDER. Mr. Chairman and members of the committee, I am C. Emory Glander, attorney at law, of Columbus, Ohio, appearing on behalf of National Tax Equality Association.

Senator KERR. Can you give the Committee the information I was trying to get from Mr. Burgess?

Mr. GLANDER. No, sir; I cannot. I am not general counsel for the company, and I have not examined their books.

Senator KERR. Mr. Chairman, I believe that the committee is entitled to know who it is that these gentlemen are appearing for.

Mr. GLANDER. Senator Kerr, the president of the association was here and testified.

Senator KERR. Well, did you hear him?

Mr. GLANDER. I heard him.

Senator KERR. Did he give the information?

Mr. GLANDER. I do not think it was asked. I am sure he would have.

Senator BYRD. Who is the president?

Mr. GLANDER. Mr. Lester, Mr. Garner Lester, who was here yesterday.

Senator BYRD. There is no objection, I assume, to asking Mr. Lester for a statement?

Mr. GLANDER. No, indeed. I am sure he would be glad to answer.

Senator BYRD. Will you ask him to give a statement of this company, what this company is?

Senator KERR. Is there anybody in the room who can tell us?

Mr. GLANDER. I am not certain.

Senator BYRD. Is there a representative here of the National Tax Equality Association who knows what the company does and what the business is?

Senator KERR. Knows who it is?

Senator BYRD. Knows who it is? We know the president's name. I will ask——

Senator WILLIAMS. I think it is in the House record.

Senator KERR. We know the president's name and the names of two men here who represent them, but it is passing strange to me that neither of them know who their client is.

Mr. GLANDER. I know who my client is; it is the National Tax Equality Association, the membership of which consists of business-

men all over the country who are interested in the problem of tax equality.

Senator KERR. If it consists of businessmen all over the country, can't you tell us one of them?

Mr. GLANDER. I have not examined their membership, sir.

Senator KERR. How do you know it consists of businessmen all over the country?

Mr. GLANDER. That is very apparent from the House hearing.

Senator BYRD. The committee will ascertain what it is.

Mr. GLANDER. I should be very glad to give that to Senator Kerr, and I think he is entitled to it.

(The information referred to was not supplied to the committee.)

Senator BYRD. I think we will go directly to the president, and I did not know he was present, and perhaps Senator Kerr did not know that. What was his name?

Mr. GLANDER. Garner Lester.

Senator BYRD. Will you proceed, sir?

Mr. GLANDER. In urging that the mantle of tax immunity be removed from cooperatives, I do more than appear in a representative capacity. I also give voice to certain personal convictions which were formed when I served as tax commissioner of Ohio and as president of the National Association of Tax Administrators.

During my 6 years of public service as tax commissioner of Ohio, I learned much about the desire of citizens and taxpayers everywhere for equitable tax policies. I learned, for example, that the one thing taxpayers dislike more than the burden of taxes they are required to pay, is a tax law or an administrative determination that favors some persons or classes to the prejudice or detriment of others who often are in competition with them. Equitable tax treatment begins with the writing of the tax statute and must pervade its administration.

It is my contention that the income-tax exemptions contained in section 101 and related sections of the Internal Revenue Code, and also afforded under the prevailing policy of the Bureau of Internal Revenue, violate the basic tenet of tax equality and also deprive the Treasury of revenue so vitally needed for the national defense.

There was a time when such tax immunities could be afforded and perhaps even justified as a subsidy. But that was in a day now gone, perhaps never to return. New conditions have arisen, new demands are upon us, and we no longer can afford or justify old indulgences which were formerly tolerable. As Mr. Roswell Magill, of the New York bar, formerly Under Secretary of the Treasury, and Mr. Allen H. Merrill, also of the New York bar, said in an article which appeared in the Michigan Law Review for December 1950:

> * * * Tax gratuities, or subsidies, in favor of worth while social experiments such as cooperatives, may have been sound and desirable under the low tax rates prevailing during the first two decades of the income tax. They cannot be justified, however, in the political, economic, and tax climate of the 1950's.

The formulation of tax policy in the present condition of our national life must take sympathetic account of the fact that the aggregate tax burden in this country—and I am taking into account Federal, State and local—is now somehwere between 25 and 30 percent of the national income, that the public debt is now well over a quarter of a trillion dollars, and that the inevitable and tragic consequence of these trends, sooner or later, will be the destruction of our cherished

American standard of living. In these circumstances, the Congress of the United States, I respectfully submit, has a moral obligation to eliminate all tax exemptions or gratuities that have lost their economic justification, if not their political expediency.

The amount of cooperative income escaping taxation is very great. Let me give you some estimates.

In general, it may be said that tax-escaping cooperatives fall into three groups: (1) farmers', consumers', and retailers' cooperatives, (2) cooperative financial institutions, and (3) mutual fire and casualty insurance companies.

As to farmers' cooperatives, the Farm Credit Administration Reports show that the total business at the local level amounted in 1949 to $9,320,000,000. Adjusting this figure upward by 20 percent to include manufacturing and wholesale cooperatives produces a total farmers' cooperative business volume of $11,184,000,000. Consumers' cooperatives, according to the Bureau of Labor Statistics Reports accounted for another $1,215,000,000 in business volume. And retailer-owned cooperatives, which the Census of Trade reported at $222,996,000 for 1939, probably did a volume of at least $445,000,000 by 1949. Adding these figures together produces an estimated total business volume for these cooperatives of $12,844,000,000 in 1 year. If we assume that these institutions earned an average of 5 percent per sales dollar the total income escaping taxation would be $642,200,000.

Senator KERR. Let us assume that they earned 1 percent?

Mr. GLANDER. Then you would have to make an adjustment.

Senator KERR. Per sales dollar. Then, how much would that be?

Mr. GLANDER. It would be 1 percent of that amount.

Senator KERR. Did you figure out what that was?

Mr. GLANDER. Yes, sir; 1 percent of that would be $128,000,000, as I get it.

Senator KERR. Well, now, let us assume that they earned one-half of 1 percent.

Mr. GLANDER. Well, you divide that by two.

Senator KERR. Can you tell us what that would be?

Mr. GLANDER. It would be $64,000,000.

Senator KERR. $64,000,000?

Mr. GLANDER. That is right.

Senator KERR. Now, then, can you tell this committee which, if either, of those estimates is accurate?

Mr. GLANDER. My answer to you, Senator Kerr, is this——

Senator KERR. Just answer me "Yes" or "No." Can you tell me which, if either, of those estimates is accurate?

Mr. GLANDER. Yes.

Senator KERR. All right. Which one?

Mr. GLANDER. I think it approaches the 5-percent figure, and I will give you the reasons if you would like to know.

Senator KERR. Now, give this committee the basis of your statement that it approaches—what do you mean by approaching?

You know the baby approaches the age of 70, but slowly. You say the figure approaches the 5-percent mark.

Mr. GLANDER. Don't hold me to the word "approach."

Senator KERR. Well, do not use it if you do not want me to hold you to it. [Laughter.]

Mr. GLANDER. Did you ever make an estimate, Senator?

Now, the answer to the question——

Senator KERR. Sure, I have made an estimate, and if I was cross-examined on it, I either said it was an estimate or I told how I arrived at it.

Mr. GLANDER. I have; I have said it was an estimate, and I am about to tell you how I arrived at it.

Senator KERR. Fine; I do not want to interrupt.

Mr. GLANDER. Now retail business, generally, does better than that. According to the Department of Commerce it has done as high as 7 percent.

Senator KERR. When did it do as high as 7 percent?

Mr. GLANDER. About 1947.

Senator KERR. What does it generally do?

Mr. GLANDER. It is about that.

Senator KERR. Don't you know that that was the highest figure in history?

Mr. GLANDER. All right; take 6 percent.

Senator KERR. Why take 6 percent?

Mr. GLANDER. Well, you do not like 7. [Laughter.]

Senator KERR. I guarantee that I do not object to 7. I just say that you have said what was probably the highest figure in history.

Mr. GLANDER. You said that, Senator.

Senator KERR. Well, what do you say?

Mr. GLANDER. I do not dispute it, but——

Senator KERR. If you did not agree with it, you might have said that you doubted it, might you not?

Mr. GLANDER. Well, now, Senator, I do not need to spar with you on this.

Senator KERR. Don't do it then.

Mr. GLANDER. Wholesale return is somewhat less than retail, and in 1947 it was 5.4. The average of the two would be somewhere around 6¼ percent. Now, I am dropping off 1¼ percent.

Senator KERR. You are a man who is supposed to have, and who has had lots of experience. You qualify yourself here as an expert. In your opinion, what is the average return of retailers in profit percentagewise with reference to their total normal business——

Mr. GLANDER. I would say roughly——

Senator KERR. Wait until I get through asking the question, because I guarantee that you do not know what it is until I get through asking it.

In an average year—not 1947, not 1946, not 1950, nor 1951, but what is it in an average year?

Mr. GLANDER. You want my opinion, do you?

I do not have the answer.

Senator KERR. If you do not know——

Mr. GLANDER. I will say I do not have the answer to that question.

Senator KERR. If you do not know, just say you do not know.

Mr. GLANDER. All right. I will say that I do not know what the average is over a long period.

Senator KERR. Or in a normal year.

Mr. GLANDER. Well, I would not say that. I will say that it is somewhat—it was 7 percent on retailers in 1947.

Senator KERR. You said that twice already.

Mr. GLANDER. It is a little less right now.

Senator KERR. You already have said that twice, and I heard you both times, and I am asking you if you know what it is in an average year.

Mr. GLANDER. I cannot give you that.

Senator KERR. You do not know?

Mr. GLANDER. I cannot give you that.

Senator KERR. Then, I am asking you how you expect this committee to think that you know what the average earnings of a cooperative are?

Mr. GLANDER. I would say this, that in the first place the cooperative's prevailing price policy is selling and buying at the market; that is their famous Rochdale principle. They claim to be as efficient as private business, and I am willing to take them at their word.

Senator KERR. If you do not know what the average——

Mr. GLANDER. Now, our position——

Senator KERR. If you do not know what the average return of private business is, how would you know what the average return of the cooperative is?

Mr. GLANDER. If you want me to give you a figure, I will say 5 percent, which I have said.

Senator KERR. I know you said it, and then you said you did not know what it was.

Mr. GLANDER. I have said 5 percent, which is approaching it as closely as you can, in the absence of specific data which not even the Treasury has.

Senator KERR. In the absence of information, that is as close as you want to estimate?

Mr. GLANDER. It is as close as the Treasury can come. They do not have specific data either.

Senator KERR. Did you get that figure from the Treasury?

Mr. GLANDER. No; I did not get that figure from the Treasury. If you do not like 5 percent, take 4 or 3, but the principle is the same, and if you do take 5, the total annual income escaping taxation would be $642,200,000. At an effective tax rate of 50 percent now contemplated, the loss in tax dollars amounts to $321,100,000 annually.

Now, there are those who argue that the taxation of these cooperatives would produce but a fraction of this amount. What they contemplate is taxing only unallocated retained earnings. That is not what we advocate, and it is not the way other corporations are taxed. The revenue, if cooperatives are placed upon the same basis as private corporations with which they compete, would be many times greater as I have pointed out.

Senator TAFT. That is not quite true, Mr. Glander, because the Treasury has just estimated $70 million, instead of $321 million, without contemplating taxing only unallocated retained earnings.

Mr. GLANDER. Well, the Treasury figures, I think, involve as much guesswork, Senator, as mine do.

Senator TAFT. They are made from these returns.

Mr. GLANDER. And they do not have the returns from all the cooperatives. I saw the attack made on the other one.

Senator TAFT. But they allowed for that, as did the gentleman who just testified, Mr. Burgess.

Senator WILLIAMS. I think a part of that—and I am not getting into the argument as to the estimates put up by either of them, because I think a lot of them are based upon assumptions, but a lot of it is—using your figures, and assuming them to be correct—based upon the farmers who are not paying any tax on it now, and to get a true picture of the revenue——

Mr. GLANDER. That is right.

Senator WILLIAMS (continuing). You would have to take this figure, even assuming it to be correct, and deduct from it the amount that the farmers are now paying on the scrip, and allocations that are going to them, and which would make some deductions, and would make the deduction and account for part of it, and I think that is where the Library of Congress——

Senator TAFT. It would not account for the difference.

Senator WILLIAMS. It would not account for the difference here, but if they tax cooperatives on that assumption, then you do not tax the farmers at the same time.

Mr. GLANDER. Of course, there is one good way in which we can avoid estimates, at least as to what is being paid by the patron members, and that is for this Senate committee to restore the House proposal for a 20-percent withholding which was, I understand, originally in the House bill, and which was removed from it. It might give you some basic information, and also assure getting the taxes about which there may be some doubt.

Now, the second group of tax-free cooperatives, consists of the so-called cooperative financial institutions. This group includes mutual savings banks, savings and loan associations, Federal and State credit unions, production credit associations, and the national farm loan associations.

Senator KERR. Would you say it also includes mutual life insurance companies?

Senator TAFT. No.

Mr. GLANDER. Did I include or exclude them?

Senator KERR. Include.

Mr. GLANDER. No, it does not. It includes just those that I have mentioned—yes, I will have to ask you to put the question again.

Senator KERR. If you would eliminate that reaction you have got to answering any question I ask as "No," and listen to it, then we might not have to repeat it. [Laughter.]

You said the second group of tax-free cooperatives consists of the so-called cooperative financial institutions, and then you say the group includes certain ones. I asked you if it might also include mutual life insurance companies.

Mr. GLANDER. This group does not.

Senator KERR. Can you tell me the difference between the structure of a mutual life insurance company, for instance, and the mutual savings and loan associations, or mutual savings banks, from the standpoint of participation by those that do business with it?

Mr. GLANDER. No, I cannot give that to you today, sir.

Senator TAFT. The mutual life has always been taxed, and they always have been excluded from this. They are taxed just like other companies, practically.

Mr. GLANDER. Mutual savings banks, basing estimates upon Federal Deposit Insurance Corporation figures, had tax-free earnings in 1949 of some $460 million.

Savings and loan associations, basing estimates upon the annual report of the Home Loan Bank Board, had tax-free earnings in 1949 of approximately $475 million.

Credit unions, according to the Bureau of Labor Statistics, had tax-free earnings in 1949 in excess of $25 million.

Production credit associations and national farm loan associations, according to figures contained in the Farm Credit Administration's report, had tax-free earnings in 1949 of some $14 million.

Altogether, it appears then that cooperative financial institutions are currently earning about $974 million, or almost a billion a year, from their business activities on which no Federal income taxes are being paid. At an effective rate of 50 percent, the Federal income tax would be $487,000,000 a year.

The third group of tax-escaping cooperatives to which I have referred consists of the mutual fire and casualty insurance companies. I have no specific data concerning these companies, but I have noted that testimony before the Ways and Means Committee of the House last March indicated—

that equal taxation of mutual and stock insurance companies would bring a minimum of $60,000,000 annually into the Federal Treasury.

I also understand that the Treasury itself has made an estimate of $70,000,000 for this group.

Senator KERR. How much better do you think the Treasury estimate there is than it is with reference to this group?

Mr. GLANDER. I think it is much easier to make an estimate on these than it is on the agricultural ones.

Senator KERR. You are willing to accept the Treasury estimate on the fire——

Mr. GLANDER. You have an entirely different thing, Senator. We know what the income is here. That is the problem in connection with the agricultural cooperatives, which is ascertaining what the income is.

Now, let us add up the tax loss from these several groups:

Farmers', consumers', and retailers' cooperatives	$321, 100, 000
Cooperative financial institutions	487, 000, 000
Mutual fire and casualty insurance companies	70, 000, 000
Total	878, 100, 000

Unlike Mr. Burgess' estimates, I have not included any figures as to the Government-owned corporations, about which I make no estimate.

Senator TAFT. Otherwise, your figures are somewhat higher in each case.

Mr. GLANDER. I think on my basis they are a little higher, but not too much difference, considering the method of approach.

In other words, the revenue loss attributable to these exemptions is approaching a billion dollars a year.

Senator KERR. Now, there is that delightful word "approaching" again. It seems to me we should take it on the same basis as we did a while ago.

Mr. GLANDER. I would say the child has grown a little bit. Eight hundred and seventy-eight million one hundred thousand dollars does approach a billion.

Senator KERR. All right.

Mr. GLANDER. There is another aspect of this matter that needs to be emphasized. It is the tremendous opportunity that income-tax exemptions now afford by way of stimulus to growth. That is amply illustrated by farmers' cooperatives. They no longer consist entirely of small groups of individuals seeking to protect their bargaining position by group action. Some of them, in size, in function and in integrated activity, constitute the most complex kind of business structure. The Tax Institute recently pointed out that a large part of the business of farm cooperative is done by the large centralized and federated cooperatives. According to the Department of Agriculture's 1947–48 survey, a large percentage of the volume of business done is accounted for by some 656 large-scale associations which operate on a regional or even a Nation-wide basis.

Moreover, the rapidity of tax-free growth of cooperatives is remarkable. Consider credit unions, for example. There is little doubt that tax exemptions will permit them to expand rapidly into multimillion-dollar businesses. Already they are in competition with taxpaying commercial institutions in the financial field.

In 1925, according to the Bureau of Labor Statistics, there were approximately 419 credit unions in this country. In 1948, there were 9,329. About half of them were chartered under Federal law and half were State-chartered. Credit union loans increased from $20,100,000——

Senator MILLIKIN. May I ask, are they chartered as corporations?

Mr. GLANDER. Yes, sir, they are set up with a corporate structure. Credit union loans increased from $20,100,000 in 1925 to $633,544,208 in 1948; and the aggregate assets of credit unions in 1948 were just under three-quarters of a billion dollars, passing that mark in 1949.

In my own State of Ohio, during the 5-year period from 1945 through 1949, the assets of State-chartered credit unions more than doubled, while net profits increased over five and one-half times. Sooner or later our taxpaying banks and credit institutions will face the consequences of this governmentally subsidized competition. And in my sincere opinion, the time to remove this mantle of tax immunity is now.

Thus far I have not discussed the argumentative devices by which tax-exempt cooperatives have sought to be differentiated from taxpaying business enterprises. Of course, I have heard all about such terms as "nonprofit," "net margins," "agency relationship," "patronage dividends," "contractual obligations," "rebates," and all the rest. I dismiss these terms because I regard them as the implements of sophistry.

Senator KERR. Now, then, in order that I might understand that, you say you know all about the term "contractual obligations." Would you explain to the committee what that means?

Mr. GLANDER. That has reference to this prior contract which is made by a cooperative and its members, which may be in the bylaws, it may be in the constitution, it may be an actual contract, but it is that prior contract which is always referred to as the basis for exempting patronage dividends. You remember the word "contract" has been used.

Senator KERR. Yes.

Mr. GLANDER. Indeed these arguments have been completely rebutted by authorities in the tax field, and by the staffs of the Treasury and the Joint Committee on Internal Revenue Taxation, to which some reference was made this morning. I cannot resist the temptation to say——

Senator TAFT. You have read these reports in places other than the Chicago Tribune?

Mr. GLANDER. I read those reports in the Columbus newspapers, but I cannot resist making the statement that there is one thing you ought to at least give the Chicago Tribune credit for, and that is for correctly reporting what the Treasury said.

Senator KERR. I want to say that if they correctly reported anything, I would be so shocked that I would be unable to give them credit. [Laughter.]

Mr. GLANDER. Well, at any rate, there is adequate legal authority to support each one of the following propositions:

First, that cooperatives are corporations. They are organized as such.

Second, the Congress does have full power under the Constitution to tax cooperatives as any other corporate entity.

Third, the so-called net margins of cooperatives are nevertheless corporate income against which Congress has the power to levy the income tax.

Fourth, the fact that cooperatives are obligated to provide patronage dividends does not alter the fact that net margins are income to them.

I think this illustration was used before this committee:

It has been argued that a cooperative is an agent for its members in the same sense that if a man sends a boy to the store with a dollar bill to buy a 90-cent item of merchandise for him, and the boy returns with the item and 10 cents in change, the 10 cents cannot be construed as income.

This argument as applied to cooperatives is ridiculous. The relationship between the cooperatives and their members does not contain the legal incidents of agency. Magill and Merrill, in the Michigan Law Review article I have cited, quote Mechem, who is a legal authority on the law of agency, in these words:

> The essence of agency to sell is the delivery of the goods to a person who is to sell them, not as his own property but as the property of the principal, who remains the owner of the goods and who therefore has the right to control the sale to fix the price and terms, to recall the goods, and to demand and receive their proceeds when sold * * * but who has no right to a price for them before sale or unless sold by the agent.

Similarly, Mechem describes an agency to buy as depending on

> Who is to determine of whom, where and to what extent, upon what terms, the goods to be supplied are to be procured.

Senator TAFT. What difference does all that make, Mr. Glander? I cannot see the point. The question of whether we want to—the question of what is a cooperative, I think we know what a cooperative is; the general policy has been approved, the idea of getting a group of farmers together, and letting them act as one in disposing of their goods.

Now, whether they are agents or not agents, or what else they are, I do not see what difference it makes.

Mr. GLANDER. Let me answer that question, and I think that question goes to the heart of the whole problem.

Senator TAFT. I think your argument is that we do not want to have cooperatives. There is no argument——

Mr. GLANDER. No.

Senator TAFT. It seems to me that is the logical result of your conclusion.

Mr. GLANDER. Requiring a corporation to pay taxes does not mean that you are arguing that that corporation should not be permitted to exist.

Senator TAFT. But you are saying it is not a group of farmers acting together, but a corporation.

Mr. GLANDER. It is not; it is a corporation.

Senator TAFT. I say, we have approved a different policy, and every Congress has approved a different policy of saying that this is not a separate corporation. It is, in effect, permitting a certain number of farmers to act together as a unit to sell their goods.

Mr. GLANDER. Congress has approved——

Senator TAFT. So they might get better terms for their sales than if they acted sepatately.

Mr. GLANDER. That is right.

Senator TAFT. That is the concept. It is entirely an independent agency; and it is not an agency, it is something entirely different from the relation of the corporation stockholders, or the relation of a corporation and its ordinary patrons, or the relation of an agent and a principal; it is something different. I do not see any sense in arguing whether or not it is or is not an agency.

Mr. GLANDER. But that argument is advanced by a cooperative as one of the reasons why they are not subject to the corporate income tax, just as they also use the collateral argument that it is a rebate or price adjustment.

Senator TAFT. But Congress says they are not subject. That is why they are not subject to the tax.

Mr. GLANDER. Oh, no. Senator, may I say you expressed this morning the view that some of these unallocated reserves of cooperatives which are not paid out in cash should be or may be subject to taxation.

Senator TAFT. Might be; I did not express that view.

Mr. GLANDER. You raised the suggestion.

Senator TAFT. It seems to me that some of the cooperatives seem to be willing to pay on unallocated reserves.

Mr. GLANDER. There is only theory. If you do not adopt the ordinary cooperative's view, there would be no theory for taxing those except for the fact that the incidence of the corporate tax is upon income earned in the corporate form.

Senator TAFT. No; that is not so. The tax would be based on a theory that anybody who accumulates a reserve in cash ought to pay on the reserve. That has been argued before. It was argued with these other things, and I do not think this agency—I do not want to interrupt you, but I think you are wasting your time.

Mr. GLANDER. I only was answering the argument. If you prefer, I will go on.

Senator MILLIKIN. I am interested in the argument.

Mr. GLANDER. At any rate, to the extent that the cooperatives make use of the agency argument——

Senator MILLIKIN. Your point is, is it not, that you are trying to establish an identity——

Mr. GLANDER. That is right.

Senator MILLIKIN (continuing). Between a business that does business as a corporation——

Mr. GLANDER. That is right.

Senator MILLIKIN (continuing). And has certain tax obligations, and the cooperatives which do business as a corporation, and you are trying to establish an identity from which you argue if one pays taxes——

Mr. GLANDER. That is right.

Senator MILLIKIN (continuing). The other should pay taxes.

Mr. GLANDER. That is right.

Senator MILLIKIN. Now you are discussing those arguments which are advanced to show why the cooperative should not pay taxes.

Mr. GLANDER. That is right.

Senator MILLIKIN. Is that not correct?

Mr. GLANDER. That is exactly what I am trying to do.

Senator MILLIKIN. As Senator Taft points out, they do not pay taxes because we have granted them certain exemptions. The question now is whether the exemptions should be continued.

Mr. GLANDER. That is right.

Senator MILLIKIN. Therefore, it seems to me what you are offering is entirely relevant to the discussion, without evidencing any expression of approval or disapproval.

Mr. GLANDER. That is right.

May I say that we must remember that cooperatives get a far greater exemption than you will find in the statutes. Remember, the Treasury has gone a long way beyond section 101 with respect to these exemptions, because in order to qualify under 101, a cooperative must pay patronage dividends on an equal basis to nonmembers, just as they do to members, and if I may answer one of the questions that was put this morning, I suspect that one of the reasons why cooperatives moved from the exempt form under 101 to the nonexempt basis, is that they can pay dividends to members and not nonmembers, and come out better in view of the Treasury exemptions.

But, at any rate——

Senator MILLIKIN. So far as this last definition by Mechem is concerned, your point, I take it, is concerned with the fact that cooperatives, as such, as principals, earn the taxable income, earn the income, and therefore should be taxed; that is your point, is it not?

Mr. GLANDER. That is exactly my point.

Senator MILLIKIN. The cooperative's argument is that the cooperative is not a principal; that it is simply an agent of the member, is that not correct?

Mr. GLANDER. That is exactly right.

Senator MILLIKIN. All right.

Mr. GLANDER. If you take the method by which net margins are computed, you will see that they are computed exactly like the profits of a corporation which are made available for dividends.

You take your gross receipts in the case of a cooperative, and it includes the payments that are made by members at these tentative

prices, and then you deduct a number of items, such as the cost of goods sold, which, I think, include the payments to members at tentative prices, the marketing or purchasing cost, the manufacturing and processing cost, the administration and the general expenses, and reserves, and after you get those deductions made, if there is anything left it is the difference which is available for patronage dividends, and that is exactly the way the profits of a corporation are computed.

How you can say that one is an agency or one represents a rebate or one represents something else, and that that is different from a private corporation is to me a distinction which I have not been able to make.

Senator TAFT. It seems to me a very clear distinction; one is a cooperative and one is a private company.

Mr. GLANDER. But they are both corporations.

Senator TAFT. That does not make any difference.

Mr. GLANDER. But the incidence of the corporate income tax——

Senator TAFT. They are not principal and agent, nor is the relationship of the corporation to a stockholder the ordinary relationship; it is a cooperative which has a different relationship, and from which you cannot argue one way or the other, it seems to me——

Mr. GLANDER. That is right.

Senator TAFT (continuing). Except on the nature of the business, the nature of the cooperative.

Mr. GLANDER. May I ask, Senator, whether your question is one of the legal relationship or one of policy? I have difficulty in answering your question unless I know.

Senator TAFT. I think it is all one of policy, the substance of what the nature of the cooperative is.

Mr. GLANDER. If it is one of policy, I have no reason for making a legal argument.

Senator TAFT. But it is not an ordinary corporation of stockholders, it is something different from that. Now, how different it is, perhaps—why is it a cooperative? Whether you shall tax it depends on what it is, not that it is an agency, nor if there is any argument I can see that it must be taxed just like a private corporation; that is what you claim, but I say I do not see why it should be.

Mr. GLANDER. I think you will agree with me on one thing, but for those arguments the Treasury would have to tax now the reserves, unallocated reserves.

Senator TAFT. What? They do tax the unallocated reserves.

Senator WILLIAMS. No.

Senator TAFT. Of nonexempt cooperatives.

Senator KERR. Nonexempt cooperatives.

Mr. GLANDER. They would have to tax the patronage dividends I misstated what I meant, but for such arguments as a matter of law now—there is nothing in the statutes that justify it except these arguments, such as the agent-principal relationship, or the rebate idea or the price adjustment theory.

