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REVENUE ACT OF 1962

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HEARINGS

BEFORE THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

EIGHTY-SEVENTH CONGRESS

SECOND SESSION

ON

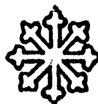
H.R. 10650

AN ACT TO AMEND THE REVENUE ACT OF 1954 TO PROVIDE A CREDIT FOR INVESTMENT IN CERTAIN DEPRECIABLE PROPERTY, TO ELIMINATE CERTAIN DEFECTS AND INEQUITIES, AND FOR OTHER PURPOSES

APRIL 16, 17, 18, AND 19, 1962

PART 5

Printed for the use of the Committee on Finance



U.S. GOVERNMENT PRINTING OFFICE
82190 WASHINGTON : 1962

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REVENUE ACT OF 1962

MONDAY, APRIL 16, 1962

U.S. SENATE,
COMMITTEE ON FINANCE,
Washington, D.C.

The committee met, pursuant to recess, at 10 a.m., in room 2221, New Senate Office Building, Senator Harry F. Byrd (chairman) presiding.

Present: Senators Byrd of Virginia, Anderson, Douglas, Gore, Talmadge, McCarthy, Hartke, Williams of Delaware, Carlson, Bennett, and Curtis.

Also present: Elizabeth B. Springer, committee clerk; and Colin F. Stam and L. M. Woodworth of the Joint Committee on Internal Revenue Taxation.

The CHAIRMAN. The committee will come to order.

The first witness is Mr. Garner M. Lester, the National Tax Equality Association.

All right, Mr. Lester. Take a seat, please, sir, and proceed.

STATEMENT OF GARNER M. LESTER, PRESIDENT, NATIONAL TAX EQUALITY ASSOCIATION

Mr. LESTER. My name is Garner M. Lester, and I live in Jackson, Miss. I am a small businessman and farmer. I am president of the National Tax Equality Association and I am appearing here today as the representative of that organization and its 8,000 members.

The association is nonpartisan and nonprofit. Its members are located in nearly every State of the Union and more than 90 percent of them are small businessmen. They are gravely concerned about the unwarranted competitive advantage that certain business corporations have under the present income tax law. They are pleased that the revenue bill of 1962 proposes legislation which will lessen the tax advantages now enjoyed by certain organizations.

For many years we have urged the Congress to tax mutual fire and casualty insurance companies on the same basis as the stock companies are taxed. This is necessary because, other factors being equal, the company subject to the highest taxes must either charge higher premiums or fail.

The burden of taxation should fall on all impartially and should not cause some forms of business to flourish and others to die off and fail. We believe that section 10 of the proposed revenue bill takes a much needed step toward the objective of tax equality.

This is not to say that the bill does all it could or should. As stated by Congressman Teague of California (Congressional Record, Mar. 29, 1962, p. 4948), during the debate on the bill:

> On pages 166 and 192 of the bill before us providing for a tax on farmer cooperatives and providing for the withholding of patronage dividends, REA cooperatives are obviously excluded and exempted. I call this rank and inexcusable discrimination.

Section 17 of the bill deals with the tax treatment of cooperative corporations. Although the need to tax cooperative corporations on the same basis as other corporations has often been brought to the attention of the Congress, I am afraid that the present provisions of H.R. 10650 offer little or nothing in the way of ameliorating the present inequitable situation.

Few people question the fact that cooperative corporations maintain their rapid growth by means of retained earnings, upon which they have paid no tax.

The objective of section 17 of the present bill, however, seems to be to make the co-op patron, who doesn't get the earnings, pay the tax thereon, while the cooperative corporation itself continues to expand on retained earnings upon which it pays no tax.

When cooperative corporations were first granted their tax privileges, their organizations were small and the tax rates were low. That is not the case any more. Thriving on their tax subsidy, cooperative corporations have become big business, able and willing to overwhelm any fully taxed competitor. Their combined assets at the present time total over $4 billion, and about 85 percent of their equity capital comes from retained profits on which they paid no Federal income tax.

To give you some idea of the way the cooperative corporation's form of doing business is expanding in various fields, I will cite the following examples.

In the marketing of farm products, total business has increased from $1.7 billion in 1940 to $9.3 billion in 1960, a rate of increase in excess of the agricultural economy generally. It is estimated that they now handle nearly 28 percent of commercial production at one or more states in the distribution process, as compared to 16 percent in 1940.

For various commodities their proportions, according to the latest figures, are approximately as follows: citrus, 60 percent; milk and butter, 45 percent; grain, 35 percent; and apples, 20 percent.

In the purchase of farm supplies, the business volume of cooperatives has increased from $358 million in 1940 to $2.4 billion in 1960. This represented 12 percent of farm supplies in 1940 and nearly 19 percent in 1960. Among the more important items the proportions are about as follows: feed, 20 percent; petroleum, 20 percent; fertilizer, 18 percent; and seed, 12 percent.

Cooperative farm supply wholesale organizations have been expanding their business at a tremendous rate. Seventeen of these major organizations had total sales of $170 million in 1941. By 1959 there were 21 of these major cooperatives and their business volume had increased to $1.3 billion or more than 660 percent. This increase far surpasses that of taxpaying businesses.

In the marketing of dairy products, the business done by cooperatives has advanced from $698 million in 1941 to $3 billion in 1960, an

increase of 330 percent. During this same period of time, the value of dairy products sold at the farm level increased approximately 140 percent.

In the refining of petroleum, the cooperatives opened their first refinery in January 1940. It had an average daily volume of approximately 4,000 barrels. A report from the Department of Agriculture, a few years back, indicated at that time that cooperatives owned 20 cooperative refineries with a daily capacity of 144,000 barrels, and that local cooperatives supplied more than 20 percent of the fuel consumed by farmers.

Cooperatives entered the field of fertilizer distribution in the early 1930's. By 1942, 8 percent of all fertilizer consumed on American farms came from cooperatives. In 1952 their share of the fertilizer distribution had increased to 15 percent, and in 1959 it reached 22 percent. It is still rising.

It must not be thought that cooperative corporations are confined to the marketing of farm products or the furnishing of farm supplies.

Consumers cooperatives, for example, are engaged in such businesses as auto repair, barbershops, beauty shops, cold storage, funeral services, laundry, insurance, medical care, shoe repair, printing, tailoring, auditing and accounting, furnishing steam heat, operating parking lots, et cetera.

Up to this point we have been discussing cooperative business volume generally. Now let us examine two cooperatives specifically. The Farmers Union Grain Terminal Association (cooperative) markets grain in 39 States, handling more than 138 million bushels of grain a year.

It began business in 1930 with $30,000 of borrowed capital and by retaining most of its corporate profits without paying any tax on them built its net worth to more than $41 million.

Within the last 6 years, it purchased a soybean plant for $6 million, 37 country elevators for $1.5 million, 11 million bushels of terminal storage at a cost of more than $5 million, a feed manufacture and elevator company for $4,800,000, and it now is starting a long-range expansion of feed manufacturing facilities, the first 6 mills costing $6 million.

It also constructed a $6 million addition to its headquarters. There seems little, if any, justification in making the farmer patrons of this organization pay income taxes on the profits that the corporation earns and keeps. It is estimated that the Federal Treasury loses more than $1 million annually because this huge corporation is able to escape corporate income taxes.

The Consumers' Cooperative Association of Kansas City, Mo., began business in 1929 with seven local cooperatives as members and $30,000 as capital. It has expanded until, at the close of its 1960 fiscal year, it served 1,702 local cooperative associations and its net worth was in excess of $59 million.

Its facilities included nearly 1,000 miles of pipelines, oil leases and wells, 3 petroleum refineries, 10 warehouses and terminals, 4 fertilizer plants, 2 feedmills, and a paint factory. It owns a part interest in other cooperative processing and manufacturing plants and in the International Co-op Petroleum Association, which transports petroleum products to its members in many European countries.

The members of the committee may recall a few years ago the Virginia-Maryland Milk Producers Association purchased the Embassy Dairy that supplies milk to the Washington area. The cooperative finally achieved a monopoly position, which the Supreme Court subsequently held was unlawful. It ordered the cooperative to divest itself of this acquisition. As a business organization able to expand on retained earnings upon which it pays no income tax, it is natural for a cooperative corporation in competition with fully taxed businesses either to put them out of business or to buy them out, and to expand until a monopoly position is achieved.

There exists no justification for not taxing a cooperative corporation in the same manner that any other business corporation is taxed.

A cooperative corporation is a corporation chartered by the State as an entity, separate and apart from its patron members.

Like any other corporation, its members elect its board of directors and the board of directors in turn set the policies of the corporation and elect the officers to carry out those policies.

Like any other corporation, it contracts in its own right. Its member patrons have no liability with respect to corporate debts. It may have common and preferred stock outstanding, and may own chains of subsidiary corporations. It owns property in its own name and can sue and be sued in its own name. A patron member has a mere equity in the organization as contrasted with a right to take a share of the current profits out of the corporation at will.

The profits earned by the Cooperative belong to the cooperative. The patrons have no rights, with respect thereto, except as may be provided in the terms of a patronage dividend declared by the board of directors.

It is true that cooperative bylaws usually require that a declaration of allocation of earnings be made, but the declaration can take the form of an allocation on the books plus a letter of advice. It creates no present claim on profits.

The cooperative corporation retains its profits, though it pays no income tax thereon. If it is sound tax policy to tax an ordinary business corporation on its income at rates up to 52 percent, we submit that it would be sound tax policy to tax a cooperative corporation in the same manner.

Cooperative spokesmen claim that the patronage dividend represents a rebate, rather than a profit distribution. They say that the price of an article, purchased at a local farm supply co-op, is not definitely known and when a patron makes a purchase, the money he pays is held for him until the exact price is known, at which time he is sent his change as a patronage dividend.

They claim that this results in a nonprofit operation so that the cooperative has no income to tax. This theory has been discredited many times by many writers, as well as by the staff of the Treasury Department and the Joint Committee on Internal Revenue Taxation. The latter, in a study released in April 1951, started in by saying:

> The fact that cooperatives are corporations and that Congress has the constitutional power to tax them as corporations may appear so obvious that discussion of the position is unnecessary.

The study then proceeds—

> to establish beyond question that cooperatives are separate entities that are taxable as such.

The cooperative corporation does not put the money it receives from a patron who makes a purchase into an individual box or envelope marked with the patron's name, and after withdrawing the proportional costs and expenses therefrom, return the remainder to the patron as a patronage dividend.

The source of the patronage dividend is money belonging to the corporation and subject to the claims of its creditors. It is money that has been subjected to the risks of business and represents the return earned by the capital risked in the business.

The fact that a dividend is distributed on a patronage rather than on a stockholding basis has no real significance as to the ownership of the earnings, particularly since the obligation to distribute it that way is made by members with their own corporation, an organization operated and controlled by them.

It is significant that in most cases patronage and stockownership are approximately the same so that it makes little practical difference on which basis the dividend is declared.

In 1951, Congress passed a law, in effect, modifying earlier Treasury rulings which permitted cooperative corporations to escape Federal income taxes and retain profits by allocating them to their patrons in accordance with a preexisting bylaw or some other legal obligation requiring them to do so. The allocation could be made in the form of letters of advice or in some other manner that disclosed to each patron the dollar amount allocated to him. Congress was advised that the patron members were already required to pay income taxes on such allocated profits, and the 1951 law was enacted on this false assumption.

The courts later held that since the patron member did not receive and could not demand such profits currently, he could not be currently taxed on them.

Consequently, at the present time, cooperative corporations can expand on retained income which is traced neither to the corporation earnings and keeping it, nor to its patron members, who have received nothing of market value.

The cooperative corporation can presently escape the tax because it has made a paper allocation of its profits to its patrons, perhaps in the form of a letter of advice, telling the patron the dollar amount of his patronage dividend. This is a fatal defect as the member patron escapes the tax because he has not, in fact, received anything of value from the cooperative by the allocation upon which income tax would apply.

It was presumably to remedy this situation in which cooperatives retain hundreds of millions of dollars, tax free, and pay little or no income taxes, and in which patrons likewise are not taxable, that section 17 was incorporated into H.R. 10650. The proposed law provides that a cooperative corporation is not required to pay income taxes on profits allocated as patronage dividends even when merely evidenced by "qualified written notices of allocation."

A "qualified written notice of allocation" is defined to mean, among other things, a written notice of allocation which may be redeemed in cash at its stated dollar amount for a period of 90 days, and the distributee receives written notice of the right of redemption at the time he receives the notice of allocation.

That, I feel, is already the rule of constructive payment, but it also is defined to include a written notice of allocation which the distributee has consented to take into account for income tax purposes. That is where the difficulties arise.

There is clearly no objection to requiring the patron members of a cooperative corporation to pay income taxes on a patronage dividend received in cash or merchandise. His income has clearly been increased by the fair market value of the merchandise or by the sum received in cash.

Similarly, there is no constitutional restriction upon making the patron member of a cooperative pay an income tax on a written notice of allocation when he is informed that he has the right, within 90 days, to redeem the notice of allocation and get the cash if he so wishes. This is constructive payment.

We believe that in order to accomplish the purpose of making the member patrons pay taxes on profits earned and kept by the cooperative, they must be given an opportunity to receive such income in a form that has a fair market value.

If the patron members of a cooperative wish the cooperative to keep its profits, they can keep their notice of allocation and not redeem them for cash but pay taxes on the amount allocated. The cooperative can then continue to expand on retained profits, on which the cooperative itself pays no income tax.

The bill goes further than that, however. It allows the cooperative corporation to escape income taxes on profits which the patrons have consented, or are assumed to have consented, to take into account for the income tax purposes. The bill provides two ways in which the patron is to be held on the consent basis. He can make his consent in writing, or he can obtain or retain membership in the organization after (1) it has adopted a bylaw that membership in the organization constitutes such consent, and (2) the patron has received a written notification and copy of such bylaw.

The ways and means discussion draft bill version of this provision required an annual consent in writing by the patrons.

It is probable that such an annual consent would encourage the patrons to take patronage dividends into account for income tax purposes.

The income tax is supposed to be based upon the ability to pay. The cooperative corporation which earns and keeps the money has the ability to pay. How can a consent in writing attach income tax liability to a patron who has not received the income, has no control over the income, and may never receive the income?

The draft bill approach, of implying consent by means of passing a bylaw and giving notification thereof together with a copy to the patron, seems far removed from letting the patron consent or dissent from his proposed role of taxpayer on earnings the cooperative makes and keeps.

Under this "bylaw consent" provision the patron is stated to have given his consent by merely continuing to do business with the cooperative. The only way the proposal permits him to dissent is by ceasing to be a member of the organization.

Through the years he may have acquired a substantial interest in the cooperative. This provision, however, would force him to pay a

tax on current income he has not received, and cannot presently obtain, or else resign from his organization.

In some areas cooperatives have expanded to the point where their facilities are the only ones available. Many farmers, in fact, might be faced with the alternative of selling their farms or else remaining members and thereby be considered to agree to pay income taxes on a paper patronage dividend in order to let the cooperative expand on retained earnings upon which it pays no income taxes.

Our attorneys advise me that this provision for a bylaw consent is certain to lead to litigation. Members may continue to patronize a cooperative after knowledge of the bylaw without actually consenting thereto. The patrons may feel that they have never in fact obligated themselves to pay taxes on mere letters of advice just because they do business with the cooperative.

Their doing business with the cooperative does not, in their minds, give rise to an obligation on their part to pay taxes on the income that they don't receive from the cooperative, in order to permit the cooperative to escape the taxes on its retained income.

The 16th amendment to the Constitution permits the taxation of income from whatever source derived. If the taxpayer actually receives, or can receive, income, the tax can be levied, but the income has to be there in the first instance.

There are a few situations, with respect to closely controlled corporations, in which the stockholder who can get the income any time he so chooses, is taxed on its earnings. The validity of such proceedings is based on the fact that the taxpayer was in a position to reduce or obtain income at any time he chooses to do so.

This is in sharp contrast with the co-op patron whose consent to pay taxes on income not received is supposed to be implied from the mere fact that he does not cease to be a member of the organization. If he does not, and he is not entitled to currently receive anything of value, if he cannot control the cooperative, if, in fact, he may never receive the income involved, there is obviously a grave question whether consent, implied from mere dealing with a co-op, gives rise to valid tax liability.

In the *Long Poultry Farms, Inc.*, case (249 F (2d) 726), the bylaws of the cooperative corporation provided for a revolving fund certificate issued in the amount to be evidenced by credits in the reserve account.

The bylaws further provided:

> All such amounts shalll have the same status as though they had been paid to the patron in cash in pursuance of a legal obligation to do so, and the patron had then finished corresponding amounts for capital in the association.

If this bylaw fiction could be a substitute for fact the situation, would be treated as though the patrons had received their patronage dividend in cash and they would have to pay an income tax on this basis. But the court said that this was "simply to exalt fiction and ignore reality."

The Commissioner then sought to rely upon one of his regulations. The court answered that any regulation that—

> attempts to tax as income what is not income under law is, of course, void and of no effect. To require the inclusion in income of contingent credits such as are here involved, would be to require the patrons of cooperatives to pay tax upon income which they have not received, over which they have been given

no control and which they may never receive. Apart from the question of constitutionality of such a requirement, which would be a serious one, it is a safe assumption that Congress never intended to impose upon the patrons of cooperatives the hardship and burden which the taxability of these contingent credits would involve.

There can be no doubt that the "bylaw consent" raises a serious constitutional question and that there will be litigation before it is finally settled.

Doubtless both the Congress and the President want a law definitely taxing co-op profits either to the cooperative itself or its patrons—a law that will not result in years of litigation.

The bill, as presently written, can result in the same situation that now exists. The courts might again hold that an implied consent by bylaw would not create any tax liability for patrons with respect to income not received. In that case, the cooperative corporation would then continue to escape taxation on its retained profits because of the law, while the patrons would escape the necessity of paying income taxes on the moneys owned and controlled by the cooperative because of court decisions.

Not only is the "bylaw consent" provision likely to be held unconstitutional, but also as a matter of tax policy it has nothing to recommend it. Should cooperative corporations be allowed to expand on retained income upon which they have paid no taxes?

Why should a co-op be invited by statute to coerce patrons into paying an income tax on its income which they have not received?

Should legislation shift the tax burden on the cooperative corporation's retained earnings to its farmer patrons? I do not believe that farmers would want this type of legislation.

If this "bylaw consent" provision were adopted, it may be assumed that most co-op managements will use it to force reluctant members into line. The Treasury Department would face costly attempts to enforce a measure like this against these patrons. The individual amounts involved often would not cover the cost of collecting them. Failure to collect would mean at least a pro tanto return to the present situation.

Section 17 of the bill must be changed to insure that this cannot happen.

We suggest that you delete those provisions of the bill dealing with consent. A cooperative corporation has everything it needs in the provision allowing a deduction for a patronage dividend paid in scrip with a 90-day option in which it can be redeemed for cash.

The patrons can indicate their consent by not exercising this option. That procedure is fair to both the cooperative and the patron. The patron receives something of value and so he cannot complain if he is taxed on it. Patrons wishing to see their co-op grow will keep their patronage dividend paper and the co-op itself can retain its earnings on a basis tax free to itself.

Co-op spokesmen claim that to have an adequate increase in capital, all patrons should contribute thereto and that the "bylaw consent" provision is necessary for this purpose. This is not the fact. The cooperative corporation can borrow funds from the bank for cooperatives at favorable rates. It can sell stock the way other corporations do. It can keep its profits and pay a tax on them the way its competi-

tors do. Cooperative corporations should have no difficulty raising capital when so many avenues are available to them for so doing.

The law, as it stands, does little or nothing to correct the present inequitable situation. We believe that cooperative corporations and their patron members should be taxed in the same way that other business corporations and their stockholders are taxed.

We urge that you deny cooperatives the right to deduct patronage dividends from taxable income. We do not believe that a cooperative corporation should be able to make all of its earnings disappear for tax purposes by means of patronage dividend allocations.

The exisitng inequity is disturbing to our economy, not only because of the impact of tax-free corporations competing with fully taxed corporations, but also because it artificially makes the cooperative corporation a favored way of doing business.

We believe the "bylaw consent" provision of the bill is unfair to the patrons. The patrons should only be taxed on income that he receives, or at least controls. If he is able to reduce it to his possession, then and then only should he be taxed on it.

The "bylaw consent" raises a serious constitutionality question, and you may be sure that years of litigation will follow the passage of this bill in its present form.

The bill's proposed basis for taxation is unfair to the other taxpayers of the country because of the special privileges it allows a special group of business corporations—the cooperatives. The full taxation of cooperative corporations should bring in at least $150 million in tax revenues. The Treasury estimates that the present bill will bring in $35 million but it may be less than that. The Government deficit being what it is, special tax privileges to this group of corporations should be fully repealed.

For the above reasons, gentlemen, we hope that you will change the existing provisions of the bill and put more equity into our tax system and raise much needed revenue for our Government.

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

Mr. LESTER. Thank you.

The CHAIRMAN. Senator Anderson?

Senator ANDERSON. You do believe then, that when the dividends are obtained or rather earned they should be immediately paid, and the income tax should be paid on them at once instead of allowing it to accumulate?

Mr. LESTER. Yes, sir, we believe when they receive patronage dividends in cash, or in scrip with a 90-day option to get cash instead of the script, the patron ought to include it in his taxable income for that current year.

Senator ANDERSON. You referred to two corporations, the one started by Mr. Thatcher, I think, of St. Paul or Minneapolis and the Cowden group in Kansas City.

Mr. LESTER. Yes, sir.

Senator ANDERSON. You recognize a great deal of the profits of the Grand Terminal Association has been made by the program of the Department of Agriculture to store grain, don't you?

Mr. LESTER. Yes, sir.

Senator ANDERSON. And, therefore, agricultural policy that results in accumulation of huge surpluses, several hundred million bushels of

wheat is a very desirable program for the people who store this grain. Money from storing that grain has made them as much profit as handling the farmers' grain, hasn't it?

Have you checked to see how much money they have made from storing the Government's grain as compared to what they have made from handling the farmers' grain?

Mr. LESTER. No, sir, I haven't figured that. If they make money from storing the Government grain who does the money belong to?

Senator ANDERSON. I think that would take a long time for me to answer. But I don't believe in the Government program to acquire huge surpluses of grain and never have. I think they ought to be disposed of. I merely say the stimulus to that program comes from these great organizations that make their money by storing grain and not by handling grain.

Mr. LESTER. Yes, sir.

Senator ANDERSON. Is there any reason since they make their money from the Government on that that they shouldn't pay tax on it?

Mr. LESTER. It seems to me they should pay taxes on it.

Senator ANDERSON. Currently?

Mr. LESTER. Yes, sir.

Senator ANDERSON. That is all.

I have no further questions.

The CHAIRMAN. Senator Williams?

Senator WILLIAMS. No questions.

The CHAIRMAN. Senator Talmadge? Senator Carlson?

Thank you, Mr. Lester.

Mr. LESTER. Thank you. I ask that our general counsel's memorandums on the constitutionality of legislation taxing cooperatives and patrons be inserted in the record as a supplemental statement.

(The supplemental statement referred to follows:)

REPLY BY A. W. ADCOCK, GENERAL COUNSEL OF THE NATIONAL TAX EQUALITY ASSOCIATION TO CONSTITUTIONALITY OF LEGISLATION TAXING TO PATRONS INCOME EQUAL TO THE FACE AMOUNT OF NONCASH PATRONAGE REFUNDS DISTRIBUTED TO THEM BY COOPERATIVES

Prepared by Mac Asbill, Jr., for National Council of Farmer Cooperatives

Mr. Mac Asbill's brief attempts to demonstrate the constitutionality of legislation taxing to patrons income equal to the face value of noncash patronage dividends distributed to them by cooperatives. The authorities he has been able to find, however, make his brief far from convincing.

As stated on page 4, the only constitutional limitation on the power of Congress to tax is the fifth amendment prohibition against the taking of property without due process of law. The relationship between the income and the person taxed must be sufficiently close to justify the imposition of the tax on such person. Mac Asbill argues that the patrons are the beneficial owners of the co-op income, and that means, he says, that they are so closely related that the patrons can be taxed on income they do not actually or constructively receive. In actuality, however, this closeness between the patron and the co-op is largely fictional. The farmer may sell his product to a co-op or buy supplies at a co-op store, yet it may not be possible for him to receive the income that is "beneficially" his for 12 or 18 months, if then. The co-op may suffer financial reverses, with the result that he may never receive the money. Is he so close to that money that in all fairness he can be made to pay a tax on it?

Mac Asbill talks about the power of Congress to select the level at which current business income will be taxed. There is no doubt but that Congress can tax the income of a corporation or the income of a partnership that operates like a corporation. There is not a doubt that it can tax partners on the income they

earn through their partnership, or stockholders on the dividends they receive from their corporation. The question, however, is whether or not an individual can be taxed on income not received.

Mac Asbill refers to the fact that the shareholders of a foreign personal holding company are taxed directly on current earnings, even though they are undistributed. Here is a device to stop tax evasion. To qualify as a foreign personal holding company more than 50 percent of the stock must be owned directly or indirectly by not more than 5 persons who are citizens or residents of the United States. Five or less persons controlling a foreign personal holding company are well able to withdraw funds therefrom. They control and are so close to their corporation that it does not seem unreasonable to tax them on the earnings they control. It might be that a minority stockholder would exist who had no control, etc., but he could sell his stock if he wished to. Such a foreign personal holding company is hardly comparable to a cooperative corporation. If the patron could get cash upon demand because he had control, the comparison would be more applicable.

The brief also refers to *Helvering v. National Grocery Co.*, 304 U.S. 282, in which the Supreme Court stated that Congress could have taxed the shareholder directly on the year's undistributed profits. Here again we have a case of tax avoidance. The National Grocery Co. had one stockholder. Any time he wished to take funds out of the corporation he could do so because he controlled it. The courts frequently "pierce the corporate veil" going through form to substance, in order to tax income to the entities that own or control it. In a tax avoidance situation the corporate form is observed or ignored, depending upon which view produces the larger tax. The *National Grocery Co.* case can only be properly compared to a cooperative that had but one member. It cannot be compared to the ordinary cooperative corporation.

Mac Asbill states that under the above authorities, which we have found to be of no help at all, Congress could constitutionally tax a patron on the face value of the worthless scrip he received from his co-op. He goes even further and says the patron would be liable for the tax on his share of the retained earnings of the co-op even though he received no document whatsoever. This certainly has not been demonstrated.

On the footnote on page 8, Mac Asbill makes the following statement: "Although the definition of gross income in the present statute is seemingly 'all embracing,' it is obviously not intended to tax every taxpayer on all income that constitutionally would be attributed to him." To prove this he points out that a cash basis taxpayer is not taxed on accrued, but unreceived income. This does not illustrate his point that the all embracing statute is not intended to tax all income but merely shows why income is not taxed twice. If an income item became taxable when it accrued, and again when it was received in cash, except for business done on a cash basis, all income would be taxed twice. To tax all income to a taxpayer once, a consistent manner of accounting has to be practiced.

The next example that Mac Asbill uses to prove his point is that a corporate stockholder is, as a rule, not taxed on undistributed corporate income—but the constitutionality of always doing so is the point he is trying to establish. We have seen that if a stockholder has control of a corporation and uses it for tax avoidance purposes, he may be taxed on the corporate income. Nothing has been said, however, that indicates that a stockholder may always be made to pay an income tax on dividends not actually or constructively received.

It follows from the above, that since Congress taxes income from whatever source derived, if the patrons derive income from co-op net margins, the Commissioner could collect a tax on such income right now. No section of the Code states that a patron is exempt with respect to his share of co-op net margins. The Internal Revenue Code taxes the patron on all of his income, and that would include the income he received as his share of the co-op net margins. That is, in fact, what the Commissioner tried to do in the *Long Poultry* case. The mere fact that the revolving fund certificates issued by the co-op were worthless should not have prevented the collection of the tax from a taxpayer on the accrual basis, if, in fact, the taxpayer's share of the net margins in any way constituted income to him before distribution. Furthermore, the bylaws provided that the revolving fund certificates should have the same status as though they had been paid to the patrons in cash and the patrons had them furnished corresponding amounts of capital for investment in the association. The court felt that such a provision exalted fiction and ignored reality. It then explained

in detail that since the patron had received nothing of value, he had not received any income on which a tax could be levied.

Mac Asbill argues that if Congress can tax partnership income directly to partners, it can tax cooperative income directly to patrons. In the first place, a partnership is not a legal entity in the way that a corporation is. If a partnership earns money, the income belongs to the partners. Entering a partnership is a much more formal act than trading at a co-op store, for example. The partners usually enter into a partnership agreement and the distribution of partnership income and the rights of withdrawal are clearly set forth. The partners have control over partnership activities and it would be unreasonable to say that the partnership income did not belong to the partners. The patron of a co-op, on the other hand, has no comparable rights with respect to co-op net margins. The cooperative corporation that earns the profits is the entity that should pay a tax on them.

Under the revenue acts prior to 1921, if a corporation were formed or availed of for the purpose of escaping income taxes, the stockholders were required to include in their gross income their distributive share of the corporation net income, as though it had been distributed to them in the form of dividends. This provision was held valid in *Collector* v. *Hubbard* in 1870. In 1920, in *Eisner* v. *Macomber* (225 U.S. 189), the majority opinion indicated the case should be considered overruled. In 1921, Congress was afraid that the law would be held unconstitutional and so it abanoned the idea of taxing the shareholders on their share of the corporate income and imposed the tax on the corporation itself. Mac Asbill, therefore, in the last part of his brief attempts to show that Congress should not have been afraid, because *Eisner* v. *Macomber* was not in point. As it isn't in point, it certainly can't be helpful in establishing the constitutionality of taxing patrons on income earned and retained by the co-op.

On the last page of his brief Mac Asbill attempts to show why a patron is close enough to his co-op to have its income regarded as his income. He points out that a patron can only become a patron by doing business with the co-op, selling his crops to it, buying supplies from it, etc. He says this makes him closer to the co-op net margins than that of a stockholder to corporate earnings. The issue is whether or not the patron has received any income upon which he could be taxed. This is not a case where a few patrons own more than 50 percent of the co-op stock and control it for the purpose of avoiding income taxes. Unless there is some tax avoidance scheme involved, the courts will take the relationship of a patron to a cooperative to be what it appears to be. The money earned by a cooperative belongs to the cooperative. Unless the co-op distributes something of value to the patrons, the patron receives nothing of value from the co-op upon which he can be taxed.

The CHAIRMAN. The next witness is Mr. Jerry Voorhis, Cooperative League of United States of America.

STATEMENT OF JERRY VOORHIS, EXECUTIVE DIRECTOR OF THE COOPERATIVE LEAGUE OF THE UNITED STATES OF AMERICA

Mr. VOORHIS. Mr. Chairman, I would like to have Mr. Townsend, the director of our Washington office, sit with me if it is all right.

Mr. Chairman and Senators, I am going to assume in my testimony that this committee and other thoughtful Americans want cooperatives to continue as a constructive part of our American free enterprise system.

May I ask, Mr. Chairman, that my written statement be included at the conclusion of my remarks in full in the record.

It is too long for me to keep it within 10 minutes and, therefore, if it is all right I would rather testify than read it.

The CHAIRMAN. Your purpose is very laudable. It will be included in the record.

Mr. VOORHIS. I might point out that my written testimony is in the nature of a legislative history of the bill as it is before the committee.

We are asking for two or three constructive changes in the bill as it stands.

I submit, to start with, if cooperatives are to actually solve the basic injustice under which our farmers now suffer, their growth needs to be even faster than Mr. Lester has indicated. We have been wrestling with this problem a long time and I don't know that we have come up with nearly as constructive an answer as could be found in cooperatives through which primary producers can own some portions of the profitable parts of the industry in which they engage.

Cooperatives are still small compared to their large integrated competitors. But that growth is not going to be achieved, Mr. Chairman, and shouldn't be, by any kind of tax favoritism or advantage.

Mr. Lester himself has pointed out that cooperatives can't achieve a monopoly position because he has pointed out that the Supreme Court made a decision which prevented it.

I am not going to go any further in answer to Mr. Lester except that I want to submit a witness and this is the president of the American Bar Association, Mr. John Satterfield, who recently in a speech said:

> The fact is that the profits of the conventional business corporation belong to the corporation and not to its individual stockholders, may be retained or distributed in the discretion of the directors and are properly a part of the corporation's taxable income.
>
> Exactly the opposite is true of the margins between the amount received by a cooperative from its patrons and the cost of the goods or services furnished to its patrons or patron-stockholders. These margins belong to the patrons (or patron-stockholders), do not become the property of the cooperative as a part of his income. They are of an entirely different nature from the profits of a conventional business corporation.
>
> Tax favoritism, tax advantage or tax discrimination in favor of cooperatives does not exist. Every individual proprietor, every partnership, every corporation in the United States may enter into patronage contracts under which patronage refunds (or delayed discounts) are deductible or excludable from taxable income of the business.

I am just doing to let Mr. Satterfield answer Mr. Lester, instead of doing so myself because I want to make a constructive statement.

Mr. Chairman, we want legislation to be passed because we do not want it to be said or the fact to exist that any income, passing through the hands of cooperatives, goes untaxed against either the cooperative or against its patrons.

We believe that in the absence of that legislation that there will be a continuance of the agitation of the past few years, and a continuance of the unjustified demand that cooperatives should be taxed upon obligations to pay which cannot be conceived as income to a cooperative.

We want every deficiency in the taxation of cooperatives or their patrons to be corrected. We want this to be done with recognition of two fundamental principles, Mr. Chairman:

The first of these is that a true patronage refund is not and cannot be taxable income to a cooperative.

Mr. Lester's testimony confused this by saying that cooperatives should be taxed on income as corporations are taxed. Well, they are now, Mr. Chairman. If the cooperative makes income, it is taxed on that income and should be, of course, but patronage refunds cannot be confused with profits, as Mr. Satterfield's statement points out.

A patronage refund is the property of the patron and it is properly excludable from the computation of income by a cooperative.

To violate that principle would be to deny groups of people in this country the right to conduct nonprofit enterprises with themselves if they want to. I don't believe this committee or anyone else really wants to do that.

But to blur the distinction between profits and patronage refunds is in effect to say you cannot set up a business on the basis of attempting to deal with yourselves as a group on the basis of the service of that business and not for profit without paying what in effect would be a penalty tax for so doing.

In the second place, we believe that the relationship between members and their cooperative is something that must be preserved. Basically, I believe that the bill before you does preserve that, and I have said so in my written testimony.

The relationship between the member of a cooperative and his cooperative is one which is different from the relationship between a customer and an ordinary business. The cooperative belongs to the members.

The cooperative has to get a certain amount of equity capital. I am not talking now just about money that it borrows, because it can't borrow the money unless it has some equity to back it up. And the logical place and the only logical place for a cooperative to get that equity capital is from its members for the simple reason that shares in cooperatives never rise above par, can't be traded in above par, are not an object of ordinary investment and cannot therefore in the nature of the cases have market value like other securities.

They are of value only to the people who are in position to make use of the services of that cooperative.

To require that all patronage refund be paid in paper which has market value is equivalent to saying that the cooperative cannot raise equity capital but must do all its dealings in the form of debt obligations.

This is not on all fours with competitors of cooperatives which have access to the regular capital markets. And the Secretary of the Treasury, in his testimony, very clearly pointed this out and showed a very clear understanding, it seems to me, of the real facts and the need of the cooperative type of business to raise equity capital from its members.

It is obvious that the time when members and patrons of cooperatives can best supply that equity capital is when they receive their patronage refund. If the cooperative actually pays the whole thing in cash and the member turns around and writes a check and invests it everybody would understand it.

But for some reason they have difficulty understanding it if the membership relationship is conceived to be one in which the member undertakes to furnish the equity capital needed by his own business. And I submit there are many times when to a farmer, for example, it is of vastly greater importance to him to own an efficient and effective fertilizer plant or an oil refinery than it would be to have cash money to spend on a television set because, after all, his real problem and the problem of other disadvantaged groups in our society is that they lack economic bargaining power, and it is the cooperative that gives

that back to people who are small producers or small operators or consumers or other groups, which they need desperately and which can give a balance to our economy without Government intervention which we can get in no other way.

I submit that no business in this country is taxed on investment in its capital as if that investment in its capital were income.

And that is what Mr. Lester proposes. He proposes that in the case of cooperatives the investment of cooperative members in the cooperative be taxed as if it were income to the cooperative.

That is an untenable position.

Now, may I say that I don't want to disassociate myself in my testimony with some other testimony that will be given, I believe, immediately after mine, and which will suggest a simpler method of solution of the problem than perhaps the pending bill provides.

We wouldn't be against that proposal certainly. It would be easier than this one. On the other hand, we are prepared to support the present bill, Mr. Chairman, and we are prepared to support it because we believe that it will correct such deficiencies as have been created by the court decisions to which Mr. Lester gave reference. We want those corrected.

Now, the bill contains a withholding tax. I make an appeal in my written testimony that two things be done about that withholding tax, the first of which is that provision be made so you will not have double and triple withholding on the same money, which you would get unless you are certain that that is not the case. You see, if a wholesale cooperative pays the patronage refund to a retail cooperative, that patronage refund belongs to the individual members of the retail cooperative, and then the retail cooperative, if required to withhold on the total amount of its patronage refunds, would be making double withholding on the amount of the patronage refund from the wholesale to the retail cooperative. This obviously would be inequitable and messy. The logical thing to do since this income all winds up in the hands of the individual member of the retail cooperative is to exempt patronage refunds paid by one cooperative to another.

Another appeal I make is that there be a floor under the amounts against which withholding applies because so many of these patronage refunds, as well as dividends, for that matter, are in such small amounts and such a large percentage of them go to people who have no income tax to pay. But, with this preface, I would like to say, on the other hand, that with a withholding tax in effect the Government will be absolutely certain to collect its taxes.

You need not worry about whether the Government is going to collect its taxes.

In the second place, no one will be able to say that cooperatives' aren't paying taxes, which is, of course, untrue but they keep saying it. And in the next place, this will in effect require the cooperative to pay 20 percent of its patronage refund in the equivalent of cash, assuming the withholding tax still prevails.

As I say, I think the total question of withholding on very small amounts of either dividends, interest, or patronage refunds as to any business whatever is a very questionable nature.

Now then, we believe it is important, as I say, after the years of uncertainty that our situation be clarified. I can see a lot of difficulties

in the present bill for us. It won't be easy to take. It will be expensive for cooperatives. It will make it especially difficult for cooperatives that now have the so-called agricultural exemption to operate, because it will put a premium to some degree upon being a nonmember.

On the other hand, we do believe that the bill fundamentally preserves the two basic principles that I have spoken of, namely, the excludability of patronage refunds and the membership relations with his cooperative.

We believe, for reasons in my written testimony, and with changes proposed in that testimony that it would be much better if this bill is passed than if nothing is done.

Now, Mr. Chairman, I have only the concern that what is done be something that will be effective and workable, and I believe this bill will be. We want the taxpayments of cooperatives and their patrons to be clear, understandable, fair, and to provide for cooperatives carrying their full and just share of the tax burden.

Basically, they do now, in our opinion. The only question arises with respect to the patronage refund that is paid in some other forms than cash.

Now then, Mr. Lester says just leave the 90-day provision in. Here is what would happen. If that is the only provision that is left in, part of the patrons will take their refund in cash and part of them will capitalize the cooperative. I leave you to imagine what the situation will be under those circumstances. It will obviously be inequitable with respect to the members who do invest their patronage refunds in capital and it will break the cooperatives to pieces.

Mr. Lester's basic proposal, namely, that all patronage refunds be taxed as if they were profits, would, of course, destroy the opportunity to operate as a cooperative corporation in this country.

We ask the committee to provide against double or triple withholding on the same money. We ask you to exempt very small dividend, interest, and patronage refunds from withholding purely on practical grounds. And we would quote from the Ways and Means Committee report to the effect that where patronage refunds are paid purely on purchases for personal, living, or family items, these patronage refunds in these cases—

> represent downward price adjustments of personal, living, or family items and should no more lead to taxable income than bargain purchases of such items elsewhere.

That is from the Ways and Means Committee report.

We want cooperatives to be taxed on the basis of exact equity with other business. Basically they are now. The bill would correct in our opinion the only outstanding real deficiency. We appeal to the committee for understanding of the basic nature of cooperatives and we ask and expect to receive the kind of legislation that will enable cooperatives to continue to live and make their contributions to American life.

This would have been impossible under the first Ways and Means Committee draft. It would be much more impossible under Mr. Lester's proposal.

Our organization believes it will be possible though difficult under the bill in its present form. We nonetheless are ready, because we try to do a patriotic job to support this bill.

That is all, Mr. Chairman.
(The prepared statement of Mr. Voorhis follows:)

TESTIMONY OF JERRY VOORHIS, EXECUTIVE DIRECTOR OF THE COOPERATIVE LEAGUE OF THE U.S.A.

Mr. Chairman and gentlemen of the committee, my name is Jerry Voorhis and I am executive director of the Cooperative League of the U.S.A. The cooperative league is a national federation of consumer, supply, and service cooperatives. Its affiliated member organizations include in their membership approximately 14 million different families who have invested in the shares of cooperative businesses of various kinds through which they obtain farm supplies, insurance, consumer goods, electric power, savings and credit, health services, housing, and other needs. These people are providing the solution to their own economic needs without relying upon the Government or any other outside agencies. They are giving real meaning to the term "people's capitalism" for the rank and file of the American people.

To give a general summary of the position of our organization respecting H.R. 10650, I should like to quote the text of a letter which I signed along with the executive directors of three other national cooperative organizations at the time the tax bill was under consideration in the House. Here is what we wrote to Mr. Mills:

"The undersigned organizations, with particular reference to the sections affecting cooperatives, support the pending tax bill, H.R. 10650. We do not endorse every provision of the bill and we will seek certain changes and improvements in cooperative sections when the bill reaches Senate. Nevertheless, we have sought for many years the clarification of the tax status of cooperative patrons which this bill seeks to provide. The bill in present form preserves the principle of the excludability of patronage refunds by cooperatives and the mutual relationship between cooperatives and their members.

"Sincerely yours,

"JERRY VOORHIS,
"*Cooperative League of the U.S.A.*
"E. M. NORTON,
"*National Milk Producers Federation.*
"ROY F. HENDRICKSON,
"*National Federation of Grain Cooperatives.*
"CLYDE T. ELLIS,
"*National Rural Electric Cooperative Association.*"

The reasons for our concern respecting this bill are twofold. First when we supported the passage of the Revenue Act of 1951, we believed that that law had established a clear and just principle: that all income passing through the hands of cooperatives be taxed once, either against the cooperative or against the patron. We are convinced that we can show that cooperatives enjoy no tax favoritism or privileges at the present time. In every important respect, cooperatives are taxed on the same basis as other businesses with which they compete. It is, of course, true that patronage refunds which cooperative business are obligated to pay to their members and patrons are not taxed as income to the cooperative. Neither are similar refunds taxed against any other businesses. There is no special privilege for cooperatives involved. Furthermore to the extent that any profit is made by cooperatives, they are taxed on such profits the same as any other businesses are. The difference comes about only because cooperatives obligate themselves to pay what would be profits to other businesses in patronage refunds to their patrons.

However, as the Secretary of the Treasury pointed out out in his testimony certain minor deficiencies in the taxation of cooperatives and their patrons were created not by the law, but by certain court decisions subsequent to the passage of the Revenue Act of 1951.

The effect of these decisions was that the patron was not liable for tax on his patronage refund, even though it affected his income, if the refund was paid in certain forms. The principle purpose of the cooperative section of H.R. 10650 is to reassert the principles of the act of 1951 and to set forth the circumstances under which a qualified and excludable patronage refund has been paid and becomes, therefore, the taxable income of the patron.

Over the past several years, the cooperative organizations of this country have been endeavoring to secure legislation of this sort for the precise reason that we do not want any special tax privileges or advantages. But we never were able to secure any cooperation from the Treasury Department until this year. Just why this has been true, I leave the committee to judge.

The bill now before the committee would correct those minor deficiencies in the taxation to which I have just referred.

This is our first reason for supporting it. No one likes taxes or tax bills. This bill will mean more taxpayments and a very great amount of additional accounting work on the part of both cooperatives and their patrons.

But for the reason just set forth as well as for additional reasons, we are supporting the bill.

The second reason we are supporting the bill as stated in our letter to Chairman Mills, is that the bill preserves the principle of excludability of patronage refunds from the computation of income by cooperatives. The language actually used in the bill is that qualified patronage refunds shall "not be taken into account" in determining income for a cooperative. This language, we understand to be in all respects equivalent to the world "exclusion."

Had this change not been made in the bill, which originally carried the word "deduction," we could not have supported the bill. By their very nature cooperatives are obligated to pay patronage refunds to their member-patrons. These patronage refunds are the property of the member-patrons and not of the cooperative. Hence the amounts paid or allocated in patronage refunds cannot possibly be regarded as income to the cooperative and should be excluded from their computation of income. Conversely patronage refunds are the property of the patron and to the extent to which they affect his business income and are not the result of purchases for purely personal living or family consumption items, the patron is clearly liable for the tax on any resulting income to him. This is a very basic principle resulting from the purpose of a cooperative business organization which is to provide goods or services to their member-patrons without profit in the transaction. This purpose is certainly understandable since it is the member-patrons who have organized the cooperative, capitalized it, and patronized it in order to meet some outstanding need of their own which could not otherwise be adequately met.

As I say, the bill preserves this principle of the excludability of patronage refunds and at the same time provides definition of "qualified patronage refunds."

This definition will present some problems to cooperatives, there is no doubt about that, and in its original form in the first draft of the bill it would have been impossible for cooperatives to have operated effectively, if at all.

But another change was made in the bill before it was presented to the House which was crucial so far as we are concerned and which provides the basic and most logical means whereby patronage refunds can be "qualified" for exclusion. This change was necessary from our point of view in order to preserve the relationship of mutuality between cooperatives and their members. The bill now provides that if the bylaws of a cooperative state clearly that the members thereof agree to receive their patronage refunds in either cash or noncash form depending upon the needs of their organization, then the act of becoming or remaining a member shall constitute consent on the part of the member to accept his patronge refunds in noncash form, thus to help to capitalize his cooperative through his investment, and to pay such tax on such patronage refunds as may be involved. Were this provision not in the bill we, again, could not support it.

Briefly our reason is this. Cooperatives like all other businesses must have capital upon which to operate. Moreover, it is obvious that some of this capital must be equity capital. But the only people who have reason to provide or will provide equity capital to a cooperative business are its members. Further, few of those members are wealthy people. And the easiest and most logical way for them to provide capital for their cooperative business, as the Secretary of the Treasury pointed out, is by investing their patronage refunds at the time of their receipt. This is the very essence of the relationship between cooperative enterprises and their members.

As to business with nonmembers, the bill requires cooperatives to obtain written consent from each of them, in order that patronage refunds allocated to them can be qualified for exclusion. This will not be easy to do. And if some nonmember patrons give such consent and others do not, an obviously inequitable situation will be created. Three possible alternatives will exist for

cooperatives dealing with nonmember patrons. They may, of course, in some cases be able to obtain written consent from practically all nonmember patrons. Or they may be unable to do this.

In such a case the cooperative will become liable for full income tax on all margins resulting from business done with these nonmembers, whether or not patronage refunds were paid to them, for such refunds would not be deemed true patronage refunds under the bill. The bill does, however provide that at the time when the certificates used in paying the unqualified refunds were redeemed in cash, the amount used in redemption thereof could be excluded by the cooperative. This provision we consider to be no more than fair, and certainly very necessary. Some cooperatives no doubt will simply make a distinction between members and nonmembers paying refunds to their members but not to their nonmember patrons. In such a case, please let me underline the fact that the cooperative will pay full corporate income tax on all earnings resulting from such nonmember business just as they do now on any business as to which they are not obligated to pay patronage refunds.

From the point of view of the Government, it is clear that since the bill provides for a withholding tax against patronage refunds as well as dividends and interest paid by cooperatives, the Government would be certain to collect its taxes regardless of any other factors.

And from the point of view of the cooperative businesses of this country, what the 20 percent withholding tax will actually mean is that cooperatives will be required to pay at least 20 percent of the patronage refund to their patrons in a form exactly equivalent to cash, since the cooperative will in effect be paying and in many cases overpaying the patron's tax for him.

A third change which has been made in the bill and without which we could not have supported it, is the provision which makes clear that there is no tax liability on a cooperative patron if the patronage refund is paid as a price adjustment on items of personal living or family expenses.

To quote the Ways and Means Committee report: "The patronage dividends in these cases represent downward price adjustments of personal living or family items and should no more lead to taxable income than bargain purchases of such items elsewhere."

It is our earnest hope that the passage of this bill, coupled with the Revenue Act of 1951, will firmly establish the principle that all margins passing through the hands of cooperatives shall be taxed once either against the cooperative or against the patron if indeed any income is generated at all. We regard the pending bill basically as a reaffirmation on the part of Congress of what we thought had been established in the Revenue Act of 1951. We hope that with the passage of this bill, irresponsible attacks on cooperatives will come to an end. We hope this not for our own sakes or even for the sake of the American cooperative enterprise, but rather for the sake of the United States of America and particularly its agriculture and indeed for the sake of the whole free world. If we really believe in a free economic system, there must be economic choice available not only in individual decisions, but as to different forms of economic organizations which groups of free people may freely use to meet their needs using their own money and their own efforts to make this possible.

Cooperatives are after all an ideal "free enterprise" method of adjustment of economic difficulties and injustices which a free economic system can offer to its people.

The formation of a cooperative business offers a fourth alternative to any group of people having any outstanding need which is not being adequately met or being met at undue cost. The other alternatives are either (1) to go without such goods or services; or (2) to accept the dictates of terms laid down by what are often monopolistic vendors; or (3) to rely upon the Government.

Certainly the self-help method through formation of a cooperative is preferable to any of the former three. And that fact ought to be fully recognized by the Congress of the United States and reflected in its legislative action.

Let me give but one example. Cooperatives could offer a wholly constructive solution to our country's outstanding economic problem and injustice. The plight of our agriculture has hardly been alleviated by any of the measures so boldly undertaken. Indeed all we have done is to slow down the liquidation process. But if marketing, supply, credit, electricity, and others kinds of cooperatives among farmers and their neighbors could be made strong enough, large enough, and well enough intergrated to enable rural people to participate in some of the earnings from and some of the controls over the profitable

segments of the food and fiber business, we would be on our way to a real basic solution to our agricultural problem.

Let me quote to the committee what Mr. John C. Satterfield, president of the American Bar Association, recently had to say about the values of cooperatives in our economy and about their tax status.

"In the free enterprise economy which is ours in the United States of America today, the cooperative is a potent factor in retarding the rapid march of this country toward socialism and a Government-manipulated economy.

"It is both surprising and alarming to observe the criticism of cooperatives by businessmen and business organizations who are blinded to the service which is now being rendered by cooperatives to the free enterprise system. This service has been a material factor in support of capitalistic free enterprise in the United States for more than 50 years * * *.

"One of the most powerful tools which the farmer may use to free himsefl of the economic pressures now being brought to bear upon him is the proper use of his farmer cooperatives. In this way, the farmer is able to manage his own business affairs, and thereby increase his profits.

"This is the free enterprise system in action. It is a true manifestation of the principle that business will flourish toward proper ends, within a fully legitimate economic framework. The farmer cooperative is not only an example of the free enterprise system in action, it is a necessary barrier to the flowing tide of governmental domination and possible eventual elimination of the free enterprise system altogether.

"The fact is that the profits of the conventional business corporation belong to the corporation and not to its individual stockholders, may be retained or distributed in the discretion of the directors and are properly a part of the corporation's taxable income.

"Exactly the opposite is true of the margins between the amount received by a cooperative from its patrons and the cost of the goods or services furnished to its patrons or patron-stockholders. These margins belong to the patrons (or patron-stockholders), do not become the property of the cooperative and as a matter of constitutional and legal right, cannot be taxed to the cooperative as a part of his income. They are of an entirely different nature from the profits of a conventional business corporation.

"Tax favoritism, tax advantage, or tax discrimination in favor of cooperatives does not exist. Every individual proprietor, every partnership, every corporation in the United States may enter into patronage contracts under which patronage refunds (or delayed discounts) are deductible or excludable from taxable income of the business."

Now in conclusion we urge the committee to make certain improvements in the bill before it is reported to the Senate. None of these improvements change the basic substance of the bill or interfere with the "consent of patrons" features which the Ways and Means Committee considered so basic.

First it is most important that the language of the bill be reviewed to be sure that, in all references to patronage refunds, the word "deductions" where it appears in either the report or the bill is changed to "not taken into account." This, as I have pointed out is a matter of basic, inescapable principle.

In the second place, the bill as presently written appears to require every cooperative in the country to enact a new set of bylaws after the passage of this act if its patronage refunds paid to members are to be considered "qualified" for exclusion. We believe this is unreasonable. We think that the provision should simply be that the bylaws should, before a certain date, contain the required provisions respecting member's consent to receive patronage refunds in noncash form.

This would relieve cooperatives whose bylaws are already in this form, of the burden of having to enact new ones. Further on this same point, the provision in the bill as presently written states that for a patron to be regarded as having given consent, it must be shown that "he has received a written notification and copy of the bylaws." We think this is too much responsibility to place on the cooperative, and we feel that instead of the language "he has received a written notification and copy of the bylaws," there should be substituted the following: "And a notification and copy of such bylaws has been mailed to his last known address or otherwise furnished to him."

We, of course, assume that so far as dividends and interest are concerned, whatever the bill finally provides respecting business generally will apply to cooperatives. Patronage refunds are not the same transactions at all as dividends and interest. However, we are ready to accept withholding with respect

to patronage refunds as well but with the expectation that the Congress will keep this difference clearly in mind and make the provisions as practical and workable as possible. At best, withholding on patronage refunds will present a severe accounting burden and increased expenses. And a real problem arises because of the relationship that exists between regional wholesales and affiliated local retail cooperatives. This problem will arise because the regional wholesale cooperatives are in most cases owned by, and their members consist of, not individuals, but local cooperatives. If the regional cooperative withholds 20 percent of its patronage refund to the local cooperative and if then the local cooperative, as it always does, includes the patronage refund from the regional in the money to be distributed to its individual members, there will then be double withholding on that amount of the refund of the local cooperative to its individual members which is made possible by the refund from the wholesale to the retail cooperative.

If I understand it correctly, section 3487A provides that a corporation can take a credit against the withholding tax in an amount equal to the amount withheld by another corporation making payments of interest, dividends, or patronage refunds to it. If this is correct, then the local cooperative could take a credit against its withholding of the amount withheld by the wholesale cooperative. This would avoid double withholding if our interpretation of this section is correct. But it would require a tremendous amount of bookkeeping because the amount withheld by the regional wholesale cooperative would have to be allocated proportionately to all patrons of the local cooperative and the amount the local cooperative would withhold from its individual members would not correspond with the amount of tax actually paid for them. The full amount of tax withheld for each individual member would be the sum of his proportionate share of the withholding by the regional wholesale plus the amount withheld by his local. If this sounds complicated it certainly is, and I would hate to be the Treasury accountants trying to compute refund claims under these circumstances. It would, therefore appear to be much more reasonable simply to exempt from withholding any patronage refunds paid by regional wholesale cooperatives to their affiliated local retail cooperatives and then to require the local cooperative to withhold on the amount of the patronage refund paid to its individual members.

As a matter of fact, we believe it quite unreasonable not to place a floor under the amount of either patronage refunds or dividends or interest against which a withholding is to be required of any business. Just what that floor ought to be, we do not suggest precisely, but certainly it makes little sense to require withholding on amounts of less than $20. And probably the same is true of amounts of less than $50 or $100. The accounting expense involved in withholding on very small amounts, much of which will be subject to refunding by the Treasury, will be far out of proportion, we are convinced, to any tax delinquency that might be avoided. Particularly will it make little sense to require credit unions to withhold on dividends or interest paid on their members' shares. For in most cases this would amount to only a very few dollars each year.

It is not the principle of withholding that is involved. We believe generally it is a good and sound principle. But it should be applied like all other said principles—with wisdom and understanding.

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

Senator Anderson?

Senator ANDERSON. You keep saying that patronage dividends cannot be considered as profits.

Mr. VOORHIS. Can't be considered as income, yes, that is right.

Senator ANDERSON. You said profits.

Mr. VOORHIS. Yes; that is right.

Senator ANDERSON. Where did you get the money for the patronage dividends if not from profits, do you get it from losses?

Mr. VOORHIS. If I didn't say it, Senator, I should have said that a patronage refund—the funds used to pay patronage refunds by a cooperative to its patrons or members—cannot be considered profit to the cooperative for the reason that they are obligations of the cooperative.

Senator ANDERSON. If you say it is profit to the cooperative then that would completely change what you said.

Mr. VOORHIS. Well, I am glad I changed it then.

Senator ANDERSON. Then you said you suggest an investment, I can't read my own writing very well—that the investment of some be taxed as income, the investment of these—I remember. You said that taxing it, when we taxed the cooperative, we were taxing investments in the business instead.

Mr. VOORHIS. Instead of profits.

Senator ANDERSON. Yes.

Mr. VOORHIS. Yes, sir.

Senator ANDERSON. And you wanted, now, in that field, that when the taxation was put on, you felt it was taken out of investment money?

Mr. VOORHIS. Here is the point, Senator.

Senator ANDERSON. Taxing it on an investment basis.

Mr. VOORHIS. The people who advocate that cooperatives should be taxed on the amount of their patronage refund obligations as if those patronage refund obligations were profit to the cooperative are proposing that cooperatives be taxed on investment in the capital of the cooperative which cannot be income to the cooperative, because investment in the stock of a company isn't income to that company.

It is an investment in the company, and what the cooperative member does when he accepts his patronage refund in noncash form is to invest that patronage refund in his cooperative business. This is not income in the sense of taxable profits to the cooperative. It is an investment that belongs to the man who makes the investment.

Senator ANDERSON. He gets a patronage dividend from his cooperative?

Mr. VOORHIS. Yes, sir.

Senator ANDERSON. He can invest that in his cooperative?

Mr. VOORHIS. Yes; or——

Senator ANDERSON. Or he could take it and invest it in some other corporation. What is the difference?

Mr. VOORHIS. If he takes the money in cash and invests in another corporation it would be obvious to everybody it was his obligation to pay the taxes on it. All we are saying it is likewise his obligation to pay the taxes on it if he invests in his cooperative.

There is, as you say, no difference between the two things so far as the patron's tax liability is concerned.

Senator ANDERSON. I get a little confused there. I tried to support cooperatives and I hope to continue to support them a great deal, but if, for example, a person bought an E bond and held it for a long period of years he wouldn't be charged on the income all through those years, but when he finally sold it he would have to pay a tax on it, isn't that right?

Mr. VOORHIS. That is right.

Senator ANDERSON. If he sold an interest in a business he finally has to pay tax on it.

Mr. VOORHIS. Yes.

Senator ANDERSON. If he holds an interest in a cooperative and finally receives something of value he should be taxed on it.

Mr. VOORHIS. Yes; that is our point.

Senator ANDERSON. When he gets a patronage dividend he gets something of value.

Mr. VOORHIS. That is right.

Senator ANDERSON. Why shouldn't he be taxed on it?

Mr. VOORHIS. We are insisting that he should. That is the burden of our testimony. Because the patron is liable for the tax, it is his property, and he should pay the tax, and we want a bill passed to make it clear what the patron's tax liability is. That is the very thing we are advocating.

Senator ANDERSON. If a person belonging to a co-op gets a patronage notice that he has a hundred dollars coming to him he pays the tax on it.

Mr. VOORHIS. That is what I have done to the cooperative I belong to if I receive it in cash or not, because I knew very well if that hundred dollars went into the working capital of my lemon house that it was doing me a lot more good than if I got the hundred dollars out and spent it. It was of more value to me and I was much more ready to pay the tax on it if my cooperative association used it to protect my economic position.

Senator ANDERSON. I was only trying to find out from my old colleague on the fifth floor of the Old House Office Building how you felt about these patronage dividends when actually received by the members, that the individual should pay tax on it.

Mr. VOORHIS. Yes; I am much obliged, Senator.

Senator ANDERSON. Yes.

The CHAIRMAN. Senator Williams?

Senator WILLIAMS. Mr. Voorhis, if this patronage of $100 is in the form of scrip which is payable to the patron only upon the liquidation of the cooperative and not upon his call for redemption who should pay the tax on $100?

Mr. VOORHIS. Well, Senator, of course, you put this in the very toughest way you can possibly put it. I am going to say to you, that I do not personally think that there is any basic objection to the Congress saying that there are certain definitions of what a proper patronage refund may be. I think that if the patron can't get this until the time of liquidation that it is questionable whether he received anything immediately which would be regarded by the courts as constructive receipt of income.

On the other hand, supposing that this $100 is, as I gave the example a while ago, invested in a fertilizer plant. This patron of the cooperative owns a part of that fertilizer plant. It serves his needs as a farmer. It enables him to participate in the profits of a part of the profitable part of the business of agriculture rather than just in the unprofitable part which is primary production.

I think this may be worth a great deal to him, and I think that the principle still stands and that that is the property of that patron, and however it may be used in his cooperative, it is the property of that patron. Particularly if the bylaws of his cooperative provide that when he enters into membership in that cooperative, that he agrees to capitalize it by investing his patronage refund; if it is decided that the cooperative needs it, that then he has given consent and he has recognized his tax liability, and if you have a withholding tax he is going to pay it because the co-op is going to pay it for him.

Senator WILLIAMS. I appreciate that answer but——

Mr. VOORHIS. Senator, let me go further.

I may be in trouble about this but I am going to say to you that I personally would not raise too much cain about the matter if you were going to say that patronage refunds should be paid in such form that they have a certain due date, that they be paid within a certain length of time, or something of the kind. I think it ought to be a reasonable length of time, but I am not opposed to considering this kind of an approach to the problem if it is necessary. But I am very much opposed to violating the principle of the excludability of patronage refunds.

Senator WILLIAMS. I again thank you for the answer but I am not quite sure that I understand what you said. Who should pay the tax on a situation in which I directed the question? We are speaking of existing law.

Under the formula where Mr. A gets a patronage refund, payable when and if the cooperative is liquidated, in those instances where there is no due date, where it could perhaps go through his estate to his children, or grandchildren, down through several generations conceivably, who should pay the tax?

Mr. VOORHIS. In the first place, Senator, I never heard of such a thing. Maybe it exists. I never heard it.

Senator WILLIAMS. Oh, yes; it exists.

Mr. VOORHIS. All right.

I think that it is impossible properly and constitutionally to say that a patronage refund on which a cooperative has an obligation can be income to the cooperative. I frankly don't think it is altogether equitable for the patron to pay the tax in that case, and I therefore would be willing to accept a provision which said that the patron must give the kind of consent to do it that is provided in this bill, where he would know what he was doing, and if he doesn't want to give that kind of consent then he doesn't have to.

But I think that is one reason for the bill before us, so that he will know what he is doing about the matter.

Senator WILLIAMS. Then you do recognize that under existing law there is a problem which must be dealt with?

Mr. VOORHIS. I do and I want it to be dealt with.

Senator WILLIAMS. All right. Thank you.

The CHAIRMAN. Senator Douglas?

Senator DOUGLAS. Mr. Chairman, I think all the members of the committee, and many members of the group in the room, remember Mr. Voorhis as a very valued Member of the U.S. House of Representatives for 10 years. I think Mr. Voorhis was almost universally respected for his ability and high public spirit, and as a member of the newspaper reporters and a certain cynical crowd said, he was one of the most conscientious and hard-working Members of the House. I see some of the members who served with him at that time and I won't say he was the most conscientious but certainly one of the most conscientious.

Mr. VOORHIS. Who were candidates for that and should have been considered before me.

Senator DOUGLAS. But he was a very fine Member of the House and 15 years ago he came to the State of Illinois, and what was California's loss has been Illinois' gain and we have been very glad to have him as a citizen of the State and he has made a fine record there.

One question, Mr. Voorhis, I would like to raise: In the past, one of the objections to treating patronage dividends as income to the recipient has been the charge that the dividends came in such small denominations that they would not be declared by the income recipient on his individual tax returns.

Now, as I understand it, you take the position that this is income and that the recipient should pay the tax upon patronage dividend. Don't you think the withholding system now should remove this objection? You would have collection at the source, so to speak.

Mr. VOORHIS. Yes; I do think so, Senator. The only problem arises in cases where the patronage refund itself does not affect the taxable income of the recipient such as where that really is just a reduction in living costs on an immediately consumable item in which case it can't obviously generate income but in all cases where it does generate income I would answer "Yes" to what you say.

Senator DOUGLAS. And the withholding system which I understand is embodied in the present bill will now insure that the individual will in virtually all circumstances pay taxes upon the income?

Mr. VOORHIS. Not only that but it will insure the cooperative will pay that tax for him and will in effect pay him 20 percent at least in cash, you see.

Senator DOUGLAS. You do not object to the withholding features either on patronage dividends or upon interest on shares, is that right?

Mr. VOORHIS. That is right. I said much of the interest on shares is going to be in very tiny amounts and it is going to be payable to people who won't have any income tax to pay in a very large percentage of the cases because a lot of farmers don't pay income tax because they haven't got income. And may I say to be fair, that there is a lot of disagreement about this, Senator, and a lot of people are going to want to skin me for having said what I did about this, but I believe what I said.

Senator DOUGLAS. That is characteristic and as one who also has always believed in the cooperative movement, I think the position that you take is correct, that this is income, and the individual should pay for it, and if in the past there has been avoidance or evasion through failure to declare, that this should be corrected and I think this is one of the loopholes which the withholding system plugs.

Mr. VOORHIS. You see one thing a lot of people forget is that people don't have to be members of cooperatives unless they want to. They can quit tomorrow if they don't like it. But our point is that as long as they are members there is a relation of mutuality between a cooperative and the member that ought to be preserved and it is the very heart of this form of business organization and part of that concerns the provision of the equity capital for the business by its members. Thank you very much, Senator Douglas.

The CHAIRMAN. Senator Carlson.

Senator CARLSON. Mr. Chairman, just this, Mr. Voorhis' appearance here this morning brings back many pleasant memories of our past association in the House of Representatives together.

Mr. VOORHIS. For me, too, Senator, thank you.

Senator CARLSON. His statement this morning was frank, and that is the way he conducted himself when he was a Member of the House of Representatives. He has never hesitated to express his views and

express them forcibly. I am pleased you are here this morning stating that it is your firm opinion and conviction that these patronage dividends should be taxable to the patron and I hope this committee will keep that in mind when it writes this legislation.

That is all, Mr. Chairman.

The CHAIRMAN. Senator Gore.

Senator GORE. No, thank you.

Mr. VOORHIS. Senator, may I just make this one brief comment? That any income passing through the hands of cooperatives should be taxed either to the cooperative or the patron but I didn't say that patronage refund should be taxed either to the cooperative or the patron because if it is a true patronage refund it can't properly be taxed against the co-op.

Senator CARLSON. That is correct.

The CHAIRMAN. Senator Talmadge?

Senator TALMADGE. Mr. Voorhis, as I understand your testimony you take the position that one who receives the patronage dividends should pay income taxes upon it at the time he receives it?

Mr. VOORHIS. Yes, that is——

Senator TALMADGE. That is based on the assumption that it is something of value and he would eventually be paid money therefor?

Mr. VOORHIS. Yes, eventually, he will.

Senator TALMADGE. Does it necessarily follow that he will always be paid money for that patronage refund? Does it not sometime occur that he never receives any money for the patronage refund?

Mr. VOORHIS. Sometimes, I suppose it does, Senator, and I also suppose that it happens in all kinds of walks of life that we anticipate that something is going to be of value to us and it doesn't turn out to be.

Co-ops fail just like other businesses do.

Senator TALMADGE. But you take the position, nonetheless, that there is a constructive receipt of income and if the co-op never pays it the member takes the risk.

Mr. VOORHIS. Yes. If I had anything to say about a cooperative that paid that kind of patronage refund I would surely change its methods of operations, I would say that much.

Senator TALMADGE. Is it a fairly common occurrence among the co-ops?

Mr. VOORHIS. No, it is not, Senator. It is not a fairly common occurrence. It unfortunately happens in a few rare instances that our opponents seize upon immediately and make the most of. But Mr. Lester's own testimony told you about the healthy growth of some of these cooperatives which means they are doing a better and better job for our people, and if that be true, and has been true, there can't be too much of this kind of bad operation that you mention. I can't, however, change my conviction about a constitutional fact which is that an obligation on the part of party A to party B, cannot be regarded as taxable income to party A because it is an obligation on his part.

If he doesn't discharge that obligation something sought to happen certainly but it doesn't, it seems to me, change the principle of taxation involved.

Senator TALMADGE. You mentioned in your testimony something about the agricultural exemption of co-ops. Specifically what is that?

Mr. VOORHIS. Well, other witnesses could do that better than I, Senator. But briefly, the law provides that as to cooperatives the overwhelming amount of whose business is with farm producers, that they may qualify under certain circumstances for what is called an exemption. Now, that exemption applies only—actually in practical effect all it does is say there shall not be double taxation of dividends paid on shares. It has nothing to do with patronage refunds but those cooperatives aren't double taxed on the dividends paid on shares.

Their shareholders are taxed on that as income but the co-op is not.

A nonexempt co-op, so called, is double taxed just like other corporations, the co-op pays and the shareholder pays, both. This is the only effective thing except that in order to qualify for this these cooperatives have to pay patronage refunds to all patrons, members and nonmembers alike whereas a nonexempt co-op need not pay patronage refund to a nonmember unless it wants to.

Senator TALMADGE. Thank you.

Senator CURTIS. I, too, want to welcome my former colleague here who is testifying.

Do you agree with the position that all income should be taxed to somebody for the year in which it was earned?

Mr. VOORHIS. Yes, sir.

Senator CURTIS. You are generally familiar with the partnership rule?

Mr. VOORHIS. I hope so.

Senator CURTIS. Yes.

Mr. VOORHIS. Well, reasonably.

Senator CURTIS. In other words, a partnership files an information return, and the partner pays tax on his share of the income, whether he draws it out or not.

Mr. VOORHIS. Right.

Senator CURTIS. And he may never draw it out.

Mr. VOORHIS. Right, and the business may go broke before he gets a chance.

Senator CURTIS. Well, it may be broke at the time.

Mr. VOORHIS. Yes.

Senator CURTIS. A partnership may own a building, a partnership may exist for the purpose of owning a building, it has a mortgage against it, and all the rents and income are assigned to pay that mortgage and maybe, neither the corpus has value nor does the earning have value.

Nevertheless, if there is income over and above the operating expenses and it would be classed as income to the partnership the partnership would pay his share whether he got it or not, is that right?

Mr. VOORHIS. Correct.

Senator CURTIS. Do you agree, is it your contention, that situation should apply to cooperatives?

Mr. VOORHIS. I think that is what the membership relationship to cooperatives is, is in effect a partnership relationship of the members of the cooperative.

Senator CURTIS. What is the source of the income from which a patronage dividend is paid?

Mr. VOORHIS. The source has got to be the dealing of that patron with that cooperative, and the patronage refund is based upon his own dealings with it.

Senator CURTIS. Is it limited to that?

Mr. VOORHIS. Yes. Basically it is.

Senator CURTIS. Suppose you have a well run cooperative which has existed for many years. They have acquired capital, either paid in or retained, they have a capital plant, they have employed competent management. They enjoy goodwill, they enjoy a reputation built up over years as an efficient worthwhile business in the community.

Now, when a patronage dividend is paid is the entire source of that income derived from the patron's dealing with that cooperative?

Mr. VOORHIS. Well, I see what you mean, Senator.

Senator CURTIS. Isn't part of it income that comes from the profit of the co-op which consists of the capital, their plant, their facilities, their goodwill?

They may be licensees for distributing certain machines or products——

Mr. VOORHIS. Yes, sir. But bear in mind that before any patronage refunds can be paid there must be dividends paid on ownership shares.

Senator CURTIS. They have all of the characteristics that makes for a successful business.

Mr. VOORHIS. Yes, but, Senator, all of those things are necessary in order for them to be in business at all?

Senator CURTIS. I am not arguing against it.

Mr. VOORHIS. But what I was trying to say was that I think you could fairly say that patronage refund, which is paid on current business to a patron currently was based on his proportionate share, based on his patronage of what the actual margins were that that total business that you have described produced.

Senator CURTIS. Would some of it be upon profits that maybe somebody is making?

Mr. VOORHIS. It shouldn't be.

Senator CURTIS. Suppose this one patron buys something that is handled at a rather nominal markup.

Mr. VOORHIS. Yes, sir.

Senator CURTIS. But the cooperative has some very or so much more profitable lines, and this particular patron doesn't have to buy them.

Mr. VOORHIS. Well, this again comes back to the question of what the mutual relationship between the member and his cooperative is.

Senator CURTIS. I see some difficulty in distinguishing between consumer cooperatives and the producers cooperative.

Mr. VOORHIS. There is.

Senator CURTIS. How are you——

Mr. VOORHIS. There is a problem about this, no doubt about it.

Senator CURTIS. How are you going to assume what portion city folks who build a cooperative grocery store, and they sell nothing but groceries and you will assume that groceries are a consumable personal family expense.

Is it your contention that any patronage dividend paid by them is not taxable at all?

Mr. VOORHIS. It is not income to them, it can't be.

Senator CURTIS. That is based upon the assumption that all of it was the profit on the business that the patron had done.

Mr. VOORHIS. Yes, that is right.

Senator CURTIS. And none of it was the result of the success of a going enterprise?

Mr. VOORHIS. Well, I don't think—if it isn't a going enterprise they couldn't have the business at all, and, therefore, I don't think I can say that none of it is a successful going enterprise, I think it is. I would like to point out to you that that same cooperative member pays a full tax on any dividend he receives on his shares.

Senator CURTIS. Who owns the cooperative?

Mr. VOORHIS. Who owns the cooperative? The members do. And they pay tax on any income they receive on their shares of ownership; and the co-op pays a tax on that money that it uses to pay him that dividend on his share, too.

Senator CURTIS. Can he sell his stock?

Mr. VOORHIS. Oh, yes.

Senator CURTIS. Above par?

Mr. VOORHIS. No, sir. He cannot. Many times he can sell it at par but he can never sell it above par.

Senator CURTIS. Is he barred from selling it above par?

Mr. VOORHIS. Yes, sir. He can't sell it above par under any circumstances.

Senator CURTIS. Where do you draw the line of ownership between stockholders and patrons?

Mr. VOORHIS. In order to—well, the ownership vests in the members, and the members must hold at least one share of equity stock in the cooperative or they are not owners. A patron may be anybody—he may be an owner or not an owner.

Senator CURTIS. I am not familiar with your consumers cooperatives. But does anyone get a patronage dividend other than an owner?

Mr. VOORHIS. Yes, sometimes and sometimes not, Senator. But if the patronage dividend is not paid, the cooperative pays a full corporation income tax on any, in that case, earnings to the cooperative which are involved.

In other words, either it has to pay a patronage refund which it is obligated to pay, not which it just decides to pay, but which it is obligated to pay, or any money not represented by such patronage refunds is taxable income to the cooperative. So that if it does not pay patronage refunds to nonmembers, it must pay full corporation income tax on all that money and does now.

Senator CURTIS. Now, it is your contention that a patronage dividend paid in anything but cash amounts, or it has the same status as if it had been paid in cash and a check written back to the cooperative for the same amount?

Mr. VOORHIS. Yes; that is right.

I think this is part of the member——

Senator CURTIS. So the due date of the slip of paper that represents that transaction really doesn't have anything to do with it so far——

Mr. VOORHIS. Not so far as the basic question of whose property it is is concerned; no, I don't think it has anything to do with it.

Senator CURTIS. That is all, Mr. Chairman.

The CHAIRMAN. Senator Hartke?

Senator HARTKE. I have no questions.

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

Mr. VOORHIS. Thank you, Mr. Chairman.

The CHAIRMAN. The next witness is Mr. Homer L. Brinkley of the National Council of Farmer Cooperatives.

STATEMENT OF HOMER L. BRINKLEY, EXECUTIVE VICE PRESIDENT, NATIONAL COUNCIL OF FARMER COOPERATIVES; ACCOMPANIED BY L. JAMES HARMANSON, JR., GENERAL COUNSEL, NATIONAL COUNCIL OF FARMER COOPERATIVES; AND MAC ASBILL, JR., OF SUTHERLAND, ASBILL & BRENNAN

Mr. BRINKLEY. Mr. Chairman, I would like to have the privilege of being accompanied by our general counsel, Mr. Harmanson. I also have available in the event that anyone should desire to question him Mr. Mac Asbill, Jr., our tax counsel, District of Columbia.

With your permission I would also like to have the memorandum prepared by Mr. Mac Asbill, Jr., included as a part of the brief.

The CHAIRMAN. The insertion will be made following your oral presentation.

Mr. BRINKLEY. Thank you, sir.

I am Homer L. Brinkley, executive vice president of the National Council of Farmer Cooperatives, Washington, D.C.

The council is a nationwide organization composed of farmer-owned and farmer-controlled cooperative marketing and purchasing associations. The council's direct members and their affiliated local and county associations number approximately 5,700 cooperatives which market agricultural commodities and purchase farm production supplies for a total of nearly 3 million farmer memberships.

The council membership includes associations of farmers who market cooperatively their cotton, grain, milk and dairy products, livestock, citrus, grapes, poultry, tobacco, apples, vegetables, and practically every type of agricultural commodity produced on the Nation's farms.

We have other members who are engaged in meeting cooperatively the farm supply needs of their farmer members. Still others of our members are engaged in serving both the marketing and farm supply needs of their patrons.

One basic purpose which all of these associations have in common is that they operate to increase the income of their farmer members and patrons by obtaining for them larger returns than they could otherwise obtain for the products marketed and by reducing the cost of the supplies purchased.

Otherwise, the cooperative fails in its basic purpose and the foundation of farmer patronage upon which the cooperative is built disappears. There can be no continuing conflict between the interest of the cooperative entity and the patrons as some allege.

If such a conflict appears and persists, the cooperative is on the road to failure from lack of support and patronage.

It is important to keep this distinguishing characteristic of the farmer cooperative clearly in mind as provisions for the fair tax treatment of cooperatives and their patrons are considered and developed by your committee.

Certain competitors and antagonists to the contrary notwithstanding, the typical farmer cooperative operates to make a profit, not for itself or its investors, but for the farmers who use its services.

The amount which is due the farmer on a patronage basis at the end of the year, which is his share of the excess of the money coming into the cooperative over the total expenses and authorized deductions for the year, is the patronage refund. Often a part or all of this patronage refund is paid in cash.

Frequently, however, the amount which would otherwise be refunded in cash will, pursuant to legally adopted policies, be retained by the cooperative for its capital needs, in which case a document evidencing the amount so retained will be issued to the patron.

In this way the patron, in effect, contributes a portion of his patronage refund income to the capital of his cooperative. The tax treatment of these patronage refunds which are so retained for necessary capital needs of the cooperative until its financial structure will permit their distribution in cash to the patrons is the principal feature of section 17 of the bill which we wish to discuss.

THE BASIC ISSUE

For the information particularly of those of you who were not members of this committee in 1951, I desire to summarize the background leading up to the cooperative provisions in the House bill.

Prior to 1951 a farmer cooperative which met the requirements of section 101 of the Internal Revenue Code of 1939 (sec. 521 of the Internal Revenue Code of 1954) was exempt from the payment of a corporate income tax.

The Congress in 1951 adopted provisions recommended by this committee intended to insure that all net margins, or earnings, resulting from the business operations of farmer cooperatives would be subjected to a single income tax, either at the cooperative or patron level. The council supported then and supports now this single-tax objective.

The provisions which were than adopted made clear the right of the cooperative to deduct or exclude from its gross income the patronage margins which it was under an obligation to return to the patron on a patronage basis, even though under its legally adopted operating plan the cooperative was authorized to retain such amounts for the necessary financing of its operations.

Such tax treatment of the cooperatives had never been successfully challenged in the courts. The Congress, however, made no specific provision in the 1951 act for the taxation to patrons of such retained amounts.

Relying upon Treasury rulings which had been in effect for many years, the Congress thought that its single tax objective would be accomplished under existing law through the continued taxation of these noncash patronage refunds to the patrons at face amount.

In the period 1952 to 1957 two principal cases—*Carpenter* and *Long Poultry Farms*—were litigated, with decisions by circuit courts of appeals holding in effect that the noncash patronage refunds of the farmer cooperatives there involved were taxable to the patrons not at their face amount, but only at their fair market value.

Thereafter in December 1959 the Treasury Department amended its regulations to follow the principle enunciated in the *Carpenter* and *Long Poultry Farms* cases.

Thus, to the extent that the noncash patronage refunds of a cooperative are not required to be included in the taxable income of the cooperative or the patron recipient, the single tax objective of the Congress has been frustrated.

In fact, as a result of these two decisions and the subsequent Treasury action based upon them, noncash patronage refunds generally may be excluded by the cooperative at face amount whereas the farmer is required to report them currently only at their fair market value. Under the criteria contained in the Treasury regulations, in many cases the noncash patronage refunds are held not to have any fair market value.

The basic issue then is how the noncash patronage refunds of cooperatives are to be treated taxwise to accomplish a single tax on patronage earnings.

THE CONSTITUTIONAL QUESTION

It has been asserted by some that under the decisions in the *Carpenter* and *Long Poultry Farms* cases, as well as other cases decided by the Supreme Court, Congress does not have the power under the 16th amendment to the Constitution to require patrons to include in their income the face amounts of noncash patronage refunds distributed to them by cooperatives.

Some members of the Ways and Means Committee stated in the course of the development of the current tax bill that they were advised that noncash patronage refunds could not constitutionally be taxed to the patrons in the absence of individual consents by the patrons.

Because of the paramount importance of this question, we have had Mr. Mac Asbill, Jr., of the law firm of Sutherland, Asbill & Brennan make a study of the applicable law and prepare for us a memorandum on the constitutional issue raised.

Mr. Asbill as cocounsel successfully argued for the patrons before the circuit courts of appeals in both the *Carpenter* and *Long Poultry Farms* cases, and we believe his study and conclusion should be of special value to your committee. I would like to request that a copy of Mr. Asbill's memorandum be included in the record following my statement.

The memorandum fully documents the conclusion that legislation requiring patrons to include in income the face amount of documents evidencing their share of current patronage income of the cooperative enterprise, regardless of the fair market value of such documents would clearly be constitutional whether or not there was consent by the patrons as required by the House bill. Mr. Asbill is present today and will be glad to answer any questions members of the committee may have concerning his conclusion or the study upon which it is based.

SUMMARY OF COUNCIL POSITION

The council's current position is contained in a policy statement attached hereto as appendix I. This policy statement was originally adopted by the members of the council in 1956, and was reviewed and reaffirmed in annual session on January 12, 1961.

The council policy as applied to the current issues is that we support the enactment of legislation by the Congress that would provide for the exclusion from the taxable income of the cooperative and inclusion in the taxable income of the patron of the face amounts of noncash patronage refunds distributed pursuant to a legally adopted operating plan of the cooperative of which the patron is given notice prior to or at the time of his patronage resulting in his share of the patronage income. Under the council policy we are opposed to the provisions of the House Bill which make this result dependent on the issuance of qualified allocations as defined in the bill. The criteria for distinguishing "qualified" from "nonqualified" allocations are arbitrary, inequitable, discriminatory, and unworkable.

We are opposed to any withholding on patronage refunds, cash or noncash. We believe that cooperatives should be, and most of them clearly are, willing to show their good faith and their concern for the interests of those they serve by agreeing to a statutory requirement, in lieu of the proposed 20-percent withholding tax, that as a condition for the exclusion of the noncash patronage refund by the cooperative, the cooperative might be alternatively required to distribute in cash for any year to each patron a percentage of the patron's total patronage refund for each year, equal to the minimum individual tax rate.

Treasury Secretary Dillon in testimony before your committee on April 2, said:

> Withholding on patronage dividends at the 20-percent rate would assure the average patron of the funds with which to meet his tax on noncash dividends.

The requirements for a direct payment to the patron of such minimum percent of his total patronage refund in cash would be a more equitable way of assuring the average patron of the funds with which to meet his tax obligation if, after including the full amount of his patronage refund, cash and noncash, in his taxable income, he should owe the Government any tax at all.

We shall give detailed reasons for our opposition to withholding on patronage refunds and the justification of the substitute suggestion in a later selection of this statement.

HOW THE HOUSE BILL WOULD TAX COOPERATIVES AND PATRONS ON NONCASH PATRONAGE REFUNDS

The House bill sets up two classifications for the certificates or other forms of documents evidencing to the patron his share of the current net patronage earnings arising from the operations of the cooperative—qualified allocations and nonqualified allocations.

Qualified allocations would entitle the cooperative to exclude the face amount thereof from its taxable income and would require the patron to include such face amount in his taxable income.

All allocations which are not qualified, according to the statutory definition, are designated as nonqualified. The amounts of patronage refunds represented by nonqualified allocations cannot be currently excluded by the cooperative, and are not currently taxable to the patron. The cooperative can exclude, and the patron must include, the amounts paid later in redemption of such nonqualified allocations.

For the allocation to be qualified, it must meet one of two conditions.

First, it may be an allocation which the patron for a period of at least 90 days from the date of its issuance has the right to redeem in cash at its face amount.

Second, it may be an allocation which the patron has consented to include currently in income at its face amount.

This consent under the House bill can take either of two forms. For members of a cooperative consent can be given by becoming or continuing as a member after the cooperative has adopted (after the date of enactment of the act) a bylaw providing that membership in the cooperative constitutes such consent and after the member or prospective member has received a written notification and copy of such bylaw.

The Ways and Means Committee report on the bill gives an example of the exact wording of a bylaw provision that would be acceptable as a consent for members under the statute.

No bylaw of the practically 10,000 farmer cooperatives in the country is worth anything for the purpose of this bill. An alternative form of consent for members of the cooperative, and the only form of consent for nonmembers, is a written statement signed by the patron in which he gives the required consent.

THE "QUALIFIED" ALLOCATION APPROACH IN THE HOUSE BILL IS SUBSTANTIALLY DIFFERENT FROM PRESIDENT KENNEDY'S RECOMMENDATIONS

Before detailing what we believe is fundamentally wrong with the "90-day cash redemption right" and "consent" approach, we deem it important to review the basic recommendations of the President, the Treasury, and the Ways and Means Committee as they relate to our position.

The President said in part in his tax message to the Congress on April 20, 1961:

> I recommend that the law be clarified so that all earnings are taxable to either the cooperatives or to their patrons, assessing the patron on the earnings that are allocated to him as patronage dividends or refunds in scrip or cash. * * * The cooperatives should not be penalized by the assessment of a patronage tax upon dividends or refunds taxable to the patron but left in the business as a substitute for the sale of securities to obtain additional equity capital.

The President in no way suggested that taxation of allocations to patrons be dependent on any "90-day redemption right" or "consent" or any other prerequisite. On the contrary, he recommended, without qualification, that all allocations, in scrip as well as cash, be taxed to the recipient patron.

The detailed explanation of the President's recommendations submitted by Secretary of the Treasury Dillon in hearings before the Ways and Means Committee on May 3, 1961, was consistent with the above recommendations of the President for the enactment of clarifying legislation to fulfill the intent of Congress in 1951—not for new and substantially different policies for taxation of cooperatives and their patrons.

The report of the Ways and Means Committee to the Congress on March 16, 1962, accompanying H.R. 10650 makes the following pertinent statements:

> The President recommended that what was thought to be the law in 1951 be provided specifically in the statute. Under the recommendation cooperatives would be allowed to deduct amounts allocated in cash or scrip as patronage

dividends and patrons would be currently taxable on the patronage dividends allocated to them arising out of business activities.

Then the committee report states:

Your committee's bill adopts an approach which in substance is substantially the same as that recommended by the President.

We respectfully point out that the prerequisites for qualified allocal tions in section 17 of the House bill are not in substance the same as, but are substantially different from and inconsistent with, the President's recommendations as quoted above. The approach in the House bill is not what Congress thought was the law after its enactment in 1951.

Yet, in his testimony before your committee on H.R. 10650, Secretary of the Treasury Dillon, in explaining section 17 of the bill, appears to have endorsed this section.

He states:

The House bill provides an adequate remedy for the unintended exemption of some cooperative income.

Secretary Dillon has made a number of major recommendation to your committee for changes in the bill as it passed the House to accomplish certain improvements which the Treasury desires.

Secretary Dillon should know, and certainly his staff does know, the substantial difference between the approach in the House bill on the one hand, and the President's recommendations and what Congress thought was the law in 1951 on the other hand.

It is difficult to understand why Secretary Dillon should recommend to your committee major changes in other sections of the bill, but should indicate that the section on "cooperatives" is acceptable without making recommendations to reconcile the substance of that section with the President's recommendations.

THE APPROACH IN THE HOUSE BILL IS INEQUITABLE AND UNWORKABLE

1. The alternative requirement imposed by the House bill for a 90-day cash redemption right is arbitrary and impracticable.

If the cooperative has a legally adopted policy that any person who uses the services of the cooperative shall contribute his patronage refunds to the capital of the cooperative on an equitable basis, why should the Federal Government make the tax consequences of such a contribution dependent on agreement by the cooperative to redeem the contributions within a period of 90 days, 6 months, 1 year, or any other period of time?

It should be obvious that no cooperative can plan a sound financing program if the capital contributed by the patrons is subject to cash withdrawal within a specific period.

With such "withdrawable" capital, the ability of cooperatives to borrow from banks for cooperatives and to meet their present repayment obligations to creditors would in many cases be jeopardized or destroyed.

It should be borne in mind that although the patronage refunds contributed by patrons in many cases constitute only a small part of the total capital needs of the cooperative, such refunds constitute in many cases the necessary capital base to enable the cooperative to obtain the additional capital required to conduct its operations.

Few cooperatives, if any, in the country could consider trying to meet the "90-day cash redemption right" alternative. Hence the "consent" alternative for qualified allocations would be the only other method in the House bill by which noncash allocations would be excludable by the cooperative.

2. The bylaw consent requirement, restricted in its applicability to members only, would place a tax premium on nonmembership and would discriminate against members in favor of nonmember patrons.

This requirement illustrates the discriminatory and destructive forces set in motion when the Government attempts, without need or justification, to regulate private business.

Take the example of a marketing cooperative serving 2,500 farmers of whom 2,000 are members and 500 are nonmembers. At the end of the year, after deducting expenses, there are net margins of $125,000 attributable equally to the patronage of all the 2,500 patrons.

Under an appropriate bylaw consent, as required by the House bill, each of the 2,000 members would include their individual noncash patronage refunds of $50 each in their taxable income. The 500 nonmember patrons could, under the House bill, decide on an individual basis whether they would treat the noncash refunds as their income or whether the refunds would be treated as the current income of the cooperative.

Obviously, many members of cooperatives would not long submit to such discriminatory treatment but would desert the cooperative as members and seek as nonmembers to avail themselves of its services. The bylaw consent, with its limited application to members only, would drive farmers to seek to get the benefits from their cooperatives without accepting responsibility for contributing to their capital needs.

3. The individual consent requirement, permitting each patron to determine whether a patronage allocation will be taxed to him or to his cooperative, would produce inequities and undermine the capital structure of cooperatives.

If the net earnings of a cooperative for a taxable year are $10,000, and the share of farmer A, a member, based on patronage is $100, and the share of farmer B, a nonmember, is $100, it is certainly inequitable for the law to provide that farmer A must include the $100 in his taxable income but farmer B can decide individually whether he wants to regard it as his income, or as the income of the cooperative and subject to a corporate tax.

The disparity in tax consequence would be even more marked if both A and B were nonmembers, and if A, but not B, consented to include his noncash allocation in income.

The House bill in this situation would permit the two individual patrons to determine whether the amounts of their noncash patronage refunds, identical to each other in every respect, would be taxed to the cooperative (as in the case of B's allocation) or to the patron (as in the case of A's allocation).

These results flow from the present provisions of the House bill. They would occur in the cases of hundreds of thousands of farmers in the practical application of the provisions of the bill.

In contrast, it would be fair to all farmers, and uniform tax treatment would be achieved, if the Congress provided that each patron,

member and nonmember, should include in his taxable income his share of the earnings evidenced by appropriate documents.

The individual consent requirement would be an open invitation to all patrons to attempt to reap the benefits from their cooperatives without bearing their share of the necessary capital contribution. A nonconsenter would pay no tax on his allocation. A consenter, on the other hand, would pay the full tax on his, and in addition would feel the impact of the corporate tax on the amount allocated to the nonconsenter.

Any corporate tax would reduce the amount available to redeem the allocation to the consenter as well as the nonconsenter. Any substantial refusal to consent could be expected to lead to dissatisfaction on the part of loyal patrons and eventually to the refusal by all (or virtually all) patrons to consent. This trend could only result in financial disaster for many cooperatives.

In short, the practical effect of the individual consent requirement will be either to subject all patronage refunds to a current corporate tax at the cooperative level or to force the cooperatives to distribute all patronage refunds in cash.

The "consent" approach might appear to be a temporarily expedient political approach, but we believe the reasons given show that it is not sound revenue legislation and that it is contrary to the clear policy of Congress and the administration to encourage farmers to organize and strengthen their cooperatives.

A WORKABLE AND EQUITABLE APPROACH

Our proposal is one which would fully effectuate the recommendation of President Kennedy as well as the intention of Congress in 1951. Briefly, Congress would provide in appropriate statutory language that where the cooperative has a legally adopted policy requiring all patrons to invest their share of the current net patronage earnings in the capital of the cooperative, such retained patronage refunds evidenced by appropriate documents issued to the patrons shall be currently taxable to the patrons and excludable by the cooperative at the face amounts of such documents.

As a further condition, it might be provided that prior to or at the time of the patronage resulting in the patronage refund, the patron shall be given notice of such policy. The form of the notice to the patron of the policy should not be prescribed—only that the notice be given prior to or at the time of the patronage from which the patron's refund arises.

Such a statute, for reasons set forth in the memorandum of Mr. Asbill, previously referred to, should not be subject to successful attack on constitutional grounds.

Such a statute would be more workable than the proposal in the House bill since it would treat all noncash patronage refunds uniformly and be subject to fuller compliance and more effective administration. It would also be fair to all farmers patronizing cooperatives.

Under our suggestions below for considering an alternative to the proposed withholding on patronage refunds, patrons would receive from their cooperatives in cash amounts sufficient to enable them at the

20-percent rate to meet any income tax they might owe attributable to the patronage refunds of any year.

REASONS WHY THERE SHOULD NOT BE WITHHOLDING ON PATRONAGE REFUNDS

We take no position as to whether withholding should be applied to corporate dividends and certain types of interest as proposed in the House bill.

We make this clear so that our discussion of the inherent differences between patronage refunds on the one hand and corporate dividends and interest on the other, in appraising the proposed withholding, will not be interpreted as advocacy of, or opposition to, withholding on corporate dividends and interest.

It should be noted, however, that any dividends or interest paid by cooperatives on their capital, which is limited by law, would be subject to withholding on the same basis as other corporate dividends and interest.

In the discussions thus far of the House bill very little attention has been given to an analysis of the practical effects of, and administrative difficulties in, withholding on patronage refunds. It seems to have been assumed by many that if withholding is applied to corporate dividends and interest, there should be withholding on patronage refunds. Even in some cooperative circles this assumption seems to have made progress. We shall point out some compelling reasons against withholding on patronage refunds.

(1) A patronage refund is one item, and one item only, of numerous items of business income which enter into the computation of the taxable income of the farmer, and it bears no direct relation to the amount of income tax, if any, that the farmer will owe the Government.

This is the first and only area of business income as distinguished from what is generally regarded as personal income on which the Government has proposed withholding.

The individual farmer details the receipt and expense items in the computation of his net farm profit, or loss, on schedule F of income tax return form 1040.

Patronage refunds are only 1 of about 27 items of farm business income reportable on schedule F. Over 20 types of expenses or deductions are reported on schedule F, to determine the amount of net farm profit or loss for the year. This figure then is carried to line 9, page 1, form 1040 to be included in the other income, if any, of the farmer, and computed with all other deductions in determining the farmer's taxable income, if any.

The farmer's income from patronage refunds is in many, and perhaps most cases, small or negligible compared to the other farm income items such as sales of livestock and produce raised. But the Treasury realizes that the patronage refund is easy to tap at the cooperative level. It would be just as logical and easy to apply the withholding tax to agricultural program payments, another income item on schedule F. But the source of that payment to the farmer is the Government itself and it has not been suggested that withholding be applied to that payment.

This should be sufficient to show the complete lack of justification for singling out any particular item of numerous items of business income of a farmer and applying a withholding tax against it when the item bears no determinable relationship to the amount of tax, if any, that the taxpayer will owe for the year.

(2) Withholding on patronage refunds would be discriminatory.

A patronage refund is, in fact, a refund of an overpayment by the farmer on supplies he has purchased or an additional payment to him for products he has sold. Withholding would discriminate against the farmer, as compared with other individual businessmen against whose refunds and proceeds of sales in business transactions withholding is not applied.

Withholding on patronage refunds would also discriminate against individual farmers in different cooperatives because of the varying methods of operations of cooperatives. Some cooperatives pay or charge the current market price at the time of the transaction, with small or no patronage refunds at the end of the year.

Others, for good business reasons, make a minimum payment for products marketed, or a maximum charge for supplies purchased, at the time of the transaction, with a comparatively large refund in final settlement at the end of the year.

Withholding on patronage refunds would discriminate in favor of the farmers who do not patronize cooperatives, and would likely tend to encourage farmers to patronize noncooperative businesses which would not be required to withhold and turn over to the Government any part of the proceeds from the sale of the farmers' products.

Withholding on the part of the farmers' gross income represented by a patronage refund from his cooperative discriminates against him unless withholding is also applied to a part of the price that noncooperative canners, packers, grain and wool buyers, produce merchants, and the like, pay other farmers for their products. All of these payments alike enter into the stream of the farmer's gross income in determination of his taxable income.

(3) There has been no showing that withholding on patronage refunds would produce significant additional revenue.

As far as we are aware, the Treasury has not produced any statistics indicating that there exists in the patronage refund area a substantial revenue gap which withholding on patronage refunds is needed or designed to close.