Senator TAFT. The price adjustment theory is the theory. I think that is clear.

Mr. GLANDER. The price adjustment theory is one that you cannot press too far——

Senator TAFT. That is the theory they went on in the Ford case

Mr. GLANDER. I think that is a different matter. That applied to specific transactions.

Senator TAFT. So does this.

Mr. GLANDER. No; it does not. You may have a member with whom the cooperative's transactions were a total loss. He may get a patronage dividend if the aggregate of the transactions showed a profit.

Senator TAFT. Well, the Ford cars were not different. Maybe he made a profit on some and not on others. Maybe he shipped in one place and absorbed the freight, and did not absorb it any place else. I do not think that was the basis of the Ford case, that they had made a profit on that particular car.

Mr. GLANDER. That was a flat rebate.

Senator TAFT. Maybe the Ford Co. did not make any profits at all.

Mr. GLANDER. That is right; that is the point.

Senator TAFT. It was based on volume of business.

Mr. GLANDER. That is where it is different; that is a true rebate, and any corporation can do that, sir.

Senator TAFT. This is not a true rebate; it is a percentage of profits that you make that goes back to the——

Mr. GLANDER. That is the fundamental difference you have, sir, and I cannot agree with the Senator on that.

Senator TAFT. I cannot see any reason why it is not an adjustment in the case where it is paid in cash at the current time within a year when you can find out what the profits are. I think there is an argument on the other question, of course.

Senator MILLIKIN. Ford hung his rebate on whether he made a profit. The legal situation would be exactly the same had he said, "I will give you a rebate if the groundhog shows on groundhog day."

Mr. GLANDER. That is right.

Senator MILLIKIN. The situation would have been exactly the same, legally.

Mr. GLANDER. But the idea of making payments of profits is something different.

Senator TAFT. But if he had said, "If I make a profit of a million dollars a year I will pay $50"——

Mr. GLANDER. No; I do not think it was the same because he was obligated to pay a rebate whether or not he made a profit, and that was the difference.

Senator TAFT. I do not think it is different. The Ford case would be the same as if I said, "If I sell 300,000 cars a year, or if I make a million cars a year"—he figured it the same way, he figured if he could make 300,000 cars, he could afford to give you $50. That was obviously the logic of the move.

Mr. GLANDER. Well, sir, there are some cases that will support the view, if you would note them.

I call attention to the Cleveland Shopping News case, *Cleveland Shopping* v. *Rontzahn* (89 Fed. (2d) 902), which was decided in the Sixth Circuit in 1937.

There you had a case where a newspaper company whose stock was owned by the advertisers, contractually agreed to return the balace of payments in excess of cost to the advertiser-stockholder in proportion to the amount of business transacted, that is, in proportion to the amount of their contributions to the advertising fund; and that was held not deductible as a rebate, but taxable as a distribution of the profits.

The National Carbide case is another good example bearing a little more on the agency argument. That is 336 U. S. 422, and was decided in 1949 by the United States Supreme Court.

There you had a corporation owning a number of subsidiaries, and they had a preliminary contract with those subsidiaries, whereby the subsidiaries were obligated to assign and turn over to the parent corporation all profits in excess of 6 percent of their capital to the parent corporation.

Nevertheless, the court held that the subsidiaries were taxable on their full income, and incidentally, the parent had pretty full control of the subsidiaries in that particular case.

Senator MILLIKIN. Let me ask you if this is true: Were we reconsidering this question of policy, the cooperative says the relations of the members to the corporate cooperative are such that the tax incident does not follow——

Mr. GLANDER. That is their contention.

Senator MILLIKIN (continuing). In the case of the stockholder and the normal corporation?

Mr. GLANDER. That is right.

Senator MILLIKIN. Correct? So, you are devoting yourself to establishing that the relationship between the member and the corporate cooperative is not in fact such as to destroy legally the tax incident.

Mr. GLANDER. That is my position; that is right.

Senator MILLIKIN. No. 1.

Mr. GLANDER. Taxation of corporate income in no case that I know of has been made dependent on how the income is distributed.

Senator MILLIKIN. I just want to find out if that is the real issue so far as the comparison and analogy, if there be one, between the members of the cooperative, a corporate cooperative, and the members of a regular corporation of stockholders—whether that is the line there where we see the field of battle.

Mr. GLANDER. That is exactly what this committee has to resolve on the legal question, and you will have to do that even if you do as Senator Taft suggests: still exempt the cash payments.

Senator MILLIKIN. Yes.

Mr. GLANDER. But tax those particular book entries which are not paid out.

Senator MILLIKIN. Now, as a matter of policy, so far as it concerns this committee and the Congress, assuming that your points were all good—just assume it, the question would then be whether the cooperatives, as they exist, serve in some way the public interest sufficiently to warrant a continuance of the present policy.

Mr. GLANDER. That is exactly correct.

Senator MILLIKIN. Is that not the issue at that point?

Mr. GLANDER. I will comment on that a little bit later here.

Senator TAFT. I could give you some other citations, but I think probably most of these cases have been covered in the brief to which reference was made.

Continuing my statement:

If the person who is to supply them is to determine these matters, then, as stated in one case, "there is nothing characteristic of agency in this."

By these tests, it is clear that the cooperative is not an agent for the sale or purchase of products for its members, and it has been so held.

The truth of the matter is that cooperatives are in the business of producing gain, profit, or income; that such gain, profit or income is no different from that produced by the ordinary business corporation; that the cooperative is in fact an incorporated business organization just like any other corporation engaged in business; and that the members of cooperatives are no different than the shareholders of an ordinary corporation and in most instances are shareholders.

A private corporation seeks to make a gain from its operations, which it calls a "net profit," and it distributes such gain in the form of "dividends." A cooperative seeks to make a gain from its operations, which it calls a "net margin," and it distributes such gain in the form of "patronage dividends." In each case, regardless of who gets what, there is a financial return to the corporate entity engaged in the business operation. There can be no valid reason why one entity should be taxed and the other not taxed.

Now, a word about this policy. Now that these conclusions have been accepted as legally sound, I probably should put in——

Senator KERR. By whom?

Mr. GLANDER. Most of the legal authorities who view this matter now, including the joint staff of the Treasury—there are those who argue that "public policy" supports continuation of tax exemption of cooperatives because of their importance to the economy.

Senator TAFT. The joint staff of the Treasury does not recommend taxation of patronage dividends.

Mr. GLANDER. I do not know what they recommend. I am talking about the legal status.

Senator WILLIAMS. In his testimony the other day, Mr. Snyder recommended, in principle, the amendment which is now pending before the committee. He did not recommend the technical language, but the principle.

Senator KERR. As being legally sound?

Senator WILLIAMS. No; not being a lawyer, I will not get into the quality of the legality of it.

Senator KERR. What I think is that the statements of the witness are assumed, and I am persuaded that the conclusions that he has reached from the assumed statements are about as assumed as the statement upon which they are based, and that is the reason I am asking my question: By whom were they accepted as legally sound? Go ahead.

Mr. GLANDER. Now, a word about the policy. There are those who argue that public policy supports continuation of tax exemption of cooperatives because of their importance to the economy.

This argument, I think, is based upon the obviously false assumption that any organization which is important to the economy should get a tax-free ride. Congress has already seen fit to tax certain income of religious and charitable organizations which, I need not remind you, are also exceedingly important to our society. Moreover, it goes without saying that our private, industrial, and commercial institutions that have adapted the discoveries of science to everyday uses on the farms, in the factories, and in the homes of America are exceedingly important to our economic and social life. They have assisted pro-

duction and distribution of those things which people want and need even more than cooperatives have done; and, yet, they pay taxes. There are millions of investors in this country—widows, children, aged and retired persons—who are dependent upon these taxpaying institutions for their personal income, and they pay taxes on that also.

This income gets taxed in the hands of the corporate concern and it gets taxed in their own hands, and yet they are supporting the free-enterprise system in this country, and I say the tax exemption for cooperatives is, especially in the 1950 decade, tax discrimination against it.

Senator Kerr, I think this morning you made some reference or asked a witness a question about how States may treat cooperatives, or perhaps it was one other.

Out in our State of Ohio we now tax cooperatives like any other form of business organization.

Four years ago we enacted legislation to remove the last vestige of tax exemption previously granted to them.

Senator KERR. How many States do that?

Mr. GLANDER. I do not know, except Ohio.

Senator WILLIAMS. North Carolina passed legislation last year.

Senator KERR. I think North Carolina does it, not with reference to the amounts that were distributed in patronage refunds but with reference to the retained——

Senator WILLIAMS. I do not know what it was.

Senator TAFT. That question does not arise in Ohio; does it?

Mr. GLANDER. Prior to the amendment I mentioned here, cooperatives were charged an annual $10 fee in lieu of all franchise or license taxes.

I appeared before the taxation committees of our general assembly, as tax commissioner, in support of a bill to subject cooperatives to our corporation-franchise tax on the same basis as private corporations for profit.

That bill was enacted by the General Assembly.

Senator TAFT. I mean there is no corporation-income tax in Ohio so, the question does not arise.

Mr. GLANDER. We do not have an income-tax question.

Senator TAFT. That is right. It does not arise with reference to net income.

Mr. GLANDER. Right. But they did have tax exemption, though, from other taxes.

Senator TAFT. Yes: that is right.

Senator KERR. They do not pay an income tax in Ohio?

Mr. GLANDER. We do not have an income tax in Ohio.

Senator TAFT. The occasion does not arise to determine what is net income, as to whether it is patronage dividends or not.

Mr. GLANDER. No; we have not——

Senator KERR. The reason I asked this morning if there was a State in the Union that taxed income from cooperatives——

Mr. GLANDER. I see; I misunderstood.

Now, the supreme court in our State in property-tax matters has refused to be sidetracked by terminology and has taken a view which is pertinent by way of analogy here. Just because a corporation is organized not for profit, or is called a nonprofit corporation, provides no immunity from taxation.

Senator MILLIKIN. Have you passed from the question of policy?

Mr. GLANDER. Yes.

Senator MILLIKIN. Had you finished your discussion on that?

Mr. GLANDER. I was just about to close on that.

Senator MILLIKIN. I would like to ask you a question or two on that subject. I think that the cooperatives could produce at least earlier history where the farmer had been badly gouged ——

Mr. GLANDER. I think that is right.

Senator MILLIKIN (continuing). By private enterprises. I do not think there is any question but at the time that Congress went into the cooperative field and granted certain exemptions there had been a demonstrable history of gouging of the farmer; and the cooperative claims, as I understand it, that by permitting these tax exemptions they are in position to maintain a yardstick against gouging, and they are in position to control their prices for the things they buy and sell. From the standpoint of public policy, you do not believe that those arguments balance the tax exemption?

Mr. GLANDER. I do not know, sir; I think they are rationalizations.

Senator WILLIAMS. Of course, at the time Congress passed that and allowed the exemptions, corporation rates were about 2 percent.

Mr. GLANDER. That is right.

Senator WILLIAMS. Whereas they are——

Mr. GLANDER. Approaching 50 effectively.

Senator WILLIAMS. Forty-seven percent. I do not know what they will be next year.

Mr. GLANDER. They will be about 50 percent under the proposed bill.

Senator MILLIKIN. You claim that time has passed when the original causes were active and might have justified this particular public policy?

Mr. GLANDER. That is my position on policy.

Senator MILLIKIN. You are saying those times have passed?

Mr. GLANDER. And I can say I feel that very sincerely.

Senator MILLIKIN. You say, as Senator Williams points out, that with increasing taxes on corporations the unfairness of the discrimination, if there be one, operates oppressively and unjustly on the private corporations?

Mr. GLANDER. Yes, sir.

Senator MILLIKIN. Is that correct?

Mr. GLANDER. That is my position.

Now, just one thing more and I am through. I did want to mention that the supreme court of our State in property-tax matters has taken the view, which is somewhat pertinent by way of analogy here, that just because you have a corporation which is organized not for profit—is called a nonprofit corporation—provides no immunity.

Our court has held that when a nonprofit corporation enters the private competitive field for gain, profit, or income, even though no private persons share in that income, it forfeits its right to tax exemption. That kind of tax policy promotes fair competition and equal treatment for all who do business under the protection of Government.

They recently applied that doctrine to the American Jersey Cattle Club, which has a worth-while purpose, just as worthy, I think, as cooperatives.

Senator TAFT. It was also applied to the housing projects in Ohio owned by public corporations.

The Supreme Court of Ohio has gone farther in removing tax-exemption than any other court in the United States.

Mr. GLANDER. That is right.

Senator TAFT. That is applying our constitution.

Mr. GLANDER. That is right.

Senator MILLIKIN. I regret that I could not be here; so, I did not hear the earlier part of your statement. Therefore, I would like to ask you this: Have you drawn any distinction between the tax-exempt and the non-tax-exempt cooperatives so far as your condemnations are concerned?

Mr. GLANDER. No, sir.

Senator MILLIKIN. In your mind they are both equally

Mr. GLANDER. Yes, sir.

Senator MILLIKIN. Both of them represent an unfair tax discrimination——

Mr. GLANDER. That is my position.

Senator MILLIKIN (continuing). Against the regular business of a corporation.

Mr. GLANDER. And unnecessary; I do not think it is a necessary break for them now.

I am confident that the great majority of the citizens and voters of this country, the men and women in every State who built and own our great industrial system, who are expected to keep alive the great free-enterprise system, and who are paying taxes to preserve it, believe that cooperatives should be taxed now; and I have never heard a single person in all my 6 years of public experience as tax commissioner, who was not connected with a cooperative, who took any other position.

They say to you in all earnestness right now that no additional taxes should be heaped upon the backs of those now bearing the already crushing tax burden in this country until those now escaping taxation are required to bear their fair share of that burden.

That is the end of my statement.

Senator BYRD. Thank you very much.

Mr. GLANDER. Thank you, sir.

Senator BYRD. The Chair is informed that Mr. Donald Lloyd, representing the Cooperative Food Distributors of America, has to catch a plane, and the Chair does not wish to invonvenience the other two witnesses, but we would like to put Mr. Lloyd on, have him testify now. He will not exceed 15 minutes. Is that understood, Mr. Lloyd?

Mr. LLOYD. Yes, sir.

Senator BYRD. You may proceed.

Senator KERR. Who is this, Mr. Chairman?

Senator BYRD. Mr. Donald P. Lloyd, of the Cooperative Food Distributors of America.

STATEMENT OF DONALD P. LLOYD, COOPERATIVE FOOD DISTRIBUTORS OF AMERICA

Mr. LLOYD. Mr. Chairman and members of the committee, as has been indicated, my name is Lloyd. I am the manager of the Asso-

ciated Food Stores, Inc., which is a retailer-owned wholesale grocery company, located in Salt Lake City, Utah.

My company is also a member of the Cooperative Food Distributors of America, Chicago, Ill., which is the national trade association of retailer-owned wholesale grocers.

We represent the interest of 24,000 retail stores employing thousands of people in every State of the United States. It is in my capacity as a representative of the Cooperative Food Distributors that I appear before you today.

To the best of my knowledge this is the first time that our organizations or our part of the food industry has appeared before any congressional committee to explain our position on this question.

Now, in the interest of time, I am going to vary from the prepared copy of my testimony—it may be a little difficult for those who are reading to follow me.

Senator BYRD. You desire your full statement inserted in the record?

Mr. LLOYD. I would like to have the full statement inserted in the record.

Senator BYRD. You may do so.

Mr. LLOYD. It has been a fundamental concept of the American economy that the small-business man is our basic economic unit; that if he disappears into the maw of the giant corporations, we will be well on our way toward a socialistic or Fascist state.

I do not pretend to be an economist. I am simply a grocery man, but I do know that the Congress of the United States has passed numerous pieces of legislation to try to assure the continuing independence of the small-business man.

We, in the grocery business are grateful for such legislation, but at the same time we feel that the old axiom that God helps those who help themselves is as true in our line of business as in any other.

It is in line with that theory that the entire retailer-owned wholesale movement in the food business had its origin nearly 50 years ago in this country.

The retail grocer at that time was unable to purchase merchandise at prices which would enable him to retail and become competitive with the chain stores of that day.

The wholesale grocers were then operating with a high cost of doing business and high mark-ups, which varied according to the customers that they sold to.

The average retailer paid the higher price, while those who had substantial volume received lower prices in many cases; the chain organizations in particular received more favorable consideration.

Wholesale grocers at that time catered to the chains with special concessions; that was before manufacturers had recognized chains as direct buyers. Now, in order to meet this competition, individual retailers banded together. They grouped their resources, they bought merchandise direct from manufacturers, but in most instances manufacturers refused to sell to them.

Wholesale grocers prevailed upon manufacturers not to recognize as direct buyers these new retail concerns. These wholesalers were successful until such time as the retail groups became strong enough to demand recognition.

Short-sighted wholesalers discriminated against the smaller retailers; eventually, however, they found themselves weakened and discontinuing business in many cases because of these policies.

Cooperating retailers continued to expand; continued to increase volume; began to get an increasing share of the market.

They developed new stores; supermarkets came into being then. All the advantages of quantity buying became available to the average retailer who became a part of these retailer-owned wholesale organizations.

The problem of the independent was simply one of self-preservation. He had one of a few choices: Either to go out of business entirely, have his business curtailed so that he could not make a living out of it, or seek some cooperative endeavor with other merchants so as to be in a position to buy quantities of merchandise through one distributing unit on an equal basis with all retailers and thus meet competition.

The retailer-owned wholesale grocery companies have grown and developed because they have been efficient. In most cases they are operating in modern warehouses, using the best in handling equipment, rendering different forms of services, and working closely with manufacturers of food products, who like the distribution that is offered to them by these retailer-owned grocery companies.

The primary reason for the continued existence of retailer-owned wholesale warehouses is to keep the small-business man in business.

They are organized to help preserve small business and make merchandies available on the same cost basis to all merchants—small or large.

It is the spirit of equality in competition for the small independent that is the basis and justification for the existing retailer-owned wholesale warehouse.

Now, with this general historical background in mind, I think the committee may be interested in exactly how one of these retailer-owned wholesale grocers operates and how it came into existence.

Our company started in the State of Utah 11 years ago. At that time large direct buyers in the retail food business, including the national chains, had the individual smaller merchants of our area on the run.

These individuals were buying from our local proprietary grocers at prices that made it impossible for them to compete with the direct buyers.

They tried various plans of group buying with little or no success. What they saved on purchases of one item was often lost on overcharges on other items and, besides that, they found by comparing invoices that they were usually charged whatever the traffic would bear.

Merchants of comparable size were paying as much as 10-percent difference on their purchases of the same item in the same quantity on the same day.

Senator Byrd. I am sorry, we will have to recess to go to the floor for a few minutes.

(A brief recess was taken.)

Senator Byrd. Go ahead.

Mr. Lloyd. Mr. Chairman, I was discussing the organization of our retailer-owned wholesale house in Utah which was organized 11 years ago, and I was talking about how merchants of comparable

size were paying as much as 10-percent difference on their purchases of the same item in the same quantity on the same day.

I know that because I sat in on numerous meetings where invoices were compared. That was how the wholesale grocery business was done in Utah before those independent merchants finally decided that if they were ever going to compete with the direct buyers they would have to go into the wholesale grocery business for themselves, and that is exactly what we did.

We organized a retailer-owned wholesale grocery company. We invited every good retail food merchant in our area to join with us in establishing a wholesale grocery company operated without profit, and at the lowest cost of doing business that we could possibly attain.

We started small, and it took us several years to become firmly established, but from the very beginning of our operations we made and kept our member stores competitive on their buying—competitive with the larger operators in the field.

Each member of our firm owns one share of stock. All the stock is owned by active retail merchants. We lease and operate a modern, streamlined, mechanized warehouse in Salt Lake today.

With the cooperation of the members we have been able to keep our costs down to a minimum. The savings accomplished by this kind of operation have been passed on to our members, thus enabling them to meet their toughest competition and, in turn, to pass the savings on to the consumer.

Then after we became established in Utah, a group of individual merchants in southern Idaho asked for our help in establishing a similar organization there. That was in 1945.

These Idaho merchants were faced with exactly the same proposition we had had at the outset in Utah. They were gradually being crowded out of the grocery business by the large direct buyers, including the chains.

We invited them to join with us as part of our organization, and a branch house was established in Pocatello, Idaho, to serve the members there.

Today these Idaho merchants own their groceries at competitive prices, and they are now competing on an equal footing with the direct buyers.

Then again last year we repeated this experience in still another area. Western Montana was one of the few remaining markets in the country without a retailer-owned wholesale grocery company. Wholesale grocery margins were high, and it was impossible for the rank and file of the trade to pay these mark-ups and stay in business.

Then a group of these retailers appealed to us for help and today we have a well-operated, efficient wholesale house in Helena, 100 percent owned and operated by the retailers; and today those retailers are meeting the competition of the largest operators in that State.

I feel sure that this same story could be told of the development of the retailer-owned movement in each of the 117 areas where Cooperative Food Distributors of America has member houses.

From this description you can see that we perform exactly the same function as any wholesale grocer, with one exception; this exception is that we are not in business to make a corporate profit in our wholesaling function. We are in business to give the benefit of mass purchasing power to our individual ratailer members and the consuming

public. This is our method of guaranteeing an equal opportunity to the independent grocer to remain in business side by side with the giant of the food industry. Everyone benefits by this cooperative effort.

The farmer has a larger competitive market in which he can sell the product of his toils. Labor gains in fruitful employment. Small business is preserved, and the consuming public gets the benefit of efficient distribution in the form of lower prices, and we are obligated to return income over and above actual operating costs to our patron members.

Our bylaws provide that all moneys received over and above operating costs shall be set down as a liability of the corporation due and payable to all members based upon the percentage of purchases.

You will see from this that on our sales to members we make no taxable income because we are obligated to return overcharges to the membership each year.

Under these circumstances, it is difficult for us to understand why our method of doing business is subject to question.

Senator KERR. Do you return those overages, overcharges in cash each year?

Mr. LLOYD. I have a comment on that just a little later, Senator, if I may.

Senator KERR. All right.

Senator WILLIAMS. Are you classified as tax-exempt or non-tax-exempt?

Mr. LLOYD. We do not operate under section 101.

Senator WILLIAMS. That is what I mean.

Senator TAFT. You are not tax-exempt?

Mr. LLOYD. No.

Senator WILLIAMS. Yes.

Mr. LLOYD. The members of the Cooperative Food Distributors of America are not tax-exempt cooperatives as defined in section 101 (12) of the Internal Revenue Code.

We have no tax exemption. We pay a Federal income tax on net corporate income just as everyone else does.

But insofar as overcharges on sales to members are concerned, a retailer-owned wholesaler is simply a means by which those moneys are returned to the retailer members.

Senator KERR. I have a question there: Are you familiar with the structure of the so-called investment trusts?

Mr. LLOYD. No, sir.

Senator KERR. Whereby they operate as a general agent or general vehicle to buy investments for members and receive profits which pass through their hands right on through to the hands of those who furnish the money—pass on directly without any tax to the investment company?

Mr. LLOYD. I am sorry, I am not familiar with that operation.

Senator KERR. You are not familiar with that operation?

Senator WILLIAMS. I think it is required in that instance that the money be passed on through; is it not?

Senator KERR. Yes; I think so.

Senator WILLIAMS. Yes.

Mr. LLOYD. Let us emphasize this point, that the individual retailer's share of these moneys is taxable to that individual and must be treated as such by him.

Senator TAFT. Assuming he makes a profit; is that not so?
Mr. LLOYD. That is right.
Senator TAFT. If he does not make a profit he is not taxed?
Mr. LLOYD. That is right.
Senator TAFT. It is not taxable separately as a dividend or anything like that.
Mr. LLOYD. No; it goes into his regular income.
In addition to that, I think it is only proper to comment that to the extent that collective buying and efficient distribution results in lower prices and lower operating costs, the result is higher income to the patrons or lower prices to the consumers. These increased earnings to patrons enter into their taxable income.
I think that you gentlemen can see that what we try to do as cooperative wholesale grocers is to pass on the savings resulting from efficient operation to our retailer members.
We buy our merchandise from normal sources. We estimate our cost of operation from time to time and our mark-ups are based on this estimate. We refund overcharges at the end of the year to bring our operation down to the cost level, because it is the most expeditious and most businesslike way to operate for us.
If patronage refunds are included as income of cooperative cooperations, and taxed as such, the almost inevitable effect of such action would be for us to eliminate or greatly curtail our operating margins on original sales.
A situation of this kind would not be of our choosing. Speaking frankly, it would be difficult to make adjustment on individual sales; and just as frankly, we do not wish to operate on a dangerous, senseless, price-cutting basis.
There has been a proposal made by Senator Williams, who is a member of this committee, for a special cooperative tax classification.
This proposal is made in S. 892, and is proposed as an amendment to the first tax bill which comes to the Senate from the House.
The measure involves a number of points, but the most important provisions of the proposed amendment, as far as we are concerned, provides that a cooperative cannot exclude patronage refunds paid or payable to its patron in computing the cooperatives' net income for Federal tax purposes, unless during taxable years——
Senator WILLIAMS. May I interrupt you at that point? You are somewhat in error, because that amendment does exclude from taxes those patronage dividends which would be paid in cash.
Mr. LLOYD. Yes. I was just coming to that, Senator. I was saying that it does not exclude them unless during the taxable year the cooperative dealt exclusively with its members, and the patronage refunds were paid in money exclusively not later than 60 days after the close of the taxable year, and there were no conditions, either precedent or subsequent, as to the application or use of such money by the members.
Senator WILLIAMS. Yes. Well, you say that those are the two major points in that amendment that you object to. Just how would that No. 1 restrict your operations?
Mr. LLOYD. I think that is next in my presentation here, Senator.
Senator WILLIAMS. All right.
Mr. LLOYD. We are aware that Senator Williams is trying sincerely to remedy what he believes to be an inequity, but we cannot help but

feel that as far as we are concerned, his language is punitive in the extreme, and will not produce a substantial increase in revenue.

With reference to the portion of Senator Williams' bill which would require the cooperative to deal exclusively with its members, we would like to respectfully point out to the Senator that we now pay income taxes on profits from sales to nonmembers, so this proposal would produce no additional tax income from our type of operation.

There are times when it is both expedient and necessary to sell to nonmembers because of certain pressures of the type of business which we operate. An example lies in the field of perishable commodities, where it becomes necessary to sell to nonmembers in order to prevent spoilage.

Senator WILLIAMS. I might point out to you that that same objection was raised by one or two other cooperatives.

If you will notice this year's amendment, it has been modified, whereby a cooperative can define its own type of membership, and we have one large cooperative in the East which defines as a member any individual who makes a purchase from that cooperative, so it is broad enough to include and can include anyone that they do business with under the terms of that language, and it would not restrict them.

In other words, you could put a similar definition under that amendment——

Mr. LLOYD. Yes, sir.

Senator WILLIAMS (continuing). And qualify under it. The only thing is that it would provide that John Jones would get his proportionate part of the refund just the same as John Doe did over on the other side. You would have to refund to all of them, but it would not restrict you.

I think you would agree with me that a redefinition of your membership, if you have one that would not come under that classification, is possible.

Mr. LLOYD. Yes.

Senator WILLIAMS. I know it was so intended at the time, because the amendment was drawn as best we could, with no intention of restricting a cooperative from being able to operate, and I recognize the problem that you would have, but I think the language of the amendment is such that it could be taken as providing for you under the provisions of the amendment.

Mr. LLOYD. Well, there is one angle there that would concern us some.

Mr. RAYMOND R. DICKEY. Senator, has your bill been amended?

Senator WILLIAMS. I am speaking of the amendment to the bill.

Mr. DICKEY. Yes, sir; on the amendment to this bill.

Senator WILLIAMS. The amendment that applies to the bill before us now requires a cooperative can set out its own definition of a member.

Mr. DICKEY. Section supplement 5, section 431 (a), I think it is (a) (26).

Senator WILLIAMS. May I see the bill that you have there?

Mr. DICKEY. Just the definition of a member here; is that the one you are talking about, sir?

Senator WILLIAMS. It has been amended to take care of that.

Mr. DICKEY. I see.

Senator WILLIAMS. Regardless of that.

Mr. LLOYD. That amendment would permit cooperatives——

Senator WILLIAMS. To define their type of membership. The original proposal, if I am not mistaken, was that a member had to be one who had a certain amount of money invested, and we tried to define it, but it would place a restriction upon it that you would have to refund to those people the amount of money earned on that.

Mr. LLOYD. Yes.

Senator WILLIAMS. Which I think they are entitled to.

Mr. LLOYD. It would give us a financing problem that would be rather difficult, though, because today we do business with members and nonmembers. However, to become a member, a merchant must put up money for a share of stock.

Senator WILLIAMS. I think, though—I mean, it is a matter of opinion, but it was my opinion that if you do business with a man you should refund to him, if you are going to be a nonprofit organization, your profit, if you were to be a nonprofit organization in the true sense of the word; but if you are going to do business with a man, an individual, just the same as an individual in private industry and make money on him, you should pay taxes. This amendment proposed if you are going to refund to the individual, if you are going to be a nonprofit organization, that you should distribute the profits to those from whom they were earned.

Mr. LLOYD. Thank you.

The next part refers to the 60-day cash refund provision. I should like to give you an example of what this would mean to our particular business.

Some years back, when we needed a means of financing our operations, our retailer members voted to accept their overcharge refunds in the form of 5-year interest-bearing debentures. This system has been voted continuously by our retailer-members since the establishment of our company in 1940. As these debentures have come due, we have paid them in full in cash, both principal and interest.

Senator TAFT. Where did you get the money to pay them? If you distributed all profits, how did you have any money left to pay them?

Mr. LLOYD. By holding the earnings in these debentures for 5 years' time until they accumulated to a point where we were able to pay them at the end of a 5-year period.

Senator MILLIKIN. You established a sort of sinking fund to take care of those debentures?

Mr. LLOYD. Yes, sir.

Senator TAFT. I thought all the profits in the business had to be distributed, unless they were so voted, so where did you get the money?

Mr. LLOYD. The members have voted each year to invest the rebates they received in the patronage certificates of deposit due 5 years from date, so we have the use of that money for 5 years.

Senator TAFT. I understand that. You have the use of their money. I still do not understand how you finally pay them. You cannot pay them out of profits, because you have to distribute the profits; do you not? Is that not what you said?

Senator WILLIAMS. They are not distributing the profits. You are, in reality, doing—the method under which you are operating is that you are 5 years later distributing the profits.

Mr. LLOYD. Yes, sir.

Senator KERR. And you pay interest on the outstanding debentures out of the profit before the amount due the members is figured; do you not?

Mr. LLOYD. That interest is part of our operating cost.

Senator WILLIAMS. And the individual members of your organization are paying the tax on something 5 years before they get it.

Mr. LLOYD. That is right.

Senator KERR. So what it amounts to is that you are just using——

Mr. LLOYD. We are using their money——

Senator KERR (continuing). The money of your member owners for a period of 5 years, and then you pay it to them, and in the meantime you have paid them the interest, and you charge that up to the operating cost?

Mr. LLOYD. That is right, Senator.

Senator WILLIAMS. You recognize that there is a possibility that with business risk being what it is you could operate for that 5 years, and at the end of the 5 years you could go bankrupt, in which event you would not be able to pay off.

Mr. LLOYD. I suppose that would be a possibility.

Senator WILLIAMS. It is possible. I do not mean any reflection, but it is possible, and, of course, then it would——

Mr. LLOYD. Of course, our members voluntarily do this. They are willing to assume this risk.

Senator WILLIAMS. But it would be a case where they would have paid taxes over a period of 5 years——

Mr. LLOYD. We feel that we save them much more than enough to pay their taxes; otherwise our business just simply would not be justified.

Senator WILLIAMS. What percentage of your earnings do you refund in cash, and what percentage do you refund in this scrip?

Mr. LLOYD. All of the overcharges have been declared as due and payable at the close of each taxable year, and they have been paid to the members as 5-year debentures.

Senator WILLIAMS. In other words, it has all been in scrip?

Mr. LLOYD. That is right.

Senator TAFT. You say "our bylaws," and that is what bothered me. You must pay the debentures in 1 year out of the profits made 5 years later, but you do not have to pay out at that time, because you take debentures for them?

Mr. LLOYD. That is right.

Senator TAFT. And above all operating costs that should be set down as a liability of the corporation due and payable to all members.

Mr. LLOYD. That is right.

Senator TAFT. So what you really have is kind of a continuing revolving loan——

Mr. LLOYD. That is right.

Senator TAFT (continuing). Of an amount equal to 5 years' profits, the last year's profits from your members, which you then invest in this warehouse; is that where the money came from to build the warehouse that you speak of?

Mr. LLOYD. Well, we are leasing our warehouse, so the money is invested in inventory, equipment.

Senator TAFT. Working capital?

Mr. LLOYD. Yes, sir; working capital.

Senator WILLIAMS. Are those debentures that you are issuing negotiable pieces of paper, or only subject to redemption by the company?

Mr. LLOYD. They can be negotiated with the approval of the Board of Directors.

Senator WILLIAMS. Not without their approval?

Mr. LLOYD. That is right.

Senator WILLIAMS. In other words, if John Doe has $1,000 worth of these debentures, he just cannot sell them without first getting your consent, and your putting the price on them?

Mr. LLOYD. That is right, sir.

Senator TAFT. Now, in the vote, if some percentage of the members vote to accept debentures instead of cash, that is binding on all those, even those who vote against accepting it in debentures, and accepting it in cash?

Mr. LLOYD. That is right. We have always had unanimous votes on that, Senator.

Senator TAFT. But the man has no choice to take either cash or debentures, the member?

Mr. LLOYD. Yes, the member would have a choice.

Senator WILLIAMS. Do you give him a choice?

Mr. LLOYD. At the time the dividend is declared, those members, if they insisted on the cash at that time, it would be paid to them.

Senator WILLIAMS. Then, in that event, this adoption of this provision that in order to get the exemption it would have to be paid in cash, would not affect your organization if you are willing to pay in cash anyway, if they wanted to receive it, because if they do not want the cash they could reinvest it anyhow.

Mr. LLOYD. They could, but I think that amendment would make it so binding that there would be no alternative.

Senator WILLIAMS. It would be merely binding upon you to offer the cash, and send them a check, and then if you can talk them out of it later, that would be——

Mr. LLOYD. It is a little easier for us to talk them out of it in advance.

Senator WILLIAMS. This way you do not have to ask them. You can tell them, and the other way you would have to ask them, that is the difference.

Senator KERR. If you had to do it that way, you might be confronted with the alternative of spending the time talking them out of it when you could be spending the time in having the money reinvested in the business, and making a profit.

Mr. LLOYD. That is a good statement.

Senator MILLIKIN. Let me ask you this: So far as the decision goes to make these debentures, is that a decision which is voted upon by a majority of the members, or is it a decision which is only binding on the individual? The individual, for example, who does not agree to do that, is he entitled to cash?

Mr. LLOYD. He would be; yes.

Senator MILLIKIN. Is that a matter of a right, or a matter of a privilege under your organization?

Mr. LLOYD. It is a matter of a policy.

Senator MILLIKIN. Is it a matter of policy? Is it determined by the members or by the officials of the cooperative?

Mr. LLOYD. By the members.

Senator MILLIKIN. By the members?

Mr. LLOYD. That is right.

Senator MILLIKIN. Has that been determined so that the other man can get his cash if he insists upon it?

Mr. LLOYD. None of our members have asked for the cash yet. We have had so much need for operating capital, that the members have voluntarily voted unanimously to leave the money in for a period of 5 years.

Senator MILLIKIN. But if they did not—if someone insisted on cash, would he have the right to cash as a matter of right?

Mr. LLOYD. Yes; I would say so.

Senator TAFT. I notice that the Treasury in its report recommends, at least the Joint Staff and Treasury recommendation makes a distinction for deductions for dividends paid in cash or merchandise or so payable at the option of the patron in proportion to patronage, so somebody has suggested that that factor as to whether or not they can get it in cash should become a determining factor in taxation, so it is important to know.

Mr. LLOYD. That is right.

Senator WILLIAMS. Yours is not payable in cash at the option of the member unless the board of directors voluntarily decide to give it to him.

Mr. LLOYD. It is entirely up to the stockholder.

Senator WILLIAMS. Any individual stockholder can ask for his money any time? In other words, suppose all of the stockholders—you are 5 years behind now—suppose they decided that they wanted their money today. Would they have a right to ask for it, or is the corporation obligated to pay them today?

Mr. LLOYD. No; because in the meantime they have accepted these 5-year debentures, and the debenture has a maturity date on it, on which the money is then payable. If at the time a dividend is declared, a stockholder refused a debenture, and asked for the cash, it would be our policy to pay the cash.

Senator WILLIAMS. It would be your policy, but is it in the bylaws that you have to do it?

Senator KERR. He would have to do it?

Mr. LLOYD. Yes.

Senator WILLIAMS. Is it in your bylaws that you would have to do it? I do not question what would be done, what you would do; I am just asking whether it is in the rules that if he would want it that way, they would have to do it. Is part of the contract where he can take it to court and make you do it, if the board of directors said, "No"?

Mr. LLOYD. The bylaws only provide that we will return these overcharges at the end of the year, and they will be shown on the books of the company as a liability.

Senator WILLIAMS. And it would be discretionary with the board of directors?

Mr. LLOYD. Not with the board—with the members. The board has no discretion on it.

Senator WILLIAMS. When did you say you started your organization?

Mr. LLOYD. In 1940.

Senator WILLIAMS. 1940. How much was the paid-in capital at that time?

Mr. LLOYD. I think our paid-in capital at the beginning was about $25,000.

Senator WILLIAMS. How much additional paid-in capital have you added during the ten-year period?

Mr. LLOYD. We have now $250,000 paid-in capital.

Senator WILLIAMS. You paid in $250,000?

Mr. LLOYD. Yes, sir.

This increase in capital was due solely and exclusively to an increase in the membership if the company. Each retailer member of the company purchases one share of stock having a par value of $1,000. When the company started in business in 1940 it had 25 members who paid in $25,000. It now has approximately 250 members who have paid in approximately $250,000. The company has never used patronage refunds to increase its capital structure.

Senator WILLIAMS. What is the net worth of your business today?

Mr. LLOYD. About $700,000.

The $700,000 figure is the total of this company's subscribed capital, surplus, and undistributed patronage refunds as shown on the company's books at the time of the last annual audit. This last annual audit was prior to the annual meeting, where refunds were paid in 5-year debentures and thus became liabilities. The actual net worth of the corporation at this time is approximately $125,000, which represents all the net profit the company has made, after taxes, in its 11 years of operation plus donated surplus, which comes from initiation fees charged all new members.

Senator WILLIAMS. You paid no corporation taxes at all during that period?

Mr. LLOYD. Yes; we have always paid corporation taxes on the net profits of the company.

Senator WILLIAMS. On the net profits, not that portion which is distributed in patronage dividends?

Mr. LLOYD. No.

Senator TAFT. How can you have any net profits if the bylaws require that you pay them all out?

Mr. LLOYD. Well, we have an accrual on business done with nonmembers.

Senator TAFT. Business done with nonmembers?

Mr. LLOYD. Yes.

Senator TAFT. I see.

Senator WILLIAMS. What percentage of your business is done with nonmembers?

Mr. LLOYD. It has varied from year to year. At the present time it is about 10 percent.

Senator WILLIAMS. Then, the bulk of this accumulation is as the result of the earnings of the members?

Mr. LLOYD. Yes.

Senator MILLIKIN. Is the condition of the membership that one agrees to take these debentures?

Mr. LLOYD. No.

Senator MILLIKIN. I am advised that many cooperatives do have that as a condition to membership. Can you comment on that?

Mr. LLOYD. No. There is no requirement on that at all.

Senator MILLIKIN. It is not in your organization?

Mr. LLOYD. No. I have about one concluding paragraph here.

Senator Williams' bill would require us to pay overcharge refunds on each year's business within 60 days of the end of the taxable year.

Now, this double burden would have serious consequences for us.

Senator WILLIAMS. When do you compute your debenture payments?

Mr. LLOYD. At the end of the taxable year.

Senator WILLIAMS. At the end of the taxable year?

Mr. LLOYD. Yes.

Senator WILLIAMS. Do you figure up at that time how much you owe each member?

Mr. LLOYD. That is right.

Senator WILLIAMS. In what way would the 60-day provision provide for you a restriction except from the standpoint of whether you should pay it in cash or not?

Mr. LLOYD. We would have to pay if that provision were enacted now, we would have a double burden each year to pay, those in cash that accumulate this year, as well as those that accumulated 5 years ago, and are represented by the debentures.

Senator WILLIAMS. No; this would not. You would only have this 1 year. You are speaking about catching up on your back——

Mr. LLOYD. Yes; we would have it for the next 5 years.

Senator WILLIAMS. That would be a burden from the standpoint of raising cash?

Mr. LLOYD. Oh, yes.

Senator WILLIAMS. Yes; I said that. I thought that you said from the standpoint of accounting.

Mr. LLOYD. In fact, I cannot see how we could finance the continuation of our operations. Our only source of capital is from the members of our group.

We simply do not have, and cannot get enough, capital to maintain regular essential operations, and at the same time assume a burden of double payment of patronage refunds. Our only recourse under these conditions might be liquidation.

Senator WILLIAMS. You are speaking of double payment of patronage dividend refunds; that is because you have not been paying, is that the double?

Mr. LLOYD. That is right. We have to use these accumulated refunds for operating capital.

Senator WILLIAMS. Of course, you recognize that we are getting the same argument from every businessman.

Mr. LLOYD. We have no other source of income whatever; we have no other source of operating capital whatever.

Senator MILLIKIN. May I ask you, so far as the funds are concerned with which to pay these debentures, you set aside a certain portion of your income, you earmark it for that purpose, or do those moneys become commingled with your other moneys, and simply represent a general charge against the company?

Mr. LLOYD. That is right.

Senator MILLIKIN. They do represent a general charge?

Mr. LLOYD. Yes.

Senator MILLIKIN. And become commingled with other funds?

Mr. LLOYD. Yes.

Senator MILLIKIN. And you do not earmark those funds and set them aside into a special sinking fund or something of that kind to take care of the debentures?

Mr. LLOYD. That is right.

Now, in the event this were to happen, the retailers depending upon our operation would then be set back to a noncompetitive position, and we fear extinction as independent merchants.

Senator WILLIAMS. Do I take it from that that the only savings that you have been able to give to your members in the 10 years you have been organized are the savings you have passed on down to them as the result of the tax exemption?

Mr. LLOYD. Oh, no.

Senator WILLIAMS. That is what I thought. You cannot justify your existence on the tax exemption that you save on.

Mr. LLOYD. To continue to operate we would have to continue to have operating capital.

Senator WILLIAMS. You would then be in the same boat as any other individual. Anyone, to operate, whether it is a cooperative or not, needs capital, and the same sources are open to them.

Mr. LLOYD. But, if we were to operate a proprietary wholesale corporation and the money were to be advanced by private investors, it would be necessary for us to return a profit on that investment to those investors instead of to the patrons who get it now, and that would make it virtually impossible—I would say absolutely impossible—for us to keep our stores competitive with the type of competition they have.

Senator WILLIAMS. I thought you said your members were all voluntarily underwriting these debentures, in which event, if they were voluntarily underwriting them now and accepting them, why could you not voluntarily underwrite your cost of carrying on business?

Mr. LLOYD. I think there would be quite a practical difference, Senator, if we were required by law, by statute, to return those rebates in cash.

Senator MILLIKIN. Supposing a corporation—I never heard of its being done—but supposing a carporation declared a dividend but prior to the distribution of the dividend circulated its stockholders and said, "We would like to have you leave this money with the company and purchase bonds or debentures of some kind." Is there any difference in principle?

Mr. LLOYD. Yes; I think there is quite a difference between a patronage refund and a corporate dividend.

Senator KERR. There would not be as much of the corporate dividend as there is of the patronage dividend, for one thing.

Mr. LLOYD. It would depend——

Senator KERR. If it were a corporate dividend, it would have to be after taxes. In the case of the patronage refund it would be before taxes.

Mr. LLOYD. That is right.

Senator KERR. So there would be that substantial difference.

Mr. LLOYD. That is right.

Senator MILLIKIN. I am not pushing any theory here, but what is the distinction between your case and the case which I have posed to you?

Mr. LLOYD. Well, sir, patronage refunds belong exclusively to cooperative patrons.

Senator MILLIKIN. I see.

Mr. LLOYD. As a result of their patronage, whereas corporate profits have nothing to do with the patronage of the stockholders. These profits accrue entirely to the business and its ownership. Stockholders in proprietary corporations invest money for the purpose of making a profit, a return on their investment. Stockholders in our type of company, in our retailer-owned wholesale movement, invest exclusively for the purpose of keeping themselves competitive in the grocery business.

Senator MILLIKIN. Thank you very much.

Senator WILLIAMS. But a wholesale grocery that would be operating in the same area as you did, if you each ended up at the end of the year with $100,000, you could keep all of that money under your existing set-up.

Mr. LLOYD. We feel, Senator, that our competition is not the wholesale grocer in the field. He performs certain services and does other things that we do not attempt to do. Our competition is the corporate chain and other large direct buyers who operate just exactly the way we operate. Their entirely wholesale and retail function is in one company. They are not required to pay a tax on their wholesale margins.

Senator WILLIAMS. How do you get that?

Mr. LLOYD. Their entire business is handled by one corporation.

Senator WILLIAMS. Yes; but they do pay taxes.

Mr. LLOYD. And their net profit is figured on the end result, so that there is not a different set-up between the wholesale profit and the retail profit.

Senator WILLIAMS. If there is $100,000 profit on your side and $100,000 on the side of the competitor, whether it is passed, as you say, up the line to other corporations, whatever it might be, the net result is under the existing law that $47,000 of that comes into the Federal Treasury.

Mr. LLOYD. It is taxed exactly the same to our members as it is to the corporate chain and the other direct buyers at the retail level.

Senator WILLIAMS. But it is taxed to a member who has not had the money, and you have been able to keep the money, and you would end up——

Mr. LLOYD. No; our member has received the money, received the rebate, and paid a tax on it.

Senator WILLIAMS. He has not received the money; he has received a piece of paper but has not received the money or a negotiable piece of paper which he can use to pay his creditors.

Mr. DICKEY. But, Senator, he has received the money after the first 5 years, and every year thereafter he has continued to receive the money.

Senator WILLIAMS. That is right. But he is paying taxes on something for 5 years and on something that doesn't happen until 5 years later; and in our system, if he fails, he will never get it.

Mr. DICKEY. That is why we pay him 4½ percent interest on it.

Senator WILLIAMS. But it may be an attractive investment for him, in which event you do not need the provision whereby you can force him to reinvest.

Mr. DICKEY. Except in the situation that we are already in, we are already in that position, and if we had to change the position in the middle of the stream, as it were, we would be forced into liquidation, perhaps.

Senator WILLIAMS. I do not follow that, because if your corporation is solvent, which it is, is it not—I mean, if your corporation is solvent, and unless you have already, we will say, dissipated these 5-year debentures that you have outstanding, if they are sound and if they are not sound, then the taxpayers are in a position that I have just described, and if they are sound we have several banks here, the cooperative bank and all, and it can be financed. You know that as well as I do, if you have got a sound organization it will just be a re-funding operation.

Senator BYRD. Have you finished your statement? We have got other witnesses here who are waiting to be heard.

Mr. LLOYD. Well, I think I have just about one more paragraph here, Mr. Chairman.

The very trend that the cooperative movement was designed to halt and set right would be reversed, if we were forced to liquidate under these provisions, as I have indicated. Wholesale prices would then immediately rise in our area. Business would be concentrated in the hands of a few large outlets.

Free enterprise for the independent businessman would be stifled. I am certain that our experience would be repeated in numerous other areas. Yes, gentlemen, I am sure that the State of Utah would not be alone in this experience. The inevitable consequences would be felt in every State of the Union.

Senator TAFT. Do you pay a return on your capital stock of $150,000?

Mr. LLOYD. No.

Senator TAFT. On that invested capital?

Mr. LLOYD. No; our entire return to the members is based on their patronage.

Senator TAFT. You do not pay any on that?

Mr. LLOYD. No.

Senator TAFT. That was cash though, put up by the members, was it not?

Mr. LLOYD. That is right. Our members have put this money up as a stock investment to provide operating capital for us.

Senator BYRD. Thank you very much, Mr. Lloyd.

Mr. LLOYD. Thank you, and may I again express my appreciation to you for the opportunity to be heard at this particular time.

Senator WILLIAMS. May I ask you a question along the line that if you did pay a return on your capital stock you would have to pay a corporation stock dividend, whereas if you pay no interest on your capital stock and earned dividends and pay them out in scrip they are tax-exempt to the corporation, are they not?

Mr. LLOYD. I think that is right. Payment of interest on capital stock would be an operating loss and deductible as an expense. Under our by-laws we could not pay a regular stock dividend because we are required to pay all earnings on members' business back to members on a patronage basis.

Senator BYRD. Thank you, Mr. Lloyd.

(The prepared statement submitted by Mr. Lloyd reads, in full, as follows:)

STATEMENT OF DONALD P. LLOYD, OF COOPERATIVE FOOD DISTRIBUTORS OF AMERICA

Mr. Chairman, members of the committee, my name is Donald P. Lloyd. I am the manager of the Associated Food Stores, Inc., which is a retailer-owned wholesale grocery company owned by the A. G. Stores and located at 1812 South Empire Road, Salt Lake City, Utah. My company is also a member of the Cooperative Food Distributors of America, 309 West Jackson Boulevard, Chicago, Ill., which is the national trade association of retailer-owned wholesale grocers. We represent the interests of 24,000 retail stores employing thousands of people in every State of the United States. It is in my capacity as a representative of the C. F. D. of A that I appear before you today.

Before beginning my formal statement, I would like to thank the committee on behalf of the members of the Cooperative Food Distributors of America for this opportunity of appearing before you.

HISTORY OF THE WHOLESALE GROCERY COOPERATIVE MOVEMENT

In order to gain the proper perspective as to the purpose, functions, and operations of the cooperative wholesale grocery business, I believe a bit of history concerning the reason for the formation of co-ops in the grocery field and the growth of the movement are important.

Retailer-owned wholesale grocery companies were organized many years ago. The retail grocers were unable to purchase merchandise at prices which would enable them to price and sell at retail and be competitive with the chain stores that were then in existence.

Wholesale grocers of that day were operating with a high cost of doing business and high mark-ups, which varied according to the customers that they sold to. The average retailer paid the higher price, while those who had substantial volume received lower prices in many cases; the chain organizations in particular received more favorable consideration.

This caused the independent retailers to get together for the purpose of purchasing merchandise in quantity lots, and in some cases carlots, and then have that same merchandise distributed to them at their stores, which enabled them to price competitively.

The chains in the twenties began to merge into larger companies, and because of the strength which developed from those mergers they began to become stronger in the retail field, with the subsequent loss of business to the independent retailer, who was finding it extremely difficult to be competitive over all. Wholesale grocers catered to these chain concerns, offering them merchandise at greatly reduced prices and in some cases buying for them in carlots, handling on cash discount only.

During this period manufacturers had not recognized these large chain companies as direct buyers; therefore they were still compelled to purchase through wholesale grocers, who gave them more favorable consideration. In order to meet this competition, individual retailers continued to band together, becoming a little stronger: they grouped their resources; they bought some merchandise direct from several manufacturers; other manufacturers refused to sell them. Some wholesale grocers prevailed upon manufacturers not to recognize as direct buyers these new concerns that had been organized by retailers; these wholesalers were successful until such time as they became strong enough to demand recognition.

During the twenties individual retailers were finding it extremely difficult to compete successfully, and it was during that period that many of them were not able to continue and were forced out of business. However, those who joined together into retailer-owned wholesale companies continued to operate and grow because they were in a stronger competitive position than their fellow independents. The short-sighted wholesalers who discriminated against the smaller retailers eventually found themselves weakening and in many cases discontinuing business because of their policies. Cooperating retailers continued to expand, continued to increase their volume, began to get an increasing share of the market, developed new stores; supermarkets came into being. All the advantages of quantity buying became available to the average retailer who became a part of these retailer-owned organizations. Given the tools with which to operate, they did a capable merchandising job, held their position, and kept pace with an expanding food industry.

Large operators at one time were able to advertise many commodities at a lower price than retail merchants were able to purchase them from their wholesale food distributor. So the problem of the independent was one of self-preservation. He had one of a few choices: either go out of business entirely, have his business curtailed so that he could not make a living out of it, or seek some cooperative endeavor with other merchants so as to be in a position to buy quantities of merchandise through one distributing unit on an equal basis with all retailers and thus meet all competition.

This took many years of hard work and heartaches because of the monopolistic tactics that were used to stop him from buying merchandise collectively through a distribution point. Corporate chains pooled purchases together to acquire quantity discounts that were not available to a small distributing group, which again necessitated the banding together of many distributive groups to receive a like quantity discount and remain in a position to meet the competition that was forced upon the small merchant.

The retailer-owned wholesale grocery companies have grown and developed mainly because they have been efficient. In most cases they are operating in modern warehouses, using the best in handling equipment, rendering different forms of services to their members, and working closely with manufacturers of food products who like the distribution that is offered to them by these retailer-owned houses.

The primary reason for the continued existence of retailer-owned wholesale warehouses is to keep the small-business man in business. They are not organized for any one individual. They are organized to help preserve small business and make merchandise available on the same cost basis to all merchants, large or small. It is the spirit of equality in competition for the small independent that is the basis and justification for the existence of the retailer-owned wholesale warehouse.

It has been a fundamental concept of the American economy that the small-business man is our basic economic unit; that if he disappears into the maw of the giant corporations we will be well on our way toward a socialistic or fascistic state. Now, I do not pretend to be an economist. I am simply an independent groceryman. But I do know that the Congress of the United States has passed numerous pieces of legislation to try to assure the continuing independence of the small-business man. We in the grocery business are grateful for such legislation. But at the same time we feel that the old axiom that God helps those who help themselves is as true in our line of business as in any other situation.

TYPICAL OPERATION OF A RETAILER-OWNED WHOLESALER

With this historical background in mind, I think the committee might be interested in knowing exactly how a retailer-owned wholesale grocery cooperative works.

Our company started in the State of Utah 11 years ago. At that time large direct buyers in the retail food business, including the national chains, had the individual smaller merchants of our area on the run. These individuals were buying from our local proprietary wholesale grocers at prices that made it impossible for them to compete with the direct buyers. They tried various plans of group buying with little or no success. What they saved on purchases of one item was often lost on overcharges on other items. And, besides that, they found by comparing invoices that they were usually charged whatever the traffic would bear. Merchants of comparable size were paying as much as 10 percent difference on their purchases of the same item in the same quantity on the same day. I know that because I sat in on numerous meetings where invoices were compared. That was how the wholesale grocery business was done in Utah before those independent merchants finally decided that if they were ever going to compete with the direct buyers they would have to go into the wholesale grocery business for themselves.

That is exactly what we did. We organized a retailer-owned wholesale grocery company. We invited every good retail food merchant in our area to join with us in establishing a wholesale grocery company to be operated without profit and at the lowest cost of doing business we could possibly attain. We started small and it took us several years to become firmly established, but from the very beginning of our operations we made and kept our member stores competitive on their buying—competitive with the largest operators in the field.