It is quite obvious that the requirement of withholding on such refunds will involve considerable expense and administrative difficulty for the cooperatives involved. These burdens should not be imposed in the absence of a clear showing of the need for withholding.

The information available to us, which is admittedly incomplete, not only fails to indicate that withholding on patronage refunds would produce substantial revenue, but it would seem to indicate that such withholding would probably produce very little revenue which was really owed by farmers.

For example, Publication No. 453 (2–62) of the Internal Revenue Service, entitled "Statistics of Income—1959–60, U.S. Business Tax Returns," reflects that 3,505,090 sole proprietorships in the category of "agriculture, forestry and fisheries," filed business returns for taxable years ending within the July 1959—June 1960 fiscal year, and

that 3,386,880, or 96.6 percent of these proprietors, were farmers. A breakdown of the returns of this entire group reflects the following:

Net profit (or without net profit)	Number of businesses	Percent of total
Without net profit	1,079,094	30.8
Net profit under $1,000	1,130,847	32.3
Net profit from $1,000 to $3,000	879,424	25.1
Net profit $3,000 and above	415,725	11.8
Total	3,505,090	100.0

Thus, assuming that farmers constitute the same percent (96.6 percent) in each net profit category, 88.2 percent of the individual farmers in the total group reported net farm profit under $3,000.

The great majority of those comprising this 88.2 percent showed farm profit of under $1,000, and more than one-third of the 88.2 percent showed no farm profit at all.

It seems quite likely that very few farmers in this 88.2 percent would owe the Government any tax at all on their farm income, and, consequently, that withholding on their patronage refunds would in almost every instance produce an overpayment subject to refund. This means that substantial expense and inconvenience has been incurred for nothing, unless the farmer, through neglect, oversight, or a desire to a void redtape, leaves with the Government money to which it is not entitled.

Many refunds of tax would be unclaimed because of the small amounts involved. Whereas we have no statistics reflecting the size of the patronage refunds paid by all cooperatives, we have, through a questionnaire to many of our members, developed some information with respect to the size of the refunds paid by those members.

This information, set forth in appendix II, indicates that a great many patronage refunds are very small in dollar amount. I would say this, that out of a total of 691,000 refunds amount to $33,100,000 paid out, a total of 586,000 of such patronage refunds—this was done in 1961—received an average of $24 or less. Of this number 385,000 received an average refund of $4 or less. Consequently, any refund of tax attributable to withholding on such patronage refunds would also be small and might not appear to the farmer to justify the effort to claim it.

As indicated above, the statistical information available to us is not complete, and, consequently, we are not in a position to prove that withholding on patronage refunds would not produce substantial revenue.

We submit, however, that the burden of proof should be on the Treasury, and that this drastic method of collection should not be invoked unless it is clearly shown that it is needed.

In this connection, we suggest that any underreporting or nonreporting of patronage refund income which may have existed in recent years has, in all likelihood, been primarily attributable to the confusion in the law as to whether such refunds in noncash form constitute gross income to the farmer.

It is entirely possible—and we believe likely—that once the law on this substantive issue is clarified, there will be very little underreporting or nonreporting of patronage refund income.

A REQUIRED CASH DISTRIBUTION OF A MINIMUM OF 20 PERCENT OF THE TOTAL PATRONAGE REFUND TO EACH PATRON HAS BEEN SUGGESTED BY MANY OF OUR MEMBERS AS A PREFERABLE SUBSTITUTE FOR THE PROPOSED WITHHOLDING ON PATRONAGE REFUNDS

Council policy does not authorize support of such a required cash distribution and it should therefore be understood that I am in this statement only pointing out at the suggestion of many of our members the merits of such an alternative course under certain circumstances in contrast to the unfairness, discriminations, and unworkability of withholding on patronage refunds, as already pointed out in this statement.

I must say in all fairness, however, some of the inequities of withholding would be reduced if the provision establishing the consent requirements were eliminated. It is the discriminatory effect of the consent that compounds the existing inequities of the withholding approach.

The application of withholding would be particularly harsh and discriminatory on members under the House bill. They would be required under the bylaw consent to include the face amount of their refunds in income and also would be subject to a 20 percent withholding.

Nonmembers on the other hand, through refusal to consent, would avoid withholding either at the time of the issuance of their allocations or when they received the cash in redemption of them. This would in our judgment in many cases cause cooperatives to lose members very rapidly.

A cash payout of 20 percent of the refunds to the consenting members or other consenting patrons would appear to be distinctly fairer under the House bill. Many of the harsh features of withholding would be greatly reduced if all noncash patronage allocations were made taxable by statute to both member and nonmember patrons alike under the conditions we have previously suggested.

The stated purpose of the Treasury in proposing a 20 percent withholding on patronage refunds is to assure that the average farmer receiving allocations will in effect be given enough cash to cover the tax attributable to the patronage refund at the first bracket rate.

This alternative suggestion will do just that and will let the farmer figure out his own tax and will avoid payment of the farmer's money to the Government in many cases in which it is not owed. Furthermore, it will accomplish the desired result without major changes in prevalent practices regarding cash distributions.

It is important in this regard to look at the record of farmer cooperatives on a national basis in making cash distribution of patronage margins to their patrons.

The only competent nationwide study available is a study conducted by the Farmer Cooperative Service, U.S. Department of Agriculture, contained in General Report 32, issued in June 1957, entitled "Methods of Financing Farmer Cooperatives." The study was based on 1954

fiscal year. This study showed that in 1954 the 9,793 marketing and farm supply cooperatives in the country, excluding bargaining organizations, paid out in cash to members and other patrons a national average of 30.9 percent of the total net margins and savings resulting from the cooperatives' operations. This is 50 percent more than the withholding rate or cash payout rate that is suggested for consideration as a substitute.

This substitute suggestion would assure that every farmer cooperative in the country, regardless of its present policy, will pay out currently in cash at least 20 percent of the total patronage refunds currently taxable to the members and other patrons. This will clearly be a financial hardship on some groups of farmers, particularly those who have formed cooperatives in recent years and those which have an inadequate capital base to provide the facilities to serve the farmers' needs.

However, it is believed by those holding this view that most cooperatives and their farmers would regard such a 20 percent cash payout requirement as more acceptable than the withholding and turning over to the Government of 20 percent of patronage refunds.

In addition the suggested payout of 20 percent of patronage refunds in cash would, we believe, eliminate many of the practical problems that would be present in the proposed withholding as applied to distributions by a federated cooperative to its locals and thence from the locals to the individual farmers.

SUMMARY

We have devoted most of this statement to discussion of the basic inequities and problems inherent in the two principal phases of the House bill in its present form, namely (1) the distinction between qualified and nonqualified notices of allocation, and (2) the withholding on patronage refunds. We have also suggested specific substitute proposals which would be fair and equitable and which would carry out the President's recommendations for achieving a single tax on all patronage margins of cooperatives in the manner contemplated by Congress in the Revenue Act of 1951.

We want to make clear, however, that the bill, as passed by the House, represents in a number of very significant aspects an improvement over the discussion draft released by the House Ways and Means Committee on August 24, 1961.

There is one particular feature of the House bill that we regard as especially desirable, and we recommend that it be retained in whatever action is taken by your committee. We refer to the provisions that would make the new tax treatment of noncash patronage refunds applicable only for fiscal years beginning after December 31, 1962, thereby allowing cooperatives and patrons sufficient time to take the necessary steps to comply with the provisions of the new act.

Patronage refunds which have been issued in the past and which may be redeemed in the future should be subject to existing law, as provided in the House bill.

This is necessary in order to prevent unjustified tax burdens on farmers as a result of the confusion and uncertainty that has prevailed for almost a decade, under Treasury regulations and rulings and court decisions, over the manner in which farmers are required to treat noncash patronage refunds. There is attached as appendix III a summary of "Treasury and Court Actions Involving Tax Treatment to Patrons of Noncash Patronage Refunds to Them by Their Cooperatives" from 1948 to 1961. This illustrates the confusion that has existed.

We appreciate this opportunity to present our views to your committee, and we shall be glad to cooperate with you and your staff in furnishing any additional facts available to us. Representatives of the council worked closely with your committee in 1951, and it has been a pleasure to work from time to time with the staff of the Joint Committee on Internal Revenue Taxation during the past 5 or 6 years in trying to develop appropriate legislation to achieve the single tax objective of the Revenue Act of 1951.

We hope very much that a fair and equitable measure will be developed by your committee so that the farmers of the country can devote more of their time to their cooperative farm business enterprises, free from the tax uncertainties that have existed and free from the propaganda charge that they are tax evaders.

I appreciate the time of the committee, Mr. Chairman.

(The appendixes and Mr. Asbill's memorandum previously referred to follow:)

APPENDIX I. COOPERATIVE TAX POLICY OF NATIONAL COUNCIL OF FARMER COOPERATIVES

(Originally adopted 1956 and 1957, reaffirmed by council delegate body, Jan. 12, 1961)

COOPERATIVE TAX POLICY

The clear intention of the Congress in 1951 in the changes made in the tax treatment of farmer cooperatives was that the savings resulting from the operation of such organizations should be subject to a single tax. A number of court decisions since 1951 tend to prevent the carrying out of the above intent.

Therefore, the National Council of Farmer Cooperatives states its support of the following policies and principles:

1. Farmer cooperatives are owned and controlled by farmers and operate on a cost-of-doing-business basis for the primary purpose of providing essential services and increasing the income of their farmer members and patrons. Under such operations and purposes, the savings resulting therefrom, which the cooperative distributes to the patron under an obligation and agreement to do so, represents income to the patron. Such amounts are, and should be, excludable or deductible by the cooperative, and the right of members and patrons to receive such refunds as income, whether in cash or noncash form, and to invest amounts in their cooperatives, either directly or by setoff, should be recognized.

The council supports the tax status of farmer cooperatives under existing law and shall seek clarification of the 1951 act as to the taxable status of patrons with regard to distributions made to them by their cooperatives, in line with the intent of Congress in the passage of that act.

2. The council is opposed to the application of a withholding tax to patronage refunds and reaffirms the principles of its resolution adopted at the 1951 annual meeting to the effect that—

"A withholding tax on patronage refunds is unnecessary and unsound. It would unduly burden cooperatives in both cost and manpower in deducting, recording, reporting, and remitting such taxes without materially increasing net revenue collections. Because the tax has no relation to the rate of taxes owed by the recipient, many recipients would be entitled to tax refunds; and the cost in money and manpower of internal revenue administration would be unnecessarily and substantially increased. Furthermore, a withholding tax would confuse, rather than clarify, the taxable status of such refunds."

3. The council seeks legislation which would eliminate the double taxation to patrons and members which occurs when the Treasury seeks to impose in the same year a tax both on cash payments in redemption of prior issues of noncash patronage distributions and also on current distributions in noncash form.

4. The national council directs and authorizes the executive committee to develop and effectuate ways, means, and methods deemed best for the implementation of the basic principles of the council's cooperative tax policy, recognizing that the long-term interests of the farmer and his cooperative are identical and inseparable.

APPENDIX II.—*Analysis of cash and noncash patronage refunds distributed to individual farmer patrons by 385 marketing and farm supply cooperatives as reported by the associations in April 1961 for recent fiscal years*[1]

Range in size of cash and noncash patronage refunds	Refunds		Amount of refund		Average size of refund
	Number	Percent of total	Dollars	Percent of total	
$0.01 to $0.99	110,617	16.0	43,011.85	0.1	$0.39
$1 to $9.99	274,068	39.6	1,103,871.30	3.3	4.03
$10 to $49.99	201,995	29.2	4,853,020.80	14.7	24.02
$50 to $99.99	49,954	7.2	3,357,992.02	10.2	67.22
$100 and over	54,870	8.0	23,726,431.22	71.7	432.41
Total or average	691,504	100.0	33,084,327.19	100.0	47.84

[1] Dominantly for fiscal years ending in 1960 or 1961 with a few reporting for earlier years. Replies were received from 178 individual associations; 1 State cooperative council submitted a summary report with combined figures for 46 member associations; and 1 regional cooperative submitted 2 combined reports, 1 covering 132 and the other 29 local member associations.

APPENDIX III. TREASURY AND COURT ACTIONS INVOLVING TAX TREATMENT TO PATRONS OF NONCASH PATRONAGE REFUNDS TO THEM BY THEIR COOPERATIVES

(1) 1948

Although the Treasury had previously issued rulings on the subject, not until 1948 did the Federal Government take steps to publicize in a manner that might reasonably be regarded as actual or constructive notice to taxpayers generally how the noncash patronage refunds of farmer cooperatives should be handled in the patrons' income tax returns.

The pamphlet entitled "Helpful Information on How To Prepare Your U.S. Income Tax Return on Form 1040 for 1948" at page 10 contained a paragraph advising that farmers should include the amount of the patronage refunds arising from business transactions with their cooperative in their gross income for the year in which paid, and that they were considered paid when remitted in cash, merchandise, stock certificates, or when credited to their account.

Form 1040–F, the schedule of farm income and expenses accompanying the individual tax return of farmers, was for the first time for 1948 revised to include under "Other farm income" a new item reading: "Patronage dividends, if not reported elsewhere in return."

Similar provisions in the individual income tax instructions and form for the reporting by farmers of their cash, as well as noncash patronage refunds, were made for the years following 1948 through at least 1957.

(2) April 13, 1950

Apparently because of knowledge that a uniform policy was not being followed in all internal revenue districts requiring farmers to report the face amount of noncash patronage refunds in their current returns, "Income Tax Information Release No. 2" over the signature of E. I. McLarney, Deputy Commissioner of the Income Tax Unit (Bureau of Internal Revenue) was released for "special distribution" on April 13, 1950, stating the policy of the Government, with respect to "patronage dividends" of farmers' marketing and purchasing associations in part as follows:

"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."

(3) May 28, 1953

The Treasury issued as Treasury Decision 6014 under section 314 of the Revenue Act of 1951 final regulations which provided that noncash patronage refunds were currently taxable at face amount to the patron recipients. This was the first time that the Treasury ever issued final regulations specifically covering this subject.

(4) January 11, 1954

Revenue Ruling 54-10 was published in the Internal Revenue Bulletin, confirming and clarifying the policy set forth in the regulations referred to in item (3) above.

(5) Pertinent Court Decisions

(a) *B. A. Carpenter* v. *Commissioner* (20 T.C. 603, affirmed 219 F. 2d 635 (C.A. 5, 1955)):

April 1952: First hearing held at Miami, Fla., before Tax Court of the United States.

June 15, 1953: Decision by Tax Court holding that a cash basis taxpayer need not include in his gross income the face amount of revolving fund certificates issued by a farmer cooperative and held that the certificates had no fair market value at time of issue.

March 2, 1955: Decision of Tax Court affirmed by U.S. Court of Appeals for the Fifth Circuit.

(b) *Long Poultry Farms, Inc.* v. *Commissioner* (249 F. 2d 726 (C.A. 4, 1957), reversing 27 T.C. 985):

March 21, 1957: Tax Court of the United States held that a patronage refund credit allocated to the account of a member who kept his books and reported his income on an accrual basis was a properly accruable item of income during the year in which the allocation was made.

November 8, 1957: U.S. Court of Appeals for the Fourth Circuit overruled the Tax Court and held that the patronage refund credit allocated to the taxpayer's account by the marketing cooperative in this case was not accruable as income to the taxpayer in the year of allocation.

(c) *Estate of Caswell* v. *Commissioner* (211 F. 2d 693 (C.A. 9, 1954), reversing 17 T.C. 1190):

January 18, 1952: Tax Court of the United States held that certain retain certificates constituted income to the patrons in year of issue to extent of their fair market value and that the fair market value of the certificates was equal to their face value.

April 1, 1954: Circuit Court of Appeals for the Ninth Circuit reversed the Tax Court and held that the certificates did not constitute taxable income to the recipients to any extent whatever in the year of issue.

(d) *Moe* v. *Earle* ((C.A. 9) 226 F. 2d. 583, cer. den. 350 U.S. 1018):

October 12, 1954: U.S. District Court for the District of Oregon held that certain revolving fund certificates issued to taxpayer Moe represented no income to him in year of receipt of certificates.

October 28, 1955: Decision affirmed by Ninth Circuit Court of Appeals.

March, 1956: The Government filed a brief in opposition to Moe's petition for a writ of certiorari in the Supreme Court of the United States.

April 9, 1956: Supreme Court of the United States denied certiorari.

(6) *February 14, 1958*

The Treasury issued technical information release No. 69 announcing that the Internal Revenue Service would follow the decisions in *Long Poultry Farms, Inc.* v. *Commissioner*, and *Commissioner* v. *B. A. Carpenter*, in connection with the tax treatment of allocations of patronage refunds by cooperative associations to their patrons. The release said steps will be taken to dispose of pending litigation and claims involving this issue in conformity with the prncple enunciated in these decisions and to conform Treasury regulations and outstanding rulings to these decisions at the earliest practicable date.

Thus the Treasury announced its decision to abandon its longstanding policy of requiring noncash patronage refunds to be reported currently by the patrons at fact amount and its intention to embrace the "fair market value" theory enunciated in the *Carpenter* and *Long Poultry Farms* decisions.

(7) *March 11, 1959*

Publication of proposed amendments to existing Treasury regulations for adoption of new policy for tax treatment of noncash patronage refunds to patrons on basis of "fair market value" theory.

(8) *December 3, 1959*

Publication of final amendments to existing regulations adopting "fair market value" theory as applied to tax treatment to patrons of noncash patronage refunds.

CONSTITUTIONALITY OF LEGISLATION TAXING TO PATRONS INCOME EQUAL TO THE FACE AMOUNT OF NON-CASH PATRONAGE REFUNDS DISTRIBUTED TO THEM BY COOPERATIVES

Prepared By

Mac Asbill, Jr.
Sutherland, Asbill & Brennan
Washington, D.C.

For

National Council of Farmer Cooperatives
1616 H St., N.W.
Washington, D.C.

January 25, 1962

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Foreword

It has been asserted by some interested persons, both in and out of Government, that under the decisions in the *Carpenter* and *Long Poultry Farms* cases by the Fifth and Fourth Circuit Courts of Appeals on March 2, 1955 and November 8, 1957, respectively, as well as other cases decided by the Supreme Court, Congress does not have the power under the Sixteenth Amendment to the Constitution to require patrons to include in their income amounts equal to the face amounts of non-cash patronage refunds distributed to them by cooperatives.

In view of the fact that this issue, which has never been presented to the Supreme Court, is involved in legislative proposals now under Congressional consideration, we have had Mac Asbill, Jr., a partner in the law firm of Sutherland, Asbill & Brennan, who as co-counsel successfully argued for the patrons before the Circuit Courts of Appeals in both the *Carpenter* and *Long Poultry Farms* cases, make a thorough and impartial study and prepare for us a memorandum on the constitutional question involved. Mr. Asbill's analysis and conclusions which follow should be of value in removing doubt, where any has existed, as to the constitutional aspects of the question and should be helpful to members of Congress in developing legislation which will be fair to farmers and their cooperatives.

HOMER L. BRINKLEY,
Executive Vice-President,
National Council of Farmer Cooperatives.

CONSTITUTIONALITY OF LEGISLATION TAXING TO PATRONS INCOME EQUAL TO THE FACE AMOUNT OF NON-CASH PATRONAGE REFUNDS DISTRIBUTED TO THEM BY COOPERATIVES

In 1951 the Congress enacted legislation limiting the exemption from corporate tax of farmer cooperatives which had theretofore been wholly exempt. This legislation provided that such cooperatives could reduce their gross income for tax purposes by patronage refunds, whether paid in cash or in revolving fund certificates, retain certificates, letters of advice or some other document that disclosed to the patron the dollar amount of the refund, in the same manner and to the same extent as their taxable counterparts had done for years. The amount by which gross income was reduced was the face amount of such document, regardless of its value. Congress had been told, and it thought, that the patron receiving such a document would be required under the then existing income tax laws to include in his income the face amount of the document. Thus it was thought that Congress had achieved its purpose of subjecting to a single tax, either at the level of the cooperative or at the level of the patron, all income resulting from operations of farmer cooperatives.

However, several court decisions (e.g., *Carpenter* v. *Commissioner*, 219 F. 2d 635 (CA 5, 1955), and *Long Poultry Farms* v. *Commissioner*, 249 F. 2d 726 (CA 4, 1957)) reached conclusions inconsistent with the representations that had been made in this regard to the Congress. These decisions held that the patron receiving such a document had income, under the then existing Internal Revenue Code, only to the extent of the fair market value of the document. Thus, since the cooperative could reduce gross in-

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come by the face amount of such a document, there was no current tax, on the cooperative or the patron, to the extent that the fair market value of the document was less than its face amount.

These cases, as indicated above, were decided under the Internal Revenue Code of 1939, which (as is true also of the 1954 Code) contained no provision specifically dealing with the taxation of patrons of cooperatives. The cases were decided on the ground that the generally applicable provisions of the Code did not impose a tax on such patrons except to the extent of the fair market value of documents received by them. The Courts were not presented with the issue whether Congress had the *power* under the Constitution to tax patrons on income equal to the face amount of such documents.

We have now been asked for our opinion on that issue— i.e., the constitutionality of legislation which would accomplish the intent of Congress as expressed in the legislative history of the 1951 Act. *We are referring in this memorandum to legislation which would provide specifically that patronage income resulting from the operations of a cooperative in any year is to be included in the income of the patrons of that year to the extent of the face amount of documents, issued to such patrons within the time required by law, apprising them of their share of such income, without regard to the terms of such documents or the consent of the patrons.* (Such legislation is hereinafter referred to as "the proposed legislation" or "the proposed tax treatment of patrons".)

We believe such legislation would clearly be constitutional.

I. The Power of Congress to Tax Income.

The power of Congress to tax *income* is derived from Art. I, sec. 8, cl. 1, of the Constitution, which grants Congress the power "to lay and collect taxes, duties, imposts and excises. . . ." The only pertinent constitutional limitations upon this general taxing power are set forth in Art. I, sec. 2, cl. 3, and Art. I, sec. 9, cl. 4, both of which provide that "direct" taxes must be apportioned among the several states according to population. In *Pollock* v. *Farmers Loan & Trust Co.*, 158 U.S. 601 (1895), the Supreme Court held that a tax upon the *income from property* was in effect a direct tax upon the property itself, and hence beyond the power of Congress to impose without apportionment. The sole purpose of the Sixteenth Amendment, adopted in 1913, was to overcome the limitations which the *Pollock* case had placed upon Congressional power to tax *income*. It provides that:

> "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."

Thus the Sixteenth Amendment was not designed to grant Congress any power which it did not already have. If the tax was truly a tax on "income," rather than a tax on property, the Sixteenth Amendment merely removed any possible basis for imposing the constitutional requirement of apportionment, whatever the source from which the "income" was derived. See *Brushaber* v. *Union Pacific R. Co.*, 240 U.S. 1, 16-20 (1916).

II. Congress Has the Power to Select the Level at Which Current Business Income Will be Taxed.

In any situation involving a group of individuals who join together in an entity to conduct a common business undertaking, the "income" which is earned as a result of the joint undertaking is subject to tax. Insofar as the Sixteenth Amendment is concerned, Congress has the power to tax such "income," as earned, either at the level of the entity or at the level of the individual participants. The only constitutional limitation on the power of Congress to select the level of taxation (i.e., the person or entity on whom the tax will be imposed) is the Fifth Amendment's prohibition against the taking of property without due process of law. This means merely that the relationship between the income and the person taxed must be sufficiently close to justify, in fairness, the imposition of the tax on such person.[1] In the setting of an individual-entity business relationship, where the individual is the beneficial owner of any income produced, it is entirely clear that both the entity and the individual participants are so closely related to the income that this requirement is satisfied and that the selection of the level of taxation is merely a matter of legislative policy. The history of the taxes which have been imposed on "income" derived within the framework of an individual-entity relationship makes these points convincingly clear.

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[1] Compare, for example, *Hoeper* v. *Tax Commission*, 284 U.S. 206 (1931), holding that a husband cannot be taxed on his wife's income, with *Burnet* v. *Wells*, 289 U.S. 670 (1933), sustaining the taxation to the grantor of a trust of trust income used to pay premiums on insurance on the grantor's life, although others were named as beneficiaries of the insurance.

A. Illustrations of the Exercise of such Power.

1. *Partnerships.*

In the case of a partnership, for example, Congress originally levied the tax on income against the partnership itself, but then shifted the tax directly to the individual partners, whether or not the income had been distributed to them. The power of Congress to tax partners directly on their undistributed shares of partnership income was expressly upheld in *Burnet* v. *Leininger,* 285 U.S. 136 (1932), where the Supreme Court stated:

> "The Congress, having the authority to tax the net income of partnerships, could impose the liability upon the partnership directly as it did under the Revenue Act of 1917 . . ., or upon the 'individuals carrying on business in partnership,' as in the statutes here involved." (p. 142)

A later case, *Heiner* v. *Mellon,* 304 U.S. 271 (1938) reached the same result although the partnership was prohibited by state law from making any distribution of partnership earnings during the year in question.[2]

2. *Corporations.*

Under the Act of June 30, 1864, the annual undivided profits of a corporation were taxed directly to its shareholders. In *Collector* v. *Hubbard,* 12 Wall. 1 (1870) the

[2] Interestingly enough, the Court there cited with approval Section 220 of the Revenue Act of 1918, taxing directly to shareholders the income of a corporation improperly accumulating earnings.

Supreme Court upheld the power of Congress to provide such treatment.[8]

For many years Congress has followed the general policy, with various exceptions, of levying the tax on business income produced by a corporation upon the corporation itself, and has taxed the shareholders individually only upon dividends paid to them. This treatment has been applied, and its constitutionality upheld, even in situations involving unincorporated associations which were not treated as corporations under state law. The power of Congress to tax income earned through such associations at the entity level, rather than at the individual level, was upheld in *Burk-Waggoner Oil Asso.* v. *Hopkins*, 269 U.S. 110 (1925).

With respect to foreign personal holding companies, Congress has undertaken since the Revenue Act of 1937 to tax United States shareholders directly on current earnings, even though undistributed, and its power to tax such shareholders in this manner was expressly upheld in *Eder* v. *Commissioner*, 138 F. 2d 27 (CA 2, 1943). Although this issue has never been presented to the Supreme Court, in *Helver-*

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[8] Later, in *Pollock* v. *Farmers Loan & Trust Co.*, 158 U.S. 601 (1895), the Court held that a tax on income from property was equivalent to a direct tax on the property and was therefore unconstitutional unless apportioned among the several states (the Sixteenth Amendment not yet having been adopted). Although the Court in *Eisner* v. *Macomber*, 252 U.S. 189 (1920) indicated that, even after the adoption of the Sixteenth Amendment the *Pollock* case must be considered as having overruled the *Hubbard* case with respect to the power of Congress to tax *accumulated* corporate earnings direct to stockholders (since such *accumulated* earnings constitute *property* and not *income* of the shareholder) there has never been any indication that, since the adoption of the Amendment, *Hubbard* is not still sound authority concerning the power of Congress to tax *current* earnings direct to stockholders. See discussion of *Macomber* case, below.

ing v. *National Grocery Co.*, 304 U.S. 282, 288 (1938), which upheld the constitutionality of the undistributed profits tax on corporations, the Supreme Court stated that Congress, if it had chosen to do so, could have taxed the shareholder directly on the year's undistributed profits of the corporation.

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As the situations referred to above illustrate, in every instance in which the Courts have been called upon to review the action of Congress in selecting the level at which a tax on current business income will be imposed, the constitutionality of *whatever action* Congress has taken has *always* been upheld.[4] Moreover, whenever parties join together to create income, it is inconceivable that Congress, having complete power to tax the income, would be limited by the particular form of the organization in choosing whether to tax the income to the entity or to the individual. There is nothing in the Constitution which could, by any stretch of the imagination, be thought to have that effect.

B. Applicability of the Foregoing Principle to Proposed Tax Treatment of Patrons.

Against this background the pertinent questions involved in determining the constitutionality of the proposed tax treatment of patrons are clear. Does the statute impose a tax on "income"? If so, can this tax constitutionally be imposed at the patron level rather than at the cooperative level? We think the answer to both questions is clearly "Yes."

There is no question but that the current net margins earned through the operation of a cooperative constitute

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[4] As we shall demonstrate, *Eisner* v. *Macomber* is not authority to the contrary.

income which is constitutionally subject to tax without apportionment. Nor is there any doubt, under the authorities referred to above, that the imposition of such a tax on each patron based on his share of total current net margins would be a constitutionally permissible exercise by Congress of its power to select the level at which such income should be taxed. This would be true even though—as in the case of a partnership—the patron received no document apprising him of the amount of his share and even though that share was not distributed to him. Since income can be taxed to the patron without the issuance of such a document, it is certainly constitutional, as the proposed legislation would contemplate, to limit the amount so taxed to that portion of the net margin with respect to which the patron is given notice in the form of a document.[5]

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[5] Some of the witnesses before the Ways & Means Committee have contended that the *Carpenter* and *Long Poultry Farms* cases, although decided under present law, mean that a statute specifically taxing the patron on income equal to the face amount of a patronage refund certificate would be unconstitutional. They reason that the definition of income in the present Code is intended to be as broad as the Sixteenth Amendment permits and that, consequently, decisions to the effect that under present law a patron realizes no income except to the extent of the fair market value of the document are decisions that the patron could not constitutionally be taxed on any greater amount. Such reasoning is patently fallacious. Although the definition of gross income in the present statute is seemingly all-embracing, it is obviously not intended to tax every taxpayer on all income that constitutionally could be attributed to him. Thus a cash basis taxpayer is not taxed on accrued, but unreceived, income; nor is a corporate stockholder, as a rule, taxed on undistributed corporate income. This does not mean that a statute, specifically taxing certain undistributed corporate income to stockholders, such as the foreign personal holding company pro-

The actual issuance of a document is unnecessary, as a matter of constitutional law, to render valid a statute taxing to the patron his share of the net margins of a cooperative. The crucial points, in the constitutional sense, are that income has been earned through business activity of the patron and others associated with him in the cooperative enterprise, and that such income can be taxed at the level chosen by Congress.[6] However, it would seem desirable as an administrative matter to provide for the issuance of such documents, and, as the proposed legislation would contemplate, to make such issuance the event which entitles the cooperative to a reduction of its gross income and which requires the income represented by the documents to be included by the patrons. Under this procedure each patron

vision, is unconstitutional. Similarly the *Carpenter* and *Long Poultry Farms* cases have no bearing on the constitutionality of the proposed tax treatment of patrons. They merely hold that the present law contains nothing which authorizes such treatment.

[6] Those who have expressed doubt as to the constitutionality of the proposed legislation have not analyzed the problem correctly; they have erroneously looked to the document itself for the constitutional justification for taxing the patron. The writer of this memorandum, before he had given any study to the constitutional issue and before he had placed that issue in focus, also took this approach. See Asbill, "Cooperatives: Tax Treatment of Partonage Refunds", 42 Va. L. R. 1087, 1112 (1956), where the question was posed: "Does a worthless piece of paper represent 'income' within the meaning of the Sixteenth Amendment?" If one starts with the false premise that the document is the constitutional *sine qua non,* it is not surprising that one questions whether a patron can realize any income when the document he receives is without fair market value. The doubt disappears, however, when one realizes that the document is merely evidence of previously earned income which could be taxed to the patron regardless of the issuance of any document.

is informed of the amount which he is required to report as income.[7]

Some have suggested that the analogies referred to above in the partnership and corporate areas do not support the conclusion that the proposed tax treatment of patrons would be constitutional. It has been claimed, for example, that in the case of a partnership, a small group of partners is normally in control and can force the distribution of partnership earnings, whereas in the cooperative situation the number of patrons is usually large and the element of control is lacking. Therefore, the argument goes, the fact that Congress can tax partnership income directly to the partners does not mean that it can tax cooperative income directly to patrons. This observation, we submit, will not stand analysis. Many partnerships—note, for example, the real estate syndicate currently in vogue—have a great many partners, no one of whom is in control. Moreover, in a limited partnership the limited partners are not even entitled to a voice in partnership management; and yet they are clearly taxable on their share of partnership earnings, whether or not distributed.

It has been suggested that the pass-through of corporate

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[7] For a similar notification requirement, see Subchapter M of the Internal Revenue Code, dealing with regulated investment companies, which provides for the taxation at the level of the individual stockholders of certain capital gains realized, but not distributed, by such companies. Sec. 852(b)(3)(D). This treatment applies to such amount of capital gain as the company shall designate in a written notice mailed to its shareholders within 30 days after the close of its taxable year. Section 852 provides for payment of the capital gains tax by the corporation and grants a credit to the shareholder for the amount paid. This provision is similar to the provision in the Discussion Draft of the Revenue Bill of 1961 for withholding on patronage refunds.

income to shareholders of foreign personal holding companies is constitutional only because it is necessary to prevent evasion and avoidance. Although the prevention of tax avoidance was what motivated Congress to impose a tax on shareholders of foreign personal holding companies, we submit that the constitutional *power* to provide such treatment is no more dependent on such considerations of policy than is the power to tax partners on undistributed earnings of a partnership. It has also been pointed out that the foreign personal holding company situation is one where a small group of shareholders controls the corporation, and it has been suggested that this fact has an important bearing on the constitutionality of the foreign personal holding company provisions of the statute. It is, of course, true that for a corporation to qualify as a foreign personal holding company, more than 50% of the stock must be owned directly or indirectly by not more than 5 persons who are citizens or residents of the United States. However, it may well be that no one member of this group can control the corporation. Moreover, the tax is imposed on shareholders whether or not they are members of this group, whether or not they have voting stock, and whether or not the corporation was a foreign personal holding company at the time they acquired their stock. Consequently, it can be imposed on a minority shareholder who has no voice in the management or control of the corporation, who acquired his stock before the corporation became a foreign personal holding company (by subsequent changes in the stock ownership of other stockholders), and who is not even aware that the corporation is a foreign personal holding company.

Thus, we submit, the above examples of the pass-through of income from the entity level to the individual level are square authority for the constitutionality of the proposed

tax treatment of patrons.[8] They support conclusively the proposition that Congress' power to choose the level of taxation cannot be controlled or limited by the label given by state law to a particular form of business operation. It is inconceivable that Congress can tax the individual associates when the state denominates the entity a partnership, but cannot do so when the state calls the entity a corporation or a cooperative. As the Supreme Court, in *Burk-Waggoner Oil Asso.* v. *Hopkins, supra,* stated with respect to unincorporated associations:

> ". . . . Neither the conception of unincorporated associations prevailing under the local law, nor the relation under that law of the association to its shareholders, nor their relation to each other and to outsiders, is of legal significance as bearing upon the power of Congress to determine how and at what rate the income of the joint enterprise shall be taxed." (269 U.S. at 114)

This language is unquestionably applicable to any form of business organization.

These examples also make it clear that it is unnecessary as a constitutional matter, to require specific consent by the patron to the proposed tax treatment, just as it is unneces-

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[8] They are also authority, if any be needed, for the proposition that dominion and control over property is not essential to the realization of income. Cases such as *James* v. *U.S.*, 366 U.S. 213 (1961) (holding embezzled funds to be taxable income), which have been cited to the Ways & Means Committee as authority against the constitutionality of the proposed legislation, merely say that dominion and control may give rise to realization of income; they by no means hold, or say, that income cannot be realized without such dominion and control.

sary to require such consent in the partnership and foreign personal holding company areas.[9]

III. Eisner v. Macomber Is Not Authority to the Contrary.

The only case which has been viewed as casting any doubt upon the power of Congress, in a business situation like that here involved, to impose the tax on current income at whichever level it considers most appropriate is *Eisner* v. *Macomber*, 252 U.S. 189 (1920). This case, perhaps more than any other in the tax field, has been offered over and over again, without analysis, in support of propositions upon which it does not even bear. Upon analysis, it is clear that the case does not touch upon the question here involved.

The issue there before the Court was whether a stock dividend which made no change in the stockholders' interests in the corporation constituted income within the meaning of the Sixteenth Amendment. The Court held that it did not.

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[9] It has been pointed out by others that several Code provisions taxing undistributed corporate profits to shareholders require the individual consent of the shareholders. See, for example, Section 565 (Consent Dividends) and Subchapter S. The existence, in these provisions, of the requirement of individual consent does not, of course, mean that such a requirement is demanded by the Constitution; it simply means that Congress, as a matter of legislative policy, has deemed it advisable in those situations to tax undistributed corporate earnings to shareholders only when such shareholders have consented to such treatment. These examples involve situations where the number of shareholders is usually relatively small and where their consent can be obtained by the corporation without great administrative difficulty. Entirely different questions of policy are involved in determining the desirability of imposing the individual consent requirement in the cooperative area, where the number of patrons is often extremely large, and where the administrative problems in obtaining consent may be very costly and disruptive of the cooperative's operation and financial structure.

That holding—that the splitting of two certificates of stock into three does not generate income—does not even remotely touch the question here involved, namely, whether income flowing *currently* to a cooperative can be taxed directly to the patrons whose patronage resulted in the realization of the income.

It is true that in the *Macomber* opinion, the Court discussed the question whether the earnings of a corporation could be taxed directly to its stockholders. Aside from the fact that the statute there involved did not present such a question, since it purported to tax only the stock dividends themselves,[10] a careful consideration of the language of the Court and of Justice Brandeis' dissent clearly reveals that the Court was referring only to the taxation of *accumulated* corporate earnings, and that it was not considering—nor was it expressing any opinion on—the question whether a stockholder may be taxed on income of the corporation *as it is currently earned.*

The Government had argued in the alternative that the constitutionality of the statute imposing a tax on stock dividends could be sustained on the theory that corporate earnings could be taxed directly to stockholders, irrespective of the power of Congress to tax a stock dividend as such. That this argument was directed toward the taxation of the earliest earnings *accumulated* after March 1, 1913, not *current* earnings, is clear from the record of the case [11] and from the following statement by the Court:

"Upon the second argument, the government, recognizing the force of the decision in Towne v. Eisner, 245

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[10] The Court stated, at pp. 199-200 that the statute "(notwithstanding a contention of the government that will be noticed) plainly evinces the purpose of Congress to tax stock dividends as income."

[11] The stock dividend was declared on January 1, 1916, in the

U.S. 418, and virtually abandoning the contention that a stock dividend increases the interest of the stockholder or otherwise enriches him, insisted as an alternative that, by the true construction of the Act of 1916, the tax is imposed not upon the stock dividend, but rather upon the stockholder's share of the undivided profits *previously accumulated* by the corporation; the tax being levied as a matter of convenience at the time such profits become manifest through the stock dividend. If so construed, would the act be constitutional?" (p. 217) (Emphasis supplied.)

The majority expressed the view that a statute which purported to tax the *accumulated* earnings of a corporation directly to its shareholders would not be constitutional, for the reason that ". . . what is called the stockholder's share in the *accumulated* profits of the company is *capital,* not income." (p. 219) (Emphasis supplied.) The opinion concluded with the following paragraph:

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amount of approximately $25 Million. Of this amount, $20 Million was a capitalization of pre-March 1, 1913 earnings, which the statute did not purport to reach. The remaining $5 Million was a capitalization of the *earliest* post-1913 earnings (total post-1913 earnings being about $25 Million). It was Mrs. Macomber's share of this $5 Million of *accumulated* earnings which the Government sought to tax. This is clear from the following statement in the Government's brief on reargument:

". . . If Congress had levied an annual tax on the stockholder's share of corporate profits *accruing during each year,* then, of course, no one would say that any part of the profits accruing during a particular year could be carried forward and treated as income of a succeeding year. But that is not this case. . . . The result is that instead of an *annual tax on accruing profits,* we have a *single tax on accumulated profits* levied when they are distributed." (pp. 25-26).

> "Thus, from every point of view, we are brought irresistibly to the conclusion that neither under the 16th Amendment nor otherwise has Congress power to tax without apportionment a true stock dividend made lawfully and in good faith, or the *accumulated* profits behind it, as income of the stockholder. The Revenue Act of 1916, in so far as it imposes a tax upon the stockholder because of such dividend, contravenes the provisions of article 1, § 2, cl. 3, and article 1, § 9, cl. 4, of the Constitution, and to this extent is invalid notwithstanding the 16th Amendment." (Emphasis supplied.) (p. 219)

Nowhere in the course of its opinion did the Court consider —or have occasion to consider—the constitutionality of a statute which taxed the *current* earnings of a corporation directly to its stockholders.

When one considers the dissenting opinion of Mr. Justice Brandeis, it is entirely clear that he also recognized that the Government's alternative argument was based upon the theory that Congress had the power to tax to shareholders *accumulated* earnings, rather than *current* earnings, of their corporation. He stated (p. 232):

> ". . . serious question of the taxability of stock dividends would probably never have been made if Congress had undertaken to tax only those dividends which represented profits earned during the year in which the dividend was paid, or in the year preceding."

Thus, since the question presented by the alternative argument in *Eisner v. Macomber* was not the power of Congress to tax *current* corporate earnings directly to shareholders but its power to tax *accumulated* earnings when represented by the declaration of a stock dividend, it would indeed be erroneous to accept the case as any authority whatever on

the question of the constitutional power of Congress to tax directly to shareholders the earnings of a corporation (or to patrons the earnings of a coöperative) *as they arise.*

In view of the above, it seems unnecessary to discuss at any length the subsequent history of *Eisner* v. *Macomber.* Suffice it to say that, even with respect to the matters to which the Court was actually addressing itself—such as the taxability of stock dividends, and the definition of income—the decision has been limited by subsequent cases to such an extent that it now must be considered as encompassing very little, if any, more than its own precise factual situation.[12] Thus, a stock dividend is taxable if there has been a segregation of assets at the corporate level (*U.S.* v. *Phellis,* 257 U.S. 156 (1921) and *Rockefeller* v. *U.S.,* 257 U.S. 176 (1921)), or if there has been any change in the stockholders' proportional interests in the corporation (*Marr* v. *U.S.,* 268 U.S. 536 (1925) and *Koshland* v. *Helvering,* 297 U.S. 441 (1935)), even though nothing has been "severed from capital" and distributed to the stockholder for his own "separate use and benefit." See *Helvering* v. *Bruun,* 309 U.S. 461 (1940).

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[12] Indeed, if the continued validity of the *Macomber* decision on the exact issue there involved were squarely presented to the Court today, we believe the case would be overruled. In *Helvering* v. *Griffiths,* 318 U.S. 371 (1943) the Government urged that *Eisner* v. *Macomber* be overruled, but a majority of the Court refused to reach the Constitutional issue because it concluded that the statute there involved was not intended by Congress to encompass the type of stock dividend involved in the *Macomber* case. Three Justices dissented on the ground that the *Macomber* case should be overruled.

Erwin Griswold, Dean of Harvard Law School, in "Cases on Federal Taxation" (5th ed. 1960) stated: "The [majority] opinion [in *Griffiths*] left little room to doubt that a statute explicitly taxing all stock dividends would be upheld." (p. 710).

IV. Factors Peculiar to Cooperatives.

It is clear from the foregoing that, notwithstanding *Eisner* v. *Macomber,* Congress has the power to tax the shareholders of a regular business corporation on the undistributed *current* earnings of the corporation. It is equally clear, if not clearer, because of the closer business relationship of patron and cooperative, that Congress can tax the patron on his share of current net margins derived from patronage.

In the cooperative situation the patron is not merely a passive investor—he plays a leading role in the transactions producing the income; he furnishes the products or purchases the supplies or services from which the income is derived. The patron must take affirmative action (i.e., he must do business with the cooperative) in order to create any patronage income which is taxable to him. Under these circumstances his relation to net margins received at the cooperative level is closer than that of a stockholder to corporate earnings. Indeed, this relationship is closer, economically, than that of many partners—and certainly all limited partners—to the earnings of their partnership. Since partnership income can be taxed directly to the partners, there is no logical or legal basis whatever for concluding that patronage income cannot be taxed directly to patrons.

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For the reasons set forth above, legislation requiring patrons to include in income the face amount of documents evidencing their share of current patronage income of the cooperative enterprise would clearly be constitutional.

SUTHERLAND, ASBILL & BRENNAN,
By: MAC ASBILL, JR.

The CHAIRMAN. Thank you very much, Mr. Brinkley.
Senator Anderson.

Senator ANDERSON. I wanted to ask one question, if I can find it. You want these amounts to be taxed when they are paid to the patrons, not when they are earned by the cooperative?

Mr. BRINKLEY. No, sir.

Senator ANDERSON. But you do not want the patron to pay unless he receives it in cash.

Mr. BRINKLEY. Well, no, not at all, no, sir. We are merely suggesting that the amount of cash be paid out to the patron in lieu of the withholding tax. If that were done, then it would——

Senator ANDERSON. But the Treasury would have to determine the face value of each such patronage dividend, would it not?

Mr. BRINKLEY. Each patronage——

Senator ANDERSON. You say—

With decisions by circuit courts of appeals holding in effect that the noncash patronage refunds of the farmer cooperatives there involved were taxable to the patrons not at their face amount, but only at their fair market value.

Was that what you desire to have continued?

Mr. BRINKLEY. This is precisely what we do not want, Senator. We want the patron's refunds taxed at face amount currently in the year of receipt. Each member or patron is given by his cooperative—has to be given—an allocation stating specifically the amount of this refund.

Senator ANDERSON. Are you worried about this decision then that the noncash patronage refunds could not constitutionally be taxed, of the patrons?

Mr. BRINKLEY. Not at all. We have Mr. Asbill, who is our tax counsel, who has delved into this at great length, and I think he would say he is completely convinced that the method of taxation we have suggested here is entirely constitutional and would be in accord with the intent of the act of Congress in 1951.

Senator ANDERSON. He handled those two cases in which it was determined that it was not proper to charge a noncash dividend?

Mr. BRINKLEY. Yes, he did. If you would like to ask Mr. Asbill directly, he is here in the room.

Senator ANDERSON. These two cases held that you could not charge the noncash portion of the refund constitutionally to the farmer, how does this change it?

Mr. HARMANSON. I am not Mr. Asbill; I am Mr. Harmanson.

Mr. ASBILL. Senator, the differences is that the *Long Poultry Farms* and *Carpenter* cases were decided under existing law, that is, the law as it now stands, which does not have a specific provision stating how the patrons will be taxed on these noncash patronage refunds.

I have concluded that if the Congress should provide that the patrons will be taxed on the face amount of these refunds—before this there has been no such provision—that law would be constitutional.

The point is that there was no such law when these two cases were decided.

Senator ANDERSON. There was not any law that said it should be only the cash portion, either, was there?

Mr. ASBILL. No.

Senator ANDERSON. So you were able to upset the first one. If you came up with the second one, how long would it take you to get into court on that one?

Mr. ASBILL. Of course, I could not guarantee there would be no litigation on this point. I do not think anybody could. I think there are a lot of features about this law with respect to which you can expect litigation.

All I can say is, I think it is clear, as in the case of a partnership, for example, that this would be constitutional.

Mr. BRINKLEY. There never has been any question about the cash payment being constitutional on taxes at all.

Senator ANDERSON. That is not what we are talking about. You are not going to give a cash payment but give a portion in cash and retain the rest of it, and there will be some constitutional question on it, won't there? If you could find a peg to hang your hat on before, you can find another one, could you not?

Mr. ASBILL. I must repeat, Senator, the peg before was not a constitutional peg. The *Carpenter* and *Long Poultry* cases were not presented to the court on a constitutional issue. We simply argued, and I think rightly, that the law did not impose the tax.

Senator ANDERSON. I only read what you say here, that, "Congress does not have the power under the 16th amendment to the Constitution, to require patrons to include in their income," and so forth.

Mr. ASBILL. Mr. Brinkley has said that that has been contended by some people.

Senator ANDERSON. Contended by some people.

Mr. ASBILL. But that it is erroneous.

Senator ANDERSON. What is your contention?

Mr. ASBILL. If Congress were to impose a tax on the face amount of the document that the patron received, that would be perfectly constitutional. In other words, you have the power to do what Mr. Brinkley recommends.

Senator ANDERSON. We have that much legislative history now to help use when we get to the floor.

Now, under the council policy, you say—

> We are opposed to the provisions of the House bill which make this result dependent on the issuance of qualified allocations as defined in the bill.

Then you say—

> We are opposed to any withholding on patronage refunds, cash or noncash.

Is that solely because of the fact that so many farmers do not have any income?

Mr. BRINKLEY. Partly, Senator. We feel it would be a very extensive windfall to the Treasury.

Senator ANDERSON. Windfall to the Treasury?

Mr. BRINKLEY. Windfall to the Treasury; maybe I should not have said that. [Laughter.]

Senator ANDERSON. This is a new type of windfall.

Mr. BRINKLEY. Well, actually, I think the figures that I read in the body of the brief would indicate that, based on the Internal Revenue Service statistics only 88.2 percent of the farmers in 1959–60 had net farm income of over $3,000.

Obviously, many of these would be in a nontaxable position, so that there would be a tremendous wasted effort in recovering, farmers recovering, this.

Senator ANDERSON. Is that total income of these farmers or income of farmers through farming?

Mr. BRINKLEY. Income of farmers by farming.

Senator ANDERSON. You and I recognize, Mr. Brinkley, that a great many farmers have income other than income from farming.

Mr. BRINKLEY. I only wish they had more.

Senator ANDERSON. Well, a great many of them have.

Mr. BRINKLEY. Undoubtedly.

Senator ANDERSON. Therefore, these figures do not mean too much, do they?

Mr. BRINKLEY. They mean a great deal, so far as their relationships with the cooperative are concerned in their farming operations; yes.

Senator ANDERSON. But if a man does not have the full amount of dollars from farming, but he has off-farm employment and supplements his income, why shouldn't it be withheld? They withhold from your salary.

Mr. BRINKLEY. I am drawing a distinction between withholding and paying the tax; certainly he should pay a tax.

Senator ANDERSON. No. You are saying—

We are opposed to any withholding on patronage refunds, cash or noncash.

Mr. BRINKLEY. That is right. What we are proposing is that they be paid an equivalent amount in cash, not less than what they would be subject to in withholding rather than the withholding tax——

Senator ANDERSON. How does a cooperative know whether this farmer has nonfarm income?

Mr. BRINKLEY. It does not need to. The cooperative is only concerned with the amount of income which it has made for this farmer, and that is paid to him.

Senator ANDERSON. I am sure I do not follow you. You are opposing any withholding?

Mr. BRINKLEY. No. I am opposing—we have no position on the general policy of withholding.

Senator ANDERSON. I read:

We are opposed to any withholding on patronage refunds, cash or noncash.

You are opposed to any withholding of patronage refunds?

Mr. BRINKLEY. Yes, sir.

Senator ANDERSON. Do you have any way of knowing how many of these farmers have outside income, outside of patronage?

Mr. BRINKLEY. I do not see why we should, Senator.

Senator ANDERSON. They withhold from Members of the U.S. Senate.

Mr. BRINKLEY. They withhold from me.

Senator ANDERSON. Why don't we both join together and make them withhold from these people who have the necessary income?

Mr. BRINKLEY. I say in my statement:

We take no position as to whether withholding should be applied to corporate dividends and certain types of interest as proposed in the House bill.

I would say if a farmer has other than farming income or other income from his cooperative, if the general withholding taxes are passed, that it should apply to him if he is on a salary.

Senator ANDERSON. Therefore, the cooperative would have to find out whether the farmer had off-farm income.

Mr. BRINKLEY. It should not. It does not need to. The cooperative, as we understand it, as we understand the proposal, would simply make a payment to the U.S. Treasury of 20 percent of the total amount the cooperative owed to all the members and patrons of the cooperative.

Senator ANDERSON. And those who did not have $3,000 would have to apply for a refund.

Mr. BRINKLEY. They would have to apply for a refund.

Senator ANDERSON. You think that is less work?

Mr. BRINKLEY. They would be getting the patronage refund that the cooperative owed them through the route of the U.S. Treasury. This is a rather long route to go.

Senator ANDERSON. You think it is desirable to increase the bookkeeping and to mail out all these checks?

Mr. BRINKLEY. Well, they are doing it now, for the most part. They are making cash refunds in addition to the noncash patronage refund. This is nothing new.

Senator ANDERSON. The Federal Government is making these refunds?

Mr. BRINKLEY. Who?

Senator ANDERSON. You said the Federal Government is making the refunds.

Mr. BRINKLEY. No. The cooperative.

Senator ANDERSON. Wouldn't they have to be making the refunds?

Mr. BRINKLEY. That was merely a figure of speech, because instead of getting his patronage refund direct from the cooperative——

Senator ANDERSON. What do you mean, a figure of speech?

Mr. BRINKLEY. That the same amount would have to come from him and what he claimed as an overpayment of the withholding tax made by his cooperative to the Government.

Senator ANDERSON. And he has to apply for a refund for overpayment of income. If you have had some experience with that, you regard that as a simple process?

Mr. BRINKLEY. Not very.

Senator ANDERSON. You regard it as a simple process at all?

Mr. BRINKLEY. No, sir.

Senator ANDERSON. So therefore you are going to take 82 percent of all farmers and give them a very difficult and complicated process in order for them to get the money back?

Mr. BRINKLEY. I do not propose that; that is in the House bill.

Senator ANDERSON. Well, you say that if there is going to be any withholding, you do not want any withholding on patronage dividends.

Mr. BRINKLEY. That is right.

Senator ANDERSON. You say then, your own figures show, 82 percent of them, you say, do not have this amount of income requiring them to pay an income tax. All the people who have nonemployment would be able to get a refund, wouldn't they, if they get a few thousand dollars and above, and all the single people would get that, and boys past 21 on the farm who might have income. You think it is better not to have withholding than to have that?

Mr. BRINKLEY. Our only position, Senator, with respect to withholding is the problem that is created by withholding applied to the noncash patronage refund of the members and patrons. We have no position with respect to the rest of them.

We point out the complications in the problems that would be involved, and in an attempt to be helpful we have suggested an alternative approach that we think would be more direct and of more benefit to the individual farmer by giving him the equivalent in cash and letting him pay his own income tax, if he owed any.

Senator ANDERSON. I had to try to obtain a refund one time, and I hope I never have to try another one.

Mr. BRINKLEY. They are a nuisance.

Senator ANDERSON. It is difficult.

Does your attorney, or did you before you were retained by the National Council of Farmer Cooperatives, take the position that these patronage dividends, when issued on paper, were not income under the 16th amendment?

Mr. ASBILL. Senator, I may say initially I am not with the National Council of Farmer Cooperatives. I am an attorney in private practice here in Washington.

Mr. BRINKLEY. He is our tax counsel on this particular——

Senator ANDERSON. What is the difference between being retained regularly and specifically?

Mr. ASBILL. Perhaps none. I simply wanted the record to show that.

Senator ANDERSON. All right.

Mr. ASBILL. In an article written, I think, in 1956, which is referred to on page 9 of this memorandum which I prepared for the National Council, I posed the question:

Does a worthless piece of paper represent 'income' within the meaning of the 16th amendment?

Senator ANDERSON. Now, Mr. Brinkley, having been with the cooperatives, with a cooperative, a long, long time, even before they had a different Secretary of Agriculture than they have now, do you think these pieces of paper are worthless?

Mr. BRINKLEY. I certainly do not, and the record will bear that out, as you well know, sir.

Senator ANDERSON. I only say, Mr. Brinkley, that most people think withholding is a fine thing applied to somebody else. I have not had a letter yet that says, "I think it would be good to apply it to me." So if you, in principle, believe in withholding, you cannot just take one organization out because it will have some difficulty.

Mr. BRINKLEY. I have some rather pronounced views on the entire subject, but I would rather confine myself to this particular problem.

Senator ANDERSON. I think I had better not get into the question in view of the time. I would like to have you submit your views to me.

Let me ask about this message of the President that you quoted:

I recommend that the law be clarified—

said the President—

so that all earnings are taxable to either the cooperatives or to their patrons, assessing the patron on the earnings that are allocated to him as patronage dividends or refunds in scrip or cash.

Do you agree with that statement of the President?

Mr. BRINKLEY. Emphatically; yes, sir.

Senator ANDERSON. You support it?

Mr. BRINKLEY. Yes, sir.

Senator ANDERSON. So there must be taxation of the income either to the cooperative or to the patron.

Mr. BRINKLEY. Yes, sir.

Senator ANDERSON. That has no relationship to whether it is paid in cash or not in cash.

Mr. BRINKLEY. Not at all.

Senator ANDERSON. That is all.

The CHAIRMAN. Senator Curtis.

Senator CURTIS. Mr. Chairman, has Mr. Asbill's brief been received for inclusion in the record?

Mr. BRINKLEY. I have asked that it be included in the record.

The CHAIRMAN. The insertion has been made.

Senator CURTIS. Now, Mr. Brinkley, how big a business are we talking about in farmer cooperatives? You represent substantially the greater portion of them?

Mr. BRINKLEY. As I stated in my opening sentence, the council is a nationwide organization composed of farmer-owned and farmer-controlled cooperative marketing and purchasing associations. The council's direct members and their affiliated local and National, State, local, and county associations, number approximately 5,700 cooperatives and serve——

Senator CURTIS. Is there a figure anywhere today as to how much was paid or allocated in patronage dividends by all farm cooperatives in a given year?

Mr. BRINKLEY. We had asked the Farmer Cooperative Service, Senator, to make an intensive nationwide study of that situation, together with other financial information that we thought desirable, and they did make an estimate, a very comprehensive estimate of the patronage refunds paid to members and patrons.

Senator CURTIS. How much was it? What year did it pertain to?

Mr. BRINKLEY. Do you recall, Mr. Harmanson?

Mr. HARMANSON. 1954 fiscal years of cooperatives. The study completed in 1957, showed there was a total, after allowing——

Senator CURTIS. This was for the year 1954?

Mr. HARMANSON. The year 1954; the study covered 1954 fiscal years. The study reflected $275 million were the total net margins after allowing for duplications in intercooperative distributions, $275 million. Of that, 30.9 percent——

Senator CURTIS. $275 million?

Mr. HARMANSON. $275 million; and of that total, according to the study by the Farmer Cooperatives Service, 30.9 percent was distributed in cash.

Senator CURTIS. But there was distributed $275 million?

Mr. HARMANSON. Well, allocated or paid in cash. That was the amount of the total net margins.

Senator CURTIS. That is what I wanted to know.

Now, a sizable portion of the farm cooperatives are nonexempt aren't they?

Mr. BRINKLEY. Quite a number are nonexempt; yes, sir.

Senator CURTIS. Now, their net income after payment of the patronage dividends is subject to tax now?

Mr. BRINKLEY. Yes, it is.

Senator CURTIS. The exempt cooperative, what net income can they have that is not paid in patronage dividends, that is exempt from taxation?

Mr. BRINKLEY. They cannot have a nickel's worth, Senator, that is exempt from taxation.

Senator CURTIS. How about the status of income not related to the patron; I am referring to the storage of grain that belongs to the U.S. Government. Is the income from that operation taxable to all farmer cooperatives?

Mr. BRINKLEY. I would like for Mr. Harmanson to tell you.

Mr. HARMANSON. The 1951 amendments recommended by this committee, adopted by the Congress, dealt specifically with nonpatronage income, income arising from sources other than patronage of patrons or members. The 1951 act provided that that nonpatronage income of the exempt cooperatives would be deductible by the exempt cooperative if allocated to the patron in the form of certificate or some other form that informed the recipient of the stated dollar amount.

Senator CURTIS. That answers the question that I have asked. Now, the nonexempt farm cooperative has to pay the corporate rate on income derived from the storage of grain from the Government, is that correct?

Mr. HARMANSON. The nonpatronage income, yes.

Senator CURTIS. Whether they pay a patronage dividend on it or not; is that correct?

Mr. HARMANSON. Well, it is not patronage income. It is not patronage, and so they pay a tax on it just like any other corporation.

Senator CURTIS. They are taxed on it.

Does the tax exempt cooperative pay a tax on it?

Mr. HARMANSON. Not if they allocate it to the patron in a manner provided in the statute.

Senator CURTIS. That is what I am trying to get at.

The one that does not qualify, as a nonqualifier, pays a tax on income from the U.S. Government for the storage of grain regardless of what they do with it.

Mr. HARMANSON. The nonexempt cooperative; yes, sir.

Senator CURTIS. The exempt cooperative—are you saying that the cooperative does not pay a tax on such income if they distribute it?

Mr. HARMANSON. That is correct.

Senator CURTIS. Or allocate it?

Mr. HARMANSON. That is correct, and that is what the 1951 amendment provided.

Senator CURTIS. Correct. Now, is there any other practical difference in tax liability between an exempt and a nonexempt farm cooperative?

Mr. HARMANSON. Yes; there is one very important one. The exempt cooperative, the one that qualifies under section 521 does not have to pay a tax on its dividends on capital stock. That is the one difference that is retained from old section 101. The nonexempt cooperative, the taxable cooperative, like any other corporation, has to go ahead and include these dividends in its income and it has to pay

a corporate tax on them, and then the recipient, when he gets his dividend, just like as from any other corporation, has to pay a tax; exempt cooperatives do not pay a tax on dividends on capital stock.

Senator CURTIS. That is according to the rules. But aren't the capital stocks held down to a nominal amount?

Mr. HARMANSON. Yes.

Senator CURTIS. And a cooperative can pay a patronage dividend without paying a stock dividend.

Mr. HARMANSON. Yes; and cooperatives are nonstock cooperatives—there are a considerable number.

Senator CURTIS. If that distinction exists it does not make any difference in actual tax paid.

Mr. HARMANSON. No; because by practically every State law under which cooperatives are organized, as well as Federal law, there is a limitation, particularly with respect to exempt cooperatives, and the rate cannot exceed 8 percent or the legal rate in the State. It is definitely limited.

Senator CURTIS. Stripped of technical differences, is it fair to say that the principal difference in the tax treatment between a tax-exempt cooperative, farm cooperative, and a nontax farm cooperative is that one pays a tax on nonpatronage income such as grain storage payments from the Government, and the other one does not?

Mr. HARMANSON. I think that is a correct statement. That is one of the principal—the principal difference.

Senator CURTIS. And this $275 million of patronage refunds or payments or allocations of 1954, would you have any rule of thumb that you could get as to what that might be at the present time? Would it be up a little bit?

Mr. HARMANSON. I could not make any informed guess.

Senator CURTIS. It might be about the same?

Mr. HARMANSON. It might be.

This may be of interest and pertinent to that point, Senator. The latest figures, which have not been published, but we understand, about 70 percent of the farmer cooperatives of the country today hold letters of exemption, are in the so-called exempt class.

Senator CURTIS. Say that again.

Mr. HARMANSON. About 70 percent of the 9,900-some farmer cooperatives in the country are exempt, in the exempt category.

Senator CURTIS. Is that right? I do not think it runs that high in my State.

Can a cooperative at wholesale or regional level have the same opportunity to qualify as an exempt cooperative as the local one that deals with the individual farmers?

Mr. HARMANSON. Yes. I think that the Federated Cooperatives whose membership directly is made up of locals which, in turn, a[illegible] made up of farmers, are considered on the same basis for letters [illegible] exemption by the Internal Revenue Service. They must be qualifie[illegible] farmer cooperatives which make up the membership of the Federated.

Senator CURTIS. Is that the group renting the most storage space to the Government?

Mr. HARMANSON. I am not in position from my personal knowledg[illegible] of say that they are.

Senator CURTIS. That is all.

Senator DOUGLAS. Mr. Chairman?
The CHAIRMAN. Senator Douglas?
Senator DOUGLAS. It may be that the record will show that it is possibly a verbal slip on the part of the witness, and in order that the record may be accurate, I would like to pose this question: I understood you to say that 70 percent of some 900 farm cooperatives were tax exempt. But your statement indicates there are 9,700.
Mr. HARMANSON. About 9,700 in 1954, excluding bargaining cooperatives.
Senator DOUGLAS. I am very glad to have the record corrected.
Mr. HARMANSON. Thank you very much, Senator.
The CHAIRMAN. Thank you very much, Mr. Brinkley.
Mr. BRINKLEY. Thank you, sir.
The CHAIRMAN. The committee will recess until 2:30.
(Whereupon, at 12:15 p.m., the committee was recessed, to reconvene at 2:30 p.m., the same day.)

AFTERNOON SESSION

The CHAIRMAN. The committee will come to order.
The first witness is Mr. Charles B. Shuman, the president of the American Farm Bureau Federation.
We certainly welcome you, sir.

STATEMENT OF CHARLES B. SHUMAN, PRESIDENT OF THE AMERICAN FARM BUREAU FEDERATION

Mr. SHUMAN. Mr. Chairman and members of the committee, I have with me Mr. Hamilton, director of research, and Mr. J. B. Thayn, assistant legislative director.
My name is Charles B. Shuman of the American Farm Bureau Federation, and I am from Sullivan, Ill.
The American Farm Bureau Federation is a general farm organization representing more than 1,600,000 member families. A brief statement on the nature and purposes of our organization will be found on the cover page of this statement. Also on the cover is a map which indicates the location of nearly 2,700 organized county farm bureaus now operating in 49 States and Puerto Rico. Each dot represents one county unit.
We appreciate the opportunity to discuss H.R. 10650, the proposed Revenue Act of 1962. Our comments will be confined to sections of the bill, and proposed amendments, that are of particular interest to our members as farmers, citizens, and taxpayers.
Section 2: Credit for investment in certain depreciable property.
Section 8: Mutual savings banks, et cetera.
Section 10: Mutual insurance companies—other than life, marine, and certain fire insurance companies—et cetera.
Section 17: Tax treatment of cooperatives and patrons.
Section 19: Withholding of income tax at source on interest, dividends, and patronage dividends.

DIVIDENDS EXCLUSION AND CREDIT

SECTION 2: CREDIT FOR INVESTMENT

Farm Bureau recognizes that capital investment is a key factor in increasing per capita production and living standards; however, we are opposed to the investment credit provisions of H.R. 10650. These provisions are both unsound and likely to have a number of undesirable effects. It would be far better to liberalize the treatment of depreciation and to work toward a general reduction in income tax rates.

The proposed investment credit is a selective form of tax relief—in reality a subsidy. This is clearly indicated by the fact that credit for new investment would be allowed as a deduction from the amount due as taxes rather than as an adjustment in the amount of income subject to tax, and the fact that it would not reduce the basis of capital assets for depreciation purposes. The result would be to give some taxpayers a competitive advantage at the expense of others.

Taxpayers who have delayed expenditures for new equipment would be rewarded, while those who have kept their productive plants up to date would be penalized. A competitive advantage would also be created for new industries that produce substitutes for older products. For example, in the textile industry, the proposed credit would create an additional incentive for the development of new synthetics. Furthermore, the adoption of this special treatment for some taxpayers would postpone the day when the present burdensome level of income tax rates can be reduced for all taxpayers.

We therefore recommend that section 2 be deleted from H.R. 10650.

SECTION 8. MUTUAL SAVINGS BANKS, ET CETERA

Senator ANDERSON. May I ask you about section 2? You know there is a provision now that permits you to have sort of favorable treatment on dairy animals and so forth if used for production.

Do you think this bill is right in providing that a man could buy a bull for breeding purposes at $50,000 and take 7 percent of that sum for credit against direct taxes?

Mr. SHUMAN. Well, you are referring, Senator, to the capital gains——

Senator ANDERSON. No. There is no capital gains. That is the dairy animals. This will let you take for production purposes the cost of a breeding bull, and charge off 7 percent of that from direct taxation.

Mr. SHUMAN. We are opposed to that.

Senator ANDERSON. Good.

Mr. SHUMAN. As a general principle, Farm Bureau believes that all income should be subject to a single Federal income tax.

In the interest of fairness to all taxpayers, the Congress should tighten up provisions of the tax code which permit some groups to accumulate large amounts of capital on a tax-free basis.

Farm Bureau believes that the amounts mutual savings institutions may add to their reserve on a tax-free basis should be based on established concepts for computing bad-debt reserves. Accordingly, we agree with the objectives of section 8 of H.R. 10650 as passed by the House.

SECTION 10. MUTUAL CASUALTY AND FIRE INSURANCE COMPANIES

Farmers buy large amounts of casualty and fire insurance. As a result, they have long taken an active interest in the mutual insurance industry. Farm Bureau has organized a number of mutual insurance companies to serve the needs of its members.

At our most recent annual meeting, the elected voting delegates of member State farm bureaus adopted a policy statement on the taxation of casualty insurance companies as follows:

We favor a system of taxation of all types of fire and casualty insurance companies which gives no segment of this business an unfair competitive advantage over the others.

We believe that it is in the interest of tax equity to permit the tax laws to recognize the basic differences between stock and mutual companies.

We therefore favor a tax plan in which any variation in the method of taxing these two types of companies is limited to that justified by such demonstrated differences.

We are in general agreement with the principles set forth in section 10 of H.R. 10650. In our opinion, however, the ceilings that would be applicable to the proposed protection-against-loss accounts would tend to defeat the purposes of such accounts. We therefore recommend elimination of the proposed ceilings on the accumulation of reserves in protection-against-loss accounts.

We further recommend that:

(1) Loss reserves established under the present tax formula shall not be taxed in the future and any loss resulting from an inadequacy of reserves existing at the time the new formula becomes effective shall be taken into consideration for tax purposes in the tax year in which such inadequacy is finally determined.

(2) Any changes made in the formula for taxing mutual insurance companies shall become effective at the beginning of the next calendar year.

Mutual fire and casualty insurance companies have not had to consider their loss reserves in determining their Federal income tax under the mutual tax formula which has been in effect since 1942. As a result, reserving policies of mutual companies have not been uniform. Some mutual companies will, therefore, have an excess in their reserves at the time a new tax formula becomes effective while other mutual companies will have an inadequacy in their reserves. We believe that our recommendations would result in equitable treatment for all mutual companies.

We also wish to call attention to the fact that in its present form section 10 discriminates against mutuals as compared to stock companies by prohibiting the use of mutual investment income for policyholder dividends unless and until mutual loss protection funds are completely exhausted. This discrimination should be eliminated.

SECTION 17: TAX TREATMENT OF COOPERATIVES AND PATRONS

Farm Bureau policy—Support cooperatives; protect the farmer member: The basic aim of agricultural cooperatives is to enable farmers to compete effectively in the sale of their products and in the purchase of supplies and services. The cooperative corporation is a valu-

able device through which farmers can enhance their capacity to achieve economic ends.

From the time it was organized in 1919, the American Farm Bureau Federation has supported the cooperative method of doing business for farmers. A majority of our 1,600,994 member families are members of farmer cooperatives. A number of State farm bureaus have organized affiliated cooperative associations to provide various economic services. Our members are also vitally interested in many cooperatives which are not affiliated with Farm Bureau.

The essence of the cooperative tax issue is the procedure that is to be used to determine tax liability for noncashing patronage dividends. This is an isssue which requires that we consider both the interests of the member patrons as individuals and the interests of cooperatives as institutions. Farm Bureau has long sought an equitable solution to this problem.

In 1950 and 1951 when this subject was under consideration our position was as follows:

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.

In a statement to the U.S. Senate in September 1951, we recommended that:

Patronage dividend deductions be allowed only if either of the following two conditions are met:

(1) The patronage dividends are paid in cash or merchandise within 6 months after the year in which the patronage occurred, or

(2) The patronage dividends are paid in the form of irrevocable obligations such as stock certificates, certificates of indebtedness, or revolving fund certificates, taxable in the hands of the patron in the year in which he received notice to be given by the cooperative within 6 months after the close of its taxable year.

COMMENT WITH RESPECT TO PROVISIONS OF THE REVENUE ACT OF 1951

The Revenue Act of 1951 provided that earnings of farmers' marketing and purchasing cooperatives are taxable in the hands of either the cooperatives or their patrons. Earnings distributed to patrons, in the form of cash, securities, other scrip, or book credits were to be considered taxable income of these patrons.

At the time these provisions appeared to be a solution to the problem. This feeling was reflected in the resolutions adopted at our convention in December 1952 as follows:

We support the provisions of the Revenue Act of 1951 which:

(1) Make it clear that cooperative savings allocated to member patrons are taxable in the hands of such patrons, and

(2) Provide that savings held by cooperatives in the form of unassigned surpluses shall be taxed in the same manner as the profits of other corporations.

These provisions constitute a great safeguard to the interest of true cooperatives. We will insist on the proper interpretation and administration of these provisions.

Since the 1951 amendment was enacted, it has been rendered partially ineffective by court decisions which have held that certain types of distributions are not income to patrons and, therefore, are not currently taxable in the hands of the patrons. We believe these decisions reflect sound legal principles. If the member patron is, by law or contract, to be legally required to include in his gross income such portion of the net savings and income of a cooperative association as is not paid in cash, the courts are fully justified in holding that distribution must be in such form as to constitute income to the patron. Under the present law, however, the effect of such court decisions has been to prevent the collection of a single Federal income tax on some cooperative savings on a current basis.

COMMENT ON SECTION 17 OF H.R. 10650

Farm Bureau members are most anxious that the Congress enact legislation that is fair to the farmers, their cooperatives and other taxpayers. Such legislation should provide an effective and equitable means of insuring that all net savings and income of farmer cooperatives are subject to a single Federal income tax to be paid either by the cooperative or by the patron as earned. We are opposed to any efforts to tax cooperatives on savings which are returned to the member patrons in such form as to be taxable in their hands, as this would result in double taxation. On the other hand, we agree that savings not returned in such form as to be taxable to the member patron should be taxable in the hands of the cooperative.

The provisions of section 17 of H.R. 10650, as passed by the House, provide for the application of a withholding procedure to patronage dividends, whether in cash or noncash allocations, and that the individual member patron shall be deemed to have consented to accept tax liability for noncash patronage refunds if he obtains, or retains, membership in a cooperative after he is notified that it has adopted a bylaw providing that membership constitutes "consent" to such tax liability. These provisions are unacceptable to us because they do not adequately protect the rights of the individual member patron as set forth in a number of court decisions.

It will be argued, of course, that a patron who objects to being made liable for income taxes on noncash patronage dividends doesn't have to do business with cooperatives. There are, however, many cases where it would be extremely difficult for farmers to avoid doing business with cooperatives if they wish to continue certain types of activities.

It will also be argued that a withholding rate of 20 percent is sufficient to cover the patron's tax liability in most cases, but there would be a substantial number of cases in which patrons would owe additional taxes.

Thus, the enactment of section 17 in its present form would be likely to lead to a new round of litigation on the question of whether noncash patronage dividends constitute taxable income to the member patron.

Under the 16th amendment, Congress has the power "to lay and collect taxes on incomes, from whatever source derived". The principle has long been recognized by the courts that what is not in fact income cannot be made income by legislative action, or by regulations of the executive branch.

In the *Carpenter* case (1955) the U.S. Court of Appeals for the Fifth Circuit held that the revolving fund certificates under consideration in that case did not constitute income to the patron. The court said:

It is fundamental in income taxation that before a cash-basis taxpayer may be charged with the receipt of income he must receive cash or property having a fair market value or such cash or property must be unqualifiedly subject to his demand (219 Fed. 2d 635).

In the *Long Poultry Farms* case (1957) the U.S. Court of Appeals for the Fourth Circuit commented as follows:

It is argued that under implied agreement arising out of the provisions of the bylaws taxpayer in effect received in cash the amount of the credit and reinvested it in the revolving fund of the cooperative; but this is simply to exalt fiction and ignore reality.

To require the inclusion in income of contingent credits, such as are here involved, would be to require the patrons of cooperatives to pay tax upon income which they have not received, over which they have been given no control and which they may never receive. Apart from the question of constitutionality of such a requirement, which would be a serious one, it is a safe assumption that Congress never intended to impose upon the patrons of cooperatives the hardship and burden which the taxability of these contingent credits would involve (249 Fed. 2d 726).

The court of appeals in the ninth circuit has held similarly. *Caswell's Estate* v. *Commissioner* (211 Fed. 2d 693 (1954)). *Moe* v. *Earle* (226 Fed. 2d 583 (1955)).

Secretary Dillon in his testimony before the Ways and Means Committee last year indicated that the court cases which refused to accept the immediate reinvestment theory can be overcome if Congress makes it clear that the patron is now required by statute to include both cash and scrip allocations in income. We doubt that the courts will sustain this view.

In this connection, it is respectfully urged that the committee consider a recent statement of the U.S. Supreme Court of what constitutes taxable income. In the case of *Eugene C. James* v. *United States* (No. 63, May 15, 1961) the Court held:

The starting point in all cases dealing with the question of the scope of what is included in "gross income" begins with the basic premise that the purpose of Congress was "to use the full measure of its taxing power" (*Helvering* v. *Clifford*, 309 U.S. 331, 334). And the Court has given a liberal construction to the broad phraseology of the "gross income" definition statutes in recognition of the intention of Congress to tax all gains except those specifically exempted (*Commissioner* v. *Jacobson*, 336 U.S. 28, 49; *Helvering* v. *Stockholms Enskilda Bank*, 293 U.S. 84, 87–91). The language of sec. 22(a) of the 1939 Code, "gains or profits and income derived from any source whatever," and the more simplified language of sec. 61(a) of the 1954 Code, "all income from whatever source derived," has been held to encompass all "accessions to wealth, clearly

realized, and over which the taxpayers have complete dominion" (*Commissioner* v. *Glenshaw Glass Co.*, 348 U.S. 426, 431). A gain "constitutes taxable income when its recipient has such control over it that, as a practical matter, he derives readily realizable economy value from it" (*Rutkin* v. *United States*, supra, at p. 137).

It is important to note that the Supreme Court continues to place emphasis on certain basic criteria for determining taxable income. The key words are:

* * * clearly realized, and over which the taxpayers have complete dominion; * * its recipient has such control over it that, as a practical matter, he derives readily realizable economic value from it.

In our opinion, patrons and members of cooperatives will resist—and resent—efforts to pass along to them a tax liability which is not clearly their responsibility and which may place them in jeopardy of prosecution for failure to report such "scrip" as income. On the other hand, farmers will welcome a clarification of the tax laws which will enable their cooperatives to develop a sound program for handling patronage dividends that will be in the best interest of the cooperative and the patrons.

We believe that the committee will be on the strongest ground if it develops legislation based upon what the courts have construed to be taxable income. It will not be in the best interests of cooperatives or their members to subject them to another long period of litigation.

Farm Bureau has developed a sound and workable proposal for resolving this complicated issue. It involves:

(*a*) Adoption of a clean-cut basis for establishing the tax liability on noncash cooperative distributions. Under this approach the individual member patron would be taxable on noncash distributions by cooperatives only if (1) at least 20 percent of the amount of each patron's dividend is paid by the cooperative in cash, (2) the remainder of the dividend is in the form of capital stock or a written instrument containing an unconditional promise by the cooperative to redeem said written instrument within a period of 12 years, and (3) the patron agrees in writing to accept tax liability for the entire amount of the distribution.

The purpose of the proposed requirement that at least 20 percent of the distribution shall be distributed in cash is to provide the patron with cash to pay his tax on cooperative dividends and to facilitate getting annual acceptance by the patron of his tax liability for the noncash portion of such dividends.

The requirement that the remainder of the distribution shall be in the form of capital stock or a written instrument meeting specified qualifications is designed to give real integrity to the "reinvestment" concept.

The patron's consent to tax liability on the full amount of such cooperative distribution could be obtained by an endorsement on the check for the cash part of the distribution. Thus, this approach would obtain "consent" by an affirmative action on the part of the individual patron, rather than by a blanket action on the part of the cooperative.

If the patron did not accept the cash patronage refund and consequent tax liability for the full value of both cash and noncash

refunds within a reasonable period he would be deemed to have surrendered his rights to these refunds which would then become a part of the unallocated surplus of the cooperative and taxable to the cooperative in the fiscal year in which the patron's acceptance rights terminated.

(*b*) Eliminating the application of withholding to farmer cooperatives. It would be impractical and unworkable to apply both a 20-percent withholding tax and a requirement that 20 percent of cooperative dividends shall be distributed as cash payments in order for the cooperative to obtain a deduction for such dividends.

We strongly recommend that section 17 of H.R. 10650 be amended to accord with the procedure outlined above.

Amend section 17 of H.R. 10650 as passed by the House by substituting the following for subsection 1388(c) line 16, p 174 through line 10 on p. 177).

(c) QUALIFIED WRITTEN NOTICE OF ALLOCATION.—

(1) DEFINED.—For purposes of this subchapter, the term "qualified written notice of allocation" means—

(A) a written notice of allocation which the distributee may redeem in cash at its dollar amount at any time within a period beginning on the date such written notice of allocation is issued and ending not earlier than 90 days from such date but only if the distributee receives written notice of the right of redemption at the time he receives such written notice of allocation; or

(B) capital stock or a written instrument issued by a farmers' cooperative described in paragraph (2), as part of a patronage dividend not less than 20 percent of which is paid in cash, and the remainder of which is distributed in the form of capital stock or a written instrument containing an unconditional promise to redeem in cash within 12 years, where the terms of such patronage dividend provide that in accepting the cash payment the distributee consents in writing to take the accompanying capital stock or written instrument into account, at its stated dollar amount, in the manner provided in section 1385.

The distributee's consent to take such capital stock or written instrument into account as provided in subparagraph (B) may take the form of an endorsement on a check conveying the cash payment provided for by said subparagraph B.

(2) FARMER'S COOPERATIVES.—The farmers' cooperatives referred to in paragraph (1)(B) are farmers', fruitgrowers', or like associations organized and operated on a cooperative basis for the purpose of marketing the products of members or other producers or for the purpose of purchasing supplies and equipment for the use of members or other persons; but only if the requirements of section 521(b)(4) (relating to transactions with nonmembers) are satisfied.

PERIOD FOR MAKING DISTRIBUTIONS

Exempt cooperative associations as defined in section 521 of the code are permitted 8½ months in which to make distributions and file returns. Taxable cooperative associations have had the same privilege; however, the Internal Revenue Service's regulations require taxable cooperatives to make distributions within 2½ months. This is too short a period for the auditing that is necessary to provide the basis for such distribution. The problems of the two classes of associations are quite familiar. We support the provisions of section 17 which are designed to correct the present discrimination against "nonexempt" cooperatives.

SECTION 19—WITHHOLDING TAX ON DIVIDENDS AND INTEREST

We are opposed in principle to the application of a withholding tax to dividends and interest.

The problems involved in applying withholding to dividends and interest are entirely different from those involved in the withholding of taxes from wages and salaries. The application of withholding to dividends and interest inevitably would lead to confusion and inequity for individual taxpayers, to say nothing of the greatly increased paperwork that would be required of concerns responsible for withholding.

We recognize that the underreporting of interest and dividends presents an administrative problem; however, the techniques for estimating underreporting are rough, and the Treasury's own figures suggest that progress is being made toward reducing underreporting. Further, progress toward the solution of this problem should result from the use of taxpayer account numbers and automatic data processing equipment without the undesirable side effects that would result from a withholding system for dividends and interest.

We recommend that section 19 be deleted from H.R. 10650.

DIVIDEND EXCLUSION AND CREDIT

The House version of H.R. 10650 does not propose to change the provisions of the tax code which allow (1) exclusion of the first $50 received by a taxpayer as dividends from a qualified domestic corporation and (2) a tax credit equal to 4 percent of the amount of such dividends exceeding $50. However, the Secretary of the Treasury has recommended consideration of amendments to repeal these provisions.

As a matter of principle, we believe all corporation earnings should be subject to a single Federal income tax. Earnings distributed as dividends and taxable in the hands of stockholders should be deductible in the computation of corporation taxes. We recognize that the budgetary situation precludes full adoption of this principle at this time but believe it should be a long-range objective of tax policy. In the meantime, we should not backtrack by repealing the dividend exclusion and credit enacted in 1954 as a step toward eliminating the dual taxation of corporation earnings.

The argument that these provisions remove more of the burden of double taxation for a dividend recipient in the higher brackets than for one in the lower brackets is not convincing. If the double taxation of distributed corporation earnings is wrong in principle—as we believe it to be—it is just as wrong for a taxpayer with a high income as for one with a low income.

The testimony of the Secretary of the Treasury before the Ways and Means Committee on this issue last year included a number of tables in which the "extra burden from double taxation of dividends" was computed by comparing the total taxes due under present law with the individual income taxes that would result if corporate earnings were distributed with no corporation income tax. Since the corporation income tax is higher than the lower bracket income tax rates, this technique makes it appear that the dividend exclusion and credit do little to remove the effect of double taxation in the lower income brackets.

A far different picture emerges if we start with the assumption that the purpose of the dividend exclusion and credit is to give some recognition to the fact that the corporation income tax has already been paid. While the corporation tax rate is higher than the lower bracket personal income tax rates, the dividend exclusion, at least, relieves the low income dividend recipient of the burden of having to pay a personal income tax on the first $50 of any dividends he may receive from corporations that have already paid the corporate income tax. Since a man and his wife may exclude up to $100 in dividends where both own stock or share in such ownership, repeal of the dividend exclusion would mean a tax increase of as much as $20 for many first bracket taxpayers.

It has been argued that the dividend exclusion and credit "have not proved effective in encouraging additional capital investment." It would be difficult either to prove or disprove this statement conclusively. It is, however, fairly well known that the number of persons owning stock has been increasing. We believe that the trend toward broader participation of the general public in the ownership of industry is desirable and that it has been encouraged by the dividend exclusion and credit. We would stress, however, that the real issue is relief from the double taxation of income earned by corporations and distributed as dividends.

Thank you, Mr. Chairman.

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

Senator Anderson?

Senator ANDERSON. Do I understand, Mr. Shuman, you do not want that portion of the patronage dividend which is not in cash to be taxed? You only want the cash portion of the patronage dividend to be taxed?

Mr. SHUMAN. No. We favor taxing the cash portion and the noncash portion. But we would favor taxing the noncash portion in the hands of the patron only when at least 20 percent is paid in cash and there is a limit on the length of time that the remainder can remain noncash.

Senator ANDERSON. Do you believe that the average patronage dividend received by a member of a cooperative is a good piece of paper or a worthless piece of paper?

Mr. SHUMAN. Well, they run the gamut from good as gold to worthless, but I would say that the average is fairly good property.

Senator ANDERSON. Would you say that 90 percent of them are pretty good?

Mr. SHUMAN. I do not—I would not know whether 90 or 70 percent, but most of them are good.

Senator ANDERSON. Has your organization any information to show that 95 percent of them are not good?

Mr. SHUMAN. No, I would not say that—I would rather say that the majority are good.

Senator ANDERSON. Has your organization any information to show that the great proportion of them are not good?

Mr. SHUMAN. No, sir.

Senator ANDERSON. Then why do you want to limit it to just the majority? If you do not know and the organization does not know——

Mr. SHUMAN. Well, I am sure that most of the paper issued by cooperatives is worth something, but I do not know what percentage that would be.

Senator ANDERSON. Lots of people buy stocks and have dividends from those stocks, and sometimes the stocks become worthless.

Mr. SHUMAN. That is right.

Senator ANDERSON. But you do not recommend that we do not tax income from stocks, do you, because some of them become worthless?

Mr. SHUMAN. No, if it is income. Of course, you are not taxable if you do not get the income. If you do not get a dividend it is not taxable and so all we are saying is that this paper ought to be something worth something before the farmer pays a tax on it or else he should sign annually giving his consent for the money to be withheld.

Senator ANDERSON. But if he gets a piece of paper that is good, and they are presumed to be until they are proved worthless, why shouldn't he pay tax on it?

Mr. SHUMAN. Well, I think that the court decision was that if it had value then it would be taxable, but the question is whether you can determine any value for some of the paper that is issued, if it does not pay anything and there is no refund for 15 or 20 years.

Senator ANDERSON. Then the farmer is getting a pretty bad gypping, is he not, if he gets something from an organization that is not any good, and he does not get anything for 20 years?

Mr. SHUMAN. I would say in those cases where the money is withheld indefinitely, he is not helped particularly, and if he had to pay tax on it he would be penalized.

Senator ANDERSON. Therefore, that farmer cooperative does not do any good for the farmer, and if that is the majority of them or the near majority of them, then we question the validity of the farm cooperative laws.

Mr. SHUMAN. No. I think even the cooperative that paid no patronage dividends could perform a valuable service to the farmer patrons by being a competitive factor even if it did not make any profit.

Senator ANDERSON. You think it is there to compete with the regular grain elevator, that is what makes it valuable?

Mr. SHUMAN. That is, I think, perhaps, the competitive factor has a greater value to farmers than the amount of the patronage dividend.

Senator ANDERSON. I am trying to follow a little of the Farm Bureau doctrine, but that is a little hard one for me to follow.

I had one other question I wanted to ask you about here. You are opposed to the withholding of tax on dividends and interest?

Mr. SHUMAN. Yes.

Senator ANDERSON. Can you tell me the basis of that other than what you have here? Here is a program that the people estimate to bring into the Treasury from $500 to $650 million a year. Why should those of us who pay our taxes be deprived of the participation of those who do not pay their taxes? Why shouldn't they come in, too?

You recognize that if I put money into a building and loan association and it is limited to 4½ or 4¼ percent, whatever it may be, and the limit of insurance is $10,000, I get $425 of interest a year, but they only have to report if it is $600 a year. So they do not report,

and whether I am taxed depends purely upon their ability to catch me someday.

Do you think that is the best way to have income tax provisions?

Mr. SHUMAN. Well, No. 1, I think that there can be improvement in the procedure of checking up and requiring reporting on the part of those who pay the dividends. But, in principle, we are opposed to the idea of the withholding principle for any kind of dividends or interest and as far as that goes, we were opposed to withholding, on principle, on wages and salaries years ago, simply because it is our belief that a taxpayer ought to be conscious of the fact that he pays taxes; that this would be good discipline and a good brake on the cost of government, and that it ought to be something that the taxpayer is conscious of.

But, perhaps, more specifically, and a point that avoids the argument over principle, is that in the case of dividend withholding it would be so difficult, very difficult, to avoid confusion and all kinds of overlapping and injustice to many low-income people who depend upon small dividend earnings, especially in later years, because this withholding would take the use of their money away from them for a considerable length of time.

Senator ANDERSON. I, at one time, administered a sales tax for the State I live in. After the first of the year I sent out a general letter to the sales-tax payers saying that the Federal Government was making available to me the income tax reports of individual merchants. I would check them against their submitted returns.

You would be surprised how much fan mail I got enclosing checks.

Now, I just hate to assume that everybody is not honest. It would be nice to assume we all are, but if you have a system that will produce $500 million, as the Treasury says it will, I cannot see why a Farm Bureau member would be opposed to that. Some people must not be as honest as others.

Mr. SHUMAN. Well, we are not opposed to collecting taxes from everyone who owes taxes, and we would favor expansion of reporting requirements and checking the reports submitted by the cooperatives as to who got the dividends, with the new procedures that are coming into being, which will make this completely practical, so that these reported dividend payments can be checked back against the taxpayer's to see if he did report those payments, and we are not in favor of avoiding, permitting the avoidance of, the payment of taxes.

At the same time, we do not believe in withholding in principle, because not only in this case would it involve a lod of redtape and confusion and inequity, but it actually makes a large segment of the population less conscious of the fact of paying taxes.

Senator ANDERSON. I cannot see why the individual is going to worry about withholding, unless he worried about not paying taxes. I just cannot see how a bill of this nature will harm anybody, because it makes the people who are not now paying taxes start paying them. There are various and sundry ways in which they can be exempt. They can file a statement, as the Treasury pointed out. Children who have limited amounts of money can file. There is a long list of exemptions, and the banks do not file on them. The banks have machinery. It is not hard to segregate that item of interest from them.

Mr. SHUMAN. Senator, our recommendation on cooperative taxation, that the cooperative be required to pay 20 percent of the dividend in cash and to get the written consent annually of the patron member would almost automatically take care of this because at the time the 20 percent was paid by the cooperative, the report would be available and made to the Treasury.

Senator ANDERSON. I am referring to your statement where you object to withholding of tax on dividends and interest.

Mr. SHUMAN. That is right.

Senator ANDERSON. You said you were opposed to withholding taxes on wages. How has it worked out?

Mr. SHUMAN. I think it has worked out as a convenience to the taxpayer, and certainly it has worked out as a more certain way of collecting taxes for the Government, so I would agree it has worked well with the wage earners.

Senator ANDERSON. That is right. Your organization opposed it. Practice has shown that perhaps, you were wrong in opposing it. It has worked out very well. Couldn't the same thing happen on dividends and interest?

Mr. SHUMAN. It is possible, except that there is quite a bit of difference where a stockholder may have one or two shares and may not be subject to Federal income tax at all. He would have all of this redtape and trouble of having to file for a refund, which he probably would not do in many cases, and in the case of the wage earner, it is easy to determine whether or not he has tax liability in advance. It is not easy in the case of the stockholders.

Senator ANDERSON. That is why it makes it so easy to avoid it.

Mr. SHUMAN. I think that the avoidance can be eliminated if we require the cooperatives to report to the Treasury on the payments of dividends, and private corporations, too.

Senator ANDERSON. Cooperatives are not the ones that are really involved in this. You can forget all the dividends of the cooperatives, and you would not touch $600 million which the Treasury hopes to get under this other section. That is what I am worried about. The influence of the Farm Bureau was thrown against the provision for the withholding of dividends and interest, which is a very important provision of this bill.

If you take that out, and with all the other things that are in there, we will end up with a bill that produces a very substantial dividend. I do not see why we should enact a bill at all if we are going to end up in worse shape than we start out.

The only way to stay in good shape is to include those taxes that are valid, and the withholding provision, I think, is one which is good.

Mr. SHUMAN. Of course, if we eliminate the investment credit, that will offset some of the contemplated loss. However, we are not suggesting that these returns on dividends not be taxed, and if the corporations are required to report, and this is checked through by the Internal Revenue Service, it is relatively easy to see that they do pay.

Senator ANDERSON. They are required to report now, are they not?

Mr. SHUMAN. Yes; they report. But I do not think they have got all this on the IBM numbering system yet.

Senator ANDERSON. And you will not have it for several years. It is going to take maybe 10 years until it gets out to the Far West,

starting out in Atlanta and gradually spreading across the country.

If it is a good catching device, we will catch the people of Georgia first in that area. Why should not the rest of the country be caught at the same time?

Mr. SHUMAN. Well, we do not condone avoidance of taxes, but I do not believe that the avoidance here is anywhere near as great as has been portrayed in the payment of taxes on dividends.

Senator ANDERSON. You think Treasury figures are wrong on this?

Mr. SHUMAN. I think so.

Senator ANDERSON. Do you have figures that are better?

Mr. SHUMAN. We just know that the Treasury's figures are quite high, and that they are as rough as ours would be. Nobody knows.

Senator ANDERSON. I think the answer, Mr. Shuman, is that they have got facts and you have feelings on it, and there is a vast difference between the two of them.

Here is something they think is very essential. I do not care to argue whatever it is, I just wanted to be sure if that was Farm Bureau philosophy; I would hate to stand up in a Farm Bureau meeting and tell a group of farmers, "You be against withholding on interest and dividends because it will only get about $500 million to the Government, and it will be annoying to people," because the average farmer is not going to be worried by that. None that I know anything about. Unless he is producing cotton, with the very special features these days, he does not have to worry about acquiring large quantities of bonds for stocks every year.

I just do not understand the Farm Bureau's position. Here is one member of the Farm Bureau who is not for it.

Mr. SHUMAN. Well, I am sure there will be others, but I am also sure that most of them are against the principle of withholding.

Senator ANDERSON. All right.

The CHAIRMAN. Senator Carlson.

Senator CARLSON. Mr. Shuman, I was asked on behalf of the Senator from Delaware, Mr. Williams, to express his sincere regret that he had to be on the floor at this particular time.

He wanted so much to be here during your presentation. He said that he had an opportunity to read your statement before he left this morning, and he appreciated very much the comments you have made on taxing cooperatives, and the other provisions of this bill.

Mr. SHUMAN. Thank you.

Senator CARLSON. Just one or two items: Following Senator Anderson's suggestion with regard to withholding, is it not reasonable to assume that now that the Bureau of Internal Revenue has been given such sums of money to establish regional offices, with IBM equipment, our citizens have all been given social security numbers, whether they had them or not, and this session of Congress is going to increase a large number of revenue agents, that we can expect a very substantial collection of what some regard as revenue that belongs to the Government that has not been collected?

Mr. SHUMAN. Well, we think so. We think that the fact that the withholding on wages and salaries has worked out as a convenience to taxpayers, and certainly as a revenue-getter for the Government, does not necessarily mean that the withholding on dividends, patronage dividends, dividends on corporation stock, is a valid way or a good way to go about this collection.

In fact, we have entirely different sets of circumstances surrounding the two situations, and we think that the Treasury can get a high percentage of collection on dividends if these new methods are pursued, and if an effort is made.

Senator CARLSON. I was interested to read the other day a letter that had been written to persons stating that they received dividend income to the extent of $4,200 a year, a man and wife, both over 65 years of age. That would entitle them to a double exemption, or $2,400.

If you take the $50 deductible, the 4 percent off, and some other medical expenses, and their taxes were $50 a year.

But in this case, the Government would withhold $840 a year. Now, that seems unfair to me in a case of that type, and I am sure there will be many people who are elderly, people who are living on dividends and interest that they had accumulated during their lifetime. It seems to me there is a positive case of where it works a real hardship.

Mr. SHUMAN. This is certainly true, and then there is also the case of the person who only holds—and this would be most farmers—a few shares of stock, and many farmers would not be subject to income tax, especially some of the smaller farmers and the retired farmers, and would not be paying income tax otherwise.

The taxpayment would be withheld, whether it was 1 share or 20 shares, and then they would be required at the end of the year to file papers to request the repayment.

Now, we know, everyone knows, that thousands of these people would never recover this money for one reason or another, and we cannot defend this kind of a tax collection device when we know of these inequities.

Senator CARLSON. Mr. Shuman, as one who has served as secretary-treasurer and president of a county Farm Bureau, and a membership that I have maintained during my mature life, I am in your corner, I appreciate your position. I think it is sound.

Mr. SHUMAN. Thank you.

The CHAIRMAN. Senator Douglas.

Senator DOUGLAS. Mr. Chairman, I regret that I was detained on the floor and was unable to hear the direct testimony of Mr. Shuman.

Mr. Shuman is a distinguished citizen of Illinois. I regret that we do not always think alike on farm policy, but he is an honorable man and deeply respected by everyone.

I regret that he is opposed to withholding of dividends and interest, but I do not expect to convert him this afternoon, so I shall not ask any questions.