Each member of our company owns one share of stock. All the stock is owned by active retail merchants. We operate a modern, streamlined, mechanized warehouse in Salt Lake City today. With the cooperation of the members we have

been able to keep our costs down to a minimum. The savings accomplished by this kind of operation have been passed on to our members, thus enabling them to meet their toughest competition and, in turn, to pass the savings on to the consumer.

After we became established in Utah, a group of individual merchants in southern Idaho asked for our help in establishing a similar organization there. That was in 1945. These Idaho merchants were faced with exactly the same problems as we had met not over 5 years earlier. They were gradually being crowded out of the grocery business by the large direct buyers, including the chains. We invited them to join with us as part of our organization, and a branch house was established in Pocatello, Idaho, to serve the members there. Today these Idaho merchants own their groceries at competitive prices and they are now competing on an equal footing with the direct buyers.

Then, again last year we repeated this experience in still another area. Western Montana was one of the few remaining markets in the country without a retailer-owned wholesale grocery company. Wholesale grocery margins were high and it was impossible for the rank and file of the trade to pay these mark-ups and stay in business. A group of these retailers appealed to us for help and today we have a well operated, efficient wholesale house in Helena, 100 percent owned and operated by the retailers. And today those retailers are meeting the competition of the largest operators in that State.

I feel sure this same story could be told of the development of the retailer-owned movement in each of the 117 areas where Cooperative Food Distributors of America has member houses.

From this description you can see that we perform exactly the same function as any wholesale grocer—with one exception. This exception is that we are not in business to make a corporate profit in our wholesaling function. We are in business to give the benefit of mass-purchasing power to our individual retailer members and the consuming public. This is our method of guaranteeing an equal opportunity to the independent grocer to remain in business side by side with the giants of the food industry. Everyone benefits by this cooperative effort. The farmer has a larger competitive market in which he can sell the product of his toils. Labor gains in fruitful employment. Small business is preserved, and the consumer gets the benefit of efficient distribution in the form of lower prices. And, gentlemen of the committee, we are obligated to return income over and above actual operating costs to our patron members.

Our bylaws provide that all moneys received over and above actual operating costs shall be set down as a liability of the corporation due and payable to all members based upon the percentage of purchases.

You will see from this that on our sales to members we make no taxable income because we are obligated to return overcharges to our membership each year. Under these circumstances, it is difficult for us to understand why our method of doing business is subject to question.

The members of the Cooperative Food Distributors of America are not tax-exempt cooperatives as defined in section 101 (12) of the Internal Revenue Code. We have no tax exemption. We pay a Federal income tax on net corporate income just as everyone else does. But insofar as our overcharges on sales to members are concerned, a retailer-owned wholesaler is simply a means by which those moneys are returned to the individual retail members. And, let us emphasize this point, too, that the individual retailer's share of these moneys is taxable income to that individual and must be treated as such by him.

I think that you gentlemen can see that what we try to do as cooperative wholesale grocers is to pass on the savings resulting from efficient operation to our retailer members.

We buy our merchandise from normal sources. We estimate our cost of operation from time to time, and our mark-ups are based on this estimate. We refund overcharges at the end of the year to bring our operation down to the cost level because it is the most expeditious and most business like way to operate. If patronage refunds are included as income of cooperative corporations and taxed as such, the almost inevitable effect of such action would be for us to eliminate or greatly curtail our operating margins on original sales.

A situation of this kind would not be of our choosing. Speaking very frankly, it would be difficult to make adjustment on individual sales. And, just as frankly, we do not wish to operate on a dangerous, senseless, price-cutting basis.

There has been a proposal made by Senator John J. Williams of Delaware, who is a member of this committee, for a special cooperative tax classification. This proposal is made in S. 892 and is proposed as an amendment to the first tax bill which comes to the Senate from the House. The measure involves a number of

points, but the most important provision of the proposed amendment as far as we are concerned provides that a cooperative cannot exclude patronage refunds paid or payable to its patron in computing the cooperative's net income for Federal tax purposes, unless during taxable years (1) the cooperative dealt exclusively with its members; and (2) the patronage refunds were paid in money exclusively not later than 60 days after the close of the taxable year and there were no conditions either precedent or subsequent as to the application or use of such money by the members.

We have a great deal of respect for Senator Williams, and we know he is trying sincerely to remedy what he believes to be an inequity. But, we cannot help but feel that as far as we are concerned, his language is punitive to the extreme and will not produce a substantial increase in revenue.

With reference to the portion of Senator Williams' bill which would require the cooperative to deal exclusively with its members, we would like to respectfully point out to the Senator that we now pay income taxes on profits from sales to nonmembers. There are times when it is both expedient and necessary to sell to nonmembers because of certain pressures of the type of business which we operate. An example lies in the field of perishable commodities, where it becomes necessary to sell to nonmembers in order to prevent spoilage.

With reference to the 60-day cash refund provision, I would like to give you an example of what this would mean to our particular business. Some years back when we needed a means of financing our operation, our retailer members voted to accept their overcharge refunds in the form of 5-year interest-bearing debentures. This system has been voted continuously by our retailer members since the establishment of our company in 1940. As these debentures have come due, we have paid them in full in cash, both principal and interest.

Senator Williams' bill would require us to pay overcharge refunds on each year's business within 60 days of the end of the taxable year. This double burden would have serious consequences for us. In fact, I can't see how we could finance the continuation of our operations. Our only source of capital is from the members of our group. We simply do not have and cannot get enough capital to maintain regular essential operations and at the same time assume a burden of double payment of patronage refunds. Our only recourse under these conditions might be liquidation. The retailers depending on our operation would then be set back to a noncompetitive position and, we fear, extinction as independent merchants. The very trend that the cooperative movement was designed to halt and set right would then be reversed. Wholesale prices would then immediately rise in our area. Business would be concentrated in the hands of a few large outlets. Free enterprise for the independent businessman would be stifled. I am certain that our experience would be repeated in numerous other areas. Yes, gentlemen, the State of Utah would not be alone in this experience. The inevitable consequences would be felt in every State of the Union.

Thank you for your kind attention.

Senator BYRD. Thank you, Mr. Holman, for yielding to the other witness.

STATEMENT OF CHARLES W. HOLMAN, SECRETARY, NATIONAL MILK PRODUCERS FEDERATION

Mr. HOLMAN. Mr. Chairman, before I qualify—and I may say that my statement has been cut completely in half so that I can finish in, I think, less than—a good deal less than—15 minutes. I would like to have the privilege of filing the larger statement as part of my testimony, and I will do my best to speed up for you, because I realize that the committee is tired and needs a little recess.

I am Charles W. Holman, secretary, National Milk Producers Federation, with headquarters in Washington, D. C.

The organization now has 92 voting members, and about 600 submembers.

Our dairy farmers—and this is exclusively a dairy-farmer cooperative organization—are about 450,000, located in every State of the Union except Nevada and New Mexico.

These organizations, which market milk all the way from wholesale to retail, handle about one-fifth of all of the milk and cream that goes off the farms of the United States. The value is about $1,000,-000,000 in 1950.

I am appearing before the committee at the direction of our organization to oppose any change in section 101(12) of the Internal Revenue Act.

We have been working in connection with that act for many years, and have appeared before this committee a number of times.

The only real purpose for taking up the time of the committee at this point is to give you an idea of the character of our organizations, which might become subject to taxation.

These organizations, practically all of them, are engaged in marketing fluid milk and cream and are nonstock cooperatives. They have no capital except that provided by loans from the members for capital purposes or such necessary reserves as are required for bad debts, depreciation, and so forth. The loans for capital purposes are usually deducted from proceeds of sales of milk and cream, and are represented by interest-bearing certificates of indebtedness issued to each member at the end of a fiscal year. These certificates are usually maturable at the end of from 5 to 10 years.

Our members engaged in the manufacture and marketing of dairy products are usually set up on a stock basis but frequently the amount of stock which any member can own is very limited. Irrespective of the amount of stock held by individual farmers, these cooperatives are operated on the basis of one-man one-vote. Also the stock capitalization of these cooperatives, whether they are the locals or the central sales agency for the locals, is usually too small to permit adequate and efficient business operations. Consequently, the capital usually is augmented by issuance of preferred stock, or by borrowings from both private and Federal cooperative banks.

Such cooperatives must necessarily finance their operations from the proceeds of the sales of the products handled. Because of the continuous uncertainty of market prices, these proceeds must provide not only the reserves which the fluid milk nonstock cooperatives must have, but also additional reserves to allow for depreciation in the value of the product either in warehouses or en route to markets, but not sold. For example, I know of several large-scale cooperative butter-handling organizations which must take all of their members' product in the spring when production is flush. They must store it, generally in public warehouses. They must defray the costs of storage and risk possible changes in prices to lower levels than those at which the product was acquired. This obligation to accept all of the product shipped by members is not shared by the cooperatives' commercial competitors who at any time may exercise their power to refuse shipments of milk or cream from farmers. Also, these organizations customarily pay their members monthly, even though all of the butter on which payments are made may not have been sold at the time the payments were declared.

It should be readily seen that there is a great deal of ebb and flow in this type of operation, and the balancing of books at the end of the fiscal year does not mean that all transactions have been completed. Organizations of this type may also suffer unforeseeable operating losses due to price changes among the several manufactured

dairy products. Consequently, unless the dairy cooperative plant is equipped to manufacture and handle practically every type of the major dairy products, it stands to lose by shrinkage in volume due to loss of patrons. Hence the need for reserves to offset such losses.

I have been asked by various friends who are Members of the Congress as to whether it would be wise to establish a line of demarcation between little cooperatives and big cooperatives. The answer to that question is "No" because the Congress, in enacting the Capper-Volstead Act, recognized the quasi-public character of our agricultural cooperatives. It recognized that they perform a very broad community service. It recognized that they serve to discourage the imposition of undue margins and spreads by proprietary handlers who, until the advent of the cooperatives, were accustomed to paying farmers any price they pleased and raising all the possible profits that the traffic would bear. The history of the development of the cooperative movement in this and other lands is that the presence of a cooperative in a community enables both member and nonmember producers to obtain consistently fairer returns out of the so-called consumer's dollar. So if a line of demarcation were made between small and large cooperatives, it would be easy to find hundreds of thousands of cases where neighbors on farms would receive unequal treatment.

Furthermore, to repeal or modify the provisions of section 101 (12) so as to impose Federal income taxes on certain reserves would be most unfair in view of the mandatory requirement of some—I might say many—State laws for the establishment of reserves by farmer cooperatives.

I will cite an actual case in another field which is typical of a number of our milk bargaining cooperatives. These organizations as a rule do not own any plant facilities but bargain for their milk with the commercial distributors. Sometimes this is done under the Federal milk order system, but more frequently it is done outside of that system. Because of the fact that the daily commercial life of many distributors is in jeopardy no one knows when one of the smaller ones will turn turtle into bankruptcy. It has been necessary for these milk-bargaining associations to set up a type of insurance reserve against losses to cover this and other emergencies. Sometimes these organizations definitely allocate those reserves at the time they are issued at the end of a year, and in some cases they have not done so.

To illustrate further, the average milk producer always has a 6-week supply of milk unpaid for, in the hands of the dealer.

Consequently, if a dealer fails in business, the producers supplying him stand to lose a considerable portion of their gross income unless reserve funds are set up by the association for the payment of losses of this character.

The case I have in mind is an association of less than 2,000 producers supplying a very large market who have found it necessary to build an adequate reserve. The money to build this reserve is taken each month on an equalized basis from the pay checks of each producer. The deduction is recorded on the books of the association and the fund is revolved on a 6-year basis. It is really administered as a trust fund although, of course, the fund is held in the name of the association and most of it is invested in Government bonds.

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Senator TAFT. Is there not some bylaw or something that permits you to deduct from the pay check?

Mr. HOLMAN. The producer contract; and, in that connection, Senator Taft, many people who do not understand cooperatives think that the contract is between the association and the member. Actually, while it may be that in name, it is a contract among producers, one with the other.

About 6 years ago, a dealer purchasing milk from the association failed. Immediately the association paid off its member producers in full for the milk owed them by this bankrupt. One of the officers of the association appeared before the court and was made an administrator of the business. After its affairs were put in order the association attempted to negotiate the sale of the property but no distributor in the community would buy it at that time. To salvage losses, the association took over the property and managed it for 4½ years, putting it on its feet. At the end of that time there were buyers in plenty. The property was sold and the net profits put into the revolving fund.

This is a case wherein it would have been against the interest of the farmers themselves for the association to have given them notices of allocation of the amounts withheld. Those amounts were taken only from what the association could save on the handling rates charged to each member on each hundredweight of milk. The custom of the association in this case is to prorate the losses incurred in each fiscal period; and should there be any gains to prorate them also. In no case does the association have anything for itself, but its producers have an excellent insurance fund on which they annually pay income taxes as they receive their rotated payments. Of course, actually under the regulations of the Treasury—and I do not know whether this association does that or not—the producer should pay his income tax at the time he receives a notification from the association, but actually I think that they simply pay each year as they get their rotated payments. I am not sure about the practice of this particular organization there.

Senator WILLIAMS. You mean as the scrip is paid off they pay it?

Mr. HOLMAN. Sir?

Senator WILLIAMS. You think they actually wait and pay the tax on it after the scrip is redeemed?

Mr. HOLMAN. I do not know what the individual farmer does. That is the responsibility of the Treasury to find that one out.

Senator WILLIAMS. I thought you were discussing that.

Mr. HOLMAN. No; I said that under the regulation of the Treasury on notification the farmer is supposed to pay his tax.

Senator WILLIAMS. That is correct.

Mr. HOLMAN. Then, if there is a loss, such as I have just described, he can, the next year, ask for credit against the loss. I believe I am right on that.

We recognize that under our present defense emergency, sacrifices must be made by everyone. The individual farmer members of the National Milk Producers Federation are willing to and are making such sacrifices. This, however, does not mean that we accept the doctrine that the end justifies the means. To increase the tax burden of the individual dairy farmer is one thing, but to compromise a principle by imposing Federal income taxes on the savings of farmer cooperatives is entirely another matter.

And, Senator Taft, as you brought out earlier today, we justify the exemption on two grounds: First, there is nothing earned; secondly, the cooperative is a quasi-public institution and of great service to the community.

Finally, we oppose any attempt to sabotage a principle that is as right today as when it was originally enunciated by the Congress. We therefore, suggest to the committee that it continue to leave unchanged the principle embodied in the Capper-Volstead Act and section 101 (12) of the International Revenue Code.

That completes my direct statement, Mr. Chairman.

Senator BYRD. Thank you. Your other prepared statement will be placed in the record at this point.

(The statement referred to is as follows:)

STATEMENT OF CHARLES W. HOLMAN, SECRETARY, NATIONAL MILK PRODUCERS FEDERATION

My name is Charles W. Holman and I am secretary of the National Milk Producers Federation. I am appearing before your committee on behalf of the dairy farmer members of the federation. Our organization consists of 92 member cooperative associations and approximately 600 submember cooperative associations in 47 States. These member associations are owned by approximately 150,000 farm families engaged in dairying and producing approximately one-fifth of the production of milk and cream from farms in America.

My appearance before your committee this morning is directed specifically to opposing any repeal or modification of section 101 (12) of the Internal Revenue Code. For several years, the voting delegates of the National Milk Producers Federation have adopted resolutions on this subject. Our position on this matter was reiterated at our Thirty-fourth annual meeting held in Minneapolis in November 1950. At that time the following resolution was adopted:

"During recent years the National Milk Producers Federation has led the fight against the proposal to double-tax producer members of bona fide farmer-owned and farmer-controlled cooperative associations. We pledge the continuance of this effort, and we oppose any change in sections 101 (12) and (13) of the Internal Revenue Code."

Our organization is fully cognizant of the problem confronting this committee in its efforts to secure the necessary revenue with which to place our Federal Government on a sound fiscal basis. In this connection, the following resolution was adopted at our recent annual meeting:

"We view with deep concern the ever-increasing national debt. We believe that a sound national fiscal policy should provide for the necessary taxes to balance the budget and allow for the general reduction of the national debt. However, such taxes must be reasonable and nondiscriminatory. They should not unduly discourage private initiative. Neither should such taxes be used as a means of social reform.

"We are cognizant of the fact that exceptions must be made during abnormal times such as are confronting the Nation today in its rearmament program. However, even under such circumstances, every effort should be made to be on a pay-as-you-go basis. Although it appears that (because of the critical international situation and the Government domestic policies) deficit financing will be continued, we urge that all nonessential governmental expenditures be eliminated

"With the present high level of employment, the tax base should be broadened and tax rates placed high enough to balance the budget as nearly as possible. Also during a period of inflation as at present a sufficiently high tax rate will contribute greatly to controlling further inflationary pressures and may avoid imposition of price ceilings and wage controls."

As to the type of organizations making up the National Milk Producers Federation, they are incorporated either as nonstock or stock cooperatives. Practically all of those engaged in marketing fluid milk and cream are nonstock cooperatives. They have no capital except that provided by loans from the members for capital purposes, or such necessary reserves as are required for bad debts, depreciation, and so forth. The loans for capital purposes are usually deducted from proceeds of sales of milk and cream, and are represented by interest-bearing certificates of

indebtedness issued to each member at the end of a fiscal year. These certificates are usually maturable at the end of from 5 to 10 years.

Our members engaged in the manufacture and marketing of dairy products are usually set up on a stock basis but frequently the amount of stock which any member can own is very limited. Irrespective of the amount of stock held by individual farmers, these cooperatives are operated on the basis of one man, one vote. Also, the stock capitalization of these cooperatives, whether they are the locals or the central sales agency for the locals, is usually too small to permit adequate and efficient business operations. Consequently, the capital usually is augmented by issuance of preferred stock, or by borrowings from both private and Federal cooperative banks.

Such cooperatives must necessarily finance their operations from the proceeds of the sales of the products handled. Because of the continuous uncertainty of market prices, these proceeds must provide not only the reserves which the fluid milk nonstock cooperatives must have, but also additional reserves to allow for depreciation in the value of the product either in warehouses or en route to markets, but not sold. For example, I know of several large-scale cooperative butter-handling organizations which must take all of their members' product in the spring when production is flush. They must store it, generally in public warehouses. They must defray the costs of storage and risk possible changes in prices to lower levels than those at which the product was acquired. This obligation to accept all of the product shipped by members is not shared by the cooperatives' commercial competitors who at any time may exercise their power to refuse shipments of milk or cream from farmers. Also, these organizations customarily pay their members monthly, even though all of the butter on which payments are made may not have been sold at the time the payments were declared.

It should be readily seen that there is a great deal of ebb and flow in this type of operation, and the balancing of books at the end of the fiscal year does not mean that all transactions have been completed. Organizations of this type may also suffer unforeseeable operating losses due to price changes among the several manufactured dairy products. Consequently, unless the dairy cooperative plant is equipped to manufacture and handle practically every type of the major dairy products, it stands to lose by shrinkage on volume due to loss of patrons. Hence the need for reserves to offset such losses.

Amid all of the hubbub which has been created by enemies of the cooperative movement, let us raise the question as to why, in earlier years, the Congress granted exemption to bona fide farmer-owned and farmer-controlled cooperative associations organized as described in the present internal revenue law. This exemption states:

"* * * for the purpose of marketing the products of members or other producers, and turning back to them the proceeds of sales, less the necessary marketing expenses, on the basis of either the quantity or the value of the products furnished by them, or (*b*) for the purpose of purchasing supplies and equipment for the use of members or other persons, and turning over such supplies and equipment to them at actual cost, plus necessary expenses. * * *"

It should be noted that this language closely follows the spirit and language of the Capper-Volstead Act of 1922 which gave Federal authorization to agricultural producers, organized for the collective processing and marketing of their products. To me it seems noteworthy that the congressional conception of the Capper-Volstead Act has affected many other laws including those governing the raising of taxes and the legislative framework of the governmental institutions engaged in the lending of money to cooperatives. Aside from that, the Capper-Volstead principles have affected State legislation and even the interpretations of the courts.

I speak of this because, from time to time, I have been asked by various friends of mine who are Members of the Congress as to whether it would be wise to establish a line of demarcation between little cooperatives and big cooperatives. The answer to that question is "No," because the Congress, in enacting the Capper-Volstead Act, recognized the quasi-public character of our agricultural cooperatives. It recognized that they perform a very broad community service. It recognized that they serve to discourage the imposition of undue margins and spreads by proprietary handlers who, until the advent of the cooperatives, were accustomed to paying farmers any price they pleased and raising all the possible profits that the traffic would bear. The history of the development of the cooperative movement in this and other lands is that the presence of a cooperative in a community enables both member and nonmember producers to obtain consistently fairer returns out of the so-called consumer's dollar. So if a line of

demarcation were made between small and large cooperatives, it would be easy to find hundreds of thousands of cases where neighbors on farms would receive unequal treatment. If an exemption were given to a smaller cooperative, this of course would be reflected back to the member on the farm. Across the road his neighbor who belonged to a larger cooperative handling the same commodity would find his organization under a competitive handicap because of the failure of the Government to grant equal rights.

It is imperative that bona fide farmer cooperatives have the right to set up reserves that are exempt from Federal income taxes. To require such reserves to be allocated in order to be given tax exemption would destroy the very purpose of such reserves. Even though the amount involved would be small, farmer cooperatives very definitely would be hurt. I want to make it very clear that I am talking about reasonable reserves. If there is any criticism with respect to the size of such reserves, the decision rests with the Bureau of Internal Revenue as to what constitutes a reasonable reserve under section 101 (12).

Furthermore, to repeal or modify the provisions of section 101 (12) so as to impose Federal income taxes on certain reserves would be most unfair in view of the mandatory requirement of some State laws for the establishment of reserves by farmer cooperatives.

I will cite an actual case in another field which is typical of a number of our milk bargaining cooperatives. These organizations as a rule do not own any plant facilities but bargain for their milk with the commercial distributors. Sometimes, this is done under the Federal milk order system, but more frequently it is done outside of that system. Because of the fact that the daily commercial life of many distributors is in jeopardy no one knows when one of the smaller ones will turn turtle into bankruptcy. It has been necessary for these milk bargaining associations to set up a type of insurance reserve against losses to cover this and other contingencies. To illustrate further, the average milk producer always has a six weeks' supply of milk unpaid for, in the hands of the dealer. Consequently, if a dealer fails in business, the producers supplying him stand to lose a considerable portion of their gross income unless revolving reserve funds are set up by the association for the payment of losses of this character.

The case I have in mind is an association of less than 2,000 producers supplying a very large market who have found it necessary to build an adequate reserve. The money to build this reserve is taken each month on an equalized basis from the pay checks of each producer. The deduction is recorded on the books of the association and the fund is revolved on a 6-year basis. It is really administered as a trust fund although, of course, the fund is held in the name of the association and most of it is invested in Government bonds.

About 6 years ago a dealer purchasing milk from the association failed. Immediately the association paid off its member producers in full for the milk owed them by this bankrupt. One of the officers of the association appeared before the court and was made an administrator of the business. After its affairs were put in order the association attempted to negotiate the sale of the property but no distributor in the community would buy it at that time. To salvage losses, the association took over the property and managed it for 4½ years putting it on its feet. At the end of that time there were buyers in plenty. The property was sold and the net profits put into the revolving fund.

This is a case wherein it would have been against the interest of the farmers themselves for the association to have given them notices of allocation of the amounts withheld. Those amounts were taken only from what the association could save on the handling rates charged to each member on each hundredweight of milk. The custom of the association in this case is to prorate the losses incurred in each fiscal period; and should there be any gains to prorate them. In no case does the association have anything for itself, but its producers have an excellent insurance fund on which they annually pay income taxes as they receive their rotated payments.

I have intentionally refrained from re-presenting evidence heard on prior occasions by this committee. Voluminous testimony has been given as recently as February 1950, with respect to the growth of farmer cooperatives and the volume of business transacted. I have made no attempt to touch on the technical or legal aspects of this subject.

We recognize that under our present defense emergency, sacrifices must be made by everyone. The individual farmer members of the National Milk Producers Federation are willing to and are making such sacrifices. This, however, does not mean that we accept the doctrine that "the end justifies the means." To increase the tax burden of the individual dairy farmer is one thing, but to compromise a

principle by imposing Federal income taxes on the savings of farmer cooperatives is entirely another matter.

We oppose any attempt to sabotage a principle that is as right today as when it was originally enunciated by the Congress. We therefore, suggest to the committee that it continue to leave unchanged the principle embodied in the Capper-Volstead Act and section 101 (12) of the Internal Revenue Code. We always have had and will continue to have complete confidence that this committee will not succomb to the propaganda of the enemies of farmer cooperatives who ostensibly advocate tax equality but in reality have as their direct objective crippling and annihilating farmer cooperatives.

Senator BYRD. There are four more witnesses. Is it the pleasure of the committee to continue this afternoon?

Senator KERR. Mr. Chairman, I wonder if we could not reconvene at 10:30 tomorrow?

Senator MILLIKIN. Mr. Chairman, I would like to ask the indulgence of the committee for the convenience of Mr. Moore of Colorado. If it is inconvenient for him to remain, I would like to hear him today. I understand he has to leave tonight.

Gentlemen, I wish to commend to the friendly consideration of this committee Mr. Moore. Mr. Moore is from Colorado, and he is an expert in this particular field, which he will discuss; and aside from that, he is one of our finest citizens from out of that State.

Mr. MOORE. Thank you, Senator.

Senator BYRD. Mr. Moore, you will proceed, sir.

STATEMENT OF WALTER C. MOORE, MANAGER, DENVER MILK PRODUCERS, INC.

Mr. MOORE. My name is Walter C. Moore. I am manager of Denver Milk Producers, Inc., which consists of approximately 2,100 grade A milk producers who supply Denver and many small towns with grade A milk. No milk can be sold in Colorado to consumers for consumption in the form of fluid milk unless it is grade A and pasteurized. As a service to milk producers the association also supplies members with all types of dairy supplies and equipment required to produce quality milk. The savings in this department for our last fiscal year amounted to $34,939.73. This entire amount was paid to producers in cash on a patronage basis, and it was paid to members and nonmembers alike.

Denver Milk Producers, Inc., is a member of the National Milk Producers Federation and supports its position in opposition to any changes in the Federal law exempting cooperatives from income taxation.

We are a cooperative bargaining agency. Our milk goes direct to the processing plants from the grade A farms as we may direct. We have four receiving stations located from 20 to 80 miles from Denver. If dealers do not have enough milk for their operations, we supply it from one or more of the receiving stations and whatever is left over at any of the stations is manufactured into cheese or moved to a condensery if the condensery will purchase it. We sell the surplus wherever we can get the most money for it and the proceeds are blended with proceeds from the sales made in Denver.

We sell the milk to dealers or handlers on the use classification basis, class 1 being fluid milk. Class 2 fluid cream, and the balance for manufactured use. Most of the so-called surplus handled in Denver

is used for ice cream. What is handled at the outside station is made into cheese, generally.

We do not have a Federal milk order in Denver. Our operations are carried on through a check-off of 1 cent a pound butterfat deducted from each shipper and paid to the association by the milk dealer. If we do not spend the amount collected it is credited to each producer in proportion to his contribution and a revolving fund certificate is issued to him. These certificates are taken up or paid off at the end of 5 years. During the 5-year interval the savings are used for operating capital.

Last fall we took up the 1945 certificates, and this fall we take up the 1946.

Our milk production varies from spring to fall from 30 to 35 percent. Generally we have a surplus in the spring but a shortage in the fall. In most cases the dealers will handle this spring surplus, but in 1949 and 1950 they would not carry it for fear of a loss due to declining market and the cost of carrying it.

In 1950 we had as much as 13,000 gallons of milk daily that dealers could not or would not take. We are under contract with our producers to market all the milk they produce for market. In order to avoid a breach in the contract and to have the milk in the fall, we had to accept delivery of over $200,000 worth of cheese, sweetened condensed milk, and sweet butter.

Senator WILLIAMS. Might I ask a question at that point? In your contract with your producers to market all the milk, does that contract carry a price at which you must pay them or only a contract to market it?

Mr. MOORE. No; only a contract to market it. The contract with the dealer sets the price. Under the contract with the producers we pay them a blended price based on utilization of the milk, but there is no price set under our contract with producers.

Everyone knew we were assuming a financial hazard when we took this cheese and butter off the market, but it so happened that the Korean situation developed and market values advanced so that we did not take a loss. Under normal conditions we would have suffered a serious loss and our capital represented by revolving fund certificates would have been impaired.

Thus our cooperative, and all farmer cooperatives, should be able to carry a reasonable amount in unallocated reserve free from income tax, in order to protect the capital structure against market fluctuations when the association is obliged to carry temporary surpluses. This is always a situation where there is a surplus in the spring. We do not have it any other time of the year.

Without this cushion of reserve any cooperative would be in a precarious position. We are therefore opposed to any change in the statutory exemption from income tax as it applies to unallocated reserves, and to any modification of section 101 (12) of the Internal Revenue Code.

In issuing these revolving-fund certificates, we handle nonmembers and members the same way. We give them the same market and same advantages that everyone else has, and the only difference is that he has no voice in who is elected a director, or in establishing the policies of the company.

Senator TAFT. You do not have to take all of his milk, necessarily?

Mr. MOORE. We do not, but we have never turned it down.

Senator TAFT. You do not have to, but you take it?

Mr. MOORE. We do not have to, but we have always done it, because we need the milk in the fall. That is a problem, handling it, taking the surplus off the market in the spring, so that the dealers will have sufficient milk in their bottles in the fall.

Senator TAFT. That is a very arid country, is it not, out there?

Mr. MOORE. We have a second drought out there, and they are starting to feed hay out there, but our area sections——

Senator MILLIKIN. They are starting to feed hay?

Mr. MOORE. They are sending hay around. We brought in hay from Nebraska last year.

Senator BYRD. Thank you very much, Mr. Moore.

Mr. MOORE. I appreciate very much being able to make my presentation tonight.

Senator MILLIKIN. It is good to see you again, and I hope you have a nice trip back.

Mr. MOORE. Thank you, Senator.

Senator BYRD. What is the pleasure of the committee with respect to these three other witnesses?

Mr. VOORHIS. Mr. Chairman, I am the next witness. My name is Jerry Voorhis. I canceled one plane reservation for tonight already. I do not want to impose on the committee. I would be willing, if the committee would prefer, to stay over until tomorrow, but I cannot stay longer than tomorrow. I would not insist on reading my whole statement if you could hear me for a few minutes now. I would be contented to do that, but so far as I am concerned, I will be glad to do whatever the committee's pleasure is. I do represent a rather substantial organization, and I skipped a meeting of my board of directors today to be here.

Senator BYRD. We will decide what is the pleasure of the committee.

(There was discussion off the record.)

Senator TAFT. I do not see Mr. Sims here.

Mr. VOORHIS. Mr. Sims has left, I might say. I spoke to Mr. Sims just as he left, and he said that his statement was going to be filed. He was sorry he could not stay.

Senator TAFT. How about Mr. Brooks?

Mr. BROOKS. I am here. I will not take the committee's time. I am only going to make one statement of 1 minute.

Senator MILLIKIN. Let us go ahead.

Senator BYRD. All right.

STATEMENT OF JERRY VOORHIS, EXECUTIVE SECRETARY, COOPERATIVE LEAGUE OF THE UNITED STATES OF AMERICA

Mr. VOORHIS. Mr. Chairman, I know how tired the committee is.

Senator TAFT. We are not tired; we just want to go home. [Laughter.]

Mr. VOORHIS. I have been here all day myself, and I would like to do that, too.

I would like to say at the outset, Mr. Chairman, that I think the essential point of these whole hearings is the fact that cooperatives are not in business for the purpose of making profits.

Senator MILLIKIN. Your full statement will be entered in the record.

Mr. VOORHIS. I would like to ask if my full statement might be put in the record.

Senator MILLIKIN. Yes.

Mr. VOORHIS. Cooperatives are in business for the purpose of making savings for members, or to put it another way around, to enable other people's economic status to be improved.

I do not think that the legal arguments need further emphasis since the courts can settle them—I only want to speak from the point of view of equity and good policy as I see it.

In the present state of the world, as I view it, the thing that is needed more than anything else in effective demonstration of the fact that the people can attack problems on their own account and meet these problems successfully. Cooperatives are one of the most basic methods by which that can be done.

I, therefore, believe an important and good policy is that nothing be done which would prevent American cooperatives from successful operation. I believe some of the suggestions that have been made would have that effect.

I have in my statement suggestions as to how the people whom I represent believe that additional revenue can be raised, and I would like to say that in every one of those cases suggestions are for taxes that cooperatives would pay, the same as anyone else, and that their members would pay the same as everyone else.

We believe that basically it is the people who pay the taxes anyway, and we believe that taxes upon business, although they may be convenient ways of raising revenue are not the soundest way to do it.

I am not going into that. I would only like to point out that in connection with the arguments that have been presented today as to how much tax might be achieved by the taxing of cooperative patronage refunds and otherwise, that two or three points have been forgotten. Mr. Burgess might quite as well have taken businesses that lose money in a given year, and computed how much those businesses would have made if they had made money, and then tried to compute how much the taxes would have been.

The reason I say that is because cooperatives exist for the purpose of passing on to other people that which would otherwise be earnings to them, and unless they do that effectively they are not fulfilling their function.

I would like to point out in connection with Mr. Glander's figures that there is great duplication between the figures of the Department of Labor on consumer cooperatives on the one hand, and the figures of the Farm Administration on farm cooperatives because in both cases farm purchasing cooperatives are included.

I would like to make one or two substantial points. I think we have, first, to decide whether or not we believe that cooperatives are a good influence in the United States. I believe they are. I think we are better off because farmers organized rural electric cooperatives and brought electricity to rural areas for the first time.

I think we are better off because a proportion of the petroleum industry, about 1 percent of it, belongs cooperatively to the people who make use of that petroleum, than we would be if ownership of the petroleum industry were completely concentrated in the major companies.

I think we are better off because responsibility and ownership are diffused, as they are through cooperative ownership, among many, many people throughout the country, and I would like to point out that that diffusion of ownership is the net result of the payment of deferred patronage refunds. Where a patronage refund is not paid in cash, then the cooperative must distribute the ownership of whatever facilities or whatever property or whatever capital is represented by the deferred refund among all of its patrons on a basis of their patronage. To talk about profits and patronage refunds as if they were synonymous is no more sensible than it would be to say that we are going to compel all businesses to distribute ownership over their assets in the same manner as cooperatives must do or that we are going to compel profit business to distribute its profits in the same manner as every cooperative must distribute its savings. It is just as sensible to propose these measures as it is to try to confuse the issue by saying that there is no difference between patronage refunds and profits.

I believe there are two principles that can be followed, and are the bases of fairness and justice, so far as the cooperatives that I directly represent are concerned. There are only two organizations in the Cooperative League who take advantage of section 101 (12). I think 101 (12) is sound agricultural policy. I think it has been proven to be. I would hate to see it changed. But I am talking to the committee primarily from the point of view of the nonexempt cooperatives today. Those cooperatives pay corporation income taxes, on any net margins that they have left over at the end of the year, after their costs of doing business have been paid, except only that money which they are obliged to pay out in patronage refund.

They cannot just suddenly decide to pay those patronage refunds. If any patronage refunds are paid by them, over which the board has discretion as to payment, that money is taxable against them just the same. It is only where the patronage refund is paid as a matter of obligation that they are not taxable upon the money.

The first principle is: If any cooperative retains net margins that pass through its hands and fails to pay them into the hands of its patrons, it now pays full corporation income taxes on that money and all other taxes, of course, the same as any other corporation does.

Senator WILLIAMS. Could you tell us what percentage of it is held, or do they pass out this scrip for them?

Mr. VOORHIS. It is held in what way?

Senator WILLIAMS. In such a manner where they paid taxes on it.

Mr. VOORHIS. I am talking about the payment of patronage refunds in whatever form they are paid.

Senator WILLIAMS. That is what I am speaking of. If you are speaking of the part not paid out in patronage refunds, and the corporation pays a tax on it——

Mr. VOORHIS. That is right.

Senator WILLIAMS. What percentage is that being done on?

Mr. VOORHIS. What percentage of their business are they paying income taxes on?

Senator WILLIAMS. What percentage of the business are they failing to allocate——

Mr. VOORHIS. I cannot answer that accurately. I can say that one regional cooperative paid a half-million dollars in taxes in 1948. I would like to say also that many of the figures that have been

submitted to the committee on how much a tax gain might be made by taxing cooperative patronage refunds do not take account of the substantial taxes now being paid by cooperatives.

Senator TAFT. They counted $3,000,000 off as paid by cooperatives. I do not know whether that figure is a correct one.

They give——

Mr. VOORHIS. I can cite the case of the Illinois Farm Supply Co. They paid $488,000,000 taxes in one year, Federal income taxes; and I do not know what the total figure would be. But what I do know, Senator Williams, is that as to the nonexempt cooperatives, either they must be obliged to pay the patronage refund or they pay full corporation income taxes on their money.

Senator WILLIAMS. Those that are paying full corporation income taxes on the money—and there are some who are not affected at all by any amendment we pass because they are—if they are already paying the tax, why, they need not be concerned about any change in the law.

Mr. VOORHIS. But they would be concerned about your amendment because under that they would be taxed on patronage refunds that were not paid in cash.

Senator WILLIAMS. That is correct.

Mr. VOORHIS. And actually that is the cooperative's way of securing its capital. Cooperatives do not have access to the normal sources of capital investment, and they are not set up so that they can have such access in the very nature of their basic purpose which is not to make money for investors but to save money for patrons.

Senator MILLIKIN. Mr. Voorhis, I wonder if you are accurate when you say this particular cooperative paid $488 million?

Mr. VOORHIS. No, I meant thousands; I beg your pardon.

Senator MILLIKIN. Yes.

Mr. VOORHIS. I am glad you corrected me. I said a half-million before, and I made a mistake the second time.

Senator TAFT. The New York Cooperative paid a million.

Mr. VOORHIS. The Grange League Federation: yes, sir. So these two cooperatives alone would account for half of all the allowance for taxes paid by cooperatives which the NTEA witnesses have made.

Now, there has been some question raised about business with nonmembers. I would only like to say this: That a nonexempt cooperative must either pay corporation income taxes on any savings made as a result of its business with nonmembers, or else it must be obligated to pay patronage refunds to them—one or the other. It cannot be a discretionary matter. Either it must be obligated so to do, or else it has to pay a corporation income tax on its money.

The real issue here is, as I see it, whether the people have the right to organize a nonprofit business and distribute savings to themselves through that medium without penalty, or whether they do not. The difference between cooperatives and other businesses is simply that the cooperatives always obligate themselves to pay what would otherwise be earnings of the business to their patrons, whereas other businesses choose to do this to a markedly less extent. But there is nothing in the law that says this shall be the case. Any business that so chooses can treat its patrons as cooperatives treat theirs, and can be in the same exact position as cooperatives are in, if it does so.

Senator FLANDERS. Mr. Voorhis, you have given your point of view as to what the heart of the matter is. May I first say that I have had the same feeling expressed, that the cooperative method of doing business is the American alternative to the present types of what you might call private business—I do not just know—the noncooperative business, rather than going to communism or state socialism, or some such—the American alternative, and then by voice and by typewriter I have sustained that thesis for many years.

I have also declared that I felt it would not come into its maturity as a cooperative movement until it was able to compete on even terms with the more conventional types of business.

Now, I refer to one respect in which many of my constituents complain that it does not compete on even terms. I have to refer to this because my constituents write to me about it.

The small-business man in the small town—he may be a grain dealer, he may be an agricultural machine dealer—says this: He says "I cannot expand my business with untaxed funds." He says, "The cooperative can put more money into its business with untaxed funds."

What would be your answer to that?

Mr. VOORHIS. My answer to it would be that it is not true, and the latter part of my statement deals with that very subject, and I think maybe I will save time if I just read a couple of paragraphs, if I may.

Senator FLANDERS. So far as the complaints that come from Vermont are concerned, that is the heart of the complaint.

Mr. VOORHIS. Well, I will try to summarize more briefly, Senator. An ordinary business that needs money for expansion seeks to do it in one of two ways; either it sets aside some of its earnings for the expansion purposes, in which case it pays an income tax, a corporation income tax on the money, and spends the money for expansion.

If a nonexempt cooperative does that same thing, it must pay a Federal corporation income tax on money the same as the other business did.

Another way in which the noncooperative business—I would like to say both of them are just as private as the other one except that the cooperatives has more private owners——

Senator FLANDERS. Let us call it cooperative and conventional.

Mr. VOORHIS. All right. The conventional business may seek to have people invest money in it. That is where they buy stock.

Senator FLANDERS. That is not the complaint.

Mr. VOORHIS. No, but I think I am correct.

Senator FLANDERS. All right.

Mr. VOORHIS. A cooperative may do the same thing; it may seek investment of money in it, but in the case of the cooperative, there because the cooperative is its members in literal effect, the cooperative—those members may decide to reinvest their patronage refunds in that cooperative.

If the members decide to reinvest their patronage refunds in their cooperative, then the cooperative is no more taxed on the reinvestment of that patronage refund than the conventional corporation would be taxed upon money invested in that conventional corporation.

In either case where it is an investment of funds, the company involved is not taxed. In both cases, the individual who has the money that is invested pays a tax upon the money that is invested.

Senator WILLIAMS. Except this vast difference: In the cooperative it is not a voluntary investment; it is just a tax assessment sent out to the customer.

Mr. VOORHIS. Essentially, it has to be a voluntary proposition, Senator Williams. Those cooperative members have got to agree that the patronage refunds shall be paid, not altogether in cash but partly in stock, or in certificates of ownership.

Now, then, I have heard the committee's concern about whether those things are of substantial value. But, after all, that is a question between the cooperative member and his cooperative. The cooperative member controls that cooperative. If this is not a proposition which is satisfactory to him, he has the remedy at hand. But, essentially, what that is, Senator Flanders, is a reinvestment of money, and that reinvestment amounts to the same thing as an investment in the capital stock of another corporation.

Remember that the cooperative is bound by certain very great restrictions that the other companies do not suffer. The cooperative is not free to dispose of the money in its hands in the same manner as other corporations are. The cooperative is obligated to operate in such a manner that it does repay, in one form or another, all funds remaining over and beyond its cost of doing business, to its patrons.

Senator FLANDERS. Let us get back to the question I asked you, which was: What is the difference between the corporation expanding out of its own funds and any method of expansion on the part of the cooperative? The corporation expanding out of its own funds expands with money on which it has to pay corporation taxes.

Mr. VOORHIS. It does unless it sells stock; yes, sir.

Senator FLANDERS. I am not talking about selling stock.

Mr. VOORHIS. All right.

Senator FLANDERS. I was confining my question to the plowing back of funds into investment of the company.

Mr. VOORHIS. All right. Now, the nonexempt cooperative, if it does that same thing, pays a full corporation income tax on that.

Senator FLANDERS. Let us talk about the exempt cooperatives under 101.

Mr. VOORHIS. In the case of the exempt cooperative my answer would be that a proper interpretation and administration of 101 (12) would make that nearly as true of the exempt cooperatives as it is of the nonexempt cooperatives.

Senator TAFT. If the exempt cooperative does not do that, you mean then it becomes a nonexempt cooperative?

Mr. VOORHIS. It does.

Senator TAFT. That is the answer to it.

Mr. VOORHIS. I think, in practical effect, Senator.

Senator TAFT. You mean the Treasury should interpret 101 (12) so that they could not force certificates, say, or letters of acknowledgment on their members?

Mr. VOORHIS. That is right, and so that where it is a "necessary" reserve those words are interpreted with care, and so on and so forth. I think the theory of 101 (12) is that it shall assure a virtually nonprofit operation.

Senator FLANDERS. I would like to talk not about theory but about bookkeeping and money.

Mr. VOORHIS. Yes, sir.

Senator FLANDERS. Does the cooperative have to go through that disturbing process of—let us see, What is the new corporation tax in this bill, 52 percent?

Senator WILLIAMS. It is about 70.

Senator MILLIKIN. It will be more; it has a ceiling of——

Senator WILLIAMS. Fifty-two is high enough.

Senator FLANDERS. Fifty-two percent is high enough. Here we have $100,000 or $50,000 that we would like to apply to the expansion of our business, but the Government is going to take 52 percent of it. Now, does the Government say the same thing to the cooperative?

Mr. VOORHIS. The Government says to the cooperative, "If you use any money that belongs to you as a business organization," it says exactly the same thing. It says, "If you distribute ownership on the basis of patronage in some other form than cash, in the form of stock, then your member will pay the tax instead of the cooperative."

Senator FLANDERS. But you pay a personal tax, not a corporation tax.

Mr. VOORHIS. That is true.

Senator FLANDERS. And, in general, his personl tax will be very much smaller than the 52-percent corporation tax.

Mr. VOORHIS. They certainly will in the case of cooperative members. But, Senator Flanders, I think there is another side to that coin, and I think it is this: If you are going to say that what happened in the case of the cooperative is unjust, then——

Senator FLANDERS. Wait a minute. We are not talking about justice; we are talking about bookkeeping.

Mr. VOORHIS. All right; bookkeeping.

Senator FLANDERS. We will get to justice afterwards.

Mr. VOORHIS. All right; bookkeeping. But my point is that the cooperative must distribute and that the other corporation does not have to distribute and that, if you are going to regard what happens to the cooperative as an advantage, then it would be equally reasonable to say to the conventional corporation that "You can only have full control over your funds providing that you make distribution as a cooperative does." Where the cooperative has money over which it has discretionary control, it is in the same tax position as the conventional corporation. It is only in the case of money where the cooperative is obligated to pay a patronage refund that there is any difference.

Senator WILLIAMS. They are obligated in every instance.

Senator FLANDERS. Is there any instance where the cooperative pays 52 percent of the part of the funds it makes——

Mr. VOORHIS. Oh, yes, sir.

Senator FLANDERS. I am talking of one under section 101.

Mr. VOORHIS. No, sir; not in that case. I was speaking of the nonexempt cooperatives.

Senator WILLIAMS. Does not the difference boil down to this: If you have a cooperative with $100,000 profit and you have a private corporation with $100,000 profit, and each one of them wants to keep all they can for expanding and keep the dividends on its capital stock, the corporation would send in $52,000 under existing rates to the Treasury, and they would have $48,000 left, and the cooperative that had $100,000 would allocate that to the members, and actually they owe the tax individually on $100,000, and you could keep it?

Mr. VOORHIS. It would not belong to the cooperative, and ownership is pretty important.

Senator WILLIAMS. But it would belong to the cooperative?

Mr. VOORHIS. No, sir. The question of who owns this money is of critical importance under American conceptions.

Senator WILLIAMS. Just a minute. They could assign this $100,000 to the owners by scrip or little letters of credit that would be payable at the discretion of the board of directors 1 year, 15 years, 20 years, or some indefinite time in the future. I am not saying they will not pay it, but they can get the——

Mr. VOORHIS. They are the obligations of the cooperative; they are the accounts payable of the cooperative.

Senator WILLIAMS. Only if and when the board of directors at some future date at their own discretion decides to pay it off.

Mr. VOORHIS. The board of directors cannot decide whether it si going to pay or not. The membership has to decide, and the membership may decide to take payment in some form other than cash. But the board of directors cannot have discretion whether a patronage refund is going to be paid, and if it is not a patronage refund it si taxable against the cooperative.

Senator WILLIAMS. Well, the Treasury Department testified this morning that there was no time limit put on the payment of these dividends, these patronage dividends, that were put out.

Senator FLANDERS. Since I have to catch a train, I would like——

Senator TAFT. We have had this all day. You could have been here.

Senator FLANDERS. I would just like to say, and Mr. Voorhis may challenge the statement or not, that I have, as a result of this discussion, the very strong impression that the cooperatives have a very important advantage in being able to apply funds, through whatever means, to the expansion of their business on terms which are very much more lenient than the corporation tax permits the convention business to do.

Now, with that conclusion from the discussion so far, it seems to me that the next question is as to whether it is in the public interest, that owing to the importance—and I conceive it to be of very high importance—of the cooperative movement, whether that is a proper thing for the Government to do. That is the question I raise, and I must say that I look on that second question rather sympathetically for the corporation, but I would like to see the statement made in terms which are real and valid rather than in such terms that we don't know just what we are doing for cooperatives.

Mr. VOORHIS. Senator, may I say one word with respect to what you just said?

Senator FLANDERS. Yes, sir.

Mr. VOORHIS. Which is this, that the cooperative is essentially the means whereby people of small capital may become owners of businesses.

Senator FLANDERS. Agreed.

Mr. VOORHIS. Operated for the benefit of that group of people.

Senator FLANDERS. Agreed.

Mr. VOORHIS. Most of those people do not have large amounts of capital to invest. The time that they do have capital to invest with

respect to their business is mainly at the time that patronage refunds are paid to them.

Senator FLANDERS. That is agreed.

Mr. VOORHIS. This is a means whereby they may capitalize their own business and themselves pay the taxes when they do it by means of deferred patronage refunds.

Senator FLANDERS. You mean individual tax and not the corporate tax. I think we are in agreement on the facts of the case; and, as I said, I am sympathetic to the point of view that the cooperative occupies a very special place in the American scheme of things. I do hope that it will eventually get along with a minimum of special assistance.

Mr. VOORHIS. So do I, Senator.

Senator WILLIAMS. Mr. Voorhis, at the time that Congress gave this first consideration to the cooperatives, corporation tax rates were 2 percent.

Mr. VOORHIS. Yes.

Senator WILLIAMS. Whereas today they have advanced up to 47 percent now, and maybe 52 percent, which does make quite a difference in the benefits that the cooperatives are getting today as compared with what they were getting at the start.

Mr. VOORHIS. I would only like to point out, Senator Williams——

Senator WILLIAMS. From the standpoint of the competition of the business—we will not get into the question of whether it should or should not——

Mr. VOORHIS. I am not going to say that——

Senator WILLIAMS. I say there is quite a difference.

Mr. VOORHIS. I only want to point out that the relative growth of cooperatives was faster in the earlier period compared to other businesses that it was more recently.

Senator WILLIAMS. Which goes to show that the tax exemption does not mean very much to it.

Mr. VOORHIS. I am not arguing for tax exemption, Senator Williams. I am only trying to explain the cooperative method of business operation is a different method of business operation. It is one that is set up for a different purpose.

Senator WILLIAMS. I might agree with you—I agree with you as to the need for cooperatives doing business, and I do not think—this has been my thought, and it has been expressed by the members of the committee—I do not think it has been the thought of the committee to destroy it and its right to organize, and certainly it is not my thought.

Mr. VOORHIS. But certainly to be effective you have got to have some opportunity of growth, the same as other business have, and a basic opportunity for growth of cooperatives comes about from the opportunity for the reinvestment of their members' patronage refunds.

Senator WILLIAMS. I think that Mr. Black, the Governor of the Farm Credit Administration, made that point very well; and I am sure, you are familiar with the speech that he made, because it has been quoted quite a number of times, when he pointed out how originally in the beginning the advantages Congress gave to the cooperatives were never intended, nor were indicated to be in proportion to what they are today under existing tax rates and, as the tax rate goes higher, that competitive advantage increases in proportion.

Mr. VOORHIS. I do not think it is a competitive advantage, as I have tried to show.

Senator WILLIAMS. Well, that is a question.

Mr. VOORHIS. I do not think cooperatives have any competitive advantages. I think, on the contrary, they have a number of competitive disadvantages, and I think that needs to be recognized.

In a cooperative you must conduct that businses democratically, and that is a lot harder job. We think it is worth while; we think it is an alternative to people running to the Government for help; but we believe that they need to be sound and that they need to be able to operate on a basis where they will not be just little ineffectual organizations but where they can be organizations with some real effect on behalf of their members. They belong to little people with little capital.

I want to explain that I have no desire to detain the committee any longer than the members want to ask any questions.

Senator MILLIKIN. Thank you very much, Mr. Voorhis.

Mr. VOORHIS. I would have done a better job, Senator, if I had been on the stand earlier in the day.

Senator MILLIKIN. We will look over your full statement; and, as always, you make an interesting witness.

(The prepared statement of Mr. Voorhis follows:)

TESTIMONY OF JERRY VOORHIS, EXECUTIVE SECRETARY OF COOPERATIVE LEAGUE OF THE UNITED STATES

Mr. Chairman and members of the committee, my name is Jerry Voorhis. I am executive secretary of the Cooperative League of the United States, with headquarters at 343 South Dearborn Street, Chicago. The Cooperative League is a business association and educational and informational agency. Its member organizations are 12 regional wholesale cooperatives, 2 large local cooperatives, 2 mutual insurance companies. Total membership of these organizations is close to 2,000,000 families. In addition, the Credit Union National Association and the National Rural Electric Cooperative Association, whose memberships respectively are about 6,000,000 and 3,000,000, are affiliated members of the league.

We are called upon to live in one of the great periods of struggle and crisis in the history of mankind. On the surface the struggle appears to be between democratic governments and Communist governments, or between free institutions and totalitarian ones. But more fundamentally we are passing through a great testing of human beings. It is a test of people all over the world to see whether they can be masters of their own destinies or whether they will succumb to a dead dependence upon powerful forces beyond their control. We are deciding now whether voluntary organizations of the people can be made strong and vigorous enough to resist a tide which threatens to sweep us by the millions in great currents toward whirlpools of concentrated financial, cultural, economic, and political power.

The world needs nothing so much as it needs effective demonstrations that ordinary people—people with little capital and small resources—can meet and conquer their problems and build a worth-while life for themselves. For all men really desire freedom. By the hundreds of millions they are today demanding it for the first time. But many of them do not really believe freedom is possible for them. Our task is to prove that it is possible. And the way we can do it is by encouraging in every possible way the solution of problems by our own people through voluntary action in voluntary organizations and by means of effective institutions built by their own efforts.

We are engaged in a struggle that can be lost without our enemy firing a single shot. That will happen if we lose America's ancient faith in the dignity of all her people and if the people themselves lose their confidence in their own ability successfully to grapple with their problems and to meet their needs. The greatest military victory of all time will avail us little unless the quality of life in the communities of this democratic Nation is strong and virile and full of hope.

And since the basic necessities of life are economic ones the most pressing single need of our time is for demonstrations which all can understand of the success of groups of American citizens in meeting their needs and solving their problems by their own effort through voluntary application of the principle of mutual aid to those economic problems. One of the most basic and certainly one of the most directly effective types of institutions through which such demonstrations can be and are being made today are cooperatives. This is so because cooperatives are economic organizations through which any group of people—even though their resources individually are very small—can attack and solve these their problems. Cooperatives make possible to the millions a full participation in the making of the practical day-to-day decisions which shape their lives. And that participation is the one essential element which makes freedom real and without which freedom cannot exist.

It is against this background that I hope this committee will consider the questions which are before you in these hearings.

We understand full well the great problem which this committee and the Congress faces. We know you are under the necessity of increasing the revenues of the Government. The people I represent would be the last to be willing to feel that they were not doing their full part to support their Government and Nation in this time of crisis. They believe fully and sincerely that they are doing so. And I do too, for reasons which I shall set forth in this testimony, or I would not be here today.

In the last analysis it is the people who pay all the taxes that are paid. Taxes might be placed upon businesses with some logic in order to adjust the inequalities between large- and small-scale enterprises, between monopoly and really free enterprise. And I suppose some argument can be made on the ground of convenience, particularly at a time like the present, for resorting to taxes upon corporations for a certain proportion of necessary revenues. But taxes upon business for the regular support of government cannot, I believe, be defended on grounds of either logic or sound policy. There is no way of determining where the real incidence of such taxation falls. We only know that, ultimately every penny of tax that is paid is paid by the people in some manner or another and that businesses which remit taxes constitute basically not taxpayers, but tax collectors for the Government, collecting the money which they pay in taxes, sooner or later, and in one manner or another from their customers.