Mr. SHUMAN. Thank you, Senator.

The CHAIRMAN. Senator Curtis.

Senator CURTIS. Mr. Shuman, you suggested that consent should be required of the patron to reuse his money if it was going to be deductible to the cooperative.

Now, you would limit the choice of the patron to accept the 20 percent cash and the balance in scrip under the conditions you outline, and agree that it was taxable to him or forfeit the entire patronage dividend?

Mr. SHUMAN. That is correct.

Senator CURTIS. Do you favor permitting the patron a choice of getting it all in cash or leaving all or any part of it with the cooperative for capital for the cooperative?

Mr. SHUMAN. It seemed to us that this should be the choice of the cooperative rather than of the patron. The board of directors of the cooperative is in better position to determine what their financial situation is, and they ought not, it seems to us, to be put in the position of being forced to offer the patrons a choice as strong as that. They could do it, of course, under our recommendation. The board of directors could offer that alternative.

Senator CURTIS. The law would not require it.

Mr. SHUMAN. We would not favor requiring it, but it certainly would be possible.

Senator CURTIS. And to require it would be out of conformity with the usual business practices for ordinary corporations.

Mr. SHUMAN. I think so. I think it would be——

Senator CURTIS. The recipient of an ordinary dividend must leave to management——

Mr. SHUMAN. Yes.

Senator CURTIS (continuing). The size of the dividends and what is to be retained.

Mr. SHUMAN. And the management or the board of directors of an ordinary corporation determines whether to declare stock dividends or cash dividends.

Senator CURTIS. I got the impression that at one time someone did advocate in connection with this bill earlier that the patron be given his choice of cash or scrip.

Mr. SHUMAN. We said at one time we favored payment of tax by the patron where cash was paid or where the obligation to the patron was certain, and then we used the possibility that the patron might be given a choice between cash and scrip as an example when the obligation would be certain and this seems to have confused some people into believing that we favored such a choice as a set alternative.

But I think our position is clear now, that we favor the payment of 20 percent of the value of the paper in cash to the patron, plus getting his consent to the retaining of the balance.

Senator CURTIS. By means of an endorsement on the check?

Mr. SHUMAN. By an endorsement on the check. This will be 20 percent or more. Of course, if the cooperative wanted to pay 100 or 80 percent, it could.

Senator CURTIS. If he refuses to cash the check, then he turns down his entire patronage——

Mr. SHUMAN. Yes, sir. The amount of the refused patronage dividend would then be added to the surplus or reserves retained by the cooperative, and could be used to increase later dividends and it would be taxable in the hands of the cooperatives.

Senator CURTIS. That is all, Mr. Chairman.

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

Senator MCCARTHY. Mr. Chairman?

The CHAIRMAN. Senator McCarthy.

Senator MCCARTHY. Mr. Shuman, I call attention to your statement regarding the dividend exclusion and the dividend credit. Your statement of principles, as I understand it, is one where you would

have no corporate profits tax if you could write the tax law with reference to that form of business organization.

Mr. SHUMAN. We are opposed to the idea of double taxation, and yet we are—we did not put any statement in as to the present corporate tax in here. We have not considered it lately.

Senator MCCARTHY. In other words, you would have much the same law as applies now to cooperatives applied to corporations. There would be no tax, strictly speaking, upon the corporation profit.

You would have all the profits excepting those that are allowed as legal reserves distributed to the shareholders and they, in turn, would be taxed.

Mr. SHUMAN. No. We favor the same kind of treatment for corporations as we are suggesting for cooperatives. If the corporation retains it in the corporate structure, we would favor its taxation there, and we would favor the taxation of the dividends in the hands of the dividend holder, the stockholder, and allow a deduction for the amount of money paid by the corporation to the stockholder.

Senator MCCARTHY. That is what I thought—that was the question I asked.

Mr. SHUMAN. Yes.

Senator MCCARTHY. What is now taken off in corporate profits taxes would be left with the corporation and would be distributed.

Mr. SHUMAN. Yes.

Senator MCCARTHY. Excepting what was left as legal reserve.

What about the legal reserves that might be permitted? Would you have them taxed in the same way and at the same rates as you would have the reserves of cooperatives, retained earnings?

Mr. SHUMAN. Yes.

Senator MCCARTHY. For both?

Mr. SHUMAN. Yes, sir.

Senator MCCARTHY. At the rate of 52 percent; or would you want us to reach back and try to have these taxed as the earnings of the stockholders or the members of the cooperative?

Mr. SHUMAN. No, no. We would favor the corporate rate apply.

Senator MCCARTHY. Apply that rate to the cooperative—to any business that would have retained earnings. Would this apply to private enterprise as well? Would you allow the private enterprisers to retain certain of their earnings and have them taxed at a different rate from what their ordinary income rate might be?

Mr. SHUMAN. I do not know whether I understood that part of your question.

Senator MCCARTHY. Well, a noncooperative or a noncorporation—partnerships or single proprietorships.

Senator BENNETT. Self-employed.

Senator MCCARTHY. Yes, sir.

Would you allow him a reserve that would be taxed at a different rate?

Mr. SHUMAN. No. We would favor the one rate for the corporation.

Senator MCCARTHY. Favor the cooperative, have them set aside a reserve, but not allow the individual owner to do so. What I am getting at is, do you think you ought to have the same system of taxation for self-employed individuals, for a cooperative and a corporation,

because that seems to be clearly implied in what you say is your principle here.

Mr. SHUMAN. Yes, we are for that in principle, yes.

Senator McCARTHY. Well, would you back up all the way through, would you say that you would treat an individual, a cooperative, and a corporation exactly the same way for tax purposes?

Mr. SHUMAN. Yes, sir; except, of course, the individual would not——

Senator McCARTHY. An individual, in other words, no differentiation on the basis of the form of business organization?

Mr. SHUMAN. That is correct insofar as the treatment of dividends is concerned.

Senator McCARTHY. Thank you very much.

The CHAIRMAN. Senator Bennett.

Senator BENNETT. No questions.

The CHAIRMAN. Thank you, Mr. Shuman.

As you know, I have been a member of the Farm Bureau for many years, and I want to congratulate you on the fine work you are doing.

Mr. SHUMAN. Thank you.

The CHAIRMAN. The next witness is Mr. Elton L. Berck, National Farmers Union.

Senator CURTIS. Mr. Chairman, I would like to have the record show that Mr. Berck is president of the Farmers Union in Nebraska statewide, that he has been active in farm matters and farm legislation for a long time.

He is one of our distinguished citizens, and has rendered distinctive public service locally and statewide, as well as his appearance here.

STATEMENT OF ELTON L. BERCK, PRESIDENT, FARMERS EDUCATIONAL AND COOPERATIVE STATE UNION OF NEBRASKA; ACCOMPANIED BY WILBUR JENNY, GENERAL MANAGER, FARMERS UNION STATE EXCHANGE

Mr. BERCK. Thank you, Senator; thank you very much.

Mr. Chairman and members of the committee, I am Elton L. Berck and, as the Senator told you, president of the Farmers Union of Nebraska, and with me as a technical consultant is Mr. Wilbur Jenny, who is general manager of the Farmers Union State Exchange, a cooperative wholesale organization, which was founded back, I believe, in 1918, and with long experience in the business. He is currently general manager.

I have a very brief statement here, and we are interested particularly in the treatment proposed for the cooperative, the farm cooperative, in the taxation of patronage savings or refunds of farm cooperatives.

We sincerely appreciate the courtesy extended to us in allowing us to present Nebraska farmer opinion concerning the proposed tax revision legislation, H.R. 10650, and in particular the section treating farm cooperatives and the taxation of cooperative patronage refunds. At the outset, we would like to present a summary of the expressed opinion of some 120 local Nebraska cooperatives together with a compilation of their business activities as related to Federal income tax proposals.

We were interested from the beginning, the subject came up, in learning as to what the farmer patron of the cooperative in Nebraska felt about this situation and how the farm cooperative treated its patrons.

So we had a survey which was a post card survey going out to some 400 Nebraska farmer-owned cooperatives. This survey went out April 5. I may say the card was out April 5 and as of last Friday, we had approximately 135 cards returned, with more coming every day, my secretary tells me.

This cooperative report has been separated into three categories according to the nature of services rendered in behalf of farmer member patrons. We have used the most recent individual fiscal reports in arriving at averages for operation experience, earnings, and distribution of patronage refunds. In this summary, we have reports from cooperative marketing associations which have no field of service other than marketing grain and other products of their members.

Next, we have reports from another group of cooperatives which perform a combination of services in both marketing farmer's product and supplying needs for farm supplies of all types from fuel and oil to fertilizer, seeds, equipment, and repairs, home heating oil and home applicances, and the like.

Finally, our reports also number farm cooperative organizations, which deal only in farm suplies and offer no marketing service.

The summary report indicates the average total dollar earnings per patron for the last fiscal year, whether the earnings were refunded in cash, deferred and allocated, or recognized by issuance of added stock to the patron.

Our report indicates the average per patron earnings in total dollars for three different classes of farm cooperatives as listed and in the overall which includes all classes.

The same procedure has been followed in indicating percentage amounts of annual earnings or refunds paid in cash and deferred by class of activity and in the overall. We have not indicated percentage amounts of patronage or earnings refunds which were accounted for by issuance of new stock in the cooperatives.

Senator BENNETT. At this point, may I ask if this last statement accounts for the differences between the total of cash paid to patrons and deferred average in every case?

Mr. BERCK. Right, sir.

Senator BENNETT. Thank you.

Mr. BERCK. Cooperatives which handle grain for their patron, marketing cooperatives only, we found the total annual per patron savings, was $117. This again includes cash, deferred, stock and the like, and we found out that on the average these cooperatives paid out 48 percent of their earnings, and they deferred an average of 13.5 percent of the total savings of the patrons.

The rest was set aside, as we indicated, in other ways.

The marketing and supplying cooperatives——

Senator CURTIS. May I inquire right there——

Mr. BERCK. Yes.

Senator CURTIS (continuing). Does that include creameries of the marketing cooperative, where they have one stage of manufacture, where they manufacture——

Mr. BERCK. That is right.

Senator CURTIS. Would that come within the top group here?

Mr. BERCK. I think we are just one creamery reporting. This was a branch of the Farmers Union Cooperative, yes. That was just one creamery, yes.

Senator CURTIS. Now, this issuance of stock from a practical standpoint, how does that operate?

Mr. BERCK. Well, the issuance of stock is handled differently by different cooperatives. The creameries you were mentioning, the Farmers Union creameries, limit the ownership of stock to one share.

Senator CURTIS. I mean this difference where they paid in cash 48 percent and deferred dividends 13.5 percent, did all the rest go into the stock dividends?

Mr. BERCK. No, some were set aside in surplus and I believe a tax of the corporate rate was paid on a good share of that amount.

Senator CURTIS. So the $117 was what was earned, not what was returned either in cash or scrip?

Mr. BERCK. Exactly, exactly.

Now, the marketing and supply cooperatives, we have the lower per patron savings on the overall or in that particular group, and the total savings per patron was $79.25.

Now, this group of cooperatives also paid a slightly lower percentage of the earnings back in cash. They deferred a larger percentage, and there again the difference between that and the 100 percent would be these other amounts we were talking about a bit ago.

In the supply cooperatives only which handled the farm supplies, farm and home supplies, the per patron savings average was $52 per patron, and they paid out, their experience, they paid out, in cash to patrons an average of 42 percent, and deferred more than the other two, deferred 37 percent.

Now, in the overall, taking the 120 that were in the offices of last Friday, we had a total annual per patron savings average of $82.77, and the patron was paid in cash 43.3 percent, and there was an average deferment of those patron savings.

Now, the summary represents, to the best of our knowledge, a good cross section of Nebraska Cooperative activity at the local level both as to geographic location and types of service rendered.

It should be noted that not only are the overall savings per patron small but also that the retention of such savings by the cooperative is but slightly over 50 percent in the overall average.

We would also point out that a considerable amount of these deferred savings are evidenced to the patron by issuance of stock certificates which are negotiable within specified limitations and which do yield interest. In addition, an undisclosed number of so-called nonexempt cooperatives pay Federal income tax at the regular corporation rate on amounts of savings which are retained for necessary cash operating requirements.

Our reports from the individual cooperative do not indicate the length of time which deferred savings were to be retained or in what form the evidence of amount of deferment was conveyed to the patron.

However, from our general familiarity with the operations of farm cooperatives as member-patron, director, and board president, we feel it is safe to assume that most, if not all, of the farm cooperatives in

Nebraska do have definite provision in organization articles and bylaws establishing member approval of patronage savings deferment by the cooperative. Without exception, the reporting cooperatives indicated firm opposition to the application of a withholding tax to cooperative patronage refunds.

The opposition stems from reasons which are both valid and readily apparent.

No. 1. Patronage refunds, depending on the transaction from which they accrue, may or may not represent taxable income. As will be noted in the accompanying survey, the majority of farm cooperatives service the needs of their farmer patrons in many ways. Such items as home appliances, heating oil, and major farm equipment, for instance, are not deductible as expenditures on Federal income tax reports.

Patronage refunds on purchase of such items are not income; they are trade discounts on nondeductible purchases and the local cooperative manager, in our opinion, should not be empowered by Federal legislation to make an arbitrary decision that a tax should be withheld on such cooperative refunds.

No. 2. If such power of decision is granted to a cooperative manager or board of directors, one can only imagine the confusion and accounting involved in segregating all the different classes of patronage refunds involved in the yearly transactions of just one farm family in dealing with a combination marketing, farm, and home-supply cooperative.

No. 3. It is probable that a considerable number of Nebraska farm operators, because of continuing cost-price disadvantage, do not enjoy a taxable income level. Necessary refunding of tax overpayment because of proposed withholding of cooperative refunds and the small individual amounts involved would, we believe, result in net adverse effects on Federal income yields from such sources.

Let us say at this point that there is no major discernible disagreement among farm cooperatives regarding the rightness of the Federal taxation of cooperative savings, when such savings represent actual income.

Farmers Union of Nebraska, a major builder and promoter of farm cooperatives for half a century, has often reaffirmed support for a policy which holds that cooperative savings or refunds, when they represent actual income, should be taxable to the member patron and not to the cooperative.

A complete knowledge of the nature of the true farmer cooperative is necessary in order to understand this position.

The farm cooperative is at once the creature, the market voice, and the bargaining agency of the farmer members who organize and use its services.

The farm cooperative is an inseparable part of the farm enterprise providing a service beyond the farm gate that is just as essential to the farm operation as the tractor, the combine, or the milking machine.

Investment in a cooperative has, as its primary and overriding motive, the providing of needed services to those who invest, its members. The cooperative is not organized primarily to make a profit from serving other than members.

Whether the cooperative is a local organization serving a handful of farmers in a limited area or whether it becomes an integrated part

of a cooperative complex serving farmers in such diversified operations as marketing, purchasing supplies, processing farm crops, or in the petroleum production and refining fields, the principal and the motives are the same. The interest of the cooperative are not divisible from the interests of its member patrons. Those who set out to prove that such division exists are either uninformed or motivated by a desire to confuse the issues and destroy or cripple the cooperative.

In our opinion, the Internal Revenue Code should be amended so as to provide that all earnings of qualified cooperatives should be included in the gross income of the patrons. A prerequisite being that such earnings, where taxable, should be distributed to patrons according to preexisting obligation or as provided for in organization articles whether such distribution be in cash or in some noncash form of evidence indicating allocation and deferment.

We believe that there should be no legislative roadblocks which would prevent democratic member patron decision to reinvest patronage refunds in the capital structure of their cooperative enterprise.

There is no business enterprise which is quite so responsive to the will of those it serves as is the cooperative. It would be a comparatively simple matter for members of a cooperative which in majority opposed such action to amend their articles in a membership meeting and so make the law inapplicable to them.

This is, in our opinion, a decision that should be made by the members under clear legislative provision that cooperative earnings must be accounted for at either the patron or cooperative level annually.

History provides evidence of strong congressional support for legislation which encourages the improvement and strengthening of farmer bargaining power through the farm cooperative.

A clarification of cooperative tax liability is long overdue but allow us to express the fervent hope that future legislative action may be in continuance of this longstanding record of congressional approval and recognition of the important and unique contribution to agricultural income made by the farmer-owned cooperative enterprise.

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

Any questions?

Senator DOUGLAS. Mr. Berck, the question I am about to ask may have already been asked by the Senator from Nebraska, Mr. Curtis, and you may have answered it, but I am not quite certain that I understood the answer.

In your summary of your statement you show that the percentage of the total annual savings per patron amounted to approximately $83, and 43 percent of that was paid in cash, and 25 precent was deferred. What happened to the other 32 percent?

Mr. BERCK. The 25 percent was deferred and allocated, indicating to the patron; a certain percentage of this, as I say—it was not in our question—was issued in the form of stock. The rest, in all probability, was set into surplus to be used for operating capital on which the cooperative itself would pay the corporate income tax.

Senator DOUGLAS. That was 32 percent that was reinvested and——

Mr. BERCK. That would be the balance——

Senator DOUGLAS (continuing). As cooperative surplus?

Mr. BERCK (continuing). That would be the balance between those two; yes.

Senator DOUGLAS. Thirty-two percent?

Mr. BERCK. Yes, approximately, because we have some of this amount which was issued in stock varying according to the cooperative.

Senator DOUGLAS. Do I understand that this is already taxed at corporate rates at 52 percent?

Mr. BERCK. That is true. I believe I am safe in saying that that is taxed at the corporate rate.

Senator DOUGLAS. And you do not propose any change in this?

Mr. BERCK. No; we have not proposed any change in that.

Senator DOUGLAS. In the amount which is given to individuals in terms of scrip or stock or deferred claims or whatnot, what is the existing practice, so far as taxation is concerned?

Mr. BERCK. Well, at present that is sort of a no man's land, and that is why we feel that the present regulations require clarifications so as to indicate that this is definitely taxable at the patron level.

Senator DOUGLAS. You say it is a no man's land. Cases must have arisen at various times. Is this taxable to the cooperative at 52 percent or to the individual at individual income tax rates?

Mr. BERCK. Well, since these court cases mentioned this morning, Senator; I do not happen to be an attorney——

Senator DOUGLAS. Yes.

Mr. BERCK (continuing). But I do realize there is an area here of particular importance to the cooperative and to the Federal Government, as well.

Senator DOUGLAS. About a quarter of the income of the farm cooperatives seems to be disposed of in this fashion.

Mr. BERCK. It would appear so from our records; it would appear so.

Senator DOUGLAS. There is no prevailing practice?

Mr. BERCK. Not currently. I think that is right, is it not, Mr. Jenny?

Mr. JENNY. Yes.

Senator DOUGLAS. What does the present bill before us provide in these cases?

Mr. BERCK. The present bill provides for in this particular instance, as near as I can gather, point 1, withholding tax, which is the bone of contention on the part of our Nebraska cooperatives, at least those that I have visited with.

Point 2, the agreement or the proposal under which these earnings can be established as being taxable to the patron, either by a written addition or inclusion in the articles of the cooperative which the patron understands, or a consent, I believe both of these are proposed as it stands in the present measure, either one or the other. If a patron is not required—the patron is required to give consent unless it is set up by the articles or bylaws of the organization that he agrees to accept this as his tax responsibility.

Those are the provisions, as I understand them, in the legislation which you are considering now.

Senator DOUGLAS. What is the positon of the Farmers Union concerning (*a*) whether these deferred payments could be taxed to the member as income; (*b*) not taxed at all; or (*c*) taxed to the cooperative at corporate rates?

Mr. BERCK. To the member?

Senator DOUGLAS. Taxed to the member as individual income.

Mr. BERCK. Yes, and I might clarify that——

Senator DOUGLAS. Even though he does not yet realize cash from it.

Mr. BERCK. Right.

I might clarify that, if you will pardon this clarification. I made the point that the cooperative is the creature and the tool of the member farmers. Now, the point has been made previously in these hearings that this paper indication may or may not have value. It is our contention that this, being a part of, in a sense, the farm equipment providing him with a bargaining power, as a continued service for him and a value to him far beyond the cash indicated on the paper or scrip or whatever it may be, because the farm cooperative has provided the farmer with the only bargaining voice he has had in history and, as such, it becomes a very important and valued tool in his farm operation.

Senator DOUGLAS. I would like to ask you what is the attitude of the Farmers Union on the application of the withholding tax on individual income in the following three sets of cases: (*a*) interest upon shares of capital owned by the member; (*b*) patronage dividends distributed in cash, and (*c*) deferred payments in the form of scrip or stock?

Mr. BERCK. We have, Senator, established the position in the overall that payments to the patron may or may not represent taxable income. We made the point here in this connection that particularly in our cooperatives which have a complex service of both marketing and sales of farm supplies, home heating oil, farm appliances, and major farm equipment, so you have mingled, comingled, in this total volume of business with the cooperatives, items which do not reflect deductibles, which cannot—which shall not—which would not in any case be reflected as income to the patron.

In many cases also I believe there are some figures which indicate about 25 percent of the farmers in the Nation have realized no profit, and a larger percentage, of course, have no taxable income after deductions.

So we are of the opinion in the Farmers Union that this withholding does create in a sense for the cooperative manager a degree of decision, give him a degree of decision as to whether or not the patronage refunds can be taxable or not or are taxable. Only the patron himself will know, the patron should be provided with the responsibility of including them in his report.

(The written statement filed by Mr. Wilbur M. Jenny follows:)

STATEMENT OF WILBUR M. JENNY, GENERAL MANAGER, FARMERS UNION STATE EXCHANGE

Mr. Chairman, distinguished members of the committee: I am Wilbur M. Jenny, general manager of Farmers Union State Exchange, a regional farm supply purchasing cooperative operating primarily in Nebraska. A sincere desire to be of service to farm families in our area motivates our supply service and has prompted me to take time to present these viewpoints to you.

It appears to us that the following points should be kept in mind in considering the role of bona fide farmer cooperatives and the possible effect of proposed legislation upon the farm patrons who own these cooperatives.

1. The passage of the Capper-Volstead Act in 1922 established as national agricultural policy the right of farmers to act together in cooperative associations. The cooperative marketing act of 1926 further encouraged farmer co-

operatives by the establishment of a division in the Department of Agriculture to carry on a program of research, advisory service, and educational work to assist farmers in the field of agricultural cooperation.

2. The tremendous productivity and efficiency of American agriculture is directly traceable to its basis of freedom and self-determination of the family type farming unit.

3. That the contribution of farm cooperatives to the maintaining of economic freedom of the family farm unit is indispensable. The failures in agricultural production in Russia, China and other nations illustrates the value of political and economic freedom.

Let us consider for a moment the impact of a withholding tax on cooperatives and their patrons.

1. A withholding tax provision applied to the patronage refunds of farm cooperatives will result in a negligible amount of new revenue to the U.S. Treasury. Farmers, when operations are profitable, are reporting their cooperative patronage refund payments whether they be in cash or other negotiable form. Such payments are reported as income and are being taxed. A withholding provision would make it necessary for the farm operator operating at a loss to file for refund of patronage refunds withheld by his cooperative. He would also need to file for a refund on patronage refunds covering home living items which do not contribute to income in the farming operation. Such patronage refunds are actually a trade discount in the cost of such items. This is also true of depreciable items like machinery and equipment.

2. The history of the taxation of farmer cooperatives in Denmark indicates that farm cooperatives can adjust their operations to minimize taxable income. This has been pointed out in testimony to this and other committees in prior years. Swedish cooperatives permit the payment or allocation by qualified cooperatives to be made to the patrons, and the cooperative can then exclude such margins from their taxable net income. The patrons, however, must pay the tax whether received in cash or other form.

3. American farmers have integrated both their cooperative marketing and processing services as well as their supply purchasing services at two or three corporate levels. Will the farmer's rightful share of the profits of these various operations, capitalized by his own dollars, be taxed at each of these levels?

4. We offer no objection to the intent of the 1951 tax legislation to require inclusion of documentary patronage refunds as income. We feel, however, that farmers should retain the freedom to reinvest refunds in cooperatives in order to expand services and facilities.

A careful and detailed survey of our affiliated member cooperatives in Nebraska indicates that they are substantially producer owned and controlled. The purchasing and marketing activities are with active agricultural producers. By no means are all of the local cooperatives tax exempt, and the exempt cooperatives pay income taxes on additions to reserves and for certain income items. Democratic controls at the community level are a distinguishing characteristic of our group. We are sure that similar situations occur in other parts of the country. We submit that the self-help that a well-organized, well-managed farmer cooperative can render to farm families is not costly to the urban taxpayer.

The economic pressures on the family-type farm are tremendous. Nebraska has only 60,000 farms and ranches that produce gross income in excess of $5,000 per year. This is about one-half the number that received a comparable amount of income in 1925–29, adjusting for the decreased purchasing power of the dollar. Average farm income in 1961 was 41 percent less than for factory workers. Our farmers need encouragement in the direction of expanding their cooperative services. They must be encouraged to reinvest cooperative savings in order to provide themselves with marketing and purchasing at prices they can afford to pay. A withholding tax would be a roadblock in the way of higher administrative costs and would tend to discourage farmers from fully utilizing this important avenue of self-help. Further attempts to reach into the pockets of every citizen, into the business operations of every corporation, savings and loan association, savings bank, and farmer cooperatives should be avoided. This is a time when private enterprise and individual initiative needs to be encouraged, not impeded. Farmers as well as all U.S. citizens, are making and will continue to make just and equitable contributions to the national defense and public welfare.

Senator DOUGLAS. Well, how would this same thing apply in the case of a grain marketing cooperative?

Mr. BERCK. I think we would maintain the same position.

Senator DOUGLAS. Even though the income was derived solely from the marketing of grain, with no purchasing of oil or major farm equipment or home appliances?

Mr. BERCK. I believe we would still maintain that, because there again, in the marketing, you have a bargaining agency and, of course, this is aside from the point that you are making, that whether or not this should be—we should withhold on that. I think there again, you have this same situation, that the individual farmer, in most cases—I think I am safe in saying that most cases would have to demand a return of the amount withheld.

Senator DOUGLAS. Why, because his income would be lower?

Mr. BERCK. Right.

Senator DOUGLAS. Well, the present bill permits refunds and refunds quarterly.

Mr. BERCK. That is true.

Senator DOUGLAS. So why could he not take advantage of the escape clause?

Mr. BERCK. Well, we feel that as I indicated in the testimony, the majority—the major portion of the experience would be such that there would be more net cost involved in withholding and consequent refunding than would be experienced if the farmer himself indicated these earnings on his own report.

Senator DOUGLAS. Well, you know, I have always been engaged in a running battle with the representatives of the National Tax Equality League and various other groups, who have insisted that savings may be distributed to individual members, but first to be taxed at corporate rates, 52 percent, and then subsequently taxed at individual rates. I have always stated that these .e not profits, that these are economies effected by the individual by cooperative or marketing purchase, and that therefore they should be taxed to the individual.

Now, one reply of the Tax Equality people has been, well, that may be true theoretically, although they do not like to grant it theoretically, but in practice, as I mentioned to Mr. Voorhis this morning, some distributors are small, but I suspect it has been the practice for the recipients not to report them on their income tax statements. Therefore it is said they escape taxation.

Now, I was greatly pleased at Mr. Voorhis' statement this morning that so far as he was concerned, he favored withholding at the source to make certain that the individuals did make their payments and that in so doing this would remove one of the arguments against cooperatives that the Tax Equality people have been advancing.

I would expect that if you are successful in defeating withholding, that the Tax Equality people will then be after you to have your earnings or savings treated as corporate profits, subject to a 52-percent tax.

My own advice to you, and I think you will find that I have always been a friend of the cooperatives, my own advice to you is do not struggle for this last pound of flesh. For heaven's sake, make it possible for the income of the individuals to be taxed.

Mr. BERCK. I appreciate that statement, Senator. I think we continue to forget the Tax Equality folks continue to forget or ignore the nature of the farm cooperative.

Senator DOUGLAS. Well, I agree with you. That is the position I have always taken. But then they say in practice the individual does not pay taxes on the savings which he realizes, and from such knowledge as I have in the farm community, I am compelled to admit that in all probability, only a small fraction of the cooperative dividends actually is declared.

Now, we thought that by collection at the source or withholding at the source we would be able to meet this objection and that we could go before the country honestly saying that the individual pays his tax on these economies as they are distributed to him or promised to him.

If you say no, we will not have that, we are not going to submit to that, I think you are playing right into the hands of—I will not say your enemies, but of those who take a very different point of view on these matters than you do.

I am disappointed, really disappointed.

Mr. BERCK. I am sorry. However, I can only report my own case and the fact that I have over a period of years had patronage refunds from several different members. I have served as board member and, as I have said, as president of the board. I have served with at least several attorneys in the making or filling out of our regular income tax report. Without exception the attorney has in each case spelled out exactly to me my responsibility with regard to declaring this income that I received from my cooperative activities.

Senator DOUGLAS. Mr. Berck, I have just a final question. Is this statement of yours your personal statement or the statement of the Farmers' Union of Nebraska, or does it represent the policy of the National Farmers' Union?

Mr. BERCK. This would be the Nebraska policy. I state in here the policy established at our annual Nebraska meeting.

Senator DOUGLAS. It does not necessarily represent the policy of the National Farmers' Union?

Mr. BERCK. That is true.

Senator DOUGLAS. Do you know whether there is going to be a statement by the National Farmers' Union?

Mr. BERCK. Not oral testimony. I understand it will be written.

Senator DOUGLAS. I await that statement with interest and I hope it will be different from yours.

Senator CURTIS. Mr. Chairman, I want to continue along but I certain concur with you in the opposition to withholding. I think that will be a very expensive thing for the Treasury. They make refunds four times a year. If banks are going to be put in a position of discouraging small savings accounts it will be the little banks which do not have the automatic data processing equipment. When we consider the fact that the holder of just a few stocks has $50 exclusion, which means $100 for man and wife, the small investor is not evading tax. There has been considerable claim as to how much revenue is lost and I have never been able to have anybody substantiate it.

Just one question: How did you guess as to the proportion of farm cooperatives that are tax exempt and those that are operated in——

Mr. BERCK. About 50-50 in Nebraska, Senator, is our information.

Senator CURTIS. About half of them, then, do not seek the exemption but they just operate as any ordinary concern would do, but they do take advantage of the patronage refund.

Mr. BERCK. That is correct.

Senator CURTIS. Thank you. That is all.

The CHAIRMAN. The next witness is Mr. Harold O. Smith, Jr., executive vice president, United States Wholesale Grocers' Association, Inc.

Please proceed Mr. Smith.

STATEMENT OF HAROLD O. SMITH; JR., EXECUTIVE VICE PRESIDENT, UNITED STATES WHOLESALE GROCERS' ASSOCIATION, INC.

Mr. SMITH. My name is Harold O. Smith, Jr. I am executive vice president of the United States Wholesale Grocers' Association, Inc., a national trade organization of wholesale grocers supplying independent retailers, supermarkets, voluntary groups, and institutional accounts throughout the United States. Our association has for many years made known to the Congress our deep concern over the inequity of tax laws that permit cooperatives to retain sizable cash earnings tax free. Retained earnings by cooperatives to expand and buy up competition do not mean a savings for the consumer or improved income for the producer.

Wide use of cost-reducing systems and methods are today enabling corporate chains, cooperatives, and independent wholesale and retail distributors to supply practically the same services with much the same cost factors, operating margins, and net profit.

It can therefore be readily understood that if one segment of the food distribution system is permitted a discriminatory advantage, such as means for escaping taxes on retained earnings, all other competing systems of food distribution are severely penalized.

Food distributors who are hard pressed for the moneys necessary to keep pace with modernization and expansion needs, very logically ask the question, Why should our Federal Government permit this one competitive element, referred to as "cooperatives," to enjoy loopholes in the law and regulations that will enable them to retail all or any part of their earnings without tax obligation, thus giving them a tremendous advantage of additional tax-free working capital?

Furthermore, such escapes from tax responsibilities have reached such sizable proportions, they are bound to place a much heavier burden of taxes on the American taxpayers as a whole, and industry in particular, in order to provide the moneys necessary to meet Government expenditures.

Most cooperatives are in direct competition with the businesses on whom the Government and the Nation depend for a substantial part of employment and taxes. Unless the Congress enacts the necessary laws and provides adequate administration to require cooperatives to fully comply with the same terms of the law governing the businesses with whom they compete, the responsible business enterprises of America will continue to rapidly diminish in numbers and share of

markets. This critical situation should be of paramount concern to every Member of the Congress.

Reports from wholesale grocers in many areas of the United States show that some cooperatives are using their growing power to gain special advantages that could be in violation of the antitrust laws. This may explain the co-op interest in the provision in the 1961 omnibus farm bill which would have set up different treatment for cooperatives with respect to antitrust law violations than the application of these laws to other businesses with whom the cooperatives compete.

Many communications from wholesale grocers received by the Washington headquarters office of USWGA set forth problems resulting from cooperatives capitalizing on their tax-exemption privileges.

During the month of March 1962 we received reports from: Newburgh, N.Y.; Dublin, Ga.; Danbury, Conn.; Vicksburg, Miss.; Paragould, Ark.; Sweetwater, Tenn.; Elgin, Ill.: Darlington, S.C.; Greenville, N.C.; Danville, Va.; Weldon, N.C.: Blackstone, Va.; Stroudsburg, Pa.; Helena, Mont.; Utica, N.Y.; Houston, Tex.; Galesburg, Ill.; Beaumont, Tex.; Cameron, Tex.; Athens, Tex.; Columbia, S.C.; Rough, Tex.; Santa Cruz, Calif.; Richmond, Ky.; Stuttgart, Ark.; Tucson, Ariz.; Ocala, Fla.; and Pittsburg, Kans.

Some of the problems set forth by wholesale grocers are as follows:

A co-op in our market has grown from $10 million volume in 1958 to $77 million in 1961, and plans to do $100 million in 1962. In soliciting customers, it boasts the ability to undersell privately owned wholesale grocers because it does not have to pay taxes.

We are put at a disadvantage in competing with co-ops due to their tax advantages and their ability to borrow money from Uncle Sam at terrifically low rates of interest. In our territory, most of the retailers who are members of the co-op warehouses have their lockboxes full of coupons which they some day hope to redeem for cash, but those who have had the opportunity to cash these, find it very difficult and at the discretion of the management of the co-ops as to when they will be willing to pay off. This backlog of capital gives them an advantage in buying over wholesalers such as ourselves.

The co-op in our market has doubled its size in the last 3 years simply by keeping their earned surplus in their organization, tax free. They will continue to grow until they have put all of the taxpaying wholesale grocers out of business.

I had rather compete with all the chains than try to compete with our local co-op. The chains pay taxes the same as I do.

One wholesaler grocer sent us a brochure published by the local wholesale co-op announcing their expansion into an exceptionally large new warehouse after 15 years of operation. The independent wholesaler figured the taxes his firm had paid, commented:

If my firm had retained all or part of the Federal income taxes we have paid since 1946, we would also have a new warehouse.

The co-op growth in our market is staggering to taxpaying businessmen. We can find nothing in the Constitution to support tax exemption for any such operation, and will never be able to understand how it has existed all these years with the sanction of the courts of our land.

We can more than compete with any co-op in our State if we receive equal treatment when it comes income tax time. Their ability to retain earnings serves their growth and the retailer looks at overcharge certificates as a big bonus although it is not cash.

As is known, the list of items and commodities is long which are being taken away from independent dealers because of unfair tax advantages, Government subsidies, and inequitable buying power. The list includes: tires—automobile, truck, and tractor; home appliances; seed, field and garden; shelf hardware; roofing, metal and composition.

The loss of business to these co-ops is not because of service, etc., but is because of their basis of selling groceries under the tax shelter of the co-op. All we ask is, again, that the Government give consideration to putting in the same ground rules in the grocery co-ops that we in corporate structures are operating under from a tax standpoint. Under that basis, we will take care of ourselves and we do not ask for Government subsidy.

We therefore respectfully urge that the Congress face up to this serious problem now and delay no longer in plugging up the tax-escaping loopholes by making it necessary that cooperatives be responsible for the prompt payment of their share of the Nation's taxes on the same identical terms as those that apply to the businesses with which they compete.

With the chairman's permission, I would like to add this association's endorsement of the statement of Mr. Brady O. Bryson for the joint committee on taxation of the Milk Industry Foundation and the International Association of Ice Cream Manufacturers.

Thank you.

The CHAIRMAN. Thank you.

The next witness is Mr. Patrick B. Healy, assistant secretary, National Milk Producers Federation; accompanied by H. R. Garstang, general counsel.

STATEMENT OF PATRICK B. HEALY, ASSISTANT SECRETARY, NATIONAL MILK PRODUCERS FEDERATION; ACCOMPANIED BY M. R. GARSTANG, GENERAL COUNSEL

Mr. HEALY. Mr. Chairman, my name is Patrick B. Healy. I am assistant secretary of the National Milk Producers Federation. I have with me M. R. Garstang who is the general counsel of our federation, who will participate with me in this testimony.

The first page of my statement is a summary which I can run over rather quickly.

SUMMARY

The National Milk Producers Federation is a national farm organization representing dairy farmers and their cooperative associations.

Our bylaws require 75 percent of our board of directors to be active dairy farmers. Our statement, therefore, carries special significance, because it reflects the willingness of dairy farmers to pay tax currently and at face value on patronage allocations which they retain in their own cooperatives for use as equity capital.

We support the provisions of H.R. 10650 relating to the taxation of cooperatives.

Basically, these provisions call for a return to the principle of the 1951 law under which one tax would be collected currently on savings made by farmers when they process their own commodities through their own plants at cost.

The tax would be paid by the farmers on savings which are allocated back to them in accordance with the legal obligation of the cooperative to do so, because such allocations are in fact the property and income of the farmer and not that of the cooperative. Net margins not allocated to the farmers would be taxed as income to the cooperative at the regular corporate rate.

The federation has consistently taken the position that this is a fair solution of the cooperative tax problem. We have never asked for tax deferment, and we have helped develop legislation to end the present deferment which results from court decision.

As long as one tax is paid currently, tax legislation should not be used to meddle in the internal affairs of farmers cooperatives or to undermine unnecessarily their finances and credit.

While a withholding tax applied to patronage refunds would cause some hardship for farmers cooperatives, we are willing to go along with a general withholding provision applied across the board to corporation dividends and interest and to patronage refunds.

The lobbying sections of the bill should be extended to include also statements and communications to Government agencies promulgating regulations, which, in effect, is an extension of the legislative process.

THE FEDERATION

The National Milk Producers Federation is a national farm organization. It represents dairy farmers and the dairy cooperative associations which they own and operate and through which they act together to process and market at cost the milk and butterfat produced on their farms.

Some of these cooperatives are bargaining associations and serve as agencies through which farmers can bargain as a group for the sale of milk to the milk companies which process and distribute it. Without such associations, farmers have no group bargaining power and are in the position of having to take for their milk whatever price the dairy companies may chose to pay.

In addition to providing a measure of bargaining power with respect to prices, many of these cooperatives check the weights and butterfat tests of the milk sold by their members, thus eliminating the possibility of false or inaccurate tests and weights.

Other dairy cooperatives represented through the federation are manufacturing units. These are simply groups of farmers who, instead of selling their milk as a raw agricultural product, have organized cooperatively to manufacture it in their own plants, at cost, in order to obtain a better return by selling it in the form of finished dairy products.

THE FARMERS' VIEWPOINT

Our bylaws require at least 75 percent of the federation's board of directors to be active dairy farmers.

This is important, because H.R. 10650 would reestablish the principle of the 1951 law under which farmers would be taxed currently on patronage refunds allocated to them in the form of retained equity capital.

Arguments have been advanced to the general effect that this provision is unfair to the farmers. These arguments have often come from those who do not represent farmers and, in some cases, from processor groups whose interest in this field is adverse to that of the farmer.

Because the federation's policies do reflect the viewpoint of the active dairy farmer, our testimony carries special significance on this issue.

COOPERATIVE COMPETITION

Cooperatives have been reasonably effective in the agricultural field, as Congress intended they should be. They have made important contributions to the agricultural economy which, in turn, is an important segment of the national economy.

Cooperatives provide a brake on excessive processing and marketing margins. Whenever those margins become too high, farmers set up their own cooperative plants and perform these services for themselves at cost. Likewise, when the cost of farm supplies becomes excessive, farmers provide these supplies for themselves at cost through their own cooperatives. In many instances, costs of marketing and costs of production have been reduced significantly through the operation of farmers' cooperatives.

Cooperatives have been opposed by those who would stand to gain if farmers had no bargaining power, if they were unable to check tests and weights, and if there were no effective controls on excessive profits and margins.

The penetration by cooperatives into fields other than agriculture is quite insignificant. In most cases it is less than 1 percent of total retail sales.

THE 1951 LAW

Under the 1951 law, business enterprises operated by farmers' cooperatives are taxed on the same general basis as similar business enterprises operated by individuals, partnerships, and small corporations.

The 1951 law contemplated that one tax would be paid currently and without deferment on the net savings which farmers make when they process their own products in their own plants at cost. It was assumed at the time the law was passed that cooperative savings allocated back to them—to the farmers—in the form of retain certificates would be taxable to the farmers at full face value. The certificates were treated as a constructive receipt of cash and an investment of the patronage allocation in the equity capital of the cooperative.

The law operated as it was intended for several years, and farmers accepted it as a fair solution of the problem.

Subsequent court cases upset the theory of the 1951 law by holding that retain certificates are taxable to farmers at market value rather than face value. This results in some cases in a deferment of the single tax.

Cooperatives and their patrons recognize that this deferment is not in accord with the principle of the 1951 law. The federation and other cooperative groups began work immediately on drafts of legislation to eliminate it.

The federation itself developed a draft which was submitted to the joint congressional staff and to the Ways and Means Committee several years ago. We also worked with other groups and with the joint staff on other drafts.

We have opposed legislation on this question which was not limited to the collection of taxes but which went further and interfered unnecessarily with the financing and credit of cooperatives.

President Kennedy's tax message recommended a return to the principle of the 1951 law as a fair solution of the cooperative tax issue. This was coupled with a recommendation for a withholding tax on dividends, interest, and patronage refunds.

Our board of directors approved the President's recommendation, and we supported it at the hearings before the Ways and Means Committee.

The Department of Agriculture working with the federation and other cooperative groups developed a revision of the Ways and Means Committee's discussion draft. The revised draft was acceptable to the Department of Agriculture, the Treasury Department, and the cooperative groups. The Ways and Means Committee incorporated most of the proposed revisions in the bill reported and passed in the House.

We support the cooperative tax provisions of the bill now pending before the committee.

I might add here, Mr. Chairman, that this revised draft had as one of its most important features the bylaw consent provisions which are contained in the bill which is now before you.

This was the thing that all of us accepted as the proper way to solve this problem, and it is toward that part of the bill that we direct our greatest support.

WITHHOLDING TAX

The proposed withholding tax will present some very real problems to farmers' cooperatives, especially those trying to get started or those trying to expand. And there are many reasons why patronage refunds, which in effect are a part of the farmer's gross selling price, should not be treated in the same manner as corporate dividends, which are distributions of net profit. We would very much prefer to let farmers themselves solve the matter of how much cash they want their own cooperatives to distribute in order to provide funds for taxes.

Nevertheless, we have weighed all these matters, and we are prepared to go along with a general withholding tax applied across the board to dividends, interest, and patronage refunds. This we will do because we believe the present tax deferment resulting from the court cases should be corrected and we think acceptance of the withholding tax may help get the matter settled. Once settled, we are hopeful that it will stay settled for many years, and this in itself will be helpful.

We would oppose a withholding tax applied to patronage refunds only and not to corporate dividends and interest as well.

The rest of this statement has to do with another part of the bill, section 3 of the bill. I would like to have it filed, but my main interest in being here is to discuss the co-op tax provisions.

The CHAIRMAN. You want it printed in the record?

Mr. HEALY. Yes, sir.

Senator BYRD. Without objection.

(The material referred to follows:)

LEGISLATIVE EXPENSES

Section 3 of the bill (p. 25) would permit deductions for expenses incurred in presenting statements and communications to Congress.

The right to petition Congress is one of our most important rights. In the case of statements, these are presented to congressional committees at the general invitation or request of the committee. The statements provide valuable information concerning the effect of proposed legislation on a particular industry, and the hearings afford affected industries an opportunity to be heard in connection with pending legislation. The hearings and the statements are an important part of our democratic legislative process.

Deductions for lobbying expenses are being denied on the basis of court decisions holding that the expenditures involved in those cases were not in the public interest. Certainly that argument is not valid against expenditures of the type mentioned above, and legislation is urgently needed to straighten out this incongruous situation.

A similar situation exists in the Government agencies when regulations which are legislative in character are promulgated. In many cases, a hearing is provided and affected industries are invited to present statements. Expenses incurred in such hearings are being treated as lobbying expenses, and deduction is being denied on the ground that such expenditures are not in the public interest. The same rule should apply to agency hearings as applies to congressional hearings.

We recommend that section 3 of the bill be amended to include a deduction for expenses incurred in presenting statements and communications to Government and State agencies.

It should also be made clear in the bill, or in the report, that expenses incurred in litigation before the courts are not to be denied deduction on the ground that they are lobbying expenditures.

We believe it would be in order, also, in the bill, or in the report, to distinguish between professional lobbying and professional public relations groups and such organizations as trade associations and farm organizations which present to Congress only the policies of their members. General eductional material of the latter organizations should not be denied a deduction even though in some cases it may be related to legislation.

In conclusion, we express again our sincere appreciation for the important privilege of appearing before this committee.

Mr. HEALY. Just one other thing, after we developed our policy regarding cooperative taxes this spring, it has been my privilege to talk to many members of our association around the country. To a very large degree, these people have reflected the viewpoint just set forth here by Senator Douglas.

The CHAIRMAN. Thank you very much.

Any question?

Senator CARLSON. You have a very fine group of cooperatives in the State of Kansas. They have visited with me and I think expressed their viewpoint. I was very much interested in the point you stressed, that you think it will be a bylaw consent.

Mr. HEALY. Yes, sir. You see, if we had to obtain individual consents from great numbers of farmers it would result in unequal treatment of members and go a great way toward breaking up the cooperatives.

Irrespective of many things that have been done for farmers, the farm legisation and everything else, the most enduring structure that farmers have is their cooperative, because it is a tool they use, you see, to improve their own position.

Senator CARLSON. That is all, Mr. Chairman.

The CHAIRMAN. Thank you very much. The Chair submits for the record a statement of Angus McDonald in behalf of the National Farmers Union.

(The statement referred to follows:)

STATEMENT OF ANGUS MCDONALD, ASSISTANT DIRECTOR, DIVISION OF LEGISLATIVE SERVICES OF THE NATIONAL FARMERS UNION, PERTAINING TO THE TAXATION OF FARMER COOPERATIVES

Mr. Chairman and members of the committee. from time immemorial the farmer has been victimized in the marketplace by unscrupulous individuals who by means of their economic power forced him to sell at low proces. In many instances these prices were below cost of production. Others who sold the farmer machines, materials, and other items necessary to farm production exacted as high a price as possible from him. Both those buying from and selling to the farmer pooled their economic power and joined in conspiracies to destroy competition.

The result of such activities was to deprive the farmer of fair prices for his products and to force him to pay privately administered prices which because they were controlled by giant corporations resulted in a disproportionate share of the Nation's income going into the pockets of speculators, processors, and middlemen, and manufacturers in the durable-goods industries. In order to protect themselves from the predatory activities of such groups, farmers organized themselves into cooperatives to pool their buying and selling power.

The organized marketing cooperatives which would enable them to get better prices for their grain, their milk, and other commodities. They organized supply cooperatives so they could collectively buy in large quantities at wholesale prices. They built grain elevators and other facilities which enabled them to hold their grain and other commodities off the market until a better price could be obtained. Historically, farmers marketing individually were an easy prey to speculators who at harvesttime, when the market was glutted, bought farm commodities at bankrupt prices and resold the commodities at double the price paid in a few months.

One of those groups who fattened on the economically defenseless farmer was the Minneapolis Chamber of Commerce whose nefarious activities were brought to light by the Federal Trade Commission. The Commission, in its complaint issued on December 28, 1923, proved that this group had deliberately set out to destroy the Equity Cooperative Exchange, a cooperate in Minnesota. It had denied farmers access to the market, it had engaged in a campaign of vilification, deception, and in other activities in violation of our antitrust laws.

The activities of such groups were repeated all over the United States wherever and whenever farmers attempted to improve their bargaining power. But the farmers' cooperative movement could not be destroyed even though members of cooperatives were harassed, persecuted, jailed, and publicly exhibited in handcuffs. No trick was overlooked; every tactic imaginable was used to destroy the cooperative movement.

This great movement sprang from the grassroots. It was as much a part of the life of a farm family as its church, as its participation in a farm organization. In the words of C. E. Huff, one of the great elder statesmen of the National Farmers Union:

"The movement of cooperative marketing sprang from the soil; it was nurtured in farm homes; it was discussed and developed in 10,000 country schoolhouses under the dim lights of kerosene lamps after the day's work in the field had been done. Patiently it has put just the necessary laws upon the statute books of the States and the Nation to protect the rights of the producers in the marketplaces. It furnished the entire capital for the earlier enterprises; it made its mistakes and out of the integrity of the movement and of the men and women who make it up, it paid honestly and in full for its mistakes."

Huff had reason to know intimately and feel deeply about cooperatives. He had suffered economic privation and had seen them come in Kansas as economic saviors to the farmers. As State president he reported in 1927 that there were 600 or 700 local units, elevators, creameries, livestock shipping associations, and retail stores locally owned in Kansas and that the whole group was joined or centralized through statewide units.

To save farmers from unwise interpretations and applications of our antitrust laws, State legislatures and the Congress turned their attention to legislation which would permit farmers to organize for their own benefit as did members of labor unions, trade associations, and stockholders in corporations. As a result laws were passed by the States and the Federal Government legalizing cooperatives and defining their duties. The distinction between the farmer cooperative, a nonprofit corporation, and the profit corporation was made clear.

Under the Capper-Volstead Act farmers were encouraged to pool their economic resources to obtain fair prices for their commodities. It was made clear however that cooperatives were subject to the antitrust laws. They could not restrain trade, use coersive methods or raise prices unduly. Because the Secretary of Agriculture was familiar with farm problems this law as administered by the Department of Agriculture.

Enemies of farmer cooperatives frustrated by the new policies designed to encourage, protect, and strengthen farm cooperatives decided to attack them from another direction. If they could not destroy them by misrepresentation, by marketplace chineanery and illegal coersive activities, they would tax them out of existence.

As a nonprofit institution, the cooperative usually had no profits. The patronage refund represented an overcharge when it related to a supply cooperative and and underpayment when it related to a marketing cooperative. The cooperative was merely an agent of the farmer patrons who made up its membership. If, however, the cooperative acquired a building and rented it, received interest on its reserves which might be loaned then it might have an income on such property. The patronage refund by definition could not be income to the cooperative. The patronage refund was income to the patron only; the law required that it be reported by him on his income tax return.

Enemies of cooperatives understand this fundamental principle of cooperatives but smarting from setbacks on the legislative front and frenzied by the success of the great cooperatives they established an organization financed by power companies and other monopolies dedicated to one purpose and one purpose only: the destruction of farmer cooperatives.

Thus the National Tax Equality Association was born. The NTEA conceived in Minnesota by members of the Minneapolis Grain Exchange was born in Chicago in 1943. The Farmers Union Grain Terminal Association arising from the tomb of the old Farmers Equity Exchange had alarmed the traders and speculators because of its unparalleled success as a cooperative. Since that time the NTEA has spent millions of dollars in lobbying and in other ways to discredit cooperatives by labeling them as "tax dodgers." The purpose of the NTEA is clear. Despite the patent unconstitutionality of their proposal they wish to subject the cooperatives to the 52-percent corporate income tax.

It is generally agreed that the framers of the 1951 Revenue Act intended that patronage refunds should be subjected to a single tax. This principle is also consistent with the policy statement of the National Farmers Union, the statement of the President of the United States on May 20, 1961, and the statement of the Secretary of the Treasury before the House Ways and Means Committee. We emphasize that the National Farmers Union agrees with the President and the Secretary of the Treasury that all patronage refunds, no matter in what form, should be subject to an income tax.

Much has been made of the fact that two court decisions have declared that patronage refunds were not subject to taxation because their market value could not be determined. But the question as to whether the Congress had the power to tax patronage refunds at their fair value did not arise in these cases. The courts simply found no authority in existing law to levy a tax on the refunds.

Competent legal authorities believe strongly that Congress does have authority to tax the refunds. The members of a partnership are subject to a tax on their share of distributed or undistributed margins appearing on the books of the business. In a limited partnership all members are subject to a tax even though they may have no voice in the management of the business. If a stockholder in a closed corporation receives a share of stock in lieu of a dividend he must report the face value of the stock on his income tax report even though its value cannot be measured.

The confused language relating to the taxability of patronage dividends apparently was inserted because authors of the legislation erroneously thought that "consent" determines value or that "consent" determines whether or not

the stated dollar amount of a patronage allocation should be included in the income tax of a patron. "Consent" cannot be used as a tool to determine whether or not the face value of a document should be included on a tax return. Upon analysis, the inclusion of the provisions relating to consent appear not only inconsistent with the taxing power of Congress, under the 16th amendment, but ridiculous and absurd. Leaving the matter of taxation up to the decision of the individual is a mischievous proposal which will be harmful to the Treasury Department and to farmer cooperatives.

We, therefore, recommend that all of the language relating to "qualified scrip," "unqualified scrip," and "consent" be stricken from the bill.

In regard to the treatment of patronage refunds by farmer cooperatives the following language should be inserted at the appropriate place:

"Patronage dividends: In determining the taxable income of an organization to which this part applies, there shall not be taken into account amounts paid durnig the payment period for the taxable year as patronage dividends (as defined in section 1388(a)) to the extent paid in money, written notices of allocation (as defined in section 1388(c)), or other property with respect to patronage occurring during such taxable year. For purposes of this title, any amount not taken into account under the preceding sentence shall be treated in the same manner as an item of gross income and as a deduction therefrom."

In regard to treatment of patronage refunds by the patron the following language should be inserted at the appropriate place:

"Written notice of allocation: For purposes of this subchapter, the term 'written notice of allocation' means (without regard to the terms of the document or whether or not the distributee has consented to take such document into account at its stated dollar amount) any capital stock, revolving fund certificate, retain certificate, certificate of indebtedness, letter of advice, or other written notice, which discloses to the recipient the stated dollar amount allocated to him by the organization and the portion thereof, if any, which constitutes a patronage dividend."

In regard to the inclusion of a patronage refund the following language should be inserted in the proper place:

"The written notice of allocation shall be taken into account at its stated dollar amount."

Finally, we urge the committee not to depart from the half century old congressional policy of encouraging farmer cooperatives. We think this policy has been a wise one. We have tried to indicate briefly why the farmer is entitled to help himself by strengthening his bargaining power by means of cooperatives. We fear that the bill in its present form is discriminatory and confusing. Members of cooperatives will be encouraged to patronize businesses who do not require "consent." A premium will be placed on nonmembership in a cooperative. The legislation will indirectly weaken cooperatives and thereby affect the farmer adversely.

The CHAIRMAN. Next witness, Mr. Wilfrid E. Rumble, of the National Federation of Grain Cooperatives.

STATEMENT OF WILFRID E. RUMBLE, IN BEHALF OF NATIONAL FEDERATION OF GRAIN COOPERATIVES

Mr. RUMBLE. I am Wilfrid E. Rumble, of the law firm of Doherty, Rumble & Butler of St. Paul, Minn. I represent, and this statement is presented on behalf of, the National Federation of Grain Cooperatives, a federation of 27 regional or federated grain marketing cooperatives which are farmers' marketing organizations serving approximately 2,700 local farmers' marketing associations.

I also speak on behalf of Land O'Lakes Creameries, Inc., a federation of dairy cooperatives and individual dairy farmers located in Minnesota, Wisconsin, Iowa, North and South Dakota, and a few other Western States; the Farmers Union Grain Terminal Association, a federated marketing cooperative whose members are cooperative elevator associations located principally in Minnesota, North and

South Dakota, and Montana; and the Farmers Union Central Exchange, Inc., a farmers' supply cooperative whose members are composed solely of local cooperative associations engaged in selling petroleum products and other articles used by farmers in the production of food and fibers and located principally in Wisconsin, Minnesota, North and South Dakota, and Montana. The total farmer membership of these organizations and their member associations exceeds a million farmers.

The cooperatives which I represent have appeared before this committee and the Committee on Ways and Means of the House of Representatives on several occasions during the past 15 years and have presented testimony and statements with respect to the proper and fair taxation of the earnings of farmers' cooperatives by the U.S. Government.

These statements have dealt with the nature of farmers' cooperatives, the manner in which they operate, the income tax treatment of them by Congress and the Internal Revenue Service since 1913, the volume of business done by them, the reasons why we have felt that the earnings of a farmer cooperative which are refunded to its members and patrons pursuant to a binding legal obligation created prior to the transactions out of which the earnings accrue should be taxed to the patrons and not to the cooperative, and other factors bearing upon the situation.

Perhaps the most thorough presentation in respect to the taxation of cooperatives was made during the symposium conducted by the Committee on Ways and Means of the House of Representatives in December of 1959. In the statements there filed I think this committee has the information it needs to decide the questions that may be involved here.

In testifying before the Committee on Ways and Means of the House in May of 1961, in respect to the recommendations made by the Secretary of the Treasury to that committee to implement those made by the President in his recommendations on tax revision, I said that the cooperatives I am representing today unqualifiedly support the recommendations made to that committee by the Secretary of the Treasury; that the suggestions of the Secretary were fair and reasonable; that a bill embodying those proposals will be accepted by the great majority of the farmers of this country and will be enforcible in the court and that it would end the unfortunate dilemma in which the Internal Revenue Service has found itself since the 1951 amendment of the Revenue Code and would undoubtedly result in some additional revenue for the Government.

The Secretary of the Treasury stated to the committee at that time that it was estimated that the proposed legislation would produce approximately $30 million of additional revenue.

I make the same statement to this committee on behalf of my clients, qualified only by what I shall say later in respect to the proposed withholding tax.

I propose to discuss with this committee the provisions of H.R. 10650, relating to cooperatives, and to give you the views of my clients in respect to those provisions.

The bill you have before you goes beyond the recommendations of the Secretary of the Treasury as made to the Committee on Ways and Means.

The Secretary of the Treasury then stated to the Committee on Ways and Means, referring to the recommendations of the President:

Under the recommendations, cooperatives would be allowed to deduct amounts allocated in cash or scrip as patronage dividends and the patrons would be taxable on the patronage dividends allocated to them.

See exhibit VII, attached to the Secretary's statement on recommended tax treatment which begins on page 224 of volume 1 of the hearings before the Committee on Ways and Means on the tax recommendations of the President, which hearings commenced May 3, 1961.

As passed by the House, the provisions of H.R. 10650, dealing with the taxation of cooperatives, are extremely technical and complicated. Fundamentally, however, the bill provides that the gross income of cooperatives is to be determined with patronage refunds included in it and that cooperatives may have these options:

(1) Pay income tax upon earnings at regular corporate rates, which with most cooperatives would mean a 52-percent rate; or

(2) Pay patronage refunds in cash or its equivalent, in which event the patron recipient of the refunds would include them in his gross income and the cooperative would deduct or exclude them; or

(3) Pay patronage refunds in paper, for which the patron could receive cash from the cooperative within 90 days from the date of issuance of the paper—such refunds would be included by the patron in his gross income and the cooperative could deduct or exclude them; or

(4) Secure from their patrons and members a written agreement to include in their gross income for tax purposes at face value all refunds paid to them regardless of the form in which paid; refunds paid to patrons signing such agreements would be deductible by the cooperative and taxable to the patrons; or

(5) Adopt after the date of the enactment of the Revenue Act of 1962 a bylaw providing that membership in the organization will constitute a consent by the members to take a written notice of allocation into account in making their tax returns. This consent will be effective:

(*a*) Only as to members as distinguished from nonmember patrons;

(*b*) As to a member only after he has received a written notification and copy of the bylaw, and then

(*c*) Only as to patronage of the member with the organization occurring after receipt of the notification and bylaw.

Refunds paid to a member subject to such bylaw provision would be includible by the patron in his gross income and the cooperative could deduct or exclude them.

The overall result is that patronage refunds which the patron must include in his gross income are deductible by the cooperative. All other earnings of the cooperative are subject to tax at regular corporate rates.

I would like to deal with the above alternatives in the order set forth above.

1. Under this alternative the cooperative would pay, roughly, one-half of its net earnings to the Government. It would pay the other half to its patrons or members in some form of nondeductible paper.

(All real cooperatives are required to distribute net earnings to member patrons or to both member and nonmember patrons in some form or another annually or oftener.) The cooperative could retain approximately half of its net earnings for corporate purposes.

Many people think this would prevent further expansion or improvement of facilities and thus reduce or destroy the effectiveness of the cooperative in its effort to improve the economic condition of its farmer patrons. It would make it extremely difficult for cooperatives to pay their long-term obligations to banks and others or to borrow funds on any basis. It would put a stop to revolving fund operations or at least greatly increase the revolving period, and would sharply reduce the value of cooperative paper now held by patrons or hereafter issued to them.

There are, of course, a few cooperatives which, because of the nature of their operations, do not need capital and can and do pay patronage refunds in cash, as to which the harsh results I have outlined would not apply, but they are few and far between and their earnings on the whole are not large.

2. Under this option, if the cooperative paid refunds in cash or its equivalent, it would have nothing left with which to build its capital, pay its long-term obligations or revolve its outstanding paper. It could pay part in cash and part in nondeductible paper—as to which it would pay the Government its tax. Thus the cooperative might pay no tax and the patrons pay tax upon the entire distribution, or the cooperative could pay a tax on part and the patrons a tax on the remainder.

3. The third option, the so-called 90-day paper, is, in my opinion, the equivalent of paying in cash, and really such paper would differ from a demand promissory note only with respect to the maturity date and the interest factor.

Many patrons would unquestionably present the paper for redemption, and it is too much to expect that many farmers would hold the paper if their neighbors were cashing it and thereby requiring those patrons who had not done so to maintain the cooperative for their benefit.

Furthermore, this option would result in gross discrimination between patrons in the payment of patronage refunds. Those patrons who had the interest of their cooperative at heart would hold the paper and get no cash, while those who did not—and who might not be members or even producers—would receive cash. That would not be equitable and would surely cause trouble within the cooperative.

Further, all of the disadvantages of (1) and (2) above would apply here, on the assumption that most of the 90-day paper would be presented for payment. The difficulty of managing the financial affairs of the cooperative under this option would be great. Most good managements want to known in advance of a fiscal year approximately what funds are going to be available. It is essential that they have this information. Under this option it would be impossible to estimate because none could know or even guess how much paper would be presented for payment.

4. On its face, this option, which is the written consent option, may seem to be fair and just. One could argue that if patrons believe that the net earnings of their cooperative should be taxed to them and not

to the cooperative, they have it within their power to accomplish that result by simply saying so in writing.

This sounds simple and right, but it is far from the fact. Letters to patrons would not secure even a substantial number of agreements. Most patrons could not be contacted at the office or plant of the cooperative. The only practical way to do the job would be by direct call upon the patron. Many cooperatives have more than 400 patrons—some have many thousands. The expense of direct calls would be tremendous and not all patrons could be reached. Of those reached, some would not sign the agreement.

Here again would be gross discrimination—the loyal patron reinvesting all of his refund in his cooperative at the cost of a tax to himself and none to the cooperative, the other type taking paper at no tax cost to himself but at a heavy tax cost to the cooperative.

5. The fifth option—and I might say here that if it were not for this option, what I say later in respect to this bill would not be said. We would strenuously oppose this bill if it did not contain the bylaw provision.

6. Most cooperatives with which I am familiar and their members believe as I do that the bylaw provision is a fair and practical way of solving the problem, although even that provision presents great difficulties. It would be effective only as to members, and most farmer cooperatives do a substantial business with nonmember patrons. However, the fact remains that if members of a cooperative believe in the principle we advocate, i.e., that earnings of cooperatives should be taxed to patrons, they could themselves adopt the provision, and if they did not believe in the principle they could reject it at a properly called and held meeting of which all had adequate notice.

The cooperatives I represent here have advocated for years a single tax upon the earnings of cooperatives and that this tax should be imposed at the patron level. We still believe in that principle. We recognize that as a result of court decisions the earnings of many cooperatives are not being taxed at any level. We want that situation corrected. We believe the bill under consideration will correct it, but we do not think such drastic steps need be taken to accomplish that result.

We think the statement of the Secretary of the Treasury, found in exhibit VII mentioned above, demonstrates that cooperatives differ radically from the ordinary profit corporation and also establishes that the tax treatment proposed by the Secretary would be upheld by the courts. In effect, he says that patronage refunds paid pursuant to a preexisting obligation should be deductible by the cooperative and taxable to the patron recipient regardless of the form in which paid, or, as he puts it:

> The form of a patronage dividend should not affect its tax treatment. As indicated earlier, the proposal would allow a cooperative to deduct from income and require a patron to include in income patronage dividends that the cooperative is under a legal obligation to allocate. The proposal would require this treatment regardless of whether the patronage dividend is paid in the form of cash, property or scrip. Since all of the elements which must be present for a cooperative to deduct patronage dividends paid in cash must also be present for it to deduct patronage dividends paid in scrip, there does not seem to be sufficient reason for treating the two differently. If under the terms of the cooperative's obligation to the patron the cooperative may make allocations in

scrip, the patron should be treated as having accepted the scrip, and as reinvesting it in the cooperative. The patron has, in effect, agreed to allow the cooperative to substitute one obligation for another.

I would like to say here that all of the witnesses that have appeared before you today and I think all that will appear before you today and tomorrow are in one way or another directly representing groups who will be affected by whatever action you may take in respect to this bill. The only person of whom that cannot be said, whose testimony is available to you, is that of the Secretary of the Treasury, who represents no particular group, who speaks for our President and for all of the people of the United States, and whose sole interest, I believe, is the collection of revenue which, in his opinion, should be paid to the Government. We believe the Secretary's proposal is a simple, effective way to handle the problem. Nevertheless, we believe that with the bylaw provision as it is in this bill, extended, however, so as to apply not only to members but to patrons who have notice of the provision, most cooperatives can live with the bill, and if for some reason or any reason the recommendations of the Secretary of the Treasury cannot be substituted for the provisions of the bill, rather than have the present situation continue, we would support the bill. The withholding provisions involve a somewhat different situation.

There is a wide split of opinion among taxpayers—including cooperatives and their patrons—concerning the proposed withholding tax. It will certainly be a tremendous administrative burden and an expensive one for most cooperatives. In many instances this expense will exceed the amount of tax withheld, and the combined cost and tax will cost a good deal more than the amount of the refund.

Many cooperatives have thousands of patrons, and in these and other cooperatives substantial numbers of refunds are less than $10. Frequently it will not be known at the time the tax must be withheld whether the refund is taxable to the patron or no. Even if so taxable, the patron may not owe any income tax and in those instances he will have to claim a refund if he is to recover the tax withheld by the cooperative and paid to the Government. Many patrons, if the tax withheld is small, will not bother to make the claim, and the result will be an unjust windfall for the Government.

There are other unjust attributes of the tax, but they need not be here described I think the withholding tax, however, is something we can live with provided some reasonable minimum is placed upon patronage refunds as to which the tax will apply and provided, of course, that the same withholding tax is imposed upon all corporate dividends and interest payments as is proposed for cooperatives.

I also think that all dividend and patronage distributions made by one cooperative to another should be excluded from withholding. Similarly I think all income distributions from one profit corporation to another should be excluded from withholding. If this were done, the withholding tax would, of course, be applied only at the local level, which is the point where it should attach.

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

Any questions?

Senator CARLSON. Just this, Mr. Chairman.

Mr. Rumble, I know of no one in the Nation who has had more experience with co-op taxes than you have. Is it not your opinion that in the interest of the co-ops themselves, we should pass legislation such as in this bill?

Mr. RUMBLE. You mean exactly as in this bill, or substantially?

Senator CARLSON. Substantially. You have some reservations, of course.

Mr. RUMBLE. Yes, sir; I do think it is in the interest of the co-ops to do that.

Senator CARLSON. I see also you think we should retain the bylaw consent instead of rewriting other provisions of the law.

Mr. RUMBLE. That is vital.

Senator CARLSON. Thank you.

The CHAIRMAN. Thank you, Mr. Rumble.

The next witness is Mr. Earl Blaser.

STATEMENT OF EARL BLASER, LIVE OAK, CALIF.; ACCOMPANIED BY RICHARD JOHNSEN, EXECUTIVE SECRETARY, AGRICULTURAL COUNCIL OF CALIFORNIA

Mr. BLASER. My name is Earl Blaser. I am a farmer from California. I am not a technical man in the sense of being an attorney or an accountant, so I have asked Mr. Johnsen of the Agricultural Council to appear with me if there are some questions on the technical side.

I have a report here which I will go through.

My name is Earl Blaser. I live and farm near Like Oak, Calif. I am appearing before your committee today as an individual farmer and as a representative of the Agricultural Council of California.

The Agricultural Council of California represents approximately 93,000 farmer members of 68 farmer cooperatives and their local affiliates throughout California. Speaking today, I represent these farmers and the off-the-farm businesses they own and control. In addition, I should like to speak as an individual farmer who is a member of and actively participating in several farmer marketing cooperatives. I am testifying here today primarily with respect to the provisions of section 17 of H.R. 10650 which apply to farmer cooperatives and their members.

It was initially encouraging to me to see that Congress was placing cooperatives and their members in the same section of the bill. You see, I am one of the farmers who has had to wrestle with the uncertainties and inconsistencies of our present cooperative tax laws over the past decade. I had hoped that section 17 of this bill would bring clarity and certainty to the tax treatment of proceeds of the cooperative operation at both the cooperative and member level. However, after studying the provisions of section 17 as passed by the House of Representatives it seems to me that the proposal will generate more uncertainties, more confusion, and more chaos than we have suffered over the past 10 years, and I do not believe that the clarifications requested by President Kennedy and Secretary of the Treasury Dillon will be forthcoming. Therefore we are appearing in opposition to section 17 of H.R. 10650.

Let me speak specifically about farmer marketing cooperatives, as I am most familiar with them. For farmers to get together to start a marketing cooperative or expand an existing one or, in fact, even to maintain the existing ones, requires capital—large amounts of capital in today's business world. In order to supply a major portion of this capital for his cooperative, the farmer is willing to defer the receipt of an annually determined stated per unit or percentage amount of his gross income from farm production.

In other words, using a specific example of the canning cooperative to which I belong—last year I agreed to leave with my cooperative $4.50 for capital purposes on every ton of tomatoes I delivered. The unit cost is calculated each year by the farmer board of directors and is set to cover the necessary processing and capitalization costs of the operation. The per unit deduction has no relationship whatsoever to the net earnings of the cooperative. I expect that this $4.50-per-ton retain will be revolved to me in cash in approximately 7 years. Regular revolvement of noncash allocations is customary with our farmer cooperatives.

Under current law, section 522 of the Internal Revenue Code, which will be repealed by H.R. 10650, permits the farmers' cooperative to exclude from gross income any fixed capital retains which are retained under a preexisting contract and other specific requirements. Also under present Treasury regulations, noncash allocations made by my cooperative to me as a farmer are included in my income in the year in which they are redeemed.

However, for the future, H.R. 10650 does not, to my knowledge, at either the cooperative or farmer-member level, deal with the question of fixed-per-unit retains. Obviously they cannot be classified as "patronage dividends" since they are in no way related to "net earnings." Since section 17 of the bill purports to deal with the full range of proceeds from cooperatives' operations, what will be the status of these fixed-per-unit retains if the bill is passed in its present form?

In talking with some accountants and lawyers at home, the possibility was raised that these per-unit retains would not be excludible from the cooperatives' gross income and therefore would be subject to regular corporate tax rates. We are sure that the Congress does not intend this drastic consequence, however, it is an example of the uncertainties, confusion, and chaos which forces us to oppose section 17 of the bill.

Incidentally, the use of the term "net earnings" in the definition of "patronage dividends" in the bill is foreign to my vocabulary in speaking of my cooperatives. We have always believed and practiced that the cooperative itself has no earnings, since it has a legal obligation to return all proceeds above operating costs to its farmer-members. I, as the farmer, have the earnings. At the very least, it would appear that H.R. 10650 should attempt to define the term "net earnings."

There are many other complex problems in H.R. 10650—section 17, including lack of clarity in the handling of pooling provisions, the doubling up of income tax during the transition period, and the uncertain position of federated cooperatives.

Laying aside the technical details, let us look at the realities. Our farmers and, I am sure, farmers across the Nation, are being faced with greater and greater problems in the marketing of their products.

To help themselves improve their net income, many farmers have joined together to market their products. This self-help approach to improving farm net income has for many decades been wholeheartedly endorsed by Congress, as well as by this and most preceding administrations. The effect of section 17 as written will be to discourage this longstanding congressional policy, to substantially weaken existing farmer cooperatives, and preclude the formation of new ones at a time when the greatest need exists for improved farmer bargaining power.

We believe that the longstanding congressional intent can be maintained by a simple method. Since 1957 we have had in our California State income tax laws a provision which gives the farmer the option of deferring payment of the tax on his noncash allocations until such time as he receives the cash. This has worked very satisfactorily in our State and I believe has once and for all insured the full payment of income tax on all earnings at the farmer-member level. It would also be extremely helpful to the Nation's farmers if it were incorporated in any tax legislation referring to noncash allocations from a farmer cooperative. As you can easily recognize, there is no loss of revenue nor any escape from taxation by this program. It is merely a deferral of time of payment, similar to that enjoyed by the average taxpayer who purchases Government savings bonds. It has one great advantage in that it negates the necessity for complicated legislative language during the transition period to assure that taxes are paid. In addition, it permits the individual farmer the right to continue his current method of either cash or accrual reporting and does not require him to handle noncash allocations in a different method from his normal bookkeeping practice.

Senator BENNETT. May I interrupt at this point?

Is there a revolving period in the California law?

Mr. BLASER. No.

Senator BENNETT. The co-op can keep it indefinitely if they wish?

Mr. JOHNSEN. There was no necessity, Senator, of placing one in the California law because of our revolvement period. We recognize that on a national level there might be a necessity. Therefore we are recognizing that on a 9- or 10-year basis——

Senator BENNETT. You say there was no necessity in California because of your revolvement period?

Mr. JOHNSEN. Yes, sir.

Senator BENNETT. Do you mean to say that all co-ops have a revolvement period regardless of the fact that the law does not require it?

Mr. JOHNSEN. The vast majority of them. In fact, we had a survey last September that found out that our revolvement period was approximately 4 months in our State.

Senator BENNETT. Do you have any that have no revolvement period?

Mr. JOHNSEN. There may be some that do not, but we feel the vast majority have them.

Senator BENNETT. Yet you feel the Federal law had better write it in?

Mr. JOHNSEN. We feel it would help to write it in the legislation.

Mr. BLASER. Shall I go on?

Senator WILLIAMS (presiding). You may proceed.

Mr. BLASER. Perhaps to assure that no moneys escape taxation there should be a maximum revolving period—say, 9 or 10 years—after which the farmer would be required to include the amount of his noncash allocation in his income tax for that year, in the event that it has not been redeemed by his cooperative. A time limit, in my opinion, would accomplish two things: It would assure the Government that the tax would be paid, and secondly, it would force a cooperative that may be retaining noncash allocations for an indefinite period of time into a reasonable period of revolvement.

May I hurriedly point out another area in this bill which will be detrimental to the farmer and his attempts to help himself through his cooperatives. Section 19 of the bill applies a 20 percent withholding tax on all patronage dividends. The application of a withholding tax to farmer cooperative patronage dividends would work a hardship on the individual farmers because it would require at least a 25 percent increase in retains in order for their cooperatives to have available the same amount of money to do the job for the farmer members. This would make it far more difficult for a group of farmers to organize a new cooperative. The results of such a withholding tax will unquestionably be a weakening of farmer cooperatives and a lowering of the net returns to farmer members.

I have expressed to you some of the points which I feel will work hardships on our country's farmers who are attempting to help themselves through the farmer cooperatives they own and control. I know from personal experience that without my farmer cooperatives I would be in an unfavorable bargaining position with a few big buyers. In years of large production these concerns have and I assume will continue to stop buying a particular product when they have enough for their own needs. This leaves the farmer without a home for his product. The cooperatives to which I belong, and I am sure this is true in all marketing cooperatives, provide sufficient facilities to handle all of the farmer member's products.

I belong to farmer cooperatives, and I am sure most of my fellow farmers do, for the reason that we are assured of a home for the products we produce, and we are further assured that the organization we own and control will process and market the products we produce in the most efficient manner to make possible the greatest returns. We do not feel that the U.S. Senate should adopt the provisions of H.R. 10650 which will result in hardships on all farmer cooperatives and the individual farmers who are trying to help themselves to improve their net farm income under longstanding congressional policy.

We thank you for this opportunity to testify and urge you to delete sections 17 and 19 of H.R. 10650 unless they are substantially amended to protect the farmer and his farm cooperative.

Senator WILLIAMS. Thank you, Mr. Blaser.

Excuse me. Since there is a vote on the Senate floor I must go over there immediately. I will come back after this vote if you have anything to add to your statement at that time.

HEARINGS RESUMED

Senator BENNETT (presiding). Gentlemen, I see no reason why we should not go forward with the hearings. We are here to see that everybody gets heard and I am sure Senator Byrd will agree that the

first man who comes back from the Senate vote should resume the hearing.

Senator BENNETT. Mr. Bryson, you may come forward and present your statement.

STATEMENT OF BRADY O. BRYSON, COUNSEL, JOINT COMMITTEE ON TAXATION OF THE MILK INDUSTRY FOUNDATION AND THE INTERNATIONAL ASSOCIATION OF ICE CREAM MANUFACTURERS

Mr. BRYSON. Mr. Chairman, I appear as counsel for the Joint Committee on Taxation of the Milk Industry Foundation and the International Association of Ice Cream Manufacturers.

I have a written statement which I should like to file for the record and then proceed orally to cover as much of the statement as time may permit.

Senator BENNETT. Your prepared statement will be inserted in the record following your oral presentation. Do you want to offer all the exhibits that have been attached?

Mr. BRYSON. Yes; we do.

Senator BENNETT. You want them printed in the committee's record, or do you want them in the file?

Mr. BRYSON. If it is permissible, we would like to have them in the record. Each is from an organization, not merely an individual. These are organizations that would, I think, like to be on record on this issue.

Senator BENNETT. May I reserve that decision for the time being? Not being the chairman, I hesitate to accept that much material for the record. Printing of the record is an expensive business and you must have 60 pages here.

Mr. BRYSON. Yes, sir. We represent and speak for some 175 different business organizations here today.

Senator BENNETT. This would give you a very disproportionate share of the total record.

Mr. BRYSON. I might suggest that if the chairman should rule that these materials should not be included in the record, that in any event, the list of those who have submitted these endorsements of my statement——

Senator BENNETT. I am sure that I am on safe ground in admitting those generally, copies of related letters are put into the file of the record rather than reprinted in the body. But I will withhold the decision on that and you may proceed.

Mr. BRYSON. We would be happy, certainly, to proceed in the normal fashion.

I would like to say that these endorsements of which we have been speaking come from a number of distributing and retail groups who are in competition with cooperatives in other industries such as hardware, farm implements, coal, bakery products, tobacco, grocery products, and petroleum products, so that in view of these endorsements and our own membership, our statement can be fairly taken as presenting the views of a highly representative cross section of privately owned business establishments, especially medium and smaller business establishments throughout the country.

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These are business establishments which are in daily competition with cooperative corporations. This is not competition in the operation of farms; on the contrary, it is competition in the many industrial, manufacturing, and commercial lines in which cooperatives do business today.

The basic plea which these privately owned businesses have addressed to the Congress over and over again is that when farmers or any other persons embark in cooperative form upon competitive industrial and commercial business activity, they should be required to pay the same taxes at the business level as are imposed on other business.

The proposed Revenue Act of 1962, as presently written, proceeds in exactly the opposite direction. It contains a series of complicated devices intended to excuse cooperative corporations of all but the 20-percent withholding tax, while continuing to impose the heavy burden of a 52-percent corporate income tax—as well as the 20-percent withholding tax—on their competitors.

In the case of consumer cooperatives, whose modern mercantile and food stores decorate some of the biggest shopping centers and who do a business running into many millions of dollars, the bill would not impose a penny of tax on either the cooperative or its patrons.

Proprietary business is obliged to protest this highly discriminatory treatment with all the vigor at its command; and to indicate its determination to continue to do so, if this bill is enacted in its present form, until the day comes when a more equitable basis for the relative taxation of proprietary and cooperative business is adopted.

Apart from this most extreme unfairness to competing business, the bill is also open to many other serious criticisms, of which we should like to mention a few.

The practical effect of the bill is to impose a 20-percent tax on the income of a cooperative; but in the most complicated fashion imaginable.

The bill begins with the assumption that cooperative corporations are taxable on their net earnings without adjustment by reason of any allocation or distribution to patrons out of such earnings. So far so good.

Then it eliminates from the cooperative's tax base any portion of the earnings paid to patrons in cash. This alone is a real break for cooperatives, but we have consistently indicated a willingness to live with this treatment of cash dividends.

Next, the bill eliminates in like fashion dividends paid in property, at fair market value. We can also live with this.

A third elimination is patronage dividends paid in currently redeemable scrip—and we can even go along with this.

Then, however, the bill eliminates all unpaid amounts to the extent merely allocated on the books to patrons who have given a written consent to treat such allocations as income for tax purposes, or to members who have retained memberships in the face of a bylaw which says that they have consented to such treatment.

By now the entire cooperative tax base has been effectively eliminated if the cooperative succeeds in passing the bylaw or securing the written consents.

This, of course, will be easy enough to do, primarily because the bill also imposes a 20-percent withholding tax on patronage dividends,

including unpaid allocations. Most patrons do not pay income tax at a rate appreciably higher than 20 percent. Accordingly, the patrons will not mind "consenting" since their tax on the unpaid allocations is collected from the cooperative, and nothing comes out of their pockets.

For all practical purposes, the net result is that the cooperative will pay over to the Treasury a tax measured by 20 percent of its earnings, and in most cases no other significant tax will be collected. This is anything but a fair result, but in any event the same tax could have been collected, very simply, by making the regular corporate income tax applicable to cooperatives, with a 20-percent rate, and excluding patronage dividends from patrons' gross income.

The way of reaching this result under the bill is unbelievably complicated, however, with potential trouble at every turn:

(1) It requires literally thousands of written consents from scattered customers—the status of all of which should be verified from year to year by the Internal Revenue Service since they may be revoked at any time.

(2) It requires a revision of the bylaws, with appropriate notice and action by directors, members, shareholders, et cetera, of virtually all existing cooperatives; and confirmation by the Service that this has been properly done.

(3) It opens the door, as we shall later describe more fully, to litigation on the validity and the tax effects of the so-called consents.

(4) It enlarges the administrative burden of the Service by requiring the processing, every year, of hundreds of thousands of credits or refunds due cooperative patrons, many so small as to be the source of little more than a headache.

(5) It likewise adds one more complication in the preparation of the annual tax returns of these hundreds of thousands of cooperative patrons.

(6) It creates the problem of properly treating in both cooperatives' and patrons' returns, and upon audit, those situations in which unpaid allocated amounts are not properly "qualified," whether because not redeemable in cash as specified, or because consent has not been procured as required. These problems arise at three points, not merely once, when the allocation is made; when the right to it is disposed of; and when it is paid.

(7) It makes necessary the formulation and enforcement of a whole host of special rules relating to such things as the time periods in which deductible patronage dividends and allocations must be made; the effect of pooling arrangements; the treatment of related earnings and patronage occurring in different years; special relief to the cooperative where nonqualified allocations are redeemed in later years; special provisions for dividends relating to personal goods or capital goods; for the transfer of allocation rights by gift or legacy; for the manner of paying redeemable allocations and of giving notice of the right of redemption; and so on.

Virtually all of these problem areas, many of which may never be satisfactorily administered could have been avoided, with no significant change in the taxes collected, by simply applying the corporate income tax to cooperatives at a reduced rate of 20 percent—analogous to the 30-percent rate on corporations having incomes of $25,000 or less—and excluding patronage dividends from patrons' income.

It is plain that the prime reason this was not done is that cooperatives have stubbornly refused to accept the status of taxpayers, even at a special rate; and some way had to be found to put the tax, in form at least, on somebody else, regardless of the resulting administrative headaches.

It is nothing less than shocking to realize, under a tax system in which even charities are expected to pay tax on business income, that out-and-out business corporations such as cooperatives are still unwilling to recognize an obligation to pay taxes on their own income. It is equally disturbing to see that the Congress might accommodate itself to this attitude.

Even putting the administrative problems aside, it is also plain that taxation by consent is wholly inappropriate in the present circumstances.

The draftsmen of the bill have outdone themselves to make it possible to say that all the income of a cooperative will be taxed at least once—thus appearing to plug an acknowledged loophole—while at the same time effectively limiting the tax to 20 percent and technically imposing it not on the cooperative corporation but on its customers, even though they neither possess nor enjoy the income in question. In the case of consumer cooperatives they have not even closed the loophole in this limited way.

This is done by resort to the patent fiction that the customer—who has the low tax bracket—becomes the real taxpayer, in lieu of the cooperative corporation, by consenting to become responsible for the tax. Nevertheless, we find that the cooperative actually pays the tax—which is gratuitously described as a witholding tax despite the fact that no dividend payment from which the tax might be withheld is made to the patron. Thus the patron turns out to have no tax responsibility after all; and his so-called consent is not really a consent to become a taxpayer, but simply a consent to be called the taxpayer so long as somebody else pays the tax on the income he does not receive.

The whole arrangement thus reduces itself to nothing more than a clever device whereby the cooperative corporation is allowed to borrow the low tax bracket of its typical patron, thus keeping its tax payment at a minimum regardless of the size of its income, and enabling it to avoid accepting the technical status of a taxpayer.

If two individuals were to work out a similar scheme to treat one of them—who has a low bracket and little income—as the taxpayer in respect of the income of the other, who actually keeps and uses the income, it would be considered outrageous today. If it turned out, moreover, that the high-bracket individual was also putting up the money for the tax, the arrangement would be quickly characterized as completely transparent.

It seems wrong that the Congress should lend its approvial to a plan of this kind, purporting to base tax liability on a theory of consent in circumstances where the so-called consent will not in fact result in an assumption of the real burden of any tax.

There is also a suspicious air of unreality about the manner in which the so-called consents are to be obtained. A cooperative merely passes a bylaw—which few of its hundreds of members ever read or really care about—since the cooperative will pay the tax in most

cases—to the effect that they have consented. This is enough, under the bill, to permit the cooperative corporation to use their low 20-percent bracket. The notion not only that the patrons are in fact being taxed, but also that they are willing to be taxed, on the income which the cooperative keeps seems to be a little absurd in these circumstances.

The same result will be achieved where so-called written consents are used. The bill says nothing as to their form except that they shall be written. It may be expected that for the most part they will appear in the fine print of some order form the customer dealing with the cooperative corporation is asked to sign. The right to revoke this consent will certainly not be given any prominence, if mentioned at all. Then for years afterward these so-called consents will be relied upon to justify deductions because not revoked in writing. Again, of course, most of the patrons could not care less, for the cooperative will continue to pay the tax—at 20 percent. We at least find it impossible to delude ourselves to the point of believing that such a customer has become a real taxpayer or has even expressed a real willingness to become a taxpayer.

The arrangement in the bill is ingenious—but this is a thin kind of ingenuity. The Congress has a responsibility to all taxpayers, not just to cooperatives, in this situation. Its tax policy must be nondiscriminatory and entirely fair. Above all, it cannot properly endorse devices which prevent the imposition of tax on real income in the hands of those who produce, control, and enjoy it.

There will be some patrons, of course, whose tax bracket exceeds 20 percent. Some of these, refusing to treat uncollectible book allocations as income, will discover—too late—that the cooperative had passed a bylaw or had secured their signature to a fine print consent in an order form. The sense of being trapped into a tax will bring some of them into court to protest what they regard as a pretty flimsy basis for taxation.

Ultimately some court will hold that the so-called consent in the particular case was given under such a basic misunderstanding of its significance as to deprive it of any real volition, and hence of validity; or, more generally, that the statutory structure invalidly attempts to create income where none exists.

The latter holding is already predictable, in light of the *Long Poultry Farm* case (249 F. 2d 726, 4th Cir. 1957) in which a bylaw of the cooperative provided that book allocations—

> shall have the same status as though they had been paid to the patrons in cash * * * and the patrons had then furnished corresponding amounts for capital for the association.

The patron, Long Poultry Farm, had retained its membership in light of this bylaw, and therefore had consented to this treatment fully as much as the present bill prescribes. Nevertheless the court held that it would "exalt fiction and ignore reality" to treat a book allocation as taxable income in this situation.

We do not see any sense in running headlong into litigation of this kind, either on the facts or on the law. The Congress may expect that the result of such suits will bring the Treasury and proprietary business before it again to correct the same loophole, which should not be allowed to develop for the second time. The bill contains no clear

provision to the effect that if the patron is held not taxable, the cooperative will not be allowed a deduction. Absent this, exactly the same hiatus that was created under present law by the *Long Poultry Farm* case, whereby nobody at all is taxed on income allocated on the books, may be expected.

The technicians have expressed the view that to put a saving clause in the bill to cover this situation would be a confession of doubt as to whether the so-called consents produce taxable income. The doubt is already obvious to any careful lawyer and there is nothing to be gained by playing ostrich in this respect.

We feel that the provisions in the bill are bad provisions. They are bad because they ignore the basic principles that income should be taxed to those who earn and enjoy it; and that only trouble can be expected when the law tries to treat A as the taxpayer in respect of B's income.

We believe that the only proper solution to the present problem, and the one which can be most easily administered, is to make cooperative corporations taxable like all other business corporations. If some tax subsidy is then thought necessary, let the cooperative corporation deduct distributions paid in cash, or cash equivalents other than the cooperative corporation's own indebtedness. This treatment would still give cooperatives a substantial tax advantage over their competitors, but we would go along with this concession in the interest of seeing a workable solution enacted.

Thank you.

Any questions?

Senator BENNETT. No. Do you want to rule on this question of whether to accept these letters and telegrams?

Senator WILLIAMS. I would suggest that you can submit your appendix, your telegrams to the committee for our information, but I do not think we can make it a part of the record.

Mr. BRYSON. Mr. Chairman, would it be satisfactory to include a list of the persons and organizations from whom these telegrams and letters have been received?

Senator WILLIAMS. I will accept it at this time, subject to the ruling of the chairman.

Mr. BRYSON. Thank you.

(Mr. Bryson's prepared statement, a list of associations and professional groups endorsing his statement and a list of the persons and organizations who posted the telegrams referred to above follow:)

STATEMENT OF BRADY O. BRYSON, COUNSEL, JOINT COMMITTEE ON TAXATION OF THE MILK INDUSTRY FOUNDATION AND THE INTERNATIONAL ASSOCIATION OF ICE CREAM MANUFACTURERS, ON THE TAXATION OF COOPERATIVES—SECTION 17 OF THE REVENUE BILL OF 1962

Mr. Chairman and members of the committee, I am Brady O. Bryson, a practicing attorney of Washington and Philadelphia. I appear as counsel for the Joint Committee on Taxation of the Milk Industry Foundation and the International Association of Ice Cream Manufacturers.

The Joint Committee on Taxation represents a large number of dairy product manufacturers spread across the country. Among these are some cooperatives, but we appear here for the owners of proprietary businesses.

We speak also for a substantial number of distributing and retail groups in competition with cooperatives in other industries, such as hardware, farm implements, coal, bakery products, tobacco, grocery products, and petroleum products; and we should like permission, Mr. Chairman, to insert in the record at the ap-

propriate place a series of communications from these groups endorsing what we say.

In view of these endorsements and our own memberships, our statement can fairly be taken as reflecting the views of a highly representative cross section of privately owned business establishments—especially medium and smaller sized establishments—throughout the country.

These are business establishments which are in daily competition with cooperative corporations. This is not competition in the operation of farms. On the contrary, it is competition in the many industrial, manufacturing, and commercial lines in which cooperatives do business today.

The basic plea which these privately owned businesses have addressed to the Congress over and over again is that when farmers or any other persons embark, in cooperative form, upon competitive industrial and commercial business activity, they should be required to pay the same taxes at the business level as are imposed on other business.

The proposed Revenue Act of 1962, as presently written, proceeds in exactly the opposite direction. It contains a series of complicated devices intended to excuse cooperative corporations of all but the 20-percent withholding tax, while continuing to impose the heavy burden of a 52-percent corporate income tax—as well as the 20-percent withholding tax—on their competitors.

In the case of consumer cooperatives, whose modern mercantile and food stores decorate some of the biggest shopping centers and who do a business running into hundreds of millions of dollars, the bill would not impose a penny of tax on either the cooperative or its patrons.

Proprietary business is obliged to protest this highly discriminatory treatment with all the vigor at its command; and to indicate its determination to continue to do so, if this bill is enacted in its present form, until the day comes when a more equitable basis for the relative taxation of proprietary and cooperative business is adopted.

Apart from this most extreme unfairness to competing business, the bill is also open to many other serious criticisms, of which we should like to mention a few.

1. THE BILL REPRESENTS AN UNBELIEVABLY COMPLICATED WAY TO IMPOSE A 20-PERCENT INCOME TAX ON COOPERATIVES

The practical effect of the bill is to impose a 20-percent tax on the income of a cooperative; but in the most complicated fashion imaginable.

The bill begins with the assumption that cooperative corporations are taxable on their net earnings without adjustment by reason of any allocation or distribution to patrons out of such earnings. So far, so good. Then it eliminates from the cooperative's tax base any portion of the earnings paid to patrons in cash. This alone is a real break for cooperatives, but we have consistently indicated a willingness to live with this treatment of cash dividends.

Next, the bill eliminates in like fashion dividends paid in property, at fair market value. We can also live with this.

A third elimination is patronage dividends paid in currently redeemable scrip—and we can even go along with this.

Then, however, the bill eliminates all unpaid amounts to the extent merely allocated on the books to patrons who have given a written consent to treat such allocations as income for tax purposes, or to members who have retained membership in the face of a bylaw which says that they have consented to such treatment.

By now the entire cooperative tax base has been effectively eliminated if the cooperative succeeds in passing the bylaw or securing the written consents.

This, of course, will be easy enough to do, primarily because the bill also imposes a 20-percent withholding tax on patronage dividends, including unpaid allocations. Most patrons don't pay income tax at a rate appreciably higher than 20 percent. Accordingly, the patrons won't mind "consenting" since their tax on the unpaid allocations is collected from the cooperative—and nothing comes out of their pockets.

For all practical purposes, the net result is that the cooperative will pay over to the Treasury a tax measured by 20 percent of its earnings, and in most cases no other significant tax will be collected. This is anything but a fair result, but in any event the same tax could have been collected, very simply, by making the regular corporate income tax applicable to cooperatives, with a 20-percent rate, and excluding patronage dividends from patrons' gross income.

The way of reaching this result under the bill is unbelievable complicated, however, with potential trouble at every turn.

(1) It requires literally thousands of written consents from scattered customers—the status of all of which should be verified from year to year by the Internal Revenue Service since they may be revoked at any time.

(2) It requires a revision of the bylaws, with appropriate notice and action by directors, members, shareholders, etc., of virtually all existing cooperatives; and confirmation by the Service that this has been properly done.

(3) It opens the door, as we shall later describe more fully, to litigation on the validity and the tax effects of the so-called consents.

(4) It enlarges the administrative burden of the Service by requiring the processing, every year, of hundreds of thousands of credits or refunds due cooperative patrons, many so small as to be the source of little more than a headache.

(5) It likewise adds one more complication in the preparation of the annual tax returns of these hundreds of thousands of cooperative patrons.

(6) It creates the problem of properly treating in both cooperatives' and patrons' returns, and upon audit, those situations in which unpaid allocated amounts are not properly "qualified"—whether because not redeemable in cash as specified, or because consent has not been procured as required. These problems arise at 3 points, not merely once; when the allocation is made; when the right to it is disposed of; and when it is paid.

(7) It makes necessary the formulation and enforcement of a whole host of special rules relating to such things as the time periods in which deductible patronage dividends and allocations must be made; the effect of pooling arrangements; the treatment of related earnings and patronage occurring in different years; special relief to the cooperative where nonqualified allocations are redeemed in later years; special provisions for dividends relating to personal goods or capital goods; for the transfer of allocation rights by gift or legacy; for the manner of paying redeemable allocations and of giving notice of the right of redemption; and so on.

Virtually all of these problem areas—many of which may never be satisfactorily administered—could have been avoided, with no significant change in the taxes collected, by simply applying the corporate income tax to cooperatives at a reduced rate of 20 percent (analogous to the 30-percent rate on corporations having incomes of $25,000 or less), and excluding patronage dividends from patrons' income.

It is plain that the prime reason this was not done is that cooperatives have stubbornly refused to accept the status of taxpayers, even at a special rate; and some way had to be found to put the tax, in form at least, on somebody else, regardless of the resulting administrative headaches.

It is nothing less than shocking to realize, under a tax system in which even charities are expected to pay tax on business income, that out-and-out business corporations such as cooperatives are still unwilling to recognize an obligation to pay taxes on their own income. It is equally disturbing to see that the Congress might accommodate itself to this attitude.

2. TAXATION BY "CONSENT" IS WHOLLY INAPPROPRIATE IN THE PRESENT CONTEXT

Even putting the administrative problems aside, it is also plain that taxation by consent is wholly inappropriate in the present circumstances.

The draftsmen of the bill have outdone themselves to make it possible to say that all the income of a cooperative will be taxed at least once—thus appearing to plug an acknowledged loophole—while at the same time effectively limiting the tax of 20 percent and technically imposing it, not on the cooperative corporation but on its customers, even though they neither possess nor enjoy the income in question. (In the case of consumer cooperatives they have not even closed the loophole in this limited way.)