It is the ultimate individual recipient of income who should pay the tax upon that income. One way or another he will do it anyway. He might better know he is doing it than to be deceived with thinking he is not. It is upon these sound considerations that cooperatives and their members are now taxed, for no American citizen can derive a cent of taxable income from his transactions with a cooperative without paying a full tax on that income today. This is as it should be and we believe the whole economy would be better off if these same principles and considerations were of universal application.

Now it is our position that the personal income tax should be the major source of revenue to the Federal Government. Nor will the members of cooperatives throughout this country object, under present circumstances, to increases in these taxes in sufficient amount to yield between 3 and 4 billion dollars of additional revenue. It is probable, too, that corporation taxes could be made to yield an additional $1,000,000,000. If this were done cooperatives would pay their share of it under present law for the great majority of the Nation's cooperatives pay their taxes under exactly the same laws as apply to any other business corporations and that happens to be true of all but two of the member organizations of the Cooperative League. We believe this is as it should be.

Certainly there can be no sound argument against the levying of excise taxes, even substantial ones, against those commodities which compete most directly for materials with the national defense program and consumption of which it is therefore at present in the national interest to discourage. Increased excises also on the consumption of exhaustible natural resources or on things which it is harmful to consume cannot be seriously opposed. A general sales tax of universal application to all commodities would be unjust to large families and to those of low income. But nevertheless some 2½ to 3½ billion dollars of additional revenue could be derived from excise taxes. And cooperatives and their members would pay in full all these taxes on precisely the same basis as any other taxpayer.

There are some loopholes that can and should be closed. Among these are those represented by the present state of the capital-gains taxes, the depletion allowances, estate and gift taxes, and tax-exempt bonds. Furthermore, any profit-making enterprise owned by a nonprofit institution, including cooperatives, should of course be taxed on any profit it makes regardless of its ownership. In other

words the decision as to whether income should be taxed should be based upon the question whether taxable income exists, not upon the nature of the institution exercising ownership. The criterion should be the nature of the operation, not the character of the owning institution.

Now I have been talking in pretty big figures. The next point I want to make is that the question of placing additional taxes upon cooperatives over and beyond those they now pay should be decided on the basis of equity and broad national interest. Especially do I make this appeal because the revenue aspects of the matter are, contrary to some misleading statements, very minor ones indeed. Attempts have been made to mislead Congress into believing that somewhere there existed a potential $1 billion of additional revenue if only the co-ops could be "got at." Well, the co-ops are easy to "get at." All their business is conducted—of necessity—in a goldfish bowl and everything they have done is a matter of open public record. It has to be if for no other reason than because their many members have to be kept fully informed. But this $1 billion has been conjured up by clever people in the following way. Gross figures of the resources owned by various types of nonprofit enterprises have been taken and added together and then estimates have been made as to how much taxable income might derive from these resources if they belonged to businesses run for profit. Furthermore, in this list cooperatives turn out to be a very minor element. Out of a total figure of $157,-500,000,000, life-insurance companies are down for $50,000,000,000, mutual savings banks for $20,000,000,000, building and loan associations for $12,000,000,000. Government pension trust funds are down for $35,000,000,000, and Federal Government Corporations for $23,000,000,000. These five figures total to $140,-000,000,000. Coooperatives are down for $2,500,000,000 of resources or less than 2 percent of the total. And yet I imagine the impression has been left with many Senators, as indeed it was fully intended to be left, that the co-ops by themselves could be made to yield $1 billion of revenue over and beyond the taxes they now pay. Any such statements are the grossest kind of deception.

The facts in the matter were fully set forth and documented by Mr. Karl Loos in an able article which appeared in the Cooperative Digest for May 15, 1950. Mr. Loos proved in that article that, taking 1946 figures—since they were the latest ones available in sufficient detail—the repeal of the so-called agricultural exemption would have yielded $10 million—not billion, please—at a maximum and that even if all patronage refunds of all cooperatives—most of which do not have any exemptions of any kind—had been taxed as if they were income the additional revenue would have amounted to only about $50,000,000 at the outside. In other words even an outright discriminatory penalty tax against all patronage refunds of all agricultural cooperatives in the whole country—and the agricultural co-ops account for at least 80 percent of all co-op business—would yield an insignificant amount of revenue.

So the question should be decided as a policy question, not a revenue one, and in that framework I ask the committee to consider just a few questions. Has it been a good or a bad thing for America to have over 3,000,000 farmers join together to bring electricity to their own farms—especially when it had not been done and would not have been done by any other agencies except through rural electric cooperatives? Has it been a good or a bad thing to have some 5,000,000 American families pool their small savings in their credit unions so as to provide for themselves agencies of thrift and sources of necessary credit at decent rates? When open formula, improved fertilizer at fair prices and in dependable supply is needed by farmers, is it better for them (*a*) to go without it or (*b*) to run to the Government to get it or (*c*) to form cooperatives to supply themselves with that fertilizer? Where a community is without a needed hospital is it a good thing to have the people in that community form a cooperative, pool their membership contributions, and build their own hospital for the benefit of the whole community and to attract the doctors there who otherwise would not come? Would it be a good idea to let the major oil companies who now control somewhere between 85 and 90 percent of all petroleum resources go ahead and complete their monopoly or would it be better to have the Government set up some kind of agency to stop this process, or is it still better that some millions of ordinary citizens, mostly farmers, have organized first their retail co-op filling stations and then their own sources of supply clear back to the oil well? Is it healthy for America to have at least 1 percent of the petroleum business in the hands of real "independents" the people who must use that oil? Is it good to have some of the ownership of this great industry spread broadly among millions of people located all over the smaller towns and rural areas or do we prefer to have the whole of that ownership concentrated in a handful of big cities in the hands of a few people?

Do we have a healthier democracy when a lot of people take responsibility for ownership and for decision making or when only a few do this? Are we for or against cooperative economic institutions which depend for their success upon a core of loyal members who learn to exercise toward one another essentially Christian relationships of mutual aid?

Does the world today need less or more cooperation among the people? And can you ever get that cooperation at top levels unless you have first found it flourishing in the neighborhoods and the local communities?

In a word, are we for or against cooperatives in the United States? It is time we decided that question. I think I know what the answer of every member of this committee will be to that question. Every one of you will say you do believe in the worth-while contribution of cooperatives to our national life. Everyone will say he really believes in economic freedom and that he knows that any system professing to be based in freedom must allow full scope for the cooperative as it does for other forms of business organization. I believe we could all agree in principal that we do not want anything to be done which would be inequitable so far as the cooperatives of this country are concerned. And that is the only thing we are here asking.

But at that point differences will appear and there will be those who will say they are for cooperatives but—and will then make various kinds of proposals regarding their regulation. Some will even propose that special taxes be devised to apply only to the operations of cooperatives and not to other forms of business. And some will say that while they believe that patronage refunds paid in cash cannot possibly be regarded as income to the cooperative, nonetheless any patronage refunds not paid in cash immediately upon their realization or at least within 60 days should in some strange manner be regarded as different from other accounts payable existing in the business structure of the country.

All in the world we are asking of the Congress is the same thing we have always asked, which is simple equity and fairness. We believe very sincerely that equity now exists as between cooperatives and other businesses so far as tax payments are concerned. I am ready to simplify the whole question down to this one main point—that patronage refunds, in whatever form paid, are not the property of the cooperative but of the patron and cannot in justice be taxed against the cooperative. I am ready to say that if the committee and the Congress observe that central principle I am entirely willing to leave decisions as to other matters in your hands without concern that you will do anything which would be seriously damaging to the right of the people to form and conduct cooperative enterprises.

Now, it is not my purpose to discuss section 101 (12), which provides, for the benefit of agriculture, an encouragement to farmers to solve their own problems instead of relying upon Government or other outside agencies. Farmer cooperatives willing to subject themselves to severe regulations and restrictions may attempt under that subsection to qualify for statutory exemption from Federal corporation income taxes only. This provision has been on the books for over a quarter of a century. It has been a part of a sound agricultural policy.

I am quite willing to leave to the committee the decision regarding 101 (12), after all the evidence has been heard. I would only want to say that 101 (12) has served to simplify the operations of a lot of small farmer cooperatives and to enable them, through abiding by its regulations, to avoid a lot of expensive red tape.

Other witnesses will deal fully with the questions revolving around 101 (12) and I shall not take the committee's time to do so.

The statement which I want to present has to do with the great majority of cooperatives in our country, most of them rural, which have no different status under the law than any other business. We neither ask nor want any different status and it is my purpose to show that, we do not have one.

If any of these cooperatives retain any of the receipts that pass through their hands and fail to pay them into the hands of their patrons they now pay full corporation income taxes on that money the same as any other corporation would do. They pay, of course, all other taxes in full amount the same as any other business.

On the other hand, if any business assumes a binding obligation to pay patronage refunds to its patrons in proportion to patronage, such out-payments are not taxes against that business. This is the case quite regardless of whether or not it is a cooperative.

All through the history of our country, the people's right to organize and conduct nonprofit businesses has been unquestioned. And we have not penalized them for so doing. Since ours is a free country, we have taken the position that while most businesses are organized to make a profit for their stockholders; nevertheless groups of people should be free without penalty of discrimination

against them to organize and conduct business enterprises, not for the purpose of making profit for their stockholders but for the purpose of making savings for their patrons, policyholders, borrowers or members. Some such businesses have been organized in such a manner that the business is required to pass on to its patrons the receipts that remain after all costs have been paid. Such businesses we call cooperatives or mutual enterprises. They are good for this country. They are an essential element in any free economy. They stand as a bulwark against private monopoly on the one hand and state monopoly on the other. They are the best safeguard we have against tendencies to depend on government or on monopoly for what we need. They are American democracy at work in the economic field. They represent the people's effort to help themselves and their neighbors through voluntary organizations.

The difference between cooperatives and other businesses is simply that cooperatives always obligate themselves to pay what would otherwise be earnings of the business to their patrons, whereas other businesses choose to do this to a markedly less extent. But there is nothing in the law that says this shall be the case. Any business that so chooses can treat its patrons as cooperatives treat theirs and can be in the same exact tax position as cooperatives are in if it does so.

Attacks, therefore, upon the present tax status of cooperatives are made, not in an attempt to establish equity but in an attempt to penalize cooperatives for the manner in which they treat their members and patrons, and thus to remove their competition from those who don't like it. Such attacks can only come from those who don't really understand the basic conception of economic freedom.

I wish to submit to the committee two basic principles. The first is that a business operation which loses money should not be taxed upon its loss and that neither should a business operation which divests itself of the opportunity to make a profit be taxed upon receipts which it never owns, which it must pay out to its patrons, and which legally belong to those patrons and not to the business enterprise.

The second principle is that, so long as we have corporation taxes, all businesses, cooperative and otherwise, should be taxed, as they now are taxed, on any net earnings which remain in the ownership of that business, or over which its board of directors is able to exercise discretionary action as to their disposition.

We are not here, Mr. Chairman, asking any favored treatment. If a cooperative makes a profit, if it has income which it is not obliged to pay and which it does not pay in patronage refunds, it is now taxed and we believe it should be upon that income.

I know that some people on the staffs of the Treasury and the joint committee have prepared and circulated a study in which they contend for some eight pages that patronage refunds of cooperatives are income to the cooperative, despite the fact that they don't belong to it, and that these patronage refunds should be subjected to corporation-income taxes as if they were profits. Then in one paragraph this clever document throws away its whole case by saying that there is another way to accomplish the purpose of "getting at" the cooperatives anyway. This other suggested way is by the astounding proposal that excise taxes equal in amount to the corporation-income tax rate be levied against patronage refunds of cooperatives and that this be done on the amazing grounds that the present corporation taxes are nothing more nor less than license or franchise taxes levied upon corporations for the privilege of doing business in the United States. Whatever the argument might be for a system of Federal licensing of corporations—and cooperatives would certainly expect to come under any such system and to pay their full taxes under it if it were put into effect—it is nothing short of fantastic to contend that our present high level of corporation taxes are levied not for the purpose of raising revenue but only as franchise taxes for the privilege of doing business. Such a conception is about the most dangerous proposal so far as the future of American business is concerned that has yet come to my ears.

The process of argument pursued in this study, however, illustrates, I think, that the attack upon cooperatives centers in an attempt to blur the distinction between profits on the one hand and patronage refunds on the other. This is the central and all-important question. For upon the right of groups of people to organize businesses to meet their needs directly and at cost depends the whole structure of American economic freedom. And, when some ivory-towered experts who think in terms only of increasing tax collections propose a system of excise taxes as a devious means of destroying that right and when they attempt to justify their proposal in the way they have done it, I think the Members of Congress who are responsible for this Nation's policy should reject any such proposal flatly and finally.

For there is another side to this coin, Mr. Chairman. If patronage refunds were to be treated as if they were profits for tax purposes, a gross inequity and

injustice would have been done which could only be corrected by requiring other businesses to treat their customers in somewhat the same manner as cooperatives treat their patrons. It would be manifestly unjust to levy a penalty tax on patronage refunds which cooperative businesses must distribute to patrons without requiring other business to make similar distribution of their savings. If there is to be no difference between patronage refunds and profits, the profits should be distributed to customers on the basis of patronage and some means should be devised to see that this is done. Moreover, if patronage refunds are just like profits, then, when profit businesses expand their plant, ownership of the new plant should be spread among all the customers of the business just as cooperatives must now do whenever their facilities are expanded by payment of deferred patronage refunds. Again, returns to stockholders would have to be limited in profit corporations just as they are in cooperatives. And finally, if this basic distinction between saving for patrons and profits for stockholders were to be rubbed out by tax favoritism for profit business, then profit business would in all justice have to be required to give control over its business to its patrons on the basis of one vote each regardless of the number of shares held just as cooperatives must do.

All this sounds ridiculous, I know. It is equally ridiculous to contend that patronage refund moneys constitute anything resembling a profit to the business which is obliged to pay out such patronage refunds. And, if the tax laws were to be used to deny to groups of American farmers or other American citizens the right to conduct, without penalty, a cooperative nonprofit business and to compel them to change their methods of operation, then it would be equally reasonable to require the same sort of disposition of profits by profit corporations as is required of cooperatives with respect to their savings.

Either proposal is wrong, Mr. Chairman, and I do not believe the committee will fall into any such trap. I hope, too, that what I have just said will serve to illustrate how very different from one another profits on the one hand and patronage refunds on the other actually are.

America's economy is tending toward what we call integration. Most of our major industries are virtually integrated. But we hear very little complaint about this until some of the ordinary citizens try it.

When a highly integrated business such as the steel industry or a power company or a major oil company buys out a link in its chain, such as mine or a power plant or a local filling station, no one suggests that they be subjected to taxation when the ore is delivered to the blast furnace or the power to the substation or the gasoline to the filling station. We hear nothing about tax dodging in connection with the veritable host of nonprofit operations that go on every day between various levels of an integrated large corporation.

But when a group of retail merchants who want to retain their independence organize a cooperatively owned wholesale, so as to put their wholesaling on a nonprofit basis, then there are loud outcries that they are "escaping taxation" by adopting one step in integration. The same outcries are raised when a group of consumer cooperatives set up their own wholesale.

And when a number of farmers decide to make agriculture a rational industry and to include the marketing of their crops or the procurement of electricity or the purchase of their supplies on a cost basis, the same as almost every big industry in the country has been doing for years, then a great cry is raised that they should be penalized for engaging in an at-cost operation and refusing to make profits at their own expense. I am sure this would not happen if a big cereal company bought out several thousand farms and turned them into a collectivist enterprise. No one would say it was escaping taxation, because, as would be the case, it paid no tax on profits when it transferred the grain from the farm to the elevator and to the mill.

It is only, apparently, when farmers or other little people with little capital want to keep their independence but to strengthen their economic position so as to gain some semblance of competitive equality that we get complaints. The cooperative is the little people's means of keeping their independence and at the same time rationalizing their economic operations. If big business can integrate without paying profit taxes on transactions between departments, it is a violation of the most basic concept of democracy to deny to the little people of the country that same opportunity through the use of cooperatives.

Now, naturally enough, as long as cooperatives were weak and helpless organizations, unable to really affect the markets of the Nation, little was said about them and few complaints were made. It is perhaps equally natural that complaints should now arise largely over the fact that some cooperatives are growing institutions and that some dirt farmers, for example, as well as other ordinary

citizens, have dared to acquire ownership of some oil wells and some power lines, some fertilizer plants and feed mills, some grain elevators and insurance companies.

It is frequently said that cooperatives are "all right" so long as they remain small local affairs engaged in just one minor line of business, but that they are "all wrong" when they begin to expand into wholesale and production activities where they can have a real impact on the economy. And people who make such statements usually follow them up by proposing that there be a different treatment of patronage refunds paid in cash on the one hand and patronage refunds paid in certificates of ownership on the other. The reason is obvious. If the reinvestment of patronage savings by cooperative members in their cooperatives could be stopped, then the growth of cooperatives could be stopped and the spread of ownership to the little people could be checked. (It is worth remembering that only 9 percent of the people of this country own even one share of corporation stock or interest in any business. We believe this situation needs correcting and that cooperatives can help to do it.)

Now, let us examine these proposals a little. Cooperatives do not pay patronage refunds just because they suddenly decide to do so. Indeed, if they do it that way, they have to pay a full income tax on the money first under present law. The only circumstance under which patronage refunds are not taxed against a cooperative or other business paying them is when there is a preexisting binding obligation to pay and when that money belongs to the patron, not to the cooperative. It belongs to the patron if it is paid at once in cash. It belongs to him equally if he makes a voluntary agreement as to the time of its payment to him and thus reinvests the money in his cooperative, receiving a certificate of ownership in token thereof. Now, no one proposes that Congress tell other businesses that they must discharge their accounts payable or other liabilities in cash within 60 days or else have those accounts payable regarded as taxable income to the business that owes them. Neither can Congress with any show of justice treat accounts payable to patrons of cooperatives or investments of cooperative members in cooperatives as if they were accounts receivable by the cooperative, and hence subject to income tax against the cooperative.

In the case of *Midland Cooperative Wholesale* v. *Commissioner of Internal Revenue*, decided in 1941, the Board of Tax Appeals decided that, where accumulated net margins are credited to patrons as accounts payable by the cooperative, the allocated amounts are debts owing to the patrons, not income to the cooperative. A borrowing corporation does not have income when its members loan money to it to provide needed operating capital. Loan capital or investment money is a corporation debt, not corporation income.

And in the case of *Commissioner of Internal Revenue* v. *Laird Wilcox et al.*, the United States Supreme Court held in 1946 that "a taxable gain is conditioned upon the presence of a claim of right to the alleged gain and the absence of a definite obligation to repay or return that which would otherwise constitute a gain." In the case of deferred patronage refunds, the cooperative has no claim of right to that money. It belongs to the patron. And the cooperative does have a definite obligation to repay and return those funds to the patron.

The question next arises whether, nonetheless, cooperatives cannot accumulate funds for expansion purposes without paying taxes on them, whereas neither a partnership nor an ordinary corporation can do so. Disregarding section 101-12, under which a constantly decreasing number of cooperatives are attempting to qualify, the answer to that question is an unqualified "No."

The accumulation of reserves by cooperatives, for any purpose, are governed by the same laws and subject to the same taxes as apply against any business. The only difference arises, again, from a difference in method of operation. If an ordinary corporation decided to build a new plant and to sell additional stock to secure funds for doing so, no one would for a moment suggest that the proceeds from that stock sale be regarded as taxable income to that corporation. It would be investment money instead. The same would be true if partners in a business decided to put more money into it for expansion purposes. If, on the other hand, the corporation or partnership retained part of its earnings for the purpose of building the new plant, then taxes on those earnings would have to be paid.

Now, if a cooperative needs to construct or acquire new facilities, such as additional storage facilities or a new fertilizer plant to meet its patrons' needs, it can do so in one of two ways, comparable in both cases in all essential respects to what other businesses can do. The first thing a cooperative can do is to retain in its own name a part of the savings made as a result of its business and use that money for the required expansion, provided it first pays every penny of

tax on such funds that any other business would have to pay. (It is my belief that a careful interpretation of 101 (12) would make this statement true of cooperatives qualifying under that section, as it is certainly true of all other cooperatives.) The other thing cooperatives can do (whether or not they are qualified under 101 (12)) is to secure investment funds from their patron-members. To be at all fair about this matter, it must be borne in mind that cooperatives do not have access to the sources of capital which other businesses enjoy. Cooperatives receive the great bulk of their capital funds from small investment by many, many people of modest means—their member-patrons. If a cooperative is to use this second method, one of two things must happen. Either the member-patrons having received their refunds in cash must reinvest them or else the member-patrons must voluntarily agree to receive their patronage refunds in stock instead of in cash. If they do so agree, then the cooperative must assign ownership over these funds to its patrons in proportion to their patronage, and this in turn means that ownership over the new facility, whatever it may be, will be broadly spread among all the patrons of that cooperative. Furthermore, it means that these co-op patrons have done nothing more nor less than exactly what the investors in a new issue of corporation stock (or partners putting more money into their business) would have done in the case of sale of a new stock issue. But on every dollar of the reinvested patronage refund which would be taxable income to anyone dealing with any business, the cooperative patron must pay a personal-income tax just the same as if the money had been received in cash. This fact, if nothing else, shows clearly that what happens when a cooperative secures funds for expansion by paying patronage refunds in a form other than cash is on all fours with what happens when a corporation sells a new issue of capital stock. In neither case are investment funds treated as taxable income against the business. In both cases the money invested is regarded, taxwise and otherwise, as the property of the individual investor, as indeed it is.

Once again therefore let me point out that there is "tax equality" now.

To propose that patronage refunds of cooperatives be subjected to corporation-income tax in the hands of the cooperatives unless they are returned in cash or merchandise is to propose to cut off investment capital which is so essential for any business operation. Cooperatives do not have access to the money exchanges in the money markets of the country. Cooperatives are based upon the principle of patron ownership ,and patrons of cooperatives ordinarily do not have huge sums of money to invest. Cooperatives must depend upon small contributions to capital from a very large number of people rather than large contributions from a few.

The great alarm voiced by opponents of cooperatives about the expansion of ownership by co-ops of physical facilities is mostly "sound and fury." But it may be worth while to point out that the factor that has enabled cooperatives to achieve such expansion as they have achieved has not been any tax advantage but rather the willingness of several million Americans, mostly farmers, to accept and pay taxes on stock in their cooperatives instead of insisting on cash patronage refunds. And the further fact is that this has meant a spreading of ownership over facilities essential to them among millions of American citizens, who could have acquired such ownership in no other way. I am sure you believe as I do that this is a 100 percent good influence on our economy and national life and a much-needed application of the basic principles of traditional Americanism.

Senator MILLIKIN. Is Mr. Sims in the room?

Senator TAFT. Mr. Chairman, I ask that Mr. Sims' statement be inserted in the record.

I also request at that point that the statement of the Independent Livestock Marketing Association of Columbus, Ohio, be inserted in the record.

Senator MILLIKIN. That will be done.

(The documents referred to are as follows:)

INDEPENDENT LIVESTOCK MARKETING ASSOCIATION,
July 17, 1951.

To Members of Senate Finance Committee:

The following brief statement is filed with and for the consideration of yourself and other members of the Senate Finance Committee by the Independent Livestock Marketing Association. This association at present is an organization of some 110 livestock markets located in the eastern Corn Belt—largely in the

State of Ohio. The membership includes individuals and corporations engaged in private and independent business enterprise in the handling and marketing of livestock.

The position of the association on exemptions of income-tax payments granted cooperatives, mutual associations, and special organized business groups so set up to avoid income-tax payment is to eliminate such provisions and regulations of the Internal Revenue Code that permit such inequities and inequalities. We stand for equality of treatment, and seek the elimination of discrimination in taxation.

The Independent Livestock Marketing Association specifically urges similar and fair treatment of all segments of business and equality in income-tax payments for the support of Government. We definitely disagree with the present exemptions of income-tax payments granted present business groups and seek your full consideration to the placing of such exempt businesses in comparable tax-paying position with private independent enterprises.

We believe that all earnings, profits, and/or savings of any business of commercial enterprise in nature should be taxed equally to assessments imposed on similar businesses. At least we insist that all earnings, profits, and/or savings of cooperatives, mutual associations, and other exempt groups placed in reserves of the organizations or corporations be taxed equally with similar private business. At this time we do not stress the position that such savings returned in actual cash to patrons be taxed. However, every saving accruing other than actual cash patronage dividends should bear its full support to maintainance of government. This should apply to all moneys retained, including allocated savings to patrons, designated by certificates of interest or other forms used to indicate such savings, or savings placed in general or special reserves. We believe it should be clearly understood that retained savings, whether allocated to patrons or placed in any other type of reserve, are always available for purchase of facilities, equipment, maintainance, operating capital, protective and credit funds, and other uses as desired and necessary. This situation alone is the prime inequality with private business. Far too often such untaxed funds purchase private taxpaying enterprises and not only take such taxpaying business out of the income-taxpaying field, but future earnings or savings on such cooperative business are tax-free. Such a common situation places great inequalities against private business and becomes tremendously burdensome with high tax rates and ever-increasing taxation payments.

We wish to register opposition of those contending that the cost of handling taxation affairs of exempt groups would nearly amount to as much as the tax to be collected, and therefore little would be gained in amount of income taxes secured. The situation of being little businesses and very small savings is extremely overdrawn. Cooperatives, with the years, are like other enterprises: they become established; they grow and prosper financially. Many are tremendously large, both in volume of business handled and in savings earned annually. A study of the situation readily indicates the erroneous position that it is all punitive, unimportant business. It is to be understood further that income taxes are not paid until earnings or savings are made. So, where savings are not established, there is no tax to be paid. Where savings are secured, every legitimate business should pay their proportionate share of income taxes.

We commend the position of many cooperatives and similar exempt groups in paying annually their legitimate income taxes based on the same rate of taxation as private business for all reserves and savings retained. This is the outstanding example of the position taken by those opposing exemptions. In business ethics, in business fair-trade practices, and in good business relationships, many groups subject to exemption of income-tax payments have for years paid their tax and met their honorable obligations to share the cost of Government. Without justly meeting the situation, we may find that the future economy of our Nation will greatly be impaired with further shrinkage of private taxpaying businesses and more and more nonincome-taxpaying businesses will be in business. Further, we will undoubtedly find that many businesses that could be exempt under present regulations and are now paying income taxes on a voluntary basis could readily rescind voluntary payments and again avoid their payments of income taxes. With a recession or depression, such a condition could become real.

Our membership contacts daily thousands of farmers and livestock producers. These folks have the respect of all interests and are of the highest integrity. They believe in honest effort and in the right of free enterprise. They state in the great majority of cases that income taxes should be paid by their organiza-

tions and business now exempt from paying income taxes. Farmers are keenly aware of the situation, are clear in their thinking that individually and collectively that they share equally to their opportunities—the cost of their Government. Our farm people cherish more than any other group in this country our democratic way of life. They have always met their fair responsibilities, and in most all cases those in cooperatives and those in private enterprise want to meet their fair and just obligations. They soundly feel that relief from this disparity will relieve most of the tension existing in business circles. Equality of obligation and with equality of opportunity, great American principles apply here. Our national economy requires more nearly balancing our income taxation methods and placing of our commercial enterprises on a basis of equality of taxation.

Respectfully submitted.