This is done by resort to the patent fiction that the customer—who has the low tax bracket—becomes the real taxpayer, in lieu of the cooperative corporation by "consenting" to become responsible for the tax. Nevertheless, we find that the cooperative actually pays the tax—which is gratuitously described as a "withholding tax" despite the fact that no dividend payment from which the tax might be withheld is made to the patron. Thus the patron turns out to have no tax responsibility after all; and his so-called "consent" is not really a consent to become a taxpayer, but simply a consent to be called the taxpayer so long as somebody else pays the tax on the income he does not receive.

The whole arrangement thus reduces itself to nothing more than a clever device whereby the cooperative corporation is allowed to borrow the low bracket of its typical patron, thus keeping its tax payment at a minimum regardless of the size of its income, and enabling it to avoid accepting the technical status of a taxpayer.

If two individuals were to work out a similar scheme to treat one of them—who has a low bracket and little income—as the taxpayer in respect of the income of the other, who actually keeps and uses the income, it would be considered outrageous. If it turned out, moreover, that the high-bracket individual was also putting up the money for the tax, the arrangement would be quickly characterized as completely transparent.

It seems wrong that the Congress should lend its approval to a plan of this kind, purporting to base tax liability on a theory of consent in circumstances where the so-called consents will not in fact result in an assumption of the real burden of any tax.

There is also a suspicious air of unreality about the manner in which the so-called consents are to be obtained. A cooperative merely passes a bylaw—which few of its hundreds of members ever read or really care about (since the cooperative will pay the tax in most cases)—to the effect that they have consented. This is enough, under the bill, to permit the cooperative corporations to use their low 20-percent bracket. The notion not only that the patrons are in fact being taxed, but also that they are willing to be taxed, on the income which the cooperative keeps seems a little absurd in these circumstances.

The same result will be achieved where so-called written consents are used. The bill says nothing as to their form except that they shall be written. It may be expected that for the most part they will appear in the "fine print" of some order-form the customer dealing with the cooperative corporation is asked to sign. The right to revoke this consent will certainly not be given any prominence, if mentioned at all.

Then for years afterward these so-called consents will be relied upon to justify deductions because not revoked in writing. Again, of course, most of the patrons couldn't care less, for the cooperative will continue to pay the tax—at 20 percent. We, at least, find it impossible to delude ourselves to the point of believing that such a customer has become a real taxpayer or has even expressed a real willingness to become a taxpayer.

The arrangement in the bill is ingenious—but this is a thin kind of ingenuity. The Congress has a responsibility to all taxpayers, not just to cooperatives, in this situation. Its tax policy must be nondiscriminatory and entirely fair. Above all, it cannot properly endorse devices which prevent the imposition of tax on real income in the hands of those who produce, control, and enjoy it.

3. LITIGATION IS INEVITABLE, YET THE BILL DOES NOT EXPRESSLY ASSURE AT LEAST ONE TAX IF THE LITIGATION IS LOST

There will be some patrons, of course, whose tax bracket exceeds 20 percent. Some of these, refusing to treat uncollectible book allocations as income, will discover—too late—that the cooperative had passed a bylaw or had secured their signature to a "fine print" consent in an order-form. The sense of being trapped into a tax will bring some of them into court to protest what they regard as a pretty flimsy basis for taxation.

Ultimately some court will hold that the so-called consent in the particular case was given under such a basic misunderstanding of its significance as to deprive it of any real volition, and hence of validity; or, more generally, that the statutory structure invalidly attempts to create income where none exists.

The latter holding is already predictable, in light of the *Long Poultry Farm* case (249 F. 2d 726, 4th Cir. 1957) in which a bylaw of the cooperative provided that book allocations "shall have the same status as though they had been paid to the patrons in cash * * * and the patrons had then furnished corresponding amounts for capital for the association." The patron, Long Poultry Farm, had retained its membership in light of this bylaw, and therefore had "consented" to this treatment fully as much as the present bill prescribes. Nevertheless the court held that it would "exalt fiction and ignore reality" to treat a book allocation as taxable income in this situation.

We don't see any sense in running headlong into litigation of this kind, either on the facts or the law. The Congress may expect that the result of such suits will bring the Treasury and proprietary business before it again to correct the same loophole which should not be allowed to develop for the second time. In

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any event, the bill contains no clear provision to the effect that if the patron is held not taxable, the cooperative will not be allowed a deduction. Absent this, exactly the same hiatus that was created under present law by the *Long Poultry Farm* case, whereby nobody at all is taxed on income allocated on the books, may be expected to develop.

The technicians have expressed the view that to put a saving clause in the bill to cover this situation would be a confession of doubt as to whether the so-called consents products taxable income. The doubt is already obvious to any careful lawyer and there is nothing to be gained by playing ostrich in this respect.

THE PROPER SOLUTION

We feel that the provisions in the bill are bad provisions. They are bad because they ignore the basic principles that income should be taxed to those who earn and enjoy it; and that only trouble can be expected when the law tries to treat A as the taxpayer in respect of B's income.

We believe that the only proper solution to the present problem—and the one which can be most easily administered—is to make cooperative corporations taxable like all other business corporations. If some tax subsidy is then thought necessary, let the cooperative corporation deduct distributions paid in cash or cash equivalents other than the cooperative corporation's own indebtedness. This treatment would still give cooperatives a substantial tax advantage over their competitors, but we would go along with this concession in the interest of seeing a workable solution enacted.

Thank you.

ASSOCIATIONS AND PROFESSIONAL GROUPS ENDORSING THE STATEMENT OF BRADY O. BRYSON

American Association of Small Business, Inc.
American Retail Coal Association.
Civic Association of America.
Material Handling Equipment Distributors Association.
Motor & Equipment Manufacturers Association.
National Association of Flour Distributors.
National Association of Refrigerated Warehouses, Inc.
National Association of Retail Clothiers & Furnishers.
National Association of Tobacco Distributors.
National Association of Wholesalers.
Air Conditioning & Refrigeration Wholesalers.
American Research Merchandising Institute.
American Surgical Trade Association.
Appliance Parts Jobbers Association, Inc.
Association of Institutional Distributors.
Automotive Service Industry Association.
Central Supply Association.
Farm Equipment Wholesalers Association.
Federal Wholesale Druggists Association.
Flat Glass Jobbers Association.
Food Service Equipment Industry, Inc.
Hobby Industry Association of America.
Independent Shoemen.
Laundry & Cleaners Allied Trades Association.
National-American Wholesale Lumber Association.
National Association of Electrical Distributors.
National Association of Musical Merchandise Wholesalers.
National Association of Textile & Apparel Wholesalers.
National Beer Wholesalers Association.
National Building Material Distributors Association.
National Candy Wholesalers Association, Inc.
National Electronic Distributors Association.
National Food Distributors Association.
National Frozen Food Association, Inc.
National Locksmiths Suppliers Association.
National Paper Trade Association, Inc.
National Wheel & Rim Association.
National Wholesale Druggists Association.

National Wholesale Furniture Association.
Northamerican Heating & Airconditioning Wholesalers.
Optical Wholesalers National Association.
Sporting Goods Jobbers Association.
Toy Wholesalers' Association of America.
United States Wholesale Grocers Association.
Wallcovering Wholesalers Association.
Wholesale Stationers Association.
National Coal Association.
National Pickle Packers Association.
National Retail Farm Equipment Association.
Alabama Farm Equipment Association, Inc.
California Equipment Dealers Association.
Carolinas Farm Equipment Dealers' Association.
Deep South Farm Equipment Association.
Florida Retail Farm Equipment Association.
Georgia Farm Equipment Association.
Illinois Retail Farm Equipment Association.
Indiana Implement Dealers' Association, Inc.
Intermountain Association Hardware & Implement Dealers.
Iowa Retail Farm Equipment Association, Inc.
Kentucky Retail Farm Equipment Association.
Mar-Del-Va Farm Equipment Association, Inc.
Michigan Farm Equipment Association.
Mid-South Farm Equipment Association.
Mid-West Retail Farm Equipment Association.
Minnesota Implement Dealers' Association, Inc.
Mississippi Valley Farm Equipment Association.
Montana Hardware and Implement Association.
Mountain States Hardware & Implement Association.
New England Retail Farm & Power Equipment Association.
New Jersey Lawn, Industrial & Farm Equipment Dealers' Association.
New York Farm Equipment Dealers' Association.
North Dakota Implement Dealers Association.
Farm & Power Equipment Retailers of Ohio.
Oklahoma Hardware & Implement Association.
Pacific Northwest Hardware & Implement Association.
Pennsylvania Retail Farm & Industrial Equipment Association.
South Dakota Retail Farm Equipment Association.
Texas Hardware & Implement Association.
Tri-State Hardware & Implement Association.
Virginia Farm Equipment Association.
Western Retail Implement & Hardware Association.
Wisconsin Implement Dealers' Association.
National Retail Furniture Association.
National Retail Hardware Association.
Alabama Retail Hardware Association.
Arkansas Retail Hardware Association.
California Retail Hardware Association.
The Hardware Association of the Carolinas.
Connecticut Hardware Association.
Georgia Hardware Association.
Florida Hardware Association.
Illinois Retail Hardware Association.
Indiana Retail Hardware Association.
Intermountain Association.
Iowa Retail Hardware Association.
Kentucky Retail Hardware Association.
Louisiana Retail Hardware Association.
Mississippi Retail Hardware Association.
Michigan Retail Hardware Association.
Minnesota Retail Hardware Association.
Missouri Retail Hardware Association.
Nebraska Retail Hardware Association.
New England Hardware Dealers Association.
New York State Retail Hardware Association.

North Dakota Retail Hardware Association.
Ohio Hardware Association.
Pacific Southwest Hardware Association.
Pennsylvania & Atlantic Seaboard Hardware Association.
South Dakota Retail Hardware Association.
Tennessee Retail Hardware Association.
Virginia Retail Hardware Association.
West Virginia Hardware Association.
Wisconsin Retail Hardware Association.
National Retail Merchants Association.
National Selected Morticians.
National Small Business Association.
National Soft Wheat Millers Association.
National Wooden Box Association.
Taxpayers Educational Association, Inc.
Northwest Furniture Retailers Association.
Northwest Independent Dairies Association, Inc.
Northwestern Retail Coal Dealers Association.
Southern States Industrial Council.
Southern Wholesale Tobacco & Candy Association.
Southwestern Peanut Shellers Association.
Alabama Petroleum Jobbers Association.
Arkansas Oil Marketers Association.
Associated Industries of Arkansas, Inc.
Arkansas L P Gas Association.
Arkansas Wholesale Grocers Association.
Florida State Retailers Association.
Illinois Retail Merchants Association.
Indiana Bakers Association.
Iowa Associated Businessmen.
Iowa Independent Oil Jobbers Association.
Independent Grain Warehousemen's Association of Iowa.
Associated Industries of Kentucky.
Kentucky Consumer Finance Association.
Kentucky Merchants Association.
Kentucky Wholesale Grocers' Association.
Michigan Tobacco & Candy Distributors Association.
Mississippi Retail Lumber Dealers Association, Inc.
Missouri Oil Jobbers Association.
Montana Automobile Dealers Association.
Montana Wholesale Grocers Association.
North Carolina Association of Launderers & Cleaners, Inc.
Independent Livestock Marketing Association.
Ohio Petroleum Marketers Association, Inc.
Lumber Dealers Association of Western Pennsylvania.
Tennessee Wholesale Grocers Association.
Dairy Products Institute of Texas.
Wisconsin Bakers Association, Inc.
Wisconsin Retail Furniture Association.
Wisconsin Retail Lumbermen's Association.
Cairo Chamber of Commerce (Illinois).
Detroit Milk Dealers, Inc.
Food Industry Committee of Detroit.
Kansas City Livestock Exchange.
Glasco Chamber of Commerce (Kansas).
St. Joseph Livestock Exchange (Missouri).
Omaha Livestock Exchange.
South Omaha Merchants Association.
Findlay Chamber of Commerce (Ohio).
Sioux City Livestock Exchange.
Sioux City Stock Exchange.
Sioux Falls Stockmen's Exchange (South Dakota).

LIST OF PERSONS AND ORGANIZATIONS WHO POSTED TELEGRAMS

Paul L. Courtney, executive vice president, National Association of Wholesalers, 1001 Connecticut Avenue NW., Washington, D.C.

J. D. Henderson, national managing director, American Association of Small Business, Inc., 404 St. Charles Avenue, New Orleans, La., April 13, 1962.

R. J. Johanson, executive vice president, American Retail Coal Association, Chicago, Ill., April 13, 1962.

William R. Noble, secretary and counsel, Material Handling Equipment Distributors Association, 1028 Connecticut Avenue N.W., Washington, D.C., letter, April 13, 1962.

A. J. Tirri, administrative assistant, Motor & Equipment Manufacturing Association, New York, N.Y., telegram of April 13, 1962.

W. P. Tanner, chairman, committee on legislation, National Association of Flour Distributors, New York, N.Y., telegram of April 13, 1962.

Richard M. Powell, president, National Association of Refrigerated Warehouses, Inc., Tower Building, Washington, D.C., letter, April 5, 1962.

Louis Rothschild, executive director, National Association of Retail Clothiers & Furnishers, 1257 Munsey Building, Washington, D.C., letter, April 12, 1962.

Joseph Kolidny, managing director, National Association of Tobacco Distributors, New York, N.Y., telegram of April 11, 1962.

Robert L. Shannon, executive secretary, Farm Equipment Wholesalers Association, Minneapolis, Minn., telegram of April 13, 1962.

J. J. Mulrooney, executive vice president, National-American Wholesale Lumber Association, Inc., 3 East 44th Street, New York, N.Y., letter, April 13, 1962.

S. M. Van Kirk, general manager, National Building Material Distributors Association, 22 West Monroe Street, Chicago, Ill., letter, April 9, 1962.

C. M. McMillan, executive secretary, National Candy Wholesalers Association, 1343 L Street NW., Washington, D.C., letter, April 12, 1962.

Robert E. Lee Hall, vice president, National Coal Association, 1130 17th Street N.W., Washington, D.C., April 12, 1962, letter.

W. R. Moore, secretary-treasurer, National Pickle Packers Association, 430 South Second Street, St. Charles, Ill., letter of April 3, 1962.

Charles R. Frederick, executive vice president, National Retail Farm Equipment Association, 2340 Hampton, St. Louis, Mo., letter of April 5, 1962.

Derek Brooks, vice president and director of Government relations, National Retail Furniture Association, 822 LaSalle Building, 1028 Connecticut Ave NW., Washington, D.C., letter of April 12, 1962.

Russel R. Mueller, managing director, National Retail Hardware Association, 964 North Pennsylvania Street, Indianapolis, Ind., letter of April 5, 1962.

John C. Hazen, vice president (Government) National Retail Merchants Association, 801 Sheraton Building, Washington, D.C., letter of April 13, 1962.

National Selected Morticians, Chicopee, Mass., April 13, 1962, telegram.

John A. Gosnell, general counsel, National Small Business Association, 801 19th Street NW., Washington, D.C., letter of April 2, 1962.

Rondal M. Huffman, secretary, National Soft Wheat Millers Asssociation, Chicago, Ill., April 13, telegram.

H. R. Hudson, executive vice president, National Wooden Box Association, Barr Building, Washington, D.C., letter, April 11, 1962.

E. Clay Lafield, executive director, Taxpayers Educational Association, Inc., Post Office Box 9352, Allandale Station, Austin, Tex., April 12, 1962, letter.

Northwest Furniture Retailers Association, 4206 Rainier Avenue South, Seattle, Wash., April 14, 1962, telegram.

N. Herman Olson, executive secretary, Northwest Independent Dairies Association, Inc., Minneapolis, Minn., April 13, 1962, telegram.

H. Hanson, secretary, Northwesten Retail Coal Dealers Association, 1014 Fourth Avenue South, Minneapolis, Minn., April 13, 1962, telegram.

Tyre Taylor, general counsel, Southern States Industrial Council, 1103–1111 Stahlman Building, Nashville, Tenn., April 9, 1962, letter.

Patricia H. Duggan, executive secretary, Atlanta, Ga., and Wayne Wilkes, chairman, legislative committee, Memphis, Tenn., Southern Wholesale Tobacco and Candy Association, April 12, 1962, telegram.

Sydney C. Reagan, general counsel, Southwestern Peanut Shellers Association, 3840 Greenbrier Drive, Dallas, Tex., April 13, 1962, telegram.

Richard C. Belser, the Alabama Petroleum Jobbers Association, Montgomery, Ala., April 13, 1962, telegram.

Jack J. Davis, executive secretary, Arkansas Oil Marketers Association, Little Rock, Ark., April 14, 1962, telegram.

Frank W. Cantrell, executive vice president, Associated Industries of Arkansas, Inc., Little Rock, Ark., April 13, 1962, telegram.

Pat Walsh, executive secretary, Arkansas LP Gas Association, Little Rock, telegram of April 12, 1962.

William L. Humphries, executive secretary, Arkansas Wholesale Grocers Association, Little Rock, Ark., April 13, 1962, telegram.

Dallas L. Hostetler, executive director, Florida State Retailers Association, 114D South Park Avenue, Winter Park, Fla., April 12, 1962, letter.

Joseph T. Meek, president, Illinois Retail Merchants Association, 26 South Wabash Avenue, Chicago, Ill., April 9, 1962, letter.

F. A. Doll, Indiana Bakers Association, Indianapolis, Ind., April 13, 1962, telegram.

Geo. Potgeter, president, Iowa Associated Businessmen, Eldora, Iowa, April 12, 1962, telegram.

E. F. Bock, chairman, Iowa Independent Oil Jobbers Legislative Tax Committee, Garner, Iowa, telegram of April 14, 1962.

James A. Potgeter, secretary, Independent Grain Warehousemen's Association of Iowa, Eldora, Iowa, April 12, 1962, telegram.

Rayburn Watkins, Associated Industries of Kentucky, 200 West Chestnut, Louisville, Ky., April 12, 1962, telegram.

Robert E. Featherston, executive vice president, Kentucky Consumer Finance Association, Lexington, Ky., April 13, 1962, telegram.

Frank W. Sower, president, Kentucky Merchants Association, Louisville, Ky., April 12, 1962.

E. V. Inman, Jr., executive secretary, Kentucky Wholesale Grocers' Association, 137 East High Street, Lexington, Ky., April 12, 1962, letter.

Michigan Tobacco and Candy Distributors Association, Lansing Mich., April 13, telegram.

E. B. (Ted) Lemmons, executive secretary-treasurer, Mississippi Retail Lumber Dealers Association, Inc., Post Office Box 1968, Jackson, Miss., letter of April 3, 1962.

John R. Hahn, executive vice president, Missouri Oil Jobbers Association, Jefferson City, Mo., April 11, 1962, telegram.

William H. Fredericks, secretary-manager, Montana Automobile Dealers Association, Helena, Mont., April 13, 1962, telegram.

E. B. Andrus, Montana Wholesale Grocers Association, Lewistown, Mont., April 13, 1962, telegram.

Fred Dodge, executive secretary-treasurer, North Carolina Association of Launderers and Cleaners, Inc., letter of April 12, 1962.

George F. Grosjean, president, Independent Livestock Marketing Association, 2025 Riverside Drive, Columbus, Ohio, undated letter.

Sam Bohlen, president, Ohio Petroleum Marketers Association, Inc., 8 East Long Street, Columbus, Ohio, letter of April 3, 1962.

R.F. McCrea, secretary-manager, Lumber Dealers Association of Western Pennsylvania, Plaza Building, Pittsburgh, Pa., letter of April 12, 1962.

Walter R. Johnson, executive vice president, Tennessee Wholesale Grocers Association, Nashville, Tenn., April 12, 1962, telegram.

George M. Clarke, executive vice president, Dairy Products Institute of Texas, Austin, Tex., April 12, 1962, telegram.

Ray G. Schiferl, executive secretary, Wisconsin Bakers Association, Inc., 161 West Wisconsin Avenue, Milwaukee, Wis., April 12, 1962, letter.

Donald W. Hill, executive secretary, Wisconsin Retail Furniture Association, Milwaukee, Wis., April 13, 1962, telegram.

Philip O. Mork, executive vice president, Wisconsin Retail Lumbermen's Association, Tomah, Wis., April 13, 1962, telegram.

Cairo Chamber of Commerce, Cairo, Ill., April 14, 1962, telegram.

Carl F. Burger, secretary, Detroit Milk Dealers, Inc., 907 Stephenson Building, Detroit, Mich., April 5, 1962, letter.

Food Industry Committee, Detroit, Mich., April 12, 1962, telegram.

W. G. Bernhardt, secretary, Kansas City Live Stock Exchange, Omaha, Nebr., April 13, 1962, telegram.

S. L. Plush, Glasco Chamber of Commerce, Glasco, Kans., April 13, 1962, telegram.

Gene Francis, secretary, St. Joseph Live Stock Exchange, Omaha, Nebr., April 13, 1962, telegram.

R. E. Cunningham, secretary, Omaha Live Stock Exchange, South Omaha, Nebr., April 13, 1962, telegram.
South Omaha Merchants Association, Omaha, Nebr., April 11, 1962, telegram.
George D. Bradson, chairman, Taxation Committee, Findlay Chamber of Commerce, Findlay, Ohio, April 12, 1962, telegram.
Harry Gamage, secretary, Sioux City Live Stock Exchange, Omaha, Nebr., April 13, 1962, telegram.
Les Harding, secretary, Sioux Falls Stockmens Exchange, South Omaha, Nebr., April 13, 1962, telegram.

Senator WILLIAMS. Next witness, Mr. Ellis.

STATEMENT OF OTIS H. ELLIS, GENERAL COUNSEL, NATIONAL JOBBERS COUNCIL, INC.

Mr. ELLIS. My name is Otis H. Ellis. I am engaged in the general practice of law in Washington, D.C., maintaining offices at 1001 Connecticut Avenue, and am appearing here today on behalf of the National Oil Jobbers Council in my capacity as general counsel for that organization.

The National Oil Jobbers Council is a trade group composed of 33 State and regional associations of independent jobbers and distributors of petroleum products. These associations, covering 40 States, represent the greater majority of the thousands of bona fide independent petroleum jobbers in the United States. Following is a list of the member associations:

Alabama Petroleum Jobbers Association, Inc.
Arkansas Oil Marketers Association.
California Petroleum Marketers Council (Jobber Division).
Colorado Petroleum Marketers Association.
Connecticut Petroleum Association.
Empire State Petroleum Association (New York).
Florida Petroleum Marketers Association, Inc.
Georgia Oil Jobbers Association.
Illinois Petroleum Marketers Association.
Independent Oil Men's Association of New England (Maine, Massachusetts, New Hampshire, Rhode Island, and Vermont).
Independent Oil Marketers Association of Indiana, Inc.
Intermountain Oil Marketers Association (Idaho, Nevada, and Utah).
Iowa Independent Oil Jobbers Association.
Kentucky Petroleum Marketers Association (Jobber Division).
Louisiana Oil Marketers Association (Jobber Division).
Michigan Petroleum Association.
Mississippi Oil Jobbers Association.
Missouri Oil Jobbers Association.
Nebraska Petroleum Marketers, Inc.
New Mexico Petroleum Marketers Association (Jobber Division).
North Carolina Oil Jobbers Association.
Northwest Petroleum Association (Minnesota and North Dakota).
Oklahoma Oil Jobbers Association.
Oregon Oil Jobbers Association.
Pennsylvania Petroleum Association.
South Carolina Oil Jobbers Association.
South Dakota Independent Oil Men's Association.
Tennessee Oil Men's Association.
Texas Oil Jobbers Association.
Virginia Petroleum Jobbers Association.
Washington Oil Marketers Association.
Wisconsin Petroleum Association.
Wyoming Oil Jobbers Association.

Twelve thousand independent petroleum distributors represented by this organization, like other small businessmen, find themselves caught between the three-pronged pincers of big government, big labor, and big business. The tax bill before you for consideration provides little or no hope that big government is lessening its attempt to strangle this category of the business community that the Government supposedly should help. The outlook is even more dismal when we recognize that this bill is but a puppy as compared to the big dog which is yet to follow.

The independent oil jobbers will be affected—directly or indirectly—by practically every provision in the bill. Due to the limitations of time I will only dwell on those provisions which most directly affect the jobber.

This bill contains a provision for tax credits to be allowed, up to certain limits, on purchases of depreciable personal property. We are advised that the purpose of this tax credit is to serve as an inducement for the stimulation of the purchase of new equipment, thereby accelerating the manufacturing segment of our economy. For whatever it is worth to this committee, I would point out that in my considered judgment, this tax credit will not be enough to induce a single jobber to buy one item more than what he would otherwise have purchased. This is particularly true when we find that another section of the bill provides that capital gains on depreciable personal property will be treated as ordinary income.

The council heartily endorses the provision in this bill which would permit deduction of ordinary and necessary expenses incurred by a taxpayer in attempting to influence the Congress on legislation of direct interest to the taxpayer.

The average small businessman, as a general proposition, learns about legislation that affects his business through the medium of his trade organization and he likewise oftentimes must work through this trade organization to present a collective front in order that the Congress may know how certain categories of businessmen feel about legislation and the reasons why. Inasmuch as big government has seen fit to dictate the every move of a small businessman, certainly it should be considered as a normal business expense when a taxpayer must incur expenses in attempting to protect himself from this ever-increasing force.

TAXATION OF COOPERATIVES

For many years independent petroleum jobbers have been advocating that petroleum marketing cooperatives should be taxed in the same manner as other commercial enterprises with whom they compete. The rank and file of independent petroleum jobbers are to be found in the small towns and rural areas of the Nation. These are the same areas in which petroleum marketing cooperatives do the greatest portion of their business and it is for this reason that the independent marketer must take the brunt of the ever-increasing participation of cooperatives in the arena of petroleum marketing.

Let us for a moment look briefly at the cooperative history. Cooperatives originally were small organizations consisting of a group of farmers who had banded together for the purpose of providing mutual economic benefits in purchasing farm equipment, seed, and other

necessities and/or to market the production of their farms on a collective basis. In most instances, at that time, the cooperative was merely the agent of the individual farmer and any profits or savings effected through use of the cooperative agency went to the individual farmer in proportion to his patronage.

The first Income Tax Act in 1913 granted exemptions to certain organizations, including agricultural groups. The specific exemption granted to cooperatives begins with the Revenue Act of 1921. Through the years certain refinements in the tax laws, as related to cooperatives were made and there were many Treasury rulings, regulations, and judicial decisions on the subject. All of these refinements, rulings and decisions, however, had little or no effect insofar as further taxation of cooperatives was concerned, and with the income tax progressively being increased the use of the tax-exempt cooperative became more widespread as a method for doing business.

Entrepreneurs and promoters entered the field and the tax-exempt rat race was on. Cooperatives were no longer simply agents of their farmer members or patrons—they became producers, processors, refiners, wholesalers, and retailers.

In brief, they became completely integrated business entities, performing all functions of commercial corporations and with their tax-exempt advantages became a serious and signficant competitive factor in the marketplace. As a matter of fact, the farmer patrons or stockholders, in many instances, became tools of the management and were used as shock troops to help retain preferential treatment at the hands of the Congress. The situation became so acute that in 1951 the Congress made a feeble attempt to tax some of the corporate earnings at the patronage level. This change in the law was nullified by the courts with the end result that today the cooperative structure is bigger and stronger than it has ever been.

There are generally two basic types of cooperatives. One is called the tax-exempt cooperative and the other is quite improperly but commonly referred to as the nonexempt cooperative. In order to qualify as a cooperative entitled to the more liberal exemptions the cooperative corporation must conform to the following requirements:

(1) Basically, the organization must be a bona fide farmers', fruitgrowers', or like association, organized and operated on a true cooperative basis.

(2) All of the voting membership, or voting stock, must be owned by bona fide producers of agricultural products, who market their products or purchase their supplies through the cooperative.

(3) If organized on a capital-stock basis, dividends thereon shall not exceed 8 percent per annum on consideration for which the shares were issued, or the legal rate of interest of the State of incorporation, whichever is greater.

(4) The volume of business done with nonmembers must not exceed the volume of business done with members, and, as to purchasing activities, the volume of purchases made for nonmembers, who are not farmers, shall not exceed 15 percent of the total volume.

(5) In the payment and crediting of patronage funds, all patrons must be treated alike, whether they be members or nonmembers. Absolutely no preferential treatment can be given a member patron over a nonmember patron in the distribution or crediting of patronage refunds.

(6) Reserves, if any, shall be limited to those required by State law, or such as are reasonable and for any necessary purpose.

(7) Records shall be kept to show the patronage refunds and credits of all members and nonmember patrons, and also the interest of each member or nonmember in retained reserves or assets of the association.

Cooperative corporations who conform to these requirements fall within the category of tax-exempt cooperatives, and those who do not qualify fall within the nonexempt category.

As a result of these provisions of the statute, as amplified by Treasury regulations and judicial decisions, these exempt cooperatives are permitted to escape taxes not only on profits resulting from patronage distributed or allocated as patronage dividends, but also on profits distributed as dividends to stockholders and profits derived from sources other than patronage distributed or allocated as patronage dividends. About the only thing subject to tax for the tax-exempt boys are unallocated retained earnings. A review of the financial statements of several cooperatives will quickly reveal that the "retained earnings" entry provides very slim "pickings" for Internal Revenue.

The other farmers' cooperative groups which do not operate in accordance with the statute, the wholesaler, dealer-owned cooperatives, the urban consumers' cooperatives, and all other types of cooperatives which fall outside the statute, are classified as nonexempt cooperatives. They file regular corporate income tax returns and make the claim that they pay income taxes just as private corporations do. The fact of the matter is, however, that most of them pay little or none of the income taxes that an ordinary corporation would pay. As a result of a loophole created by a Treasury ruling, not by statute, income tax must be paid by a nonexempt cooperative only on such small amounts as are paid in dividends on stock and on reserves which are retained without being allocated to patrons. It is the general practice of these nonexempt cooperatives to pay out practically all profits on tax-free patronage dividends in noncash form.

Under existing law these tax-exempt cooperatives are therefore wholly exempt except for earnings which they do not pay out or allocate. Thus, even this type of cooperative can expand out of tax-free earnings. All it needs to do is establish that its earnings ultimately belong to the patron but the cash represented by such earnings can be kept indefinitely.

After reviewing the legal history as related to the practices of cooperatives, we then took a look at the amount of business being done by the major regional cooperatives handling farm supplies. We found that in dollar volume of business, petroleum products stood second on the list. Of the $1,122 million in business done by 21 of the principal regional cooperatives of the United States in 1959, and I might add that those are the latest figures available from the Department of Agriculture, petroleum products represented $332 million or 29.6 percent of the total. This was a 6.3 percent increase over the preceding year.

Looking further into the specifics of those cooperatives which compete in petroleum marketing, we found that many of these regional cooperatives were engaged in producing, transporting, and refining crude oil, as well as in the handling of the wholesale and retail distribution of the products therefrom.

One glaring example is the Consumers Cooperative Association with headquarters in Kansas City, Mo. This group was organized with relatively small capital in 1929. By August of 1959, it was serving 1,684 local and regional member associations. This little farmer-owned cooperative has three refineries, many producing oil wells, 935 miles of pipeline, 19 warehouses and terminals, 106 highway transports, and a net worth at the end of 1959 amounting to $54,594,584. In 1959 out of a total of $153 million total business, petroleum products accounted for $96 million, and tires, tubes, and auto accessories accounted for another $8 million.

Interpolating, I might add that in addition to these special tax privileges which they have enjoyed and which has enabled them to grow to this vast state of wealth, they have also had the benefit of the depletion allowance and the intangible drilling costs, deductions which many of my members feel is about equivalent to a license to steal and some of them think it is even better.

Another example is the Farmers Union Central Exchange, Inc., with headquarters in St. Paul, Minn., organized in 1931. In 1959 petroleum marketing cooperatives it became quite obvious that these nearly $92 million. Another little farmer-owned cooperative is the Illinois Farm Supply Co., with headquarters in Chicago. In 1959 petroleum products accounted for $36 million of its total volume of $76 million. Another is the Indiana Farm Bureau Cooperative Association, Inc. In 1959 petroleum products accounted for $23 million of its nearly $67 million total business.

After reviewing partial financial statements of these and many other petroleum marketing cooperatives it became quite obvious that these were corporations organized for profit and bore no resemblance to the original cooperative concept or the concept that cooperatives are simply nonprofit buying and selling agencies for the downtrodden, bedraggled farmers of the Nation.

Some argue that these cooperatives pay cash dividends and patronage refunds to their stockholders or patron members and therefore such payments amounted to nothing more than rebates due the patron members. These people further argue that, such being the case, all of this inures to the benefit of the "poor farmer" and therefore this is an adequate basis to continue this special privilege of total tax or quasi-tax exemption.

I could also use this same argument by way of showing that if my independent jobbers were relieved of taxation they too could sell to the farmers cheaper. As a matter of fact, so could United States Steel—I might at this time have substituted Inland Steel—and the Standard Oil Co. of New Jersey.

For one who knows the competitive advantages that have been available to these petroleum marketing cooperatives, it is quite apparent that the amendments contained in the House bill, with reference to additional taxation of cooperatives, are but a timid forward step which falls short of even beginning to establish equity as between competing taxpayers. About the only change these new amendments will accomplish will be to impose a 20-percent withholding provision on patronage dividends and provide the basis for another protracted legal action which quite probably will result in a determination by the courts that this attempt to tax the patron for patronage dividends withheld by the cooperative is illegal.

Why cannot these petroleum cooperatives finance themselves in the same way that most independent jobbers do—by borrowing money for expansion or operating capital? Why should these cooperatives have the vested right to use tax-free money as the capital base to drive independent businessmen out of business?

I hope the committee will answer that somewhere in its report.

Our recommendation to this committee is that it should do one of two things—either tax petroleum marketing cooperatives in the same manner as independent oil jobbers are taxed, or conversely tax the independent oil jobber in the same way that these cooperatives are taxed under any existing or amended law. We ask no greater or better position than our competitors; neither do we think there is any equity for them being granted competitive advantages over us by way of tax exemption. If the amendment approved by the House is construed as "plugging a loophole" we must point out that no loophole was ever plugged merely by making a slight decrease in the diameter of the hole.

With this concluding statement, Mr. Chairman, I have been listening here all day to these cooperative witnesses testify. I believe if you took their total testimony and ran it through a fine strainer or filter, you would about come out with a composite statement such as follows:

> We appear here with flag in hand, the flag which we carry is not that of the Stars and Stripes, but of the well-worn, well-stained pair of overalls of a bedraggled farmer. And under that banner we ask your special consideration. In the first place, we do not think these poor farmer co-ops should be taxed even though they can go from 1959 to 1962 and accumulate assets of $54 million. But if you are going to tax them a little bit, what we ask you to do is please put in some innocuous words that will allow us to do as we please with their money.
>
> We want you to pass a law which says that through the medium of our bylaws, you either belong to the union or you do not work, or conversely, we can keep your money and if you do not like it, get out. Now we want you to put a little something in this bill about co-ops, for the simple reason that if you put a little something in now that is relatively innocuous, it will permit us to continue to drive private business out of business as we have been doing for years.
>
> It will also preclude for another 10 or 15 years that the Congress won't bother us, because we can always point back and say that in 1962 you hung a tax bill on us.

Now if you boiled it all down, that is about all they have said.

I appreciate your time, Mr. Chairman.

Senator WILLIAMS. Thank you, Mr. Ellis.

The next witness is Mr. H. L. Thompson.

STATEMENT OF H. L. THOMPSON, JR., CHAIRMAN, COMMITTEE ON EQUAL TAXATION, NATIONAL WHOLESALE HARDWARE ASSOCIATION; ACCOMPANIED BY BRUCE WALL, SECRETARY OF NATIONAL WHOLESALE HARDWARE ASSOCIATION

Mr. THOMPSON. I would like to have appear with me Mr. Bruce Wall, secretary of the National Wholesale Hardware Association.

Senator WILLIAMS. You may proceed.

Mr. THOMPSON. My name is Henry L. Thompson, Jr. I reside in Perrysburg, Ohio, but conduct my business in Toledo, Ohio. I am representing the National Wholesale Hardware Association as a vice

president of the association and as chairman of their committee on equal taxation.

As I mentioned earlier, I have with me Mr. Bruce Wall. He is secretary of our association, and lives in Philadelphia.

Gentlemen, may I thank you for granting us the opportunity of appearing before you to discuss the most important question of equalizing taxation between cooperatives and other full-taxpaying businesses with which they compete.

For the past 6 years I have been president of the Bostwick-Braun Co., of Toledo, and for more than 25 years I have been active in the wholesale distribution of hardware. Our annual volume of sales approximates $18 million. Profits in recent years have been slipping, but we are paying our full 52 percent of tax on what profit we do earn.

Mr. Wall has been associated with the wholesale hardware industry for many years, and he has observed not only the gradual loss of profits of its members, but also the collapse of a number of our larger and more important distributors.

From statistics gathered by our association, the average net profit of our members has decreased to a point where it is indicating only 3.5 percent return on investment for 1960, down from 4.42 percent in 1959. We do not have the figures for 1961 as yet, but it is anticipated the percentage will still be lower. When Government bonds yield a return of 3 to 4 percent, how can the wholesale hardware industry possibly attract capital?

Within our industry there are more than 600 hardware wholesalers. It is estimated that the combined sales volume of this group amounts to over $2 billion, and its business is conducted in every State in the Union.

THE PROBLEM AFFECTING OUR INDUSTRY

In the early years of the 20th century when the lawmakers of our country granted certain tax advantages to co-ops, I am sure their desire was to aid the farmer who was, at that time, struggling to make ends meet. However, at the present time the development of the co-ops in the merchandising field, in the manufacturing area, and as brought out in the testimony you have just heard, in the petroleum business, and in many other forms of business endeavor unrelated to farming, is a direct result of the extension of those tax advantages far beyond the field of agricultural production.

Prior to World War II, the number of cooperative in the wholesale hardware field was very limited. The high taxes during the war, when corporate income and excess profits taxes took a high percentage of each income dollar, provided tax-favored cooperatives an opportunity for tax savings so great that they expanded at an unprecedented rate in many new fields of endeavor. Wholesale hardware cooperatives sprang up all over the United States.

Attempting to compete with these tax-favored cooperative corporations has been most difficult for our full-taxpaying hardware wholesalers. We have seen the demise of many well-known, full-taxpaying distributors. Although we cannot list them all, looking at the midwest area alone where co-ops have shown real growth due to their

tax-free advantage, the following hardware distributors have gone out of business by either selling out or liquidating, namely:

Marshall-Wells and Kelly, How, Thompson, of Duluth, Minn.
Janney, Semple, Hill, of Minneapolis, Minn.
Luthe Hardware, of Des Moines, Iowa.
Richard-Conover, of Kansas City.
Pritzlaff Hardware, of Milwaukee, Wis.
Paxton-Gallagher, of Omaha, Nebr.
Shapleigh Hardware, of St. Louis, Mo.
Buhl Sons, of Detroit, Mich.
Tracy Wells, of Columbus, Ohio.
Michigan Hardware, of Grand Rapids, Mich.
Saginaw, Hardware, of Saginaw, Mich.
The W. Bingham Co., of Cleveland, Ohio.

You can see they come from many States throughout the Midwest. I would like to emphasize, this is just picking one area of the country. There are many others that have discontinued business in other parts of the country.

I would estimate that the combined sales volume of this group would have amounted to well over $200 million, and the annual taxes they paid are now lost forever to our Government.

One of our members from Texas who recently discontinued the hardware distribution part of his business wrote President Kennedy as follows:

> They [the co-ops] have used this tax money to undersell the taxpaying wholesalers and this fact had a great bearing on this company's recent decision to discontinue the sale of wholesale hardware.

This same member has also written to me with some most interesting comments as follows:

> We did sell our inventory of hardware and housewares to the local co-op, Walter H. Allen Co.

That is in Dallas, Tex.

> He paid us considerably more than I have seen similar inventories sold for in the last several years by other firms. It would seem obvious that there were distinct advantages to him in purchasing this inventory and that his tax advantage assisted him considerably in his ability to make the purchase.

Just as bad money drives out good, so tax-free business is bound to drive out taxpaying industry. As this occurence continues, the number of businesses carrying their fair share of the taxes become smaller and smaller while the co-ops continue to grow larger and larger.

This problem of equalizing taxation has been the subject of many discussions and hearings before the Committee on Ways and Means of the House of Representatives and your committee, and these deliberations have been carried out over a period of the last 17 or 18 years. Except for one abortive attempt in 1951, no law to correct the situation has been forthcoming till now.

Before commenting on H.R. 10650 I should like to clearly state the position of our industry. We feel very strongly that the co-ops should pay the full corporate tax of 30 to 52 percent on all profits before patronage dividends and the recipients of these dividends should pay full personal income tax. To us this is the only fair approach since it treats all competitors equally. Eventually, I am confident Congress will recognize the importance of fairness in our tax laws and will establish this equity. For now, any reduction in the inequities will be welcomed by our industry.

H.R. 10650, which you are now considering, provides that a single tax be imposed on cooperative earnings, to be paid either by the member or by the cooperative corporation. As far as the wholesale hardware industry is concerned, this represents a restatement of the 1951 act to insure that a single tax be paid on cooperative earnings. In the past, the independent hardware retailers who are members of hardware cooperative wholesalers have paid this single tax. The cooperative wholesalers have gone tax free. They would continue to do so under this bill; therefore this legislation would be practically meaningless to taxpaying hardware wholesalers who compete with the cooperative wholesalers.

The withholding tax also incorporated in this bill would be helpful to our industry because it would be collected at the wholesale level. This would have the same effect on our cooperative competitors as a 20-percent tax on their earnings. For that reason, our industry supports the withholding provision of this bill. Without this provision, little would be gained.

Members of our industry firmly believe that the existing inequities can only be corrected by subjecting cooperative wholesalers and their members to the same double taxation that applies to us. Failing in this, any single tax that might be imposed should be levied against the earnings of the cooperative wholesaler corporation.

In summary, let me say:

First, full-tax-paying businesses in the wholesale hardware industry are being forced out of business by the inequities in our tax laws which permit wholesale merchandising cooperatives to grow on completely tax-free retained income.

Second, continued growth of these tax-free cooperatives will mean the demise of ever more taxpaying independent wholesalers and an even greater loss of income by the Government. As a result of these tax-free or tax-favored groups, a greater load is heaped on those who pay their way. As these tax-free groups grow, it merely compounds the inequity.

Third, to solve this problem is easy—tax all competing corporations alike. The bill before you, H.R. 10650, goes only part way in eliminating the present unjust tax favoritism and only accomplishes this through the withholding tax. We do hope you will see fit to strengthen the bill by fully taxing the cooperative wholesale corporations or at least by limiting deductible patronage dividends to those paid in cash or those on which the recipient has a 90-day option to redeem in cash.

Gentlemen, I wish to thank you for the time you have permitted me to present the case of the full-taxpaying hardware wholesalers to you. Should you have any questions, either Bruce Wall or I shall be most happy to do our best to answer them.

Senator WILLIAMS. Thank you, Mr. Thompson. There are no questions.

This completes the witnesses for today.

The committee will recess until tomorrow morning at 10 o'clock.

(By direction of the chairman, the following is made a part of the record:)

AGRICULTURAL COOPERATIVE COUNCIL OF OREGON,
Gresham, Oreg., January 24, 1962.

Hon. WAYNE LYMAN MORSE,
Senator from Oregon,
Senate Office Building, Washington, D.C.

DEAR SENATOR MORSE: I have been instructed by the membership of the Agricultural Cooperative Council of Oregon to transmit the attached resolutions expressing the unanimous opinion of council membership.

The ACCO is a service organization, representing 64 farmer cooperatives and their 40,000 members, founded in 1921 to provide educational and service benefits to farmers and their business organizations. A list of our farmer cooperatives, which unanimously voted for these resolutions, is attached.

Farmer cooperatives contribute vitally to the economy of Oregon by increasing incomes of farmers, thereby making possible increased volumes of business for merchants. Increased incomes of farmers are also reflected in increased income taxes paid by farmers to the Treasury. Furthermore, farmer cooperatives make possible increased employment of permanent and seasonal employees, as well as income for schoolchildren who harvest farm crops.

For these reasons, we encourage you to take all steps possible to bring to the attention of appropriate Members of Congress, the interests of farmer cooperatives from your district.

Sincerely yours,

R. H. WILCOX, *President.*

COOPERATIVE TAXATION

Whereas the Agricultural Cooperative Council of Oregon believes that there exists considerable confusion and uncertainty concerning the taxability of patronage refunds and/or allocations of cooperatives; and

Whereas Congress made clear in the 1951 Revenue Act its intent that cooperatives should continue to treat patronage refunds, under whatever form issued, as treated at that time and a long time past; that is, patronage refunds allocated to patrons pursuant to a preexisting contract between patrons and the cooperative shall not be deemed to be income to the cooperative or be included in computing its net or gross income. If the net savings or retains were unallocated, then such earnings should be taxable to the cooperative, but if the retain funds are allocated to patrons, then each individual patron should be liable for the tax on his allocation for the year in which it is made: Now, therefore, be it

Resolved, That this, the Agricultural Cooperative Council of Oregon, assembled this 12th day of December 1961, at its 40th annual membership meeting, recommend that appropriate legislation be adopted to clarify and make effective the intent of the 1951 Revenue Act to the effect that all patronage allocations of agricultural cooperatives distributed under a preexisting contract be included in the gross income of the recipient patron; and be it further

Resolved, That a copy of this resolution be sent to each of the Oregon congressional delegation, and to each member of the House Committee on Ways and Means, and to each member of the Senate Committee on Finance, the National Council of Farmer Cooperatives, and other interested parties.

Unanimously accepted, December 12, 1961.

MONTROSE, COLO., *February 21, 1962.*

Re tax treatment of cooperatives.

Hon. GORDON ALLOTT,
U.S. Senate, Senate Office Building,
Washington, D.C.

DEAR GORDON: I represent the Western Colorado Producers Association, the Eastern Colorado Dairymen Association, and Denver Milk Producers, Inc. The producers who are members of these associations produce probably 80 percent or more of all grade A milk produced in the State of Colorado. All of these associations are organized under the cooperative marketing law of the State of Colorado and are qualified cooperatives under the Capper-Volstead Act. Each of these associations belongs to the National Milk Producers Federation.

The federation has, for several years, taken the position that savings made by farmers through the operation of their own cooperatives should be subject to a single tax and that such tax should be paid by the farmers on distribution of evidence of equity as well as on cash. A copy of the policy established by the federation is attached hereto as exhibit A.

The House Ways and Means Committee is presently working on proposed cooperative tax legislation. The federation basically agrees with the policies which the committee seeks to effectuate, but the federation does not agree with certain of the methods proposed to be used, as set forth in the working draft of the committee. I attach hereto as exhibit B a policy statement adopted by the federation board of directors a week or so ago.

In very simple terms, the House Ways and Means Committee wishes to tax all savings made by cooperatives which are either paid in cash to members or retained for capital use by the cooperative. The federation has no argument with this principal. The federation, however, cannot sanction the method of collecting the tax on retained savings as now set forth in the House Ways and Means Committee draft bill. This draft legislation would tax cooperatives on such savings retained as capital in the same manner and at the same rate as a profit corporation, unless the cooperative had written consent from the farmer member to make an individual deduction as would be done in the case of withholding as applied to stock dividends and interest. The obtaining of individual consents from each individual member would create a somewhat difficult administrative problem for cooperatives.

The cooperatives have proposed a simple remedy; namely, that the inclusion of a consent provision in the bylaws of the associations be adequate to meet the requirements of the law. It is on this simple issue that the federation is in disagreement with the House Ways and Means Committee. In all honesty I cannot see why consent is needed in the first place, but I assume the legal talent of the committee has a valid reason for the consent requirement.

If the legislation is passed in its present form, it would mean that the smallest of the three Colorado cooperatives would have to obtain over 100 written consents. If for any reason it proved impossible to obtain 100 percent consents, it would be necessary for this small association to set up a rather complicated bookkeeping procedure to cover equity distributions made to nonconsenting members. The office administration of this procedure would be technical and difficult. The problem would, of course, be compounded in the larger associations.

We would request your support in seeing that the bill as finally drafted by the Congress of the United States does have a provision therein allowing consent for deductions to be given in the bylaws of the associations. As we see it, this would not cost the Government any money but would certainly simplify the administrative procedures of the cooperatives.

Sincerely,

HOWARD S. BJELLAND.

EXHIBIT A

Congress has for many years maintained a public policy of encouraging farmers to improve their own position by organizing and operating agricultural cooperatives. One of the objectives of this policy is to strengthen the bargaining power of farmers in their negotiations for the sale of their products with powerful processing corporations and to enable farmers to obtain fair tests and weights by providing their own testing services. Cooperatives provide a brake on excessive processing and marketing margins, because when margins become too high farmers can perform these services for themselves at cost through the operation of their own cooperatives.

Savings made by farmers through the operation of their own cooperatives are subject to a single tax. Thus business enterprises operated by farmers' cooperatives are taxed on the same general basis as similar business enterprises operated by individuals or partnerships.

The single tax should be currently paid by farmers on distribution of evidence of equity as well as on cash received through the operation of their cooperatives. The federation will support legislation and regulations to accomplish that objective. It will support tax proposals directed in good faith toward securing a single tax. The federation, therefore, approves that portion of the administration's tax message relating to the 1951 law on the tax treatment of farmer cooperatives and vigorously opposes the current proposals of the House Committee on Ways and Means.

The federation will oppose legislation which would result in unfair taxation of cooperatives.

EXHIBIT B

COOPERATIVE TAX POLICY

The federation reaffirms the policy stated in its resolution adopted at the last annual meeting. We are in agreement with the proposal for cooperative taxes contained in the President's message to Congress under which cooperatives would pay tax on retained unallocated net savings and farmers would pay tax currently on retained net savings allocated to them. While we do not favor a withholding tax on patronage refunds, we will support the President's proposal coupled with a withholding tax, provided the withholding tax is practical and that it applies across the board to all dividends and interest.

We do not believe the draft published by the House Ways and Means Committee would carry out the spirit of the President's proposal, and we oppose this legislation.

The draft of legislation developed by the Department of Agriculture working with cooperative groups, and accepted by the Treasury Department, would carry out the spirit of the President's message, assure the current collection of one tax on savings made by farmers through the operation of their own cooperatives, and not interfere unnecessarily with the financing and operation of cooperatives. We will support legislation which embodies the principles set forth in that proposal.

The revision in the Ways and Means Committee draft which fail to recognize consent of members through bylaw provisions ignore the historic democratic principle under which cooperatives operate; namely, that all members have an equal voice in the operation of the cooperative and all are equally bound by provisions adopted by majority vote.

The federation will endeavor to get the Ways and Means Committee to reconsider its action and to adopt as the cooperative tax provisions of the tax bill, the draft developed by the Department of Agriculture.

NORTHRUP, KING & CO.,
Minneapolis, Minn., March 20, 1962.

Hon. HARRY F. BYRD,
U.S. Senate, Washington, D.C.

DEAR SENATOR BYRD: No doubt you have been deluged with letters for or against taxation of cooperatives. Enclosed is copy of a letter we sent to President Kennedy a year ago. Our views, which include most of our 1,400 employees, have not changed. In fact, during the past year the situation has become further aggravated.

We hope you will find time to look over the attached letter.

Sincerely,

MAURICE KEATING.

NORTHRUP, KING & CO.,
Minneapolis, Minn., March 16, 1961.

THE PRESIDENT,
The White House,
Washington, D.C.

DEAR MR. PRESIDENT: We understand you will soon be considering the matter of taxes. We sincerely hope you will give serious consideration to the preferential tax treatment for cooperatives. The gravity of this situation, as it affects independent and private firms, should not be underestimated.

We believe cooperatives have a definite place in our distribution system and that it is healthy for independent firms to compete with cooperatives by giving the best service possible to farmers.

But, we are decidedly against the very unfair tax advantage most of the cooperatives have, with whom we compete, which has enabled them to build capital twice as fast as their independent competitors.

Within the last year or two the farmers union has purchased lines of elevators from several private grain firms. Many of these elevators were our customers for hybrid seed corn, farm and grass seeds. However, today the managers of these many elevators are instructed to buy their seeds only through the farmers union or one of its cooperative affiliates.

We have approximately 1,400 employees and 40 branch processing plants throughout the different Midwest and Far Western States. Many of our em-

ployees participate in our profit sharing trust. During the last 2 years our profits, after taxes, have made it impossible to make but a small contribution to the trust.

This situation is due largely to the effect of rapidly increasing competition from cooperatives both in the producing and consuming areas. Our employees are well aware of this unfair tax situation and how it affects their compensation and their future security.

There must be hundreds of thousands of employees, with firms in other agricultural lines such as grain, feed, fertilizer, and agricultural chemicals, who are similarly affected.

Our Government not only urgently needs the additional taxes which the cooperatives should pay, but if cooperatives are fairly taxed, the independent firms would be able to make fair profits again and pay much larger taxes into the U.S. Treasury.

Many Members of Congress seem to feel that taxing cooperatives on the same basis as private enterprise would be politically unwise, particularly during the time when the Congress is attempting to improve farm income. Actually, many farmers have told our field men that they are becoming alarmed at the rapid growth of cooperatives, as there are now many localities where there are no independent dealers and the farmers must buy and sell through a cooperative. Whether a farmer is a member of a cooperative or not, he is surely intelligent enough to know that the competition between cooperatives and independent dealers creates better market prices. If this tax inequality continues to exist, there is no alternative for private enterprise but to sell out to a cooperative.

Very truly yours,

MAURICE KEATING.

RALSTON PURINA CO.
St. Louis, Mo., March 26, 1962.

Hon. HARRY FLOOD BYRD,
Senate Office Building,
Washington, D.C.

DEAR SENATOR BYRD: According to the official announcements your Senate Finance Committee will begin hearings this week on the vital tax measure which the Ways and Means Committee of the House has reported out.

Federal income losses from businesses operating under escape clauses of our current taxation laws has reached enormous proportions. Most of such businesses are in direct competition with taxpaying private corporations and certainly I am sure that you agree that all businesses which are competitive should operate under the same Federal regulations.

The traditional answer of the tax exempt corporations to private business on the Federal income tax questions is that any business which wishes to forgo its privilege of making a profit may operate under the requirements afforded cooperatives and thus escape Federal income taxes. If this philosophy were followed and carried to its own conclusion, the Federal Treasury would lose a major portion of its Federal revenue.

There are many examples where a private business has been sold to an ex panding cooperative. The sale as a rule to a cooperative who is not paying taxes eliminates immediately the Federal income even though the purposes and functions of this business do not change.

We certainly trust that you and your committee will exert every effort possible to provide additional Federal revenue by closing these current loopholes in our present laws.

Sincerely yours,

J. D. SYKES,
Vice President.

THE MAUSER MILL CO.
Treichlers, Pa., March 28, 1962.

Hon. HARRY FLOOD BYRD,
Senate Office Building,
Washington, D.C.

DEAR SENATOR BYRD: A bill (H.R. 10650) to amend the Internal Revenue Code of 1954, which bill, in part, deals with taxation of cooperative businesses and their patronage dividend receiving members, has been passed favorably by the House Ways and Means Committee and is now before the Senate Finance Committee for consideration.

Being in the flour and feed business where we are taxed anywhere from 30 to 52 percent on our earnings and being in direct competition with cooperatives, you can realize the unfair advantage which they have over us. They can sell for less and can use their earnings to purchase new equipment which will make their plants far more efficient than ours. We understand that records kept by the U.S. Department of Agriculture on 16 co-op grain terminals tell a typical story. Since 1939, largely by purchasing competing firms with their tax-free profits, these 16 big co-ops have increased their assets from $6,600,000 to nearly $200 million.

While this bill would skim off only 20 percent of the cooperative's earnings, thus reducing the amount their current tax-free staus provides for expansion of growth and competition against taxpaying noncooperative competitors, it is a move in the right direction, and we urge you to vote in favor of it.

Very truly yours.

J. MAUSER LERCH, *Secretary-Treasurer.*

RUSTON, LA., *March 23, 1962.*

Hon. ALLEN J. ELLENDER,
The U.S. Senate, Washington, D.C.

DEAR SENATOR ELLENDER: This is to register with you my opinion concerning taxation of income-producing properties which are not now taxed. It is my understanding that certain nonprofit organizations may own and administer income-producing properties and yet pay no income tax on the profits from these holdings and operations.

I firmly believe that profits from income-producing properties should be taxed, even though owned by so-called nonprofit organizations. I also believe that regular estate taxes should be levied and collected on all properties obtained by such organizations by gift or bequest. I believe that the amount of such income-producing property held by any one organization should be limited by law or that a maximum time limit for retaining such property be set.

I hope that the current tax reform legislation will eliminate the loophole that allows nonprofit organizations to escape taxes on income from productive assets.

Sincerely yours,

MILTON R. JOHNSON, Jr.

RICHMOND FOOD STORES, INC.,
Richmond, Va., April 10, 1962.

Subject: Senate committee hearings on tax bill (H.R. 10650) with specific reference to section 17 of the bill and sections 1381 to 1388 of the code—tax treatment of cooperatives and patrons.

Senator HARRY F. BYRD,
Chairman, Senate Finance Committee,
Washington, D.C.

DEAR SENATOR: As you perhaps know, Richmond Food Stores, Inc., is a distributive food warehouse owned and operated by some 585 independent retail grocers in the Richmond trading area.

Our retailers have banded together and through their own ingenuity, effort, and capital investments have arranged cooperative mass purchasing in order to remain competitive. Their very survival has been dependent on efficiencies of distribution that they have generated through their cooperative warehouses. Our small independent businessmen are very similar to small farmers who have found it necessary to work out cooperative purchasing as well as cooperative marketing enterprises in order to survive in America's "bigness" economy.

In Richmond, as elsewhere in the Nation, the strength of competition from large corporate grocery chains and new large discount centers that include food supermarkets has intensified. With almost unlimited capital and credit, the chain enterprises are able to obtain key shopping center locations and further to develop individual markets, in overdeveloped areas.

Governmental census studies have shown that between 90,000 and 100,000 independent food retailers went out of business from 1948 to 1958. In reverse, the Federal Trade Commission has pointed out that 27 percent of all food sales lie in the hands of just 10 corporate chain firms.

That our members have remained competitive and sustained individual growth in the face of this stringent economic pressure is a direct result of their unification through cooperative purchasing.

There are 100 food distributive cooperatives like Richmond Food Stores, Inc., together in the Cooperative Food Distributors of America, a trade association. As chairman of C.F.D. of A.'s National Affairs Committee, I represent the views of some 25,000 independent retailers who comprise the ownership of these distributive organizations.

Our membership is gravely concerned with the legislation now under consideration by your committee with respect to changes in the manner of taxing cooperatives and patrons. Through the years despite organized attempts to destroy cooperatives, Congress has recognized the need of small independents to band together to offset the competitive advantage of bigness inherent in our economy.

We have followed closely the development of H.R. 10650 and with specific reference to the taxation of cooperatives and patrons our association feels that the House solution is an equitable one.

We agree totally with the purpose of the administration's recommendations to provide that either the cooperative or the patron pay income tax on patronage. This was the obvious intent of Congress in its 1951 legislation.

In our food distributive cooperative organizations taxes have been paid by the recipients of patronage. Our patrons have been continually advised to include patronage refund certificates as a part of their current income and form 1099 has been forwarded to the Treasury Department on all patronage allocations.

The House proposal to clarify patronage as income to the patron when issued in certificates and other forms apart from cash has provided for several options for cooperatives to be sure of qualifying patronage for deductibility of the corporate level.

It seems to us that both the needs of the Government and that of cooperatives have been fully met. First, through a clear-cut patronage constructive receipt definition, the Treasury will be able to promptly collect income tax from the patron without contest. Second, at the cooperative level, three sound optional plans permit flexibility in arriving at patronage deductibility.

We feel that our member warehouse organizations can qualify patronage within the limits of the three alternatives without difficulty, while at the same time the position of the patron is protected.

It is our feeling that the procedures worked out by the House will accomplish the desired Treasury Department aim without undue restraint and dislocation of our cooperative enterprises.

We fully support the House legislation on this portion of the tax bill and hope that you will permit our position to be made a part of the record of the committee hearings.

Very truly yours,

LEONARD E. STARR, Jr.,
Chairman, Committee on National Affairs, Cooperative Food Distributors of America.

STATEMENT OF FRED V. HEINKEL, PRESIDENT, MISSOURI FARMERS ASSOCIATION

(In particular reference to secs. 17 and 19, relating to the tax treatment of cooperatives and patrons and withholding of income tax at the source of patronage dividends)

I am Fred V. Heinkel, president of the Missouri Farmers Association, which has a membership of over 156,000 producers of agricultural products in Missouri and adjoining States. The Missouri Farmers Association and its member units are farmer-owned, farmer-controlled marketing and purchasing cooperative associations.

I had requested time to appear before this committee or to present a statement to the committee without an appearance. Permission was granted to file this statement on behalf of the Missouri Farmers Association; however, since making this request I have had the opportunity to read the statement of the National Council of Farmer Cooperatives as prepared and presented by Mr. Homer L. Brinkley, its executive vice president, relating to this subject matter. Rather than burden the record with repetitious statements, I would like to adopt as my statement the excellent presentation of the national council. Embodied

in that presentation is the most complete analysis of this problem that it has been my experience to review. On behalf of the Missouri Farmers Association, I respectfully request that in lieu of reading a lengthy statement from me that the distinguished members of this committee review the presentation of the national council again.

In addition, however, I do want to point out one factor which must be considered. I am sure that the members of this committee understand the economic situation facing the American farmer. I am also sure that you understand the role that farmers cooperatives play in the farm picture today. Without an effective system of farmer cooperatives in this Nation, I am absolutely convinced that farm income would be substantially lower. That is not saying that farm income is any place close to the levels where it should be, but without effective farmer cooperatives, net farm income could drop to much lower levels, putting intense strain on the national economy and resulting in vastly increased demands for Government expenditures. Statistics of the Internal Revenue Service, as announced in publication 453 and as reflected in the statement of the national council, shows that 88.2 percent of the individual farmers reported net farm profit of $3,000 or less. Even this level can be maintained only with the assistance of farm cooperatives in the country. Without their marketing and purchasing associations, it is possible that this entire group, together with a substantial number of the remaining 12 percent, would be completely eliminated from any taxable status whatsoever.

Just as the President has recommended that American industry be given tax incentives because of the needs of American business, so must this committee recognize that the needs of the American farmer are far more acute. A tax bill which, by administrative encumberances, destroys or materially reduces the effectiveness of farmer cooperatives, will do more harm to the national economy, to our farming community, and the Government's financial situation than is justified by the mere pittance of additional revenue which might be forthcoming. I earnestly request that this committee, if they find that clarification of the previous intent of Congress on this issue is required, refuse to adopt wasteful administration requirements which would destroy the effectiveness of our farmer cooperative system.

U.S. SENATE,
COMMITTEE ON COMMERCE,
April 17, 1962.

Hon. HARRY F. BYRD,
Chairman, Senate Finance Committee,
Washington, D.C.

DEAR MR. CHAIRMAN: I think you are aware that many California farmers, especially those who are members of one of our numerous marketing cooperatives have serious objection to section 17 of H.R. 10650, the Revenue Act of 1962. This objection is founded on the basic organizational and operating differences between our western marketing cooperatives and the great production cooperatives which exist in the Middle West and other parts of the country.

Essentially, our marketing cooperatives have no earnings or income as of themselves. Under their setup it is only the individual farmer members who receive any net earnings, since the cooperatives have a legal obligation to return all proceeds above operating costs to their members. Accordingly, it is appropriate that the farmer members be taxed on these earnings when they receive them—and they have no objection to this—but it sems questionable that the cooperatives or the members should be taxed on capital retained or on noncash allocations, until such time as these funds are distributed to the members as cash income.

You were kind enough to arrange at my request for committee time to hear the testimony of the Agricultural Council of California on this matter. This testimony was given by Mr. Earl Blaser on April 16. I hope you will give his statement careful consideration.

With kindest regards,
Sincerely yours,

CLAIR ENGLE, *U.S. Senator.*

INTER COUNTY FARMERS COOPERATIVE ASSOCIATION, INC.,
Woodridge, N.Y., April 19, 1962.

To: Senate Finance Committee.
Subject: Tax statement of farmer cooperatives and their patrons.

Our organization, representing over 500 poultry and dairy farmers in New York State, are categorically opposed to the inclusion of any provision such as section 17 of H.R. 10650 which affects tax treatment of cooperatives and patrons for the following reasons:

1. Because of increased costs of bookkeeping and administration, the withholding at the source—20 percent of current earnings—small cooperatives such as ours would have to reduce the cash retirement of previous year's allocations by at least the same amount as current earnings being withheld. The net return to the Treasury would be reduced as against the present method of patrons paying taxes on their patronage allocations when received in cash.
2. We believe that the present method of patrons paying taxes on allocations in the year in which they are paid in cash to them is a fair and equitable method of payment of taxes by farmer patrons as defined by the Federal court rulings under the terms of the Tax Revenue Act of 1951.
3. This Congress has repeatedly gone on record as favoring the economic betterment of the family-type farm. Any change in the tax treatment of farmer cooperatives and their patrons as proposed in H.R. 10650 would adversely affect the economic well-being of cooperatives and family-type farms as typified by our organization.

We respectfully request that the Senate Finance Committee take the above facts into consideration before reporting out any tax legislation affecting the treatment of farmer cooperatives and their patrons.

We welcome an opportunity to appear before this committee in person.

MORRIS KROSS, *President,*
ALBERT COHEN, *General Manager.*

NATIONAL SMALL BUSINESS ASSOCIATION,
Washington D.C., April 23, 1962.

Hon. HARRY FLOOD BYRD,
Chairman, Senate Finance Committee,
Washington, D.C.

DEAR SENATOR BYRD: This letter is to present the views of the National Small Business Association on section 17 of H.R. 10650, respecting the taxation of earnings of cooperatives.

The entire small business community of the Nation is critically concerned with the taxation of cooperatives—as taxpayers who believe that every business should bear its fair share of the tax burden and as businessmen who are keenly aware that tax favors to any segment of business means unfair and eventually destructive competition inconsistent with the principles of equal protection under law and the preservation of free competitive enterprise.

Our position is that every enterprise which competes in the marketplace with the economic advantages of being operated as a corporate entity, should be subject to the same corporate income tax law. That this law should apply equally to all is particularly critical in the case of earnings which, regardless of their allocation are in fact retained in the business. Untaxed earnings afford any holder of a tax-escape privilege a Government-provided economic weapon against its fully taxed competition. This weapon is so potent that it has been properly denied even to charitable and religious organizations that engage in competitive businesses whose business income is ultimately used for public interest purposes.

The pending bill, unfortunately, does not even purport to have the objective of fully taxing cooperative corporation income at corporate rates. It has only the much more limited objective of eliminating the present situation where hundreds of millions of dollars of income generated by the rapidly expanding tax-favored organizations are not taxed to any taxpayer. How it signally fails to achieve even this limited objective, will be pointed out in this letter, with constructive suggestions for remedying some of the bill's more glaring inadequacies, inconsistencies, inequities, and unnecessary complications.

The bill, with the exception of attempting to tax patrons on no-market-value paper, involves tax policy rather than constitutional questions, and our suggested changes raise no constitutional questions. To the contrary, it avoids the one mentioned.

Even the National Council of Farmer Cooperatives has now taken the position that it is a question of tax policy rather than constitutional power, whether a cooperative's income, in whole or in part, is to be taxed at the cooperative level. Its brief, filed with your committee for the purpose of attempting to show that, even without distribution, the patron-members could be taxed on a patronage allocation as a participant in the cooperative's earnings, makes the statement with respect to a legal entity's income, that:

"Insofar as the 16th amendment is concerned, Congress has the power to tax such income as earned, either at the level of the entity or at the level of the individual participants."

The pending bill would, and should be made simpler and more equitable if it were amended to recognize that where a person actually receives a dividend from a cooperative, whether computed on an ownership basis or a patronage or other basis, that he is receiving income.

Section 1385(a), as applied to distribution of co-op income actually received, requires that the recipient shall include "the patronage dividend in his gross income." But this is in part set at naught by subsection (b) that "under regulations prescribed by the Secretary * * * the amount of * * * any patronage dividend shall not be included in gross income to the extent that such amount—

"(1) is properly taken into account as an adjustment to basis of property, or

"(2) is attributable to personal, living, or family items."

As all cooperative income is attributable to its capital, management, labor, and other factors, the use made of a person's purchases has no proper connection with the appropriate taxability to him of the share he is paid of the cooperative's earnings.

Subsection (b) thus creates an unwarranted inequity as between recipients. Further it requires unnecessary and expensive recordkeeping and decisions as to when the money received from a cooperative is to be included in or excluded from the recipient's gross income. It likewise creates inequities and difficulties in the withholding requirements of section 3471. For example, subsection (c) of section 3472 provides that "a cooperative which the Secretary * * * determines is primarily engaged in selling goods and services of a type that are generally for personal, living or family use, shall upon application * * * be granted exemption from the tax imposed by section 3471."

Certainly both as a matter of equity between distributees of cooperative income and between cooperatives themselves, and between cooperative corporations and other corporations required to withhold, the exceptions and exemptions of proposed sections 1385(b) and 3472(c) should be stricken from the bill.

Retaining these exceptions and exemptions would mean not only the inequitable results and administrative difficulties we have pointed out, but also tax escape of a large amount of cooperative corporation income.

If the tax policy of the bill is that distributees are not to be taxed on the earnings of their cooperatives, how are the earnings of the cooperative to be taxed except to the cooperative itself—the combined capital, management, and labor of which resulted in the earnings?

The answer is obvious. If this patron tax escape is retained the consumer cooperative must be taxed if anyone is taxed.

But contrary to the basic policy of the bill that the cooperative's earnings must be taxed to some taxpayer, is the proposed section 1382 of the bill which provides that consumer cooperatives shall not be taxed on earnings which are "allocated"—whether or not actually distributed—on the basis of patronage.

We submit that, even under the limited approach of the bill, the city consumer cooperative must be taxed on its distributed earnings if the distributee is not taxed. Specifically applied to the provisions of the pending bill, this means that proposed section 1382 of the code in section 17 of the bill must be amended so that there is no exclusion or deduction of patronage dividends which are not fully taxable to the recipient.

The second point which our association insists is fundamental in deciding when the cooperative is to be currently taxed on its earnings, is the concept that the cooperative shall not be taxed where it is not certain that the patron-member-distributee will be in fact currently taxed on his distributed share of the co-op's income.

To stress this point, we point out that the basic theory of the current amendments is to correct a tax loophole occurring because receipt of non-market-value script and letters of advice, contrary to the assumptions of the 1951 law, is not receipt of income.

Congress could simplify and add equity and certainty to the bill by accepting the conclusion of the courts and taxing the cooperative rather than the patron when the income is in fact retained by the cooperative, and the member patron can neither demand "or receive more than a mere letter of advice of no-market-value certificates." This would eliminate the intricate and uncertain provisions respecting bylaw consents. This would also eliminate the constitutional question as to whether recepients are in even constructive receipt of income.

As to the constitutional limitations, I should like to quote briefly from *Eisner v. Macumber* (226 U.S. 189), where the Supreme Court described the fallacious reasoning now advanced for the theory that receipt of these no-market-value letters of advice and script evidencing co-op income, retained for its own uses by the co-op, can be taxed to the recipient as income. The court there said (p. 213-14):

"Throughout the argument * * * in a variety of forms runs the fundamental error * * *—a failure to appraise correctly the force of the term 'income' as used in the 16th amendment, or at least to give practical effect to it. Thus the Government contends that the tax 'is levied on income derived from corporate earnings,' when in truth the stockholder has 'derived' nothing except paper certificates which, so far as they have any effect, deny him present participation in such earnings * * * we cannot disregard the essential truth disclosed, ignore the substantial difference between corporation and stockholder, treat the entire organization as unreal, look upon the stockholders as partners when they are not, treat them as having in equity a right to partition of the corporate assets when they have none, and indulge in the fiction that they have received and realized a share of the profits of the company which in truth they have neither received nor realized."

It is our position that Congress should, as a matter of fair tax policy (as well as to avoid conflict with the constitutional definition of income), limit the pending bill to taxing patrons only for cooperative earnings, offered or distributed to them in cash or its equivalent—such as 90-day cash option paper.

Only on the basis of thus limiting income taxes to realized income, can Congress insure against a repetition of the present situation where no one is taxed—which even the cooperatives agree must be corrected.

We therefore earnestly request that the bill's proposed section of the Internal Code 1382(b) respecting exclusion of patronage dividends by cooperatives, and section 1385 respecting patronage distributions taxed to patrons, be so amended as to limit cooperative tax escape and patron taxation on noncash distributions to those items which are in fact the equivalent of cash— such as 90-day cash option paper.

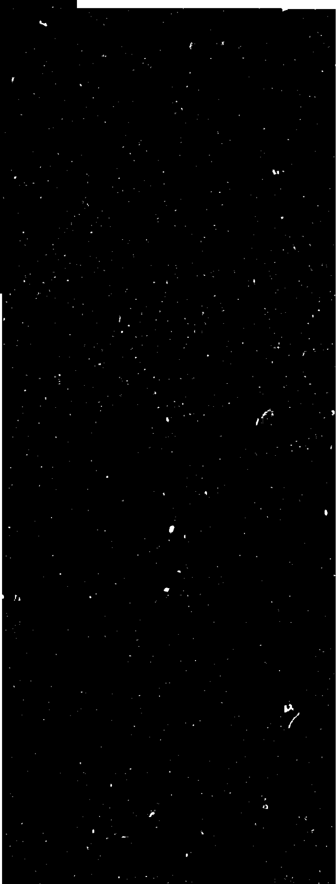
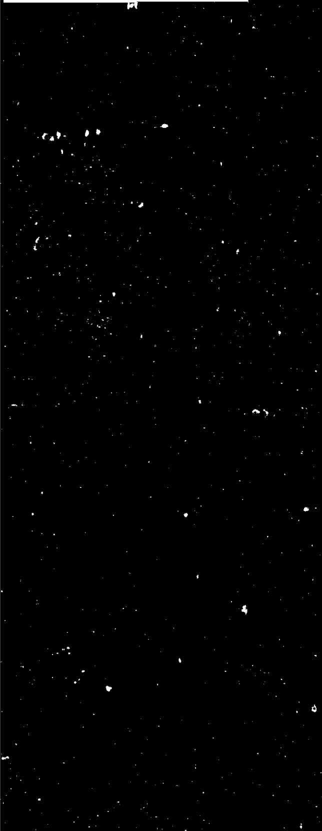
If these recommended changes are incorporated in the proposed legislation, the legislation would be a significant step toward relief against a gross inequity against the small business community. Without these changes, the pending bill, like the 1951 compromise, would fail to achieve even its limited purpose and result in a protracted period of uncertainty and expensive litigation.

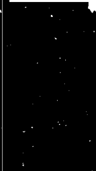
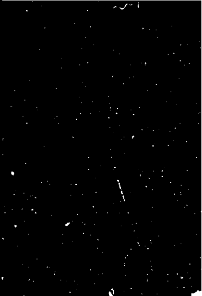
We would appreciate having this letter appear in the record of the current hearings.

Respectfully,

JOHN A. GOSNELL, *General Counsel.*

(Whereupon, at 5:55 p.m., the committee recessed, to resume Tuesday, April 17, 1962, at 10 a.m.)

REVENUE ACT OF 1962

TUESDAY, APRIL 17, 1962

U.S. SENATE,
COMMITTEE ON FINANCE,
Washington, D.C.

The committee met, pursuant to recess, at 10:15 a.m., in room 2221, New Senate Office Building, Senator Harry F. Byrd (chairman) presiding.

Present: Senators Byrd, Douglas, Hartke, Williams, and Bennett.

Also present: Elizabeth B. Springer, committee clerk, and Colin F. Stam, and L. M. Woodworth, Joint Committee on Internal Revenue Taxation.

The CHAIRMAN. The committee will come to order.

The first witness is Mr. William L. Clayton, of the Anderson, Clayton Co.

Mr. Clayton, will you come forward and take a seat. We are glad to have you, sir.

STATEMENT OF WILLIAM L. CLAYTON, ANDERSON, CLAYTON & CO.

Mr. CLAYTON. Thank you, sir.

Mr. Chairman and Senator Williams, for the record my name is Will Clayton, and I live in Houston, Tex.

I was formerly president and chairman of the board of Anderson, Clayton & Co. I am still a member of the board of directors of Anderson, Clayton & Co., and I appear here as their representative.

I am here concerned only with that portion of the Revenue Act of 1962 relating to the taxation of cooperatives.

Anderson, Clayton & Co. was organized in 1904 to engage in the business of the merchandising of raw cotton.

We soon added other activities, among them cotton ginning, cottonseed oil milling, and cotton warehousing, and compressing.

In all these businesses our chief competitor now is the cooperatives. The cooperatives have an enormous tax advantage over us.

I would like to give you, Mr. Chairman, and Senator Williams, a simple illustration of this tax advantage. First of all, it is necessary to say that the businesses of cotton ginning, cottonseed oil milling, and cotton warehousing are all activities which are progressing technologically just like other businesses.

This requires the investment of much new capital if one is to keep modern and competitive.

The first cotton gin built by Anderson, Clayton & Co. in 1907 cost $7,500. A modern cotton gin today costs $250,000 or more.

A short time ago a solvent process was developed for the extraction of oil from cottonseed, and the conversion of an old mill from the present process of extraction to the solvent process costs from a half million to a million dollars, depending upon the size of the mill. But the main thing which has caused the necessity of investing large sums of capital in these three businesses, the main thing that has happened, has been a shift in the centers of production of cotton in the United States.

To give you an example, in 1944, 15 percent of the cotton crop was produced in west Texas—not the whole of Texas, but just the western portion—west Texas, New Mexico, Arizona, and California.

In 1961, 44 percent of the crop was produced in these same areas, and the shift still continues.

To sum up, these businesses are no different from any other business. They are insatiable consumers of capital if they are to keep modern and competitive.

Whether it be Anderson-Clayton Co., the cooperatives or some other operators, this capital must come largely from savings out of profits. This is an important element in the free enterprise system under which America has become the greatest industrial nation in the world.

The cooperatives, in addition to tax-free savings, also have access to cheap government capital.

Now, let us see what the respective opportunities are for the accumulation of these savings as between a taxpaying corporation and the tax-free cooperatives. For this purpose we will take two cottonseed oil mills in the West, one owned and operated by a tax-free cooperatives, and the other owned and operated by a taxpaying corporation.

With a good crop and a good season, each of these mills should show an annual profit of about $500,000 before taxes.

Out of this sum the taxpaying corporation must pay to the U.S. Treasury in taxes about $250,000. Hence, it has left only $250,000 for dividends to stockholders, on which they also must pay heavy taxes, income taxes, personal taxes, and for expansion or modernization.

But its cooperative competitor, by issuing to its patron members these little slips of allocation or scrip—on which the courts have held that the recipient cannot be taxed—the cooperative corporation will have left $500,000 for expansion or modernization.

It is easy to see that the cooperatives under present laws and court decisions can continue adding to their existing gins, mills, and warehouses, and building new ones with tax-free earnings until their taxpaying competitors are squeezed out of the picture. This is the situation under existing law and court decisions.

Under this situation, Anderson, Clayton & Co. and their domestic subsidiaries have in the last 10 years paid a total in corporate income taxes to the Treasury of the United States a sum exceeding $62 million and, in addition, our stockholders have paid heavy personal income taxes on dividends received from the company. I estimate roughly that that tax would probably come to $20 million, so that the total which the U.S. Treasury has received from this enterprise would be around $80 million in the last 10 years.

If the business conducted by Anderson, Clayton & Co. which yielded this tax revenue to the U.S. Treasury, had been conducted by a cooperative corporation, the latter could have conducted its affairs in such a way that all this revenue to the U.S. Treasury paid by a taxpaying corporation and its stockholders would have remained in the treasury of the cooperative for purpose of expanding its activities and increasing its tax-free profits.

The pending bill requires the cooperative corporation to withhold 20 percent of profits paid or allocated to patron members. This withheld 20 percent, I understand, is to be considered a patronage dividend paid in cash.

This withholding feature of the pending bill is extremely important because if the House version of the cooperative tax measure should prevail, what the U.S. Government picks up in this 20 percent withholding feature is probably about all they will get in revenue.

The pending bill permits the cooperative corporation to disburse to patron members the remaining 80 percent of their profits in the same kind of allocations or scrip that are now issued, after the adoption of a bylaw requiring all patron members to pay taxes on such allocations.

This, despite the fact that the courts have held that these allocations bearing no interest or due date, have no ascertainable market value, and hence are not taxable to anyone.

If the bylaw provision in the pending Revenue Act of 1962 is adopted, it is almost sure to result in the same type of litigation heretofore experienced.

Presumably, the cooperative corporation, in need of accumulating cash for expansion or working capital, will issue the same type of allocations as heretofore, bearing no interest and without due date, and thus of no ascertainable market value.

The cooperative corporation may then exclude such allocations from income for tax purposes.

If the courts should hold, as is expected, that such allocation is not taxable to the recipient regardless of the bylaw, then, in that event, the exclusion is improper and should be disallowed.

It is respectfully suggested that the pending bill be amended to read that if the courts should decide that the patron member cannot be required to pay income taxes on such an allocation, then the cooperative corporation would be required to pay the regular corporate tax on its total profits, including such allocated profits.

This would make certain that the evident intention of the Congress that at least one tax should be paid to the U.S. Treasury on such profits is realized.

I am sure that the chairman and the members of the Senate Finance Committee recognize that the U.S. Treasury urgently needs this revenue.

Under existing law, and even under the conditions of the pending bill, many hundreds of millions of dollars of cooperative profits are escaping and will continue to escape taxation.

If this condition is not corrected, the sums lost to the Treasury will grow steadily by year as cooperatives take the place of taxpaying businesses.

I want to say to the committee with all the earnestness that I can command that no business paying 52 percent of its profits in taxes to the U.S. Treasury can long continue to compete with another similar business paying no tax to the U.S. Treasury or which can conduct its affairs in such way that it will pay no tax to the U.S. Treasury. The same statement will apply to the 20-percent withholding tax if that should be the only tax in fact collected on cooperative profits. No business paying 52 percent taxes can compete with a business that pays 20 percent taxes.

The business paying the 52-percent tax must liquidate or sell out to the cooperatives.

This is the situation which all taxpaying businesses now face in those activities in which the cooperatives find their best opportunity for expansion, such as the ginning of cotton, the milling of seed, the cottonseed mills, the milling and storage of wheat and other grains. I have only named a few.

I heretofore mentioned one aspect of the free enterprise system under which America has become the greatest industrial nation in the world.

Our antitrust laws are another element contributing greatly to this result. Competition is, indeed, the life of trade.

Our tax laws relating to the cooperatives are leading to their monopoly of cotton ginning and cottonseed oil milling in west Texas, New Mexico, Arizona, and California.

These areas produce 44 percent of the cotton crop of the United States, and in them is located 86 percent of the cooperative cottonseed oil mills, and more than 50 percent of their cotton gins.

Monopoly breeds inefficiency and inhibits initiative, ingenuity, inventiveness.

Anderson, Clayton & Co.'s investment in the United States in cotton gins and cottonseed oil mills lies almost exclusively in the four areas in west Texas, New Mexico, Arizona, and California, which will be shown on Mr. A. L. Reed's map when he testifies later on. His map is exhibit A.

Gradually, but assuredly, we are being squeezed out of the picture. The cooperatives needing to invest their swollen tax-free profits are increasing their facilities, particularly in cotton ginning and cottonseed oil milling.

Even if we attempted to negotiate with the cooperatives for the sale to them of our cottonseed oil mills and cotton gins to be paid for out of their tax-free profits, we feel sure that they would not negotiate seriously for the following reasons: The cooperatives would know that so large a transaction, tending strongly toward monopoly, would certainly arouse public opinion against them in the areas of which I have spoken, that is, of west Texas, New Mexico, Arizona, California, and would endanger their tax-free status.

I feel sure that members of the committee will not have forgotten the decision of the U.S. Supreme Court in the famous case involving the Maryand and Virginia Milk Producers Association, which is a cooperative composed of about 2,000 dairy farmers in Maryland and Virginia.

In that case involving the acquisition by the cooperative of their only important taxpaying competitor left in the area, the Embassy Dairy,

the Supreme Court denied the cooperative's plea of immunity from antitrust law, and required the dissolution of that acquisition.

In view of this unanimous Supreme Court decision condemning the monopoly in milk which the cooperative established by the acquisition of the Embassy Dairy, it is very unlikely that the cooperatives in the geographical areas to which I have referred will purchase the plants of any of their important taxpaying competitors.

It will be safer for them to continue to invest their savings, their tax-free swollen profits, in building new facilities and just to let their taxpaying competitors die on the vine.

There is now almost no market for the gins, mills, and warehouses of taxpaying corporations and, in the end, the stockholders of such corporations will lose their property unless Congress provides promptly for some equalization of taxes between the two types of business.

Mr. Chairman and members of the committee, thank you very much for your patience in listening to this statement. If there are any questions I will try to answer them.

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

Senator Douglas.

Senator DOUGLAS. No questions.

The CHAIRMAN. Senator Williams.

Senator WILLIAMS. No questions.

The CHAIRMAN. Senator Bennett.

Senator BENNETT. I have no questions.

The CHAIRMAN. Thank you. Your statement was directed at the House bill?

Mr. CLAYTON. I beg your pardon?

The CHAIRMAN. Your statement was directed at the House bill relating to the taxation of cooperatives——

Mr. CLAYTON. It was, Mr. Chairman.

The CHAIRMAN (continuing). And not the present law?

Mr. CLAYTON. No, sir.

The CHAIRMAN. You did not mention the present law.

Mr. CLAYTON. I stated the difficult situation we face under the present law, and my statement, as you say, is directed additionally against certain aspects of the House bill.

The CHAIRMAN. And you regard the House bill as being inadequate with respect to——

Mr. CLAYTON. Inadequate; indeed it is, Mr. Chairman. It does not assure collection of one tax upon cooperative profits.

The CHAIRMAN. Thank you, Mr. Clayton.

Mr. CLAYTON. Thank you, sir.

The CHAIRMAN. The next witness is Mr. Samuel J. Lanahan of the Progressive Tax Committee. Mr. Lanahan, take a seat, sir, and proceed.

STATEMENT OF SAMUEL J. LANAHAN, ATTORNEY, PROGRESSIVE TAX COMMITTEE

Mr. LANAHAN. Mr. Chairman and members of the committee, my name is Samuel J. Lanahan. I am a lawyer practicing in Washington, D.C., with offices in the Transportation Building.

I am representing the Progressive Tax Committee, a group of corporations who are suffering from competition given by cooperative businesses.

Mr. Chairman, I do not propose to read my statement but, with your permission, may I have it inserted in the record?

The CHAIRMAN. Without objection it will be inserted in the record following your oral presentation.

Mr. LANAHAN. Before proceeding with my planned remarks, I would like to clear up a point made by a cooperative representative yesterday in his testimony.

He said that allocated patronage dividends cannot possibly be regarded as income to the cooperative. Now, this is entirely inaccurate, in my opinion. This argument has already been answered by this committee. It is quite similar to arguments made by representatives of mutual life insurance companies in resisting tax on underwriting profits of those companies. In a publication of the Farmers Cooperative Service of the Department of Agriculture, it is stated:

> It is a fact frequently overlooked that virtually all persons who carry life insurance in a mutual company receive what amounts to patronage dividends or refunds. It is true that these dividends are not referred to as patronage dividends, but in essence they are practically the same thing.

As you know, in the Life Insurance Company Income Tax Act of 1959 underwriting gains of mutual insurance companies were made subject to the income tax. So if the cooperative spokesman is accurate in his statement, then this committee was incorrect in what it did in the Life Insurance Company Income Tax Act of 1959, and I do not believe that this committee acted incorrectly on that occasion.

Turning now to the bill in the tax message of the President of April 20, 1961, it was recommended that cooperative earnings be subjected to one tax, either at the cooperative level or at the level of the patron. This is an appropriate first step in taxing cooperatives, but it must be recognized as only a first step.

An attempt to accomplish the same result was made in 1951, and various court decisions nullified that legislation. As a result of those court decisions, cooperative income allocated to patrons was deductible by the cooperative, but was not included in the income of the patron.

Cooperative earnings fell through the crack and were not subjected to tax. They have enjoyed a tax holiday for a period of a decade.

In evaluating the current proposal to try to effectuate the 1951 legislation, it is well to examine why the 1951 legislation failed. This is said to be because there were no provisions in that legislation dealing with how the patron was to be taxed on amounts allocated to him but not paid.

It is in the allocation of cooperative earnings which are not actually paid out to the patron that the stress and strain falls on any legislative proposal. The mere insertion of provisions dealing with the patron's side of this problem is not an entire cure, I submit, unless those provisions are effective.

Now, the administration proposal is that cooperative earnings be taxed once, either at the cooperative level or at the patron level. It is a concomitant of this proposal, I believe, that if they are not taxed effectively at the patron level then they should be taxed at the cooperative level.

During the course of the study of this problem by the Ways and Means Committee, three solutions have been considered.

The first solution dealing with how noncash allocations of patronage dividends are to be taxed, would require that the patron file an annual consent to take the unpaid amount into his income. If this consent is filed, then the cooperative may deduct the amount allocated to the patron and the patron, of course, picks it up for tax purposes.

This achieves a nice balance. The deductibility by the cooperative occurs at the same time as the patron reports it in his income.

In a press release of January 25, 1962, the Ways and Means Committee announced a tentative modification of this earlier annual written-consent requirement. Under the modification, the patron would be required to file a permanent written consent with the cooperative, and he would have an annual option to revoke this permanent consent.

This is probably, as a matter of income tax law, as effective as an annual written consent. It is a negative rather than an affirmative act on the part of the patron and, I suppose, to whatever extent a negative act is less effective than an affirmative act, it may be somewhat less effective, however, in insuring taxability of the allocated amount to the patron.

When the bill was reported out by the Ways and Means Committee and, as passed by the House, a third solution was offered, and this solution contains two alternative methods of consenting to take into income allocated but unpaid amounts.

The permanent revocable consent is retained but, in addition, it is provided that consent may be evidenced by becoming a member of a cooperative which has bylaws stating that membership constitutes agreement that patronage dividends shall be includible in income.

Cooperatives have stated that the bylaw consent is desirable in order to remove from them the administrative burden, said to be tremendous, of obtaining and processing annual consents. It seems, however, that organizations which have shown such ability to grow should be able to deal with such a problem. Taxpaying corporations, for example, have been able to survive, although it has been necessary for them to obtain and process stockholder proxies.

The various solutions to obtaining patrons' consents have shown a progressive decline from certainty of tax consequences. Each new solution not only removes to a greater extent the patron's opportunity to decide for himself whether he is going to pay a tax on an amount which is not paid to him, but also increasingly injects by statute a degree of uncertainty which does not seem warranted at this time if we are seeking to effectuate the 1951 legislation.

We are aware of the problems of the 1951 legislation, and we are aware that a case involving a fact situation analogous to the bylaw consent has already been litigated.

In the *Long Poultry* case there was a bylaw which provided that if a patron dealt with that cooperative he should treat the patronage dividends as if they were paid to him and reinvested by him in the cooperative. To be sure, when the *Long Poultry* case was litigated there were no specific statutory rules dealing with the tax consequences to the patron of such a bylaw.

However, it is not entirely clear what this proposed legislation would do. For example, let us assume that there is a cooperative having a bylaw consent provision, and that a patron of such a cooperative also files a permanent written consent.

Now, some years later the patron, still dealing with the cooperative, revokes his written consent. I think that the situation offers to cooperatives the happy prospect of a generation of litigation.

I would like briefly to refer to the withholding provisions proposed on patronage dividends. It is, of course, entirely appropriate that patronage dividends be withheld upon, just as dividends and interest generally would be.

There are three reasons, it seems to me, why withholding on patronage dividends is appropriate.

The first also applies to dividends and interest generally; that is, that there is underreporting with respect to these items.

The second is pointed out in the President's tax message. The confusion of existing law has probably contributed to a great deal of underreporting in this area, and withholding is needed if only for educational purposes to show patrons that these patronage dividends are income.

The third reason is that objections to withholding are frequently made because the distributee of the item is going to have his spendable income decreased. He is going to have less income to spend by reason of amounts being withheld.

It seems to me that this argument does not apply in the case of patronage dividends allocated in the form of scrip. The patron in this case is not having his spendable income decreased. He is merely having his tax paid for him at the cooperative level.

Accordingly, I recommend that the rules of proposed section 3483, whereby it is proposed that any individual who does not anticipate being subject to tax may file an exemption certificate, be made inapplicable in the case of patronge dividends paid in the form of scrip.

That concludes my statement, Mr. Chairman.

The CHAIRMAN. Thank you very much.

Any questions, Senator Douglas?

Senator DOUGLAS. Mr. Lanahan, I wonder if I could try to boil your testimony down as to the three points.

First, do I understand you to say that in the case of patronage dividends distributed they should be taxed to the recipient, and 20 percent withheld by the cooperative?

Mr. LANAHAN. That is correct, Senator.

Senator DOUGLAS. And in the case of noncash patronage dividends to the individual evidenced by the payment of scrip, this is treated as income to the individual and deductible at the source or 20 percent withholding at the source?

Mr. LANAHAN. That is the proposal in the bill, Senator.

Senator DOUGLAS. Yes; and you agree with that?

Mr. LANAHAN. I am endorsing that proposal.

Senator DOUGLAS. That is right.

Mr. LANAHAN. But I am hoping that the taxability to the individual patron will be made clearer than it is now.

Senator DOUGLAS. I understand. But I mean, that is the principle you favor?

Mr. LANAHAN. That is the principle, sir.

Senator DOUGLAS. Then on the proportion of the savings reinvested by the cooperative and not credited to the account of any individual, you are proposing that that be treated as corporate profits and subject to the 52 percent tax?

Mr. LANAHAN. That is the present law, Senator; that would be continued under the bill.

Senator DOUGLAS. And you favor that?

Mr. LANAHAN. Yes, I do.

Senator DOUGLAS. Thank you.

The CHAIRMAN. Senator Williams.

Senator WILLIAMS. Mr. Lanahan, do you recommend that the committee retain the withholding provisions of this bill as they relate to interest and dividends, as well as——

Mr. LANAHAN. Senator, it is difficult for me to make that recommendation at this time. I am only saying that if there is to be withholding on dividends and interest generally, then certainly patronage dividends fall into that kind of income with respect to which tax should be withheld.

Senator WILLIAMS. Have you read the brief prepared by Mr. Mac Asbill for the National Council of Cooperatives and, if so, do you agree with his conclusions?

Mr. LANAHAN. Senator Williams, I have read that brief. Mr. Asbill writes very persuasively that a bylaw consent provision is constitutional. I believe that it is very probably constitutional, Senator Williams.

I must say, however, that even the writer has to admit that the matter is not free from doubt. He has the candor in footnote 6 of his brief to say:

> Those who have expressed doubt as to the constitutionality of the proposed legislation have not analyzed the problem correctly. They have erroneously looked to the document itself for the constitutional justification for taxing the patron. The writer of this memorandum, before he had given any study to the constitutional issue and before he had placed that issue in focus, also took this approach.

He then cites an article wherein he took the approach that the paper allocation was not income within the meaning of the 16th amendment. His article appeared in the Virginia Law Review in 1956. Now, I doubt if a journal of the stature of the Virginia Law Review would accept an article by a writer who had not placed the issue in focus

So I submit that it is not entirely clear when we have an able attorney on both sides of the same question.

Senator DOUGLAS. You mean the same attorney on both sides——

Mr. LANAHAN. Yes.

Senator DOUGLAS (continuing). At different periods.

Mr. LANAHAN. At different periods, to be sure. But the issue was later put in focus.

Senator DOUGLAS. I am very glad to see a lawyer get in that position. Politicians are frequently placed in that position. [Laughter.]

Senator WILLIAMS. I have no further questions, Mr. Chairman.

The CHAIRMAN. Senator Hartke.

Senator HARTKE. No questions.

The CHAIRMAN. Senator Bennett.

Senator BENNETT. No questions.
The CHAIRMAN. Thank you very much, Mr. Lanahan.
(The prepared statement of Mr. Lanahan follows:)

TAX TREATMENT OF COOPERATIVES AND PATRONS—SECTIONS 17 AND 19 OF H.R. 10650

(By S. J. Lanahan)

In his tax message of April 20, 1961, the President recommended that all cooperative earnings be taxable either to the cooperative to its patrons. This proposal is an appropriate first step in the solution of the difficult problem of cooperative taxation. As this committee well knows, an attempt to achieve this result was made in the Revenue Act of 1951 but various court decisions rendered this legislation ineffective by holding certain allocations of patronage dividends to be nontaxable to the patron, although deductible by the cooperative. Even though the patron is not taxed on the paper allocations, cooperatives are allowed a deduction for the amount of current earnings so allocated even though not paid. As a result, cooperative earnings have enjoyed a holiday from current taxation for a period of over 10 years.

In evaluating any proposal to implement the President's recommendation, it is important to keep in mind the fact that the 1951 legislation failed to achieve its stated objective. The failure of the 1951 legislation is said to be attributable to the fact that Congress made no specific provision in the law for the tax treatment to be given noncash patronage dividends by the patron. The insertion of such a specific provision, it is assumed, would cure the problem. However, it is well to remember that the mere insertion of specific provisions is not the answer if the confusion of the 1951 amendments is contained in the specific rules to be inserted.

THE CONSENT RULES

The administration proposal that cooperative earnings be taxed once, either at the cooperative level or to the patron implies that allocations of noncash patronage dividends be deductible at the cooperative level only if the allocated patronage dividend is includible in the income of the patron. This was not spelled out by the administration but it seems to be the necessary concomitant of any proposal that cooperative earnings be taxed—if only once. During the course of study of this problem by the Ways and Means Committee, three different solutions have been considered.

(*a*) In the so-called discussion draft, dated August 24, 1961, of what is now H.R. 10650, a cooperative was to be allowed a deduction for patronage dividends paid in money or qualified scrip. For this purpose, qualified scrip was scrip which could be redeemed in cash at its stated dollar amount within 90 days after issuance and also scrip which the patron has consented to take into account at its face value in computing his income. In order for the paper allocation of cooperative earnings to be deductible by the cooperative, the patron must have given a written consent to have it treated as a distribution for income tax purposes. In this draft, this consent would have had to be given annually by the patron. Thus the draft achieved a nice balance—a deductible item at the level of the cooperative and an includible item in the income of the patron. The annual consent removed any doubt concerning taxability to the patron.

(*b*) In a press release of January 25, 1962, the Ways and Means Committee announced its tentative modification of the earlier provisions concerning written consents. The written consent would be required to be made only once rather than every year. Such a consent would stand until revoked by the patron. The revocation could, however, be made only on an annual basis.

As a matter of income tax law, a permanent written consent to include an amount in income—even though not received—which is valid until revoked is quite probably effective in achieving the tax result requested in the President's tax message. There may seem little difference between a requirement that there be an annual written consent to pay tax on amounts not received and an annual revocable opportunity to decline to pay such a tax. Still the annual consent is an affirmative and new agreement that the earnings will be reported by the patron as income for tax purposes. The annual opportunity to revoke a permanent consent is negative in nature, that is, the patron agrees that he will report his annual allocated earnings unless he decides to refuse to do so and takes steps to refuse to do so.

To the extent that a negative statement is less certain than a positive agreement to include something in income, the action proposed in the January 25, 1962, press release, jeopardized the objective sought in the President's message, i.e., to insure that cooperative earnings are definitely currently taxable.

(*c*) The third solution to the consent problem is that now, in H.R. 10650, as passed by the House, there are two alternative methods by which a distributee may make a consent so that the amount of a patronage dividend allocation is not taxable to the cooperative. The first is by the annually revocable permanent consent. The second is by becoming a member of a cooperative which has adopted a bylaw providing that membership constitutes consent and by receiving a written notification and copy of the bylaws.

The proposed solutions to the problem of insuring that noncash allocations shall be taxed to the patrons have undergone a progressive decline from certainty. Certainty is retained, however, with respect to the allowance of a deduction by the cooperatives for such allocations.

A situation analogous to the bylaw consent rule has already been the subject of litigation. In *Long Poultry Farms, Inc.* (249 F. 2d 726 (4th Cir. 1957)), the bylaws of the cooperative there involved provided that the patronage dividends should be treated as distributed to the patron and then reinvested by him. The court held that the patron did not have to report the amount of these paper allocations in his income in spite of the Government's argument that dealing with a cooperative with bylaws containing such a provision should be treated as consent by the patron to report allocated but undistributed income. While it is true that if H.R. 10650 were enacted there would, unlike the situation in the *Long Poultry* case, be statutory rules dealing with the taxability of noncash distributions to patrons. It would be regrettable, however, if these rules are so drafted as to permit the confusion of existing law to continue.

H.R. 10650 would also insert a new opportunity for confusion not present in existing law. As indicated above, the bill retains the revocable individual consent as an alternative method of consent. Assume that a cooperative has obtained its members' consent to reporting patronage dividends through both alternatives, i.e., through individual consents and also through the bylaw route. Assume further that a member revokes the written individual consent but continues to deal with the cooperative. This situation offers to cooperative management the happy prospect of a generation of litigation.

Cooperatives have argued that the necessity of obtaining and processing written consents would impose a tremendous administrative burden and expense on them. In view of the acumen and energy which cooperatives have shown in their competition with other businesses, the argument seems unrealistic. It seems unlikely that the burden of obtaining annual written consents would be insuperable. The taxpaying competitors of cooperatives have been able to meet and solve the problem of obtaining and processing stockholders' proxies. Acceptance of this argument by cooperatives would seem to disparage the ability of cooperative management.

Any contention that the administrative burden of individual revocable consents would be too great for cooperatives to bear must stand or fall on a showing that the farmer will not do as well financially as if he remains in control of his own tax liability. To allow the individual farmer the opportunity to make his own choice concerning payment of income tax on amounts he has not received is clearly more advantageous to him than if he were to be denied this choice.

In addition to a progressive decline from certainty of tax consequences, each new proposed solution removes to a greater extent the patron's opportunity to decide for himself whether he is going to pay a tax on his share of the net profits of the cooperative which he is not allowed to receive. It is difficult to understand why the responsibility for determining the taxation of cooperative patrons should rest solely with management and should not be entrusted to the individual taxpayer.

It is recommended that there be only one rule concerning the consent by a patron to include noncash allocations of cooperative earnings in his income. This rule should require an annual written consent to do so on this part. This seems not only fair to the patron but also the most effective means of preveting litigation over the question whether the patron has income with respect to these undistributed amounts.

In the event this solution is not adopted, it is recommended that, at the very least, steps be taken to insure that this 1962 legislation shall not result in a

contained tax holiday for cooperative earnings. An appropriate safeguard to this end would seem to be to require that the cooperative be held taxable on earnings allocated to its patrons to the extent held not to be includible in their income.

WITHHOLDING ON PATRONAGE DIVIDENDS

In the President's tax message proposing withholding on dividends and interest generally, the withholding system, of course, included patronage dividends. The message stated that there is underreporting of patronage dividends just as there is underreporting of dividends and interest. The message further pointed out that the confusion in the law during the past few years with respect to the includibility of paper allocations could not help but bring about underreporting.

Accordingly, in addition to normal underreporting in the case of patronage dividends, there is a further reason for withholding on these items, i.e., the necessity of educating patrons that their patronage dividends are includible in income. A withholding sytsem will assure that the average patron will have sufficient cash with which to pay his tax on scrip which he has consented to take into income. As the President's message points out "rather than constituting a hardship, withholding would assist many patrons."

Proposed section 3483 in section 19 of H.R. 10650, contains special rules allowing an individual to file an exemption certificate with the payor of amounts which would otherwise be subject to withholding. Payments to such an individual will not be subject to withholding if he certifies that he reasonably believes that he will not be liable for any income tax for the year in which the payment would be withheld. According to the report of the Committee on Ways and Means, this rule is inserted to prevent hardships in the case of those who may be subject to overwithholding and thus may otherwise have a drop in their spendable income—at least during the first year in which a withholding system is introduced.

Proposed section 3483 may be an appropriate provision for payments of dividends and interest to persons who will not be liable for income tax. However, the reasons for its insertion do not seem to apply in the case of patronage dividends where the payment is to be in the form of scrip. In such a case the distributee does not receive cash in any event and does not undergo any hardship by being deprived of spendable income because of the introduction of a withholding system. Accordingly, it is suggested that patronage dividends be eliminated from the scope of proposed section 3483.

The CHAIRMAN. The next witness is Mr. G. G. Giebink of the Grain and Feed Dealers National Association.

Take a seat, sir, and you may proceed.

STATEMENT OF GILBERT G. GIEBINK, GRAIN AND FEED DEALERS NATIONAL ASSOCIATION

Mr. GIEBINK. Thank you.

Mr. Chairman and members of the committee, my name is Gilbert G. Giebink. I am financial vice president and treasurer of F. H. Peavey & Co. of Minneapolis, Minn.

My company is engaged in the grain, flour, and feed business.

I appear here today on behalf of the Grain and Feed Dealers National Association of which our company is a member.

Just by way of background, the Grain and Feed Dealers National Association is 66 years old, has approximately 1,700 members in 47 of the 50 States.

The document that you gentlemen are looking at is obviously entirely too long to be read. I would like to request that it be made a part of the record following the oral statement which I would like to make at this time.

The way I would like to approach this is to call your attention to particular parts of the long statement and some of the charts and facts and figures that are appended to it as exhibits.

It occurs to me that there could be no more appropriate time to appear before this committee urging that the cooperatives be taxed.

I, as an individual, have just parted with the last of my tax dollars for 1961. I have just paid the first small installment on what it looks like I will owe for 1962. I suspect that most of you have done exactly the same thing.

To the best of my knowledge, any single one of you has paid more than the combined tax paid by the multimillion Farmers Union Grain Terminal Association, Farmers Union Central Exchange, and several hundred other tax-exempt cooperative corporations which are doing business in competition with my employer. That happens to be my own personal position, and I think it should be yours. There are many more individuals just like us.

There is another point that occurs to me which has been obscured by the heat of the controversy over this question the past 15 or 20 years. Many people lose sight of the fact that it is not the inanimate taxpaying corporation that is objecting to the privileged tax treatment which is received by cooperative corporations. These corporations, like my employer corporation, are just people—people like me, who are employees and who have their lives and futures tied up with the business people like our stockholders who have a lifetime of savings invested in the business.

There are literally millions of us whose jobs and investments are jeopardized by the lack of taxation of cooperatives.

Here is the way I would like to cover the balance of the statement. I am going to make a number of points to provide the groundwork and the background for the conclusions and the recommendations which we will make—then the recommendations.

First, I would like to show that the cooperatives generally have grown in size and importance. I would like to review a few specific examples.

Second, I want to show that tax advantage influences growth and competitive position.

Then I would like to discuss a few facts and some of the fallacies which apply to the controversy, and finally we have a few specific recommendations to make which have particular application to the bill which you gentlemen are considering.

First, about the present size and importance and growth: Something has occurred in recent years which I have never been quite able to understand. Cooperatives at many times are inclined to minimize the importance of our economy. For example, Mr. Rumble, who appeared before you yesterday, at the time of the panel discussions before the Ways and Means Committee, suggested that the $14 or $15 billion of gross business done by cooperatives was no more than that done by just a few large corporations in the country. I think he referred to Standard of New Jersey, A. & P., and a few others.

An important fact which he neglected to point out was that these corporations, although they did the same amount of corporation business, also paid in the same year approximately $300 million of income tax to the Federal Government.

The point is that in our statement we have made the important point that cooperatives are large, that they have grown, and that they are continuing to grow at a rapid rate.

Now, all of this is pointed out in a bar chart which we have used, which shows in chart form exactly what has happened in recent years.

If you will look at the chart you will notice that back in 1926 the total volume of business done by the cooperatives amounted to $2.4 billion.

Using the Farmer Cooperative Service's own figures, this business had increased to $14.9 billion by 1959.

We like to be eminently fair in approaching this matter of growth, and it is quite obvious that part of this growth is attributable to change in price during this period of time, so we made another calculation. We attempted to take price out of this by using a series of price indexes. The methods of computation are described in detail in the particular exhibits.

The bars on the right-hand side of the chart show the increase in adjusted volume of business, giving effect to constant dollars.

It is always helpful if you think in terms of the matter of growth in the light of a few specific examples. I would like to use the Farmers Union Grain Terminal Association, which happens to be a close competitor of my own company. I use it because they operate in my own backyard, and because I maintain a rather complete file on their operations.

I would like to have you take a look, if you would, at the statement, in which we have included a comparative balance sheet for the Grain Terminal Elevator Association. I think it is particularly interesting to notice that their total assets increased from approximately $1,350,000 in 1939 to approximately $89 million at the end of their last fiscal year.

Obviously, this occurred in conjunction with increases in liabilities at the same time, but their increase in the net worth of their business during the same period of time was from about $350,000 to approximately $41,300,000.

Some of the more recent acquisitions of this large business are outlined in my statement.

A few years back they acquired the McCabe Elevator Co., 57 elevators in 1958, at a cost of $6 million.

A little later on they acquired 40-odd Archer-Daniels-Midland Co. elevators at a cost of approximately $1.5 million.

In 1960 they acquired the assets of the Honeymead Products Co., a soy bean processing corporation located in Minnesota. The cost was $6 million.

In the fall of last year they acquired the assets of the Minnesota Linseed Oil Products Co. at a cost which I do not know.

The acquisitions of this large cooperative corporation in the past few years have amounted to approximately $15 million of assets of businesses which were taxpaying corporations.

Our exhibit D shows the growth of this terminal association over a 10-year period ending 1961. What we did in this bar chart was to show the actual growth of the Farmers Union Terminal Association. Then we tried to use the same annual rate of earnings, applying those

same percentage earnings to a taxpaying corporation, starting out with the same net worth.

It is interesting to notice that the Farmers Union Terminal Association's net worth increased from $21.9 million at the beginning of the period to $41.3 million at the end of the period, whereas a taxpaying corporation operating under identical circumstances and with a similar rate of return would have increased from $21.9 to $29.3 million.

We did one other thing in conjunction with this in an attempt to get at this problem—this matter of the growth of taxpaying and nontaxpaying corporations which is before you. We put together another chart which is exhibit E. Here we took the Farmers Union Grain Terminal Association's beginning net worth in 1962, $41.3 million, and we started them out with that. Then we made a few assumptions, and these are brought out in the figure work that follows the bar charts. We assumed, for example, that they would earn at the rate of 10 percent a year before taxes on their beginning net worth at each year, and we projected this annual rate of return out over a 10-year period.

The black bars in exhibit E show that if they were able to sustain this rate of growth, they (the FUGTA) could approximately double their net worth in 10 years.

We then did another projection and we assumed that they had 20 percent less money each year to grow on, this being the money approximately equivalent to the withholding tax which would have been paid under the House bill.

The growth could still have been from $41.3 to $82.7 million in the 10-year period.

Then we compared this with a taxpaying competitor operating under a 52-percent tax assumption. It could have increased its net worth from $41.3 to only $54.6 million.

In the process of doing this, we do not want to overlook the regional supply cooperatives. We refer to these in exhibit F.

We show some figures in exhibits F, G, and H relating to the financial statements of 16 major regional farm supply cooperatives.

I think it is particularly interesting to note the increase in assets of this particular group of cooperatives which, as I recall, was from approximately $100 million in 1945 to approximately $600 million by 1959, a growth of approximately 600 percent.

Exhibit I is another exhibit which relates to the Farmers Union Central Exchange—an increase in net worth during the last 10 years of the difference between $25 million beginning and $67 million net worth at the end of the period.

We also show some figures at page 12 which relate to the Farmers Elevator Service Co., at Fort Dodge, Iowa, to show what can happen to a substantially smaller regional supply cooperative: $1,400,000 at the beginning of a recent 5-year period and almost $3,300,000 at the end of the 5 years.

I think we can see that these figures and facts do establish the fact of growth, establish a fact of rate of growth, and we derive a conclusion from this that under existing circumstances we may assume this growth to continue over an extended period of years.

We also know that tax advantage has a very real bearing and influence upon the growth of these cooperative corporations.

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It has been a major contributing factor.

We go on at pages 13 and 14 to show how grain elevators operate.

I am sure that many of you who are familiar with the agricultural areas know how grain elevators receive and store grain, how they handle it, ship it to terminal market, and if they buy it and sell it they hope to obtain a margin to compensate them for the services performed. If it is grain for storage, storage is performed for a storage fee.

We point out how grain cooperative elevators operate under similar circumstances, how the types of their operation are the same.

We point to the present tax treatment of these grain cooperatives under existing Treasury regulations, and more specifically under the statutory exemption available to the tax-exempt cooperatives, and from this we derive two conclusions:

1. That the tax advantage received by cooperative corporations is translated either into price, the price at which grain can be bought by the country grain elevator, or (2) if it not directly translated into price it is translated into retained earnings.

In either event, whether price or whether earnings retention, this has a very direct bearing upon the rate of growth of the cooperative elevator.

If it is price, the cooperative corporation is able to pay slightly more for grain than its noncooperative competitor. We all know that farmers will patronize an elevator where they can consistently get the best total price.

This influences volume, and volume, in turn, has a direct bearing upon unit cost. The greater the volume the lower the per unit cost, and the advantage attributable to income tax avoided rapidly pyramids.

The growth of cooperative corporations is more dramatically affected by the amount of earnings which they retain. Here we prepared two exhibits, J and K, and I think they will be worth a little bit more careful examination.

I would like to have you look at exhibit J first. This is a series of bar charts supported by the figure work in the tables 1 through 7 immediately following the main chart.

What we have tried to do here is to take a series of assumptions, and we apply identical assumptions to taxpaying corporations and to cooperative corporations. Then we try to project these out for a 10-year period of time.

For example, we start in this chart with beginning net worth of $1 million. We do this so we can talk about a 52-percent tax rate situation.

We apply a uniform rate of return through this 10-year period of 16 percent before taxes per year.

We use this figure because this will permit a taxpaying corporation to pay a dividend and to retain earnings for growth.

Now, here is what exhibit J shows: The first bars recite the information in table 1, and they show that growth of a noncooperative taxpaying corporation during a 10-year period, starts at $1 million and at the end of 10 years it will be up to approximately $2.1 million. It will have paid a tax of $1,187,000.

An identical cooperative corporation starts with the same net worth, earnings at the same rate of return during this period of time will have grown to approximately $4.4 million by the end of the 10-year period.

Then in tables 3 and 4 all we have done is introduce another assumption. We have said that both corporations are going to pay a 4-percent cash dividend on their beginning capital or $40,000 a year as a return on that $1 million of investment.

Even under these circumstances the growth of the cooperative is substantially more rapid and will grow to a greater extent than can its taxpaying corporate competitor.

Then in tables 5, 6, and 7 we introduce some other assumptions. In table 5 we assumed 20 percent withholding and the balance retained. In table 6 we introduced a revolving fund assumption, and in table 7 we introduce a revolving fund assumption and a 20-percent tax.

Then we go on and we have applied exactly the same type of an approach to $100,000 beginning net worth corporations in exhibit K. We apply a series of assumptions to these groups. Here we have a noncooperative corporation in the table 1 example which, at the end of the 10-year period, will have grown from $100,000 beginning net worth to $271,000.

The cooperative competitor, under the same types of assumptions, will have grown to $405,000.

Tables 3, 4, 5, 6, 7, 8, and 9, as I said, introduce other assumptions; the payment of dividends, withholding which, incidentally, is incorporated in table 7, and it shows that a cooperative corporation, even under a 20-percent withholding assumption will still have grown from $100,000 to $300,000—$311,000 in this 10-year period of time.

I think you will find these figures, these bar charts, helpful to you in understanding the rate of growth, how tax advantage contributes to this growth, and the potential end result where you continue to permit cooperative corporations to accumulate capital at a relatively low cost.

We have used a couple of other exhibits, and I am going to skip over those very hastily.

Exhibit L is a very interesting exercise in figures. We tried to set up a cooperative corporation with an assumption that it would pay a 4-percent cash dividend on its beginning equity, that it would distribute all of its earnings in cash, and that it would be successful in obtaining the reinvestment of approximately 50 percent of these cash dividends. Even under those circumstances we find that a cooperative corporation can grow at a much more rapid rate than its taxpaying corporate competitor.

Then we get around to discussing some facts and fallacies, and I suspect this is where a certain amount of the heat involved in this argument has developed. I would like to point out just one or two of those.

It is erroneously alleged that cooperative corporations do not have income. We have discussed this.

We point to a statement by Mr. Roswell Magill who has appeared on behalf of our association a number of times previously, in which he concludes that it cannot be fairly held that a cooperative has not realized income.

I have lived with corporate finance for the past 10 or 15 years. A point that I want to get across to you is the importance of capital and the contribution which it makes to the success or lack of success of our company.

For some reason or other—and I am not entirely sure why cooperatives do this—they almost completely disavow the contribution which capital invested in a business makes to the yearend result. At the same time, however, they argue that capital is absolutely necessary for survival.

If capital is necessary to sustain growth, then it must contribute importantly to the margins which arise at the end of the year—or why have it?

In any other business, these yearend margins are regarded as earnings on capital or the cost of the hire of capital, and the income tax consequences on the realization of this income cannot be avoided by any anticipatory contractual arrangement however skillfully devised.

The facts are that the yearend margins of any cooperative corporation, just like any business corporation, are the result of the patronage of the cooperative's customers, the skill of the cooperative's laboring force, the enterprise and ingenuity of its management and, above all, the capital which is invested in the facilities, the tools, machines, and working capital which makes all of this possible.

Another fallacy: Patronage dividends are merely price adjustments, the additional yearend payments for commodities purchased, or a refund of overcharge for goods sold. We cover this in our statement.

I have been in the grain business for many years. I was raised in a small town in Iowa. I worked in a grain elevator out in North Dakota. I am not going to go into the detail of a typical grain transaction, but I think most of you will appreciate that the grain which is bought by a country elevator is of many grades, many qualities. It is commingled when stored.

It is almost impossible to identify patron A's grain with patron B's grain, or to trace transactions through. And yet almost without exception the patronage dividend on all customers' grain is identical with respect to the class of grain handled. The wheat dividend may be 5 cents a bushel, and this applies to patrons A through Z.

The point that I want to make is that, in my opinion, it is impossible to devise a system which will effectively determine and trace the profit margin or earnings margin or patrons' overdeposit, call it what you wish, with respect to any single patron's individual transaction with his cooperative. It simply cannot be done.

Here, again, the main point we are trying to make is that something other than the commodity itself is involved in creating whatever it is that the cooperative corporation ends up with at yearend.

Capital and labor and a sometimes forgotten element called enterprise have something to do with yearend profit and loss.

No one should fool themselves in talking about price adjustment. To say that patronage dividends are price adjustments is merely a convenient way of describing earnings which are distributed on the basis of patronage rather than as a return on investment.

This point becomes very clear when you examine any of the 10-year exhibits. It is very apparent because farmers who do business with a

cooperative association, who have done business with a cooperative association, 10 years ago left their earnings with the cooperative corporation to provide the capital needed.

The same was true of the patrons 9 years ago, 8 years ago, 7 years ago.

In the case of the Farmers Union Terminal Association, if this money had been worth only 5 percent, the value of the cumulative earnings retentions this year would have amounted to about $2 million. In other words, if they had not had this money available and had had to borrow at 5 percent, it would have cost them $2 million to obtain it.

This money was, in fact, distributed to the current year's patrons on the basis of this year's patronage.

So what has happened is that the earnings derived from the accumulations of a period of years, from many, many patrons, are distributed to this year's patrons.

Then we go on to fallacy No. 3: Cooperatives are small and immature, need protection as infant industries.

It is difficult for us to see how this point can be made in view of the very large and substantial growth of many cooperatives in recent years.

Fallacy No. 4: This is one that I would like to get across to you—many prominent cooperative spokesmen say, in effect, that any business which chooses may organize so as to refund earnings to customers on the basis of patronage and may deduct such refunds for tax purposes.

I suspect that is right, but it is an obvious impossibility.

Any corporation such as mine or any corporation which has an obligation to its stockholders, if it distributed all of its earnings to its customers rather than to its stockholders, would have little reason to exist.

To suggest this as a desirable alternative is to deny the existing owners of taxable corporations the right to a return on their investment, and it will, in effect, prevent the creation of any corporations where capital must be obtained for a price.

Then, there is another fallacy. Cooperative corporations do not have access to capital markets as do taxable noncooperative corporations.

We included an exhibit, exhibit M, which shows the loans to farmer cooperative associations made by selected U.S. lending agencies, and this is primarily the Bank for Cooperatives, during the years 1930 to 1960. The most recent figure would indicate that these loans amounted to approximately $648 million on the first of January 1961. By July they dropped off to $594 million, but this is a seasonal-type fluctuation.

So far as I know, and I have been in the business of raising money for grain companies for many years, cooperatives can, and often do, borrow from many nongovernment agencies.

They regularly issue various types of debt instruments and have been successful in selling them. They can and do issue preferred stock, and exempt cooperatives have a significant advantage over their

taxable competitors because the dividends on such stock can be paid with 100-cent dollars.

I see no reason why a cooperative corporation that is well run and well managed does not have access to capital markets to obtain the capital necessary for operations and consistent growth.

It is quite obvious when you put this together, that this association cannot agree to the limited and substantially ineffective proposals for partial taxation of cooperative corporations and their patrons as proposed in H.R. 10650 which is now before your committee.

In this respect, we would subscribe to a conclusion previously expressed that the bill represents an unbelievably complicated way of imposing a 20-percent tax on cooperatives.

There are a lot of legal objections. I think these have been well stated by some of the persons who have appeared before you. Mr. Lanahan considered and covered all of them that I know of, Mr. Bryson before him, yesterday afternoon.

We do have one particular point, and this relates to the consent provision. We have never quite believed that it was right to make a farmer or other patron pay a tax out of his own pocket when he receives a noncash dividend over which he can exercise no real dominion and control.

In this respect, I would just like to point to the paragraph in Mr. Shuman's statement in which he concluded yesterday that the consent provisions of the bill are unworkable and unacceptable.

Now, a little more about the recommendations which we would like to make, and these are incorpoarted on the last page of the prepared statement. We would like the privilege, Mr. Chairman, of submitting some specific recommendations for the taxation of cooperatives, but these recommendations would include essentially the following:

They would include a suggestion that sections 521 and 522 of the Internal Revenue Code be amended to allow the benefits of exemption to newly organized cooperatives for a limited number of years.

We do not think it quite right to continue to permit this exemption to apply to cooperatives which have grown, which have had the benefit of exemption for 25, 30, 35, 40 years, and which are already now well-established and mature.

This amendment should bear some relationship to the size of the business and, perhaps, it should be made progressively applicable over a period of the next few years.

In conjunction with sections 521 and 522, we see no reason whatsoever for the provision which, in effect, allows the income from Government business to be distributed tax free. This privilege should be terminated immediately.

On the patronage dividend question, we believe that the deduction for patronage dividends should be limited to cash patronage dividends, and when we say cash it must be interpreted and defined to mean only those distributions paid in cash as that term is commonly understood in commercial usage.

The recipient of the dividend should have complete dominion and control over it; he ought to be able to call it his own; he should be able to do with it what he wants.

To the extent that withholding is applied to other dividend and interest payments, we believe it must also be made applicable to all patronage distributions.

Finally, we believe that a large part of the earnings of a cooperative must be taxed at the corporate level. The earnings so subject to tax should be substantially equivalent, to the income which is derived from the capital invested or employed by the cooperative corporation.

We would like to recommend that this committee give serious consideration to the Canadian system under which patronage dividends may not be used to reduce the income of a cooperative corporation below a certain percentage of the capital which it employs in any taxable year.

This was their way of getting at the problem of income on capital used or retained in the business, and it is one way of resolving this problem and the similar problem of price adjustment or the price adjustment factor which may be involved in any patronage distribution.

I would like to conclude this statement with a request and a hope that this committee will take significant action to give noncooperative taxable corporations a Magna Charta of their own. We need it very badly if we are to continue to survive in competition with these large businesses. Without it we are all going to encounter considerable difficulty, and in many areas I feel that there will be little, if any, noncooperative competition to the large and growing cooperatives which have preempted the field.

Thank you very much.

The CHAIRMAN. Senator Douglas.

Senator DOUGLAS. Mr. Giebink, you referred to the banks for the cooperatives. When were they set up and approximately when was the authorizing legislation passed, do you remember?

Mr. GIEBINK. As I recall, this was back in about—the original exemption was set up a a form different than it is today, back in about 1916. For many, many years, the exemption obviously had limited effect because the corporate income tax——

Senator DOUGLAS. I am speaking for the banks of the cooperatives which you mention, the special banks.

Mr. GIEBINK. The central banks for cooperatives—I am looking at the chart on exhibit M—the banks for cooperatives in 1930 had no loans on farmer cooperative organizations. By 1940 they had made $76 million of loans, so I would assume that somewhere between that period of time the banks for cooperatives started making loans.

Senator DOUGLAS. Can anyone supply that fact?

Mr. REED. 1933, Senator, was the first Farm Credit Act which set up the Bank for Cooperatives, and in 1950, the 1950 act enlarged it.

The CHAIRMAN. Will you identify yourself, please, sir?

Mr. REED. Yes, sir. I am A. L. Reed.

Senator DOUGLAS. Thank you.

No, Mr. Giebink, I want to see if I understand your specific recommendations. In the matter of cash patronage dividends, are you saying these should be first taxed in the cooperatives and then be subject to individual income tax?

Mr. GIEBINK. Senator, a cash patronage dividend consists of two things, as a general rule. It is part income and, to some extent, it is part price adjustment. It is our basic premise that the part of that patronage dividend which is income should be taxed at the corporate level, and would then be taxed again at the patron level.

Senator DOUGLAS. That is your position?

Mr. GIEBINK. That is correct. But under the circumstances which exist with respect to this bill, our recommendation has been made that you make your start at this time by permitting the cooperative corporation to deduct cash patronage dividends. These would then be taxable to the patron recipient of that cash.

Senator DOUGLAS. In other words, you are not now contending that there should be a prior tax on the cash patronage dividends of 52 percent and then a subsequent taxation on individual income, but you are willing to have these taxed purely as individual income; is that correct?

Mr. GIEBINK. We will not ask for that at the present time; that is correct.

Senator DOUGLAS. And, of course, to have that accompanied by withholding.

Mr. GIEBINK. Yes, sir.

Senator DOUGLAS. Now, second, as to noncash dividends credited to the account of individual members according, presumably, to their sales or purchases, do you wish to have those taxed as individual income or as profits to the cooperative?

Mr. GIEBINK. We believe that those should be taxed at the corporate level.

Senator DOUGLAS. At the corporate level.

Mr. GIEBINK. At the corporate level rather than——

Senator DOUGLAS. Would you also have them taxed as individual income?

Mr. GIEBINK. In this respect, when ultimately distributed in cash they would then become allowable deduction at that subsequent date to the cooperative corporation and would be taxable at that time to the patron. You see, scrip at some later date will be paid in cash.

Senator DOUGLAS. In other words, you would only have the corporate tax superseded by the individual tax when there was a later cash distribution; it that correct?

Mr. GIEBINK. That is correct.

Senator DOUGLAS. In the case of reinvested savings, not credited to individuals, you believe this should be taxed at the corporate level?

Mr. GIEBINK. These amounts of money which a patron or a member would reinvest——

Senator DOUGLAS. Not reinvestment by individuals, but withheld by the cooperative without being credited to the account of any individual member.

Mr. GIEBINK. I am sorry, sir. Those should be taxed to the cooperative corporation, as they are, incidentally, at the present time.

Senator DOUGLAS. Yes.

The CHAIRMAN. Senator Williams.

Senator WILLIAMS. No questions.

The CHAIRMAN. Senator Bennett.

Senator BENNETT. Mr. Chairman, I have several questions to ask the witness.

You are in the grain elevator business, and you have referred particularly to cooperative grain elevators as your competitors.

In the process through which the grain is brought to the elevator by the farmer, he gives a mortgage to the Commodity Credit Corporation. He later decides to let the CCC take the grain, and at some point along the line the Commodity Credit Corporation becomes the owner of the grain; is that right?

Mr. GIEBINK. That is correct; essentially so, Senator, yes.

Senator BENNETT. Well, I am sure——

Mr. GIEBINK. We are assuming a farmer who has taken a loan on grain and the loan has been defaulted so that Commodity acquires title.

Senator BENNETT. Can you tell me approximately the percentage of the business done by the Farmers Union Grain, whatever they call it?

Mr. GIEBINK. The Terminal Association.

Senator BENNETT. What percentage of grain stored by the Terminal Association is actually grain that belongs to the Federal Government and has passed out of the hands of the cooperative.

Mr. GIEBINK. I think, Senator, that they, as is typical of many other large cooperative corporations or noncooperative corporations in the business, derive a very substantial part of their earnings in the business of storing government grains; in their instance it would be several millions of dollars, I do not have the specific figure.

Senator BENNETT. Would it be fair to say when the grain actually passes into the hands of the Government the cooperative has no longer any interest in it, and these elevators, in fact, perform a function for the Government and not for the cooperative? Isn't that the reason why the income from the rental of storage of grain that belongs to the Government should be handled differently from the income of grain that still belongs to the cooperatives?

Mr. GIEBINK. Yes, Senator. This is why we have specifically recomended that the exemption provision which permits the avoidance of tax on this on income from Government business be terminated immediately. We can see very little reason for allowing this income to be placed in a position where the Federal income tax be completely avoided.

The income derived from this business is attributable to a relationship between the cooperative elevator and the Government storer of grain; the income is derived from that relationship. The continued tax-free distribution of this income is unwarranted at the present time.

Senator BENNETT. Is that contained in any of these four recommendations?

Mr. GIEBINK. Yes; it is. It would be contained in our recommendation in our statement.

Senator BENNETT. I see. I was, unfortunately, called out of the hearing room just when you were getting into the middle of those recommendations.

It has seemed to me that this point is something which the committee should look at very carefully because this has nothing to do with the relation between the cooperative and the patron. This is business that is done by a cooperatively owned unit, with the Federal Government, or it might be done with any other private organization that wishes to store grain.

Mr. GIEBINK. I believe you are almost entirely correct, Senator.

There is one point that I want to make before my co-op friends make it for me. That is the fact that at least to some extent this grain may have originated way back down the line a year or 2 years previous from a member of the cooperative association, you understand that.

Senator BENNETT. I can understand that. But it seems to me at the point he transfers title to the Commodity Credit Corporation he no longer has any legal interest in that grain.

Mr. GIEBINK. That is correct, sir.

Senator BENNETT. And the cooperative is then in the business of supplying a service to the Federal Government regardless of the source of the grain.

Mr. GIEBINK. I believe that is correct, sir.

Senator BENNETT. Thank you.

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

Mr. GIEBINK. Thank you, Mr. Chairman.

(Mr. Giebink's prepared statement follows:)

STATEMENT OF GRAIN AND FEED DEALERS NATIONAL ASSOCIATION

REGARDING

TAXATION OF COOPERATIVES

BEFORE THE SENATE FINANCE COMMITTEE

APRIL 17, 1962

The purpose of this statement is to restate the position of this Association regarding taxation of cooperative corporations; to supplement and bring up to date information given to the Ways and Means Committee in 1958 and again in 1960; and to discuss this material as it applies to H. R. 10650 now before your Committee.

The Grain and Feed Dealers National Association is a national trade association which is 66 years old and has approximately 1,700 members in 47 of the 50 states. The members represented are principally engaged in the operation of country grain elevators and retail feed stores. They are as a general rule small businesses although some members operate large flour and feed mills and terminal grain marketing facilities.

The national association has offices at 400 Folger Building, Washington, D. C.

Position of Association

The basic position of this Association is incorporated in the following resolution:

"This Association aims to secure for the public the benefits of a competitive economy, and expects its members to meet their responsibilities to the public under this system.

"We advocate a free-market limited-government approach to our nation's economic affairs because the competitive system has proved itself more capable than any other of delivering results beneficial to all people.

. . . . .

"We will work to bring about fully equitable treatment by government of all firms in our industry so as to foster a competitive marketing system.

"(a) Oppose any legislation, executive order, administrative ruling or regulation that would create discriminatory operational or ownership advantages for one segment or group of the grain and feed industry to the detriment of another; and

"(b) Work for constructive legislation to correct inequities of government taxation and financing procedures where they exist today between competing companies."

The main point we want to make has been stated by Mr. Roswell Magill who has appeared for this Association before the Ways and Means Committee on two different occasions:

"Cooperative corporations are business enterprises just like their non-cooperative competitors, they are organized and operate subject to generally the same laws as apply to their competitors, and they enjoy the same rights and privileges as do other corporate citizens of the United States. These rights and privileges and the government services which are demanded and received cost money. A large part of this money is furnished by the Federal corporate income tax but cooperative corporations although a large and important part of the business community make only a nominal contribution to the corporate income tax and, hence, to the cost of Federal government. Congress must correct this situation."

The proposals contained in H. R. 10650 for limited taxation of cooperatives and their patrons are wholly inadequate and will neither correct the tax-induced unfair competitive situation now existing between cooperatives and their non-cooperative competitors or produce significant revenue for the U. S. Treasury at a time when every dollar is needed.

So that there will be no misunderstanding about our position and our concern about non-taxation of cooperative corporations, it should be made entirely clear at the outset that --

1. We stand for a competitive marketing system capable of handling large volumes of commodities at low margins of profit.

2. We believe that cooperatives have a place in this system. We do not object to cooperation as a way of doing business. However, no single form of business organization (and cooperation is a way of doing business) should have an exclusive right to operation and existence in this country. By the same token no form of organization by reason of the peculiar form of its legal business structure should be permitted to derive an advantageous position in our economy or in the application of its laws.

3. We believe that income taxation has an important and far-reaching effect upon the competitive position of business organizations. "The power to tax is the power to destroy." Chief Justice Marshall could as appropriately have said, and certainly did imply, that the exercise or non-exercise of the power to tax is the power to destroy. In our business the non-exercise of the power to tax cooperative corporation has either directly or indirectly caused many privately-owned and operated business to close their doors or has impaired competitive ability to the extent that such an end is imminent.

To summarize, this association seeks only legislation from this Committee and Congress which will permit cooperative and non-cooperative corporations to compete in the market places of this country under tax laws which do not discriminate in favor of either form of business organization. Important steps can and must be taken now to that end.

In the remainder of this statement we will try to do several things:

1. Show how cooperatives have grown in size and importance.

2. By use of a few examples, show how specific farmers marketing and supply cooperatives have grown.

3. Show how tax advantage influences competitive position

4. Discuss legal and economic facts and fallacies in the cooperative taxation controversy.

5. Finally, offer specific recommendations for the consideration of this Committee.

The Present Size, Importance and Growth of Cooperatives

Cooperatives have grown substantially in recent years. This is a fact proclaimed by many cooperative managers and directors and also a fact apparent to businessmen in competition with cooperatives. At times, however, cooperative proponents plead smallness and inconsequence in defense of their position. That this is not now the case is capable of proof.

In order to evaluate the present size and importance of cooperatives and their rate of growth, with particular reference to grain and feed cooperatives, the most recent available statistics prepared by the Farm Credit Administration have been analyzed carefully and tabulated. Reference has been made to all cooperatives because it is difficult to examine grain and feed cooperatives alone. Cooperative interrelationships are extensive and complicated and the business of any particular group of cooperatives must be viewed in the light of these circumstances.

Exhibits A, B-1, B-2, B-3, C-1 and C-2, relating to number, memberships and marketing and supply business of local and regional cooperatives are appended. These exhibits relate generally to all cooperatives but include to the extent statistics are available specific reference to cooperatives engaged in the grain and feed business.

In using these statistics to determine the present size and importance of cooperatives and their rate of growth, two main tests are available. These are:

1. The number of members belonging to such cooperatives, and

2. The total volume of business done.

A third test, number of associations, although available, is of little value because of the decrease in number of associations in the face of a substantial increase in business.

(1)
Number of Members

The estimated total membership in all cooperatives reached 7.5 million members in 1959. This was an increase of 4.8 million members since 1926 and 3.3 million since 1945. Memberships in 1959 were approximately 280% larger than in 1926, 180% larger than in 1945, and approximately the same in 1955.

The rate of growth has been largest in the farm supply field, although memberships in marketing cooperatives also increased substantially from 2.4 million in 1926 and 2.9 million in 1945 to about 3.9 million in 1959.

Membership figures reported by the Farmer Cooperative Service do include some duplication for many farmers are members of more than one cooperative and, hence, are counted more than once. It is believed the duplication pattern of error is quite consistent from one year to another, however, so that even though the total membership figure may not be entirely correct, the rate of growth figure is reasonably so.

If the number of farmers in the United States or the number of farms or total acres in farm crops or purchases of farm supplies had increased materially during the period surveyed, a proportionate increase in number of cooperative members would have been normal. This was not the case, however:

The farm population has declined steadily from 30.6 million in 1926 to 25.3 million in 1945, 22.2 million in 1955, and 21.2 million in 1959.

The annual average number of people employed on farms (including farm workers) has decreased from 11.3 million in 1929 to 10.0 million in 1945, 8.2 million in 1955, and only 7.4 million in 1959.

The number of farms has decreased from 6.4 million in 1925 to 5.6 million in 1945, 5.4 million in 1950, and 4.8 million in 1954.

The total harvested acreage which went to 349 million acres in 1926 and 356 million acres in 1945, had decreased to 333 million acres in 1955, and was only 325 million acres in 1959.

In view of these facts, there is reason to believe that cooperatives, both marketing and purchasing, have grown materially in size, and that a substantial amount of such growth has been at the expense of competitive businesses operating on other than a cooperative basis. This conclusion applies equally as well to cooperatives engaged in the marketing of grain and the sales of feed, seed and similar farm supplies, where it appears that membership has almost doubled since 1945.

It is difficult to appraise statistically by reference to number of cooperative members the relative present importance of marketing and farm supply cooperatives in the farm marketing and supply field. When reviewed in relation to total farm population, number of farms and similar statistics, however, the approximately 7.5 million members, whether adjusted for reasonable duplication or not, still indicates that cooperatives occupy a very important and substantial place in the farm marketing and supply field.

(2)
Business Done by Cooperatives

The estimated total gross volume of business done by cooperatives was about 14.8 billion dollars in 1959, and increase of 12.4 billion over 1926, 9.6 billion over 1945, and 2.5 billion over 1955. Business volume in 1959 was about six times as much as it was in 1926.

As was true in connection with cooperative members, the greatest percentage increase in business volume occurred in connection with farm supply cooperatives. The marketing cooperatives continue to do the largest part of cooperative business, however, increasing from 2.3 billion dollars in 1926 to 4.8 billion in 1945, 9.3 billion in 1955, and 11.4 billion in 1959. Gross business volume figures have been used in preference to the net business volume figures published by the Farmer Cooperative Service. Gross business volume reflects the business done at all marketing levels rather than only at the first level at which cooperatives transact business for farmers. This follows sound and accepted business and accounting procedures for profits are made with respect to such business at each level where the business is done.

The startling expansion of business done by cooperatives as indicated by the three schedules might be misleading if either or both of two circumstances existed during the periods studied, viz:

(a) There was a substantial increase in price level causing increases in dollar volume even though physical volume remained the same or showed only minor increases, or

(b) There was a substantial growth in the total volume of business done in the farm marketing and supply field.

Prices received by farmers for the products they sold did of course increase during the period 1926-59. For example, the index of prices received by farmers for all farm products was 146 in 1926, 207 in 1945, 232 in 1955, and 240 in 1959. Price increases also occurred in many of the component commodities whose indexes make up the one for all farm products.

A similar situation existed with respect to the many commodities bought by farmers from suppliers for use on their farms or in their homes. Thus, the index of all commodities bought for use in production and family maintenance was 150 in 1926, 179 in 1945, 259 in 1955, and 275 in 1959.

Exhibit C-2 indicates, however, that despite p increases there has been a large increase in the physical volume of products by both marketing and farm supply cooperatives. In this schedule the volume of business done by cooperatives during 1926, 1945, 1955, and 1959 has been adjusted by using price indexes applicable to prices received and paid by farmers. This eliminates the effect of price changes.

The total adjusted volume of business done by all marketing cooperatives in 1959 had increased 3.6 billion dollars as compared with 1926, 2.7 billion as compared with 1945, and 1.1 over 1955, increases of 231%, 116% and 28% respectively.

Grain marketing cooperatives also showed substantial real gains in business volume; 1959 business being 188% larger than 1926, 122% larger than in 1945, and 39% over 1955.

The most striking increases are of course found in the farm supply field where general changes in consumption patterns in addition to price had a substantial effect.

The price adjusted data may be misleading if there has been a growth in the total volume of business done in the farm marketing and supply field. For example, so far as the farm supply cooperatives are concerned, the use of commercial fertilizer almost doubled between 1945 and 1955. Quite naturally this had a direct bearing on fertilizer sales by cooperatives. On the other hand, the increase in sales of total tons of commercial feed was relatively slight.

Actually there have been only slight changes in the volume of physical production of crops and livestock when 1959 is compared with 1926, 1945 and 1955. For example, the production of wheat in 1959 was actually less than in 1945. Similarly, the farm production index for food grains, including of course wheat, was 93 in 1959 as compared with 89 in 1945. Production of feed grains on the other hand had increased to a greater extent. Other typical farm production and output indexes in 1926, 1945 and 1955 (using 1947-1949= 100) are as follows:

	1926	1945	1955	1959
Farm Output	73	95	133	126
Dairy Products	77	103	108	111
Fruits and Nuts	89	93	107	117
All Crops	80	93	105	118
Meat Animals	75	103	127	134
Poultry and Eggs	77	106	123	150

With the real increase in business volume, cooperatives have become increasingly more important in the farm marketing field. Although it is difficult to appraise statistically their relative present importance, it is believed that farm marketing co-ops now occupy a dominant position in many areas. This is particularly true with respect to grain marketing cooperatives which at the present time in the United States as a whole are doing approximately one-third of the grain marketing business at the country level. In certain important commercial producing areas such as Minnesota, the two Dakotas, Montana, Nebraska, Kansas, Oklahoma, Iowa, Indiana, and Ohio where cooperatives have been established for many years, substantially in excess of that amount is handled at the country level by country grain elevators.

The statistics which have been outlined confirm the opinions of a number of people actively engaged in the grain and feed business in all areas of the country. These persons, who are experts in their fields, state without dissent that the volume of business done by cooperatives as a percentage of the total grain marketing business has increased materially, and that at the present time cooperatives as a group are the most important single factor in the grain marketing field.

Specific Examples of Cooperative Growth

The members of this association operate country, subterminal and terminal grain elevators for the purpose of marketing grain and also sell feed, seed, fertilizer, and other supplies to farmers. The foregoing statistical material shows how cooperatives have grown generally. A few specific examples will show how important this growth has been in a few selected areas.

Farmers Union Grain Terminal Association

A detailed analysis of this large regional grain marketing cooperative which does business in the States of Minnesota, South Dakota, North Dakota, and Montana, was included in our 1958 statement before the Ways and Means Committee (Hearings on General Revenue Revision Before Ways and Means Committee, 85th Congress, 2nd Session, Part 2, page 1538).

This large cooperative corporation has continued to expand on income tax-free money since that time as shown in the following comparative balance sheet analysis.

FARMERS UNION GRAIN TERMINAL ASSOCIATION
COMPARATIVE BALANCE SHEETS

Description	5/31/39	5/31/49	5/31/58	5/31/59	5/31/61
ASSETS			(1000 Dollars)		
Current Assets					
Cash	105	3,374	2,413	3,245	446
Government Bonds	-	5,130	5,000	5,000	5,000
Receivables & Accruals (Net)	758	11,163	14,740	19,949	26,407
Inventories	245	1,611	3,534	11,917	13,888
Total	1,108	21,278	25,687	40,111	45,741
Noncurrent Assets					
Stock in other Co-ops, Margins, noncurrent receivables, etc.	235	2,142	2,545	2,517	4,538
Fixed Assets					
Land, Buildings, etc. (Net)	12	6,988	20,566	30,552	39,080
TOTAL ASSETS	1,356	30,408	48,798	78,180	89,359
LIABILITIES					
Current Liabilities	668	11,344	10,882	25,012	26,277
Noncurrent Liabilities	343	185	-	-	
Long Term Debt	-	-	2,500	9,400	21,800
Total Liabilities	1,011	11,529	13,382	34,412	48,077
Patron's Capital Equity & Reserve (Includes voting stock, equity, allocated reserves, etc.)	344	18,879	35,416	38,768	41,287
TOTAL LIABILITIES & NET WORTH	1,356	30,408	48,798	78,180	89,359

The large increase in fixed assets between 1958 and 1959 represented the purchase of the McCabe Elevator and feed mills for $6,000,000. In the fiscal year ending in 1961, 40 additional elevators were acquired from Archer-Daniels-Midland Company at a cost of $1,500,000, and a large soybean processing plant was purchased from Honeymead Products Co., Mankato, Minnesota, for $6,000,000. The most recent acquisition occurred in the fall of 1961 when the assets of the Minnesota Linseed Oil Company were acquired for an undisclosed amount.

Major steps in the recent growth of FUGTA is described in the following statement contained in their 1961 Annual Report.

"Major Steps in Our Growth

"This is what GTA has already done to keep growing:

"In 1958 GTA invested $4 million to add nine million bushels of storage space to elevators in St. Paul, Superior, Wisconsin, and Sioux City, Iowa

"In 1958 GTA bought The McCabe Company's 57 elevators with a capacity of 5,500,000 bushels and nine country feed plants.

"In 1959 GTA began building modern feed plants at Edgeley, North Dakota, and Ellis, near Sioux Falls, South Dakota.

"In 1960 GTA bought from the Archer-Daniels-Midland Company 38 elevators and 4 subterminals in southern Minnesota. Capacity 5,500,000 bushels. Many of these elevators had their own feed plants.

"In 1960 GTA bought the assets of the Honeymead Products Company at Mankato, Minnesota, the world's largest oil seed crushing plant.

"In 1960 GTA began deepening the channel and slip and modernizing and extending loading facilities at the GTA Superior elevator, so we could load the largest ocean-going ships on the Great Lakes.

"In 1961 GTA put into operation two of the finest and most modern feed plants in the nation. They are at Edgeley, North Dakota and Ellis, near Sioux Falls, South Dakota.

"In 1961, as part of GTA's related cooperative operations, two seed processing plants were bought at Bassett and Scottsbluff, Nebraska. Now GTA seeds move all the way from farmer producer to farmer consumer cooperatively, being harvested, cleaned, treated and distributed from plants at Minot and Williston, North Dakota, Billings and Miles City, Montana, Sioux Falls, South Dakota, and at Bassett and Scottsbluff, Nebraska.

"In the fall of 1961 GTA took another giant step forward by putting farmers in the flaxseed crushing business. Farmers acquired the assets of the 93-year-old Minnesota Linseed Oil Company. This company's processing operations are carried on at its modern plant in Minneapolis, which was built in 1949 and enlarged several times since."

Exhibit D supported by Tables D-1 and D-2 show the growth in net worth of FUGTA during the ten-year period ending in 1961. This growth is compared with that of an income-taxed competitor which is assumed to have started with the same beginning net worth and whose earnings rate was the same as FUGTA.

During the ten-year period the net worth of FUGTA increased 19.4 million from 21.9 million at the beginning of 1952 to 41.3 million at the end of 1961, an increase of about 90%. During the same period of time the net worth of the income-taxed competitor if it had earned at the same rate would have increased from 21.9 million at the beginning of 1952 to 29.3 million at the end of 1961, an increase of 7.4 million, or 34%.

It is interesting to note that if the cash dividends of FUGTA had been taxed at a 20% effective rate, the total tax would have been $2,199,000 as compared with an estimated income tax of $15,196,000 which would have been imposed on the tax-paying competitor of FUGTA.

Exhibit E supported by Tables E-1 and E-2 projects the growth in net worth of FUGTA for the period 1962-71 assuming continued earnings at the rate of 10% on beginning net worth each year with the further assumption that it follows its presently announced policy of retaining all earnings to pay off debt incurred in conjunction with the purchase of McCabe, Archer-Daniels-Midland elevators, Honeymead, and Minnesota Linseed. A further comparison is made on the assumption that 20% of the earnings are siphoned off each year as either a 20% distribution in cash or as a 20% tax amount withheld.

This exhibit graphically portrays the substantial difference in rates of growth resulting from the effect of either no tax or limited imposition of tax. It is also interesting to note the differences in the amounts of tax paid. The tax-paying competitor and its stockholders during this period of time would have paid $25,360,000. If the present tax law continues FUGTA and its patrons will pay no tax. If only a 20% withholding tax is imposed, it is reasonable to believe that the total tax upon the cooperative and its patrons would not exceed 11.9 million under the earnings conditions assumed.

Other Examples

Other examples of growth are numerous.

The Farmers Grain Dealers Association of Iowa included the following statement in its 1961 annual report:

How FGDA Has Grown in the Past 10 Years

1952		1961
461,377	Net Savings	1,067,013
14,829	Dividends on Stock	94,481
1,321,164	Working Capital	2,652,598
4,075,037	Total Assets	9,026,529
3,109,098	Net Worth	6,212,114

Country cooperative grain elevators also have capacity for growth as indicated in the following statistics reported in our 1958 statement:

Statistics of North Dakota Cooperative Grain Elevators*
Years 1942-57 Inclusive

		PER GRAIN ELEVATOR					
		Number of					
Fiscal Year Ending in Year	No. of Grain Elev-ators	Stock-Holders	Patrons	Total Assets	Business Trans-acted	Net Earnings	Ratio Net Earnings to Business Transacted
1942	197	133	219	$ 58,840	$170,442	$ 8,567	5.03%
1943	268	146	234	64,024	235,097	11,670	4.96%
1944	268	172	266	61,504	440,744	17,227	3.91%
1945	265	199	298	83,486	428,031	14,168	3.31%
1946	273	211	320	78,541	533,959	17,832	3.34%
1947	278	238	337	108,070	532,398	14,803	2.78%
1948	278	248	322	149,299	717,534	24,572	3.42%
1949	278	265	338	177,385	686,579	13,425	1.96%
1950	304	288	337	142,918	458,488	13,183	2.88%
1951	296	273	342	154,803	529,688	15,854	2.99%
1952	296	275	334	200,194	560,076	16,331	2.92%
1953	296	286	346	178,999	470,238	13,110	2.79%
1954	284	294	360	219,679	395,221	14,118	3.57%
1955	282	302	356	239,912	436,741	20,341	4.66%
1956	282	312	370	234,868	531,814	18,372	3.45%
1957	282	312	373	270,356	546,332	16,083	2.94%
AVERAGE	277	247	322	$151,430	$479,586	$15,603	3.25%

*Source: Annual Bulletins compiled by North Dakota Division of Cooperatives.

Both the steady increase in number of stockholders and of patrons follows the usual pattern found in many other states. Steady growth is shown despite the fact that the number of farms and farmers in North Dakota has decreased substantially during the reported period of time.

The large increase in total assets reflects a real growth in the physical plant and facilities of these cooperative elevators. It is a fact well known to those of our members operating in this state. A part of the increase is attributable to price change but the growth is so large that price could account for only a relatively small part.

The amount of business transacted fails to show a steady pattern, a fact accounted for by variations in production and price. Production of grain has decreased substantially in North Dakota during the period studied and price levels currently are not as high as they were in the years immediately following World War II.

Regional Farm Supply Cooperatives

Exhibit F, G and H report financial information for a group of 16 major farm supply cooperatives. The most important conclusions are:

1. With a few minor exceptions, these cooperatives are large, profitable, incorporated going businesses.

2. There has been a substantial growth in the period 1945-59 both in earnings capacity as well as in total assets.

3. A large part of the business done by these cooperatives involves the sale of feed, fertilizer, insecticides, fungicides, and seed, items commonly handled by our members in the grain and feed business. The sale of these items has been a major contribution to the growth and present earnings capacity of these cooperatives.

Exhibit G shows the large increase in members' equities during the ten-year period. The reports from which these exhibits were prepared indicate that this increase is attributable almost entirely to the retention of earnings in these businesses, such retained earnings being evidenced by stock issued, certificates of indebtedness, surplus allocations, or the like, all common and well-known financing devices used by cooperatives. Had these retentions been subject to corporate income tax at the rates prevailing in those years, expansion would have been less rapid and on a basis more comparable to that of the income-taxed competitors of these cooperative corporations. The important thing is that with few exceptions substantially all of these earnings were retained tax free.

Exhibit I reports the 10-year growth of the Farmers Union Central Exchange, a regional supply cooperative located in St. Paul. This example is used because it shows the tremendous growth possible with tax and interest-free funds. Included are some computations which will be referred to subsequently and which show the time value of money.

Farm supply cooperatives do not have to be extremely large in order to grow. An example of this kind of cooperative is Farmers Elevator Service Company of Fort Dodge, Iowa. The following chart reported at page 18 of the FELCO report for 1961 shows how net worth can be doubled in the short period of five years:

FIVE YEARS OF GROWTH AT FELCO

Description	9/30/57	9/30/58	Period 9/30/59 ($1000)	9/30/60	9/30/61
Sales	$9,978	$12,140	$16,792	$16,535	$20,961
Net Savings	338	552	650	519	801
Total Assets	1,836	2,291	3,331	3,495	4,104
Member's Equity*	1,656	2,074	2,483	2,735	3,292

*Est. Member's Equity on 10-1-56 $1,400,000

FELCO reports that it has now paid up patronage dividends issued through 1955. If it holds its existing rate of return on equity it will encounter no difficulty whatsoever in continuing to revolve its capital on a seven or eight-year basis while at the save time expanding at a rapid rate. As a matter of fact, FELCO could revolve its capital on a seven or eight-year basis and at the same time pay a reasonable tax on its earnings. True, its rate of growth would be slowed but not in a manner which could in any way seriously impair its financial structure.

How Tax Advantage Influences Cooperative Growth and Competitive Position

Cooperatives in the grain and feed business have grown and in general have prospered. To the contrary, it can be shown that competing non-cooperative businesses have been reduced in number and have not grown in recent years as rapidly or to the same extent as their cooperative competitors. This result has been influenced materially by the substantial freedom from income tax enjoyed by most cooperative corporations.

How Grain Elevators Function

In order to understand how tax advantage influences growth in the grain industry, it is necessary to know how grain elevators function.

The business function of an ordinary country grain elevator is to receive grain from producers, such grain to be (1) purchased and sold; or (2) to be handled, stored for a period of time, and then either bought and sold or delivered to someone at the direction of the customer depositing the grain in such elevator. Prior to the government's commodity loan program, the bulk of all grains received by country elevators was purchased from farmers and subsequently sold. Under the commodity loan program, however, grain may be pledged or mortgaged to Commodity Credit Corporation as security for a nonrecourse loan. If such grain is stored in a country grain elevator and the loan is defaulted, CCC becomes the owner of the warehouse receipt pledged as collateral. As owner of such warehouse receipts, CCC ordinarily orders the grain delivered to some other location. For this the elevator is paid a storage and handling charge. Much of the grain upon which commodity loans are obtained is also stored on farms and in the event of a loan default title to this grain is acquired by Commodity Credit. This agency then uses the facilities of the country elevators for handling and storage of such grains and compensates such country elevator under the terms of a so-called Uniform Grain Storage Agreement.

In addition to assembling grain for sale and storage, the normal country elevator does many other things. It sells feed, seed, fertilizer, and many farm supplies; it grinds, mixes and manufactures feed, it sells lumber and fuel, and in general usually does a rather complete farm supply business.

The facilities employed by a country elevator in its business consist of buildings designed for the handling and storage of grains and the neccessary equipment to do the grain handling job. In addition, buildings are owned for whatever feed and farm supply business is conducted.

Grain is received at country elevators from farmers who ordinarily deliver in truck-load quantities. The grain is weighed on receipt and carefully graded according to government grain standards. After this has been done, the grain is dumped into a pit and then elevated and conveyed to a selected bin within the elevator. As a general rule, grain of common quality is commingled and no effort is made to preserve the identity of any particular lot grain nor is that legally required. Farmers delivering grain in this manner either sell the grain immediately or if it is not sold but stored the farmer receives a warehouse receipt reciting the grade and quality of the grain. When the grain stored in the elevator is sold it is loaded out either into railroad boxcars or into trucks. Grain from the common lots within the elevator are so delivered, the elevator operator conducting his business so that sales and deliveries on such sales are made to the best advantage. If the grain is not sold but is redelivered on warehouse receipts, grain of the grade and quality called for by such receipt is delivered. Delivery in this case may also be made into railroad cars or into trucks.

The buying policies of country grain elevators are quite standard whether the elevator is cooperative or otherwise. As described in University of Minnesota Agricultural Station Bulletin 407, "the prevailing method of buying grain by cooperative associations is outright purchase and the producer received the current price at the time of delivery." The determination of the buying price is the manager's responsibility. Over a period of time this price is such that the difference between the buying and selling price is sufficiently large to cover operating and other costs and to provide for reasonable net returns. It is the general policy for country elevators to change their buying prices during the day, depending upon changes in price at the appropriate terminal grain market.

The method of pricing grain by local cooperative grain elevators in Kansas is described in Bulletin 66 of the Farm Credit Administration. This explains that grain is handled by local farmers cooperative elevators on a purchase and sale basis. Under that plan of cooperative marketing the title to grain is transferred to the local country elevator when the contract of sale is consummated. Usually upon delivering the grain or transferring title, the patrons are paid the current market price, grade and quality considered, less a nominal amount per bushel as an operating margin. Incoming price offers or bids are numerous and frequent and the margin the local elevator takes is generally the difference between the best bid price it has received from buyers and the price it pays to its patrons. The price difference is the margin that the association hopes to realize and on which it expects to operate. This price difference is the initial charge for services and possible risks. Buying margins vary in amount from year to year and season to season. Buying margins for individual customers also vary, depending upon market conditions and grade and quality of grain.

Accounting policies and methods followed by country grain elevator operators are quite standard. Except for terminology the practices followed are the same whether the country elevator operation is cooperative or otherwise.

Country grain elevators, as is typical of any business, may be owned in any one of several different ways. A relatively few country elevators are now owned by persons as individuals or in partnership with others. Cooperative country grain elevators are owned by cooperative associations incorporated as corporations under appropriate state laws. Most privately-owned country grain elevators are operated as corporations. The legal effects of these various methods of ownership are all well known.

Terminal grain elevators are similar to large country elevators in many respects but are of course much larger and are located at terminal marketing points. They receive grain by rail or truck, ordinarily from country elevators and not directly from producers. The grain so received is either purchased and sold or received for storage. In this latter event, it may eventually be redelivered for the account of the person storing it or it may be subsequently purchased and sold as any other grain. The facilities used and the mechanics followed in handling grain at the terminal market level follow the country elevator pattern except on a much larger scale.

All grain elevators whether cooperative or otherwise are organized for profit. The business of the private elevators is for the profit of the owners - usually the stockholders of the corporation. A cooperative grain elevator business also is conducted for profit - that of its members and/or patrons.

Here are a few general conclusions applicable to both country and terminal elevator grain operations:

> As the volume of grain handled increases the cost per bushel decreases. This is a fact disclosed by many elevator surveys conducted by the Farm Credit Administration as well as various agricultural experiment stations. It is a fact well known in the grain and feed trade.
>
> A large grain elevator operated near its maximum practical volume level has an important competitive advantage over a smaller elevator similarly operated. In other words, size of the facility is important provided the elevator is used effeciently.
>
> The foregoing conclusions apply to the storage of grain as well as to the merchandising or handling of grain.

It may be concluded that as both country and terminal grain elevators increase the volume of grain handled and their size, they decrease their unit costs per bushel of grain handled and improve their competitive position. This creates an endless chain of events. Volume and size breed greater efficiency and lower costs per unit. These in turn create greater volume and larger total profits.

How Tax Advantage Influences Competitive Position

The Federal income tax advantages which grain cooperatives enjoy are:

1. All cooperative corporations, whether exempt or non-exempt under the Code are permitted under administrative practices to exclude from gross income the amounts allocated to patrons as patronage dividends. The treatment is no different whether the dividends are paid in cash or in so-called scrip. If, however, the dividends are distributed in non-cash form, present court rulings do not require the patron-recipient to include the amounts in income or to pay a tax thereon. Thus, under present law, the Federal income tax may be completely avoided.

2. Cooperatives exempt under sections 521 and 522 of the Internal Revenue Code are allowed a statutory deduction for dividends paid on capital stock and for allocations of incidental non-patronage receipts to patrons on a patronage basis and may attribute to a taxable year patronage receipts allocated to patrons within 9½ months after the close of the taxable year.

The fact that these tax advantages influence growth and competitive position would seem to be too obvious to require explanation. Cooperative proponents however deny that they have any particular advantage; say that competitive position is not really influenced; and allege that favorable tax treatment is necessary to permit them to compete effectively. Moreover, they conclude that any corporation can achieve identically the same result by paying patronage dividends. As will be shown, exactly the opposite is true unless of course the non-cooperative corporation wishes to forego all profit and deny a return upon stockholders' capital invested in it. The cooperative argument is valid to this extent for no business corporation need pay a corporate income tax if it has in fact no income. The Federal government of course must also forego revenue under such circumstances and non-cooperative corporations will have to look to some source other than private capital for financing. More will be said about this later.

Tax advantage does have a direct bearing upon growth and competitive position for two main reasons:

1. Tax advantage is translated into price paid for grain marketed or the price charged for farm supplies sold.

2. If tax savings are not translated into price, then they are retained and grow at a rate directly proportional to the profitability of the cooperative business.

These reasons may be explained more fully by reference to specific examples.

Effect on Tax Advantage on Price

A typical average Minnesota cooperative grain elevator in 1952 according to a study conducted by the University of Minnesota Department of Agricultural Economics (Mimeo. Report No. 502) had earnings (before taxes) of about $15,000 based on total sales of $700,000 (grain $600,000 and merchandise $100,000). The net worth of this average cooperative amounted to a little more than $100,000, consisting of about $40,000 of stock and the balance members and patrons equities of one kind or another. The return of slightly more than 2% on sales is quite typical according to similar studies conducted in Kansas (Farm Credit Administration Bulletin 66, May 1951), Illinois (University of Illinois Department of Agricultural Economics, A.E.R.R.-17, February 1957), and Ohio (Ohio State University Department of Agricultural Economics, Mimeo. Bulletin No. A.E. 247, 1953).

For purposes of further study, assume a cooperative elevator with the foregoing characteristics. Further assume for purposes of comparison a non-cooperative competing corporation with a similar capital structure and with equal before-tax earnings of $15,000.

The earnings of the cooperative corporation in this example would have permitted it to pay a dividend on its equity of 5% (a practice seldom followed) and still have $10,000 left to distribute as a patronage dividend on grain and merchandise. If the grain elevator in this example had handled 300,000 bushels of wheat at $2.00 per bushel and $100,000 of merchandise upon which it had $1,000 of net earnings, the wheat dividend would have been 3¢ per bushel and the merchandise dividend 1% of sales.

A substantial competitive advantage will inure to the cooperative corporation as a result of these cash patronage dividends. This is true because farmers doing business with the cooperative will receive 3¢ per bushel more for their wheat than if they had marketed it through a taxable corporation unless the taxable corporation performs its function so much more efficiently than the cooperative that it can reduce its costs by an amount large enough to offset the cooperative patronage dividend. This is highly unlikely in a business as competitive as the grain business which is conducted on a low-margin high-volume basis. Small reductions in volume create higher per-unit costs, as a matter of fact, and the advantage attributable to the taxes avoided rapidly pyramids. This result will continue as long as cooperatives service their capital requirements with 100¢ dollars while their non-cooperative competitors must attempt to service their capital with dollars which are worth only 45¢ to 70¢, depending upon the size of the taxable corporation. The alternative of course is to reduce the return on invested capital in the taxable corporation. If this is carried to a point where the return is lower than the cost of capital, the sources of capital will dry up. This is why taxable corporations in many instances have greater difficulty in obtaining capital than their cooperative competitor which have a relatively tax-free source available to them.

Effect of Tax Advantage on Retained Earnings

The growth of cooperative corporations is more directly affected by the amount of earnings which are retained. Under present law this can be accomplished relatively tax free and under H. R. 10650 at a cost which will probably not exceed 20%. To the contrary, the earnings of a taxable corporation are subject to tax at rates which range between 30% and 52% at the corporate level and which earnings, to the extent distributed, are again taxed at varying tax rates applicable to individuals.

The effect of tax advantage on the growth rate of cooperative corporations and taxable corporations is shown under various assumptions in Exhibits J, K, and L, and supporting Tables.

Exhibit J

In this exhibit the growth rate of a $1 million beginning-size tax exempt cooperative corporation is compared with the growth rate of $1 million beginning-size non-cooperative taxable corporation. Certain assumptions have been made. These are reasonable but obviously cannot exhause the many combinations of circumstances which exist in actual operation.

A 16% rate of return before tax on beginning equity has been assumed. With an effective tax rate of 52%, slightly less than half of earnings are available to service a stockholders investment. This will permit a dividend at the rate of 4% on beginning equity and the accumulation of surplus needed for a taxable corporation to grow -- a desirable objective recognized by this and the previous administration. It is obvious that if the rate of return is higher the rate of growth will be more rapid. The opposite will be true if the rate of return is less. The identical assumption has been applied, however, to both cooperative and non-cooperative corporations.

As might be expected, Tables 1 and 2 show the greatest disparity of growth. This is true because the non-cooperative corporation must pay a tax while under present law the cooperative corporation and its patrons pay none. The rate of growth is also influenced by the interest or dividend-free cost of the retained earnings, a situation applied equally to both corporations. The substantial increase in size shows the compounding effect of these retentions. This illustrates the time value of money. For example, $1.00 left at 6% compound interest will grow to $1.79 at the end of ten years while $2.00 left at 6% compound interest will grow to $3.58 at the end of ten years. The $1.00 difference between the original invested amount has widened out by $1.79. This in very simple terms is why a relatively small advantage pyramids to a substantial one in a period of years.

Tables 3 and 4 change the rules of the game slightly by introducing a 4% cash dividend on beginning equity. The taxable corporation will start by distributing about 50% of its after-tax earnings. As it grows no effort has been made to increase the amount of the cash distribution. Thus of a total of $915,000 of after-tax income, $400,000 is distributed. The cooperative distributes only 25% of its net savings however because it has no tax to pay. During the ten-year period this distribution amounts to $400,000 out of a total of $2,958,000 net savings.

Because some of the earnings are distributed in both instances the rate of growth is less than in Tables 1 and 2. The disparity in growth remains approximately the same, however.

Tables 5, 6 and 7 feed different sets of circumstances into the growth pattern.

In Table 5 it is assumed that 20% of net savings are withheld and paid to the government. The balance is retained. A dividend on the beginning equity has not been assumed because under these circumstances it is quite unlikely that it would be paid. The resulting increase in growth is still substantial and shows what can happen under the proposal now before this Committee. The growth rate is 65% greater than in the case of the non-cooperative corporation which retains all of its earnings and is more than double the rate of growth for the non-co-op corporation which is paying a 4% cash dividend to keep its stockholders happy.

Table 6 assumes a typical cooperative ten-year revolving fund situation. Under present law no taxes are paid but an obligation is created to revolve certificates issued ten years previous. In arriving at the amount of certificates revolved at 16% rate of return growth pattern has been used during the preceding ten-year period of time. The results in this table should be compared with those in Table 3 for a taxable corporation. Here the co-op discharges its obligation to patrons by revolving its capital and in Table 3 the taxable corporation discharges its obligation to stockholders by paying a 4% cash dividend.

Finally, Table 7 takes the Table 6 situation and adds withholding at 20%. The rate of growth is the slowest of all examples but there is every reason for it to be so. The cooperative corporation is retiring certificates issued under tax-free circumstances out of dollars which are now being partially taxed at a 20% effective rate. It is able to do this and still have money left for growth.

Exhibit K

This exhibit makes assumptions generally similar to those in Exhibit J and supporting tables but applies these to a $100,000 beginning-size cooperative and non-cooperative business. The tax-induced rate of growth advantage is less because the tax rate differential is smaller than in the Exhibit J situation. An important growth advantage still exists, however.

Tables 1 and 2 show a significant difference in growth when all earnings are retained. Tables 3, 4 and 5 inject some more realistic assumptions into the picture. In Table 3 a 5% dividend is paid and the balance is retained. The corporate tax and the individual tax on the dividend received is slightly more than if the Subchapter S election is made. This result is shown in Table 4. The situation in Table 5 shows what happens when a 52% tax rate is applied. The importance of tax rate differential upon rate of growth is readily apparent.

Tables 6, 7, 8 and 9 apply various assumptions to a cooperative corporation. These are the same as those applied in Exhibit J, Tables 4, 5, 6 and 7.

Exhibit L

Exhibit L is an attempt to show a comparison between a taxable corporation and a cooperative corporation when a 4% dividend is paid on stock and the balance of savings are paid as a cash patronage dividend. We have assumed in this example however that the cooperative is able to obtain 50% re-investment of its net savings each year. We have given the taxable corporation the advantage of retaining all earnings except those needed to pay a 4% cash dividend on beginning equity.

At the end of ten years the stockholders' equity in the taxable corporation amounts to $1,525,000. In addition, we have assumed that the stockholders of this corporation have been able to invest the amount of the dividend received after payment of tax at a 20% rate at 6% compounded annually. The stream of these earnings adds up to $423,000 at the end of ten years. Thus, the stockholder's situation in the taxable corporation has been improved from $1,000,000 to $1,948,000.

Compare this result with the situation applicable to the cooperative corporation. The patrons' equity in the cooperative has increased from $1,000,000 to $2,159,000. In addition, the cash retained by the patrons again compounded during the ten-year period at 6% has increased in value to approximately $884,000. The total value is thus $3,043,000.

This again shows the net effect of tax advantage. In the co-op situation the patrons have paid approximately $463,000 of tax assuming a 20% effective tax rate. By comparison the stockholders of the taxable corporation have in effect paid a total tax of $1,082,000. The difference in tax liability compounded during the ten-year period of time is the major contributing factor to the substantially larger growth.

Conclusions Applicable to the Effect of Tax Advantage

A thorough analysis of the foregoing exhibits and the supporting tables will lead to the following conclusions:

1. The growth of any business concern (whether cooperative or non-cooperative) is directly proportional to (a) the amount of capital employed during any given period of time and (b) the rate of after-tax return on this capital. The larger the amount of capital or the greater the rate of return, the more rapid is the growth of the business.

2. The amount of capital employed during any period of time is influenced by the rate of return on such capital. More capital is available for investment as rate of return after tax and earnings increase.

3. Rate of return before tax depends upon the application of labor and managerial skills to the capital employed. Rate of return after tax depends upon the foregoing plus the level of tax.

4. Cooperative and non-cooperative corporations are assumed to have equal skill in the utilization of capital. To assume to the contrary is to condemn the cooperative form of organization. Hence, the rate of return before tax may be assumed to be equal.

5. Under present law the return on capital employed by a cooperative corporation is subjected to a lower rate or level of tax than the return on capital employed by a non-cooperative corporation. Hence, the after-tax rate of return is less in the case of a non-cooperative corporation.

6. As a result a non-cooperative corporation has less capital available to it than a cooperative corporation because (a) the after-tax rate of return is less and (b) the non-cooperative business cannot attract new capital because the rate of return is inadequate by comparison with the return on investment available to the cooperative.

This is the story the exhibits tell in theory. The actual growth of cooperatives in fact is demonstrated in countless examples in every area of the country.

Facts and Fallacies

It is the purpose of this part of the statement to examine some of the fallacies inherent in the cooperative argument that cooperative corporations are entitled to and in fact require different and more favorable income tax treatment under the Internal Revenue Code than do their non-cooperative corporate competitors.

Fallacy No. 1

Cooperative corporations do not have income. "The profits of the conventional business corporation belong to the corporation and not to its individual stockholders, may be retained to be distributed at the discretion of the directors and are properly a part of the corporation's taxable income. Exactly the opposite is true of the margins between the amount received by the cooperative from its patrons and the cost of the goods and services furnished to its patrons or patron-stockholders. These margins belong to the patrons, do not become the property of the co-op as a matter of a constitutional and legal right, cannot be taxed to the cooperative as a part of its income. They are of an entirely different nature from the profits of a conventional business corporation."

Fact

Cooperative corporations do have income. This is a fact recognized by prominent lawyers and economists, the Staff of the Joint Committee on Internal Revenue, and many others. The point was convincingly covered by Mr. Roswell Magill in a talk to the Montana Bar Association in 1959:

> "Is a cooperative entitled to buy products from it patrons or sell to them at current market prices; realize gains from its operations durin the year; and then, by distributing to the patrons cash, or evidence of a remote interest in such gains, avoid earning taxable income? If its neighboring competitor, an ordinary partnership or private corporation, does exactly the same thing, but makes its distributions or accountings t partners or stockholders, it will certainly be held to have realized taxable income. I do not believe that it can fairly be held that the cooperative has not realized income in the like situation. Cooperatives ar and have been operated for profits--very large profits. In an equitable sense, those profits belong to the patrons, but only in the sense that a business corporation's profits belong to its shareholders. The corporatio whether business or cooperative, first realizes the profits for itself; an then decides whether to retain them for expansion or to distribute them."

For some reason or other cooperatives disavow the contribution which capital invested in the business makes to the year-end result while at the same time arguing that capital is absolutely necessary for survival. If capital is necessary to sustain growth, it must contribute importantly to the margins which arise at the end of the year. In any other business these year-end margins are regarded as earnings on capital (the cost of hire of capital) and the income tax consequences on the realization of this income cannot be avoided by any anticipatory contractual arrangement however skillfully devised.

The facts are that the year-end margins of any cooperative corporation just like any business corporation are the result of the patronage of the cooperative's customers, the skill of the cooperative's laboring force, the enterprise and ingenuity of its management, and above all, the capital which is invested in the facilities, tools, machines, and working capital which makes all of this possible.

If there is any further doubt regarding the important contribution which capital makes, it is suggested that the various examples of growth previously cited in this statement be re-examined.

Fallacy No. 2

Patronage dividends or refunds are merely price adjustments, that is, additional year-end payments for commodities purchased by cooperatives, or the refund of an overcharge for goods sold.

Fact

There is little if any true price adjustment involved in the patronage distribution of any modern cooperative corporation. Price adjustment has become a convenient explanation of the device used by cooperatives to distribute earnings to patrons. It is as much of a fiction as the reinvestment argument dismissed summarily in the Long Poultry Farm Case. The fallacies inherent in the price adjustment argument are readily apparent from examination of cooperatives operating in the grain business.

There are many different kinds of grain and many grades and qualities of each grain. These grains are produced by many farmers and ordinarily marketed through a country grain elevator which may or may not be owned by a cooperative corporation. Grain that is marketed may be purchased immediately at a price which fluctuates greatly depending upon market conditions or grain which is marketed may be stored, in which case it is usually sold and/or delivered at a later date. The entire marketing process is tremendously complicated by the government loan program with which most of you are familiar. The grain which is initially marketed through the country grain elevator is stored, handled and shipped to a terminal market, where it is again either sold or stored. Such grain may then move directly to consumers or it may be purchased for additional processing (as in the case of wheat) for sale in its processed form.

There are numerous transactions involved between the farmer who first raises and sells the grain and the consumer who eventually uses it.

It will be quite obvious that varying amounts of profit (or loss) will be earned at the various stages in the marketing process. The amount of these profits or losses will depend upon market conditions which exist at the time, the grade and quality of the particular grain involved, the skill used by the grain elevator manager in purchasing, handling, and selling the grain, and numerous other factors. If wheat, for example, is marketed by two farmers on the same day, the likelihood that the same amount of profit will result on each transaction is extremely remote. In the first place, the initial price which may have been paid will usually be different. The chance that the two lots of wheat are of the same grade and quality is quite unlikely and, finally, there is little chance that the two lots will be stored, handled and eventually sold at the same time and in the same manner. Despite this fact, there is not one cooperative out of a thousand which will differentiate between the amount of the patronage dividend paid Farmers A and B. Naturally, the situation becomes more complex as additional farmers are introduced in the picture and price adjustment is completely out of the question when a regional co-op is used which commingles the grain of its co-op members and the thousands of farmers patronizing them.

Thus, the margins earned on the grain of one farmer may be used to pay the losses resulting from the purchase and sale of another farmer's grain. How can this possibly be price adjustment?

Much the same kind of situation will exist with respect to supplies which are sold to farmers through a country elevator. There are a multitude of different kinds of feed, for example, and the same thing is true of agricultural seeds. Fertilizer has an amazing number of different formulas. Profit margins are different in almost every case. Nevertheless, the patronage distributions made with respect to these supplies sold have an amazing similarity. It is usual, for example, to pay a uniform patronage distribution on all merchandise sold. This means in most instances that the profits on the sale of some kinds of fertilizer, feed or seed will be used to offset the losses on the sales of other kinds. The same situation applies in almost every instance.

It is impossible to devise a system which will effectively determine and trace the profit margin or earnings margin or patrons' overdeposits, or call it what you wish, with respect to any single patron's individual transactions with his cooperative. It simply cannot be done.

The point we are trying to make is that something other than the commodity itself is involved in creating whatever it is that the cooperative corporation ends up with at year end. As previously explained, capital and labor and a sometimes forgotten element called "enterprise" have something to do with year-end profit and loss.

No one should fool themselves in talking about "price adjustment". To say that patronage dividends are "price adjustment" is merely a convenient way of describing earnings which are distributed on the basis of patronage rather than as return on investment.

Reference to the examples of cooperative growth which we have previously given further reinforces these conclusions. The exhibit which shows the last ten-year growth of the Farmers Union Grain Terminal Association is a good one to examine. The farmer and cooperative association patrons of FUGTA ten years ago left earnings with the Terminal Association to provide capital. The same situation was true nine years ago, eight years ago, etc. During the current year these accumulated investments worked for the benefit of this year's patrons. If this money was worth 5%, the cumulative value of these earnings retentions this past year would have amounted to about $2,000,000. This money was in fact distributed to the current year's patrons on the basis of this year's patronage whereas in fact the earnings were derived from the capital invested in the corporation by the preceding year's patrons. The patronage dividends received by the current year's patrons represent a distribution of earnings on previous years capital accrual measured by current years business.

Fallacy No. 3.

Cooperatives are small and immature and during the period of early growth need protection as infant industries. The statutory exemption must be retained.

Fact

The conditions described in Exhibits A through I are no indication of smallness. Exactly the contrary is true. It is hard to conceive that business giants such as the Farmers Union Grain Terminal Association, Farmers Union Central Exchange, etc. need the protection which is given to them in the exemption provisions of the Internal Revenue Code.

Sections 521 and 522 of the Code which now provide for favorable treatment of dividends on capital stock and of allocations of incidental nonpatronage receipts provide important advantages to cooperative associations. In a recent Farmer Cooperative Service study common and preferred stock represent about 40% of the equity capital of marketing and farm supply co-operatives. With statutory exemption available, this capital can be serviced by the payment of dividends from tax-free earnings. A taxable corporation must service its equity from taxed earnings.

An exempt cooperative is also allowed to deduct from gross income amounts derived from sources not directly related to the marketing, purchasing, and service activities of the co-op corporation. Business done

with the United States falls into that category. At the present time a substantial part of the income of grain cooperatives is derived from business done with Commodity Credit Corporation, a government agency. Qualification as an exempt cooperative permits the distribution of such income to be deducted even though that income is not derived from business done with the cooperative's individual or association patrons. This too provides an important advantage for exempt cooperative corporations.

These important advantages provided by statute involve a direct government subsidy to cooperative corporations. The following justifications are advanced:

1. Farmer cooperatives make a special contribution to our economy because (a) they assist in maintaining a financially stable agriculture, (b) they compensate for the basic differences between agriculture and industry, and (c) cooperatives operating under tax exemption permit farmers to obtain a greater share in the consumer's dollar.

2. Tax exemption is necessary to permit equal competitive opportunity.

Statutory tax exemption for certain farmer cooperatives has many of the elements of a direct subsidy to domestic producers of agricultural commodities because the effect is to transfer the benefit of tax subsidy to these producers by permitting a marketing cooperative to pay more or a purchasing cooperative to sell for less, the exact amount of such increse or decrease being dependent upon the amount of tax not paid by the cooperative.

Any subsidy granted in the foregoing manner is in fact a subsidy available only to those farmers which utilize the services of cooperatives and then only in proportion to the degree of utilization. In many instances, those who need the subsidy most derive the least benefit.

It is also argued that a subsidy to cooperatives compensates for basic differences between agriculture and industry. The argument generally proceeds on the theory that farmers sell the commodities they produce on a buyer's market and buy the supplies required on a seller's market. It is not certain how cooperatives would proceed to correct this situation. Presumably, the result could be accomplished by the development through cooperatives of a more efficient marketing and farm supply organization; the net savings resulting from such increased efficiency accruing to the benefit of the producers of agricultural commodities. This is a desirable result but hardly a suitable basis for tax subsidy.

The main argument for subsidy through tax exemption is based upon the theory that the cooperative form of organization permits farmers to obtain a greater share of the consumer's dollar. This result is obtained by permitting farmers to obtain all or a part of middleman's profits. The fact that farmer-patrons of cooperatives share in these profits is an admitted fact but should provide no basis for tax exemption. We do not believe that Congress wishes to deny the rights of individuals acting individually or together as corporations to derive a profit on capital invested, a right which is in fact denied if the cooperative form of organization is to be regarded as the "chosen instrument" in certain fields of operation.

BEST AVAILABLE COPY

The theory of subsidy to agriculture via tax exemption for cooperatives fails in theory. It is also inconceivable that such subsidy need be extended to cooperatives which are large and in many instances have reached maturity.

Fallacy No. 4

"Every individual proprietor, every partnership, every corporation in the United States may enter into patronage contracts under which patronage refunds are deductible or excludable from taxable income of the business." In other words, any business which chooses may organize so as to refund earnings to customers on the basis of patronage and may deduct such refunds for tax purposes.

Fact

This is an obvious impossibility. Any corporation that distributed all of its earnings to customers rather than to stockholders would have little reason to exist. To suggest this as a desirable alternative is to deny to the existing owners of taxable corporations the right to a return on their investment and to prevent the creation of new corporations where capital can only be obtained for a price.

Fallacy No. 5

Cooperative corporations do not have the same access to capital markets as do taxable non-cooperative corporations.

Fact

With a few limited exceptions, cooperative corporations have access to the same types of capital as do non-cooperative corporations and in some instances enjoy notable advantages.

The full resources of the Bank for Cooperatives are available to cooperative corporations. That these resources are substantial is indicated in Exhibit M appended which shows the loans to farmer cooperative corporations by selected U. S. leading agencies during the years 1930 to 1961. The total amount extended recently by the Bank for Cooperatives has been approximately $600,000,000, a very sizable amount when considered in relationship to the total net worth of cooperative associations operating in this country.

Cooperatives can and often do borrow money from non-government sources such as banks, insurance companies, and other lenders of short and long-term credit. They regularly issue various types of debt instruments and have been successful in selling them. They can and do issue preferred stock, and in this regard the exempt co-op corporations have a significant advantage over their taxable competitors because the dividends on such stock can be paid with 100¢ dollars.

The only area in which cooperatives have any real disadvantage is in obtaining venture capital looking for large capital gains. This type of capital should not be necessary to the conduct of the ordinary cooperative business. Cooperative management has done little to try to obtain permanent equity capital because they have refused to compensate such capital with an adequate rate of return. The reason for this action is simple -- they have not been required to resort to such financing. As long as lower cost sources of capital are available they will be tapped. When this situation has changed, cooperatives should find no difficulty in obtaining equity capital under present circumstances if they will make a reasonable attempt to compensate for it.

Fallacy No. 6

If cooperatives are taxed in the same manner as their competitors, many will be forced out of business.

Fact

This is a ridiculous conclusion. Taxation will impede growth but as long as earnings are derived from the operation of a business, taxation will not destroy it.

In no other country in the world has the cooperative movement advanced so far as in Sweden and Denmark. Producer members of farm co-ops in these countries supply much basic food, especially dairy products, to all of their European neighbors. These co-ops have been eminently successful in their enterprise; their growth has been steady and healthy, and in directions beneficial to their national economies. Yet these highly successful co-op corporations carry a tax burden equal to that of competing non-cooperative corporations. In Sweden the structure for taxing the co-op -- so long as it is a true co-op -- is basically the same as that applicable to other businesses. In both countries the co-op and the patron are liable for taxes on income from co-op earnings.

Conclusions and Recommendations

It will be apparent from the foregoing arguments for taxation of cooperative corporations that this Association cannot agree to the limited and substantially ineffective proposals for partial taxation of cooperative corporations and their patrons as proposed in H. R. 10650 now before the Committee. In this respect we subscribe to Mr. Bryson's conclusion that the bill before you "represents an unbelievable complicated way of imposing a 20% tax on co-ops."

We will not attempt to state the numerous legal objections to the cooperative provisions of H. R. 10650. We do believe, however, that litigation is inevitable and that as a result the existing tax loophole under which no tax is legally imposed on either the cooperative corporation or its patrons may exist for years to come.

We are particularly concerned with the economic consequences which will result from the enactment of the cooperative provisions of H. R. 10650.

First, and most important, this kind of a proposal will do little to alleviate the tax-induced competitive inequality now existing between cooperative and non-cooperative corporate competitors.

Second, from the revenue standpoint, taxation of cooperative earnings to the patron-recipients will produce insignificant amounts of revenue.

Third, from an administrative standpoint, it is much easier to work with a tax imposed at the corporate level.

Fourth, and this is a basic objection, the proposal before you will not contribute to economic stability or inspire economic growth. This is true because it will result in the continued gradual elimination of non-cooperative business in competition with cooperatives, which taxable businesses perform real services for agriculture. Thus, cooperative monopoly in many areas will tend to be created. This is not in the best interest of the agricultural economy nor is it in the direction which most farmers desire.

Finally, it has never seemed quite right to us to make a farmer or other patron pay a tax out of his own pocket when he receives a non-cash dividend over which he can exercise no real dominion and control, which he may never receive in cash, and, hence, which is not properly taxable to him because it does not have "readily realizable economic value".

The consent provisions of this bill would require many patron-members of cooperatives to involuntarily consent to the imposition of tax. This is true because such consent can be obtained by majority action through the by-laws of the cooperative association. A non-consenting member presumably need not do business with such a cooperative corporation. This line of thinking is legally and economically unsound. Many farmers have no freedom with respect to the exercise or non-exercise of a so-called consent privilege. This is particularly true in areas of the country where cooperatives offer the only marketing services available. Such a farmer can give up his membership in the cooperative but as a result may deny himself access to the only market which can possibly serve him. The effect of this kind of situation is to require that a farmer involuntarily assume the obligation of income tax upon patronage dividend amounts which he may never receive. Your Committee should not take this position.

We have a study under way analyzing the competitive position of cooperatives in many states. If it is completed in time, we would like an opportunity to file the results with your Committee and to have these findings made a part of this record.

Recommendations

We would also like the privilege of submitting specific recommendations for the taxation of cooperatives, these to be incorporated in the record of this hearing. These recommendations will recognize the situation as it exists today, will not be punitive, but will provide significant relief for non-cooperative corporate competitors which today occupy a completely untenable position.

The recommendations we will submit will include the following:

1. A suggestion that Sections 521 and 522 of the Internal Revenue Code be amended to allow the benefits of exemption only to newly organized cooperatives for a limited period of years. In addition, the proposed exemption should bear some relationship to size. We would make the amendment progressively applicable during the next few years. This would give existing exempt cooperatives an opportunity to effect reasonable and necessary adjustments.

In conjunction with amendment of Sections 521 and 522, we see no reason whatsoever for the provision which in effect allows the income from government business to be distributed tax free. This privilege should be terminated immediately.

2. We also believe that the deduction for patronage dividends should be limited to cash patronage dividends. When we say cash, it must be interpreted and defined to mean only those distributions paid in cash as that term is commonly understood in commercial usage. Moreover, the distribution must be made in such a manner that when received the money is subject to the complete dominion and control of the patron-recipient and not subject to any pre-existing legal obligation regarding its dispositon or reinvestment.

3. To the extent that withholding is applied to other dividend and interest payments, we believe that it must also be made applicable to all patronage distributions.

4. We believe that a part of the earnings of a cooperative must be taxed at the corporate level, the earnings so subject to tax being substantially equivalent to the income which is derived from the capital invested or employed by the cooperative corporation. We recommend that serious consideration be given the Canadian system under which patronage dividends may not be used to reduce the income of a cooperative corporation below a certain percentage of the capital which it employs during any taxable year.

We conclude with the plea that this Committee take significant action to give non-cooperative taxable corporations a magna charta of their own, viz., the right to compete with their cooperative competitors under substantially the same rules.

EXHIBIT A

ESTIMATED NUMBER, MEMBERSHIPS AND MARKETING AND FARM SUPPLY BUSINESS
OF LOCAL AND REGIONAL COOPERATIVES
1958-1959[1]

Commodity	Local Cooperatives			Regional Cooperatives				Total Cooperatives			
	Number Associations	Number Members	Business Volume ($1000)	Number Associations	Number Members	Business Volume Gross ($1000)	Business Volume Net ($1000)	Number Associations	Number Members	Business Volume Gross ($1000)	Business Volume Net ($1000)
Marketing Cooperatives											
Beans & Peas	6	2,110	8,016	9	6,085	31,727	19,434	15	8,195	39,743	27,450
Cotton & Cotton Products	499	99,385	137,708	30	311,435	495,152	436,730	529	410,820	632,860	574,438
Dairy Products	1,318	406,610	1,185,101	276	288,585	2,380,877	1,787,524	1,594	695,195	3,565,978	2,972,625
Fruits & Vegetables	663	80,875	516,404	77	45,290	740,856	343,039	740	126,165	1,257,260	859,443
Grain, Soybeans, Soybean Meal & Oil	2,065	973,045	1,721,226	28	48,585	1,146,542	174,205	2,093	1,021,630	2,867,768	1,895,431
Livestock & Livestock Products	449	186,375	246,851	41	675,830	1,440,104	1,280,191	490	862,205	1,686,955	1,527,042
Nuts	28	12,315	28,505	6	49,175	109,137	80,988	34	61,490	137,642	109,493
Poultry Products	113	73,235	222,680	22	27,250	222,869	148,679	135	100,485	452,549	371,359
Rice	53	5,570	46,182	6	6,955	111,159	89,030	59	12,525	157,341	135,212
Sugar Products	—	—	—	68	34,625	331,575	331,575	68	34,625	331,575	331,575
Tobacco	—	—	—	32	401,760	175,092	175,092	32	401,760	175,092	175,092
Wool & Mohair	160	33,280	5,645	25	76,925	23,109	22,177	185	110,205	28,754	27,822
Miscellaneous	64	15,250	39,565	4	400	6,524	3,458	68	15,650	46,089	43,023
Total - Marketing	5,418	1,888,050	4,157,883	624	1,972,900	7,221,723	4,892,122	6,042	3,860,950	11,379,606	9,050,005
Farm Supply Cooperatives											
Feed			639,659			582,658	255,896			1,222,317	895,555
Fertilizer			236,607			281,393	77,661			518,000	314,268
Seed			75,571			60,255	21,803			135,826	97,374
Farm Chemicals			37,456			32,662	9,619			70,118	47,075
Total			989,293			956,968	364,979			1,946,261	1,354,272
Building Material			61,393			65,273	25,994			127,116	87,387
Containers & Packaging Equip.			21,537			35,132	7,144			56,669	28,681
Meat & Groceries			49,467			13,374	3,046			62,841	52,513
Petroleum Products			499,451			430,905	80,699			930,356	580,150
Other Supplies			155,319			162,611	36,493			317,930	191,812
Total Farm Supplies	3,269	2,838,220	1,836,330	118	805,305	1,713,592	534,731	3,387	3,643,525	3,549,922	2,371,061
Total - Marketing & Farm Supply	8,687	4,726,270	5,994,213	742	2,778,205	8,935,315	5,426,853	9,429	7,504,475	14,929,528	11,421,066

(1) Source: Farmer Cooperative Service, U.S.D.A.
Statistics of Farmers Cooperatives, 1958-59, Aug. 1961

EXHIBIT B-1

ESTIMATED NUMBER OF LOCAL AND REGIONAL COOPERATIVE ASSOCIATIONS, 1926, 1945, 1955, 1959(1)

	1926	1945	1955	1959	Increase (Decrease) 1959 Over 1926	1945	1955
Marketing Cooperatives							
Cotton & Cotton Products	121	530	538	529	408	(1)	(9)
Dairy Products	2,197	2,214	1,824	1,594	(603)	(620)	(230)
Fruits & Vegetables	1,276(2)	916	734	740	(536)(2)	(176)	6
Grain, Soybeans, Meal, Oil, Rice	3,338	2,285	2,187	2,152	(1,186)	(133)	(35)
Livestock & Livestock Products	1,770	661	493	490	(1,280)	(171)	(3)
Nuts	- (3)	46	37	34	- (3)	(9)	(3)
Poultry & Poultry Products	71	160	150	135	64	(25)	(15)
Tobacco	-	12	32	32	-	20	0
Wool & Mohair	91	130	181	185	94	55	4
Miscellaneous							
Beans & Peas				15			
Sugar Products				68			
Other				68			
Total - Misc.	722	446	140	151	(571)	(295)	11
Total - All Marketing	9,586	7,410	6,316	6,042	(3,544)	(1,358)	(274)
Purchasing or Supply Cooperatives	1,217	2,750	3,344	3,387	2,170	637	43
Total - All Cooperatives	10,803	10,150	9,660	9,429	(1,374)	(721)	(231)

(1) Source: Farmer Cooperative Service, U.S.D.A. Various issues "Statistics of Farmer Cooperatives".

(2) Includes Nuts

(3) Included in Fruits & Vegetables.

EXHIBIT B-2

ESTIMATED NUMBER OF MEMBERS OF LOCAL AND REGIONAL COOPERATIVE ASSOCIATIONS 1926, 1945, 1955 and 1959[1]

	1926	1945	1955	1959	Increase (Decrease) 1959 over 1926	1945	1955
Marketing Cooperatives							
Cotton & Cotton Products	300,000	266,000	492,780	410,820	110,820	144,820	(81,960)
Dairy Products	460,000	726,000	818,970	695,195	235,195	(30,805)	(123,775)
Fruits & Vegetables	200,000[2]	162,000	126,415	126,165	(73,835[2]	(35,835)	(250)
Grain, Soybeans, Meal, Oil, Rice	520,000	484,000	955,040	1,034,155	514,155	550,155	79,115
Livestock & Livestock Products	400,000	695,000	904,110	862,205	462,205	167,205	(41,905)
Nuts	- [3]	46,700	41,510	61,490	- [3]	14,790	19,980
Poultry & Poultry Products	50,000	130,600	122,170	100,485	50,485	(30,115)	(21,685)
Tobacco	-	122,000	582,800	401,760	-	279,760	(181,040)
Wool & Mohair	50,000	122,500	117,090	110,205	60,205	(12,295)	(6,885)
Miscellaneous							
Beans & Peas				8,195			
Sugar Products				34,625			
Other				15,650			
Total - Misc.	473,000	140,200	52,005	58,470	(414,530)	(81,730)	6,465
Total - All Marketing	2,453,000	2,895,000	4,212,890	3,860,950	1,407,950	965,950	(351,940)
Purchasing or Supply Cooperatives	247,000	1,610,000	3,322,360	3,643,525	3,396,525	2,033,525	321,165
Total - All Cooperatives	2,700,000	4,505,000	7,535,250	7,504,475	4,804,475	2,999,475	(30,775

[1] Source: Farmer Cooperative Service, U.S.D.A. Various issues "Statistics of Farmer Cooperatives".