INDEPENDENT LIVESTOCK MARKETING ASSOCIATION,
FRANK TEEGARDIN, *President.*
C. K. ELLIOTT, *Chairman Legislative Committee.*
B. H. ANDERSON, *Chairman, Executive Committee.*
R. Q. SMITH, *Secretary.*

STATEMENT OF JOHN W. SIMS, GENERAL MANAGER OF THE FARM BUREAU COOPERATIVE ASSOCIATION, COLUMBUS, OHIO

My name is John W. Sims. I am an Ohio farmer as well as general manager of the Farm Bureau Cooperative Association, Columbus, Ohio, and executive secretary of the Ohio Farm Bureau Federation. The federation has a membership of approximately 65,000 farm families in Ohio, and the cooperative association is a federation of 87 local cooperative associations dealing with approximately 185,000 farm patrons.

It is a pleasure to have the opportunity of appearing before the Senate Finance Committee. I have had an opportunity to work with Senator Robert A Taft on many problems affecting Ohio farmers, and respect his judgment and statesmanship.

I appreciate the problems which face your committee. You have been called upon to provide higher revenue for the Government.

Farmers as primary producers are one of the groups which are hardest hit by increased taxation. Unlike corporations and many other forms of business, they are unable to pass the tax burden on to another group. Despite this handicap, farmers are willing to pay their fair share of increased taxation.

I am here today to testify concerning the taxation of farmer cooperatives. The organization which I represent—the Farm Bureau Cooperative Association—serves 185,000 farmer patrons in the State of Ohio. Through this cooperative, Ohio farmers provide themselves with feed, seed, fertilizer, and general farm supplies, as well as market their grain. The volume last year was 52½ million dollars. Notwithstanding this volume, the job being done by farmer cooperatives in Ohio is still too small. It represents only less than 10 percent of the farmers' business.

The Farm Bureau Cooperative Association is farmer-owned and farmer-controlled. The farmer patrons receive the savings from its operations. These farmers are at present required to pay taxes on all of the savings of their cooperative associations.

Farmers in Ohio face these three problems: efficiency in production; efficiency in marketing of their products; and efficiency in purchasing their farm production supplies. Their cooperatives help them with all these operations. In other words, a farmer's business is like a three-legged stool. Its three legs are production, marketing, and purchasing of production supplies. Farms today are food factories and must be operated in the same manner as any other efficiently operated factory. The farm itself is the production department while the purchasing and marketing functions are furnished by the cooperative.

Out of every $100 which the Ohio farmer has invested in his business, $98 is invested in production and only $2 is invested in both procurement of production supplies and marketing through agricultural cooperatives. If farmers are to protect their investment in their farms, they need larger and stronger cooperatives in the State of Ohio.

Farmer cooperatives, being relatively unknown to the great bulk of the people and to loaning institutions, have difficulty in securing capital. The usual profit business is able to float securities through stock exchanges or by issues to the general public, or obtain capital from ordinary loaning institutions. Generally

speaking, these sources of obtaining capital are not so readily open to farmer cooperatives. Therefore, it has been necessary for the cooperatives to obtain their capital largely from farmers themselves. In order to do this readily, farmer cooperatives have provided the machinery in their articles and bylaws by agreement of a majority of the farmers who are shareholders, whereby some of the savings may be retained by the cooperative and shares, or certificates, issued to the farmer member. In this manner the farmer reinvests, by his own majority vote, some of the savings in his cooperative and thereby furnishes capital. This is one of the features least understood by the general public and probably has caused much of the misunderstanding of farmer cooperatives on the part of other business people. Certainly it is one of the main features seized upon by those seeking to destroy farmer cooperatives, such as the National Tax Equality Association. The enemies of farmer cooperatives are attempting to tax patronage savings in order to restrict the cooperatives' source of capital. We Ohio farmers can never forget that only 30 years ago seven of our farmers were arrested and spent a week in jail at Cleveland, Ohio, because they sold their farm products cooperatively. Those who wish to profit from farmers' marketing and purchasing operations still are fighting farmers' cooperatives.

For 10 years I was employed by a large chemical corporation, and I understand how corporate business operates. I am not critical of them—they are in business to make money for their stockholders. But I do insist that the competition provided by farmer cooperatives is necessary if farmers are to get their production supplies at the most reasonable prices and receive the best return on their farm products marketed.

Farmer cooperatives are used by farmers in the operation of their food factories in just the same manner as other factories use their purchasing and marketing divisions. These operations are just as much a part of the business of farming as the above divisions are a part of other factory operations.

There is not now, nor should there be, a tax on the purchasing and marketing divisions of factories. Neither should there be taxation on the purchasing of farm production supplies and marketing of farm products through the farmers' own cooperative, since both are an important part of the business of farming. Again—I repeat that the savings made through these farmer-cooperative activities do not escape Federal income taxation because farmers individually are required to pay income taxes on all such savings.

Congress in its wisdom granted Federal income-tax exemption to farmer cooperatives as an aid to agriculture, just as it has in its wisdom granted tariff protection to industries, grants of land for the development of railroads, mail subsidies to airlines, etc. I have always argued that it was better for farmers to help themselves through their farmer cooperatives than for them to receive subsidies from the Government.

At the moment farm prices are at a higher level than they were 3 years ago. Yet, many prices are still below parity and there are indications that prices will decline in the months ahead. As you know, farm prices have declined in each of the last 4 months. The United States Department of Agriculture has consistently asked for greater food production as a part of the defense effort. Certainly now is not the time to hamper the farmer who is patriotically responding to the request for increased production in the defense effort even though he well recognizes that such production may result in a surplus causing further price declines in the market.

What I have said so far leads to this conclusion:

Congress should not reverse its position maintained for over 25 years and tax the farmer's marketing and purchasing departments—(his cooperatives) at the same time that the farmer is asked by the Government to increase production for defense purposes with further declines of farm prices still possible.

The next point I urge for your consideration is that further cooperatives are like partnerships and as such the tax should continue to be paid by the individual partners and not the partnership as a separate entity. The fact that the members of a corporate farmer cooperative have limited liability is not decisive on the question of how a farmer cooperative should be pigeon-holed for taxation. I understand that even in partnerships there can be limited liability of the partners.

The farmer cooperative is a special kind of corporation organized under special acts in almost all States with many restrictions not common to ordinary profit corporations. We agree with Senator Taft, who said: "The farmer cooperative is a multiple corporate partnership of America's basic capitalists—the farmers. They are essential because the number of farmers and the small size of the farm unit deprives the farmer of the bargaining power enjoyed by other businessmen."

The problems of American agriculture are not new. Neither are the basic solutions of these problems unknown. During the last 50 years we have experienced numerous agricultural adjustment acts. These have, for the most part, been temporarily helpful. If we can devise some method whereby unwanted farm surpluses will not set the price for the entire agricultural production and at the same time allow farmers the continued right to operate their food factories in a manner comparable to the rights of other factory operators through the use of agricultural cooperatives, we will have gone a long way toward the solution of the problems of agriculture.

One of the first thorough studies of agricultural problems was conducted during the Presidency of Theodore Roosevelt by The Country Life Commission, which was appointed by this President. After a thorough study, this Commission stated that the basic problem in agriculture was brought about because individual farmers were unable to compete with the people with whom they must do business and, further, to solve this problem, that farmers must group themselves together in agricultural cooperatives.

Agricultural cooperatives are an important segment of the free-enterprise system of this Nation. A recent survey showed that 70 percent of Ohio farmers wanted their cooperatives to expand.

Farmers are a clear-thinking group. I have never known or even heard of an Ohio farmer as being even friendly toward communism. Farmers know that they are paying their share of taxes. They want to continue to do so. I am sure that a complete search of the facts will result in a conclusion that the present system of taxation of farmer cooperatives is fair and just.

Senator MILLIKIN. Mr. D. W. Brooks of the Cotton Producers Association.

STATEMENT OF D. W. BROOKS, COTTON PRODUCERS ASSOCIATION

Mr. BROOKS. Mr. Chairman, I know that you are even more tired than most of us, and I am going to take just one moment. I am not going to offer a statement.

Senator MILLIKIN. Have you got a statement that you wish to put in the record?

Mr. BROOKS. I have not. My statement is not ready to file. I had a death in my family, which made it impossible for me to complete my statement and have it typed.

Senator MILLIKIN. If you should finish your statement, send it in, and I am sure that Chairman George will see that it is put into the record.

Mr. BROOKS. I will be glad to do that, sir.

The first point I would like to make is that the reason we cotton farmers formed a cotton cooperative was to raise our per capita income.

I am from Atlanta, Ga., and the per capita income of the cotton farmers in the State of Georgia, when our association was organized, was $74. We were described as the economic problem No. 1 of the Nation, and I believe quite a few comments were made that we did not have shoes to wear down in that area, and we have to admit that probably a good deal of that was true.

From that $74 per capita income in 1933, our per capita income has now increased on the farms in the State of Georgia to $380.

That, of course, is still very low in relation to the income of the people generally in this country, but we, as farmers, feel that by working together cooperatively, we have been able to increase our income substantially, and to that extent we feel that we have taken some of the burden off of the Nation that we thought we were going to put on them when we were the economic problem No. 1.

I would have liked to have had the time to have told you something about what we did with our reserves in the form of research. For example, through research, we increased the yield of corn in Georgia, and largely through the research of the Cotton Producers Association we increased the yield of corn from 10½ bushels per acre, where it had been for 25 years, in 3 years' time, to 18 bushels per acre. This increased the income tremendously of the farmers of that area; and, except for the reserves that we had to use in research, we could not have done that.

Now, we have recently worked out, through a research program, a method whereby we can carry corn for 12 months in the year, where heretofore, because of high humidity and insect damage, we could not carry corn but a very few months. Heretofore, because we could not carry our corn, it always sold for half the price in the fall that it brought in the summer.

It meant that our farmers took a very low price because we could not carry our corn.

It was through the research of Cotton Producers Association that we worked out means whereby we can now carry corn the year around, and we have leveled the price not only for our members but for all farmers of the Southeast. So there are many things of that kind that I would have liked to have had a chance to discuss in detail with you, because we feel that we have made a contribution to the welfare of the Nation, and we have tried to do it through cooperative means ourselves rather than be dependent on Government to do it for us.

Now, second, I would like to say that cooperatives have made it possible for small family-type farmers to continue to own our farms. We have 122,000 members of our association. They are practically all small farmers, and most of them own their own farms.

Now, we have felt that certainly we have made a contribution to the capitalistic system in this country. Certainly the greatest group of capitalists left in this country are the farmers of this country, the farmers, especially the family-type farmers, who own the reasonable-sized farms of this country.

We can only compete and continue to own our farms if we can work together in groups, because otherwise we cannot meet the competition of large farmers, or partnership farmers, or even large corporation farming, but by working together cooperatively, we can compete, and we can continue to own our farms and be capitalists in this country.

This Nation is spending billions of dollars to stop communism in the world and to make capitalists of the peoples of the world. Certainly it is most fortunate that we have so many people who own farms in this country, because one easy way to maintain a capitalistic system is to permit farmers to continue to work together cooperatively, and thereby continue to be farm owners and capitalists.

Now, there is one other point or two other points I would like to cover hurriedly. One is that there has been an effort to confuse regular corporations with cooperatives. They are entirely different, and to try to make them the same is foolish in many respects.

For example, I have stock in a number of corporations—a very small amount. I am not financially able to own much stock—I am one of these 10-share stockholders, but I put my money in stocks hoping to make a profit off of somebody else.

I want my corporation that I invest in to do business with somebody and make a profit from him, and give me the money, because of my investment.

Now, in the case of a cooperative, I, as a farmer, go in with other farmers, not to make a profit off some other farmers, but only to get back that which is mine that my product brings, or if I purchase supplies, to get them at cost, so that the whole motive, the whole idea between the two, is entirely different, and to try to confuse it and say that they are the same, seems to me is a very foolish kind of comparison.

Now, the next thing that I would like to bring out is this: The objection that I think cooperatives generally have to Senator Williams' bill is the fact that he attempts to tell the members of the farm cooperatives and other cooperatives how they should run their business exactly. In other words, he takes the position in his bill that they do not know how to run their business.

Senator WILLIAMS. In what way?

Mr. BROOKS. In this way, that you say that unless they pay out all patronage refunds in cash, every penny that is saved, that it is not a cooperative.

Senator TAFT. No, no. What he says is – it is a legitimate distinction. He says if you accumulate money that a surplus accumulated by a business organization ought to be taxed. Now, the question is, Is it? Whereas money paid out during the year is not a surplus accumulated at all, but is part of the deal you made when you bought the wheat or the cotton that year, there is a very legitimate distinction. I do not think he is telling you how to run your business. You are saying if you do certain things, the accumulation of the surplus is taxable. I do not say that ought to be, but I do think he is trying to say he is telling you how to run your business. You draw a distinction——

Mr. BROOKS. Let me elaborate. For example, let us take the case of the grocery cooperative that was described here a moment ago. As I understand your bill, Mr. Williams, you propose that you will not permit these grocerymen to accept this patronage in 5-year debentures.

Senator WILLIAMS. Oh, no. They can accumulate it.

Mr. BROOKS. Unless the corporation pays a tax.

Senator WILLIAMS. That is correct.

Mr. BROOKS. Well now, that, it seems to me, denies the right to the member to determine the way in which he wants to take his money.

Senator WILLIAMS. Well, no. It just merely says that he gets a right to get it. We tell every corporation in the country, we tell every individual in the country how he should pay his taxes, and I do not think the proposal here is any different from the other. Now, there can be an argument as to whether or not they should be taxed, and we can have opinions on that, but to say that we are trying to tell you how to run your business is not correct, because a cooperative as spelled out here, is one in which you can define your own type of membership, how you want to run your cooperative. At the end of the year, in fact, you have 60 days after the year in which you can determine whether you want to pay out any money, 10 percent of your money, all of your money. That is solely at the discretion of the cooperative, whether you want to do it or not, but it is just a case

where if you do not pay it out you pay the tax instead of passing the tax obligation on to the farmer. It is a question of whether you are going to pay it or the farmer pays it.

Mr. BROOKS. As I get your viewpoint—maybe I am incorrect—but as I get your viewpoint, Mr. Williams—maybe I have gotten the wrong slant on it, but your viewpoint has been that the cooperative is deliberately withholding money from its members which the member does not like, and he objects to, and he is opposed.

Senator WILLIAMS. I did not say anything about the member objecting to it or opposing it or anything else. If the cooperative withholds it deliberately, and it is deliberately done, you either do it or do not do it in accordance with the way you wish to do it.

Mr. BROOKS. As a practical matter, our members meet, and financial statements are presented to them, and then the need for capita is stated to them, and then they vote as to how much they want to distribute in cash, how much they want to distribute in other forms of patronage refund.

Now, that was the only privilege that I feel that the farmer should continue to have.

Senator WILLIAMS. If you will read this amendment you will find that they still can do that any time within 60 days after the close of the business, and still determine whether they want to pay out, what percentage, and all of that. I do not know who explained the amendment to you. Have you read the amendment?

Mr. BROOKS. Yes.

Now, let me ask you one other point, in this respect.

What difference does it make to the Government or to you if the individual member is willing to pay the tax on his money that he has in the cooperative? If he is willing to pay that tax, what difference does it make to you whether the cooperative pays it out in cash or whether it pays it out in debentures?

Senator WILLIAMS. We get that same question asked of every stockholder, What difference does it make to us if the corporation is willing to pay dividends out? You have double taxation of corporate dividends, and the committee is faced with the problem of raising additional money, and you do have in this present set-up—and I think you will agree with me—this situation. Forget the grocery company for a while, and get back to your own company. Are you tax-exempt or non-tax-exempt?

Mr. BROOKS. We are tax-exempt.

Senator WILLIAMS. You are tax-exempt. Do you set aside unallocated earnings?

Mr. BROOKS. No, not as a general rule, we do not.

Senator WILLIAMS. But you do it at times?

Mr. BROOKS. If we had a project like a research project that I was speaking of, which I have not the time to describe, but it is a very nominal amount.

Senator WILLIAMS. For plant expansion, have you ever set aside any earnings for future plant expansion?

Mr. BROOKS. No, sir. All of our savings are allocated to our members.

Senator WILLIAMS. All of them are allocated?

Mr. BROOKS. Yes, sir, and they revolve.

Senator WILLIAMS. Then you believe that they should continue to be allocated?

Mr. BROOKS. Yes; I think so.

Senator WILLIAMS. Then that portion of the amendment is one part of the amendment that you would not have any objection to being incorporated into the law, because you are doing what we suggest that all cooperatives do. So there is not argument about that part, I take it, because you are already doing that.

Mr. BROOKS. No. I think there are reasons for having unallocated reserves. I have not the time to discuss it before the committee.

Senator WILLIAMS. The part for unallocated earnings that you were speaking of for research is allowed to any corporation for that type of research, I think you will find. But I am speaking about the allocation of earnings, of this year's earnings, for a plant or some machine that you wish to buy next year or the year after. For instance, during the war years, a substantial part of the earnings of some of the cooperatives were set aside for postwar expansion, with the net result that the plants were written off in their entirety before they were ever constructed in the postwar period. But you say you are not doing that; you do not think it should be. So you would endorse that part of the amendment anyway?

Mr. BROOKS. I think you are probably saying something with which I do not agree. I think to some extent you are putting words in my mouth.

Senator WILLIAMS. No. You said that you do not do those things.

Mr. BROOKS. I know. But you are saying now that you want to apply it to all cooperatives.

Senator MILLIKIN. Let me say this from your standpoint, that even though you may be doing this in a way that would not be offensive to Senator Williams, you want the right to do it another way——

Senator WILLIAMS. The old way.

Senator MILLIKIN. If you choose to do it.

Mr. BROOKS. That is exactly correct, sir.

Senator WILLIAMS. You still want to retain the right?

Mr. BROOKS. That is exactly correct, sir.

Senator WILLIAMS. But you recognize what I had in mind when we put that information in.

Mr. BROOKS. The main objection I have to your bill, and I think it is a very serious objection from the farmer's viewpoint, is that you say to the farmer, "The Government will get taxes from the farmer on his patronage refunds whether it is cash or whether it is in a certificate, either way; the Government gets the same amount of tax from that farmer." But if the member does not agree to pay the money out in cash, then the co-op has to pay tax the same as a private corporation.

That is the objection I have.

Senator WILLIAMS. No; you are wrong. If this amendment goes through, the cooperative would pay the tax on that portion that they kept, and the farmer would not be taxed at all.

Mr. BROOKS. I am getting to that. The objection that I have is that you then say that if the members desire to take, say, half of his savings in patronage refund certificates instead of cash, then in order for him to do that, the cooperative must pay a corporation tax on that part.

Senator TAFT. No

Senator WILLIAMS. Only on the half that they keep.

Mr. BROOKS. I know that. But I said on that part, Senator. I think that is correct, sir.

Senator WILLIAMS. The farmer would not pay the tax on it.

Senator TAFT. If they paid the cash out within 10 days and then asked every fellow to buy stock with the cash, there would be no tax on it, under Senator Williams' amendment.

Mr. BROOKS. Yes. But what I am saying, though, is that if we pay half out in cash the members vote to pay half out in cash, and take half in certificates, then I say the members must pay tax on all of it.

Senator TAFT. Why not pay it all out in cash? It is just an exchange. Pay it all out in cash and let him pay you back for the stock.

Mr. BROOKS. As a practical matter, Senator, that sounds well, but it does not work that way. It is, as Senator Kerr said. Now, let me show you, for example, in the case of our members—we have small growers—our patronage refunds may be in some instances only 50 cents per member. Now, as a practical matter, Senator, you go out and pay the 50 cents and then go back and get the 50 cents back. It is not a practical way of doing it and it is impossible to finance your association.

Senator WILLIAMS. How many members do you have?

Mr. BROOKS. One hundred and twenty-two thousand. And I got the impression from Senator Williams that the members were being held in servitude and that this money was being held without their knowledge or consent or anything else.

Now, I want to say this to you, Senator——

Senator WILLIAMS. Where did you get that impression?

Mr. BROOKS. I got it from some of your questions.

Senator TAFT. That may be true of many of them. Even though the majority voted to pay it out, maybe others want it.

Mr. BROOKS. It might be in the case of a few. But I do not believe that that is generally true, Senator. I got the impression when you kept asking the groceryman here why he objected to your provision.

Senator WILLIAMS. What I was pointing out to him was that it was not, according to law, voluntary on the part of the members to leave the money in.

Mr. BROOKS. It is. We think that it is voluntary, Senator. We disagree with you in that respect.

Senator WILLIAMS. If it is voluntary, as Senator Taft said, they will put it back in. But anyway, that is——

Mr. BROOKS. The problem is the mechanics of doing this. But I do not think that the members object to it. In fact, I do not believe that the Senators have had any letters from members of cooperatives saying that the money is being withheld.

Senator WILLIAMS. I have had some.

Mr. BROOKS. You might have had one or two.

Senator WILLIAMS. No, I have had quite a few of them, because we have had a few cooperatives that have failed. Most of them are just as strong, and I assume that they are stronger, than the business organizations.

Mr. BROOKS. If they failed, then the member, of course, could claim that back as a loss.

Senator WILLIAMS. If it had gone back 10 years, you know, no man can open up his tax return after 10 years. You realize that.

Mr. BROOKS. He can take it into his tax return the year it failed.

Senator WILLIAMS. The one year it failed.

Mr. BROOKS. That is right; the year it failed.

Senator WILLIAMS. But it would be at a lower rate if his income was running normally.

Mr. BROOKS. There are two points that I would like to clear up, and then I shall have taken too much time. One point is this, that as far as the Government is concerned, you get the same tax. I am not talking about your bill, now, but as it now stands the Government gets the same tax from the farmer whether the money goes to him in cash or whether it is paid to him in patronage-refund certificates. The tax liability of the member is exactly the same.

The second is that I think the member should have the right to determine how he wants to take his savings.

Senator WILLIAMS. He still has that right. I disagree with you as to whether he would or would not have it.

Senator MILLIKIN. Thank you very much for coming.

Mr. BROOKS. Thank you, sir.

Senator MILLIKIN. We will meet again at 10 o'clock on Monday morning.

(The following information was subsequently received for the record:)

STATEMENT OF HAROLD O. SMITH, JR., EXECUTIVE VICE PRESIDENT, UNITED STATES WHOLESALE GROCERS' ASSOCIATION, INC.

My name is Harold O. Smith, Jr. I am executive vice president of the United States Wholesale Grocers' Association, Inc., a national food trade organization, with headquarters located in Washington, D. C. In behalf of wholesale grocers, I want to express to you their deep concern and the deep concern of their customers, the many thousands of retail grocers throughout your local communities, over the rapid invasion of their markets and threat to their very existence occasioned by the spread of tax-exempt merchandising cooperatives.

We wish it to be clearly understood that we have no quarrel with the type of co-op for which the law, as we understand it, was originally written, namely, the farm co-op formed to aid the farmer in marketing the unprocessed products of his farm. Everybody wants to help the farmer. No one wants to harm him. When, however, co-ops engage in commercial, merchandising, and manufacturing activities, many processes and operations removed from the farm, and take advantage of the law as written and as interpreted by the Bureau of Internal Revenue, to obtain income tax exemption advantages and, armed with these advantages compete with tax-paying business, we think the movement is getting out of hand and creating unjustified dislocations and unnecessary inequalities in our free enterprise system, and should in all fairness be stopped.

When the co-ops get into the business of processing, wholesaling, and retailing, they go far beyond the original intent of the law and become processors or merchants exempt from taxes but in direct competition with other tax-paying industries. These tax exempt co-ops buy from the same people, sell to the same people, and use the same Federal and State facilities as do the tax-paying industries whose taxes have to be increased because of the loss of revenue from a tremendous volume of business now being handled through co-op channels.

GROCERY DISTRIBUTION, VITAL

Wholesale groces and your retail grocers whom they serve, have risked their money and the welfare of their families to engage in a most vital business, serving you and the other members of your communities. I say vital advisedly, since the service of bringing the products of the farmer and of labor to the American housewife is perhaps the most important function performed by any trade in this country.

These wholesale grocers bring together the products of the farm and of labor in large quantities and redistribute these products to the retail outlets which in turn make them available to the millions of housewives throughout the Nation. This operation involves large-scale purchases, warehousing, financing, transportation, and numerous other business services, all financed by the wholesale grocer. It provides the most economical means of transferring the products of the farmer and the processor to the retailer, thence to the consumer at very low cost to the housewife.

If through efficient operation and good management the wholesale grocer is able to show, at the end of each year, returns in excess of his purchase price and operating cost, he then pays on this sum a sizable amount of tax to the Government which is the means by which the Government obtains a large portion of its revenue.

The cooperative merchants who are invading this market can virtually escape the payment of this income tax which not only discriminates against the wholesale and retail grocers and gives the co-op competitor an unfair advantage over the taxpaying merchant, but it also cuts the Government out of a large amount of revenue. Since the Government must have revenue to operate, the greater the loss of revenue through tax-dodging co-ops, relatively greater is the amount of tax increase that must be borne by these wholesale grocers and other businesses of free enterprise and the American people at large.

TAXING RETAINED SURPLUS OF CO-OPS URGED

Therefore we request and urge the Senate Finance Committee to recommend taxing the retained surplus of merchandising cooperative organizations on the same basis and at the same rate as competitive taxpaying corporations are assessed, both from the viewpoint of essential fairness and that of revenue raising.

This request is made in line with a resolution adopted by the United States Wholesale Grocers' Association at its annual convention at Miami Beach, Fla., on April 25, 1951. This resolution reads as follows: "We favor elimination of income tax exemption privileges on retained surplus now allowed the merchandising co-ops, in the interest of taxpaying equalization with competitive business and of increasing revenue vital to national defense."

Our request and the resolution passed by our association are the outcome of the fact that the grocery merchandising co-ops, subsidized by their tax exemption, are growing so rapidly and making such inroads on the business of taxpaying wholesale and retail grocers that the very life span of these wholesale and retail distributors is threatened in many sections of the country.

We have no objections to the grocery merchandising co-ops as competitors but we earnestly submit that we should compete with them on an equal basis and not one-sidedly as now, with such co-ops having freedom from taxation, an advantage that permits them to expand operations and increase net worth and facilities beyond the ability of their taxpaying competitors. We do not believe that the Government should subsidize by tax exemption one form of food distribution against another form.

QUESTIONNAIRE ON TAXING CO-OPS

On June 28, 1951, we sent a questionnaire to a cross section of wholesale grocers of America on the subject of taxing the merchandising cooperatives. The results show the rapid growth of such co-ops, the detriment to the business of their taxpaying competitors and the inability of such competitors continuing in business very much longer under such conditions.

To this questionnaire we received 135 replies, 112 of which were usable and 23 usable in only a few particulars.

GROWTH OF MERCHANDISING CO-OPS

This survey shows that in some 95 trading areas in 34 States and the District of Columbia, the number of merchandising co-op head companies, mostly grocery merchandising co-ops, increased from 80 in 1941 to 228 in 1951, an increase of 185 percent, and that the retail units of these companies increased from 7,156 in 1941 to 33,915 in 1951, or an increase of 374 percent.

The States involved in the foregoing figures are: Alabama, Arizona, Arkansas, California, Colorado, Delaware, Florida, Georgia, Idaho, Illinois, Kansas, Kentucky, Louisiana, Massachusetts, Minnesota, Mississippi, Missouri, Montana, Nebraska, New Hampshire, New Jersey, New Mexico, New York, North Carolina, Ohio, Pennsylvania, South Carolina, Tennessee, Texas, Utah, Virginia, Washington, West Virginia, Wisconsin, and the District of Columbia.

Thirty-six of the largest merchandising co-ops mentioned in the survey have totaled estimated annual sales of approximately $463,480,000, or an average of more than $12¾ million.

PAY LITTLE OR NO INCOME TAX

Wholesalers giving replies on the subject state that so far as they know the co-ops mentioned by them pay no Federal income taxes except on sales to nonmembers in some instances. There are instances of a State taxing co-ops on the same basis as other corporations.