[2] Includes Nuts

[3] Included in Fruits & Vegetables

EXHIBIT B-3

ESTIMATED VOLUME OF GROSS BUSINESS OF LOCAL AND REGIONAL COOPERATIVES

	1926	1945	1955	1959	Increase (Decrease) 1959 over 1926	1945	1955
				($1000)			
Marketing Cooperatives							
Cotton & Cotton Products	150,000	178,000	452,833	632,860	482,860	454,860	180,027
Dairy Products	535,000	1,294,000	2,905,961	3,565,978	3,030,978	2,271,978	660,017
Fruits & Vegetables	296,000(2)	784,000	1,031,411	1,257,260	961,260(2)	473,260	225,849
Grain, Soybeans, Meal, Oil, Rice	750,000	1,286,000	2,513,039	3,025,109	2,275,109	1,739,109	512,070
Livestock & Livestock Products	320,000	730,000	1,443,283	1,686,955	1,366,955	956,955	243,672
Nuts	- (3)	200,000	80,481	137,642	- (3)	(119,519)	(62,358)
Poultry & Poultry Products	40,000	225,000	393,935	452,549	412,549	227,549	58,614
Tobacco	-	27,000	216,946	175,092	-	148,092	(41,854)
Wool & Mohair	10,000	35,000	31,767	28,754	18,754	(6,246)	(3,013)
Miscellaneous							
Beans & Peas			38,939	39,743			804
Sugar Products			132,278	331,575			199,297
Other			99,901	46,089			(53,812)
Total - Misc.	164,000	76,000	271,118	417,407	253,407	341,407	146,289
Total - All Marketing	2,265,000	4,835,000	9,340,774	11,379,606	9,114,606	6,544,606	2,038,832
Purchasing or Supply Cooperatives	135,000	810,000	2,920,096	3,549,922	3,414,922	2,739,922	629,826
Total - All Cooperatives	2,400,000	5,645,000	12,260,870	14,929,528	12,529,528	9,284,528	2,668,658

(1) Source: Farmer Cooperative Service, U.S.D.A. Various issues "Statistics of Farmer Cooperatives".

(2) Includes Nuts

(3) Included in Fruits & Vegetables

EXHIBIT C-1

VOLUME OF BUSINESS OF MARKETING AND FARM SUPPLY COOPERATIVES
ADJUSTED FOR PRICE FOR THE YEARS 1926, 1945, 1955 AND 1959(1)

	1926			1945			1955			1959		
	Unadjusted ($1000)	Index(2)	Adjusted ($1000)	Unadjusted ($1000)	Index(2)	Adjusted ($1000)	Unadjusted ($1000)	Index(2)	Adjusted ($1000)	Unadjusted ($1000)	Index(2)	Adjusted ($1000)
Marketing Cooperatives												
Cotton & Cotton Products	150,000	127	118,110	178,000	179	99,441	452,833	272	166,483	632,860	266	237,917
Dairy Products	535,000	156	342,949	1,294,000	229	565,066	2,905,961	252	1,153,159	3,565,978	256	1,392,960
Fruits & Vegetables	296,000(3)	145(5)	204,138	784,000	234(8)	335,043	1,031,411	222(10)	464,600	1,257,260	236(13)	532,737
Grain, Soybeans, Soybean Oil & Meal & Rice	750,000	128(6)	585,938	1,286,000	169(9)	760,947	2,513,039	207(11)	1,214,029	3,025,109	179(14)	1,690,005
Livestock & Livestock Products	320,000	146	219,178	730,000	207	352,657	1,443,283	249	579,632	1,686,955	256	658,967
Nuts	(4)		-	200,000	228	87,719	80,481	212	37,963	137,642	212	64,925
Poultry & Poultry Products	40,000	157	25,478	225,000	198	113,636	393,935	188	209,548	452,549	142	318,696
Tobacco		170	-	27,000	360	7,377	216,946	437	49,644	175,092	506	34,603
Wool & Mohair	10,000	186	5,376	35,000	232	15,086	31,767	250	12,707	28,754	227	12,667
Miscellaneous												
Beans & Peas							38,939			39.743		
Sugar Products							132,278			331,575		
Other							99,901			46,089		
Total Misc.	64,000	139(7)	46,043	76,000	207(7)	36,715	271,118	236(7)	114,881	417,407	240	173,920
Total - All Marketing	2,265,000		1,547,210	4,835,000		2,373,687	9,340,774		4,002,646	11,379,606		5,117,397
Farm Supply Cooperatives												
Feed							1,071,555	212	505,450	1,222,317	199	614,230
Fertilizer							396,877	153	259,397	518,000	152	340,789
Seed							139,017	247	56,282	135,826	202	67,241
Farm Chemicals							44,731	269	16,629	70,118	263	26,661
Building Material							109,570	360	30,436	127,116	393	32,345
Containers & Packaging Supplies							50,281	269	18,692	56,669	263	21,547
Farm Machinery & Equipment							93,595	317	29,368	108,749	372	29,234
Meats & Groceries							53,176	265	20,270	62,841	278	22,604
Petroleum & Auto Products							731,210	164	445,860	930,356	173	537,778
Other Supplies							229,944	249	92,347	317,930	266	119,523
Total - Farm Supplies	135,000	112(12)	120,535	810,000	140(12)	578,571	2,920,096	198(12)	1,474,731	3,549,922		1,811,952

(1)Source: Farmer Cooperative Service, U.S.D.A. Statistics of Farmer Cooperatives. Various Years. Indexes from Agricultural Statistics, U.S.D.A. Various Years.

(2)Index numbers used in case of marketing cooperatives are obtained from prices received by farmers index computed by the U.S.D.A. using 1910-14= 100. Index numbers for farm supply cooperatives in 1955 are obtained by using prices paid by farmers index computed by U.S.D.A. and using 1910-14= 100. The adjusted volume of business for each year is in terms of 1910-14 base period equivalent.

(3)Includes nuts. (4)Included in fruits & vegetables. (5)Average of index numbers for fruits (140) and vegetables (150). (6)Average of index numbers for food grains (152) and feed grains (104). (7)Index for all farm crops used. (8)Average of fruits (228) and vegetables (240). (9)Average of food grains (172) and feed grains (167). (10)Average of fruits (212) and vegetables (233). (11)Average of food grains (228) and feed grains (187). (12)1955 index for all commodities bought for use in farm production was 249. The index of 198 is computed by dividing the unadjusted total volume of business by the adjusted total volume. The resulting index gives effect to the indexes for particular items. The ratio of the index so determined (198) to the index for all commodities bought for use in farm production (249) is .795. This factor is applied to the 1926 and 1945 indexes for all commodities bought for use in production and the resulting indexes are used in determining the adjusted gross volume of business for 1926 and 1945. (13)Average of fruits (212) and vegetables(260). (14)Average of food grains (202) and feed grains (156).

EXHIBIT C-1, CHART I

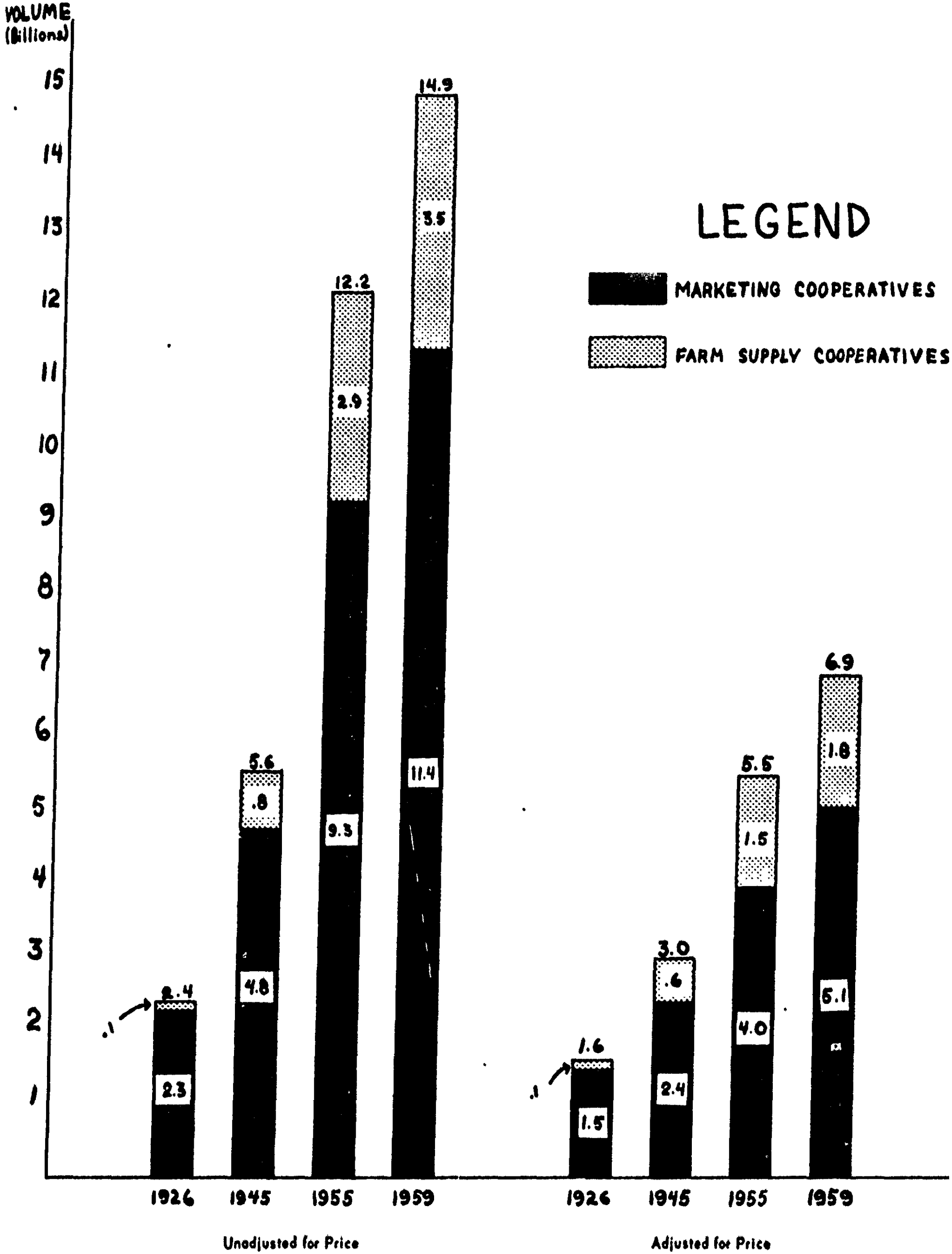


EXHIBIT C-2

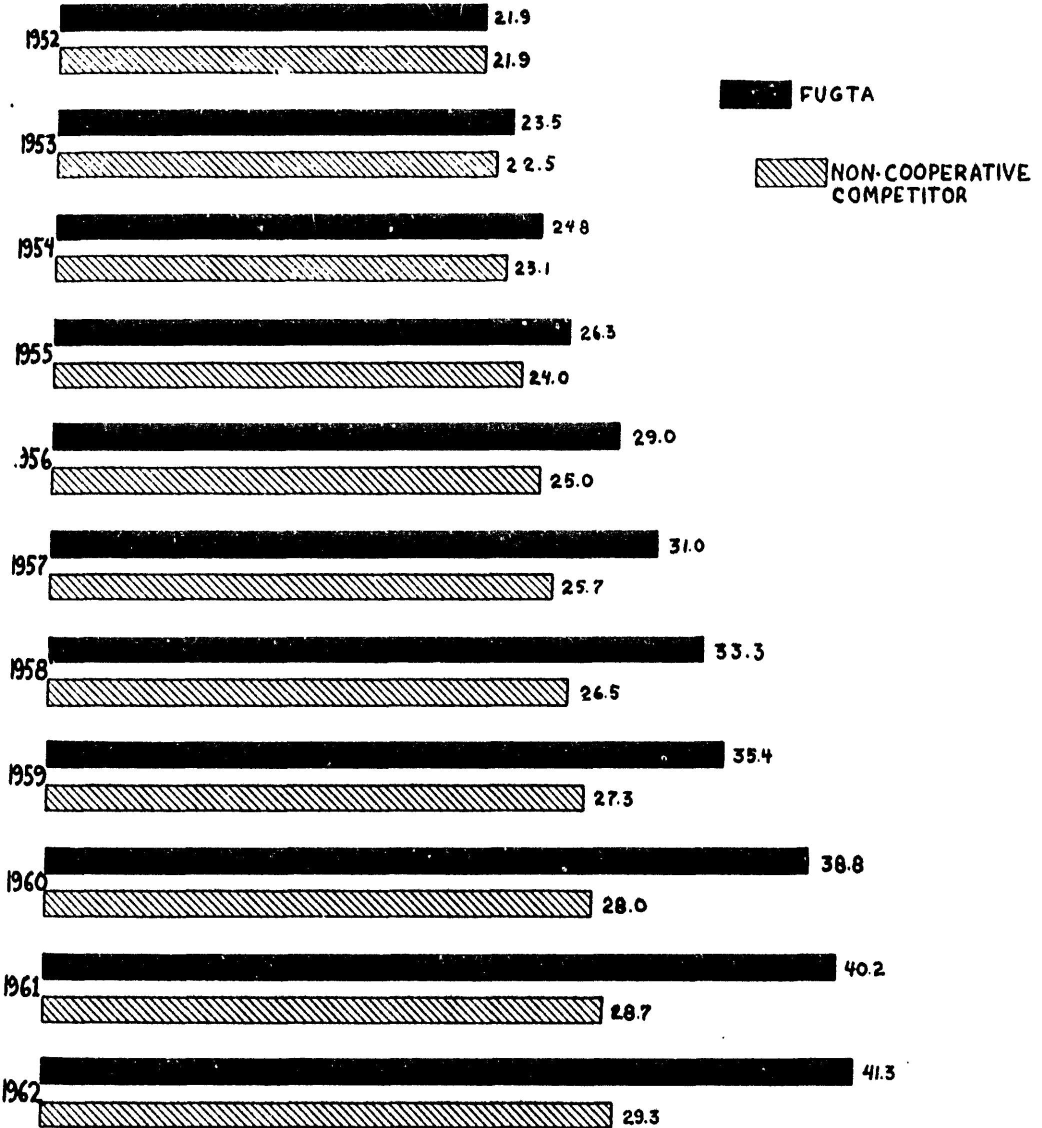
REAL INCREASE IN VOLUME OF BUSINESS OF MARKETING AND FARM SUPPLY COOPERATIVES

	1959 over 1926		1959 over 1945		1959 over 1955	
	Amount ($1000)	Percent	Amount ($1000)	Percent	Amount ($1000)	Percent
Marketing Cooperatives						
Cotton & Cotton Products	119,807	101.4%	138,476	139.3%	71,434	42.9%
Dairy Products	1,050,011	306.2	827,894	146.5	239,801	20.8
Fruits & Vegetables	328,599	161.0	197,694	59.0	68,137	14.7
Grain, Soybeans, Soybean Oil & Meal & Rice	1,104,067	188.4	929,058	122.1	475,976	39.2
Livestock & Livestock Products	439,789	200.7	306,310	86.9	79,335	13.7
Nuts	64,925	-	(22,794)	(26.0)	26,962	71.0
Poultry & Poultry Products	293,218	1,150.9	205,060	180.5	109,148	52.1
Tobacco	34,603	-	27,226	369.1	(15,041)	(30.3)
Wool & Mohair	7,291	135.6	(2,419)	(16.0)	(40)	(0.3)
Miscellaneous						
Beans & Peas						
Sugar Products						
Other						
Total Misc.	127,877	277.7	137,205	373.7	59,039	51.4
Total - All Marketing	3,570,187	230.7	2,743,710	115.6	1,114,751	27.8
Farm Supply Cooperatives						
Feed					108,780	21.5
Fertilizer					81,392	31.4
Seed					10,959	19.5
Farm Chemicals					10,032	60.3
Building Material					1,909	6.3
Containers & Packaging Supplies					2,855	15.3
Farm Machinery & Equipment					(134)	(.5)
Meats & Groceries					2,334	11.5
Petroleum & Auto Products					91,918	20.6
Other Supplies					27,176	29.4
Total - Farm Supplies	1,691,417	1,403.3	1,233,381	213.2	337,221	22.9

EXHIBIT D

GROWTH IN NET WORTH, 1952-1962
FUGTA* VS NON-COOPERATIVE COMPETITOR

(In Millions of Dollars)



*Farmers Union Grain Terminal Ass'n.

Gilbert G. Giebink
Grain & Feed Dealers Nat'l. Ass'n.
4-17-62

TABLE D-1

FARMERS UNION GRAIN TERMINAL ASS'N
(An Income Tax Exempt Regional Cooperative)
Earnings & Growth
1951 - 1961

Year	Beginning Net Worth*	Net Savings for Year	Return on Beginning Net Worth	Cash Distribution			Estimated Tax on Cash Distribution @ 20%
				Preferred Retired	Current Year Dividend	Total	
1952	$21,906,821	$2,353,538	10.74	$320,449	$473,997	$794,446	$158,889
1953	23,465,913	2,269,045	9.67	495,719	453,809	949,528	189,905
1954	24,785,430	2,564,965	10.35	488,695	536,140	1,024,835	204,967
1955	26,325,560	3,913,208	14.86	475,066	782,642	1,257,708	251,541
1956	28,981,060	3,200,376	11.04	510,222	640,075	1,150,297	230,059
1957	31,031,139	3,613,340	11.66	596,596	723,468	1,320,064	264,012
1958	33,324,415	3,449,513	10.35	667,973	689,902	1,357,875	271,575
1959	35,416,053	3,850,086	10.87	(271,780)	769,940	498,160	99,632
1960	38,767,979	2,933,017	8.28	N/A	N/A	1,493,212	298,642
1961	40,207,754	2,224,194	5.74	N/A	N/A	1,150,424	230,084
1962	41,281,554						
TOTAL		$32,686,907				$10,996,549	$2,198,812

* Data shown in bar 1, Exhibit D

Gilbert G. Giebink,
Grain and Feed Dealers
National Ass'n 4-17-62

TABLE D-2

A NON - COOPERATIVE COMPETITOR OF FUGTA
Estimated Earnings and Growth
1952 - 1962

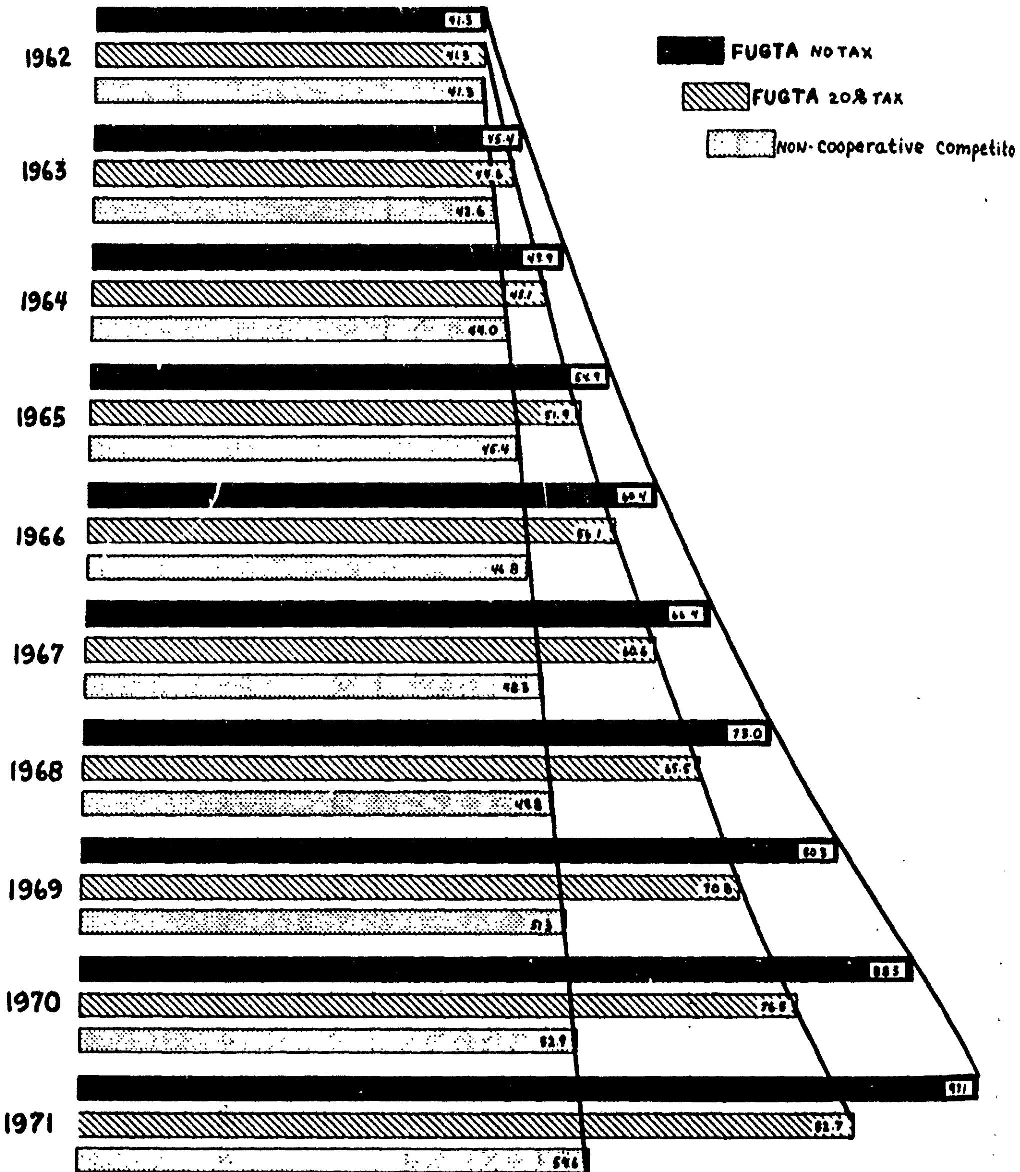
Year	Beginning Net Worth *	FUGTA Rate of Return	Net Income Before Tax	Income Tax @ 55%	Net Income After Income Tax	Rate of Return After Tax	Assumed Dividend @ 40%	Earnings Retained	Est. Tax to Stockholder on Div. @ 20%	Total Income Tax
1952	$21,906,821	10.74	$2,352,793	$1,294,036	$1,058,757	4.83	$423,503	$635,254	$84,700	$1,378,736
1953	22,542,075	9.67	2,179,818	1,198,900	980,918	4.35	392,367	588,551	78,473	1,277,373
1954	23,130,626	10.35	2,394,020	1,316,711	1,077,309	4.66	430,924	885,787	86,185	1,402,896
1955	24,016,413	14.86	3,568,839	1,962,861	1,605,978	6.69	642,391	963,587	128,478	2,091,339
1956	24,980,000	11.04	2,757,792	1,516,400	1,241,392	4.97	496,557	744,835	99,311	1,615,711
1957	25,724,835	11.66	2,995,158	1,647,337	1,347,821	5.24	539,128	808,693	107,825	1,755,162
1958	26,533,528	10.35	2,746,220	1,510,421	1,235,799	4.66	494,320	741,479	98,864	1,609,235
1959	27,275,007	10.87	2,964,793	1,630,636	1,334,157	4.89	533,663	800,494	106,732	1,737,368
1960	28,075,500	8.28	2,324,651	1,278,558	1,046,093	3.73	418,437	627,656	83,687	1,362,245
1961	28,703,156	5.74	1,647,561	906,158	741,403	2.58	296,561	609,597	59,312	965,470
1962	29,312,753									
Total			$25,931,645	$14,262,405	$11,669,240		$4,667,696	$7,001,544	$933,539	$15,195,944

* Data shown in bar 2, Exhibit D

Gilbert G. Giebink
Grain & Feed Dealers
Nat'l Ass'n 4-17-62

EXHIBIT E

PROJECTED GROWTH IN NET WORTH, 1962-1971*
FUGTA** VS. NON-COOPERATIVE COMPETITOR
(In Millions of Dollars)



*In the Absence of Change in Relative Tax Status of Cooperatives and Competing Corporations.

**Farmers Union Grain Terminal Ass'n.

Gilbert G. Giebink
Grain & Feed Dealers Nat'l. Ass'n.
4-17-62

EXHIBIT E

Table E-1

FARMERS UNION GRAIN TERMINAL ASSOCIATION
ESTIMATED EARNINGS AND GROWTH
1962-1971(1)

Year	NO TAX(2)				20% TAX WITHHELD(3)					
	Beginning Net Worth	Assumed Return on Net Worth	Net Savings for Year	Cumulative Savings Retained	Beginning Net Worth	Assumed Return on Net Worth	Net Savings for Year	Tax Withheld @ 20%	Net Savings Retained	Cumulative Savings Retained
	(Million Dollars)									
1962	41.3	10%	4.1	4.1	41.3	10%	4.1	.8	3.3	3.3
1963	45.4	"	4.5	8.6	44.6	"	4.4	.9	3.5	6.8
1964	49.9	"	5.0	13.6	48.1	"	4.8	1.0	3.8	10.6
1965	54.9	"	5.5	19.1	51.9	"	5.2	1.0	4.2	14.8
1966	60.4	"	6.0	25.1	56.1	"	5.6	1.1	4.5	19.3
1967	66.4	"	6.6	31.7	60.6	"	6.1	1.2	4.9	24.2
1968	73.0	"	7.3	39.0	65.5	"	6.6	1.3	5.3	29.5
1969	80.3	"	8.0	47.0	70.8	"	7.1	1.4	5.7	35.2
1970	88.3	"	8.8	55.8	76.5	"	7.7	1.5	6.2	41.4
1971	97.1	"	9.7	65.5	82.7	"	8.3	1.7	6.6	48.0
Totals			65.5				59.9	11.9	48.0	

Chart

Chart

(1) Assuming ability to earn 10% return on Net Worth at beginning of each period and all earnings retained

(2) As under present law

(3) Assuming a 20% tax is imposed on each patron recipient of dividend and this amount is withheld

EXHIBIT E

Table E-2

A NON-COOP. COMPETITOR OF FUGTA
ESTIMATED EARNINGS & GROWTH
1962-1971(1)

(Million Dollars)

Year	Beginning Net Worth	Assumed Return on Net Worth	Net Earnings Before Tax	Net Earnings After Tax @ 50%	Assumed Dividend @ 40%	Net Earnings Retained	Cumulative Earnings Retained	Est. Tax To Stockholder on Div. @ 20%	Total Corp. & Indiv. Inc. Tax
1962	41.3	10%	4.2	2.1	.8	1.3	1.3	.16	2.26
1963	42.6	"	4.3	2.2	.8	1.4	2.7	.16	2.26
1964	44.0	"	4.4	2.2	.8	1.4	4.1	.16	2.36
1965	45.4	"	4.5	2.3	.9	1.4	5.5	.18	2.40
1966	46.8	"	4.7	2.4	.9	1.5	7.0	.18	2.48
1967	48.3	"	4.8	2.4	.9	1.5	8.5	.18	2.58
1968	49.8	"	5.0	2.5	1.0	1.5	10.0	.20	2.70
1969	51.3	"	5.1	2.6	1.0	1.6	11.6	.20	2.70
1970	52.9	"	5.3	2.7	1.0	1.7	13.3	.20	2.80
1971	54.6	"	5.5	2.8	1.1	1.7	15.0	.22	2.82
Totals			47.8	24.2	9.2	15.0		1.84	25.36

Chart

(1)Assuming ability to earn 10% before taxes on Net Worth at beginning of each period and all earnings retained

EXHIBIT F-1

COMPARATIVE OPERATING STATEMENTS
16 MAJOR REGIONAL FARM SUPPLY COOPERATIVES
FOR YEARS ENDING IN 1945, 1955 & 1959

Association	Feed			Fertilizer, Insecticides and Fungicides			Seed			Total - Feed, Fertilizer and Seed		
	1945	1955	1959	1945	1955	1959	1945	1955	1959	1945	1955	1959
					($1000)							
Coop Grange League Fed.	69,959	90,651	86,921	7,421	19,038	21,955	3,709	8,368	7,809	81,089	118,057	116,685
Eastern States Farmer's Exchange	47,812	62,278	56,604	2,883	10,123	13,936	2,331	4,309	3,823	53,026	76,710	74,363
Southern States Coop	24,958	55,490	80,829	6,796	13,361	19,370	2,865	7,367	6.461	34,619	76,218	106,660
Consumers Coop Association	1,575	5,408	10,885	15	10,192	26,232				1,590	15,600	37,117
Illinois Farm Supply Co.	3,812	12,986	17,343	805	12,233	16,322				4,617	25,219	33,665
Farm Bureau Coop Ass'n. (Ohio)	7,278	9,503	13,740	2,778	7,892	10,127	1,063	2,305	2,179	11,119	19.700	26,046
Indiana Farm Bureau Coop Ass'n.	2,951	10,098	13,585	2,486	13,471	16,263	661	1,894	1,743	6,098	25,463	31,591
Farmers Union Central Exchange	1,097	3,484	5,428	21	4,060	11,455		663	645	1,118	8,207	17,528
Midland Coop Wholesale	1,201	2,563	3,805	370	3,240	5,876	375	953	824	1,946	6,756	10,505
The M.F.A. Milling Co.	9,507	34,760	31,757				341	1,242	1,415	9,848	36,002	33,172
Pa. Farm Bureau Coop Ass'n.	4,208	7,608	8,880	1,040	3,281	3,780	809	1,290	1,253	6,057	12,179	13,913
Pacific Supply Coop	2,043	664	1,109	585	3,851	7,282	743	201	285	3,371	4,716	8,676
Farm Bureau Services, Inc.	2,278	4,006	4,389	1,134	6,144	6,283	691	1,390	1,208	4,103	11,540	11,880
Central Coop Wholesale	2,293	2,426	2,101	10	264	434	64	155	145	2,367	2,845	2,680
Farmers Coop Exchange	3,956	10,620	17,221	855	5,664	6,354	1,326	1,932	1,904	6,137	18,216	25,479
Farmers Union State Exchange	107	100	-(1)		380	-(1)	16	72	-(1)	123	552	1,037
Total - 16 Associations	185,035	312,645	354,597	27,199	113,194	165,669	14,994	32,141	29,694	227,228	457,980	550,997
Not Available in 1945												
Western Farmers Association		20,912	25,663		1,531	2,564		425	668		22,868	28,895
Nulaid Farmers Association		23,853	24,139		-	-		-	-		23,853	24,139
Arkansas Farmers Ass'n.		7,321	6,432		1,746	1,016		527	794		9,594	8,242
Tennessee Farmers Coop		1,489	3,687		4,699	7,650		1,737	2,436		7,925	13,773
Total - 4 Associations		53,575	59,921		7,976	11,230		2,689	3,898		64,240	75,049
Total - 20 Associations		366,220	414,518		121,170	176,899		34,830	33,592		522,220	626,046

(1) Total only available for Feed, Seed and Fertilizer

EXHIBIT F-2

COMPARATIVE OPERATING STATEMENTS
16 MAJOR REGIONAL FARM SUPPLY COOPERATIVES
FOR YEARS ENDING IN 1945, 1955 & 1959

Association	Sales and Other Merchandise			Total all Sales			Net Earnings		
	1945	1955	1959	1945	1955	1959	1945	1955	1959
Coop Grange League Fed.	12,384	29,023	39,577	93,473	147,080	156,262	4,030	7,070	8,684
Eastern States Farmer's Exchange	670	3,718	7,527	53,696	80,428	81,890	1,477	3,310	1,473
Southern States Coop	5,939	15,693	24,917	40,558	91,911	131,577	1,641	4,861	2,967
Consumers Coop Association	20,345	74,953	116,727	21,935	90,553	153,844	1,766	2,337	9,032
Illinois Farm Supply Co.	14,720	37,872	42,580	19,337	63,091	76,245	1,247	2,993	5,461
Farm Bureau Coop Ass'n. (Ohio)	6,713	21,330	20,871	17,832	41,030	46,917	510	1,494	845
Indiana Farm Bureau Coop Ass'n.	11,111	32,667	35,306	17,209	58,130	66,897	1,094	5,360	3,673
Farmers Union Central Exchange	12,946	54,510	74,260	14,064	62,717	91,788	1,640	6,435	8,863
Midland Coop Wholesale	9,530	25,360	38,738	11,476	32,116	49,243	686	920	2,271
The M.F.A. Milling Co.	183	-	-	10,031	36,002	33,172	330	1,729	1,023
Pa. Farm Bureau Coop Association	3,067	10,192	11,893	9,124	22,371	25,806	238	462	351
Pacific Supply Coop	4,532	14,554	15,620	7,903	19,270	24,296	450	60	367
Farm Bureau Services, Inc.	2,760	2,063	3,018	6,863	13,603	14,898	330	39	431
Central Coop Wholesale	4,326	9,833	14,428	6,693	12,678	17,108	192	292	309
Farmers Coop Exchange	124	3,226	6,212	6,261	21,442	31,691	389	746	334
Farmers Union State Exchange	2,747	5,919	7,691	2,870	6,471	8,728	230	432	719
Total - 16 Associations	112,097	340,913	459,365	339,325	798,893	1,010,362	16,250	38,540	46,803
Not Available in 1945									
Western Farmers Association		10,628	12,835		33,496	41,730		2,936	4,243
Nulaid Farmers Association		2,822	4,398		26,675	28,537		3,031	2,522
Arkansas Farmer's Ass'n.		1,777	2,158		11,371	10,400		62	99
Tennessee Farmers Coop		2,145	6,250		10,070	20,023		330	797
Total - 4 Associations		17,372	25,191		81,612	100,690		6,359	7,661
Total - 20 Associations		358,285	484,556		880,505	1,111,052		44,899	54,464

EXHIBIT G-1

COMPARATIVE CONSOLIDATED FINANCIAL STATEMENT

16 MAJOR REGIONAL FARM SUPPLY COOPERATIVES

For Years Ending in 1945, 1955, & 1959

(1,000 Dollars)

Association	Current Assets			Fixed Assets (Net)			Other Assets			Total Assets			Increase (Decrease)	
	1945	1955	1959	1945	1955	1959	1945	1955	1959	1945	1955	1959	1959 over 1945	1959 over 1955
Cooperative Grange League Fed.	18,072	43,718	60,597	3,386	30,363	34,715	1,638	9,263	8,447	23,096	83,344	103,758	80,662	20,414
Southern States Coop.	6,590	24,545	42,171	3,780	17,959	29,963	522	7,336	5,683	10,892	49,841	77,818	66,926	27,977
Eastern States Farmers Exchange	7,687	14,240	19,058	1,377	22,053	24,462	267	932	1,292	9,331	37,225	44,811	35,480	7,586
Farm Bureau Coop Assn. (Ohio)	4,678	12,950	19,288	1,679	5,418	8,713	1,172	7,996	9,768	7,529	26,364	37,768	30,239	11,404
Consumers Coop Assn.	7,084	21,982	33,396	5,924	43,087	62,695	1,859	10,222	15,219	14,867	75,291	111,310	96,443	36,019
Illinois Farm Supply	3,095	12,497	15,863	504	7,536	9,165	138	4,034	2,936	3,737	24,067	27,964	24,227	3,897
Indiana Farm Bureau Coop.	4,627	23,827	30,987	1,723	16,825	21,984	3,642	4,968	9,027	9,991	45,620	61,908	51,917	16,288
Farmers Union Central Exchange	3,772	19,260	31,655	1,125	8,561	17,899	1,703	14,423	3,757	6,600	42,243	70,149	63,549	27,906
Farmers Coop Exchange	1,355	6,832	11,005	120	3,576	5,925	234	879	1,133	1,708	11,286	18,062	16,354	6,776
Midland Cooperatives	2,357	8,014	12,740	1,029	5,319	6,970	1,366	6,374	8,033	4,752	19,707	27,743	22,991	8,036
M.F.A. Milling Co.	981	3,341	4,540	370	2,978	2,212	42	112	253	1,393	6,432	7,006	5,613	574
Farm Bureau Services	1,197	4,052	4,998	347	3,579	3,797	293	741	987	1,836	8,372	9,781	7,945	1,409
Pa. Farm Bureau Coop.	1,055	3,431	3,398	364	1,282	1,645	453	3,872	3,894	1,873	8,585	8,938	7,065	353
Pacific Supply Coop.	1,635	4,190	6,623	591	2,019	4,038	96	1,462	2,236	2,323	7,672	12,896	10,573	5,224
Central Coop. Wholesale	784	2,200	3,514	284	472	571	324	1,225	1,844	1,393	3,897	5,929	4,536	2,032
Farmers Union State Exchange	313	1,338	1,519	154	192	287	465	1,850	2,336	933	3,381	4,142	3,209	761
Total	65,282	206,417	301,352	22,757	171,219	235,041	14,214	75,689	76,845	102,254	453,327	629,983	527,729	176,656

EXHIBIT G-1 (Cont.)

COMPARATIVE CONSOLIDATED FINANCIAL STATEMENT

16 MAJOR REGIONAL FARM SUPPLY COOPERATIVES

For Years Ending in 1945, 1955, & 1959

Association	Current Liabilities			Other Liabilities			Member Net Worth				
										Increase (Decrease)	
	1945	1955	1959	1945	1955	1959	1945	1955	1959	1959 over 1945	1959 over 1955
Cooperative Grange League Fed.	5,161	14,686	17,522	700	5,730	12,527	17,235	62,928	73,709	56,474	10,781
Southern States Coop.	1,174	3,623	6,999	19	7,243	20,986	9,699	38,975	49,832	40,133	10,857
Eastern States Farmers Exchange	4,173	5,217	10,241	—	5,000	4,279	5,157	27,008	30,291	25,134	3,283
Farm Bureau Coop Assn. (Ohio)	3,403	4,148	6,121	765	8,311	13,980	3,361	13,905	17,667	14,306	3,762
Consumers Coop Assn.	3,209	15,881	27,744	4,389	31,341	28,971	7,270	28,069	54,595	47,325	26,526
Illinois Farm Supply	1,527	5,539	7,203	230	5,920	3,920	1,980	12,608	16,841	14,861	4,233
Indiana Farm Bureau Coop.	4,432	5,205	7,110	140	3,227	5,871	5,420	37,188	48,927	43,507	11,739
Farmers Union Central Exchange	1,455	8,376	12,643	—	—	—	5,145	33,867	57,506	52,361	23,639
Farmers Coop Exchange	83	1,899	4,107	—	377	2,436	1,626	9,011	11,519	9,893	2,508
Midland Cooperatives	1,435	3,828	6,711	590	4,895	5,283	2,727	10,983	15,749	13,022	4,766
M.F.A Milling Co.	15	1,016	1,553	—	37	402	1,378	5,379	5,050	3,672	(329)
Farm Bureau Services	307	1,249	1,818	—	4,604	861	1,529	2,519	7,102	5,573	4,583
Pa. Farm Bureau Coop.	185	1,062	1,152	4	1,088	1,063	1,684	6,435	6,723	5,039	288
Pacific Supply Coop.	390	1,241	3,805	—	50	1,053	1,932	6,381	8,039	6,107	1,658
Central Coop. Wholesale	308	319	919	—	358	744	1,085	3,220	4,267	3,182	1,047
Farmers Union State Exchange	15	343	335	333	481	423	584	2,557	3,384	2,800	827
Total	27,272	75,632	115,983	7,170	78,662	102,799	67,812	301,033	411,201	343,389	110,168

EXHIBIT H

COMPARATIVE CONSOLIDATED FINANCIAL STATEMENT
16 MAJOR REGIONAL FARM SUPPLY COOPERATIVES
For Years Ending in 1945 and 1959

	Total of 21 Cooperatives 1959	Exclusion of Cooperatives Not Consolidated in 1945 Report						16 Cooperatives Included 1945 Report		Increase 1945 to 1959
		Western Farmers	Nulaid Farmers	Poultrymen's Cooperative	Arkansas Farmers	Tennessee Farmers	Total Exclusions	1959	1945	
	(1,000 Dollars)									
Assets										
Current Assets	334,499	15,680	12,077	1,634	878	2,968	33,237	301,262	64,211	237,051
Fixed Assets (Net)	259,318	9,267	7,179	1,589	259	2,227	20,521	238,797	30,583	208,214
Other Assets	92,696	1,549	548	105	146	424	2,720	89,924	14,214	75,710
Total	686,513	26,496	19,804	3,328	1,283	5,619	56,526	629,987	109,008	520,979
Liabilities & Members Equities										
Current Liabilities	129,129	5,359	5,126	770	511	1,380	13,146	115,983	29,338	86,645
Other Liabilities	105,578	--	2,320	46	162	249	2,777	102,801	12,870	89,931
Members Equities	451,806	21,136	12,357	2,512	610	2,990	39,605	412,201	66,800	345,401
Total	686,513	26,495	19,803	3,328	1,283	5,619	56,528	629,985	109,008	520,977

EXHIBIT I

FARMERS UNION CENTRAL EXCHANGE, INC.
COMPARATIVE FINANCIAL DATA
10 YEARS ENDED 1961

	1952	1953	1954	1955	1956	1957	1958	1959	1960	1961
Assets										
Current Assets	12,553	14,239	16,225	19,259	24,928	26,777	28,750	31,655	32,959	36,177
Fixed Assets	7,653	7,446	7,884	8,561	10,652	14,558	17,006	17,898	28,407	27,312
Investments	9,631	10,765	11,834	13,178	11,688	13,287	13,549	16,839	14,893	16,212
Other	729	846	1,166	1,244	1,632	3,082	3,167	3,757		
Total Assets	30,566	33,296	37,109	42,243	48,890	57,705	62,472	70,149	76,259	79,701
Liabilities & Net Worth										
Current Liabilities	5,458	5,666	6,583	8,376	10,314	12,289	12,222	12,643	10,131	10,564
Noncurrent Liabilities									2,267	1,731
Patron-Stockholders Net Worth(1)	25,108	27,630	30,525	33,867	38,585	45,416	50,250	57,506	63,861	67,406
Total Liabilities & Net Worth	30,566	33,296	37,109	42,243	48,899	57,705	62,472	70,149	76,259	79,701
Operating Statement										
Sales	45,708	50,408	55,303	62,717	67,951	75,792	85,046	91,788	90,711	91,839
Net Savings on Operations	2,682	4,050	4,096	4,760	5,709	6,147	5,196	6,610	5,708	5,554
Other Income									268	442
Patronage Refunds & Income from Other Cooperatives	979	933	1,322	1,676	1,678	2,430	1,541	2,253	2,057	2,817
Net Savings	3,661	4,983	5,417	6,435	7,387	8,577	6,737	8,863	8,033	8,814
Value of Net Savings at End of 1962 if compounded @ 6% Interest										
Compounding Factor	1.791	1.689	1.594	1.504	1.419	1.338	1.262	1.191	1.124	1.060
Amount	6,556	8,416	8,635	9,678	10,482	11,476	8,502	10,555	9,029	9,342
Interest Earned	2,895	3,433	3,218	3,243	3,095	2,899	1,765	1,692	996	528
Return on Beginning Net Worth	16.5%	19.8%	19.6%	21.1%	21.8%	22.2%	14.8%	17.6%	14.0%	13.8%

(1) 1951 Net Worth was $22,151,000
Stock issued through the first half of 1952 has now been retired.

EXHIBIT J

Comparitive Effect of Tax Advantage on Growth Rate

$1,000,000 Tax Exempt Coop Corporation and $1,000,000 Taxable Corporation

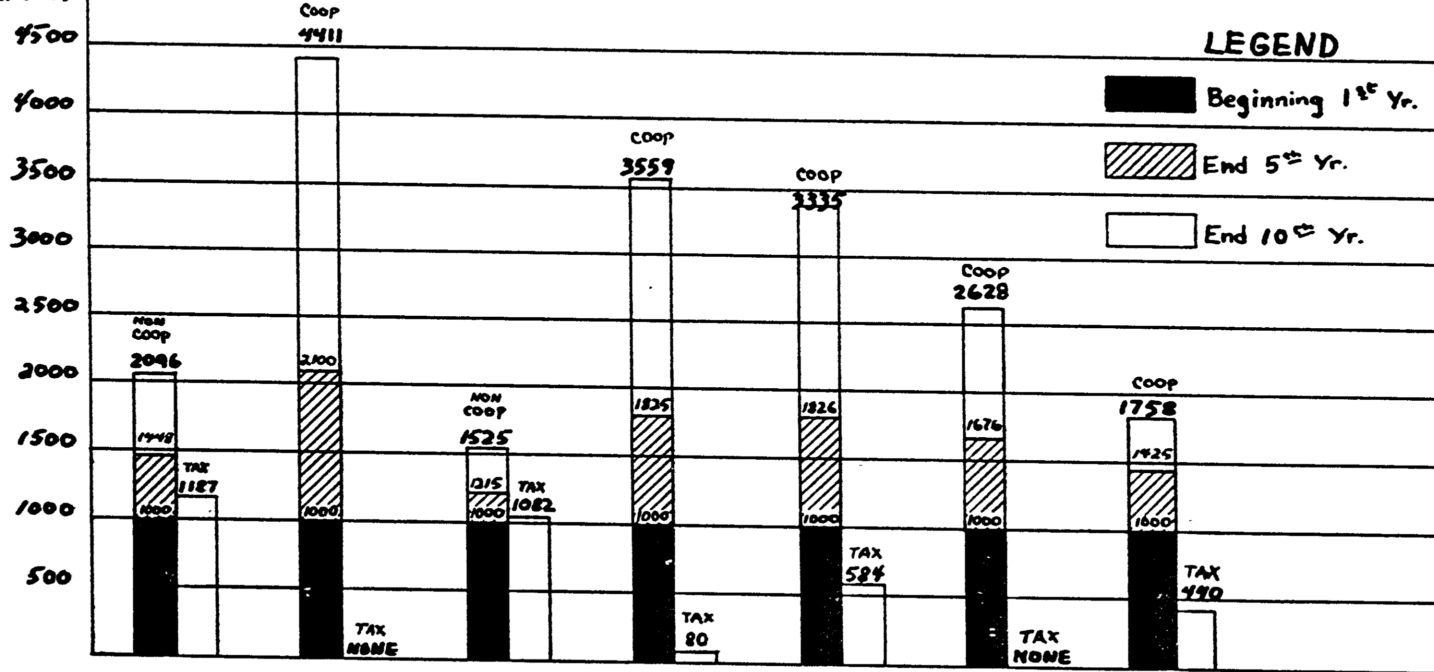


EXHIBIT J
Table 1

A $1,000,000 Non Cooperative Corporation Subject to 52% Tax
Earnings & Growth in 10 Year Period
(If All Earnings are Retained) (1)

Year	Stockholder's Equity Begin. Year	Rate of Return on Col.(1) Before Tax	Net Income before Tax	Corporate Income Tax	Net Income After Tax	Cumulative Earnings Retained	Cum. Stockholder's Equity	
							Amount	As % of $1,000,000
1	1,000,000	16%	160,000	83,200	76,800	76,800	1,076,800	107.7%
2	1,076,800	"	172,290	89,590	82,700	159,500	1,159,500	115.9
3	1,159,500	"	185,500	96,500	89,000	248,500	1,248,500	124.8
4	1,248,500	"	199,800	103,900	95,900	344,400	1,344,400	134.4
5	1,344,400	"	215,100	111,800	103,300	447,700	1,447,700	144.8
6	1,447,700	"	231,600	120,400	111,200	558,900	1,558,900	155.9
7	1,558,900	"	249,400	129,700	119,700	678,600	1,678,600	167.9
8	1,678,600	"	268,600	139,700	128,900	807,500	1,807,500	180.8
9	1,807,500	"	289,200	150,400	138,800	946,300	1,946,300	194.6
10	1,946,300	"	311,400	161,900	149,500	1,095,800	2,095,800	209.6
Totals			2,282,890	1,187,090	1,095,800			

(1) Not an entirely proper assumption in view of the Code limitation upon unreasonable accumulation of surplus.

EXHIBIT J
TABLE 2

A $1,000,000 Beginning Size Exempt Coop. Corporation
Earnings & Growth in 10-Year Period Under Present Law
(If All Savings are Retained as Patrons' Equity)

Year	Patrons' Equity Begin. Year	Rate of Return on Col.(1)	Net Savings Before and After Tax	Net Savings Retained	Cumulative Savings Retained	Cumulative Patrons' Equity	
						Amount	As a % of $1,000,000
1	$1,000,000	16%	$ 160,000	$ 160,000	$ 160,000	$1,160,000	116.0
2	1,160,000	16%	185,600	185,600	345,600	1,345,600	134.6
3	1,345,600	16%	215,300	215,300	560,900	1,560,900	156.1
4	1,560,900	16%	249,700	249,700	810,600	1,810,600	181.1
5	1,810,600	16%	289,700	289,700	1,100,300	2,100,300	210.0
6	2,100,300	16%	336,100	336,100	1,436,400	2,436,400	243.6
7	2,436,400	16%	389,800	389,800	1,826,200	2,826,200	282.6
8	2,826,200	16%	452,200	452,200	2,278,400	3,278,400	327.8
9	3,278,400	16%	524,600	524,600	2,803,000	3,803,000	380.3
10	3,803,000	16%	608,400	608,400	3,411,400	4,411,400	441.1
Totals			$3,411,400	$3,411,400			

EXHIBIT J
TABLE 3

A $1,000,000 Non Cooperative Corporation Subject To 52% Tax
Earnings & Growth in 10 Year Period
(If 4% Cash Dividend on $1,000,000 Beginning
Stockholder's Equity Paid & Balance Retained)

Year	Stockholder's Equity Beginn. Year	Rate of Return on Column (1) Before Tax	Net Income Before Tax	Corporate Income Tax	Net Income After Tax	4% Cash Dividend on $1,000,000	Net Income Retained	Cumulative Net Income Retained	Cumul. Stckholder's Equity Amount	Cumul. Stckholder's Equity As a % of $1,000,000	Assumed Tax on 4% Div. @ 20%	Total Corp. & Indiv. Inc. Tax
1	1,000,000	16%	160,000	83,200	76,800	40,000	36,800	36,800	1,036,800	103.68	8,000	91,200
2	1,036,800	"	165,900	86,300	79,600	40,000	39,600	76,400	1,076,400	107.64	8,000	94,300
3	1,076,400	"	172,200	89,500	82,700	40,000	42,700	119,100	1,119,100	111.91	8,000	97,500
4	1,119,100	"	179,100	93,100	86,000	40,000	46,000	165,100	1,165,100	116.51	8,000	101,100
5	1,165,100	"	186,400	96,900	89,500	40,000	49,500	214,600	1,214,600	121.46	8,000	104,900
6	1,214,600	"	194,300	101,100	93,200	40,000	53,200	267,800	1,267,800	126.78	8,000	109,100
7	1,267,800	"	202,800	105,500	97,300	40,000	57,300	325,100	1,325,100	132.51	8,000	113,500
8	1,325,100	"	212,000	110,200	101,800	40,000	61,800	386,900	1,386,900	138.69	8,000	118,200
9	1,386,900	"	221,900	115,400	106,500	40,000	66,500	453,400	1,453,400	145.34	8,000	123,400
10	1,453,400	"	232,500	120,900	111,600	40,000	71,600	525,000	1,525,000	152.50	8,000	128,900
Totals			1,927,100	1,002,100	925,000	400,000	525,000				80,000	1,082,100

EXHIBIT J
TABLE 4

A $1,000,000 Beginning Size Exempt Coop. Coorporation
(Earnings & Growth in 10 Year Period Under Present Law
If 4% Cash Dividend on Beginning Patron's Equity Paid & Balance Retained)

Year	Patron's Equity Begin.Year	Rate of Return On Col.(1)	Net Savings Before and After Tax	4% Cash Dividend on 1,000,000	Net Savings Retained	Cumulative Savings Retained	Cumul. Patron's Equity		Assumed Tax on 4% Cash Divid.@ 20%
							Amount	As a % of 1,000,000	
1	1,000,000	16%	160,000	40,000	120,000	120,000	1,120,000	112.0	8,000
2	1,120,000	"	179,200	40,000	139,200	259,200	1,259,200	125.9	8,000
3	1,259,200	"	201,500	40,000	161,500	420,700	1,420,700	142.1	8,000
4	1,420,700	"	227,300	40,000	187,300	608,000	1,608,000	160.8	8,000
5	1,608,000	"	257,300	40,000	217,300	825,300	1,825,300	182.5	8,000
6	1,825,300	"	292,000	40,000	252,000	1,077,300	2,077,300	207.7	8,000
7	2,077,300	"	332,400	40,000	292,400	1,369,700	2,369,700	237.0	8,000
8	2,369,700	"	379,200	40,000	339,200	1,708,900	2,708,900	270.9	8,000
9	2,708,900	"	433,400	40,000	393,400	2,102,300	3,102,300	310.2	8,000
10	3,102,300	"	496,400	40,000	456,400	2,558,700	3,558,700	355.9	8,000
Totals			2,958,700	400,000	2,558,700				80,000

EXHIBIT J
TABLE 5

A $1,000,000 Beginning Size Exempt Coop. Corporation
Earnings & Growth in 10 Year Period
(If 20% of Net Savings is Withheld and Paid as Tax
and Balance Retained)

Year	Patron's Equity Begin. Year	Rate of Return on Col.(1)	Net Savings Before Tax	20% Tax Withheld	Net Savings Retained	Cumulative Savings Retained	Cumul. Patron's Equity Amount	Cumul. Patron's Equity As a % of 1,000,000	Patron's Tax @ 20% of Net Savings
1	1,000,000	16%	160,000	32,000	128,000	128,000	1,128,000	112.8	32,000
2	1,128,000	"	180,500	36,100	144,400	272,400	1,272,400	127.2	36,100
3	1,272,400	"	203,600	40,700	162,900	435,300	1,435,300	143.5	40,700
4	1,435,300	"	229,600	45,900	183,700	619,000	1,619,000	161.9	45,900
5	1,619,000	"	259,000	51,800	207,200	826,200	1,826,200	182.6	51,800
6	1,826,200	"	292,200	58,400	233,800	1,060,000	2,060,000	206.0	58,400
7	2,060,000	"	329,600	65,900	263,700	1,323,700	2,323,700	232.4	65,900
8	2,323,700	"	371,800	74,400	297,400	1,621,100	2,621,100	262.1	74,400
9	2,621,100	"	419,400	83,900	335,500	1,956,600	2,956,600	295.7	83,900
10	2,956,600	"	473,100	94,600	378,500	2,335,100	3,335,100	333.5	94,600
Totals			2,918,800	583,700	2,335,100				583,700

EXHIBIT J
TABLE 6

A $1,000,000 Beginning Size Exempt Coop. Corporation
Earnings & Growth in 10 Year Period
(If All Savings Are Retained and Patron's Equity Revolved
On a 10 Year Basis)

Year	Patron's Equity Begin. Year	Rate of Return on Col. (1)	Net Savings Before & After Tax	Patron's Equity Certificate Redeemed	Net Savings Retained	Cumulative Savings Retained	Cumulative Patron's Equity Amount	Cumulative Patron's Equity As a % of $1,000,000
1	1,000,000	16%	160,000	46,900	113,100	113,100	1,113,100	111.3%
2	1,113,100	"	178,100	54,400	123,700	236,800	1,236,800	123.7
3	1,236,800	"	197,900	63,100	134,800	371,600	1,371,600	137.2
4	1,371,600	"	219,500	73,200	146,300	517,900	1,517,900	151.8
5	1,517,900	"	242,900	84,900	158,000	675,900	1,675,900	167.6
6	1,675,900	"	268,100	98,500	169,600	845,500	1,845,500	184.6
7	1,845,500	"	295,300	114,300	181,000	1,026,500	2,026,500	202.7
8	2,026,500	"	324,200	132,500	191,700	1,218,200	2,218,200	221.8
9	2,218,200	"	354,900	153,800	201,100	1,419,300	2,419,300	241.9
10	2,419,300	"	387,100	178,400	208,700	1,628,000	2,628,000	262.8
Totals			2,628,000	1,000,000	1,628,000			

EXHIBIT J
TABLE 7

A $1,000,000 Beginning Size Exempt Coop. Corporation
Earnings & Growth in 10-Year Period
If All Savings are Retained, a 20% Tax is Withheld and Paid
and Patrons' Equity Revolved on a 10-Year Basis

Year	Patrons' Equity Begin. Year	Rate of Return on Col.(1)	Net Savings Before Tax	20% Tax Withheld	Net Savings After 20% Tax	Patrons' Equity Certificate Redeemed	Total Tax and Cert. Redeemed	Total Net Savings Retained	Cumulative Savings Retained	Cumulative Patrons' Equity		Patrons' Tax @ 20% of Net Savings
										Amount	As a % of $1,000,000	
1	$1,000,000	16%	$ 160,000	$ 32,000	$ 128,000	$ 46,900	$ 78,900	$ 81,100	$ 81,100	$1,081,100	108.1	$ 32,000
2	1,081,100	16%	173,000	34,600	138,400	54,400	89,000	84,000	165,100	1,165,100	116.5	34,600
3	1,165,100	16%	186,400	37,300	149,100	63,100	100,400	86,000	251,100	1,251,100	125.1	37,300
4	1,251,100	16%	200,800	40,200	160,600	73,200	113,400	87,400	338,500	1,338,500	133.9	40,200
5	1,338,500	16%	214,200	42,800	171,400	84,900	127,700	86,500	425,000	1,425,000	142.5	42,800
6	1,425,000	16%	228,000	45,600	182,400	98,500	144,100	83,900	508,900	1,508,900	150.9	45,600
7	1,508,900	16%	241,400	48,300	193,100	114,300	162,600	78,800	587,700	1,587,700	158.8	48,300
8	1,587,700	16%	254,000	50,800	203,200	132,500	183,300	70,700	658,400	1,658,400	165.8	50,800
9	1,658,400	16%	265,300	53,100	212,200	153,800	206,900	58,400	716,800	1,716,800	171.7	53,100
10	1,716,800	16%	274,700	54,900	219,800	178,400	233,300	41,400	758,200	1,758,200	175.8	54,900
Totals			$2,197,800	$ 439,600	$1,758,200	$1,000,000	$1,439,600	$ 758,200				$ 439,600

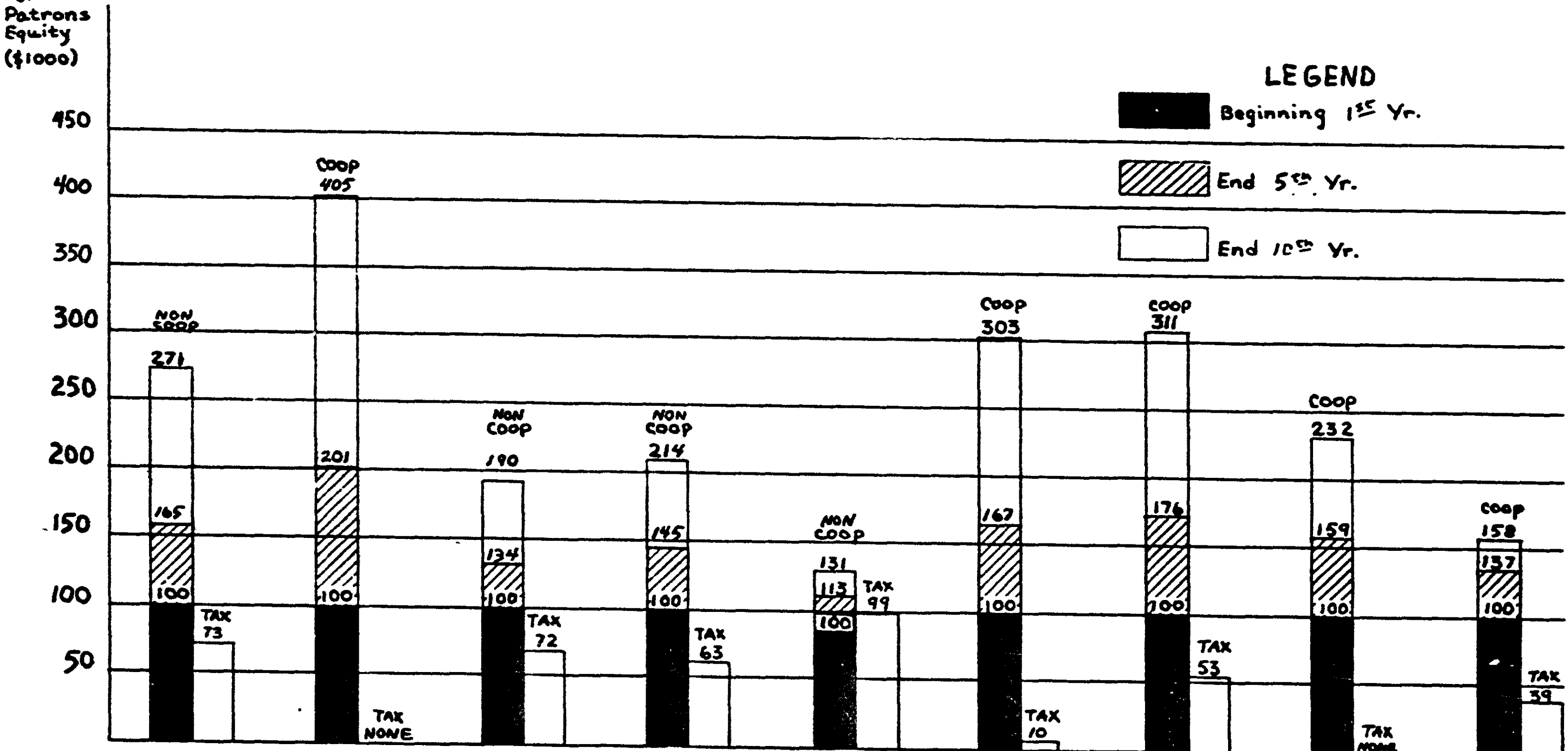


EXHIBIT K
Comparative Effect of Tax Advantage on Growth Rate
$100,000 Tax Exempt Coop Corporation and $100,000 Taxable Corporation
Stockholder or Patrons Equity ($1000)
450
400
350
300
250
200
150
100
50
LEGEND
Beginning 1st Yr.
End 5th Yr.
End 10th Yr.
NON COOP 271 165 100 TAX 73
COOP 405 201 100 TAX NONE
NON COOP 190 134 100 TAX 72
NON COOP 214 145 100 TAX 63
NON COOP 131 113 100 TAX 99
COOP 303 167 100 TAX 10
COOP 311 176 100 TAX 53
COOP 232 159 100 TAX NONE
COOP 158 137 100 TAX 39
TABLE 1
TABLE 2
All Earnings Retained
TABLE 3
5% Dividend Balance Retained
TABLE 4
Subchap. S
TABLE 5
5% Dividend 52% Rate
TABLE 6
5% Dividend Balance Retained
TABLE 7
20% Withheld
TABLE 8
10 Year Revolving
TABLE 9
20% Withheld 10 Year Revolving

EXHIBIT K

TABLE 1

A $100,000 Non Coop. Corporation Subject to 30% Corp. Tax
Earnings & Growth in 10 Year Period
(If All Earnings are Retained)(1)

Year	Stockholder's Equity Begin. Year	Rate of Return on Col.(1) Before Tax	Net Income Before Tax	Corporate Income Tax @ 30%	Net Income After Tax	Cumulative Earnings Retained	Cumul.Stockholder'sEquity	
							Amount	As a % of $100,000
1	100,000	15%	15,000	4,500	10,500	10,500	110,500	110.5
2	110,500	"	16,575	4,973	11,603	22,103	122,103	122.1
3	122,103	"	18,315	5,495	12,820	34,923	134,923	134.9
4	134,923	"	20,238	6,071	14,167	49,090	149,090	149.1
5	149,090	"	22,364	6,709	15,655	64,745	164,745	164.7
6	164,745	"	24,712	7,414	17,298	82,043	182,043	182.0
7	182,043	"	27,306	8,192	19,114	101,157	201,157	201.2
8	201,157	"	30,174	9,052	21,122	122,279	222,279	222.2
9	222,279	"	33,342	10,003	23,339	145,618	245,618	245.6
10	245,618	"	36,843	11,053	25,790	171,408	271,408	271.4
Totals			244,869	73,462	171,408			

(1) Not an entirely proper assumption in view of the code limitation upon unreasonable accumulation of surplus.

EXHIBIT K
TABLE 2

A $100,000 Beginning Size Exempt Coop. Corporation
Earnings & Growth in 10 Years Under Present Law
(If All Savings Are Retained as Patron's Equity)

Year	Patron's Equity Begin. Yr.	Rate of Return on Col. (1)	Net Savings Before & After Tax	Net Savings Retained	Cumulative Savings Retained	Cumulative Patron's Equity Amount	Cumulative Patron's Equity As a % of $100,000
1	100,000	15%	15,000	15.000	15,000	115,000	115.0
2	115,000	"	17,250	17,250	32,250	132,250	132.3
3	132,250	"	19,838	19,838	52,088	152,088	152.1
4	152,088	"	22,813	22,813	74,901	174,901	174.9
5	174,901	"	26,235	26,235	101,136	201,136	201.1
6	201,136	"	30,170	30,170	131,306	231,306	231.3
7	231,306	"	34,696	34,696	166.002	266,002	266.0
8	266,002	"	39.900	39,900	205,902	305,902	305.9
9	305,902	"	45,885	45,885	251,787	351,787	351.8
10	351,787	"	52.768	52,768	304,555	404,555	404.6
Totals			304,555	304.555	1,334.927		

EXHIBIT K
TABLE 3

A 100,000 Non Coop. Corporation Subject to 30% Corp. Tax
Earnings & Growth in 10 Year Period
(If 5% Cash Dividend on 100,000 beginning Stockholder's
Equity Paid and Balance Retained)

Year	Stockholder's Equity Begin. Year	Rate of Return on Col. (1) Before Tax	Net Income Before Tax	Corporate Income Tax @ 30%	Net Income After Tax @ 30%	5% Cash Dividend on 100,000	Net Income Retained	Cumulative Net Income Retained	Cumul. Stkh. Equity Amount	Cumul. Stkh. Equity As a % of 100,000	Assumed Tax on 5% Div. @ Rate (1)	Total Corp. & Indiv. Inc. Tax
1	100,000	15%	15,000	4,500	10,500	5,000	5,500	5,500	105,500	105.5	1,200	5,700
2	105,500	"	15,800	4,700	11,100	5,000	6,100	11,600	111,600	111.6	1,200	5,900
3	111,600	"	16,700	5,000	11,700	5,000	6,700	18,300	118,300	118.3	1,200	6,200
4	118,300	"	17,745	5,324	12,421	5,000	7,421	25,721	125,721	125.7	1,200	6,524
5	125,721	"	18,858	5,657	13,201	5,000	8,201	33,922	133,922	133.9	1,200	6,857
6	133,922	"	20,088	6,026	14,062	5,000	9,062	42,984	142,984	143.0	1,200	7,226
7	142,984	"	21,448	6,434	15,014	5,000	10,014	52,998	152,998	153.0	1,200	7,634
8	152,998	"	22,950	6,885	16,065	5,000	11,065	64,063	164,063	164.1	1,200	8,085
9	164,063	"	24,609	7,383	17,226	5,000	12,226	76,289	176,289	176.3	1,200	8,583
10	176,289	"	26,443	7,933	18,510	5,000	13,510	89,799	189,799	189.9	1,200	9,133
Total			199,641	59,842	139,799	50,000	89,799				12,000	71,842

Note (1) It is assumed Stockholder-Owner of business is married, has 2 children, files a joint return, has salary and other income which results in a tax liability of $1,200 on the $5,000 dividend.

EXHIBIT K
TABLE 4

A $100,000 Non Coop. Corporation Subject to 30% Corp. Tax
Earnings & Growth in 10 Year Period
(If Stockholder Elects to be Taxed Under Subchapter S.
and Corporation Retains Remainder in Excess of Assumed Withdrawal)

Year	Stockholder's Equity Begin. Year	Rate of Return on Col. (1) Before Tax	Net Income Before Tax	Income Tax Attributable Corp. Income (1)	Net Income After Tax	Withdrawn From Business (2)	Balance Retained in Business	Cumulative Stockholder's Equity		Total Corp. & Indiv. Inc. Tax
								Amount	As a % of $100,000	
1	100,000	15%	15,000	3,900	11,100	3,800	7,300	107,300	107.3%	3,900
2	107,300	"	16,100	4,400	11,700	3,800	7,900	115,200	115.2	4,400
3	115,200	"	17,300	4,600	12,700	3,800	8,900	124,100	124.1	4,600
4	124,100	"	18,600	5,000	13,600	3,800	9.800	133,900	133.9	5,000
5	133,900	"	20,100	5,500	14,600	3.800	10,800	144,700	144.7	5,500
6	144,700	"	21,700	6,000	15,700	3.800	11,900	156,600	156.6	6,000
7	156,600	"	23,500	6,600	16,900	3,800	13,100	169,700	169.7	6,600
8	169,700	"	25,500	8,000	17,500	3,800	13,700	183,400	183.4	8,000
9	183,400	"	27,500	8,800	18,700	3,800	14,900	198,300	198.3	8,800
10	198,300	"	29,700	10,000	19.700	3,800	15,900	214,200	214.2	10,000
Totals			215,000	62,800	152.200	38,000	114,200			62,800

NOTE: (1) It is assumed Stockholder-Owner elects to be taxed under Subchapter S. He is married; has 2 children and files a joint return. He has salary and other income so that average effective tax rate on corporate income attributable under Subchapter S is 26% for first $16,000 of corporate net income. When corporate income exceeds that amount effective tax rate will be increased to give effect to higher bracket rate.

(2) It is assumed stockholder will withdraw $3800 each year. This is the equivalent of the after tax remainder of $5000 dividend paid stockholder in Exhibit K - Table 3 example.

EXHIBIT K
TABLE 5

A $100,000 Size Division of Non-Coop. Corp. Subject to 52% Tax
Earnings & Growth in 10-Year Period
(If 5% Cash Dividend on $100,000 Beginning Stockholders' Equity Assigned Division is Paid and Balance Retained)

Year	Divisional Equity Begin. Year	Rate of Return on Col.(1) Before Tax	Net Income Before Tax	Corporate Income Tax @ 52%	Net Income After Tax	5% Cash Dividend on $100,000	Net Income Retained	Cumulative Net Income Retained	Cumulative Stkh. Equity Amount	Cumulative Stkh. Equity As a % of $100,000	Assumed Tax on 5% Div.	Total Corp. & Indiv. Inc. Tax
1	$ 100,000	15%	$ 15,000	$ 7,800	$ 7,200	$ 5,000	$ 2,200	$ 2,200	$ 102,200	102.2	$ 1,200	$ 9,000
2	102,200	15%	15,300	7,956	7,344	5,000	2,344	4,544	104,544	104.5	1,200	9,156
3	104,544	15%	15,700	8,164	7,536	5,000	2,536	7,080	107,080	107.1	1,200	9,364
4	107,080	15%	16,100	8,372	7,728	5,000	2,728	9,808	109,808	109.8	1,200	9,572
5	109,808	15%	16,500	8,580	7,920	5,000	2,920	12,728	112,728	112.7	1,200	9,780
6	112,728	15%	16,900	8,793	8,116	5,000	3,116	15,844	115,844	115.8	1,200	9,993
7	115,844	15%	17,400	9,048	8,352	5,000	3,352	19,196	119,196	119.2	1,200	10,248
8	119,196	15%	17,900	9,308	8,592	5,000	3,592	22,788	122,788	122.8	1,200	10,508
9	122,788	15%	18,400	9,568	8,832	5,000	3,832	26,620	126,620	126.6	1,200	10,768
10	126,620	15%	19,000	9,880	9,120	5,000	4,120	30,740	130,740	130.7	1,200	11,080
Totals			168,200	87,469	80,740	50,000	30,740				12,000	99,469

EXHIBIT K
Table 6

A 100,000 Beginning Size Exempt Coop. Corporation
Earnings & Growth in 10 Years Under Present Law
(If 5% Cash Dividend on Beginning Patron's Equity Paid & Balance Retained)

Year	Patron's Equity Begin. Year	Rate of Return on Col. (1)	Net Savings Before and After Tax	5% Cash Dividend On 100,000	Net Savings Retained	Cumulative Savings Retained	Cumul. Patrons Equity		Assumed Tax on 5% Cash Div. @ 20%
							Amount	As a % of 100,000	
1	100,000	15%	15,000	5,000	10,000	10,000	110,000	110.0%	1,000
2	110,000	"	16,500	5,000	11,500	21,500	121,500	121.5%	1,000
3	121,500	"	18,200	5,000	13,200	34,700	134,700	134.7%	1,000
4	134,700	"	20,200	5,000	15,200	49,900	149,900	149.9%	1,000
5	149,900	"	22,500	5,000	17,500	67,400	167,400	167.4%	1,000
6	167,400	"	25,110	5,000	20,110	87,510	187,510	187.5%	1,000
7	187,510	"	28,127	5,000	23,127	110,637	210,637	210.6%	1,000
8	210,637	"	31,596	5,000	26,596	137,233	237,233	237.2%	1,000
9	237,233	"	35,585	5,000	30,585	167,818	267,818	267.8%	1,000
10	267,818	"	40,173	5,000	35,173	202,991	302,991	303.0%	1,000
Totals			252,991	50,000	202,991				10,000

Year	Patrons Equity Begin. Year	Rate of Return on Col.(1)	Net Savings Before Tax	20% Tax With-held	Net Savings Retained	Cumul.Patrons Equity		Patrons Tax @ 20% of Net Savings
						Amount	As a % of 100,000	
1	100,000	15%	15,000	3,000	12,000	112,000	112.0%	3,000
2	112,000	"	16,800	3,360	13,440	125,440	125.4	3,360
3	125,440	"	18,816	3,763	15,053	140,493	140.5	3,763
4	140,493	"	21,074	4,215	16,859	157,352	157.4	4,215
5	157,352	"	23,603	4,721	18,882	176,234	176.2	4,721
6	176,234	"	26,435	5,287	21,148	197,382	197.4	5,287
7	197,382	"	29,607	5,921	23,686	221,068	221.1	5,921
8	221,068	"	33,160	6,632	26,528	247,596	247.6	6,632
9	247,596	"	37,139	7,428	29,711	277,307	277.3	7,428
10	277,307	"	41,596	8,319	33,277	310,584	310.6	8,319
Totals			263,230	52,646	210,584			52,646

EXHIBIT K
TABLE 8

A $100,000 Beginning Size Exempt Coop. Corporation
Earnings & Growth in a 10 Year Period
(If All Savings Are Retained and Patron's Equity
Revolved on a 10 Year Basis)

Year	Patron's Equity Begin. Year	Rate of Return on Col. (1)	Net Savings Before & After Tax	Patron's Equity Certificate Redeemed	Net Savings Retained	Cumulative Savings Retained	Cumulative Patron's Equity	
							Amount	As a % of $100,000
1	100.000	15%	15,000	4,690	10,310	10,310	110,310	110.3%
2	110,310	"	16,546	5,440	11,106	21,416	121,416	121.4
3	121.416	"	18.212	6,310	11,902	33,318	133,318	133.3
4	133,318	"	19.998	7,320	12,678	45,996	145,996	145.9
5	145,996	"	21,899	8,490	13,409	59,405	159,405	159.4
6	159,405	"	23,911	9,850	14,061	73,466	173,466	173.4
7	173,466	"	26,020	11,430	14,590	88,056	188,056	188.0
8	188,056	"	28,208	13,250	14,958	103,014	203,014	203.0
9	202,646	"	30,397	15,380	15,017	118,031	218,031	218.0
10	217,663	"	32,649	17,840	14,809	132,840	232,840	232.8
Totals			232,840	100,000	132,840			

EXHIBIT K
TABLE 9

A $100,000 Beginning Size Exempt Coop. Corporation
Earnings and Growth in a 10-Year Period
(If All Savings are Retained, a 20% Tax Withheld and Paid
and Patrons' Equity Revolved on a 10-Year Basis)

Year	Patrons' Equity Begin. Year	Rate of Return on Col. (1)	Net Savings Before Tax	20% Tax Withheld	Net Savings After 20% Tax	Patrons' Eq.Certif. Redeemed	Total Tax and Cert. Redeemed	Net Savings Retained	Cumulative Savings Retained	Cumulative Patrons' Equity		Patrons' Tax @ 20% of Net Savings
										Amount	As a % of $100.000	
1	$ 100,000	15%	$ 15,000	$ 3,000	$ 12,000	$ 4,690	$ 7,690	$ 7,310	$ 7,310	$ 107,310	107.3	$ 3,000
2	107,310	15%	16,097	3,219	12,878	5,440	8,659	7,436	14,748	114,748	114.7	3,219
3	114,748	15%	17,212	3,442	13,770	6,310	9,752	7,460	22,208	122,208	122.2	3,442
4	122,208	15%	18,331	3,666	14,665	7,320	10,986	7,345	29,553	129,553	129.6	3,666
5	129,553	15%	19,433	3,887	15,546	8,490	12,377	7,056	36,609	136,609	136.6	3,887
6	136,609	15%	20,491	4,098	16,393	9,850	13,948	6,543	43,152	143,152	143.2	4,098
7	143,152	15%	21,473	4,295	17,178	11,430	15,725	5,748	48,900	148,900	148.9	4,295
8	148,900	15%	22,335	4,467	17,868	13,250	17,717	4,618	53,518	153,518	153.5	4,467
9	153,518	15%	23,028	4,606	18,422	15,380	19,986	3,042	56,560	156,560	156.6	4,606
10	156,560	15%	23,484	4,697	18,787	17,840	22,537	947	57,507	157,507	157.5	4,697
Totals			$ 196,884	$ 39,377	$ 157,507	$ 100,000	$ 139,377	$ 57,507				$ 39,377

EXHIBIT L

COMPARISON OF EARNING & GROWTH FOR 10 YEAR PERIOD

1,000,000 BEGINNING SIZE EXEMPT COOP. CORP. AND COMPARABLE TAXABLE CORP.

UNDER CERTAIN ASSUMPTIONS (1)

Year	Patrons Equity Begin. Year	Rate of Return on Col. (1)	Net Savings Before & After Tax	4% Cash Dividend of Begin. Equity	Patronage Dividend In Cash	Patrons Total Tax @ 20% of Net Savings	Patrons Invest 50% Net Savings	Coop. Equity After Investment	Patrons Retain After Tax	10 Year Compounding Factor @ 6%	Value at End of 10 Year Period	Comparable Non Coop. Corp. Exhibit J Table 3: Cumulative Stk. Equity	Stock Holder's Dividend (After 20% Tax)	10 Year Factor @ 6%	Value at End Period
1	1,000,000	16%	160,000	40,000	120,000	32,000	80,000	1,080,000	48,000	1.6895	81,100	1,036,800	32,000	1.6895	54,100
2	1,080,000	"	172,800	40,000	132,800	34,560	86,400	1,166,400	51,840	1.5938	82,600	1,076,400	32,000	1.5938	51,000
3	1,166,400	"	186,600	40,000	146,600	37,300	93,300	1,259,700	56,000	1.5036	84,200	1,119,100	32,000	1.5036	48,100
4	1,259,700	"	201,600	40,000	161,600	40,300	100,800	1,360,500	60,500	1.4185	85,800	1,165,100	32,000	1.4185	45,400
5	1,360,500	"	217,700	40,000	177,700	43,500	108,800	1,469,300	65,400	1.3382	87,500	1,214,600	32,000	1.3382	42,800
6	1,469,300	"	235,100	40,000	195,100	47,000	117,600	1,586,900	70,600	1.2625	89,100	1,267,800	32,000	1.2625	40,400
7	1,586,900	"	253,900	40,000	213,900	50,800	127,000	1,713,900	76,200	1.1910	90,800	1,325,100	32,000	1.1910	38,100
8	1,713,900	"	274,200	40,000	234,200	54,800	137,100	1,851,000	82,300	1.1236	92,500	1,386,900	32,000	1.1236	36,000
9	1,851,000	"	296,200	40,000	256,200	59,200	148,100	1,999,000	88,900	1.0600	94,200	1,453,400	32,000	1.1060	35,400
10	1,999,000	"	319,800	40,000	279,800	64,000	159,900	2,158,900	95,900	1.0000	95,900	1,525,000	32,000	1.0000	32,000
			2,317,900	400,000	1,917,900	463,460	1,159,000		695,640		883,700		320,000		423,300

(1) Coop. Corp. pays a 4% dividend in cash on beginning equity each year
" " pays balance in cash patronage dividends
" " secures reinvestment of 50% of Net Savings each year
Taxable Corp. pays a 4% dividend on 1,000,000 of stock out at beginning of period and retains balance in surplus
Members of Coop. and stock holders of Taxable Corp. are able to invest amounts they receive and retain in cash @ 6% compounded annually.

EXHIBIT M

TABLE 22.--Loans to farmers' cooperative organizations: Amounts held by selected lending agencies, United States, specified years 1930 to 1961[1]

Beginning of year or month	Agencies supervised by Farm Credit Administration			Rural Electrification Administration		Farmers Home Administration[2]	Commodity Credit Corporation
	Federal intermediate credit banks	Banks for cooperatives	Agricultural Marketing Act revolving fund	Electrification loans	Telephone loans		
	1,000 dollars	1,000 dollars	1,000 dollars	1,000 dollars	1,000 dollars	1,000 dollars	1,000 dollars
1930..........	26,073	---	14,510	---	---	---	---
1940..........	1,835	76,252	20,547	169,122	---	6,721	26,845
1941..........	1,490	74,741	16,461	232,086	---	9,978	27,931
1942..........	2,152	[3] 150,038	16,914	304,407	---	20,114	14,369
1943..........	2,000	[3] 222,744	12,551	328,235	---	28,490	10,325
1944..........	2,000	[3] 254,838	7,351	331,318	---	28,912	3,655
1945..........	700	[3] 214,278	3,067	345,688	---	25,150	1,552
1946..........	2,042	[3] 157,680	2,693	391,137	---	17,233	737
1947..........	4,151	[3] 212,564	2,232	509,604	---	12,218	645
1948..........	4,000	[3] 274,943	2,603	709,428	---	10,229	177,317
1949..........	4,709	304,684	1,315	963,814	---	8,847	354,542
1950..........	2,400	301,887	1,365	1,252,648	---	8,574	224,535
1951..........	3,233	344,978	1,309	1,483,953	---	8,336	128,893
1952..........	4,000	423,952	1,451	1,669,592	1,128	8,161	203,333
1953..........	2,000	418,504	905	1,820,005	10,105	8,058	316,368
1954..........	500	372,110	0	1,955,186	23,313	8,579	142,963
1955..........	2,200	361,615	---	2,037,704	47,706	9,703	143,783
1956..........	3,000	370,683	---	2,103,961	74,477	10,657	857,953
1957..........	---	457,108	---	2,170,414	104,387	8,819	805,086
1958..........	---	454,452	---	2,256,018	133,641	10,010	683,522
1959..........	---	509,829	---	2,342,831	158,608	9,996	756,960
1960..........	---	622,433	---	2,453,937	181,037	10,249	557,956
1961:							
January.....	---	648,859	---	2,543,184	208,610	12,470	462,903
July........	---	594,549	---	2,573,853	219,730	13,563	401,201

[1] Includes data for all States and other areas where loans were made.

[2] Also includes loans to defense relocation corporations and water-facility associations and similar loans from State corporation trust funds.

[3] Also includes loans and advances under Commodity Credit Corporation programs, except advances on wool in which farmers had no beneficial interest.

[4] SOURCE VOL. 23 AGRICULTURAL FINANCE REVIEW, APRIL 1962, U. S. D. A.

The CHAIRMAN. The next witness is Mr. William C. Blethen of Northwest Independent Dairy Association.

Is Mr. Blethen present?

(No response.)

The CHAIRMAN. The next witness then is Austin W. Carpenter, Eastern Federation of Feed Merchants.

Take a seat, sir, and proceed.

STATEMENT OF AUSTIN W. CARPENTER, EXECUTIVE DIRECTOR, EASTERN FEDERATION OF FEED MERCHANTS, INC.

Mr. CARPENTER. Mr. Chairman and members of the committee, I am Austin W. Carpenter, Sherburne, N.Y., the executive director of the Eastern Federation of Feed Merchants, Inc., which is a trade association of 476 livestock feed manufacturers and retailers with business operations in the States of New York, Pennsylvania, New Jersey, Delaware, Maine, Maryland, New Hampshire, Vermont, Massachusetts, Connecticut, and Rhode Island.

The members of our association are independent operators at country points throughout the Northeast. They have as competitors, farmer cooperatives who engage in the manufacture and merchandising of livestock and poultry feeds and many other farm supplies. Our independent operators pay Federal income taxes on the earnings of their businesses at the rate of 52 percent. Their cooperative competitors pay no Federal income taxes, except in the case of the Cooperative, Grange League Federation Exchange, which operates in New York, New Jersey, and portions of Pennsylvania. In recent years this cooperative has voluntarily paid Federal income taxes on most of its earnings.

The great changes that have occurred in recent years in agricultural operations, notably the size enlargement of livestock and poultry operations, and the necessity that such operations be carried on at the lowest possible cost, has brought about the necessity for the modernization of feed mills and plants that serve this new pattern of farming. Notable examples of this is the need for installing new modern machinery and automatic mechanical facilities to replace the more costly manual labor. Machinery for pelleting feed and equipment for the bulk handling of feed are good illustrations of modernizing requirements.

Such modernization and addition of facilities requires large capital investments. The cooperatives have the available capital built from the earnings on which they escaped income taxes under the present law, while their independent taxpaying competitors have not been able to build capital reserves from which to similarly modernize their mills and plants.

Thus, the current tax law which exempts the cooperative businesses from the payment of income taxes nullifies the constitutional concept of equality of competitive opportunity.

The proposed Revenue Act of 1962, including its provision for the cooperative to withhold and pay to the Government 20 percent on all patronage dividends, including unpaid allocations, would in practical effect impose a 20-percent tax on the earnings of the cooperative. This is a step in the direction of narrowing the tax favoritism now enjoyed

by cooperative businesses as against their independent competitors—but only a short step.

Representatives of the cooperatives, we understand, are bringing great pressure to bear upon your committee to delete the 20-percent patronage dividend withholding provision of the bill. To do this would make the law practically meaningless so far as equalizing even to a small degree the tax treatment for proprietary businesses and cooperative enterprises. We strongly urge the retention of the 20-percent dividend withholding provision of the bill.

Our feed industry taxpaying people are also deeply concerned about the provision in the bill which eliminates from taxation of the cooperative all unpaid amounts allocated on the books to patrons who have given a written consent to treat such allocations as income for tax purposes, and to patrons who retain membership in the cooperative in the face of a bylaw adopted by the cooperative which says that they have consented to such treatment of the dividend allocations.

This provision of the bill brings into focus the fact that in 1951 Congress used a similar provision when it made certain changes in the tax status of exempt farmer cooperatives.

In 1957 the legality of this provision of the 1951 law was tested in court with the result that it was held illegal. The court found that patrons of a cooperative do not have to take into account, for income tax purposes, patronage dividends which have no fair market value or moneys which they do not control and which they may never receive.

Currently there is a movement underway to merge many existing cooperatives into a few gigantic units, which would expand their competitive power aginst proprietary taxpaying competitors. This makes it all the more important that in any changes made in the tax law intended to equalize the tax burden between the cooperatives and proprietary businesses, that the law be written to avoid all possibility of its nullification by a court decision similar to that handed down in 1957. Now is the time to make sure that a law enacted to tax the earnings of a cooperative either to the cooperative corporation or to the patron member be bulletproof from the standpoint of legality.

To accomplish this the provision of the bill which eliminates from the cooperative's tax base patronage dividends merely allocated on the books of the cooperative to patrons who have given a written consent to treat such allocations for tax purposes or to members who have retained membership in the face of a bylaw which says that they have consented to such treatment should be eliminated.

Thank you for the opportunity of presenting the viewpoint of our members.

The CHAIRMAN. Thank you, Mr. Carpenter.

Any questions?

Senator WILLIAMS. Mr. Carpenter, I have a couple of questions.

First, is it the position of your group that all profits must be taxed at some source?

Mr. CARPENTER. Correct.

Senator WILLIAMS. In analyzing your testimony, it is my understanding that you are recommending that these be taxed by whoever keeps those profits?

Mr. CARPENTER. Correct.

Senator WILLIAMS. If they are distributed to the patron, the tax would be paid by the patron and they would not be taxed to the cooperative?

Mr. CARPENTER. That is right.

Senator WILLIAMS. But if the cooperative retains them, you feel the tax should be paid by the cooperative?

Mr. CARPENTER. And the important thing about it is that the phraseology of the law be such that we do not find ourselves back in the same position we are in now as a result of the 1957 court decision.

Senator WILLIAMS. Yes.

I agree with you on the importance of that point, because I happened to be one in 1951 who raised the question of whether Congress could tax the patrons or the farmers on something, on a piece of paper, which had no value, and upon which they could not demand payment. I fully agreed with the court decision, and I think we must take that into consideration now because I question the right of the Congress to tax on something which, unless it has a definite termination date, is a bona fide transfer.

Thank you.

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

Mr. CARPENTER. Thank you, sir.

The CHAIRMAN. The next witness is Mr. E. J. Putzell, Jr., of the Monsanto Chemical Co.

Mr. PUTZELL. Thank you, Mr. Chairman.

The CHAIRMAN. Take a seat, sir, and proceed.

STATEMENT OF EDWIN J. PUTZELL, JR., CORPORATE SECRETARY AND DIRECTOR, LAW DEPARTMENT, MONSANTO CHEMICAL CO.

Mr. PUTZELL. My name is Edwin J. Putzell, Jr. I am corporate secretary and director of the Law Department of Monsanto Chemical Co. which, with its predecessors, has manufactured fertilizer ingredients for over 30 years. Today, with your kind permission, I appear to testify with respect to the taxation of cooperative income.

At the outset, let me state that the fundamental principles reflected in H.R. 10650, as they relate to the tax treatment of co-ops and patrons, are sound—as far as they go—and are supported. While the bill's provisions are definitely steps in the right direction, it is our firm view, however, that such proposals are but the first step toward dealing with the basic and far-reaching cooperative tax problem.

From the business and economics viewpoints, there is no reason why the tax burden on co-op income should be less than on competing organizations. Yet our failure to modernize fundamental tax concepts as they relate to cooperatives has resulted in the inequitable situation where organizations operating as cooperatives, whose earnings go largely untaxed, do compete most successfully for customers and sales with other organizations which pay a 52-percent tax on their earnings.

The bill now before the committee, H.R. 10650, which seeks to establish a single tax on the earnings of co-ops, preserves the traditional method of cooperative financing by retaining earnings through the issuance of paper (scrip) to its patrons. The bill also provides for withholding by the co-op on patronage dividends, thus furnishing the

patron with a means for paying his tax without being burdened with raising the cash. As a result, the bill will, in effect, collect for the Treasury Department a 20-percent tax on cooperative retained earnings which heretofore escaped tax.

However, we foresee serious legal difficulties arising from the bill's provisions for taxation to patrons of the so-called face amount of scrip patronage dividends where the co-op charter or bylaws provide that membership constitutes consent.

We respectfully suggest that the bill would be far more likely to accomplish its intended purpose, and avoid the probability of extended litigation, if it requires only annual written revocable consent by the patron to take into his income the amount of the cooperative's earnings allocated to him in the form of scrip, revolving fund certificates or similar patronage dividends.

The provision that a patron shall have consented to be taxed if the co-op charter or bylaws provide that membership constitutes consent leaves to the individual no alternative but to report as income co-op earnings which he has not received and may not receive for many years, if ever. Inclusion in the bill of both the annual consent and the bylaw provisions will result in only one situation: Obviously no co-op management will seek annual consents if only by the simple inclusion of the bylaw provision it can achieve the same end over a period of many years into the future. Annual written revocable consent would not only be reasonable, but would not force the patron to resign rather than be taxed on paper having little or no value. In many instances, a farmer has no choice but to remain a member of a co-op as there is no other available facility to handle his produce.

In this connection I just saw a newspaper editorial which refers to the bylaw provision as a union shop for farmers in such a situation where in order to market his produce, he has got to work with and belong to a cooperative which has such a bylaw requirement as proposed by the bill.

We, therefore, believe that the original consent proposals contained in the Ways and Means Committee print bill of last August should be restored to H.R. 10650. They provided for a co-op deduction on patronage dividends if paid in cash, scrip convertible quickly into cash, or scrip which the patron by written consent agreed to include in his taxable income. Such freedom of choice by the patron would minimize, if not eliminate, the possibility of the effectiveness of the co-op income tax provisions being set aside by subsequent court decisions as was the case with the 1951 statute.

Now a word with respect to withholding taxes. Provisions of the bill relating to the application of withholding on patronage dividends, as well as to other dividends and interest, are consistent with the long-established principle of withholding on salaries and wages. In fact, unless withholding applies to patronage dividends, the bill's effectiveness in taxing cooperative income would be largely vitiated.

We therefore support withholding. However, we see no reason why exemption from withholding should be granted to persons over 18 years of age who expect to make no tax payments. There was no such exemptions from withholding on wages and salaries when the statute was adopted some 20 years ago, even though its application to those types of income is of far wider scope than that under consideration today.

If, however, exemption from withholding on dividends and interest be made available, the decision should surely not be left to the discretion of the taxpayer as to whether he, in the language of the bill, "reasonably believes that he will not be liable for the payment of any tax."

The exemption as now proposed would, in our opinion, almost completely nullify the intended result of the bill's provisions for taxing cooperative income. In a recent publication by the National Council of Farmer Cooperatives, Mr. Homer Brinkley, that organization's executive vice president, was quoted as citing data to the effect that in 1958-59, 98 percent of all farmers had net farm profits, including co-op patronage refunds, of less than $8,000.

Were such an individual at the beginning of the tax year to believe that, based on then-anticipated income and expenses, he would not be liable for the payment of income taxes for that year, he would so certify to the co-op as withholding agent and no withholding tax would be applied to co-op earnings allocated to him in the form of scrip. This would be true even though the patron had consented in writing or by application of the above-mentioned bylaw provision, or both.

In such a case, the allocated co-op earnings would be retained by it free of even the 20 percent withholding tax and by April of the following year, the patron would have to find the cash with which to pay income taxes on the scrip he had received were it to develop that he, in fact, did have taxable income for the previous year.

It is therefore our recommendation that exemption, if any, from withholding should be based on the expectation by the taxpayer of taxable income in an amount less than a minimum figure to be specified in the bill.

Earlier I referred to the situation where co-ops, largely tax-free, compete for customers with corporations which pay a 52-percent income tax. The bill properly would subject to tax by the co-op its income from sources other than transactions with patrons. The difficulty is that the definition of such taxable income does not cope with the changing pattern of cooperatives' activities, particularly those commonly described as purchasing cooperatives.

The startling growth of co-op enterprises in this country is not just the result of increased activity in the purchase of farm supplies and sale of farm products. A large part of it is the product of the entry of cooperatives into areas of activity which widely depart from their traditional service functions. Nowhere is this departure more noticeable than in their use of retained earnings for investment purposes and in manufacturing, mining, and processing.

Today, as you know, cooperatives own elaborate facilities to manufacture, to process and to can. They also own well-integrated nitrogen production plants, phosphate mines, and furnaces, oil wells, oil refineries and oil distributing facilities. Many have investments in the securities of other cooperatives or of taxpaying corporations.

In all such cases, patronage dividends contain the element of profit, either that attributable to direct manufacturing, processing, or mining activities or to the return on investments in securities or other types of capital assets. Such extensive use of capital is a departure from the historical concept of cooperative service activities.

It is also, in our opinion, plainly designated as "unrelated business activity" and income.

Congress has dealt with a similar situation. Certain charitable and nonprofit organizations, exempt from Federal income taxes, had been actively engaging in businesses competitive with taxpaying corporations. In the Revenue Act of 1950, income from such business activities of charitable organizations was properly made the subject of income taxation.[1]

It is in this unrelated business area where the co-op effort ceases to be joint purchasing and selling and becomes the accumulation of capital, its joint investment, and the receipt of profits resulting therefrom. It is also in the manufacturing, processing, and mining areas that the competitive advantage of tax-free operation by the cooperative is most marked.

Therefore, in the interest of equitable taxation and fairly broadening the tax base, we recommend the inclusion in H.R. 10650 of provision for the taxation on a current basis and at corporate rates of all co-op earnings from unrelated businesses, including those which result from manufacturing, processing, and mining activities, as well as from investment income, rents, and royalties.

Enactment of this proposal would be fair and just to all. Co-ops could continue to enjoy their tax-free status to the extent of income from transactions with or for patrons, and would be placed on a taxpaying basis with respect to income received from manufacturing, processing, and mining activities pursued in direct competition with taxpaying organizations. The co-op would then not enjoy an unfair advantage over its competitors, and the tax burden would be more evenly borne.

In closing, let me express my sincere appreciation for this opportunity to express my company's views on this important subject.

Thank you.

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

Senator Bennett.

Senator BENNETT. No questions.

The CHAIRMAN. The next witness is Mr. A. L. Reed, Public Information Committee of the Cotton Industries.

Mr. Reed, take a seat and proceed.

STATEMENT OF A. L. REED, PUBLIC INFORMATION COMMITTEE OF THE COTTON INDUSTRIES

Mr. REED. Mr. Chairman and gentlemen of the committee, my name is A. L. Reed, and I am speaking for the Public Information Committee of the Cotton Industries, to which I shall refer as the committee.

We appreciate the opportunity to be heard on this important question. We have a prepared statement, but I shall ask that it be placed

[1] "The problem at which the tax on unrelated business income is directed here is primarily that of unfair competition. The tax-free status of these sec. 101 organizations enables them to use their profits tax free to expand operations, while their competitors can expand only with the profits remaining after taxes. Also, a number of examples have arisen where these organizations have, in effect, used their tax exemption to buy an ordinary business. That is, they have acquired the business with no investment on their own part and paid for it in installments out of subsequent earnings—a procedure which usually could not be followed if the business were taxable" (H. Rept. 2319, 81st Cong., 2d sess., 26–37 (1950)).

in the printed record and I shall briefly summarize it rather than read it.

The CHAIRMAN. The complete statement will be inserted in the record at the end of your oral presentation.

Mr. REED. Thank you, sir.

The cotton industries consist of the cotton gins, cotton warehouses, cotton compresses, cotton merchants and cottonseed oil mills and, of course, the cotton spinning mills, but the cotton spinning mills are not members of and are not associated with our committee.

Our committee is a rather informal organization brought together in 1954 following the court decisions which invalidated the intent of Congress in the 1951 act.

Senator BENNETT. Mr. Chairman, may I ask Mr. Reed a question at this point?

Mr. REED. Yes, sir.

Senator BENNETT. Are there any cooperative cotton spinning mills?

Mr. REED. I know of none.

Senator BENNETT. Thank you.

Mr. REED. The President, in his Federal tax message of April 20, stated:

> Contrary to the intention of Congress substantial income from certain cooperative enterprises reflecting business operations is not being taxed either to the cooperative organization itself or its members.

I am appearing here for fully taxed competing business in cotton ginning, warehousing, compressing, and oil extraction, and I wish to say that listening to the witnesses for the cooperatives yesterday, I was impressed by the confusion which they created in talking about small marketing agencies.

The difficulty in this co-op tax matter arises out of the fact that cooperative corporations have broadened out and gone far beyond mere marketing, of the products of the farmer, and engage in processing, manufacturing, warehousing and other fields of industry.

H.R. 10650, in our opinion, does not eliminate the unfair competitive situation referred to by the President. It, if anything, increases competitive difficulties of taxpaying competing industries. It attempts to dignify cooperative corporations tax dodging by imposing, in theory, on their patrons, taxes on earnings retained by these wealthy cooperative corporations for their sole use and benefit, and the destruction of their competitors.

The effect of any act of Congress, of course, depends upon the facts. We spent about 18 months investigating the facts concerning the cooperative organizations in the cotton industries as compared with the taxpaying organizations.

We reduced the results of our investigation, which covered some 6,500 documents, to 2 small volumes. I believe your staff expert, Mr. Stam, has copies of them. If he does not, I have a few left. I think he has these. I have a few copies left that I will deliver to him, if he does not already have them.

These documents illustrate the type of investigation we made and the facts which we developed.

The facts involved in the application of the law will be found in these volumes.

Our investigation covered six concentrated areas, and if you will glance at the small map I have had placed before you, you will see three areas in solid black and three areas circled in black.

(The map referred to is made a part of the record and is retained in the committee files.)

Mr. REED. The first area on the map is in the Mississippi Valley; the second small area in the center of the map is in the Texas Plains area; the third solid black area is in the San Joaquin Valley of California.

The first of the three circled areas is in the Lower Rio Grande Valley, the second one is in New Mexico and in the Texas Upper Rio Grande Valley, and the third one is in the Pima County area in Arizona.

These six concentrated areas contain 29 percent of the cotton farms. But they produce 50 percent of American cotton.

These are the areas, not of small, but of big farmers. But they contain 86 percent of the cooperative cottonseed oil mills, 88 percent of the cooperative compress companies, and 50 percent of the cooperative cotton gins.

To illustrate the point, in the entire State of Georgia, where you have small cotton farms and small production performed, there are only seven cooperaitve gins. There are 471 taxpaying cotton gins. There are no cooperative cottonseed mills providing those farmers with a market for their cottonseed.

Cooperative corporation promoters look to areas of big farming operations for their industrial processing and storage areas.

Do you know where the Georgia marketing cooperative organization went to build a gin with the money of the farmers of Georgia? To Pima County, Ariz., where there are large farms. One of them, for instance, is getting some $250,000 in a year out of farm support money.

In these six concentrated areas on that map you will find the great majority of your large acreage farms, your wealthy landowners, and your big profit cooperatives.

In a news release by the Departemnt of Agriculture some time ago, it was stated that one-third of our farms received nearly all of our price support money and that one-fourth of the cotton farms received three-fourths of the acreage allotments. These farms, this money, and these cooperatives are similarly concentrated.

The Staple Cotton Cooperative Association of Mississippi Valley, in the first black mark on that map, from the latest figures that we have, which are August 31, 1956, has a net worth of $5,806,000.

Three of its officers and six of its directors have a net worth of $4,875,000.

One member controls 38,000 acres of land in the Mississippi Delta, and has a net worth of $3,583,000.

This Staple Cotton Co-op Corp. of Mississippi owns a fertilizer plant at Gulfport, Miss. It owns a discount corporation with assets of some $3 million. Its members and officers are associated with the Farmers Supply Cooperative that distributes automobile tires, oil, gas, fertilizer, and other commodities, not just to the farms but to anybody who will come along and purchase from them.

Now, the Texas plains area, the little black mark in the center of the map, contains 2 percent of the cotton farms of America, but it produces from 15 to 20 percent of the cotton produced in America.

Cooperatives have been expanded spectacularly—to the destruction of their tax-burdened competition.

In that area in 1937 there were only 32 cooperative cotton gins. Today there are 140 handling nearly 40 percent of the production.

In 1937 there were no cooperative compresses in that area. Today the largest inland compressing plant in America is located in that area at Lubbock, Tex. with an investment of $6,200,000.

In 1937 there were no cooperative oil mills in that area. Today there is the largest oil mill in the country located there, owned by a cooperative corporation with an investment of $6,700,000. Its operators have now announced for 1962 an expansion of $3 million, which will give it almost double capacity and an investment of $10 million.

Who owns these compresses and this oil mill? You have heard some testimony here about the little farmer owns cooperatives and how you must take care of him. Who in fact owns these big business cooperatives I am discussing?

Cooperative corporations in the area own these 140 gin plants and these cooperatives are the owners of the oil mill and the compresses. In fact, the bylaws of the oil mill and the compresses provide that the farmer cannot be a member.

The combined investment of these cooperative organizations in that little, small concentrated area of cotton gins, cottonseed oil mills and cotton compresses, was $40 million, with an annual income in excess of $6 million per annum.

What type of men are interested in this multimillion-dollar unincorporated industry? We investigated their directors.

Seventy-six of the directors had a net worth of around $100,000; 73 of their directors owned and controlled 61,354 acres of this land. If it is worth a dime it is worth $400 an acre; 73 directors had a total annual income in excess of $2 million. One man in the group had a net worth of $750,000. They are the beneficiaries of the income tax treatment of cooperative corporation profits.

In the interest of time and showing how they operate, I shall use only the oil mill. The cooperative cottonseed oil mill located at Lubbock in its operations clearly shows the effect of an income tax exemption to a purely manufacturing business enterprise—and that is all it is.

In 1938 the cooperative gins in that area formed an oil mill cooperative which purchased a secondhand oil mill for $125,000. In 1958 its net worth was $4 million; in 1961 $6,732,000, with an announced expansion of $3 million, making it approximately $9,732,000—all owned by the cooperative gin corporations.

Its annual earnings have expanded as its investment has grown. In 1960 it earned $1,394,000 profit; in 1961 it earned $1,364,000 profit.

In its entire history it has never paid one dime of income taxes.

I delivered to the chairman of the House Ways and Means Committee its own audited report showing that it had never paid any income taxes.

Let us compare this plant with the largest independent taxpaying plant owned by Anderson-Clayton Co. In fact, there were seven such plants; some of them have since closed. But I took 5-year earnings of these fully taxed plants and added them together so that there would be no appearance of good and bad years.

Their total earnings for 5 years were $4,469,000, and they paid the Government $2,296,000, or 51 percent in income taxes.

Only what they had left after these income taxes was available for dividends, reserves, and for reinvestment in their facilities.

The cooperative plant right along beside it, the same 5 years, had annual profits of $5,644,000, on which they did not pay a dime in income taxes. How long can the tax-burdened competitor of this untaxed corporation compete with it for the raw product and in the distribution of its manufactured commodities?

Its tax-free retained earnings afford the cooperative a destructive and competitive advantage.

In 1939 the cooperatives purchased 15 percent of the cottonseed in this area. In 1961 they purchased 43 percent of it; with a $3 million announced expansion they can presently take over practically the entire business.

The same success story based on tax excape can be told to you about the cooperative compress. It started from zero in 1948, and today has an investment of $6 million, with an annual income ranging around $1,200,000.

Now, how do these wealthy cooperative corporations retain these earnings tax-free? This is important, I think, in order to understand whether and how H.R. 10650 will operate.

Using the oil mill and its gin owners as illustrated, the oil mill issues preferred stock as dividends to its oil mill owners. It covers all of its earnings with this issue along with some cash. The total amount is deducted or excluded from gross income for income tax purposes.

The cooperative gin, in turn, receives the oil mill profits, the compress profits and its own profits, and distributes them to the farmers, some in cash, much in scrip.

I have an original piece of scrip issued by a cooperative in 1951, and I have presented you with a photostatic copy of it. This was issued in 1951 and has not been paid to date. The scrip means that the cooperative kept the money and expanded its facility. In fact, this gin went into the grain elevator business with the retained earnings out of its cooperative corporation activities.

This kind of no market value paper is what they are asking you to tax the farmer on, this piece of paper that he got in 1951—and still has.

The Secretary of the Treasury stated that this kind of paper has been floating around on an average of from 9 to 10 years.

Various types of paper are issued by these organizations from stock and other certificates to simply a letter stating "We have credited your account with *x* dollars"—but you can't get it until the co-op decides to pay it.

Take a look at what has happened to the profits of the oil mill. Their own statement on June 30, 1961, shows that the profits of the oil mill are evidenced by paper held by the cooperative gin corporations in the form of preferred stock, and that they had $5,297,000 of such paper allocations, some dating back to 1955.

This money was retained out of earnings by the oil mill and used for the expansion which we have just described. I want to give you an illustration of how and why one of our customers, the South Gin Corp. of Brownfield, Tex., "went co-op". It was a taxpaying gin corporation owned by 19 farmers, with an excellent financial rating.

In February 1961 it converted to a cooperative. When we called and asked them why they deserted us, they stated that it was a matter of arithmetic; that as a cooperative they would get co-op oil mill profits, co-op compress profits, co-op gin profits, and co-op marketing association profits, and that they could retain those profits tax-free until the cash actually reach the individual farmers. They cover these earnings with scrip and pay no taxes on them.

Now, farm cooperatives tell you that you should tax everybody but them. They point out to you the farmer. But I want to tell you that the farmer who receives this document is so far removed from the control of the earnings of these cooperative corporations that I do not believe any court in the land would hold it to be income taxable to him.

Listen to this. The cooperative oil mill, by law, section 5 or article V, section 1, states that only gin co-ops can be its members.

Article VI, section 2, says that it may issue preferred stock as dividends.

Article VI, section 7, provides that the retirement of the preferred stock so issued as dividends rests in the sole discretion of its board of directors.

Article VIII, section 2, provides that its profits thus retained tax free may be used in the discretion of its board for any necessary purpose.

Could a court hold that the recipient of this no-market-value piece of paper, has by its receipt obtained income, or has any rights to demand anything in payment of it or out of the profits of the cooperative corporation which issued it?

H.R. 10650 ignores the facts dealing with the practical operation of cooperative organizations. It ignores the findings of the courts in the *Long Poultry* case and in the *Carpenter* case, that in order to be income the recipient must have a fixed and unconditional right to demand payment.

I would like to suggest to the committee that the present law provides that all individuals shall include their income in their annual income tax statement.

The addition of the provisions in H.R. 10650 that the farmer shall report a piece of paper like this as income because of a co-op's bylaw provisions does not really change the situation. It still is a question of whether or not it constitutes taxable income.

The key provision to the proposed Revenue Act of 1962 is the one which permits the deduction from the cooperatives' gross income the cooperative "qualified allocations" of that income. Scrip such as I have presented to you before it becomes a "qualified allocation" when consented to in writing or where the proposed "bylaw consents" covers it.

The farmer who receives it thus "consents" to include it in his taxable income, but that does not give him any rights with respect to it, which gives it the fundamental character of income.

It should be noted that the proposed law does not state that the cooperative corporation cannot deduct this document from gross if no taxes are paid. It simply says that the cooperative can deduct it from gross if consent can be obtained from the farmer in writing or

forced upon the farmer by including a set or words in the bylaws of the cotton gin and notifying him.

We propose that the bill be amended by eliminating from section 1382 all deductions from gross income except dividends, patronage or otherwise, paid in cash, and allocation of dividends which shall be made by documents that state the dollar amount to be interest bearing and have a fixed date of maturity no greater than 3 years.

In the alternative, we most earnestly appeal to you to put something of this nature in the act as follows:

> Should it be determined by any court having jurisdiction that any patronage or other dividends not paid in cash by the cooperative corporation is not taxable income to the patron, member or recipient, its deduction from gross income shall be disallowed to the cooperative corporation and the resulting tax shall be assessed against the cooperative corporation within 1 year after such determination becomes final.

The Secretary of the Treasury was asked what he thought of a provision of this character, and he said he thought it would be fair.

Certainly, if what they have said to you here in their testimony that they want to pay one tax, they should have no objection to a provision in the law which would see that somebody did pay a tax on these fabulous earnings.

In concluding, Mr. Chairman, I must add in response to an opinion expressed this morning that retained co-op earnings can be constitutionally taxed to its patrons, that this is based on the same fundamental error which the Supreme Court ascribed to the Government in *Eisner* v. *McComber* (252 U.S. 189) when the Court stated:

> Throughout the argument of the Government, in a variety of forms, runs the fundamental error already mentioned—a failure to appraise correctly the force of the term "income" as used in the 16th amendment, or at least to give practical effect to it. Thus the Government contends that the tax "is levied on income derived from corporate earnings," when in truth the stockholder has "derived" nothing except paper certificates which, so far as they have any effect, deny him present participation in such earnings.

The partnership analogy of taxing a partner on earnings which are not presently distributable under the partnership agreement was shown by the Court in this case, to be false when applied to corporations.

The Court stated (p. 214):

> * * * we cannot disregard the essential truth disclosed, ignore the substantial difference between corporation and stockholder, treat the entire organization as unreal, look upon stockholders as partners, when they are not such, treat them as having in equity a right to a partition of the corporate assets, when they have none, and indulge the fiction that they have realized a share of the profits of the company which in truth they have neither received nor realized. We must treat the corporation as a substantial entity separate from the stockholders, not only because such is the practical fact but because it is only by recognizing such separateness that any dividend—even one paid in money or property—can be regarded as income of the stockholder.

Thank you very much, sir.

The CHAIRMAN. Thank you, Mr. Reed.

(The prepared statement of Mr. Reed follows:)

STATEMENT PRESENTED FOR THE PUBLIC INFORMATION COMMITTEE OF THE COTTON INDUSTRIES

Mr. Chairman and gentlemen of the committee, my name is A. L. Reed. I reside in Dallas, Tex., and I am a retired attorney at law. I am appearing for the Public Information Committee of the Cotton Industries, which I shall here-

inafter refer to as "the Public Information Committee" or just "the committee." I am appearing as a member of the committee.

The cotton industries consist of the following: Cotton gins, cotton warehouses, cotton compresses, combination compress and warehouse facilities, cottonseed oil mills, the spinning mills and the cotton merchants. There are no cotton spinning mills associated with the Public Information Committee. Its headquarters are maintained at 1211 South Brighton Street, Dallas, Tex. Mr. Leonard Calhoun, 412 Washington Building, Washington, D.C., is its attorney. The committee was organized in November 1954, for the purpose of obtaining a correction of the situation which followed, because the 1951 Revenue Act failed to exact, as intended by Congress even one tax on cooperative business income.

I. THE TAXPAYING MEMBERS OF THE COTTON INDUSTRIES ARE CONFRONTED WITH A REAL AND DESTRUCTIVE TAX DISCRIMINATION

The President of the United States in his message to Congress April 20, 1961, on our "Federal Tax System," stated the facts confronting the independent taxpaying cotton industries which resulted from the income tax discrimination in favor of the cooperative industries of the Nation. We quote a significant paragraph from his message:

"Contrary to the intention of Congress, substantial income from certain cooperative enterprises, reflecting business operations, is not being taxed either to the cooperative organization itself or its members. This situation must be corrected in a manner that is fair and just to both the cooperatives and competing businesses" (p. 14, vol. 1, May 1961, hearings, Committee on Ways and Means of the House of Representatives).

It seems incredible that Congress has enacted legislation taxing charitable institutions and has at the same time permitted these wealthy cooperative business organizations to go tax free.

II. THE SOURCE OF OUR TROUBLES—RETAINED TAX-FREE EARNINGS OF COOPERATIVE ORGANIZATIONS

The present provisions of the Internal Revenue Code provide, as to farm cooperatives, that dividends, paronage or otherwise, may be paid either in cash or by certificates of indebtedness, letters of advice, etc., so long as such documents disclose the dollar amount of such dividends. The intent of Congress with the passage of the 1951 Act, as expressed in the report was that the patron or owner of the cooperative organization would be required by law to pay taxes on these certificates or letters of advice so long as they stated the dollar amount credited to the account of the patron or owner. There was of course no difficulty wher payments were in cash. Exhibit F attached hereto is a sample of the type of paper issued by a cooperative organization under the present law (see note). It was issued during the 1951–2 cotton season to a producer of cottonseed and cotton in the Quanah, Tex., area, and the amount of $34.65. It has not been paid up to date (March 30, 1962). In other words, this cooperative organization retained its earnings tax free which resulted from the patronage of this farmer for more than 10 years. It has reinvested such earnings in the expansion of its facilities in the Quanah area. At 4 percent interest this money would have cost any other corporation $13.86; but this cooperative retained it tax free and without interest costs.

NOTE.—There are many varieties of this paper distribution including everything from fixed-interest preferred stock on down to simple letters stating "we have credited your account with X dollars."

The earnings of the cooperative corporations are retained tax free for an average of 9 to 10 years before the scrip now held to be nontaxable, is redeemed by the cooperative organizations (exhibit 7, p. 2, attached to the statement of the Hon. C. Douglas Dillon, Secretary of the Treasury, before the House Ways and Means Committee, 1961 hearings, vol. 1, p. 225). Because the law permitted the cooperative organization to deduct the $34.65 from gross receipts (exhibit F) that organization did not pay income taxes on it. The recipient of this piece of paper did not pay income taxes because he received no money or rights to demand payment at any time.

This entire matter has been reviewed by the Federal courts in several cases, the two leading ones are the *Long Poultry Farm, Inc.*, case (249 Fed. 2d 726), by the fourth circuit and the *Carpenter* case (219 Fed. 2d 635). The two cover the accrual and the cash basis of computing income taxes. There were

several other cases reviewing the authority of Congress to tax the recipient of this method of distribution of profits. The Supreme Court denied certiorari in one case (350 U.S. 1013). Subsequently, the Secretary of the Treasury canceled all efforts to collect taxes on this method of distribution of profits, either from the cooperative organizations, the members or the patrons. At the 1958 hearing before the House Ways and Means Committee (vol. 1, p. 1098), Hon. Robert B. Anderson, then Secretary of the Treasury, testified as follows:

"We have already called to your attention the fact that a series of court decisions have made largely ineffective the 1951 legislation which was intended to assure that all cooperative income would be taxed either to the cooperative or to its members as it was earned.

"The Treasury rulings under which all patronage refunds in the form of certificates were held to be taxable at their face value, which were assumed to be valid at the time of the 1951 legislation, have been held invalid where the certificates do not have a determinable market value. Thus, it is possible for the cooperative to receive a deduction in computing its taxable income, while its members are not taxable on the certificate they receive."

III. THE COOPERATIVE ORGANIZATION QUICKLY SEIZED UPON THEIR TAX ADVANTAGE AND RAPIDLY EXPANDED THEIR FACILITIES AT THE EXPENSE OF AND TO THE COMPETITIVE DISADVANTAGE OF THE TAXPAYING COTTON INDUSTRIES

Attached hereto is exhibit A. It is a small outline map and I have had one of these placed before you. Cotton is regularly produced in 14 States, extending along the southern part of the United States from Virginia to California. On the map before you there are three blacked-out areas, and three areas circled in black. The first solid black area is the Mississippi Valley. The second solid black area is the Texas plains area. The third blacked-out area is generally referred to as the San Joaquin Valley of California. The circled area at the bottom of the map is the Lower Rio Grande Valley in Texas; the next one is the Upper Rio Grande Valley located in Texas and New Mexico. The third circled area is the cotton producing area in Arizona, primarily Pima County.

Twenty-nine percent of the cotton farms are located in these six small areas. They produce 50 percent of the U.S. cotton crop. These six areas contain 86 percent of the cooperative cottonseed oil mills; 88 percent of the cooperative compress companies and more than 50 percent of the cooperative cotton gins. To illustrate the point, in the entire State of Georgia, where there are only small farms with small production per farm, you will find only six cooperative cotton gins and no cooperative cottonseed oil mills. In these six concentrated areas, you will find also the large-acreage farmers and the wealthy landowners. In a press release issued some time ago by the Department of Agriculture, concerning price supports and acreage allotments, it was stated that about one-third of our farms account for nearly all of the price-support outlays and one-fourth of the cotton farms have three-fourths of the cotton acreage allotments. These facts show the concentration of the production in the hands of the large and wealthy producers. In a like manner the ownership of the cooperative corporations is also concentrated in the hands of these large and wealthy producers of cotton.

The Public Information Committee investigated the operations of the cooperative organizations in all six of the areas shown on this map. We presented our studies to the House Ways and Means Committee at the 1958 hearing in two volumes. Volume I was an analysis of the financial statements which we had gathered, comparing the cooperative corporations, their income and volume, with the income and volume of the independent taxpaying cotton industries. Volume II contains illustrations of the financial statements and other data relating to our investigation. These two volumes were not incorporated in the record of the House Ways and Means Committee, but they were made a part of the record by reference. Wo do not ask that they be made a part of this record, but we do offer them to the staff of this committee so that they may see the details of the investigation we made.

Time does not permit discussion of the details of our investigation with respect to all six of these areas. We have selected the Texas plains area, as illustrative of all six areas. It is the small solid black dot in the center of the map.

These cooperative organizations in the six concentrated areas shown on this map are not small business. For instance, before giving you the facts concerning the Texas plains area, we call your attention to the first solid black area, gen-

erally known as the Mississippi Valley. It contains the finest and most productive cotton acreage in all of the United States. It is here that you will find your large cotton plantations. The Mississippi Valley also contains some of your largest and most wealthy farm cooperative corporations. For instance, the Staple Cotton Cooperative Association of Greenwood, Miss., at the end of its fiscal year 1956 (the latest year available to us) had a net worth of $5,800,000. One of its members owns, controls, and/or farms 38,000 acres of the finest land in America. This one member has a net worth of $3,583,000, as of the same date. Three of its officers and six of its directors, nine men, have a net worth of $4,875,000. In addition, these key men are linked with the Farmers Supply Cooperative and engage in many lines of business, such as automobile tires, oil, gas, fertilizer, and many other commodities.

We call attention to these items in the Mississippi Valley so that you will understand that we have not selected the Texas plains area as being anything other than the same type of operation to be found in all of these concentrated areas.

IV. COOPERATIVE EXPANSION IN THE TEXAS PLAINS AREA IS ILLUSTRATIVE OF THE RAPID EXPANSION MADE POSSIBLE BY RETAINED TAX-FREE EARNINGS

In 1937 there were 32 cooperatives gins in the Texas plains area; there were no cottonseed oil mills and no cotton compresses and warehouses. Today (1962) there are 140 cooperative cotton gins in the area; 14 of these were erected in 1961, and, in addition, the cooperative corporations purchased 10 taxpaying independent gin plants, thus expanding their operations by 24 gin plants in 1961. For 1962 there are 18 new cooperative gin plants scheduled either for erection or purchase from present independent owners of gin plants. Today the Texas plains area has one of the largest compress and warehouse facilities in the Nation located at Lubbock, Tex., and the cooperatives in this area have an additional compress and warehouse facility at Plainview, Tex. Today the cooperatives own and operate at Lubbock, Tex., one of the largest cottonseed oil mills in the Nation. It probably exceeds the capacity of any oil mill in the Cotton Belt.

Exhibit E attached to this statement contains two letters, one from Mr. Roy B. Davis, general manager of the Plains Cooperative Oil Mill and one from Mr. Clarence Davis, manager and secretary of the Littlefield Farmers Cooperative Gin. These two letters explain their method of operation, and while they contend, contrary to the statements of the Secretary of the Treasury, and contrary to the findings of the Federal courts, that the farmers paid taxes on allocated earnings, the statements contained in the letters clearly show their methods of retaining, tax free, the earnings of large and profitable corporations. Obviously, if the farmers voluntarily paid taxes not required of them by law, there could be no objection to a provision in the law which would insure that either the cooperative corporation or its members and patrons do pay income taxes.

The purpose of attaching the two letters to this statement is to show the method of operation from the statements of the cooperative operators themselves. It will be noted that in 1937 the 32 cooperative gins in the Texas plains area organized a cooperative corporation and purchased a cottonseed oil mill valued at $125,000. Since that period it has been expanded and enlarged so that in February 1958, it had a net worth of $4 million. It should be particularly noted from these two letters that the gin cooperative corporations own and operate the cottonseed oil mill and the cotton compresses. These two key organizations, the oil mill and the compresses, are not owned directly by the farmers. The gin cooperative corporations are owned directly by the producers.

Exhibit D attached hereto contains a statement listing the owners of the cooperative oil mill of Lubbock, Tex., together with the amount of the preferred stock which they hold in that facility. It should be noted from exhibit E that in February 1958, the net worth of the oil mill was approximately $4 million, and it should be further noted from exhibit D that on June 30, 1961, the gin cooperative corporations owned $5,297,000 of the capital stock of the Plains Cooperative Oil Mill. In other words, there was an expansion of this facility through the method and means of retained tax-free earnings represented by the preferred stock issued by the oil mill to the gin cooperative corporations.

As stated in exhibit E the gin corporations (not the oil mill or the compresses) passed some of these dividends of the oil mill and the compress on to the farmers in the form of cash and the remainder in the form of scrip or letters of credit.

It is contended by Mr. Clarence Davis in exhibit E that the farmers paid income taxes on the scrip. If they did they are entitled to a refund. The point we make here with respect to exhibit D is that the earnings of the oil mill and the compress were retained and preferred stock issued to the cotton gin cooperative corporations to cover these earnings. Some of the capital stock listed in exhibit D extends back to the 1955 operations of the cottonseed oil mill ($554,842.80).

In exhibit C attached hereto we show the tons of cottonseed produced in the Texas plains area and the tons purchased by the cooperative oil mill at Lubbock. It should be noted that in 1939 this oil mill purchased 15 percent of the production of the Texas plains area. In 1961 it purchased 43 percent of the Texas plains production; in the meantime the plains production had increased from 118,000 tons per annum to 765,000 tons per annum.

The tax-free retained earnings have resulted in the closing of the independent taxpaying cottonseed oil mills at Slaton, Plainview, Brownfield, and Littlefield—all in the Texas plains area. There are now only three such oil mills, other than the cooperative, left in the Texas plains area.

In exhibit B we have reproduced the public announcement of the Plains Cooperative Cottonseed Oil Mill of Lubbock, Tex., of an expansion program of $3 million in its plant at Lubbock, practically doubling its capacity.

The cooperative method of operation involves the control of the cotton production, the marketing of cotton, cottonseed distribution, the warehousing and compression of the cotton through the cotton gin. The cotton gin is the machine that makes cotton a merchantable commodity and creates the supply of cottonseed for the oil mills. Through the cooperative cotton gins these vast cooperative operators in the Texas plains area are gradually establishing a monopoly of the cottonseed business, the marketing of cotton, the cotton warehouse and compression business, and the cottonseed oil mill business. From a small beginning of 32 cotton gins in 1937 these cooperative organizations now have an investment of approximately $40 million in the small concentrated area and a net income of approximately $8 million per annum.

The Plains Cooperative Oil Mill, which is shown by exhibit D to have outstanding preferred stock issued as dividends to its cooperative gin cooperative owners of $5,297,000 as of June 30, 1961, is shown by its financial statement of June 30, 1961, to have a total value of $6,732,000, to which announced plans (exhibit B) for expansion will add $3 million.

The earnings of the Plains Cooperative Oil Mill for the year ending June 30, 1961, were $1,364,664. It had net earnings for the year ending June 30, 1960, of $1,394,739; its admitted value at that time was $6,261,282. This wealthy cooperative corporation has never paid one dime income tax to support the heavy Federal Government budget. We are only asking Congress to collect one tax from it, either at the corporate level or the member level, while we pay double taxes—both on the corporate earnings and on dividends paid out of those earnings.

Exhibit E attached hereto contains the statements of the Cooperative Oil Mill's general manager, telling you precisely how these earnings were distributed to the cooperative cotton gin corporations which own the oil mill. The method used is to issue preferred stock to the cooperative cotton gin owners. As of June 30, 1957, these owners held $3,956,830 of the capital stock of the oil mill. This did not include the capital stock distributions of the compresses and other interests owned by the cooperative corporations in the Texas plains area. Note how closely these holdings of the capital stock balanced with the $4 million referred to as the plant investment in the letter exhibit E attached hereto.

As of June 30, 1961, these same cooperative cotton gin owners held $5,297,195 of the preferred stock issued by the oil mill to cover its earnings. In other words, as the capital investment increases and as expansion takes place in the oil mill, capital stock is issued and deducted from gross income, under the present income tax laws. By this method, the oil mill cooperative corporation channeled its earnings tax free into the plant and facility which it is operating at Lubbock, Tex.

In exhibit E, particularly the letter from Mr. Clarence Davis, manager and secretary of the Littlefield Farmers Cooperative Gin, you will find how the earnings of the cotton gin and the oil mill, plus the compresses are distributed to the farmers, members, and patrons of the cooperative organization. To use the language of Mr. Davis:

"We allocated to our patrons on a patronage basis 100 percent of these net margins."

He further states:

"To the best of our knowledge and belief all of our farmer patrons included the full amount of these patronage allocations in their incomes and paid income tax thereon."

Exhibit F attached hereto illustrates the method of allocation. If taxes were paid on any allocations, then the farmers are entitled, according to the Secretary of the Treausry, to a refund of the amounts paid. We do not doubt that some farmers have paid taxes on this paper by mistake or error. What we do say is, however, that they are not required by law to do so and since these cooperatives are contending that members do pay the taxes on the co-op earnings certainly they are in no position to object to a valid act of Congress which will require all patrons, members, and owners of cooperative corporations to pay their fair share of income taxes.

It is particularly significant that neither officer of the cooperatives—oil mill or gin—came forward with any evidence that anyone had paid any income taxes on any part of their fabulous retained earnings, distributed only by certificates or other means of retention. There is, of course, no question raised about earnings distributed in cash.

What these cooperative corporations have done with these retained tax-free earnings is shown by the expansion in the Texas plains area. The cooperative oil mill at Lubbock from a small beginning in 1939 expanded to the point where it purchased 43 percent of the production of cottonseed in the Texas plains area for the year ending in 1961. There is now in progress (exhibit B attached hereto) an additional $3 million expansion of that plant. Since 1937 the gin plants of the cooperative organizations in this small area have been expanded from 32 to 140 plants. There was a like expansion of the combination compress-warehouse facilities. For instance, the cooperative compress at Lubbock recently increased its capacity by the erection of 18 new warehouses of 50,000 square feet each, at a cost of $1 million. These warehouses were completed for use in the receiving of cotton for the 1961–62 season. Here follows the bales received and the earnings for 12 years, since its erection, not including the 1961–62 cotton season, of the Farmers Cooperative Compress at Lubbock, Tex.

Bales received and earnings for 12 years of operations

Season	Bales received	Earnings	Season	Bales received	Earnings
1948-49	78, 164	$48, 099. 94	1955-56	270, 914	$528, 118. 02
1949-50	173, 329	163, 040. 38	1956-57	345, 098	505, 723. 21
1950-51	125, 991	119, 767. 65	1957-58	351, 266	662, 559. 38
1951-52	190, 696	173, 533. 36	1958-59	446, 907	1, 045, 038. 46
1952-53	247, 594	309, 492. 50	1959-60	424, 984	782, 574. 97
1953-54	192, 339	252, 503. 99	1960-61	485, 087	697, 077. 70
1954-55	270, 552	457, 700. 65	1961-62	[1] 750, 000	([2])

[1] Estimate.
[2] Not available.

In addition to the Lubbock plant of this cooperative organization there is an additional cooperative compress at Plainview, Tex., which received approximately 150,000 bales during the 1961–62 season, making the estimated total for that year 900,000 bales out of an estimated production of 2,500,000 bales. The remainder of the production was distributed between the 25 compresses and 18 warehouses located in the Texas plains area and operated by taxpaying organizations. Since 1949 the cooperative compress organizations have expanded to where they are now handling 36 percent of the production in the Texas plains area.

V. IN THE TEXAS PLAINS AREA THERE IS A $40 MILLION COOPERATIVE CAPITAL STRUCTURE WITH ANNUAL NET INCOME FROM $6 TO $8 MILLION, ALL FINANCED THROUGH THE CERTIFICATE METHOD OF ALLOCATING EARNINGS

In the Texas plains area, the small black dot in the center of the map before you includes 21 counties, 19 in Texas and 2 in New Mexico. There are 140 cooperative gins active and in operation in that area. We do not have possession of their financial statements as of today, but they have an approximate valua-

tion of $25 million with an annual net income of approximately $5 million. The Plains Cooperative Oil Mill's financial statement of June 30, 1961, shows a capital investment in the oil mill of $6,732,000. The financial statement of the Farmers Cooperative Compress of Lubbock, Tex., shows a capital investment, which does not include the expansion of 1961–62, of $3,026,000. The expansion approximated $1 million which would give the cooperative compress at Lubbock a capital investment of $4,206,000.

We have no late figures on the cooperative compress at Plainview, but in 1957 it had a capital investment of $1,089,000. Expansion since that date is roughly estimated to make the present capital investment approximately $2 million. The net earnings of the cooperative compress at Lubbock are available for the 1960–61 season only, and they were $697,077. For the 1961–62 season they are estimated at approximately $1,200,000. To this should be added the net income of the Plainview Cooperative Compress.

The amount of outstanding paper issued by these cooperative corporations is not available to us, but some idea of the method of financing this vast industrial empire in the Texas plains area can be gained from exhibit D. It is a statement of the preferred stock of the cooperative oil mill which is presently held by the cooperative gin corporations which own the oil mill. As of June 30, 1961, the gin corporations, owners of the oil mill, held $5,297,000 of the preferred stock issued by the oil mill. Some of this extended back to 1955. There is no record available to us of the stock held by the cooperative gin corporations issued by the compresses at Lubbock and at Plainview. Neither do we have a record of the certificates of indebtedness or the amounts of the outstanding paper issued by the gin corporations to allocate their profits to the farmers and landowners in the Texas plains area. In order to arrive at a complete statement of the outstanding paper not taxable under the present law, we would need to know how much of the paper has been issued by the gin corporations to the producers and landowners and how much paper has been issued by the compresses as well as the oil mill to the cotton gins.

Without these facts, we come to a logical conclusion, that this vast capital structure of the cooperatives in this small area of the Texas plains has been financed out of retained tax-free earnings. There can be no other logical conclusion. Reasonable men must be presumed to take advantage of the opportunities afforded them and we are sure that our friends in the Texas plains area have not overlooked any of their opportunities.

That reasonable men do take advantage of their opportunities such as provided by the 1951 cooperative tax law is well established by a recent incident in the west Texas plains area. In February 1961, the South Gin Corp. of Brownfield, Tex., was converted from a taxpaying corporation to a cooperative. As an independent taxpaying corporation it was owned by 19 farmers with excellent financial ratings. They were the customers of the taxpaying compresses, warehouses, and oil mills in that area. We sent a man out to investigate why they had become a part of the cooperative organizations. These 19 men are some of the finest patriotic citizens in America. In substance, they told us that it was simply a matter of arithmetic. They stated, "As a cooperative, we will receive substantial dividends from the cooperative oil mill, the cooperative compresses, and the cooperative marketing association. No income tax will be paid on the dividends from the oil mill, compress, and marketing association or on the earnings of our gin unless and until the money reaches us as individuals." In other words, it was simply a matter of arithmetic—so long as they distributed the earnings of the cotton gin and the dividends from the oil mill and the compresses, in script to themselves, these 19 men would have their capital investment, money for expansion, money for the operation of the gin and would not be required to pay income taxes on the paper distribution. Since they are men of high financial rating it is reasonable to assume that income taxes will be held to a minimum and the profits of the entire cooperative setup distributed by paper so that they will not be taxable.

Through the creation of this cooperative corporation these substantial men expect to be able to gain the large rewards presently enjoyed by thousands of others—whose incorporated business enterprise retains large earnings, income tax free for expansion by issuing no-market-value script or stock. As script or stock recipients they pay no income tax by virtue of its receipt. They thus receive a splendid type of tax-free security to pass on to their heirs. Valued at face amount for estate purposes, its later sale or redemption involves no income tax liability for their families.

VI. THE FARMERS IN THE CONCENTRATED AREAS OF THE TAX PLAINS ARE PARTICULARLY ABLE FINANCIALLY AND OTHERWISE TO BEAR THEIR FAIR SHARE OF OUR INCOME TAX BURDEN

We presented the financial status of 73 of the directors of the Plains Cooperative Oil Mill and the two compresses as well as some of the directors of the Gin Cooperative Corps. to the House Ways and Means Committee in the two volumes which covered the documents we gathered concerning the cooperative organizations engaged in the business of conducting cotton industries. This financial data established as follows:

First, that 76 directors of the Oil Mill & Compress Corps. had an individual average net worth of $92,000.

Second, 73 of these directors owned, controlled, rented, or leased 61,354 acres of land in the west Texas plains area averaging 840 acres per director.

Third, the average annual income of these 73 directors was shown as $16,352 per director.

Fourth, the total annual income of these 73 directors was $1,193,700.

These men are indeed Cadillac farmers and, as pointed out by the Secretary of the Department of Agriculture in his press release, they receive the majority of the money paid to the cotton farmers under the price support outlays, and in fact they receive the great majority of the cotton acreage allotments.

Among the 73 directors will be found one who owns 1,445 acres of land in Hockley County and 800 acres in Lamb County and in addition he owns other farmland in Hale County. His reported net worth is $750,000 and his reported annual income $25,000. These are not handpicked examples. They are thoroughly representative of the concentration of wealth and power resulting from the many advantages conferred upon these wealthy landowners by the Congress.

VII. THE FARM CREDIT ACT OF 1933 CREDITED THE BANK FOR COOPERATIVES AND THERE ARE NOW 13 SUCH BANKS STRATEGICALLY LOCATED THROUGHOUT THE NATION. CONGRESS HAS ALSO PROVIDED FOR THE COOPERATIVE CORPORATIONS TO TAKE OVER THESE BANKS THROUGH THE PURCHASE OF THE GOVERNMENT STOCK

The Government has amply provided for the financing of the expansion of cooperative corporations particularly with reference to the handling, distribution, and sale of farm products. The Farm Credit Act of 1933, which provided for the establishment of 13 banks for cooperatives to make loans to cooperative associations made the Agricultural Act revolving fund available for subscriptions to the capital stock of the banks for cooperatives. Those banks have developed into a wealthy and substantial financial institution devoted solely to the financing of the operation and expansion of cooperative farm organizations.

The original investment of the Government from the revolving fund in 1933 was $110 million, consisting of $5 million for each of the 12 district banks and $50 million for the Central Bank for Cooperatives. The Government capital in the banks was increased from time to time and the maximum amount outstanding was $178,500,000 during the period from 1945 to 1950. On January 1, 1956, when the Farm Credit Act of 1955 became effective as to the banks for cooperatives, the capital stock of the banks was $150 million.

The net worth of the 13 banks as of December 31, 1961, was $273,489,513, consisting of—

Government capital	$106, 817, 000
Stock owned by cooperatives	57, 676, 623
Total	164, 493, 623
Plus surplus	108, 995, 890
Total	273, 489, 513

At the present time the revolving fund totals $185,918,743, composed of Government capital stock of $106,817,000 and cash in the fund of $79,101,743. Government capital retired since January 1956 through the investment of cooperatives was $43,183,000. The cooperative corporations in the west Texas plains area as of January 1960 held $809,000 of this stock.

Thus it will be seen that the Government has financed the development of banking facilities for the financing of the operations and expansion of cooperative corporations, thus providing the machinery for financing at low interest

rates—much lower than paid by their competitors. Surely they do not need in addition to these wealthy banking facilities a method of retaining their own earnings tax free for expansion purposes. Indeed, the cooperatives, under the 1951 act and their method of allocation of earnings, have been able to purchase out of tax-free earnings stock in these banks as well as expand their own facilities. This is the type of Government-financed competition which has materially affected the ability of private enterprise industries to compete with cooperative organizations. We are appealing to this committee to correct this situation which obviously was not intended by the passage of the 1951 act.

VIII. THERE ARE GRAVE DOUBTS AS TO WHETHER OR NOT H.R. 10650 IN FACT REMEDIES THE DEFECT IN THE 1951 LAW AND SUBSTANTIAL DOUBT EXISTS THAT IT INSURES EVEN A SINGLE TAX ON THE EARNINGS OF A COOPERATIVE CORPORATION

The cotton industries are subject to double taxation where they are operated by corporations except cooperative corporations—taxation of the earnings of the corporation and an additional tax on the same earnings when they are distributed as dividends to the stockholders. Nevertheless, we have only proposed and asked Congress to provide a single tax for cooperative corporations' earnings. The difficulty with respect to legislating a single tax centers around the efforts of the cooperative organizations to shift the burden of the income tax on their earnings to the farmers. We have gone into great detail with respect to one specific illustration in the Texas plains area showing how these so-called certificate distributions of profits have worked out to the detriment of taxpaying industry. The facts are well known and we are sure that the House Ways and Means Committee in reporting H.R. 10650 fully intended to provide for one tax on the profits of the business operations of such cooperative corporations. However, there is doubt in our mind as to whether or not this has been accomplished.

The proposed Revenue Act of 1962 undertakes to correct this, as stated in the report of the House Ways and Means Committee, page 79, as follows:

"Qualified allocations for this purpose are defined by the bill as including first, allocations which the patron can redeem in cash at the stated dollar amount at any time in the first 90 days after they are issued. Second, qualified allocations also include allocations which the patron has consented to take into account at their face amount as income. * * * In the case of members, consent may be given by being a member of the cooperative if there is a provision in the bylaws requiring all members to agree to take the allocations into account."

It is this provision concerning consent of a member as a result of the provisions in the bylaws which causes us much concern. We believe the House Ways and Means Committee overlooked the fact that the courts invalidated prior certificate allocations not because of the lack of such consent, but because of the lack of rights of the recipient to demand anything as the result of the certificated allocation to him.

In order to understand why the proposed change (referred to as consent) in fact does not meet the requirements of the decision of the Federal courts, it is essential to have complete knowledge of the facts under which such certificates, qualified or otherwise, are issued.

There were several of the Federal court cases dealing with this question and one reached the Supreme Court and certiorari was denied (350 U.S. 1013). The two cases covering the important questions involved will be here reviewed. The first important case is the *Long Poultry Farm, Inc.* (249 F. 2d 726). It was a decision by the fourth circuit court. There the court cited with approval the other authorities defining taxable income. Specifically, it stated that in order to be taxable income:

"There must be no contingencies or unreasonable uncertainty qualifying the payment or receipt. Income does not accrue to a taxpayer using an accrual method until there arises in him a fixed or unconditional right to receive it."

The other important ruling had to do with the taxpayer on the so-called cash basis. It was the *Carpenter* case (219 F. 2d 635). There the court held:

"Furthermore, it is obvious that the funds withheld by the cooperative were not subject to the demand of the respondent. The respondent could control neither the amount of the funds that he would ultimately receive nor the time at which he might receive them."

These rulings are of extreme importance and should be considered by this committee in arriving at a factual conclusion which would bear upon these proposed amendments to the 1951 act.

It is not a matter of consent. Indeed by examining the charters and bylaws of the cooperative corporations of the Nation, we will find ample provisions containing authority of the cooperative corporation to retain the earnings and we will find language which could be construed as the consent of the owner, patron, or member that the profits be retained. The important provisions, however, of the charters and bylaws of the cooperative corporations are those which deal with the right of redemption of noncash distribution certificates. We have examined some 50 charters and bylaws of cooperative organizations and we find they follow a uniform pattern concerning redemption of all noncash distribution certificates or script. The bylaws provide that such redemption shall rest in the sole discretion of the board of directors, thus denying the recipient of any type of certificated distribution, all rights and all control over the payment of the certificates covering the patronage dividend distributions. The charters, constitutions, and bylaws of the cooperative corporations present a factual situation similar to the state of facts before the court in the *Long Poultry* case and the *Carpenter* case. In addition, the farmer is far removed from the control over the profits of the cooperative. He in fact has no right to receive income except in the sole discretion of the board of directors. What result could follow, therefore, from his consent to pay taxes on an item which the court has held does not constitute taxable income under the income tax laws? Would the courts now hold because a cooperative corporation handed a patron a copy of its bylaws that worthless paper was thereby converted into taxable income? The committee should consider the tedious and confused manner of calculating the gross income for income tax purposes of a member or patron of a cooperative corporation under the Revenue Act of 1962. Such method is sufficient within itself to destroy the effort of Congress to exact a single tax out of the revenues of the cooperatives.

Section 17 covers the treatment of cooperatives and their patrons. Item (sec.) 1382 covers taxable income of cooperatives. It provides that in determining taxable income of cooperatives "there shall not be taken into account amounts * * * patronage dividends * * * paid * * * in qualified written notices of allocation." Part II, section 17, item (sec.) 1385 covers the taxable income of the patrons or members of the cooperatives. It provides that the members and patrons shall include the amount of this so-called qualified written notice of allocation in their taxable income. These written notices of allocation become qualified for deductions from gross income by the cooperative and must be included in the gross income of the member or patron if the patron or member has consented to include such written notices of allocation in their taxable income. This consent may be obtained (1) by written consent; (2) by obtaining or retaining a membership in the cooperative after such cooperative has adopted a bylaw which provides that membership constitutes consent to include in the taxable income of the member the earnings of the cooperative corporation although the cooperative corporation actually retained its earnings for its own use.

The general bylaw provisions of the cooperative today provide that patronage alone constitutes membership. Now, in order to tax the farmers, the cooperative, under the Revenue Act of 1962, needs only to adopt a bylaw which states that all members consent to report written allocation of earnings where no cash is paid, where no date of maturity is fixed, no interest is paid, and no rights are granted to demand anything at any time.

Now consider the complication confronting the patron or member. A farmer comes to a cooperative cotton gin in the Texas plains area to have his cotton ginned. The gin, along with other cooperative gins in the area, own an oil mill and compress and warehouse. The gin hands the farmer a copy of its bylaws which state that his patronage constitutes membership in the cooperative corporation operating the gin. The bylaws further provide that as a member he consents to include in his taxable income the profits of the gin cooperative, the profits of the oil mill which the gin owns, and the profits of the compress and warehouse owned by the gin cooperatives. The situation is not different where the farmer is a member and brings his cotton to the gin for ginning. Bear in mind that the farmer cannot be a member of the oil mill or the compress. The

gin cooperatives are the members and owners of the oil mill and the compress and warehouse. Now, look at exhibit D. It is a statement of the preferred stock of the oil mill issued to the cooperative gin corporations and held by them as of June 30, 1961. Some of this preferred stock dates back to 1955. The total is $5,297,105.91. It was deducted from gross income by the oil mill and as a result it retained its earnings tax free for expansion purposes and did in fact expand. Should the farmers in the Texas plains area be required to pay income taxes on this $5,297,105.91 profits of the oil mill which they do not own? Indeed they are not members and cannot become members. The theory of the Revenue Act of 1962 is that Congress can make taxable income out of this $5,297,105 simply by requiring the farmers to include it in their taxable income, if they patronize a cooperative gin and become a member of it. Provided of course the gin cooperative has adopted a bylaw which states that the farmer has consented to include it in his taxable income. Now look at exhibit F and see what the farmer gets—a mere slip of paper from the gin stating to the farmer that he has a dividend credit. Exhibit F was issued in 1951 and has not been paid to date.

Could there be any doubt in anyone's mind that the Congress has no such power to define taxable income. This complicated farce involves both legal and moral concepts. Morally Congress should not try to tax any man under such circumstances. Legally it has no power to so tax.

We ask this committee to consider the following facts:

First, the bylaws of the Plains Cooperative Oil Mill of Lubbock, Tex., article V, section 1, provides that only cooperative corporations engaged in the operation of cotton gins may be members of the oil mill cooperative.

Second, article VI, section 2 of those bylaws contain a provision that preferred stock may be issued to members and nonmembers as patronage dividends.

Third, article VI, section 7 provides that the retirement of the preferred stock so issued shall rest in the sole discretion of the board of directors.

Fourth, article VIII, section 2 provides with reference to cooperative corporation reserves that

"From the margins retained by the association the board of directors in its discretion may create and authorize the establishment of reasonable reserves for necessary purposes."

Certainly any member or indeed any patron of a cotton gin corporation which owns this oil mill corporation would be far removed from any control over the payment of a dividend, or a right to demand anything. In the first place, the producer and farmer that the cooperatives ask Congress to tax in the instance of the cooperative oil mill would have no rights whatever to demand anything. Such producers would receive their dividends whether in cash or in qualified certificates through the cotton gin corporation and indeed that is the method of operation generally. See exhibit E.

What would the term "consent" mean with respect to these remote profits of the cooperative oil mill and the cooperative compress? Would it not be stretching the imagination beyond all reasonable bounds to assert that a farmer who brought a bale of cotton to a gin, upon being handed a copy of the bylaws of the gin, would be consenting for the oil mill to retain its profits from the cottonseed owned by the producer and consenting for the compress to retain its profits earned on the storage of the bale of cotton?

The facts with respect to the practical operation of these matters must be considered in order to understand why H.R. 10650 does not remedy the defect in the 1951 act.

Certainly there should be some safeguard; the matter should not be left in doubt as it was in 1951. We are proposing first that the provision in the proposed Revenue Act of 1962 covering qualified allocations based on consent found in the bylaws of the cooperative corporation be eliminated from the bill. And we are further proposing that deductions from gross income by cooperative corporations of dividends, patronage or otherwise, shall be limited; first, to those paid in cash, and, second, to those allocated by documents which shall state the dollar amount and provide that such amount shall be interest bearing and have a fixed maturity date and shall be redeemable in cash on that date which shall not be greater than 3 years from date of issue.

In the alternative, we propose that the Revenue Act of 1962 contain a provision substantially as follows:

"Should it be determined by any court having jurisdiction that any patronage or other dividends not paid in cash by the cooperative corporation is not taxable income to the patron, member or recipient, its deduction from gross income shall be disallowed to the cooperative corporation and the resulting tax shall be assessed against the cooperative corporation within one year after such determination becomes final."

At record pages 332–333 of volume I, 1961, hearing before the House Ways and Means Committee, the Secretary of the Treasury was asked if the administration would be willing to insert something of the character above proposed in the new revenue act, to which he answered:

"Secretary DILLON. I think it should. I think that would be fair. We are suggesting that this be handled in a different manner, which appears to us to be preferable, but certainly that would be a way of eliminating this anomalous situation which is contrary to the intent of the law passed in 1951 where the cooperative now can deduct these scrip payments as a payment and they are not taxable to the recipient."

It is quite obvious that some means of meeting the requirements of the court must be clearly stated in the bill. Consent in our opinion cannot be obtained through a multiplicity of bylaws of corporations who exercise the discretion to distribute profits in all instances and reserve to themselves the sole discretion to retain profits for unlimited periods of time. In fact retain profits without limitation of time.

In addition, we point out to this committee that it is quite unfair to ask a farmer and producer to pay income taxes on a document depicted by exhibit F which merely states that the profits had been allocated to his account in 1951 and have not been paid to date. It is our most sincere opinion that the Congress of the United States has not and will not assume any such power and authority to tax a man on a document of this character as constituting taxable income.

Respectfully submitted.

A. L. REED
(For the Public Information Committee
of the Cotton Industries).

(Exhibit A. The county outline of the United States has been made a part of the record and is retained in the committee files.)

THE PLAINS COOPERATIVE COTTONSEED OIL MILL
OF
LUBBOCK, TEXAS

HAS IMMEDIATE PLANNED CONSTRUCTION OF A FIFTY PERCENT EXPANSION OF ITS PLANT WITH A LIKE EXPANSION IN THE NEAR FUTURE.

THE STORY APPEARED IN THE LUBBOCK AVALANCHE-JOURNAL OF JANUARY 24, 1962

THE STORY FOLLOWS:

$3 Million Plant Approved Here

Site Near Oil Mill Is Sought

Construction To Start Soon

By DUANE HOWELL
Avalanche-Journal Staff Writer

The Plains Cooperative Oil Mill board of directors agreed here this morning to build a new cottonseed crushing plant in Lubbock if land near the present mill can be acquired.

Officials said the new plant would cost approximately $3 million and would employ about 100 persons. It would have a capacity of about 400 tons a day.

Roy B. Davis, manager of the mill, said the board was assured that 20 acres adjoining the plant on the south can be purchased for the new facility.

Largest In World

The mill is located at 2901 Ave. A. It is regarded as the largest single cottonseed oil mill in the world.

"We hope to have construction underway in the near future," Davis said. He said present plans are to have the new plant in operation by October.

The oil mill's executive committee, headed by Wilmer Smith, New Home, had been investigating the possibility of locating the new plant either here or in the area.

Plans for expansion were approved earlier by the full board, and the executive committee was authorized to work out the details.

It was on the executive committee's recommendation that the board acted this morning.

Owned By Co-Ops

The co-op at present crushes around 250,000 tons annually. Davis said the new plant will have about half that capacity on an annual basis.

Some consideration has been given to handling soybeans and castorbeans at the new plant, in addition to cottonseed, but Davis said a final decision will not be reached until further investigations are completed.

Davis said the new facility will be "primarily a cottonseed crushing plant."

The oil mill is owned by 86 member co-op gins on the South Plains and is governed by a board composed of one director from each association.

$6.7 Million Capital

It paid approximately $2 million in dividends for the 1960-61 season.

The mill's operating revenue comes primarily from the sale of cottonseed meal and cake, cottonseed oil, hulls and mixed feeds and linters.

Total capital invested in the cooperative at the end of its last fiscal year on June 30 amounted to roughly $6.7 million.

The oil mill here is part of a big area industry which employs about 680 persons depending upon the time of year, with annual payrolls totaling about $2.7 million, excluding executives.

The value of the area's cottonseed and the raw products derived from them has been estimated at approximately $55 million annually.

Exhibit C

Year	Tons of cottonseed produced in Texas plains counties [1]	Tons of cottonseed purchased by cooperative mill	Co-op percent of total	Year	Tons of cottonseed produced in Texas plains counties [1]	Tons of cottonseed purchased by cooperative mill	Co-op percent of total
1939	118,000	18,060	15	1951	408,600	105,954	26
1940	134,000	22,600	17	1952	474,000	142,690	30
1941	161,000	27,006	17	1953	448,000	140,170	31
1942	193,000	40,260	21	1954	505,600	157,287	31
1943	157,000	41,265	26	1955	451,000	133,973	30
1944	175,000	45,040	26	1956	548,000	177,511	32
1945	28,000	8,150	29	1957	511,000	163,930	32
1946	68,600	21,029	31	1958	657,000	207,834	32
1947	315,000	92,608	29	1959	621,000	194,204	31
1948	205,000	59,560	29	1960	636,000	244,000	38
1949	540,000	50,000	9	1961	765,000	329,977	43
1950	232,600	72,518	31				

[1] 19 Texas and 2 New Mexico counties.

Exhibit D

Owners of Plains Cooperative Oil Mill, Lubbock, Tex., with amount of preferred stock held as of June 30, 1961

Name of cooperative gin owners of cooperative oil mill	1955 preferred stock unredeemed as of June 30, 1961	Total preferred stock held, June 30, 1961
Abernathy Farmers	$15,500.40	$104,232.40
Ackerly Farmers	2,636.40	39,631.40
Acuff	9,378.60	124,848.60
Afton	1,761.60	29,345.60
Amherst Farmers		9,150.00
Anton Producers	20,565.60	131,593.60
Brownfield Farmers	5,325.60	85,646.60
Carlisle		51,834.00
Castro	6,383.40	37,878.40
Citizens	7,989.60	102,573.60
Close City	3,203.40	30,898.40
College Avenue	8,463.00	57,580.00
Cotton Center Farmers	14,074.20	81,359.20
County Line	8,247.60	81,144.60
Crosbyton	7,349.40	82,633.40
Earth	12,381.00	66,646.00
Edmondson	19,211.40	107,607.40
Enochs Farmers	2,274.00	37,587.00
Fieldton	9,700.80	65,203.80
Flower Grove		31,627.00
Floydada Farmers	2,851.80	53,318.80
Floyd County		
Graham	3,552.60	39,845.60
Grassland	3,561.00	47,166.00
Hackberry	3,472.80	39,468.80
Hale Center	21,082.20	104,959.20
Halfway		26,089.00
Hart Camp	4,002.00	41,825.00
Hart Producers		23,556.00
Idalou	12,054.00	139,814.00
Inadale		16,733.00
Knott Farmers	1,738.20	25,785.20
Lamb County	21.60	4,287.60
Lamesa	9,189.60	92,644.60
Lesley		
Levelland Farmers	7,689.60	71,736.60
Liberty	9,220.20	87,096.20
Littlefield Farmers	11,251.20	87,181.20
Lockney		59,211.00
Lorenzo	9,271.20	129,394.20
Lovington	6,690.00	42,197.00
McAdoo Farmers	5,265.00	48,938.00
Maple	3,339.00	73,887.00
Mayfield	8,542.20	71,339.20
Meadow Farmers	6,835.80	111,309.80
Midland Farmers		
Morton	5,157.00	63,405.00
Muleshoe	11,532.60	97,300.60
Needmore	3,410.40	36,890.40

Owners of Plains Cooperative Oil Mill, Lubbock, Tex., with amount of preferred stock held as of June 30, 1961—Continued

Name of cooperative gin owners of cooperative oil mill	1955 preferred stock unredeemed as of June 30, 1961	Total preferred stock held, June 30, 1961
New Home	$13,071.00	$107,694.00
O'Donnell Farmers	8,379.60	127,589.60
Olton	26,824.20	180,540.20
Opdyke		31,725.00
Owens	7,357.20	59,111.20
Petersburg	21,960.00	177,623.00
Pettit	5,023.20	42,426.20
Plainview	12,538.20	103,493.20
Pleasant Hill		
Producers, Grassland		30,904.00
Ralls	10,275.60	84,456.60
Ropes Farmers		53,906.00
Seagraves		37,421.00
Shallowater	14,004.00	102,332.00
Slaton	9,568.20	90,195.20
Slide	5,661.60	44,465.60
South Gin		
South Plains		13,074.00
Spade	12,948.60	67,979.60
Springlake Farmers	12,963.60	71,355.60
Spur Farmers	1,613.40	6,001.40
Stanton Farmers	4,826.40	57,562.40
Star Route		33,635.00
Sudan Farmers	6,007.20	70,205.20
Swisher	10,039.20	76,364.20
Tahoka	4,119.00	38,638.00
Tahoka Farmers No. 1	8,994.00	94,537.00
Tokio Farmers		7,550.00
Tulia	13,716.60	88,336.60
Union		22,705.00
Vincent	1,303.20	12,531.20
Wake		
Wellman	4,946.40	57,891.40
Wells	4,642.20	56,022.20
Whitharral	11,053.80	103,623.80
Wilson No. 1	11,825.40	70,177.40
Wilson No. 2		33,797.00
Acme		484.00
Amherst Producers		7.00
Big Spring Co-op Gin-Spl		2,683.00
Country Club Gin		141.00
Big Spring Farmers Gin		797.00
Farmers Gin, Lamesa		1,445.00
Loop Co-op Gin	5,289.60	21,798.60
Matador Farmers	316.20	354.20
Midland Marketing Association	105.00	1,158.00
New Moore Gin Co		98.00
Quitaque		38.00
Roscoe Co-op Gin	241.20	1,410.20
Roswell Farmers Gin		561.00
T-Bar	1,047.00	1,047.00
Leo V. Smith (Tri-County)		12,995.00
Seed Exchange		1,889.11
Total	554,842.80	5,297,195.91

EXHIBIT E

EXCERPT FROM PART 2 OF HOUSE WAYS AND MEANS COMMITTEE HEARINGS ON GENERAL REVENUE REVISION

Thank you very much.

(The above-mentioned statement is on file with the committee.)

The CHAIRMAN. Are there any questions?

Mr. MASON. Mr. Chairman, just one.

The CHAIRMAN. Mr. Mason will inquire.

Mr. MASON. As I gather in summarizing your testimony, you are trying to show that of 12 cooperatives, 8 were legitimate, and you do not want them hurt, and 4 were giants and were taking advantage of the situation, and you would like to have them restricted. Is that it?

Mr. A. L. REED. That applies to the marketing agencies only; that is right.

Mr. MASON. That is all, Mr. Chairman.

The CHAIRMAN. Are there any further questions of Mr. Reed?

If not, Mr. Reed, we thank you very much for your appearance and the information you have given to the committee.

Mr. REED. Just a minute, Mr. Chairman.

The CHAIRMAN. The gentleman from New York, Mr. Reed, will inquire.

Mr. REED. Have the cooperatives been of great advantage in building up the financial background of the areas in which they operate?

Mr. A. L. REED. Mr. Reed, the taxpayers were the pioneers in that area, and the cooperatives came in after the tax rate got up to so high that it was profitable for them to do it.

Mr. REED. What I am asking you is, have they been an advantage to that area financially?

Mr. A. L. REED. I would say anybody that spends money in that area is an advantage to it; but when they spend their money for capital investment in there, they are replacing a taxpayer who could spend money if he had the opportunity.

Mr. REED. But I am asking you the question, have the cooperatives been a benefit to that area financially?

Mr. A. L. REED. I think they have been a benefit; yes, sir.

Mr. REED. Thank you.

Mr. MASON. And may I add something?

The CHAIRMAN. Yes, Mr. Mason.

Mr. MASON. Those eight legitimate cooperatives have been an advantage, but the four giants certainly have been a great disadvantage to all the others around there.

Mr. A. L. REED. Yes, sir. And let me say that those that conduct themselves as a legitimate co-op are not limited to those eight on that appendix B. There is a cottonseed oil mill over at Helena, Ark., that conducts its business just as legitimately as a co-op anywhere in the country. The profits are distributed into the hands of the farmers, and there is one tax applied to it, at the farm level.

The CHAIRMAN. Are there any further questions?

If not, Mr. Reed, again we thank you for your appearance and information given to the committee.

(The following letters were filed with the Committee:)

PLAINS COOPERATIVE OIL MILL,
Lubbock, Tex., February 19, 1958.

Hon. WILBUR D. MILLS,
House Office Building, Washington, D.C.

DEAR MR. MILLS: We did not ask to testify before the House Ways and Means Committee in their recent hearings when the committee was considering taxation of cooperatives, but since Mr. A. L. Reed of the public information office of the cotton industries singled out the cotton cooperatives of the Plains in his testimony of January 23, we would like to supply information relative to our members, board of directors, cooperative gins, and the cooperative oil mill and cooperative compresses.

There are approximately 10,000 cotton producers on the south plains of Texas who own and operate 78 cooperative gins. The cooperative gins own and operate the Plains Cooperative Oil Mill and they own and operate, as separate corporations, the Farmers Cooperative Compress at Lubbock and the Plainview Cooperative Compress at Plainview. Each of the cooperative gins has a director on our board. These men are just average producers, farming about 320 acres each. Most of the cotton acreage in this area is irrigated, and the average price is about $300 per acre. The farm equipment, including tractors, implements, trucks, trailers, and irrigation equipment, I believe would average about $25,000 per farm, which means that each farmer would have an investment of around $125,000. Since we have 78 board members, their net worth could easily exceed $7 million, and they would still be just average producers for this area. I want to make it clear here and throughout that every dollar in dividends, whether cash or stock or allocated credits, received by these directors has been taken into their income each year as received, and they have paid the Federal income tax on the same.

There are 365 cotton gins in this area. Of these, 78, or about 25 percent, are cooperatives and are owned by the producers. We estimate the cooperative gins handle one-third of the cotton produced in this area, or approximately one-half million bales. Last year there was one new cooperative organization that built a new gin. There were three cooperative associations that added a

new gin in order to take care of the increased volume of their community. One cooperative gin was destroyed by tornado and the association rebuilt it. Another association practically built a new gin in modernizing their old plant. The total of these exceeds the million dollars as referred to by Mr. Reed. In building these new gins, the producer members of these associations understood that they would pay income tax on all of the earnings, regardless of whether they received their dividends in cash or if the cash was used to pay for this new equipment and the producer was issued stock.

The cooperative gins in 1937 organized and bought a used oil mill at a total cost of $125,000. Since that period they have added to this plant approximately $4 million in new buildings, new warehouses, and new equipment. The mill was not paid for out of tax-free income, because each year, in addition to paying current cash dividends, it has issued preferred stock, and the producers have paid the income tax on both the cash and the stock as it was received. We retire older outstanding stock each year, and the oldest unretired stock we have was issued in 1953.

The Farmers Cooperative Compress was organized in 1948. The producers did not build this compress in order to drive someone else out of business. Neither did they organize it for the profit that it might make them. It was organized solely because the grower in 1947 could not get his cotton in a warehouse within a reasonable period of time so that he might secure a warehouse receipt and sell his cotton. As a result of the slow and inefficient service being offered by other warehouses, the grower was penalized in income because of the declining cotton market. Since the cooperative compress was built, all compresses have given quick and efficient service, and both the producer and the cotton shipper have benefited by virtue of this competition. Since 1948, the Farmers Cooperative Compress at Lubbock has had a total net income of $2,820,902.17, on which they have sent the Internal Revenue Service forms 1099 to their members, and the producer has paid an income tax on every penny of the net earnings of this compress. The cooperative compress, too, rotates its stock, and its oldest outstanding stock was issued in 1953. The producers in this area are not paying the income tax on their stock when it is retired, but they are following the rules and regulations of the Bureau of Internal Revenue and are paying it in the year received.

The Plainview Cooperative Compress was organized in 1953. It has had $795,398.47 net income, and it, too, has issued its form 1099 and the producers have paid their income tax on the stock as received.

Each and every cooperative in this area has an annual audit made by disinterested certified public accountants. The stockholders are advised in their annual meeting by the officers of the cooperatives and by the auditors of the cooperatives that they must pay in income tax on all dividends, regardless of the form in which they are received. Those producers who have not wanted to do this have left the cooperatives, but most of them have stayed with their associations, and as far as we know, every producer is paying an income tax on all dividends he receives from his cooperative, and there is absolutely no cooperative income that is escaping taxation.

We respectfully request that this letter be accepted as our testimony and be recorded in the Congressional Record, or in its proper place.

Yours truly,

ROY B. DAVIS, *General Manager.*

LITTLEFIELD FARMERS COOPERATIVE GIN,
Littlefield, Tex., February 17, 1958.

Hon. WILBUR D. MILLS,
Chairman, Ways and Means Committee,
Washington, D.C.

DEAR MR. MILLS: This letter is intended as a factual answer to some completely erroneous statements made about our cooperative association by A. L. Reed, of Dallas, when he appeared before your committee as a witness in Washington on January 23. The statement to which we refer is found about midway in his testimony and reads as follows:

"On page 90 I give you a comparison of the Petersburg gin, a taxpayer, with the cooperative gin at Littlefield. The taxpayer had a net income of $33,235, and the heavy hand of the Federal income tax collector took 40 percent of it.

The cooperative gin at Littlefield had a net income of $104,000, and the tax collector did not touch it. That cooperative gin retained 55 percent of that net income, tax free, $57,625, which exceeded the total profits of the Petersburg gin.

"What is more important, I want to call your attention to the fact that that gin is a proprietary corporation, owning the oil mills and the compresses, and it received in dividends $26,724. The oil mill paid no income tax; the gin paid no income tax. That amounted to $3.25 per bale of tax-free dividends. After the tax collector got through with the Petersburg gin, he had only $1.66 per bale."

It is true that our cooperative association had net margins, before allocations, of $104,154.66; but it is not true that "the tax collector did not touch it." In accordance with section 522 of the Internal Revenue Code of 1954, we allocated to our patrons on a patronage basis 100 percent of these net margins, and we so notified these patrons of their allocations before the 15th day of the 9th month following the end of our fiscal year. Also, we notified the Director of Internal Revenue on his form 1099 of each patron—his name, address, and amount—who had dividends allocated to him of $100 or more. To the best of our knowledge and belief, all of our farmer patrons included the full amount of these patronage allocations in their incomes and paid income taxes thereon. Possibly, many of our patrons paid income taxes on these earnings at a higher rate than was paid by the gin mentioned at Petersburg.

As for Mr. Reed's statement that we own the oil mills and the compresses, that we received dividends from the oil mill, that neither the oil mill nor our gin paid income tax, we offer a correction for your records. The cooperative oil mill follows the Internal Revenue Code in making its allocations of earnings; we and the other member gins follow the Internal Revenue Code in taking these allocations into our earnings; and then the entire net margins of our local cooperative association (which include any allocations from the oil mill or compresses at 100 percent) are allocated to our farmer-patrons, and they pay income taxes thereon.

Throughout Mr. Reed's testimony there are flagrant untruths and misrepresentations. Whether he made these statements with malicious intent, or from ignorance of the Internal Revenue Code and our method of operations, we are not able to say. We do say he was in error, and we offer this letter to correct the record insofar as the statement quoted above pertaining to our cooperative is concerned.

We respectfully request that your committee delve deep into the facts about income taxes and farmers' cooperatives. If you do this, we feel certain that you will find that full income taxes are being paid on all net margins. In our opinion, sections 521 and 522 of the Internal Revenue Code are fair—and they are working. For the best interests of all concerned—including certainly our Government—we ask that you leave the code as it now stands on this subject.

Respectfully submitted.

CLARENCE DAVIS,
Manager and Secretary.

OFFICE OF
QUANAH FARMERS CO-OPERATIVE SOCIETY, No. 1
QUANAH, TEXAS

DIVIDEND CR. FOR SEASON OF 1951-52

Name [redacted] Address [illegible] Texas

	DR.	CR.
Rebate on 38750 Lbs. Seed Cotton @ 5c cwt.		19 39
Rebate on 15260 Lbs. Cotton Seed @ 10c cwt.		15 26
Rebate on ___ Lbs. Milo & K... @ 5c cwt.		
Rebate on ___ Bushels Wheat.. @ 5c Bu.		
Total		34 65

The CHAIRMAN. The next witness is Mr. Robert G. MacDonald, Hagerstown, Md., president, Potomac Edison Co.

Please proceed Mr. MacDonald.

STATEMENT OF ROBERT G. MacDONALD, THE POTOMAC EDISON CO., HAGERSTOWN, MD.

Mr. MACDONALD. Mr. Chairman and members of the committee, My name is Robert G. MacDonald. I live in Hagerstown, Md. I am president of the Potomac Edison Co. and I am appearing on its behalf.

Our company is much concerned with the tax treatment accorded certain advertising expenses under existing law. We feel that this tax treatment is inequitable and will become more controversial and impractical of application in the future unless modified by legislative action now. Accordingly, we have requested this opportunity to appear before your committee to express our views since they directly relate to the tax policy underlying section 3 of the House bill now being considered.

Our company has been participating for some years in an institutional advertising program known as the electric companies advertising program. This program, in which more than 100 investor-owned electric companies participate, has centered around 6 major topics of fundamental importance to companies like ours, including the cost and value of our service, the adequacy of our growth, the character of our ownership, our general citizenship, our developmental work in the field of atomic power, and certain aspects of Government competition in our business.

Our company considers the cost of this program, which amounted to about two-hundredths of 1 percent of our gross revenues for 1961, to be an ordinary and necessary business expense deductible under section 162 of the Internal Revenue Code and regulations thereunder, for purposes of computing taxable income.

Regulation section 1.162–15(c)(1) states that no deduction shall be allowed for any advertising expense which is related to lobbying, the promotion or defeat of legislation, or political campaigns. Although not defining the term "lobbying," the regulations do specifically state that expenses for the promotion or defeat of legislation include, but are not limited to, expenses for the purpose of attempting to (1) influence members of a legislative body by urging or encouraging the public to contact such members for the purpose of proposing, supporting, or opposing legislation or (2) influence the public to approve or reject proposed legislation in a referendum, initiative or other similar procedure. The regulation states that the cost of advertising to promote or defeat legislation or to influence the public as to the desirability or undesirability of proposed legislation is not deductible as a business expense, even though the legislation may directly affect the taxpayer's business. On the other hand, the regulations state that expenses for advertising which present views on economic, financial, social, or other subjects of a general nature but which do not involve any of the so-called lobbying activities are deductible if they otherwise meet the provisions of code section 162. Regulations somewhat similar to these were held to have the force and effect of law in *Cammarano* v. *U.S.* ((1959) 358 U.S. 498).

The ever-present problem in applying these regulatory provisions to determining the deductibility of advertising expenses incurred in our situation is obvious; what constitutes lobbying or the promotion or defeat of legislation in advertising? Are mere inferences enough

or are direct references to pending legislation required? Does the subject matter of the advertising determine its deductibility? Where is the line drawn between advertisements which present views on economic, financial, social, or other subjects of a general nature, and those which constitute lobbying? In the first instance, advertising costs are deductible; in the second, they are nondeductible.

The administrative problems incurred in enforcing such regulations seem insurmountable. Uniformity of application is impossible.

The Treasury Department considers that the income tax regulations which it has issued under section 1.162–15 are a proper reflection of existing law. But the Department indicated its awareness of the serious impact of such regulations on business generally in a letter dated February 26, 1960, to the chairman of the House Ways and Means Committee. In this connection, the Treasury recognized that existing law, as developed, has frozen certain concepts as to expenditures in the area of the legislative process. Those concepts are quite distinct from generally accepted attitudes as to expenditures in the related fields of administrative and judicial processes. The Department pointed out the anomaly observed by many that no expenditures involving legislation, whatever their character, are deductible, while expenditures involving similar activities before administrative and judicial bodies are clearly deductible if they otherwise constitute ordinary and necessary business expenses.

In its letter the Treasury recommended early consideration by the Congress of the various proposals designed to modify the tax treatment of expenditures in connection with the legislative process.

The Treasury suggested that any proposed legislative revision in this area should necessarily take account of the practical administrative problems which exist under present law, as well as those which might develop under any proposed modification. It particularly pointed out that the present law was difficult to administer both as to institutional-type advertising, as well as in regard to dues paid to trade associations. It specifically stated that it is difficult, if not impossible, for the Internal Revenue Service to censor or monitor lobbying of the advertising or grassroots variety. It stated that it has been the position generally of the Internal Revenue Service that it is not only impractical but undersirable to attempt to substitute the judgment of the tax collector for that of the businessman in determining the character of the advertising appropriate for his business as long as such advertising may be reasonably expected to increase patronage of the business.

Section 3 of the bill is an attempt to eliminate the administrative problems and inequities which the House feels exist under present law as to the tax treatment of expenditures in the legislative area. The stated objectives of section 3 as set forth in the committee report are (1) to overcome the administrative and enforcement problems which exist under present law in allocating ordinary and necessary expenses between those which are deductible for Federal income tax purposes and those which are not so deductible because they relate to lobbying, (2) to place presentations to the legislative branch of the Government on substantially the same footing as presentations to the other two branches of the Government, (3) to encourage taxpayers who have information as to the impact on their business of present or

proposed legislation to make such information available to legislators at various levels of the Government, and (4) to permit taxpayers to arrive at a true reflection of their real income for tax purposes.

Although our company fully supports these desirable objectives and recognizes that section 3 is a step in the right direction, we do not feel that the present proposal completely meets the need for tax reform in this field. It is our view that, since this is the first corrective action that has been taken by the Congress to deal with the tax treatment to be accorded such expenditures, it should be complete. The inadequacy of the section 3 proposal lies in the fact that it only deals with certain designated types of expenses in the legislative area, rather than such expenses as a whole.

Section 3 as proposed does not resolve the fundamental administrative and enforcement problem of the apportionment of ordinary and necessary business expenses incurred for advertising between (*a*) those which are deductible and (*b*) those which are nondeductible. This omission points up the inconsistency and discrimination inherent in section 3 as proposed. We believe that as a matter of policy it is unreasonable and unfair to allow as a deduction certain types of ordinary and necessary expenses incurred in lobbying, while disallowing other types of such ordinary and necessary expenses. Such tax treatment places emphasis on form rather than substance. Further, the need for extending the deductibility feature of the present proposal to advertising expenses is actually reflected in the statement of the Committee Report that tax revision in this area should be made on a basis which would permit a true reflection of real income for tax purposes.

It is obvious that section 3 does not accomplish all of its designated objectives. Equity and fairness demand revision of this section to eliminate the discriminations it perpetuates.

In this context, we would like to point out several of the many problems and considerations which we feel should be taken into account before tax reform in this confused area is completed.

First, suppose our company incurs expenses in advertising in local newspapers to bring to the public's attention the efficiency of the operation of our business and the low cost of our service in order to (1) improve or at least maintain our sales position, (2) improve customer relations, (3) increase the morale of our employees and (4) improve the market for our stock and debt securities. Further suppose, however, that 5 percent of the words contained in this advertising explain that lower rates for a competing energy supplied by a competitor are attributable to a special tax advantage, percentage depletion, Government loans at low interest rates, or other forms of subsidies. If the mere publication of information is considered lobbying within existing Treasury regulations, the question is whether all, or any portion, of the cost incurred should be disallowed as a tax deduction solely because 5 percent of the language used may be interpreted as suggesting legislative action, even though the advertising qualifies as an ordinary and necessary business expense.

Second, assuming it is possible to make a fair and proper allocation of the expenses involved in this hypothetical situation, certain reasonable standards, such as the primary purpose of the advertising, the number of words or lines attributed to legislative references, the nature of the legislative references, the overall effect on the general

public, and other similar factors, would have to be applied and appropriate allocations would have to be made each year. Annual negotiations with the Internal Revenue Service obviously would be necessary. Such a procedure would increase rather than eliminate existing administrative burdens, especially in view of the recurring nature of the required determinations and the indefiniteness of the standards to be applied.

Third, we believe that when expenditures not only are ordinary and necessary but also are reasonable in amount and when they serve the best interest of our customers, employees, and security holders, they should not be discouraged because they happen to take the form of advertising.

Fourth, we believe that the tax law should not make a distinction between ordinary and necessary business expenses incurred for advertising (*a*) to compete with a nongovernmental competitor and (*b*) to compete with a governmental competitor.

Fifth, we believe that it is not sound tax policy to permit the deductibility of certain expenditures in the legislative area and to deny the deductibility of similar expenditures in that same area.

For these reasons, we feel that the proposal in its present form does not fulfill the entire need for legislative reform with which the committee is concerned. Accordingly, we strongly urge that the proposal be modified to make clear that the cost of advertising incurred by a taxpayer in the ordinary course of his business is deductible for Federal income tax purposes even though the advertising may be related to pending or prospective legislative matters. We feel that the administrative and enforcement problems and inequities which under the present law require that the deductibility of legislative or lobbying expenses be geared to the ordinary and necessary test provided for in section 162. Accordingly, we urge your favorable consideration of the recent amendment to section 3 of the House bill as offered by Senator Hartke, a member of your committee.

The CHAIRMAN. Thank you Mr. McDonald for your very informative statement.

The committee will recess until 2:30.

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

AFTERNOON SESSION

The CHAIRMAN. The committee will come to order.

We are very much honored this afternoon to have the distinguished minority leader of the U.S. Senate, Senator Dirksen.

You may proceed, sir.

STATEMENT OF HON. EVERETT M. DIRKSEN, U.S. SENATOR FROM THE STATE OF ILLINOIS

Senator DIRKSEN. Mr. Chairman, I appreciate the indulgence of the committee, and I shall not trespass upon your good grace and time too long. At the moment, at least, I have three modest items I would like to bring to the attention of the committee.

As I suggested earlier, if you are still taking testimony a month hence, I shall invite myself to come around for some more testimony.

The CHAIRMAN. We shall be glad to have you.

Senator DIRKSEN. The first item, Mr. Chairman, relates to a bill I introduced, S. 2716, to secure a tax exemption for a nonprofit corporation in Illinois that concerns itself with the revision of the judicial article of the Illinois constitution.

(A copy of the bill referred to follows:)

[S. 2716, 87th Cong., 2d sess.]

A BILL To amend section 170 of the Internal Revenue Code of 1954 with respect to certain organizations for judicial reform

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That section 170(c)(1) of the Internal Revenue Code of 1954 (relating to charitable contributions) is amended to read as follows:

"(1) A State, a territory, a possession of the United States, or any political subdivision of any of the foregoing, or the United States or the District of Columbia, or any nonprofit organization created and operated exclusively to consider proposals for the reorganization of the judicial branch of the government of any of the foregoing to provide information, to make recommendations, and to seek public support or opposition as to such proposals, but only if the contribution or gift is made for exclusively public purposes."

SEC. 2. The amendment made by the first section of this Act shall apply to taxable years ending after the date of the enactment of this Act.

Our constitution is 92 years old, and to get it amended you have to have two-thirds of all the votes that are cast by members of the general assembly. That is an almost impossible task, and particularly so in dealing with an abstruse matter that is not always of great interest to the people. Yet the Chicago bar, the Illinois bar, and others know that something has to be done.

In the superior and circuit courts of Cook County now, they are hearing jury cases that were filed in 1955 and 1956, so those cases were filed 7 years ago and they are only now getting around to trial. Witnesses disappear, litigants disappear, and we must improve our judicial system.

But to do it, you have to sell this idea to the people of the State. The lawyers have tried to do it before, and it takes a very considerable amount of money to campaign a State of 10.5 million people in order to arouse the electorate that this is in their interest.

Now, it is quite unfair just to ask good-spirited citizens to put up the money and then not be able to get a tax deduction for the money they contribute for the judicial well-being of the State. That bill addresses itself to that matter. It only seeks to get tax deduction for contributions made to this nonprofit organization wholly and for no other purpose than to secure judicial reform in the State of Illinois.

They have been turned down once before and the House bill does not give them any comfort, because in the House bill is an item to the effect that you can probably get deductions for so-called lobby expenses where you make a presentation or an appearance, but it does not apply if you are out for the purpose of changing or influencing public opinion.

Well, this effort to improve our judicial system necessarily requires that you mold and change and influence public opinion in the State of Illinois. The bill is directed to that purpose.

Now, I shall not bother you any longer about it except to say that Mr. Louis Kohn, the vice chairman of the Committee for Modern Courts—that is the name of the organization—the Committee for Modern Courts in Illinois will be here and probably testify at some length and fill you in on all the details. But I introduced the bill on all occasions, and since it calls for a tax deduction, I think it has a proper place before this committee and I hope it will have good consideration. With the permission of the Chair I submit for the record a copy of the amendment which I advocate as well as an explanatory statement thereon.

(The matter referred to is as follows:)

[H.R. 10650, 87th Cong., 2d sess.]

IN THE SENATE OF THE UNITED STATES

APRIL —, 1962

Referred to the Committee on Finance and ordered to be printed

AMENDMENT Intended to be proposed by Mr. Dirksen to the bill (H.R. 10650) to amend the Internal Revenue Code of 1954 to provide a credit for investment in certain depreciable property, to eliminate certain defects and inequities, and for other purposes, viz: On page 27, beginning with line 3, strike out all through line 9, and insert the following

"(B) in connection with any attempt to influence the general public, or segments thereof, with respect to legislative matters, elections, or referendums, except with respect to proposals for the reorganization of the judicial branch of a State, a territory, a possession of the United States, or any political subdivision of any of the foregoing, or the United States or the District of Columbia."

(b) Section 170(c)(1) (relating to charitable contributions) is amended to read as follows:

"(1) A State, a territory, a possession of the United States, or any political subdivision of any of the foregoing, or the United States or the District of Columbia, or any nonprofit organization created and operated exclusively to consider proposals for the reorganization of the judicial branch of the government of any of the foregoing, to provide information, to make recommendations, and to seek public support or opposition as to such proposals, but only if the contribution or gift is made for exclusively public purposes."

(c) *Effective date.*—

(1) *In general.*—Except as provided in paragraph (2)), the amendments made by this section shall apply to taxable years beginning after December 31, 1962.

(2) *Contributions relating to judicial reorganization.*—The amendments made by subsection (b) shall apply with respect to taxable years ending after December 31, 1961.

DEDUCTIONS OF CONTRIBUTIONS RELATING TO PROPOSALS FOR JUDICIAL REORGANIZATION

The attached amendment to H.R. 10650, the Revenue Act of 1962, now pending in the Committee on Finance, would amend section 3 of that bill to provide expressly for deduction of contributions to organizations concerned exclusively with improvements in the administration of justice and of certain business expenses incurred in connection with the proposals for reorganization of local, State, and Federal courts.

Section 3 of H.R. 10650 would provide a limited deduction for expenses incurred in direct connection with appearances before, or for statements or communications to, committees and individual Members of Congress and of State or local legislative assemblies—if such amounts would otherwise be an ordinary and necessary expense of a trade or business of the taxpayer. There is an express denial of deduction, however, for expenses incurred "in connection

with any attempt to influence the general public, or segment thereof, with respect to legislative matters, elections, or referendums."

Improvement of the administration of justice can be accomplished in many States only by the adoption of constitutional amendment, which has been construed by the Internal Revenue Service to involve legislative activity. For this reason, "action" organizations dedicated solely to effectuating reorganization of courts in the various States will not be given tax exempt status which would permit deductibility for Federal income tax purposes of contributions in support of their activities.

Denial of deductibility for such purposes would severely handicap efforts throughout the Nation to modernize State court systems. Accordingly, the American Bar Association, the American Judicature Society, the Illinois State Bar Association, and the Chicago Bar Association have urged enactment of legislation in conformity with this amendment to H.R. 10650.

A judicial amendment to the 1870 Illinois constitution is to be submitted to referendum at the November 1962 general election. It is crucial that passage of the proposed legislation approving deductibility to be expedited so that funds be available for an intensive educational program informing the public of the urgent need for the approval of the amendment. This will require the expenditure of substanial funds for staff, publicity, literature, and other campaign essentials, in time to facilitate adoption of the amendment by the voters. The problem is not confined to Illinois, for in 1962 the following States will also submit constitutional amendments to the electorate for the purpose of improving the State's judicial system. These are (with dates of voter referendums):

Colorado: November 6, 1962 (general election).
Iowa: June 4, 1962 (special election).
Nebraska: November 6, 1962 (general election).
North Carolina: November 6, 1962 (general election).

Bar and citizen groups are also working in Michigan, West Virginia, and various other States toward formulation of proposals for modernization of their courts but these have not yet reached the stage of submission to the voters.

The adoption of the proposed legislation would be a major forward step and stimulate the widespread movement for modernization of our State courts, and help immeasurably in bringing about marked improvements in the administration of justice throughout the Nation.

Senator DIRKSEN. It will be so much better if it can be incorporated in the bill before it leaves the committee. I know the difficulty of amending a tax bill when it gets to the floor of the Senate.

So in the interests of favorable consideration, I trust that can be done.

Now, the next mater, Mr. Chairman, relates to a bill, S. 2666, which I introduced in this session. It has a very simple purpose, and that is to exclude from gross income any gain realized from the sale of a principal or a primary residence by a person who is 60 years of age or older.

(A copy of the bill referred to follows:)

[S. 2666, 87th Cong., 2d sess.]

A BILL To amend the Internal Revenue Code of 1954 so as to exclude from gross income gain realized from the sale of his principal residence by a taxpayer who has attained the age of 60 years

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That (a) part III of subchapter B of chapter 1 of the Internal Revenue Code of 1954 (relating to items specifically excluded from gross income) is amended by renumbering section 121 as 122, and by inserting after section 120 the following new section:

"SEC. 121. GAIN FROM SALE OR EXCHANGE OF RESIDENCE OF INDIVIDUAL WHO HAS ATTAINED AGE 60.

"(a) GENERAL RULE.—In the case of an individual, gross income does not include gain from the sale or exchange after December 31, 1961, of property used by the taxpayer as his principal residence, if—

"(1) the taxpayer has attained the age of 60 years before such sale or exchange occurs, and

"(2) such property has been used by the taxpayer as his principal residence for a period of not less than 5 years at the time such sale or exchange occurs.

"(b) PROPERTY HELD JOINTLY BY HUSBAND AND WIFE.—In the case of property held by a husband and wife as joint tenants or as tenants by the entirety, the age requirement contained in subsection (a)(1) and the use requirement contained in subsection (a)(2) shall be treated as having been met by both the husband and the wife if it is met by either spouse.

"(c) PROPERTY USED IN PART AS PRINCIPAL RESIDENCE.—In the case of property only a portion of which is used by the taxpayer as his principal residence, subsection (a) shall apply to so much of the gain from the sale or exchange of such property as is determined, under regulations prescribed by the Secretary or his delegate, to be attributable to the portion of the property used by the taxpayer as his principal residence.

"(d) INVOLUNTARY CONVERSIONS.—For the purposes of subsection (a), the destruction, seizure, requisition, or condemnation of property, occurring after December 31, 1961, shall be treated as the sale or exchange of such property."

(b) The table of sections for such part is amended by striking out

"Sec. 121. Cross references to other Acts."

and inserting in lieu thereof

"Sec. 121. Gain from sale or exchange of residence of individual who has attained age 60.
"Sec. 122. Cross references to other Acts."

SEC. 2. (a) Section 1033(h) of the Internal Revenue Code of 1954 (relating to involuntary conversions) is amended by adding at the end thereof the following new paragraph:

"(3) For exclusion from gross income of gain from involuntary conversion occurring after December 31, 1961, of residence of taxpayer who has attained age 60, see section 121."

(b) Section 1034 of such Code (relating to sale or exchange of residence) is amended by adding at the end thereof the following new subsection:

"(k) CROSS REFERENCE.—

"For exclusion from gross income of gain from sale or exchange after December 31, 1961, of residence of taxpayer who has attained age 60, see section 121."

SEC. 3. The amendments made by this Act shall apply to taxable years beginning after December 31, 1961.

Senator DIRKSEN. Obviously, we would like to have our senior citizens go it on their own and protect their pride, insofar as possible.

Yet at the same time, under existing law, we put a penalty on them.

Here is a family that starts out in life, they raise a family, the youngsters marry off, but while they are growing up, usually father and mother expand the house or buy a larger one. Then as the family looks after its own family chores, here is an aged couple, or maybe a widow or a widower with a rather substantial residence on his hands, on which he has to pay maintenance and taxes. He could live in a far more modest home and yet, if he sells his home, if he takes advantage of what inflation we have had in the real estate market, he is subjected to a capital gain, and in so doing, obviously, you diminish his cash resources and the opportunity to use that cash to improve his own lot.

I think it is only in the interest of equity and fairness and commonsense if we give them a break and say, if you are 60 and you have lived in this home during the last 5 years so that it is your principal and primary residence, and then you sell it because you do not need

this room any longer and you can live cheaper, I think we could exclude that from the provisions of the capital gains section of the Internal Revenue Act.

That is how simple that bill is.

Senator BENNETT. Mr. Chairman, while my friend is shuffling his papers, I would like to remind him that if this bill passes without that provision in it and your aged friend sells his home, then he will pay the profit at ordinary income rates, no longer at capital gains rates. Is that not right?

Senator DIRKSEN. Well, whatever tax provision applies, I want to give him a break. I think it is one of the best and most constructive things we can do for the senior citizens of the country.

And may I say, Mr. Chairman, I introduced this as a result of a hearing we held in St. Louis. I am a member of the Committee on Aged and Aging. So is the distinguished Senator from Utah, and he has attended some of the meetings around the country. We had a whole courtroom full of people and I talked with many of them.

Some of their suggestions, of course, you just could not accept. But here was a suggestion which I thought was extremely good, and after I introduced it, I noticed that the editorial response in different sections of the country was excellent. I do not want that to influence the committee particularly, but I do hope it can be done.

Now, neither the Treasury nor anybody else can give me a hint as to how much revenue will be lost as a result. I apprehend it will not be too great, and certainly the benefits that inure to our senior citizens will more than compensate for what modest revenues may be lost. So I commit this to your good keeping in the hope that this also can be added to and enrich the bill that is presently before you.

Now, I have one other item, Mr. Chairman. I shall not let that take too much time, either, but it relates to section 4 in the bill, with respect to gifts. Of course, as it is written today, it is going to catch these people who manufacture inscribed advertising specialties. That provision is found on page 28 of the bill that is before you, section 274(b) relating to gifts.

Now, it is all-encompassing and obviously even a minor gift, even though it be an advertising specialty, is going to have to be included within that gift provision.

Now, I brought my own props along. You see, we have thousands of people engaged in the business of manufacturing these advertising specialties. This was gotten out for a lumber company and I suppose it is a potholder. It has no trade-in value. You cannot sell it. It is inscribed with the name of the advertiser, and yet it comes within that gift section.

Now, you see, this ought to appeal to every farmer, Acme Feed & Seed Service, Jonesboro. Now, that is a gift and they are going to have to do an awful tall lot of bookkeeping if a lot of these things are acquired and given away, and it is going to add materially to their difficulties.

This is a gift. You see, it is very practical. If you have a grandchild, you just take this prop picture out and put your grandchild's picture in. But it has not anything more than a modest amount of intrinsic value.

Now, there is an ashtray. That is inscribed for the U.O. Coates & Co. You see, actually these are advertising specialties. They have no trade-in value. They are not like Cadillacs. They have no intrinsic value, they are not like mink coats. And the fellow who gives these away gets the principal benefit. So I do not know that you can call those gifts particularly, in the contemplation of the revenue statutes.

That is a little desk calendar and a blotter. I do not know what that is worth, maybe about a quarter, but intrisically it comes to your desk and you look at it, you say, well, that is from the Carlson Insurance Agency. I cannot imagine that the Government is going to put a gift tax on these things.

For all I know, this may be one of those things you put in your car to indicate the mileage when your oil is changed. But it is a gift and cumulatively, it is going to have to come under section 274(b).

Now, I have lots of other gifts here. That is another thing to put on your desk, just a desk calendar, but it has advertising value and virtually nothing more.

Now, this is probably the most useful of the lot. I am sorry I did not bring one for every member of the Committee, but you see, it is inscribed, too, there.

But the chances are 100 to 1 that after you have finished with a desk pad, you do what I do, you shove it off in a corner and then you do not see it any more, so really, you do not have any great gift value in it.

You see, that is inscribed, too. That is a very useful item, but actually that is an ice scraper for your windshield.

Now, are we formally, in a tax bill, going to call that a gift? Well, all of these, cumulatively, have to enter into the books unless this is modified so that you make an exemption or exclusion for advertising specialties.

This is a little gadget you use instead of your forefinger to use the telephone. Intrinsically, it has no value at all, and yet it is a useful gadget. Yet if you do not accept it, it is a gift, and cumulatively, as I read the bill, it is going to have to be included.

Finally, I have this little gadget. You would think I was going out to the airport. I do not know what that is worth, maybe 50 cents, but it has advertising in it. You can dump some papers in it and set it off in a closet and maybe you will not see it for 2 or 3 months. But you cannot trade it in and it has no gift value as such, because the fellow who gave it to you expects you to have it around and say, well, look, that is from the so-and-so insurance agency. You get the advertising.

Now, there are 50,000 or 100,000 people, mostly girls, who are engaged in this business. It seems to me that if you want to hike up business and make more business and generate income so that the income can be had, I think this committee would be wise indeed if they undertook to make that exception in section 274(b) and simply excluded advertising specialties from gifts.

Now, Mr. Chairman, I have covered three important items. I am sorry I have not more, but I do not want to take too much time of the committee and I shall come back for some of the other things.

Senator CARLSON. Mr. Chairman, on this point, I think it is interesting to note that the matter that has been discussed by our distinguished minority leader states very specifically that no deduction shall be allowed in section 212 for gifts made directly or indirectly to any individual to the extent that such expense, when added to prior expenses of the taxpayer for gifts made to such taxpayer exceeds $25. That seems to me to be a very low figure, I assure you.

Senator DIRKSEN. Indeed so. I have trouble understanding that abstruse catch language. But as I wrestled with it, I felt that was a terrible limitation, particularly so in this day and age, when even these little gadgets cost money to produce.

So I do not ask the committee to give me a commitment today, but that I hope that—I earnestly hope that you will modify that section and do generously by these other items.

Senator WILLIAMS. I might say to the minority leader that perhaps this is Harvard language and may need a little revision.

Senator DIRKSEN. Harvard language? Oh, yes; I would go further than that and say it might be Oxford language.

Senator BENNETT. Mr. Chairman, I would like to inquire if the giving of a commitment by a member of this committee to support the majority leader constitutes a gift in excess of $25 in value?

Senator DIRKSEN. That I would not know.

Now, I hope you will not regard it as influencing the committee if I leave these useful little items, because I am going to leave them here with the staff. Some of them may cook and need a potholder. A member may have a child or grandchild and might like to have that picture frame. Then, of course, the rest of it I shall leave for the staff, and may the record show that it was not done to influence the committee.

Mr. Chairman, I thank you very much.

The CHAIRMAN. Thank you, Senator Dirksen.

Senator DIRKSEN. Now Mr. Louis Kohn of Chicago will testify on this very important item later this afternoon. I thank all the members of the committee.

The CHAIRMAN. Thank you very much. Your remarks will have the full consideration of the committee.

The next witness is Mr. M. W. Armistead III, of the American Newspaper Publishers Association.

I would like to say that Mr. Armistead is from Virginia and is one of the most outstanding publishers in the United States. He represents at this hearing today the American Newspaper Publishers Association.

STATEMENT OF M. W. ARMISTEAD III, AMERICAN NEWSPAPER PUBLISHERS ASSOCIATION

Mr. ARMISTEAD. Thank you very much, Senator.

My name is M. W. Armistead III. I did not come here bearing gifts, I am sorry to say, but I do want to talk a little bit about advertising.

I am the publisher of the Roanoke Times and the Roanoke World-News. I am chairman of the Federal Laws Committee of the American Newspaper Publishers Association and I appear before your committee to urge revision of section 3 of the tax reform bill, H.R. 10650.

In its present form, this section would prohibit tax-deductibility of expenditures for institutional advertising but permit and recognize the cost of lobbying.

The ANPA is a trade association incorporated under the laws of the State of New York. Its membership comprises more than 850 daily newspapers, ranging from circulations of less than 5,000 to more than 1 million per day.

Our members have more than 90 percent of total daily newspaper circulation in the United States.

Each of these members has a very real and direct interest in the consideration being given by your committee to income tax reform. This is especially so with respect to the proposed discriminatory treatment of advertising costs by administrative agencies in their determination as to whether or not those costs should be treated as an ordinary and necessary business expense.

Section 162 of the 1954 Internal Revenue Code, in referring to trade or business expenses which are deductible, does not specifically mention advertising, but states that all the "ordinary and necessary expenses" of a business may be deducted. Similar language was in the 1939 Internal Revenue Code and the previous codes.