DETAILS OF CO-OP GROWTH

Concerning these largest co-ops, some expressions from those replying to the questionnaire, with respect to the growth of co-op sales are: "considerable", "alarming," "tremendous," "phenomenal." Their replies show:

1. That a Wisconsin co-op's net worth and invested capital is increasing each year.
2. That a Kentucky co-op's sales have doubled in 5 years.
3. That the Nebraska co-op in the past 10 years has increased its sales by $500,000 and its capital structure by $100,000.
4. That one large California co-op is estimated to have quadrupled its assets and facilities in recent years.
5. That a Colorado co-op in the last few years has built two large streamlined warehouses.
6. That a New Hampshire co-op has just purchased its formerly rented building and has added fruit and meat divisions.
7. That a California co-op has grown from 800 members in 1940 to 2,500 members, absorbing two wholesale grocery houses during that period.
8. That one grocery co-op in Richmond, Va., now does 80 percent of the business in the city and is reaching out into surrounding areas. Questionnaire respondent predicts that within 5 years there will be no tax-paying independent wholesale house doing business in that city.

This wholesaler says "10 years ago we enjoyed a fairly large business in Richmond city area as well as in the rural communities. Today were it not for our rural business, we would not be here. During the past 10 years, three large wholesale houses doing business mainly in the city, have liquidated."

9. That a Washington State co-op built its sales from nothing to $24,500,000 in 16 years, and is now erecting a $2 million warehouse. The mortality of wholesale grocers in this territory has been terrific. Seven wholesale houses have gone out of the grocery business in the last 6 years.
10. Another Washington State co-op increased its sales of approximately $2½ million in 1941 to nearly $7 million in 1949. It completed in 1951 a new $700,000 warehouse. Its real estate amounts to well over $100,000 exclusive of the cost of the new warehouse. In addition it owns fleets of city and county trucks, creamery machinery, printing presses and other equipment.
11. That a Texas grocery co-op increased its sales of $1,840,181 in 1947 to $4,807,987 in 1950.
12. That a Massachusetts co-op has expanded constantly over the years and new spur tracks have been added.
13. Other new warehouses have been completed by co-ops in the last few years in Rhode Island and Virginia.
14. A Utah food co-op increased its sales of $147,000 in 1941 to $12 million in 1951.

GROWTH, RESULT OF TAX EXEMPTION

Fifty-eight respondents replied to the question: To what do you attribute the growth of the merchandising co-ops? Of these, 32 said it was because of their tax-free privileges; 14, because of the benefits retailers receive from the co-op form of operation, and 5, to low prices. It is recognized that these benefits including low prices are largely made possible by tax exemptions. Only seven wholesalers attributed co-op growth to good management.

PROPRIETARY BUSINESS HURT BY TAX-FREE CO-OP COMPETITION

Eighty-eight respondents gave data on the extent to which tax-free co-op competition had hurt their business. Seventeen expressed this loss as a percentage of their sales. These percentages run from 5 to 80 percent, the median figure being about 35 percent.

Three expressed the loss in dollars, as follows: $200,000 per year; $30,000 a month for a time; and $1 million annually. One respondent said he had lost 200 of his best customers to the co-ops; another, 15.

Only six replying to this question said they had not yet been harmfully affected by co-op competition. The remaining 60 who replied all said they had been affected either by loss of business or customers, but they did not give specific figures. For example, one wholesaler said he had lost all his best accounts to the co-ops and another said all the large retailers in his trading area were co-op members.

CANNOT CONTINUE TO COMPETE

Asked whether they could continue to compete with the income-tax-free co-ops considering the increasingly high income taxes they are compelled to pay, 101 wholesale grocers replied, of which 92 stated they could not continue to compete under such conditions. Among the other nine who replied, some stated they could compete but could not grow or expand, while others said they had not yet been affected by co-op competition.

Some of the comments on this question were:

1. "Definitely we cannot continue to compete—we are not magicians."
2. "Our tax will be 1½ percent of our net sales."
3. "We have given up trying to compete and work outside their membership."
4. "No, we cannot compete—will either have to go co-op ourselves or go out of business."
5. "Over 50 percent of our earnings paid in Federal taxes."
6. "Partners in our firm required to pay approximately 40 percent of their net to Federal and State Governments in income taxes."
7. "We cannot and do not try to compete. We now confine our sales to smaller stores and institutions."
8. "If we make $100,000, we pay 52 percent in taxes. They can do the same business and give it out in dividends or plow back into the business."
9. "The merchandising co-ops take into their organizations the cream of the retail stores. Sixty percent of their earnings are retained in the business for building purposes. Balance tendered retailer in form of check, often cashed without reporting."
10. "Twelve years ago taxes were a small part of operating expense. Today Federal, State, and city taxes will figure very close to 15 percent of the entire operating budget of wholesale grocers who operate on fast turn-over with extremely small mark-up. State and city tax departments have taken their pattern from the Federal Government, with the result that those who pay Federal taxes carry the entire tax burden."

RETAINED SURPLUS OF CO-OPS SHOULD BE TAXED

In reply to the question: Should the retained surplus of merchandising co-ops be taxed the same as the retained surplus of other corporations? 112 replied and all of them stated emphatically that retained surplus of the co-ops should be so taxed.

CONCLUSION

We submit that this cross section of the growth of the tax-exempt merchandising co-ops and the detriment they are causing the business of their taxpaying competitors affords ample proof that this tax inequality should be removed; that there was never any excuse for taxing the retained surplus of proprietary corporations and leaving the retained surplus of merchandising co-ops untaxed. In these times of national peril and the need for all Government revenue possible, to allow this inequality to remain would be a tragic error, perpetuating a historical injustice and sinning against the defense effort.

STATEMENT OF JACK GARRETT SCOTT, GENERAL COUNSEL, NATIONAL ASSOCIATION OF MOTOR BUS OPERATORS

My name is Jack Garrett Scott. I reside in Washington, D. C. I appear before you as the representative of the National Association of Motor Bus Operators, of which I am general counsel. That association is the national trade association of the intercity motor bus industry. It represents nearly 1,000 members of that industry, either directly or through affiliated State motor bus associations.

The primary purpose of our appearance before you is in opposition to those provisions of H. R. 4473, as it passed the House, which would increase the Federal gasoline tax from 1½ cents to 2 cents per gallon, impose for the first time a tax of 2 cents per gallon on Diesel fuel oil used for highway purposes, and increase from 5 go 8 percent the excise tax on busses, parts, and accessories.

Preliminarily, I should like to emphasize to you a fact which may not be generally known or is often overlooked in such matters as the imposition of taxes. The intercity motor bus industry, like the entire motor carrier industry, has become and now is an integral and indispensable part of our national transportation system; it is in no sense a mere adjunct thereto. That was conclusively demonstrated during World War II when, because of restrictions upon the use of private automobiles necessitated primarily by petroleum and rubber shortages, a very large part of essential wartime travel could not have been accomplished in the absence of intercity busses. During the later war years, and since, busses have actually transported more passengers in intercity travel than the railroads. For example, in 1950, we carried over 365 million intercity passengers as against about 208 million rail passengers. Both figures exclude local and commutation passengers. At the present time we are transporting between 90 and 95 percent of all inductees between their homes and induction centers. Troop movements completed by bus are now more than three times what they were during the corresponding period of last year. During 1950, almost 2,400 military movements were carried out by bus and the total for the first 4 months of 1951 alone was in excess of that figure. Nearly a fourth of all military personnel moved on official business, in the course of transfers and the like, are now moved by bus. Travel of men on furlough and by relatives to and from training camps is practical only by bus in many areas.

In addition it should be noted that there are many thousands of communities in the United States which have no other public passenger transportation except intercity busses. Within or near many of these communities are located important defense plants, many of them newly established, which depend in very large part on busses for the movement of workers to and from their homes. We operate over 400,000 route-miles of highway in supplying these necessary services.

Essentially our industry is one of small enterprises. Of the approximately 1,500 intercity motor bus operators subject to the jurisdiction of the Interstate Commerce Commission, less than 200 have gross annual passenger revenues of $200,000 or more.

Ever since the close of World War II, revenues in all segments of our industry have continuously decreased as a result of the tremendous rise in the use of private automobiles. Our expenses have just as continuously increased. The primary element of increased costs arises from increases in wages, which constitute nearly half our total operating costs. But there have also been substantial and continuing increases in the prices of vehicles, tires, fuel, and, indeed, nearly everything we have to buy in order to carry on our operations. The net result is that our operating ratios are precariously high, and, in large segments of the industry, particularly among the smaller operations, the financial condition of the carriers is such as to threaten their continued operation. Moreover, many of these small carriers serve communities which, except for this service, would be completely isolated so far as public transportation is concerned.

We look with serious apprehension, therefore, upon any imposition which will increase our costs and further jeopardize our ability to continue performance of an essential public function. From the very beginning of motor carriage, it seems that motor vehicles and everything they must use have been singled out for ever-increasing taxes. This is true both of Federal Government and the States. We sincerely subscribe to the principle that highway users should pay their fair share for the use of the highways, and we assert that intercity busses pay substantially more than their fair share. Not only do we pay all of the various types of taxes paid by those in other industries but, in addition, we must pay various types of special taxes, such as the excise taxes here in question, registration and license fees, special tolls and franchise taxes, and many others imposed by the States and local political subdivisions.

In any consideration of the equity or inequity of increases in Federal taxes on motor fuel, it should be remembered that every State of the Union and the District of Columbia imposes taxes on our motor fuel, and the amount of such taxes is always going up. It varies now from 3 cents to 9 cents per gallon, averag-

ing about 5 cents on a Nation-wide basis. The legislatures of six States have just recently added increases of 1 to 1½ cents per gallon, and the combined Federal and State taxes on our fuel already amount to 20 to 40 percent of its retail price, a tax rate far in excess of any levied on a commodity outside the luxury category. In our industry, it is estimated that our total special highway-user tax payments alone, exclusive of the many other types of taxes, amount to about 7 percent of our total revenues. This one tax burden alone amounts to exactly 5 times the industry's entire margin between revenues and expenses during the first quarter of this year. That is not only astounding but obviously inequitable in the case of an essential industry which is already having all that it can do to keep alive.

It is important to note that, unlike most industries, we are unable to pass along freely increases in taxes and costs to those who patronize us. First, our fares are strictly regulated by Federal and State agencies; but, more important, there is a limit to fare increases if we are to avoid pricing ourselves out of the market and creating a situation of diminishing returns.

This is particularly important in respect of the intercity bus industry because of the position which it occupies in the national transport system. Its rates of fare are the lowest for any form of intercity travel; a susbstantial proportion of its patronage comes, in consequence, from the lower-income groups. Any increases in rates of fare thus fall most heavily upon those groups least able to bear it. There is no doubt that the increased levies provided in the House bill (H. R. 4473) will necessitate fare increases because they amount to a total rise of 63 percent in the Federal excise taxes now paid by intercity bus companies on their fuel, oil, tires, vehicles, and parts. In the circumstances, any such increase is manifestly inflationary as well as discriminatory.

Section 2450 of H. R. 4473 provides for the imposition of a tax of 2 cents per gallon on fuel used by Diesel-powered highway vehicles. There is, in our opinion, no conceivable justification for such a discriminatory impost. The purpose of levying additional taxes at this time is that of raising general revenues for any and all purposes for which Federal funds are properly expended and to exert counterinflationary pressure. These proposed levies are not for highway purposes as is apparent from the fact that Federal excise tax collections from highway users are already nearly 3 times the total of Federal contributions to highway costs. Federal contributions to highway costs are based on Federal responsibility for the highways necessary for delivery of the mails, national defense, and the performance of other such essential Federal functions. There is, therefore, as indicated above, no reason to impose such levies exclusively or principally upon highway users. Nor would this proposed levy provide the desired counterinflationary force; by falling most heavily upon the low-income groups, its ultimate effect would obviously be inflationary.

If the Congress deems it essential that a levy be imposed on internal-combustion-engine fuel other than gasoline, then such a levy should obviously be made against all such fuel whether it be used in a highway vehicle, a power plant, a vessel, or a railroad locomotive. Such a levy cannot properly be imposed exclusively on the highway user since its purpose is not and should not be to defray the cost of the highway system.

A somewhat similar and unsound element of discrimination appears in the proposed increase in the excise tax rate on motor vehicles and parts. The projected increase in the case of busses amounts to 60 percent, whereas a rise of 43 percent is suggested in the case of passenger cars, the vast majority of which are used as private automobiles.

While a substantial amount of the travel performed by private automobile is essential, there is no doubt that a vastly greater proportion of it can properly be classified as pleasure or luxury travel than is the case with bus transportation. Yet the proposed increases discriminate in favor of the private automobile and at the same time, add a heavier burden to the commercial carrier and to the lower-income groups that constitute a substantial element in the total voume of bus travel.

If the welfare of the country requires additional taxes, which it apparently does, we in the motorbus industry are willing to do our fair share, to the extent of our ability to pay. But we feel that any tax increases should be uniformly imposed across the board, and that an essential industry such as ours should not be singled out for special levies which are discriminatory and unreasonable and will certainly be found to be regressive and injurious.

PENDLETON GRAIN GROWERS, INC.,
Pendleton, Oreg., July 13, 1951.

Hon. WALTER F. GEORGE,
Senate Office Building, Washington, D. C.

DEAR SENATOR GEORGE: We know that you are now considering tax programs as applied to farm cooperatives. There has been so much misunderstanding and untruthful statements made about this subject that we would like to briefly give you our opinions and thinking.

Our association is a farm cooperative composed of 1,000 farm members in this area, representing wheat growers, cattle, sheep, poultry, small seeds, and every type of agricultural production in this area which is produced through the medium of the family-owned and -operated farm.

This cooperative is in effect a multiple partnership of these 1,000 individual farm families, using a corporate entity as a convenience in order to obtain the economic advantages of the group.

The operation of this business, founded in 1930 during the start of the farm depression, has been: (*a*) the farmer's method of self-help; (*b*) his guaranty of fair prices; (*c*) his assurance of prompt, honest service; and (*d*) his business organization for obtaining up-to-date information on markets, methods, and business details affecting his farm and his family.

In carrying out such a program, this farm cooperative naturally concentrated on two primary objectives:

1. To handle the basic supplies and equipment required in the production of farm crops.
2. To effectively engage in the handling, storing, processing, and marketing of the farmer's produce.

Now, if these jobs are properly done, then we go a long way toward keeping 1,000 farm families operating as individuals in this community. If corporation farms or large integrated farms come into the community, because of economic advantages in large-scale buying, operation, marketing, and processing integration, then we eventually end up with perhaps 100 operators where now a thousand independent operators exist. Our philosophy and our existence as a cooperative is predicated upon keeping the family-size farm in existence. If we can do this or help to do it, as we are going, then the community is better off. The small-business man can exist because he has opportunity to get business from 1,000 farmers instead of 100 big integrated operators. This agricultural community is better because 1,000 farm families exist as individual business owners as compared to working for the large-scale operators as employees.

In order to build, operate, and compete successfully, our farm cooperative must have capital. In a farm cooperative, service to the farm member is the end-use expected for the capital invested. Financing a co-op must be dependent (if you remain a co-op) upon getting capital equity in relation to business done by each member, because the returns are paid to the user of the product or service. Hence, we cannot hope to attract capital from the standpoint of paying high returns on invested capital as do private corporations. Secondly, we are not able to accumulate large surplus accounts because this money is allocated and issued to our members and eventually must be returned to them by revolving their equities.

Therefore, the best method developed to date is for the members to agree by contractual relationship with the association that all net margins belong to the members on a patronage basis and that these margins, once allocated and issued, are to be reinvested in the association on a revolving basis to provide this necessary capital.

These allocations, or patronage refunds, or certificates of equity (whatever one calls them) are taxable income to the member when issued and declared. Our farmers are taking them into their yearly income and paying tax on them at the top bracket of their income for the year.

Our farm cooperative is not accumulating tax-free surplus reserves, and we don't intend to.

A cooperative cannot operate as a private corporation and exist as a cooperative.

Stopping the source and method of farm cooperative equity capital is the quickest and easiest way to kill farm cooperatives. You merely force the cooperatives to become private corporations.

In conclusion, it is paramount that cooperatives have the right, as we now have, of a one-tax system, such as partnerships or individuals enjoy.

We believe that you should tax any retained surplus or retained reserves that are not allocated and distributed to the members or patrons and are held as profit or gain to the corporation itself.

It is our firm conviction that the existence of the farm cooperative is essential to the existence of the family-sized farm.

And we believe that it is in the interest of the small-business man, himself, that the farmer's cooperative be allowed to operate for the benefit of the entire farm community.

This is a major economic problem in determining the destiny of free enterprise in agriculture and we feel that it deserves your careful consideration.

Yours very truly,

JAMES HILL, Jr., *Secretary.*

NEW YORK, N. Y., *July 17, 1951.*

Hon. WALTER F. GEORGE,
Chairman, Finance Committee of the Senate,
Senate Office Building, Washington, D. C.

DEAR SIR: In the course of the pending consideration of H. R. 4473, the Senate Finance Committee will duly give its attention to section 501 of the bill which is designed to eliminate undue hardship resulting from the enactment of the so-called feeder provisions of the Revenue Act of 1950. I am addressing this letter to you as a member of the bar with current knowledge of the problems of university presses to bring to your attention the urgent need for further clarification of the feeder provisions of the Internal Revenue Code as enacted by the Revenue Act of 1950. I respectfully submit that in the absence of an appropriate expression of congressional intent, a number of leading university presses may be deprived of their tax-exempt status despite the widespread understanding that Congress never intended such a result.

Examination of the committee reports submitted in connection with the Revenue Act of 1950 discloses congressional intent that university presses be accorded tax exemption. Thus, there appears the following statement:

"Income from a university press would be exempt in the ordinary case since it would be derived from an activity that is 'substantially related' to the purposes of the university" (S. Rept. 2375, 81st Cong., 2d sess., p. 29; H. Rept. 2319, 81st Cong., 2d sess., p. 37).

There seems to be no question in the ordinary case regarding the tax-exempt status of income derived from the operation of a university press where such press is operated by a university itself. The question which has lately risen, however, is whether the income of a university press is similarly tax-exempt where the press is operated by a wholly owned subsidiary of the university rather than by the university itself. Although the form of organization of a university press would appear in principle to be completely immaterial, some doubt appears to be entertained within the Bureau of Internal Revenue as to the tax-exempt status of a university press operated through a subsidiary. Apparently, the view is held that the enactment of the feeder provisions contained in section 301 (b) of the Revenue Act of 1950 indicates congressional intent that such a subsidiary is taxable as a feeder organization.

The committee reports accompanying the bill which was enacted as the Revenue Act of 1950 state that the income of schools and universities are tax-exempt if such income is derived from activities which are "substantially related" to their educational functions (S. Rept. 2375, 81st Cong., 2d sess., p. 29; H. Rept. 2319, 81st Cong., 2d sess., p. 37). The language of the reports, however, appear to mention only those situations where the "substantially related" activities are carried on by an educational organization itself. Neither the reports nor the statute specifically declare that a subsidiary operated for the purpose of carrying on related activities shall not be treated as a taxable feeder organization. As a consequence, the possibility exists that the income of university presses operated through wholly owned but separate entities may be deprived of tax exemption, while the same type of income will not be taxed to universities operating presses as a formal division or part of their organizations. Even if judicial interpretation should ultimately sustain the claim of tax exemption for subsidiary university presses, nevertheless the tax controversies involving this issue can only give rise to costly litigation and the uncertainties which inhere in such disputes.

These untoward results, I believe one must agree, should be avoided, particularly since it is difficult to conclude that Congress intended to deprive a subsidiary university press of the tax exemption which is clearly accorded to a university which itself operates a press. In this connection, it should be noted that the form of an organization is regarded as of no importance. Thus, the committee reports state that some of the witnesses appearing before the committees had asked that

unrelated business income should be taxed only if received by a subsidiary organization. In refusing to follow this suggestion, both committees stated:

"However it is difficult to see why the difference in tax treatment should be allowed merely because in one case the income is earned directly by an educational or charitable organization, while in the other it is earned by subsidiary of such an organization. In both cases the income is derived from the same type of activities and disposed of in the same manner" (S. Rept. 2375, 81st Cong., 2d sess., p. 29; H. Rept. 2319, 81st Cong., 2d sess., p. 37).

Despite the foregoing considerations, there are definite indications the university presses operating as subsidiaries will be obliged to resist efforts to classify them as taxable feeder organizations, unless the Congress now undertakes to clarify its intent. Accordingly, I earnestly urge that consideration be given at this time to the adoption of a statutory amendment to provide that the definition of a feeder organization shall specifically exclude any subsidiary organization whose activities are substantially related to the performance of the functions upon which its parent organization's exemption is based. It is believed that this object can be readily achieved by amending the next to the last paragraph of section 101 of the Internal Revenue Code, as amended by section 301 (b) of the Revenue Act of 1950.

I further urge that section 501 of H. R. 4473, now before the Senate Finance Committee, be amended to grant the same retroactive relief to a subsidiary (whose activities are substantially related to the performance of the functions upon which its parent organization's exemption is based) as the proposed section 501 now provides for a pure feeder organization. It is submitted that unless this or some similar measure is adopted, true feeder organizations will be accorded retroactive tax exemption, while such treatment might be denied to subsidiaries which have been operated for the advancement of the educational purposes of their parent organizations and not for the primary purpose of carrying on a trade or business for profit. Such a result would be not merely anomalous but, indeed, thoroughly inequitable.

I respectfully submit that since section 501 of H. R. 4473 undertakes to relieve against a hardship affecting educational feeder corporations, the present occasion is peculiarly opportune for the clarification of congressional intent with respect to educational subsidiary organizations not engaged in trade or business.

Respectfully yours,

DAVID BOYD CHASE.

THE FIRST NATIONAL BANK OF LOVELL,
Lovell, Wyo., July 16, 1951.

Senator LESTER E. HUNT,
Senate Office Building, Washington, D. C.

DEAR SENATOR HUNT: I would like to urge enactment of legislation to tax all co-ops and mutual companies on the same basis as other businesses are taxed and I would like to see this accomplished in the 1951 tax bill.

Will you kindly relate this to the Senate Finance Committee.

Very truly yours,

J. W. PEARSON.

BANK OF COMMERCE,
Sheridan, Wyo., July 17, 1951.

Hon. LESTER C. HUNT,
United States Senator,
Senate Office Building, Washington, D. C.

DEAR SENATOR HUNT: It is my understanding that the Ways and Means Committee of the United States House of Representatives, in considering the 1951 tax bill, has failed to levy taxes against the profits of cooperatives and mutual corporations. In my opinion, this is an unjustifiable exemption, besides being a further incentive for the people of this country to become socialistic-minded, besides the fact it definitely contributes to the socialistic trend that is tending to destroy our system of free enterprise which has built the greatest country on earth with the highest standard of living.

Furthermore, it seems that there was no other reason for the action of the committee than one of political purpose. In this time of crises when our Government finds it necessary to increase taxes for defense purposes on both individuals and private industry, there is no excuse to discriminate and leave any segment of our citizenry free from taxation. If we have a law taxing profits and income, then

there should be no exceptions or inequities through exemptions. Every American citizen, either as an individual or participant in a group, should carry his proportionate share of the tax load as we are now burdened with, necessarily, in defending our country. What would happen if such a policy was pursued until exemptions were so great that there was no tax money available to finance our Government? It would appear in such a case that we would be vulnerable to a change in the form of our Government which each and every one of us, as American citizens, and our Senators and Congressmen, have sworn to support and defend. It is very foolish, in my opinion, to defend outselves against ideologies which we abhor while at the same time permitting them to creep in from within. This is not the time for special favors to be granted, but rather for sacrifices to be made.

I sincerely hope when this matter of the tax bill comes to your attention that you will give consideration to the thoughts and statements expressed in this letter.

Thanking you, I am,

Sincerely yours,

GUY STURGEON, *President.*

CONVERSE LUMBER CO.,
Douglas, Wyo., July 6, 1951.

Refer to section 123 of the revenue bill of 1951 (H. R. 4473).

Senator LESTER C. HUNT,
Washington, D. C.

DEAR SENATOR HUNT: Will you please vote against this bill. Our tax auditor informs us it is bad business. The bill ignores minority interests and will result in a tax burden we may not be able to take. If you wish any more information as to why the bill is bad business for the little guy, please write me.

I would appreciate a note from you as to how you vote on this bill.

Yours truly,

CONVERSE LUMBER CO.,
H. M. PETERS, *Vice President.*

CHEYENNE LUMBER CO.,
CHEYENNE, WYO., *July 5, 1951.*

Re section 123 of the revenue bill, 1951 (H. R. 4473).

Hon. LESTER C. HUNT,
Senate Office Building, Washington, D. C.

DEAR SENATOR HUNT: In regard to the above bill, wish to advise you that we are very much opposed to the passing of the same. We are very much alarmed to hear of its passing in the House and everything that can possibly be done to defeat this bill we feel should be done. Will appreciate your efforts regarding this matter.

Thanking you most kindly, I remain,

Yours very truly,

CHEYENNE LUMBER CO.,
By S. A. CUNDIFF, *Assistant Manager.*

CHEYENNE LUMBER CO.,
CHEYENNE, WYO., *July 5, 1951.*

Re section 123 of the revenue bill, 1951 (H. R. 4473).

Hon. LESTER C. HUNT,
Senate Office Building, Washington, D. C.

DEAR SENATOR HUNT: In regard to the above bill, wish to advise you that we are very much opposed to the passing of the same. Everything that can possibly be done to defeat this bill we feel should be done, since the bill ignores the minority interests and will result in a great tax burden.

Thanking you most kindly, I remain,

Yours very truly,

CHEYENNE LUMBER CO.,
By WARREN L. GULLETT, *Manager.*

BLOEDORN LUMBER CO., INC.,
Torrington, Wyo., June 27, 1951.

Senator LESTER C. HUNT,
Washington, D. C.

DEAR SENATOR HUNT: My income tax consultant has called attention to section 123 of the revenue bill of 1951 (H. R. 4473) whereby it is proposed to allow only one $25,000 surtax exemption to a group of controlled corporations, irrespective of the number of companies involved and the number of States of incorporation.

I am one of the principal stockholders in a corporation which owns the controlling interest in 14 retail country lumber yards in Wyoming, Nebraska, Colorado, and Montana, and I sincerely urge you to do all you possibly can to defeat this measure.

It not only ignores differences in legal taxable entities for the first time in the history of our income tax law—in effect forcing affiliated companies to file consolidated returns—even though the companies may not all be oragnized in the same States; it ignores possible different minority interests, and at least insofar as our group is concerned, will result in a confiscatory tax burden.

Thanking you for your attention, I am,

Sincerely,

A. O. BLOEDORN.

POWELL LUMBER CO.,
Powell, Wyo., July 6, 1951.

Senator LESTER C. HUNT,
Washington, D. C.

DEAR SENATOR HUNT: Relative to section 123 of the revenue bill of 1951 (H. R. 4473). I feel that this bill will result in a great tax burden on small businesses and I request that you oppose this bill when it comes to the Senate.

Yours very truly,

POWELL LUMBER CO.,
I. E. HEIMSOTH, *Manager.*

WHEATLAND LUMBER CO.,
Wheatland, Wyo., July 7, 1951.

Senator LESTER C. HUNT,
Washington, D..C.

DEAR SENATOR HUNT: Our income-tax consultant has informed us that, section 123 of the revenue bill of 1951 (H. R. 4473), will impose a tax burden the small-business firm will not be able to bear. It is unfair to small business. If passed as is, it will impose an unfair burden on the small-business firm.

As a small stockholder in a small business I hereby register my opposition to the above bill. Will you please use your influence to defeat the bill as above written.

Very truly yours,

W. A. SHAFER, *Manager.*

(Thereupon, at 6:20 p. m., the committee adjourned to reconvene at 10 a. m., Monday, July 23, 1951.)

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