Under the present state of law, as interpreted by the U.S. Supreme Court, Federal authorities have set themselves up as censors of information disseminated in the form of advertising and as judges of what messages to the public constitute necessary advertising related to the taxpayer's business.

And now section 3 of bill H.R. 10650 passed by the House proposes to put a congressional stamp of approval on censorship by taxation. The bill would allow businesses to treat expenses in connection with lobbying activities as a tax-deductible item, but it would forbid the tax-deductibility of advertising expenditures for the promotion or defeat of legislation—even if the business life of a firm is at stake.

Should this bill become a law as it now stands, the net effect would be to sanction lobbying costs and expenses of direct contact with legislators, but it would disallow expenses of taking the same message to the public through advertising. Involved here is the encroachment of the Government on the people's right to information affecting the public interest.

A business firm wishing to back a local school bond drive through advertising or letters to its employees, for example, could not deduct the expense involved.

A company which feels that its back is to the wall with respect to proposed legislation could not take its fight to the public and show those activities as legitimate expenses for tax purposes. But individual lobbying, by the company, including pay to lawyers to appear and other costs, would be considered tax deductible.

It is plainly apparent what is involved here. Institutional advertising is, essentially, directed at the American public and only indirectly at the individual Members of Congress. Lobbying activities are generally in the reverse direction: to influence individual legislators.

The net effect of the present proposal would be to segregate the public—which should be best informed at all times—from the issues that come before Congress and which have much influence on the everyday lives of the American people.

The concern with this basic issue is clearly shown by the numerous editorials in many newspapers of all sizes in all sections of the country. We are supplying copies of a selection of these editorials for your record of this hearing.

Newspapers are not alone concerned with this proposal. The advertising business generally is disturbed over what seems to be a lack of knowledge in some Government circles either of the tremendous force of advertising upon our economic welfare or the harmful effect of regulations by Federal agencies upon that tremendous economic force.

Those high in Government for many years have urged the use of advertising to counteract recessions, to fight inflation, to sell U.S. savings bonds, to save our forests, to mention but a few. They want the aid of the Advertising Council but some of them are cool about the lifeblood that permits the council to exist.

There is an ironic note to all of this. Recently, President Kennedy, addressing the Advertising Council, complimented members of the council on their fine public service advertising and urged them not only to continue it, but to produce advertising in behalf of his international trade program. No one present asked the President if such advertising would be tax deductible. It is a pertinent question. If this bill passes, the chances are good that it would not be recognized as a tax deductible business expense even though such advertising would contribute to public understanding of this important matter.

From the standpoint of our national welfare, the right to free speech and to have a free press becomes of paramount importance when related to issues that are or may become the subject of legislation, because it is precisely these issues in which the public interest is vested.

One of the basic cornerstones of our system of government is an informed electorate. This in turn is dependent not only upon the right to acquire knowledge but to impart it, whether the issue be the merits of the free enterprise system as against those of the communistic system, the merits of privately owned as against State owned business, whatever the nature of the business may be, or the merits of any other question of vital public interest.

It is a matter of serious concern, therefore, that it is precisely here in the area of public policy, the most vital of all areas pertaining to our life as a nation, that the taxing power is used to exact a penalty on the exercise of one of our most cherished rights by those most competent to speak and inform the public.

The management and the board of directors of any American business know what is justifiable as an "ordinary and necessary" expense of the business.

Substitution of judgment by a Government administrative agency for the judgment of responsible business is incompatible with our basic American freedom.

So long as Congress permits the taxing authorities to censor advertising by determining what kinds of advertising are ordinary and necessary to a business, it is assisting the Government in curtailing the opportunity for the acquisition of knowledge by the people in respect of the conduct of their Government's affairs.

Accordingly, we respectfully urge that your committee reject the language in section 3 of H.R. 10650, and instead recommend language which will clearly permit a business to choose its own way to tell its story to the legislative branch of Government and to the public, free from tax penalty on the method it chooses.

The remedy is at hand. Bill S. 467 by Senator Hartke of Indiana, now in your committee, or similar language, would accomplish exactly that. Cosponsor of that bill is the senior Senator from Oklahoma, Senator Kerr.

We thank you for the opportunity to present the views of our association.

The CHAIRMAN. Thank you, Mr. Armistead.

Are there any questions?

Senator DOUGLAS. Mr. Chairman, I would like to ask Mr. Armistead, what is the present practice as regards institutional advertising which has a political implication? Can it be deducted from taxable income?

Mr. ARMISTEAD. If it is designed or, in the opinion of the Internal Revenue Service, is to influence or affect legislation or perhaps regulation by Government, I believe it is not, Senator Douglas, by a decision of the Supreme Court.

Senator DOUGLAS. But ordinary institutional advertising, devoid of a political content, is regarded as a business expense, and hence is not subject to taxation, is that correct?

Mr. ARMISTEAD. Yes, sir. I think that is correct, so long as it comes within the purview of ordinary and necessary. Of course, that is subject to interpretation.

Senator DOUGLAS. So the problem is for the courts to draw the line as to where the influence upon legislation or elections begins, is that true?

Mr. ARMISTEAD. I believe, sir, that the decision is made initially by the Internal Revenue Service. When somebody objects to that, of course, it does go before the courts for examination.

Senator DOUGLAS. Frequently in elections, some will emphasize the importance of a balanced budget which a certain political party tries to appropriate as its own. Under those conditions, what have been the decisions of the Internal Revenue Bureau? Have they held that that had a political overtone or undertone, or have they said this is merely a contribution to economic stability which it is proper for business to promote?

Mr. ARMISTEAD. Senator Douglas, I am not aware of any decisions on that specific point. If I can find any, I shall be glad to send them to you, sir, for the record.

Senator DOUGLAS. I would like to find out about that, because we find those ads very frequently occurring close to election time. I have always felt they were not totally dissociated from politics.

Do you know of any cases where institutional advertising of this nature has been rejected as not being tax deductible or income deductible?

Mr. ARMISTEAD. I believe, sir, there have been some cases involving some electric power companies, and also I believe a case involving a liquor company.

Senator DOUGLAS. On a fixed price, you mean, or resale price maintenance?

Mr. ARMISTEAD. No, sir; in the liquor case I believe it was a question of their taking a position in a referendum which would have dried up the area which they served, as I recall.

Senator DOUGLAS. Was that a tax case, or what? Was the question whether it should be included in the costs to be met out of rates? Can you remember?

Mr. ARMISTEAD. I do not remember.

The CHAIRMAN. Any further questions?

Senator CARLSON. Mr. Chairman, I was trying to find but have been unable to locate at the present a very excellent statement on institutional advertising. The witness, I believe, was Professor Haring from Indiana last week, and I appreciate your comments, Mr. Armistead, because I think they confirm what he stated before this committee.

Mr. ARMISTEAD. Thank you.

Senator BENNETT. Mr. Chairman, just for the record, when one political party abandons a good economic concept, I am sure there is no reason why the other political party could not adopt it.

Do you remember the words on the masthead of the Denver Post?

Senator DOUGLAS. Will the Senator yield?

Senator BENNETT. May I finish this?

Senator DOUGLAS. Certainly.

Senator BENNETT. Do you remember the words on the masthead of the Denver Post?

Mr. ARMISTEAD. No, sir; that is a little far removed from Roanoke, Va.

Senator BENNETT. I wish I could remember them exactly, but it said something like this, sir:

"Oh, Truth, when deserted by everybody else, make this thy dwelling place."

Mr. ARMISTEAD. Yes, I do remember that.

Senator BENNETT. I think that goes for the balanced budget.

Senator DOUGLAS. It is always a matter of marvel to me how our Republican friends try to embrace all the virtues in the world and try to identify them with the Grand Old Party, and ascribe to the Democrats by implication all of the vices.

Senator BENNETT. We have been well taught by our Democratic friends.

Senator DOUGLAS. I will say that the Denver Post made itself into an extremely good paper. But in the days when Bonfils and Teammen ran the Denver Post, it kept justice holed up within its walls.

Mr. ARMISTEAD. I would like to say that the American Newspaper Publishers Association, Mr. Chairman, is nonpartisan.

The CHAIRMAN. Thank you very much, sir. The reproductions of the 13 newspaper editorials attached to your prepared statement will be inserted in the record.

(The editorials referred to follow:)

[From editorial page, the Press-Chronicle, Johnson City, Tenn., Mar. 1, 1962]

STILL COUNTENANCING CENSORSHIP BY TAXATION

For some years there has been much controversy over a "censorship by taxation" ruling imposed by the Internal Revenue Service. It holds that a businessman, in making out his tax returns, cannot deduct as a business expense the money he spent trying to influence legislation.

Now, a House committee has tentatively decided to take steps to guarantee the right to speak without incurring heavy tax penalities. And the danger is that people may come to believe that the committee recommendations properly and adequately take care of this manifest injustice.

They do not. They go only a part of the way—and a small part. Specifically, they would allow the deduction only of expenses incurred in connection with "legislative appearances"—that is, in giving formal testimony before legislative bodies. Such appearances, obviously, are a relatively minor means of reaching the public with one's views pro or con on legislation. Still nondeductible, for example, would be newspaper advertisements a businessman might use to discuss such matters as zoning ordinances and taxes, or letters and pamphlets mailed to employees and stockholders about some issues with legislative overtones.

One bill—the Boggs bill—would revoke the IRS ruling and truly assure freedom of speech and petition. Until such a bill is passed, we will continue to have "censorship by taxation."

[From the Daily Times-Call, Longmont, Colo., Mar. 12, 1962]

EDITORIAL: WORKING ON A WASHINGTON-DESIGNED BLINDFOLD

One of these days, the "ivory tower thinkers" and the overfed philosophers of the we-know-what-is-best-for-you school are going to be amazed at the reaction of the general public.

Right now, in the House Ways and Means Committee, there is strong indication that careful preparation is being made to assure that a new nail is being driven in the coffin of the people's right to know. This is one of those perpetual problems to certain of our elected representatives, who are happiest when the people know less and less.

It is both very simple and very clever. The key to the entire philosophy was voiced in 1819 by Chief Justice John Marshall: "The power to tax involves the power to destroy."

By very carefully planning a provision to disallow any tax deduction for institutional advertising about pending legislation, the sponsors can be sure that a major step is being taken to keep the public in the dark.

If a business organization is deeply concerned about some proposed legislation, why should it not be permitted to advertise its position to the public?

The proposed bill will permit deductions for the cost of travel, preparing testimony, appearing at legislative hearings, or communicating with legislators. In plain, simple language, that merely means that you can lobby the representative, but you cannot tell the general public about the issues involved.

This all began in 1959, when the Internal Revenue Service refused to allow the expenditures of two concerns that sought to prevent the enactment of State laws which would have put them out of business. One of the key points of the battle was that advertising to tell their side of the story was not considered tax exempt.

We believe that despite our friends with the ever-ready cloak of secrecy, the American people have a right to know. If they are sufficiently concerned about legislation, they will make their voices heard.

If we have to make something nondeductible, let's disallow the lobbying cost and allow necessary expenses to tell the story to the American people.

If you agree, write to your Congressman.

[From Duluth (Minn.) Herald, Mar. 13, 1962]

BILL TO END BUSINESS DEDUCTIONS: AD TAX BENEFIT THREATENED

(By William Sumner of the Herald Washington Bureau)

Washington.—The administration's tax revision bill contains, among other controversial provisions, a clear-cut and ruthless curtailment of freedom of speech.

In this so-called tax reform bill, deductions for the expense of appealing to the public in regard to legislation—local, State or National—will not be allowed for tax purposes.

Opponents of this particular clause refer to it as censorship by taxation, and that doesn't seem to be an exaggeration.

It was included in the bill at the behest of the Treasury Department. Legislative appearances, or lobbying, for or against legislation would be considered deductible expenses. But appealing to the public through advertising, newsletters or other means can not be considered a business expense. This would be true even though the business involved is directly affected by the legislation.

A firm wishing to back a local school bond drive through advertising or letters to its employees, for example, could not deduct the expense involved.

A company which feels that its back is to the wall in regard to proposed legislation can't take its fight to the public and consider its activities legitimate expenses.

A company which wished to take a public stand in favor of free enterprise or against backdoor spending would find itself with an unhappy ruling by the Internal Revenue Service.

The history of this bit of tax reform began 3 years ago in the State of Washington. A liquor dealer there fought a pending local option measure by means of newspaper advertising. IRS agents ruled that this was not a deductible expense. Though there was nothing in the IRS Code to back this up, the Supreme Court ruled against the liquor dealer.

Then there were some battles between public and private utilities being waged in all forms of communication media. Internal Revenue began moving in on the private utilities with the backing of the court decision, and the process of stifling an opposition voice set in.

The tax reform bill puts in black and white an even less ambiguous admonition. And in the case of public vs. private utilities the tone may have been set this past week with a two-page advertising spread in a national magazine in behalf of the Rural Electrification Administration. This was financed, of course, by tax money. An answer will not be deductible.

One of the strangest roles in these proceedings has been played by Representative Hale Boggs, Democrat of Lousiana, the majority whip and a member of the House Ways and Means Committee. He had sponsored legislation which would have allowed such deductions and declared that this was the American way.

"To deny such speech," he said at the time, "is to deny the very essence of the democratic process."

Boggs, however, has fallen into line. The vote on the subject in Ways and Means was by strict party division. An amendment by Representative James Utt, Republican of California, which would have permitted such deductions was killed by Boggs and the rest of the Democrats.

Utt describes it as another move in the direction of the Big Brother state. Boggs is disinclined to discuss his change from that of flag-waving champion of free speech.

There was an ironic note to all this during the past week. President Kennedy, addressing an advertising group, complimented them on their fine public service advertising and urged them to not only continue it but to produce advertising in behalf of his trade program.

No one asked him if such advertising would be deductible, for there are few in the business who know what is about to hit them. It would not, of course, be deductible as a business expense, but perhaps the administration wants these men to put up a kitty, out of their salaries or company earnings, out of patriotic impulse.

[From editorial page, the Oregonian, Portland, Oreg., Mar. 14, 1962]

"SLEEPER" TAX BILL

The administration's new comprehensive tax bill, now in gestation in the House of Representatives, should have minute examination.

Take, for example, two provisions that may appear relatively minor. One would specifically authorize the deduction as business expense of the cost of lobbying on legislative issues directly related to a firm's interest. But another part of the law would outlaw such tax deduction of expenses incurred in seeking to influence legislation through advertising.

In short, it would be a legitimate business expense to carry your's firm's views on legislation to Congress or to the legislature, but not so to carry them to the public through advertising in newspapers and magazines.

The question of deduction of expenses of lobbying and advertising on public issues was first raised by the Internal Revenue Service a few years ago when it refused to allow deductions of expenditures by two liquor firms in the interest of defeating legislation that would have put them out of business. The U.S. Supreme Court in 1959 upheld IRS in both cases, and the IRS has spelled out the position in its regulations.

The House bill would remove this restriction on a firm's freedom of self defense only in the particular of direct lobbying. It would make a distinction between talking to your Congressman and talking to the public, to the disadvantage of the latter approach. Such distinction has no support in reason.

This is a sample of the issues of consequence that may be found in great number in this omnibus package.

[From editorial page, the Californian, Bakersfield, Calif., Mar. 14, 1962]

A DISCRIMINATORY AND DANGEROUS BILL

A piece of legislation is now before Congress which involves such drastic and discriminatory provisions inimical to the right of the people to be informed that its defeat should be the primary order of business. We refer to the provisions of the so-called tax reform bill which relate to the deductions that may be made for expenses related to supporting or criticizing legislation.

The manner in which these provisions are written would in effect prevent an open and forthright effort one way or the other, but would exempt lobbying from the taxing formula. The net result would be, as one critic observed, to force the taxpayers to pay for lobbying while dening a business or industry the right to deduct advertising expenditures for the promotion or defeat of legislation.

A deeper principle involved here does not readily lend itself to immediate perception but it is present and this matter may set a precedent that would be vastly injurious to the freedom of choice now offered by newspapers and other media to advertising. The encroachment of the legislature on the people's right to information is also involved.

As one informed observer has noted, these provisions would sanction lobbying costs and expenses of direct contacts with legislators, while denying the right to keep the public itself informed regarding the issues involved. This is a point that every citizen, interested in his own freedom and the right to be heard on legislation introduced in legislatures, should mark well and he should not delay in informing the Members of Congress of the unfairness and danger of this proposal.

He way well observe that if Congress passes a law preventing a business from taking its case to the public in an effort to survive the threat of injurious legislation, Congress will be permitted in the future, on the basis of this precedent, to apply the same restrictions to the individual, with obvious effect on his freedom and security.

[From editorial page, the Daily World, Tulsa, Okla., Mar. 14, 1962]

PENALIZE INITIATIVE, SUBSIDIZE LOBBIES

When it comes to enacting reforms in Uncle Sam's almost indecipherable income tax statutes, Congress invariably approaches remedies in round-about ways.

Under consideration before the House Ways and Means Committee is a tax "reform" measure specifically precluding deductions from income taxes of funds

spent on institutional advertising seeking to influence the course of legislation before the Congress.

However, in taking this slap at industries, associations and trade groups, the committee wants to permit tax deduction for expenses involved in maintaining active lobbying forces in congressional halls.

It is readily apparent what is involved here. Institutional advertising is, essentially, directed at the American public and only indirectly at the individual Members of Congress. Lobbying activities are generally in the reverse direction: to influence individual legislators on legislation.

A prime example of what is involved can be found in the case of the private power companies, in association, who for some years have been investing in institutional advertising expounding the actual and real problems resulting from the encroachment of public power production and distribution. The Internal Revenue Service has forbidden the utilities to assume these expenses as business deductions in reporting income. The legislation before the Ways and Means Committee would extend this administrative decision into law. Congress seeks to give a tax break to the lobbyists.

What Congress seems to be doing, whether it realizes it or not, is segregate the public—which should be advised at all times—from the issues that come before Congress and which have much influence on the everyday lives of the American people.

Encouraging the investment of private funds in sometimes dubious lobbying activities—and offering to subsidize such expenditures—is a less healthy policy. Some of the worst scandals of the past in Washington have evolved from nefarious lobbying activities; some people call it influence peddling.

But far more basic, as we see it, is the attempt to invoke tax policies that seek to deter the enlightenment of the public through advertising and, instead, place a penalty upon such activities. Tulsa newspapers, incidentally, carry little advertising of this type, which usually is directed at a mass audience through nationally circulated publications.

Far better it would be, in our opinion, to permit tax relief on institutional advertising directed to public enlightenment than to encourage the increase of raucous and sometimes predatory lobbying in the Nation's Capital—where the general public is innocent of what takes place.

There can't be many "black bags" showing up on the printed page.

[Editorial in Westerly (R.I.) Sun, Mar. 14, 1962]

TAX REFORM BILL TO PROMOTE LOBBYING

Advertising expenditures for the promotion or defeat of pending legislation—regardless of whether a firm's business life is at stake—would not be tax-deductible as a business expense under provisions of a tax reform proposal completed by the House Ways and Means Committee in Washington last February 27.

However, dues or other expenses paid by a taxpayer to an organization and used by such an organization "with respect to legislation of direct interest to the taxpayer and to such organization" would be tax deductible. This would include cost of travel, preparing testimony as well as expenses incurred in actually appearing at legislative hearings, or communicating with legislators.

Under present Internal Revenue Service regulations, lobbying expenses are not deductible. The net effect of this nex tax-reform proposal would be to sanction lobbying costs and expenses of direct contacts with legislators, but it would disallow expenses of taking the same message to the general public through institutional advertising such as newspapers, radio, and television.

Chairman Mills of Arkansas expects to present the bill to the House of Representatives this week or next week. No amendments can be made in the House, which can either vote to accept the measure or return it to committee.

The net result of this proposed action is to make it impossible for a reputable businessman to make his feelings known to his customers or business associates and claim the cost as a business expense.

At the same time, it promotes the use of lobbyists or pressure groups in direct contact with the legislators.

Apparently Congress isn't at all interested in the private individual speaking his mind in public. Congressmen seem to be adopting the slogan, "See me, but don't talk to anyone else."

It is tough enough for a businessman to make a legitimate profit—either before or after taxes—these days. Why should Congress try, through tax reforms, to further stifle the process of free enterprise and freedom of speech?

We plan to write to our Congressman, Representative John E. Fogarty, and ask him to vote against this tax-reform proposal. Will you do the same?

[From the Times-Union, Albany, N.Y., Mar. 16, 1962]

INCONSISTENT THINKING

A tax reform bill soon to be introduced in the House of Representatives contains a provision which should concern every business and industrial executive in the area. The measure provides that while lobbying expenses in making direct contacts with legislators are deductible, the costs of the same message, taken to the public in the form of institutional advertising, is not.

It need not be pointed out (except, apparently, to tax law writers) that there is more than one kind of lobbying. Legitimate efforts to present a point of view directly to legislators and press for this or that legislation beneficial to this or that industry or organization have long been accepted in this country. But also accepted have been efforts to enlist public support on some occasions—particularly where the public interest is involved or it is believed that public concern should be expressed.

We fail to see the distinction implied in this hair-splitting interpretation of lobbying which does not include an advertising message to the public. Interested persons who agree should urge their Congressmen to take appropriate action.

[From editorial page, the Times Herald, Norristown, Pa., Mar. 16, 1962]

A MUZZLE FOR MAIN STREET

A tax reform bill soon to be introduced in Congress has a provision that would prohibit income tax deduction of any money a company spends to advertise its position, pro or con, regarding pending legislation.

Thus if one of Norristown's major industries wanted to explain to our people how a law might undermine our economic security, or enhance it as the case may be, the money spent to drive home the point would not be tax free.

The same "reform" bill, however, would consider lobbying a deductible expense. The net effect of such an enactment would be to discourage legislative enlightenment at the grassroots level, while encouraging cubbyhole conferences between the legislators, on one hand, and the old prolobbyists who aren't exactly emptyhanded when they arrive in Washington, their devious duties to do.

It would appear that the bill is intended deliberately to throttle discussion of legislation through the medium of the local press, while subsidizing the oft-discredited practice of deciding the destiny of a bill over cocktails and cavair.

Unfortunate though it may be, the average citizen has neither the time nor the patience to become an avid student of contemplated legislation. Its phaseology is rarely outstanding for its clarity and it takes an astute lawyer, and sometimes the U.S. Supreme Court, to interpret what the law writer was trying to say in the first place.

Conversely, each grassroots area has its conscientious watchdogs who are practiced in peering into legislative loopholes, and in exposing insidiously hidden details that could destroy a business, a segment of workers or the economy of an entire community.

Robbing Peter to pay Paul is a common rather than uncommon legislative process these days.

When skulduggery of this sort looms over the legislative horizon, these community watchdogs use the best media within their means to alert an unsuspecting public. They have found that nothing equals the local newspaper as the means of bringing the truth to the local people who stand to be affected, favorably or disastrously, by any given law.

Hometown folks usually open an eye and bend an ear when a knowledgeable neighbor begins to give out with facts. Furthermore, it is academic that the local newspaper, catering to families in all stations in life, of all creeds and political philosophies, depends on a diet of truth for its survival. It is read, and generally believed.

Perhaps that is why some in high office want to use the tax gag as a way to stifle such open and honest discussion, at the local level, of a law's merits and demerits. They can't muzzle the watchdogs but they can make their warning barks expensive. It amounts to a dollars-and-cents drugging of free speech and free thought on the homefront.

Meanwhile, lobbyism in the corridors and clubs of the capital would be blessed with tax exemption. The voices speaking for a few, silvered in tone and subsidy, would be heard * * * sometimes in profitable murmurs and often in a high crescendo of demand and menace.

The idea seems to be to keep Joe Doaks back home totally in the dark about what's happening in the District of Columbia. The provision is just another detail in the trend away from local dominion, toward an unhealthy and hazardous concentration of power at the Federal bureau level.

It was excusable some years ago when the income tax gimmick was first used as a way to smash organized crime. But extension of that technique in so many ways, during recent years, to smash human initiative, free enterprise, and basic liberties is unforgivable. The trend is treacherous and ultimately could be fatal to freedom.

[From Congressional Record, Apr. 9, 1962]

Blocking Free Press

Extension of remarks of Hon. Peter H. Dominick, of Colorado, in the House of Representatives, Monday, April 9, 1962

Mr. Dominick. Mr. Speaker, the tax bill which recently passed the House had a number of provisions to which many of us objected but, because of the closed rule, no amendments to change the bill could be offered unless the committee itself proposed them. One of these objectionable features involves the right of American citizens to take the public messages advertising their position on important legislative matters or positions concerning fundamental political principles. Under the recent bill as passed such advertising may no longer be deducted as a business expense. One of the best explanations of the effect of this discriminatory provision appeared in an editorial of March 16, 1962, in the Daily Sentinel, which serves the western slope of Colorado. It reads as follows:

"BLOCKING FREE PRESS

"Advertising expenditures for promotion or defeat of legislation—regardless of whether a firm's business life is at stake—would not be tax deductible as a business expense under provisions of a tax reform proposal completed by the House Ways and Means Committee recently.

"Dues or other expenses paid by a taxpayer to an organization and used 'with respect to legislation of direct interest to the taxpayer and to such organization' would be tax deductible. This would include cost of travel and preparation of testimony as well as expense incurred in appearance at legislative hearings or communicating with legislators. (One assumes from this that entertaining legislators to influence their votes might also be deducted?)

"Under present Internal Revenue Service regulations lobbying expenses are not tax-deductible. The net effect of the new proposal is to sanction lobbying costs and expenses of direct contacts with legislators and disallow expenses of taking the same message directly to the people through advertising.

"The unfairness of such legislation is obvious. It interferes with the right of the individual or organization to go to the public. Lobbying efforts which can be and usually are personal are hidden from the public. These are sanctioned. The right to use the press, TV or radio to make a point for or against legislation is not. Lawmaking and the lobbying which influences it will thus become more and more isolated from the people who are vitally concerned.

"This is obviously an effort of Government to find one more way to collect taxes from the people. But it is far more than that, it is a deliberate attempt of Government to shut itself off, protect itself if you will, from the results of the use of a free press to express views with which the Government may not agree.

"As such it involves far more than the free press. It involves the rights of all free people and should be protested just as loudly by them as by the press itself."

[From editorial page, the Times, Roanoke, Va., Mar. 18, 1962]

CENSORSHIP BY TAXATION

The House Ways and Means Committee's tax reform bill contains at least one provision which doesn't make sense. The bill would allow businesses to deduct from their taxes expenses in connection with lobbying activities but would forbid deduction of advertising expenditures for the promotion or defeat of legislation.

Enactment would mean that money spent for personal contact with legislators would be tax exempt while funds for calling public attention to public issues and matters of public policy would not be tax exempt. In fact, a businessman would, in effect, be penalized even for stating his views in an advertisement about legislation which might put him out of business.

We fail to follow the House committee's reasoning. Under present Internal Revenue Service regulations, lobbying expenses are not tax deductible. We have no deep-seated feeling about the committee's decision that such expenses should be put in the deductible class. But we do contest the committee's obvious inconsistency in this matter.

In an arbitrary administrative order, the IRS in 1959 issued a regulation under which expenditures for lobbying purposes at Federal, State, or local levels for the promotion or defeat of legislation, for political campaign purposes or for carrying on propaganda (including advertising) would be non-tax-deductible. A bill to overturn a Supreme Court decision upholding the IRS stand has been introduced in the House but apparently is to be ignored.

On the surface at least, it appears the House committee has attempted to deal with a controversial matter by compromise but its effort is unrealistic.

If the committee's bill passes Congress, it will mean that business will continue to be taxed on exercising freedom of speech. There is in this case an abridgment of the right to petition and the right to speak freely on matters affecting the public. It is nothing less than censorship by taxation. It is an utterly foolish regulation.

No amendments can be made to the bill in the House, which must either accept the measure as is or send it back to committee. If it passes the House, it is to be hoped that the Senate, which will not be so shackled, will right the wrong which now exists.

[From editorial page, the Advocate, Stamford, Conn., Mar. 20, 1962]

DISTURBING PROPOSAL

A two-part provision in the administration's tax bill, which is due to come before the House any day now, has us considerably disturbed inasmuch as it would, in effect, penalize business and industry for taking the public into its confidence about laws it is proposing or supporting.

The first part of the two-part provision is most desirable—it would make deductible from taxation, any lobbying expenses incurred in attempts to inform Congress or other legislative bodies on the position of a business or industry on pending or needed legislation.

It is the second part of the provision that is particularly onerous. This is the part that would exclude from deduction any expenses incurred in persuading the public to a business or industry's point of view on legislation that is pending or considered to be needed.

There can be no question that legislation which affects any business or industry also affects the employees, stockholders, customers and, as a result, the public at large.

In addition, this provision would even prevent business from telling its stories on matters coming up in public referendum. This could be particularly harmful in Stamford or other Connecticut communities where changes in the city charter are determined by referendum.

Experience in referenda in Stamford in the past has shown that, in the absence of a concerted effort against a proposed change in the charter, passage is almost automatic.

It is conceivable that a charter change could be proposed that might be particularly damaging to business—such as a basic change in zoning policy or a change in the relationship between the master plan and the zoning map.

In cases such as this, it is not only desirable, but imperative that business or industry inform the public on the consequences of such legislation.

We can think of many other cases where it is imperative that the public be fully informed on the position of business or industry with respect to pending legislation.

There are occasions where legislators look to the public for direction. The public must be fully informed in order to give their legislators the proper direction. It must be informed in order to determine whether their legislators are acting in the best interests of the community, State or country as a whole.

Any attempt to stifle the flow of information to the public, whether it be through the advertising media or through any other media is a step toward ignorance or lack of interest.

[From editorial page, the News-Argus, Goldsboro, N.C., Mar. 20, 1962]

LOBBYISTS ARE FAVORED

Congress is now studying a proposal on tax loophole filling that is an out-and-out special favor for the lobbyist. The latter, as you know, is the paid agent who pleads the cause and works for the benefit of a special bloc, industry, program, or organization or individual.

It has been accepted policy for years that advertising done by firms which falls under the designation of institutional advertising could be tax deductible. The proposal now up in Washington would end this long-accepted practice.

But money spent for lobbying and lobbyists would continue to be tax deductible. It doesn't take a Solomon to see that there is no fairness in such a proposal. We don't expect to see such a one-sided proposal passed by Congress.

The CHAIRMAN. The next witness is Mr. George D. Webster, of the District of Columbia Bar Association.

STATEMENT OF GEORGE D. WEBSTER, BAR ASSOCIATION OF THE DISTRICT OF COLUMBIA

Mr. WEBSTER. Mr. Chairman, gentlemen of the committee: my name is George D. Webster. I am attorney in the District of Columbia and am appearing here on behalf of the Bar Association of the District of Columbia. We take this opportunity to appear before the committee to make known the position of the association on section 3 of H.R. 10650.

As you know, section 3 provides for the deductibility under section 162 of the Internal Revenue Code of 1954 of certain expenses incurred with respect to legislative matters, if in all other respects such expenses qualify as ordinary and necessary trade or business expenses.

While we are mainly concerned in our statement with the deduction of the lawyers' fees and expenses, we generally favor the language contained in H.R. 7123, 86th Congress, 2d session, reported by the Ways and Means Committee of the House on July 1, 1960, as a substitute for the language now contained in section 3 of H.R. 10650. (For provisions of H.R. 7123, see appendix attached.)

The association shares the view that the legislators' ability to legislate may be severely hampered by the lack of intelligent presentation by the supporters and opponents of specific legislation. We are also concerned that free speech or the free expression of views may be effectively or arbitrarily limited through the exercise of the taxing power. The principle was pointed out in *Speiser* v. *Randall*, 357 U.S 513 (1958), wherein the U.S. Supreme Court stated:

It cannot be gainsaid that a discriminatory denial of a tax exemption for engaging in speech is a limitation on free speech * * *. It is settled that speech can be effectively limited by the exercise of the taxing power. *Grosjean* v.

American Press Co., 297 U.S. 233. To deny an exemption to claimants who engage in certain forms of speech is, in effect, to penalize them for such speech.

And, as Mr. Justice Black phrased it in his concurring opinion in this case:

* * * I am convinced that this whole business of penalizing people because of their views and expressions concerning government is hopelessly repugnant to the principles of freedom upon which this Nation was founded and which have helped to make it the greatest in the world.

PRESENT LAW

As you know, the present Treasury Department regulations deny a deduction for efforts to influence legislation, even when a clear business motive for the expenditure has been demonstrated. Specifically, these regulations provide in relevant part as follows:

Expenditures for lobbying purposes, for the promotion or defeat of legislation, for political campaign purposes (including the support of or opposition to any candidate for public office), or for carrying on propaganda (including advertising) related to any of the foregoing purposes are not deductible from gross income.

The revenue statutes themselves have never contained any provision precluding the deduction of an expense because it is incurred for "lobbying purposes" or "for the promotion or defeat of legislation."

Basically, the position of the association is that these current Treasury regulations permit a tax which (1) operates as a burden on the citizen's basic right of petition, and (2) discriminates against the legal profession in the ordinary and usual practice of law. The association starts out, of course, with the basic premise that lobbying is not a reprehensible occupation but is just a shorthand word for what, in legal parlance, would be called advocacy. The association also accepts the premise that lobbying in the ordinary and accepted sense is helpful to legislators and legislative bodies. It permits the proponents as well as the opponents as to any particular legislative question to bring all of the pertinent facts and arguments to the attention of those who must ultimately make a decision on the merits.

Legislation is the preparation and enactment of laws; and the giving of advice as to interpretation, scope and application of laws is a lawyer's stock in trade, not only in the area of Federal legislation but also in the area of representation before State and local government legislative bodies. The lawyer is frequently consulted and retained to advise with, and advance the cause of his client. Under the present Treasury regulation, the expenditure of a lawyer's client, including expenditures for the lawyer's own fee in this area, may be disallowed, as well as the expenses incurred by the lawyer in the course of carrying out his representative function.

It appears anomalous to the association that expenses incurred for the appearance of a lawyer before legislative bodies or contacts with individual legislators may not be deductible while appearances of a lawyer before executive or administrative officials with respect to administrative matters, or before the courts with respect to judicial matters, are deductible when the expenses otherwise qualify as trade or business expenses. The association believes that presentations to the legislative branch of the Government should not be discriminated against in this respect and should be placed on the same footing and

given equal tax treatment as presentations before administrative agencies and the courts. In this connection, reference should be made to the fact that canon 26 of the "Canons of Professional Ethics of the American Bar Association" recognizes that a lawyer may render professional services before legislative or other bodies, whether by individual contact or as a committee witness.

PREVENTION OF UNEQUAL TREATMENT

This deduction is necessary to prevent unequal treatment. At present, the largest lobbyist is the Government itself, at all levels. If the Government using taxpayers' money advocates legislative changes harmful to a particular business, equity requires that business funds which are used in advocating an opposing position be deductible, or otherwise the departments are given an unfair advantage over the citizen.

PRESERVATION OF BUSINESS

It may be extremely important to the preservation of a business that presentation of its position be made before the Congress, or that individual Members or their staffs be contacted. For example, probably in June of this year this committee will consider the sugar bill with its quota provisions. These quota provisions may affect the very existence of certain domestic enterprises (both beet sugar and sugarcane producers) and yet, under the present law, the presentation of a lawyer before the committee, or a Member, or the staff of either, on a matter involving the life of the business will not be deductible. Presentations made on the same matter before the U.S. Department of Agriculture would be deductible under present law.

To the association, this distinction in the present law seems completely insupportable.

To take the example one step further, under present law, a sugar producer could deduct a lawyer's fee for an appearance in court to resist a $100 action arising in contract, the loss of which would not materially affect its business. And yet, as stated, the same producer could not deduct the cost of the apearance of a lawyer before this committee to protect its sugar quota which might affect the very survival of the business itself.

Our position is consistent with the position that the U.S. Treasury Department took in a letter dated February 26, 1960, which stated in part as follows:

With the growing impact of government at all levels upon individuals and upon all segments of our society, businessmen and organizations representing their interests, farm groups, labor organizations, and the like have often found it necessary to make large expenditures for the purpose of influencing legislation. The proper treatment of such expenditures is important to the equity and fairness of the income tax. Their tax treatment in turn is relevant to sound governmental policy in a modern democracy.

* * * * * * *

The proposed legislation and the broader question to which it is addressed merit consideration by your committee. Existing law as developed has frozen concepts relating to expenditures in the area of legislative process which are quite distinct from generally accepted attitudes in regard to expenditures related to fields of administrative and judicial processes. It appears to many anomalous that no expenditures involving legislation, without regard to their character,

are deductible, while similar activities before administrative and judicial bodies are clearly deductible if they otherwise constitute ordinary and necessary business expenses.

Reference should be made to the contrast between the status of honest and legitimate expenditures incurred in the exercising of constitutional rights with the treatment accorded persons engaged in admittedly illegal activities.

This contrast was emphasized by the Supreme Court decision in *Commissioner* v. *Sullivan*, 356 U.S. 27 (1958), involving expenditures for wages and rent incurred in connection with a Chicago gambling enterprise found to be illegal under Illinois law, and as to which the acts performed by employees as well as payment of rent were also illegal under that law. The Supreme Court held their expenses to be deductible.

It is a strange anomaly, indeed, when our tax law denies to a business concern a tax deduction for legitimate expenses incurred in making known its views—to Congress or the public—on issues of vital concern to it, while a person conducting an admittedly illegal enterprise and whose employees are likewise violating the law, is entitled to a deduction for unlawful expenditures.

UNIFORM ENFORCEMENT IMPOSSIBLE

In addition to these policy considerations, there are other reasons why the association supports section 3 of H.R. 10650.

In the first place, the prohibitions of the Treasury regulations have never been uniformly enforced. "Lobbying" expenses have been allowed by the Internal Revenue Service in many instances, whereas in the same circumstances as to the other taxpayers such expenses have been disallowed. This result may be inherent in the problem, and uniform enforcement in this area may be impossible. As stated by the report of the House Ways and Means Committee on this provision, the difficulty in part stems from the difficulty in segregating and isolating expenses relating to legislative matters. To segregate such expenses constitutes a most difficult problem of allocation.

The problems of uniform enforcement have also been made difficult by the inability of the Service through 47 years (the first Treasury regulation was issued in 1915[1]) to define "lobbying." In an audit today, after 47 years of the Treasury position, we don't know what the Department considers to be properly classified as lobbying. We can argue with the examining revenue agent for months over a single problem because he has been supplied no firm dividing lines.

As stated by the Treasury Department:

> It is only realistic to recognize that many of the expenditures in these areas which have passed the permissible borderline under the existing regulations have doubtless escaped detection in the audit of tax returns. Unless the Internal Revenue Service were to devote disproportionate manpower from its basic collection function to policing this difficult and controversial area, it would seem that uniform enforcement would be an unattainable goal. If there were to be a modification or relaxation of the existing rules, therefore, it would appear to be a desirable objective that it should help reduce rather than aggravate the practical administrative problems which are inherent in this area, and at the same time reduce to a minimum whatever inequalities among some taxpayers result from unavoidable imperfections in the administration of the law.

[1] T.D. 2137, 17 Treas. Dec., Int. Rev., pp. 48, 57–58.

Consider the case, for example, where a client requests a legal opinion on the applicability of the Tariff Act to a certain set of facts. Later the client, openly relying on the opinion, becomes interested in and expresses himself pro or con as to an amendment of the escape clause provision. Is the law firm lobbying nunc pro tunc, or would its expenses be disallowed? Or suppose the law firm knew at the outset that the opinion was to be used as the basis for a decision as to whether or not an amendment of the escape clause should be sought. Would it then be lobbying? Or suppose further that the law firm is hired to prepare statements, letters, briefs, etc., which the client expects to use in supporting or opposing the proposed amendment. Quite aside from whether use of this material might be "carrying on propaganda," is the preparation of it a lobbying activity?

Or suppose the client is invited to testify, for example, on small business and defense subcontractors and turns to his law firm to prepare and present the testimony. Is the law firm lobbying? Or suppose the client is invited or subpenaed to testify in a conflict-of-interest investigation and hires the law firm to advise him as to his rights in connection with answering questions which he may be asked, is the law firm lobbying? The "ergo" of these suppositions might then logically be: Is not the law firm also lobbying when the client is cited for contempt and the law firm defends him in court?

When does the practice of law stop and lobbying begin? The present Treasury regulation applies to the practice of law whenever the lawyer's work product is used to aid in the promotion or defeat of legislation or in connection with any legislative function. And if the latter is the intent and purpose of the present regulation, does it make any difference if the lawyer's work product is given to the client without any knowledge that it will or might be used for lobbying purposes?

The difficulty of drawing proper lines of demarcation does not deter a lawyer. But it has prevented the Service for 47 years from uniformly enforcing the law and giving equal treatment to taxpayers.

DEDUCTIBILITY UNDER OTHER TAX SYSTEMS

In the English case of *Tate and Lyle, Ltd.* ((1953) 2 All E.R. 162 (C.A.)), expenditures by a sugar company to defeat proposed nationalization were held deductible. This represents the rule in England where expenses in connection with legislative matters are deductible if they constitute ordinary or necessary expenses.

CONCLUSION

In conclusion, it is clear that lobbying and other activities seeking to promote or defeat legislation on the Federal, State and local levels have become ordinary, necessary, and governmentally encouraged modes of representation. This factor, together with the Commissioner's inability to administer the present law upon a uniform basis, makes this provision a proper one to be added to the Internal Revenue Code of 1954.

(The appendix referred to follows:)

APPENDIX

H.R. 7123

(As reported by Committee on Ways and Means, July 1, 1960)

"That section 162 of the Internal Revenue Code of 1954 (relating to trade or business expenses) is amended by redesignating subsection (d) as subsection (e), and by inserting after subsection (c) the following new subsection:

"'(d) CERTAIN EXPENSES TO INFLUENCE ACTION WITH RESPECT TO LEGISLATIVE PROPOSALS, ETC.—

"'(1) GENERAL RULE.—No expense which otherwise qualifies as a deduction under subsection (a) (including, but not limited to, dues and other amounts paid to any organization) shall be disallowed as a deduction merely because paid or incurred to support or oppose or otherwise influence action by the Congress or by any legislative body of a State, a possession of the United States, the District of Columbia, or any political subdivision of the foregoing, with respect to any legislative or constitutional proposal, or to support or oppose or otherwise influence action of the voters with respect to any legislative or constitutional proposal submitted or proposed to be submitted to the voters by initiative, referendum, or similar proceeding.

"'(2) EXCEPTION.—The provisions of paragraph (1) shall not be construed as allowing the deduction of any amount paid or incurred (whether by way of contribution, gift, or otherwise) for participation or intervention in any political campaign on behalf of, or in opposition to, any candidate for public office.'"

The CHAIRMAN. Thank you very much.

Any questions?

Senator DOUGLAS. I have here the Internal Revenue Code, and I am reading from section 501(c), which lays down the criteria for organizations which are exempt from taxation. It says:

Organizations for religious, charitable, scientific, or other literary or educational purposes are exempt, provided that no substantial part of the activities it is carrying on is propaganda or otherwise attempting to influence legislation.

As I understand it, the courts have held that the League of Women Voters, which does advocate legislation, is therefore denied the opportunity of being tax exempt, and that as a consequence of this ruling, contributions to the League of Women Voters are not tax exempt. And I believe the General Federation of Women's Clubs is tax exempt, but this is because it does not carry substantial activities in connection with influencing legislation.

Now, you are arguing that a sugar producer should be permitted to deduct lobbying expenses so that the present 2-percent differential above the world price, which domestic and foreign sugar producers now enjoy, could be deductible, and a previous gentleman argued that newspaper advertising to preserve this 2-percent differential should be deductible. But if the League of Women Voters were to try to lobby against it or if the General Federation of Women's Clubs were to try to lobby against this proposal, they would lose their tax-exempt status.

What I am asking is, and the general question I would like to pose, is this: With the exemptions in the bill as it comes to us from the House, and still more to broaden these exemptions as proposed by many others, are you not giving a privilege to the direct producing interests of the country which is not accorded to the consuming interests of the country, since the consuming interest is diffused and the general citizenship interest of the country is diffused, and are you

therefore not arming the comparatively strong bodies, while continuing to disarm the weaker bodies?

Mr. WEBSTER. Senator, I think the answer to that is contained in the distinction that the Internal Revenue Code makes, itself. Section 501(c)(3), which you read from on charitable and educational—the section we are talking about here is section 162 which has to do with ordinary and necessary business expenses.

Senator DOUGLAS. I understand, but it is not regarded as part of the business of an organization to defend the public interest.

Mr. WEBSTER. But their income is not——

Senator DOUGLAS. But individual contributions to these organizations cannot be tax deductible.

Mr. WEBSTER. That is exactly right, because there is no income involved as far as those organizations are concerned.

Senator DOUGLAS. In other words, only if income is involved can an expenditure for lobbying be tax deductible. The expenditure of money to protect the general interest, or the consuming interest, which in a particular case affects a consumer only to a moderate degree, that is not tax deductible?

Mr. WEBSTER. Senator, that is true of a trip to Chicago. If I want to go to Chicago on personal business, it cannot be deducted. But if I go to Chicago on behalf of a client, it can be deducted.

Senator DOUGLAS. I want to say you are giving a very one-sided interpretation of what the law should be. Take these very important matters of legislation, these tax measures. What you are saying is that the appearance of lawyers in connection with this legislation should be tax deductible, and newspaper advertising, to get added loopholes, for example, should be tax deductible. But if a person in pursuit of the general interest wants to tighten the loopholes, he cannot deduct his expense. As I say, what I think this does is to further strengthen the groups which have special interests and weaken those which have general interest.

One of the great weaknesses in political democracy, as I see it, is this disparity in power. This would further accentuate it.

Mr. WEBSTER. Well, this is an income tax and that is what is taxed.

Senator DOUGLAS. I understand. But you would lose the income tax to still further strengthen the special interests that would want to have the laws fashioned in their image.

Does not that strike you as unfair?

Mr. WEBSTER. No, sir, because I do not think that is the result here. If I want to sponsor a law because I have a personal interest in it, I cannot deduct those expenses as a citizen. But if I have a business which is about to lose its quota to produce sugar, I should be entitled to deduct those expenses, because otherwise, I should be out of business.

Senator DOUGLAS. You would be justified, then, in deducting an advertising campaign in the New York Times, the Washington Post, the Denver Post, the Deseret News, the Chicago Tribune, the Louisville Courier-Journal, and so forth?

Mr. WEBSTER. Section 3 does not go that far, because as you know, it does not have advertising expenses in it.

Senator DOUGLAS. No, but I mean the proposal that the representative of the ANPA——

Mr. WEBSTER. This section does not go that far. Advertising is a more difficult area to control.

Senator DOUGLAS. Suppose it is said to be a necessary lobbying expense to give a cocktail party at the Mayflower Hotel and invite Senators and Congressmen to lubricate the legislation. Do you think that should be deducted?

Mr. WEBSTER. Senator, we have discussed that very carefully in our group in the association, and I think you will find in the committee report—that entertainment expenses go back over to the entertainment provisions of the bill.

Senator DOUGLAS. Well, the entertainment provisions of the bill are quite weak. Could not they be held to be necessary and proper, the inevitable concomitant being to try to get favorable action?

Mr. WEBSTER. It could be, but the way I understand the bill, when you get into entertainment, you would leave the lobbying provisions entirely and the entertainment provisions would be applicable.

Senator DOUGLAS. What do you understand those provisions to be?

Mr. WEBSTER. The entertainment provisions?

Senator DOUGLAS. Yes.

Mr. WEBSTER. They are very involved and detailed, as you know.

Seantor DOUGLAS. There is no limit as of today, is there?

Mr. WEBSTER. No, there is not.

Senator DOUGLAS. So a cocktail party could be held to be a very legitimate business interest?

Mr. WEBSTER. Under the entertainment provisions of the bill.

Senator DOUGLAS. Now, nightclub bills, they might be tax deductible, might they not? Dinners in night clubs?

Mr. WEBSTER. As the present bill as it came from the House?

Senator DOUGLAS. Yes, so that the lobbyists could invite highly priced Senators and Congressmen to go to the Casino Royal. Is that true? Or perhaps some of the Egyptian night clubs which have sprung up like mushrooms, I am told, in the city.

Mr. WEBSTER. But, as you recall, in the language of the committee report, it has to be a place that is conducive to business discussions.

Senator DOUGLAS. But these are conducive to business. You might get votes very well in a night club, perhaps more effectively than in Child's Restaurant. And you might have tickets to the theater, is that not true? Is that not a good way to make friends and influence people?

Mr. WEBSTER. That is true.

Senator DOUGLAS. Do you not think there are real dangers here that should be guarded against? Do you not want to protect the virtue of your Senators and Congressmen, as well as the virtue of the lawyers so that they can practice law and not be panderers?

Mr. WEBSTER. I think the Senators can take care of themselves.

Senator DOUGLAS. But not the lawyers.

Mr. WEBSTER. The lawyers can take care of themselves, also. I might point out, that most of these expenses are being deducted today, as I am sure the Congress is well aware of.

Senator DOUGLAS. Unfortunately; unfortunately.

Mr. WEBSTER. I do not know how you are going to get at this unless you have some kind of a reasonable restriction. That is what we want, a reasonable restriction.

Senator DOUGLAS. What about $32 a day for room and board? Would that not be a reasonable restriction? That is twice what a Government official is allowed.

Mr. WEBSTER. That depends on where you go. I think in New York, that might not be enough. I think in Atlanta or Peoria, that might be too much.

Senator DOUGLAS. Well, you have opened up a very interesting line of thought, but I think as a citizen, you want to be careful how far you go.

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

The next witness is Mr. Louis A. Kohn, the Committee for Modern Courts.

STATEMENT OF LOUIS A. KOHN, COMMITTEE FOR MODERN COURTS

Senator DOUGLAS. Mr. Chairman, may I be permitted to praise Mr. Kohn as a distinguished citizen of Chicago, a very able member of the bar, a member of one of the leading law firms in Illinois, and active in all good causes.

Mr. KOHN. Thank you, Senator.

Mr. Chairman, Senator Williams, and members of the committee, I think it is indeed fitting that the last witness was named Webster, because I think it was Daniel Webster who said that justice is the greatest burden on us.

I am here today as vice chairman of the Committee for Modern Courts in Illinois, which is a statewide organization representing many groups throughout the State interested in improving the administration of justice in the State courts.

I also have attached as exhibits to my statement resolutions of the American Judicature Society of which I have been director, the American Bar Association, the Illinois State Bar Association, and the Chicago Bar Association.

I have been vice chairman of the Joint Committee on the Judicial Article of those two organizations since 1961.

In addition, I am authorized to express to the committee the views of the Committee for Modern Courts in New York, which just recently was successful in having adopted a constitutional amendment reorganizing the court system in New York, but which is further interested in this question because of subsequent legislation and other matters which may be necessary to implement the constitutional amendments.

Mr. Duncan Elder, chairman of the executive committee of the Committee for Modern Courts in New York, has wired me that the committee endorses Senate bill 2716, introduced by Senator Dirksen, and supports the statement that I am filing today. With leave of the chairman, I would like to file those resolutions and a copy of the wire which I shall furnish later as a part of my statement.

The CHAIRMAN. Without objection, the full text of your prepared statement, attachments, and telegram referred to will appear at the end of your oral presentation.

Mr. KOHN. After Senator Dirksen's excellent and succinct statement, it is perhaps superfluous for me to continue at great length, but in view of the importance of this matter and the urgency because of imminent referendums, which I shall refer to later, I crave the committee's indulgence and I am indeed grateful for the opportunity of presenting this statement.

First of all, I would like to point out that the appendix, showing a list of the constituent organizations, is as of April 9 and is not complete. We shall have, as had in 1958, the support of labor organizations, and one of our directors is Joseph Germano, an outstanding labor leader in Illinois.

Prior efforts, prior to 1961, on the part of the organized bar and of citizens' groups in Illinois results in the adoption of a judicial amendment by the Illinois General Assembly, which narrowly missed obtaining the required two-thirds vote, but in 1961 we came back and obtained the necessary two-thirds vote and the support of both parties. This is a bipartisan matter, which has the support of all the groups in Illinois. But as Senator Dirksen has pointed out, to assure adoption of the judicial amendment, it will be necessary to prosecute a vigorous, statewide campaign in the months ahead.

Past experience indicates that adequate funds cannot be obtained unless contributions be granted deductibility for Federal income tax purposes, and if the efforts of dedicated citizens to improve the administration of justice are to succeed, legislation to that end is essential.

The urgency of the situation was expressed in Fortune magazine last December, when the writer there said:

> The American courts must move fast if they are to purge themselves of their present low esteem. If they do, they can be the principal institution that gives point to American national development. If they do not, there will not be much point to the development.

As far back as 40 years ago, Chief Justice Taft said:

> If one were asked in what respect we had fallen furthest short of ideal conditions in our government, I think we would be justified in answering, in spite of the glaring defects of our system of municipal government, that it is our failure to secure expedition and thoroughness in enforcement of public and private rights in our courts.

Unfortunately, section 3 of H.R. 10650, as passed by the House, would be a step in the opposite direction. Although it would permit deduction of legislative or lobbying expenses, if otherwise an ordinary and necessary expense of a trade or business, this section would expressly deny deduction for any expense in connection with a referendum. For reasons hereinafter indicated, if it is to be the policy of Congress to deny deduction for expenses incurred in connection with a public referendum, we ask that section 3 be amended or clarified so as not to apply to matters involving judicial reform.

Moreover, we urge that section 3 be amended by adding a new subsection which would provide expressly for deductibility of contributions for an organization committed solely to this cause.

We are dedicated to the charitable aspect of this, and we are merely asking for organizations organized solely for the purpose of court reform.

In prior efforts we were able to get rulings from the Internal Revenue Service that would achieve this result.

In 1958 we did obtain a favorable ruling only for that year. But as the committee knows, in 1959 the *Cammarano* case, 358 U.S. 498, applied a provision in the Treasury regulations which denied deductions for lobbying expenses to expenses incurred for the purpose of defeating an initiative measure calling for a statewide election on prohibition.

I believe, Senator Douglas, that that answers one of your questions put to the previous witness. The *Cammanano* case would deny deductibility for an expenditure of that type.

Shortly thereafter, the Internal Revenue Service promulgated very broad regulations which would definitely deny deductibility of contributions to organizations such as the Committee for Modern Courts. Recognizing that such tax treatments might thwart the efforts of public-spirited citizens and bar groups throughout the Nation to modernize State court systems, the organized bar associations, whose names I have mentioned, have all gone on record as favoring legislation which would permit contributions to organizations such as the one I represent to be deductible for Federal income tax purposes.

Senator Dirksen has introduced S. 2716, and Congressman Yates has introduced H.R. 10080 to amend section 170(c)(1) of the Internal Revenue Code of 1954.

Time is of the essence. The Illinois proposal will be presented to the voters next November, and it is crucial that passage of the proposed legislation be expedited so that funds required for an intensive educational program, as Senator Dirksen pointed out, informing the voters of the urgent need for the proposed judicial amendment, may be gotten.

This will require the expenditure of substantial funds for staff, for publicity, literature, and other campaign essentials in time to facilitate adoption of the proposal by the voters.

The problem is not confined to Illinois. It is nationwide. In 1962, Colorado, Iowa, Nebraska, and North Carolina will have referendums on constitutional amendments involving the judicial systems in those States. Citizen and professional groups are working in Michigan, West Virginia, and other jurisdictions toward formulation of proposals for court modernization. But they have not yet reached the State through submission to the voters. This is evidence of the mounting recognition that improvements to our legal system should be the constant concern not only of the legal profession but of all citizens. The article in Fortune that I referred to said:

> The American message of the rule of law is getting some serious jamming from, of all places, the courts themselves. Delay in the trial of today's civil cases is so bad that justice could founder under tomorrow's loads unless reformers get their way.

At this critical period in history, substantial improvement must be made promptly in the administration of justice so that efficiency and dispatch will prevail in the operation of our courts. As the late revered Chief Justice Charles Evans Hughes said:

> You cannot maintain democratic institutions by mere forms of words or by patriotic vows. You maintain them by making the institutions of our Republic work as they are intended to work.

The adoption of the proposed legislation would be a major forward step and would stimulate the widespread improvement to make our most basic institution work as it was intended to work, and help immeasurably in expediting long overdue improvements in the administration of justice throughout the Nation.

I want to emphasize that the public policy in favor of making our courts work and be responsive to the needs of the time should prevail over any possible loss of income or revenue which the Govern-

ment feels may result. We can only guess, but we think it would be only minimal.

We submit that this proposal is not preferential legislation for the benefit of a special interest group, but rather a practical means of helping meet one of the great challenges of the day in accordance with the American tradition of citizen participation in the Government.

It deserves the support of all who, in the words of Dean Pound—

> look forward to a near future when our courts will be swift and certain agents of justice, whose decisions will be acquiesced in, and respected by all.

That concludes my formal statement. I am indeed grateful for the opportunity to appear before you.

I have a pamphlet that relates to the Illinois proposal so that you will understand how comprehensive this reform is, and also a reprint of an article from Fortune entitled "The Crisis in the Courts," which I would like to leave for the information of the committee.

The CHAIRMAN. Thank you, Mr. Kohn. The pamphlet and article will be made a part of the committee files.

Are there any questions?

Senator BENNETT. No questions.

The CHAIRMAN. Thank you very much.

(The full text of Mr. Kohn's prepared statement, with attachments and a telegram referred to follow:)

STATEMENT OF LOUIS A. KOHN, VICE CHAIRMAN, THE COMMITTEE FOR MODERN COURTS IN ILLINOIS, CHICAGO, ILL.

The Committee for Modern Courts in Illinois, Inc.[1] is a statewide organization representing civic, religious, business, professional, agricultural, educational and other groups in Illinois interested in improving the administration of justice in State courts. It is spearheading the current campaign for the adoption by the voters at the general election in November 1962 of a revision of the judicial article of the Illinois State Constitution of 1870. The proposal received the required two-thirds vote of the General Assembly of Illinois in 1961 and the leaders of both major political parties have pledged their support of the amendment in the forthcoming campaign. The need for complete reorganization of the Illinois court system is most urgent as the vast changes which have taken place during the last century have rendered the structure under which the Illinois courts are now operated wholly outmoded and inadequate to meet the current needs of the State.

Prior efforts to win legislative approval resulted in the adoption of a judicial amendment by the Illinois General Assembly in 1957 for submission to the voters in 1958 (which narrowly missed obtaining the required two-thirds vote of those voting on the issue) and in the adoption by the legislature in 1961 of another similar proposal to be submitted to the voters next November. The need for comprehensive reorganization of the State's judicial system is even more acute today with the ever-increasing backlog in the courts[2] and solution of this problem is one of our most pressing domestic problems. To this end and to assure adoption of the judicial amendment, it will be necessary to prosecute a vigorous statewide campaign in the months ahead. Past experience indicates that adequate funds cannot be obtained unless contributions be granted deductibility for Federal income tax purposes, and if the efforts of dedicated citizens to im-

[1] Incorporated as a not-for-profit corporation in Illnois on Jan. 17, 1962, for the following purpose stated in its charter: "To consider proposals for reorganization of the judicial branch of the government of the State of Illinois; to provide information and make recommendations with regard thereto; to seek public support for the judicial amendment to the Constitution of the State of Illinois accomplishing such reorganization; and for no other purpose."

A list of its constitutional reorganizations is attached hereto.

[2] The jury cases being tried in April 1962 in the Circuit and Superior Courts of Cook County, Ill., were filed in 1955 and 1956.

prove the administration of justice are to succeed, legislation to that end is essential.

Unfortunately, section 3 of H.R. 10650, as passed by the House of Representatives, would be a step in the opposite direction. Although section 3 would permit deduction of legislative or lobbying expenses, if otherwise an ordinary and necessary expense of a trade or business, this section would expressly deny deduction for any expense "in connection with any attempt to influence the general public, or segments thereof, with respect to legislative matters, elections, or referendums." For the reasons hereinafter indicated, if it is to be the policy of Congress to deny deduction for expenses incurred in connection with a public referendum, we ask that section 3 be amended so as not to apply to matters involving judicial reform. Moreover, we urge that section 3 be amended by adding a new subsection which would provide expressly for deductibility of contributions to an organization committed solely to this cause.

In the prior efforts for constitutional revision in Illinois, the Illinois Committee for Constitutional Revision, Inc., organized as a not-for-profit corporation under Illinois law, was active in publicizing the need for constitutional reform and in seeking public support in 1950 and 1954 of constitutional amendments endorsed by it (other than the judicial amendment) which were approved by the voters. In connection with these activities through 1958, favorable rulings had been issued by the Internal Revenue Service, holding that contributions thereto were deductible as charitable contributions under the provisions of section 170 of the 1954 code. However, in 1958 (although allowing deductibility for that year in which the prior judicial amendment was voted on), the Internal Revenue Service changed its position with regard to the future status of such organizations, and since then has indicated that contributions for such purposes would not be deductible. This position was based on the conclusion that the activities of the committee constituted "carrying on propaganda, or otherwise attempting, to influence legislation," in violation of the restriction in section 170(c)(2)(D). Treating constitutional amendments as an extension of the legislative process, a 1958 revenue ruling (Rev. Rul. 58–255, 58–1 C.B. 91) states that "inasmuch as a constitution is a general or fundamental law, an attempt to influence the adoption or rejection by the general electorate of a constitutional amendment is basically an attempt to promote or defeat legislation." Subsequently, in 1959, the Supreme Court in *Cammarano* v. *United States*, 358 U.S. 498, applied a provision in the Treasury regulations (under the 1939 code) denying deductions for lobbying expenses to expenses incurred for the purpose of defeating an initiative measure calling for a statewide election on prohibition.

Shortly thereafter the Internal Revenue Service gave a similarly broad interpretation to the statutory restriction against lobbying activities in section 170(c)(2)(D), and the applicable Treasury regulations were amended to state expressly that the term "legislation" in the statute included "action by the public in a referendum, initiative, constitutional amendment, or similar procedure," section 1.501(c)(3)–1(c)(3). Accordingly, an organization created and operated for the principal purpose of supporting constitutional revision would be denied the benefit of deductions for contributions made to it under present regulations.

Recognizing that such tax treatment might thwart the efforts of public spirited citizens and bar groups throughout the Nation to modernize State court systems, the American Bar Association, the American Judicature Society, the Illinois State Bar Association, and the Chicago Bar Association have gone on record as favoring legislation which would permit contributions to organizations such as the Committee for Modern Courts to be deductible for Federal income tax purposes. Resolutions of these organizations to that effect and endorsing legislation for such purpose introduced in the current session of Congress (S. 2716 by Senator Dirksen, and H.R. 10080 by Congressman Yates) to amend section 170(c)(1) of Internal Revenue Code of 1954 to be effective with respect to taxable years ending after December 31, 1961, are attached hereto. It is therefore recommended that a new subsection in conformity with these bills be added to section 3 of H.R. 10650 which would allow deductibility of contributions made to:

"(1) A State, a Territory, a possession of the United States, or any political subdivision of any of the foregoing, or the United States or the District of Columbia, *or any nonprofit organization created and operated exclusively to consider proposals for the reorganization of the judicial branch of the Government of any of the foregoing, to provide information to make recommendations, and to seek*

public support or opposition as to such proposals, but only if the contribution or gift is made for exclusively public purposes." [New matter in italic.]

As indicated above, the Illinois proposal will be presented to the voters of that State next November, and it is crucial that passage of the proposed legislation approving deductibility be expedited so that the funds required for an intensive educational program informing the electorate of the urgent need for the proposed judicial article. This will require the expenditure of substantial funds for staff, publicity, literature, and other campaign essentials in time to facilitate adoption of the proposal by the voters.

The problem is not confined to Illinois, but is nationwide. In 1962, voters in the following States will also pass on constitutional amendments improving the State's judicial system. (With dates of referendum:)

Colorado (November 6, general election).
Iowa (June 4, special election).
Nebraska (November 6, general election).
North Carolina (November 6, general election).

Bar and citizen groups are also working in Michigan, West Virginia, and other States toward formulation of proposals for court modernization but these have not yet reached the stage of submission to the voters.

This is evidence of the mounting recognition that improvements of our legal system should be the constant concern not only of the legal profession but of all citizens. As stated in the article "The Crises in the Courts" in Fortune (December 1961):

"The American message of the rule of law is getting some serious jamming from, of all places, the courts themselves. Delay in the trial of today's civil cases is so bad that justice could founder under tomorrow's loads unless reformers get their way."

At this critical period in history substantial improvement must be made promptly in the administration of justice so that efficiency and dispatch will prevail in the operation of our courts. As stated by Chief Justice Charles Evans Hughes:

"You cannot maintain democratic institutions by mere forms of words or by patriotic vows. You maintain them by making the institutions of our Republic work as they are intended to work."

The adoption of the proposed legislation would be a major forward step and stimulate the widespread movement to make our most basic institution work as it was "intended to work," and help immeasurably in expediting long-overdue improvements in the administration of justice throughout the Nation.

We submit that this proposal is not preferential legislation for the benefit of a special interest group but rather a practical means of helping meet one of the great challenges of the day in accordance with our American tradition of citizen participation in government. It deserves the support of all who, in the words of Dean Roscoe Pound, "look forward to a near future when our courts will be swift and certain agents of justice, whose decisions will be acquiesced in, and respected by all."

COMMITTEE FOR MODERN COURTS, CHICAGO, ILL.

ORGANIZATIONS ENDORSING JUDICIAL ARTICLE OF 1962 AS OF APRIL 9, 1962

American Association of University Women, Illinois Division.
American Institute of Architects, Chicago chapter.
Better Government Association.
Building Managers Association of Chicago.
Chicago Association of Commerce and Industry.
Chicago Bar Association.
Chicago Committee of One Hundred.
Chicago Crime Commission.
Chicago Junior Association of Commerce and Industry.
Chicago Real Estate Board.
Chicago Teachers Union.
Chicago Women's Aid.
Citizens of Greater Chicago.
City Club of Chicago.
Civic Federation.
Committee on Illinois Government.

Conference of Jewish Women's Organizations.
DePaul University.
Emanuel Congregation.
Federal Bar Association, Chicago chapter.
Firman House.
Illinois Agricultural Association.
Illinois Bankers Association.
Illinois Congress of Parents and Teachers, Chicago region.
Illinois Congress of Parents and Teachers.
Illinois Council of Churches.
Illinois Division of the American Civil Liberties Union.
Illinois Federation of Women's Clubs.
Illinois Manufacturers' Association.
Illinois Real Estate Association.
Illinois Retail Merchants Association.
Illinois Society of Certified Public Accountants.
Illinois State Bar Association.
Illinois State Conference of National Association for the Advancement of Colored People Branches.
Illinois State Medical Society.
Independent Voters of Illinois.
Japanese American Citizens League.
Judicial Advisory Council of Illinois.
Juvenile Protective Association.
League of Women Voters of Illinois.
Metropolitan Housing and Planning Council.
National Council of Jewish Women.
Public Relations Society of America, Chicago chapter.
Taxpayers Federation of Illinois.
Union League Club.
United Church Women of Oak Park and River Forest.
United Church Women of Greater Chicago.
Wabash Avenue Association.
Welfare Council of Metrolopitan Chicago.
Women's Bar Association of Illinois.
Women's City Club of Chicago.
West Side Christian Parish.
Young Voters League of South Shore.

RESOLUTION OF BOARD OF GOVERNORS OF ILLINOIS STATE BAR ASSOCIATION ADOPTED APRIL 28, 1961

Whereas the Illinois Committee for Constitutional Revision, Inc., an Illinois not-for-profit corporation, hereinafter called the Illinois committee, has supported in the past, campaigns to revise various provisions of the Illinois State Constitution including the judicial article; and

Whereas, prior to 1959, the Internal Revenue Service had ruled that contributions made to the Illinois committee would be deductible for income tax purposes as charitable gifts under section 170 of the 1954 Internal Revenue Code; and

Whereas, since 1958, the position of the Internal Revenue Service with regard to the construction of the statutory prohibition against any "substantial part of the activities [of the otherwise tax-exempt organization] carrying on propaganda, or otherwise attempting to influence legislation" has changed to include within the proscribed area action taken to influence the public in regard to proposed constitutional amendments; and

Whereas this newly broadened interpretation of the Internal Revenue Service with regard to the statutory prohibition on legislative activities has been recently incorporated in Treasury regulations (sec. 1.501(c)(3)-(1)(c)(3)) relating to the deductibility of contributions to organizations engaged in the influencing of the views of the public with regard to constitutional measures; and

Whereas, in view of the foregoing, the Illinois committee is unable to obtain a favorable ruling from the Internal Revenue Service as to the deductibility for income tax purposes of current or future contributions made to it for

the purpose of supporting the revision of the judicial article of the Illinois State constitution; and

Whereas the success of the current effort to revise the judicial article may depend in large measure upon the ability of the Illinois committee to inform and educate the public as to the need for constitutional revision in this regard; and

Whereas it is believed that sufficient funds for this educational program cannot be obtained by the Illinois committee without the aid of tax deductions for contributions made for such purpose: Now, therefore, be it

Resolved by the Board of Governors of the Illinois State Bar Association, That the association support and urge the enactment of appropriate legislation which would permit the deductibility for income tax purposes of contributions made to support revision of the judicial article of the Illinois State constitution; and

Be it further

Resolved that the legislation be in the form recommended by the section on Federal taxation of the Illinois State Bar Association, copy of which is attached hereto and made a part of this resolution, or in such modified form as may carry out the purpose of this resolution;

Be it further

Resolved that the Executive Committee of the section on Federal taxation be and it hereby is directed to take whatever steps may be deemed necessary to obtain the introduction and passage of the legislation in the current session of the 87th Congress of the United States, including the sending of not more than two witnesses to Washington to support the legislation.

I, Amos M. Pinkerton, executive director of the Illinois State Bar Association, do hereby certify that the above and foregoing is a true and correct copy of a resolution unanimously adopted by the Board of Governors of the Illinois State Bar Association at a meeting of said Board held in Chicago, Ill., on April 28, 1961, as same appears in the official records of the association.

[Seal] AMOS M. PINKERTON, *Executive Director.*

RESOLUTION RE: CONTRIBUTIONS FOR JUDICIAL ARTICLE

Whereas contributions made to the Illinois Committee for Constitutional Revision for the purpose of supporting an amendment of the Judicial Article of the Illinois State Constitution are considered by the Internal Revenue Service to be nondeductible for income tax purposes, and

Whereas it is believed to be important to the success of the current effort to revise the Judicial Article of the Illinois State Constitution that there be allowed an income tax deduction for contributions made for such purpose.

Now, therefore, be it resolved that the Executive Committee of the Federal Tax Section of the Illinois State Bar Association support, and urge the enactment of, appropriate legislation which would permit the deductibility for income tax purposes of contributions made to support revision of the Judicial Article of the Illinois State Constitution, and

Be it further resolved that said legislation be in the form of the bill submitted herewith, or in such modified form as may carry out the purpose of this Resolution, and

Be it further resolved that the position of the Executive Committee of the Federal Tax Section as represented by this Resolution, be brought to the attention of the Board of Governors of the Illinois Bar Association and that the Board of Governors be urged to make every effort to secure the enactment of the foregoing legislation.

Adopted unanimously by the Executive Committee of the Federal Tax Section of the Illinois State Bar Association, at a duly-called special meeting thereof held in Chicago, April 12, 1961, at which a quorum was present.

A BILL To amend section 170 of the Internal Revenue Code of 1954 with respect to certain civic organizations

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That section 170(c)(1) of the Internal Revenue Code of 1954 (relating to charitable contributions) is amended to read as follows:

"(1) A State, a territory, a possession of the United States, or any political subdivision of any of the foregoing, or the United States or the District of Columbia, or any organization created and operated exclusively to provide information and make recommendations as to the merits of proposals for the reorganization of the executive, judicial or legislative branches of the Government of any of the foregoing, but only if the contribution or gift is made for exclusively public purposes."

SEC. 2. The amendment made by the first section of this act shall apply to taxable years ending after the date of the enactment of this act.

CHARITABLE DEDUCTIONS FOR CONTRIBUTIONS FOR JUDICIAL REFORM IN ILLINOIS

The Illinois State Bar Association and the Chicago Bar Association are again recommending to the State Legislature and to the people of Illinois a proposed revision of the present Judicial Article of the Illinois Constitution. The Judicial Article under which the Illinois courts are now constituted and operated was adopted almost 100 years ago and has not been revised since; the vast changes which have taken place in Illinois during the last century have made the court system, as established in the 1870 Constitution, wholly outmoded and inadequate to meet the current needs of the State. As Albert J. Harno, Court Administrator of Illinois and former Dean of the University of Illinois College of Law, has said: "Our judicial framework, with its multiplicity of courts, which often overlap in jurisdiction, each operating in administration in its own orbit, demands immediate attention. The present system is confusing, it produces delays in justice, and it is needlessly expensive."

Vigorous efforts were made by the Illinois Bar and other civic-minded groups in 1953, 1955, and 1957 to obtain the adoption of a modernized Judicial Article in the State Constitution, but all were unsuccessful. With the passage of time, it has become even more necessary that constitutional reform be adopted in this area. To this end, and for the purpose of obtaining the funds needed to educate and inform the Illinois voters as to the facts involved in judicial reform, it is believed essential that public contributions to the advancement of this cause be granted income tax deductibility as charitable contributions.

In the prior efforts for the constitutional revision of the judicial article, the Illinois Committee for Constitutional Revision, Inc., an Illinois not-for-profit corporation, was active in publicizing the need for reform and in urging the support of the public therefor. In connection with these operations through 1958, favorable rulings had been issued by the Internal Revenue Service, holding that contributions made to the Illinois committee were deductible as charitable contributions under the provisions of section 170 of the 1954 code. However, in 1958 the Revenue Service changed its position with regard to the status of the Illinois Committee, and for the years after 1958, has refused to rule that contributions to such an organization would be deductible for income tax purposes. This position has apparently been based on the conclusion that the activities of the Illinois committee constituted "carrying on propaganda, or otherwise attempting, to influence legislation," in violation of the restriction in section 170(c)(2)(D). Equating a constitutional amendment to legislation, the Revenue Service reasoned in a 1958 revenue ruling (rev. rul. 58-255, 58-1 C. B. 91) that "inasmuch as a constitution is a general or fundamental law, an attempt to influence the adoption or rejection by the general electorate of a constitutional amendment is basically an attempt to promote or defeat legislation."

Subsequently, in 1959, the Supreme Court in *Cammarano* v. *U.S.*, 358 U.S. 498, applied a provision in the Treasury regulations under the 1939 code denying deductions for lobbying expenses to expenses incurred for the purpose of defeating an initiative measure on a prohibitions issue. Shortly thereafter the Internal Revenue Service gave a similarly broad interpretation to the statutory restriction against lobbying activities in section 170(c)(2)(D), and the applicable Treasury regulations were amended to state expressly that the term "legislation" in the statute included "action by the public in a referendum, initiative, constitutional amendment, or similar procedure," section 1.501(c)(3)-1 (c)(3). Accordingly, an organization created and operated for the principal purpose of constitutional revison, as is the case of the Illinois committee, would be excluded from the benefits of deductions for contributions made to it.

In order to correct this situation and to permit contributions from the general public to be deductible when made for the purpose of the reorganization of the

Illinois judicial system, the Illinois State Bar Association, through its board of governors, urges the Congress to adopt legislation along the lines of the bill attached hereto. This bill would amend section 170(c)(1) of the code to permit deductions for contributions made to a nonprofit organization created and operated exclusively to study and develop proposals for the reorganization of any of the three branches (executive, judicial, and legislative) of the State or local governments, to issue educational material with regard to such proposals, to make public recommendations and to seek the voters' support (or opposition) thereon.

The type of organization which this proposed legislation would cover is well illustrated by the Hoover Commission, as an organization whose sole purpose was to reorganize and modernize the executive branch of the Federal Government. While the Hoover Commission was established and supported by the Federal Government, it has been found necessary in Illinois for the bar associations, civic groups, and private citizens to develop and sponsor the reorganization of the State court system. Since the proposed legislation is directed at and limited to organizations whose objective is the reorganization of a branch of the Government, no association or private group sponsoring or lobbying for substantive legislation would be granted the benefits of tax deductibility. This limited objective is made even more clear by having the amendment incorporate within paragraph (1) of section 170(c), which now enumerates the governments and political subdivisions to which deductible contributions may be made, any nonprofit organization devoted to the improvement and modernization of such governments.

To be entirely equitable, the proposed bill would cover both organizations which sponsor reorganization plans as well as those which may oppose them. However, the present statutory restriction to the effect that all contributions under paragraph (1) must be "for exclusively public purposes" would also apply to the newly added organizations so that no deductions under the bill would be allowed for contributions made purely for private interests.

The type of reorganization proposal to be sponsored by the organizations covered by the bill may be accomplished either through constitutional amendments and other action necessary thereto in the case of situations where the State constitution contains restrictive provisions requiring revision as in the case of Illinois with regard to judicial revision, or through legislation, initiative, and referendum in those situations where only such latter action is needed to effectuate the proposal.

In view of the fact that action on the Illinois constitutional proposal for judicial revision is anticipated at the current session of the State legislature and that the question of approval may be presented to the Illinois voters at the next general election in November 1962, it is very important for the administration of justice in Illinois that a strong educational program be undertaken immediately to assure the adoption of the program. Accordingly, the proposed legislation would be made effective with respect to all contributions made during taxable years ending after its enactment.

AMERICAN BAR ASSOCIATION

RESOLUTION ADOPTED BY THE HOUSE OF DELEGATES, FEBRUARY 20, 1962

Whereas it has long been a primary purpose of the American Bar Association to improve the administration of justice; and

Whereas there is a widespread interest and activity on the part of civic organizations as well as bar associations throughout the United States in reorganizing and modernizing State court systems and making them responsive to present-day needs by adopting legislation and constitutional amendments to that end; and

Whereas to accomplish such purpose it is necessary to conduct extensive research, publicity, and educational programs requiring substantial funds; and

Whereas experience in some States indicates that adequate funds for such activities cannot be obtained unless contributions therefor are deductible for Federal income tax purposes; and

Whereas there has been introduced in the 87th Congress of the United States legislation amending the Internal Revenue Code which would accomplish such result: Be it

Resolved, That the American Bar Association approves in principle S. 2716 (87th Cong., 2d sess.) introduced by Senator Dirksen of Illinois and H.R. 10080 (87th Cong., 2d sess.) introduced by Congressman Yates of Illinois, amending section 170(c)(1) of the Internal Revenue Code by allowing deductibility of contributions to any nonprofit organization created and operated exclusively to consider proposals for the reorganization of the judicial branch of governments to provide information, to make recommendations, or to seek public support or opposition as to such proposals, but only if the contribution is made for "exclusively public purposes," and the association favors the adoption of this legislation.

I hereby certify that the above is a true and correct copy of the resolution as adopted.

JOSEPH D. CALHOUN, *Secretary*.

Dated March 14, 1962.

THE CHICAGO BAR ASSOCIATION

RESOLUTION OF THE BOARD OF MANAGERS, MARCH 29, 1962

Whereas the organized bar of Illinois and civic groups throughout the State of Illinois, through an organization known as the Committee for Modern Courts, are engaged in a campaign for the adoption of a proposed revision of the present judicial article of the Illinois constitution; and

Whereas sustained efforts over a long period of years to obtain the adoption of a modernized judicial article resulted in failure by a narrow margin in 1958 to obtain the required two-thirds vote in the general election, even though contributions toward support of the campaign for its passage were then ruled to be deductible as charitable contributions for Federal income tax purposes; and

Whereas the Internal Revenue Service has ruled, in reliance upon recent court decisions and revised Treasury regulations, that contributions for such a purpose are no longer deductible; and

Whereas past experience in Illinois indicates that adequate funds for the educational program for judicial reform cannot possibly be raised without the stimulus of deductibility of such contributions; and

Whereas the urgency of the need for constitutional authority for improvement of the administration of justice in Illinois is so great that a contribution to an organization dedicated solely to this cause is well nigh equivalent to the payment of taxes to State and local governments, which are fully deductible; and

Whereas, section 8 of H.R. 10650, the Revenue Act of 1962, would expressly deny deductibility of a contribution with respect to the forthcoming referendum on the revised judicial article for Illinois, even though it might otherwise be an ordinary and necessary business expense: Be it

Resolved, That the Chicago Bar Association recommends that section 8 of H.R. 10650 be amended by adding thereto a new subsection (in conformity with S. 2716 (87th Cong., 2d sess.) introduced by Senator Dirksen and H.R. 10080 (87th Cong., 2d sess.) introduced by Congressman Yates) to amend section 170(c)(1) of the Internal Revenue Code of 1954 (relating to charitable contributions) to be effective with respect to taxable years ending after December 31, 1961, and to read as follows:

"(1) A State, a territory, a possession of the United States, or any political subdivision of any of the foregoing, or the United States or the District of Columbia, *or any nonprofit organization created and operated exclusively to consider proposals for the reorganization of the judicial branch of the Government of any of the foregoing, to provide information, to make recommendations, and to seek public support or opposition as to such proposals*, but only if the contribution or gift is made for exclusively public purposes."

RESOLUTION IN SUPPORT OF S. 2716, 87TH CONGRESS, 2D SESSION, 1962

Whereas efficient administration of justice is essential to the preservation of democratic government and freedom in America; and

Whereas judicial organization and procedure must be modernized and improved if the administration of justice is to keep pace with the needs of modern times; and

Whereas revisions of judicial articles of State constitutions are now scheduled to go to the voters in six States and other proposals for reorganization of the judicial branch of government by constitutional amendment or by legislation are in course of preparation in other States, the whole amounting to a nationwide movement for judicial reform; and

Whereas such judicial reform efforts cannot succeed without proper study, research, and evaluation, and without adequate opportunity for the voters to understand the need and the remedies proposed; and

Whereas an adequate research and public information program for that purpose cannot be carried on without substantial financial support: Now, therefore, be it

Resolved by the executive committee of the American Judicature Society, That the society favors and urges the enactment by Congress of S. 2716 providing that gifts and contributions to States or political subdivisions or to nonurofit corporations for research, study, and educational efforts in support of or in opposition to proposals for reorganization of the judicial branch of the government shall be deductible for Federal income tax purposes.

In witness whereof, the undersigned have set their signatures in certification of the foregoing resolution duly adopted by the executive committee of the American Judicature Society on April 1, 1962.

Attest

President and Chairman, Executive Committee.
Secretary and Executive Director.

NEW YORK, N.Y., *April 18, 1962.*

Mrs. ELIZABETH SPRINGER,
Chief Clerk, Senate Finance Committee,
New Senate Office Building, Washington, D.C.:

Pursuant to request of Mr. Louis A. Kohn, we desire the following added to the record in support of his testimony favoring S. 2716 and H.R. 10080 to permit deduction of contributions to court reform organizations.

Delay, overlapping jurisdiction, and obsolete courts in New York State have required 10-year fight for court reform. Expect several more years to complete our job. Raising funds is essential to support court reform. We believe that the slight loss of revenue to the Government in this connection is greatly outweighed by the urgent need to modernize the courts, which are the pillars of the American way of life.

DUNCAN ELDER,
Chairman Executive Committee, Committee for Modern Courts, Inc. (New York).

The CHAIRMAN. The next witness is Mr. John J. Ryan, of the Advertising Federation of America.

STATEMENT OF JOHN J. RYAN, ADVERTISING FEDERATION OF AMERICA

Mr. RYAN. Mr. Chairman and gentlemen, my name is John Ryan and I am general counsel for the Advertising Federation of America. This is an organization whose membership centers around 138 advertising clubs located in leading cities from the Atlantic seaboard as far west as Denver, with 20 national associations of advertisers, media, and advertising agencies represented on our board of directors. We have nearly 1,000 individual corporation members which are also representative of advertisers, agencies, and media.

In addition to all this, the Advertising Federation of America maintains close liaison with the Advertising Association of the West, an organization of 44 advertising clubs operating in the area between the West coast and Denver.

The Advertising Federation of America is not a trade association; it represents too many divergent interests to be that. But it is the organization which has carried on the fight for truth in advertising for over a half a century, which was the No. 1 sponsor of the Federal Trade Commission back in 1913, and was the father of the better business bureaus in this country a few years later. We have played a role of both critic and defender of this industry which is the catalyst that has triggered the union of American mass production and mass consumption to produce the greatest economy the world has ever known.

I should like to address myself to one and only one aspect of the bill before us; that is, its flat prohibition against the deduction of expenses lawfully incurred in publicly supporting or opposing or otherwise commenting to the general public on legislative matters or referendums even where it can be clearly demonstrated that such expenditures are an ordinary and necessary expense of a business.

The famous *Cammarano* case is the very prototype of the problem which this legislation fails to correct. In that case, you will remember, a beer distributor in the State of Washington made a contribution to a fund to defeat a statewide referendum that would have made beer distribution in Washington a State monopoly.

He deducted this expenditure as a business expense on the theory that if the referendum had prevailed, he would have been put out of business. Although the Supreme Court of the United States found that the amounts expended were "ordinary and necessary," in fact, essential to the very survival of the taxpayer's business, and that they otherwise met all the requirements for deductibility as a business expense, it held that the regulation of the Internal Revenue Service which prohibited the deduction of such an expense was valid and until legislation was introduced which would countermand that regulation, it went along with the regulation.

Since that time, approximately 20 Members of the National Legislature have introduced bills to correct this clearly inequitable situation and no less a personage than the Honorable Hale Boggs of Louisiana has introduced such legislation for the past two sessions. In 1960, the House Ways and Means Committee, by unanimous vote, approved the Boggs bill but unfortunately the session ended before the bill could be called up for a vote.

The report of the House Ways and Means Committee, which was prepared after a public hearing on the subject and a great deal of study and research into the history and the complications involved, set forth the reasons why the committee recommended this amendment to the tax law.

No small part of the report is devoted to a consideration of the difficulties involved in the fair administration of the existing law. On page 3 the report says:

> The administrative problems of a rule disallowing deduction for expenses incurred to influence legislation are such as to make very difficult administration on a uniform and nondiscriminatory basis.

As authority for this conclusion, the committee cites a letter received by it from the Treasury Department dated February 26, 1960, which reads in part as follows:

> Present law, particularly as it relates to the dues paid to trade associations, institutional advertising, and the grassroots type of lobbying expenditure, is difficult for the Internal Revenue Service to administer * * *.
>
> Unless the Internal Revenue Service were to devote disproportionate manpower from its basic collection function to policing this difficult and controversial area, it would seem that uniform enforcement would be an unattainable goal.

In summing up, the report had this to say:

> It seemed to your committee that if an expenditure is ordinary and necessary to the conduct of a taxpayer's trade or business and is lawful, it is unfair for the deduction to be disallowed just because the expense is incurred to influence legislation.

This seems to be about as fair a test for allowable deductions as could be devised and it is submitted that it is the only valid test that should be employed in determining whether an expenditure is or should be a deductible expense of a business.

Suppose the tax regulation read, "All ordinary and necessary expenses of a business may be deducted except moneys expended for payment of rent." I am sure no one would attempt to justify such a law and yet the bill before us employs just as arbitrary a test. The point is that if it would be unfair to prohibit a taxpayer from deducting money spent to protect his business from the weather, it is just as unfair to prohibit him from deducting money spent to protect his business from legislative dangers.

Commenting to the House committee on the test that should be employed to determine deductibility, the Department of Commerce made the following statement to the House Ways and Means Committee:

> It is our view that lawful expenditures by business enterprise to support or oppose legislation at all levels of government, when involving the interests of their particular businesses, should be deductible as ordinary and necessary expenses * * *.
>
> We feel that the sound policy would be to permit full deduction for all lawful expenditures that are related to the business of the taxpayer.

The time-honored test of deductibility has always been, "Is the expense ordinary and necessary in the business of the taxpayer?" And it needs no savant of the law to inform us that when an expenditure is made to prevent legislation that threatens economic life or the very existence of a taxpayer, it is, in fact, an ordinary and necessary expense.

We were very hopeful that the omnibus bill would contain a provision adopting this sound standard, but unfortunately it does not. We are informed that there were many Members of the House who wished to amend this section of the bill on the floor but were unable to do so because the House was operating under a "closed rule" and the Representatives could only vote for or against the bill as a whole. But we would like you gentlemen to know that we feel very strongly that there are principles involved in this measure which far transcend the amount of money involved and we are hopeful that this committee will amend this bill to insure the basic rights of citizens shall not be violated.

The basic rights I refer to, of course, are the constitutional rights of freedom of speech and the right of petition.

When the Founding Fathers spoke of the right of freedom of speech, they were concerned mostly with the right of a citizen to stand up in the Town Square and speak his mind to every citizen in the community, for generally by doing that he could reach every citizen in the community. Basically what he was guaranteed by the Constitution was the right to use the most effective means available to get across his message and, in doing so, he was free to attack his Government's policies, laws and leaders with impunity and immunity.

Today both the electorate and the elected have become so large and so diffuse that such limited personal appeals would have small impact.

Today only by employing the most far-reaching media, can the citizen's rights be expounded adequately and brought to the attention of even a limited segment of this great Nation of ours. To deny the citizens that right to employ the public press, radio, and television to express his grievance to his fellow countrymen, except at prohibitive cost, is to deny him both the right of freedom of speech and the right to petition effectively for a redress of grievances.

And when you tell a corporate person whose income tax rate is 52 percent of net earnings that he may not deduct the cost of such expression except out of whatever profits are left after the payment of taxes, you are imposing a fearful price on the exercise of these freedoms.

Freedom of the press can be attacked in two ways: either by outright censorship, or by the more devious method of taxation.

Of the two, the latter is unquestionably the greater danger because it is more difficult to recognize for what it is. The present Internal Revenue Service regulation which will become law by the passage of the bill before us is an example of this type of censorship by taxation.

The proponents of this legislation would disarm us by arguing that no direct tax is being levied here, that all this bill does is to disallow institutional advertising as a business expense.

This may not be absolute censorship but it takes no mathematician to realize that it is more than 50 percent censorship. And it may not be direct taxation in the accepted sense, but it is painfully evident that the taxpayer who tells the public that he can produce a better and cheaper product than his rival, the U.S. Government, is going to have a much bigger tax to pay at the end of the year if that rival happens to be the U.S. Government instead of the XYZ Corp. down the block.

Let us bear in mind that the first amendment does not guarantee that the citizen shall have the right to say one-half of what is on his mind without fear or favor. Freedom of speech is an absolute guarantee of the Constitution. There are no degrees of freedom of speech spoken of in the Constitution. You either have it or you don't have it. Under this bill we will have it at a price and, if only those who can afford it can enjoy it, then we as a nation haven't got it at all.

Hard cases make hard laws, we are told. And perhaps hard times make for hard taxes. But, however great the need for tax money, it should never be procured at the cost of the sacrifice of the liberties of any of our citizens.

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

Any questions?

Senator BENNETT. No questions.

The CHAIRMAN. Thank you, sir.

(Mr. Ryan's prepared statement follows:)

STATEMENT BY HON. JOHN J. RYAN, GENERAL COUNSEL FOR THE ADVERTISING FEDERATION OF AMERICA

My name is John J. Ryan and I am general counsel for the Advertising Federation of America. I am appearing here as the representative of an organization whose membership centers around 138 advertising clubs located in leading cities from the Atlantic seaboard as far west as Denver, with 20 national associations of advertisers, media and advertising agencies represented on our board of directors, and nearly 1,000 individual corporation members which are also representative of advertisers, agencies, and media. Thus we combine under one roof all facets and phases of advertising—the advertiser, the agency, and media. In addition to all this, AFA maintains close liaison with the Advertising Association of the West, an organization of 44 advertising clubs operating in the area between the west coast and Denver.

AFA is not a trade association; it represents too many divergent interests to be that. But it is the organization which has carried the fight for truth in advertising for over half a century, which was the No. 1 sponsor of the Federal Trade Commission back in 1913 and was the father of the better business bureaus in this country a few years later. So we have been both critic and defender of this industry which is the catalyst that has triggered the union of American mass production and mass consumption to produce the greatest economy the world has ever known.

I should like to address myself to one and only one aspect of the bill before us; and that is, its flat prohibition against the deduction of expenses lawfully incurred in publicly supporting or opposing or otherwise commenting to the general public on legislation matters or referendums even where it can be clearly demonstrated that such expenditures are an ordinary and necessary expense of a business.

The bill as drawn forbids such deductions for this most open and above board type of lobbying wherein the taxpayer proclaims his point of view openly and publicly, to all of his fellow citizens and asks their support, but at the same time it authorizes the deduction of what might be described as "private" lobbying expenses, the kind more susceptible to the secret practices which in the past have given people the impression that there is something evil per se about lobbying and lobbyists. This is a strange and unrealistic approach to this problem which has vexed the Internal Revenue Service for many years.

The famous *Cammarano* case is the very prototype of the problem which this legislation fails to correct. In that case, you will remember, a beer distributor in the State of Washington made a contribution to a fund to defeat a statewide referendum that would have made beer distribution in Washington a State monopoly. He deducated this expenditure as a business expense on the theory that if the referendum had prevailed, he would have been put out of business. Although the Supreme Court of the United States found that the amounts expended were "ordinary and necessary," in fact essential, to the very survival of the taxpayer's business, and that they otherwise met all the requirements for deductibility as a business expense, it held that the regulation of the Internal Revenue Service which prohibited the deduction of such an expense was valid and it felt bound to enforce it in the absence of legislative enactment to the contrary.

Since that time over a dozen legislators have introduced bills to correct this clearly inequitable situation and no less a personage than the Honorable Hale Boggs of Louisiana has introduced such legislation for the past 2 years. In 1960 the House Ways and Means Committee, by unanimous vote, approved the Boggs bill but unfortunately the session ended before the bill could be called up for a vote.

The report of the House Ways and Means Committee, which was prepared after a public hearing on the subject and a great deal of study and research into the history and the complications involved, set forth the reasons why the committee recommended this amendment to the tax law.

No small part of the report is devoted to a consideration of the difficulties involved in the fair administration of the existing law. On page 3 the report says:

"The administrative problems of a rule disallowing deduction for expenses incurred to influence legislation are such as to make very difficult administration on a uniform and nondiscriminatory basis."

As authority for this conclusion, the committee cites a letter received by it from the Treasury Department dated February 26, 1960, which reads in part as follows:

"Present law, particularly as it relates to the dues paid to trade associations, institutional advertising, and the grassroots type of lobbying expenditure, is difficult for the Internal Revenue Service to administer. It is difficult, if not impossible, for the Internal Revenue Service, with its present manpower, to 'censor' or 'monitor' lobbying of the advertising or grassroots variety. Indeed, it has been the general position of the Internal Revenue Service that it is not only impracticable but undesirable to attempt to substitute the judgment of the tax collector for that of the businessman in determining the character of the advertising appropriate for the business * * *

"Unless the Internal Revenue Service were to devote disproportionate manpower from its basic collection function to policing this difficult and controversial area, it would seem that uniform enforcement would be an unattainable goal."

The Treasury Department then concludes,

"The Treasury recommends early consideration by the Congress of the various proposals designed to modify the ban to deduct the bar to deductibility of expenditures in connection with the legislative process."

The balance of the report is devoted to the question of policy involved. With regard to that, the report states:

"It seemed to your committee that if an expenditure is ordinary and necessary to the conduct of a taxpayer's trade or business and is lawful, it is unfair for the deduction to be disallowed just because the expense is incurred to influence legislation. Many have pointed out, for example, that expenditures to influence legislation or the outcome of a referendum may be necessary for the very survival of the taxpayer's business. This might be the case, for example, where a measure before the voters in a referendum would outlaw the taxpayer's business, as was the situation in the *Cammarano* case."

This seems to be about as fair a test for allowable deductions as could be devised and it is submitted that it is the only valid test that should be employed in determining whether an expenditure is or should be a deductible expense of a business.

Why should the Internal Revenue Service penalize a taxpayer for engaging in an activity which no other statute on the books condemns, particularly where said activity is plainly for the advancement of his own business? Gambling is illegal and so it is fair for the Internal Revenue Service to impose such penalties as it may desire on gambling profits. So too with income which is the result of unlawful activities. But here no unlawful activity is involved. Please note that the regulation does not specify that the lobbying must be unlawful or even unethical in nature.

Suppose the tax regulation read, "All ordinary and necessary expenses of a business may be deducted except moneys expended for the payment of rent." I am sure no one would attempt to justify such a law and yet the bill before us employs just as arbitrary a test. The point is that if it would be unfair to prohibit a taxpayer from deducting money spent to protect his business from the weather, it is just as unfair to prohibit him from deducting money spent to protect his business from legislative dangers, which might well be far more destructive to it than the weather.

Commenting to the House committee on the test that should be employed to determine deductibility, the Department of Commerce made the following statement:

"It is our view that lawful expenditures by business enterprise to support or oppose legislation at all levels of government, when involving the interests of their particular businesses, should be deductible as ordinary and necessary expenses. The impact of government has become so pervasive that businessmen and the organizations which represent their interests often find it necessary to convey to legislative bodies and to the public their views regarding existing or proposed legislation. Freedom of expression is an essential element of a free economy.

"It appears that a realistic solution to the problem will be found only in appropriate legislation changes. We feel that the sound policy would be to permit full deduction for all lawful expenditures that are related to the business of the taxpayer."

The time-honored test of deductibility has always been, "Is the expense ordinary and necessary in the business of the taxpayer?" And it needs no savant of

the law to inform us that when an expenditure is made to prevent legislation that threatens economic life or the very existence of a taxpayer, it is an ordinary and necessary expense. It is surely necessary and it is certainly ordinary for the Supreme Court has defined the term "ordinary" to mean that which is the accepted and common defense against attack. And, gentlemen, speaking out against legislation that is injurious to it is the only means of defense business has against such attacks.

We were very hopeful that the omnibus bill would contain a provision adopting this sound standard, but unfortunately it does not. We are informed that there were many Members of the House who wished to amend this section of the bill on the floor but were unable to do so because the House was operating under a "closed rule" and the Representatives could only vote for or against the bill as a whole. But we would like you gentlemen to know that we feel very strongly that there are principles involved in this measure which far transcend the amount of money involved and we are hopeful that this committee will come to understand how fundamental are the principles herein involved and, understanding them, amend this bill to insure that the basic rights of citizens shall not be violated.

The basic rights I refer to are the constitutional rights of freedom of speech and the right of petition.

When the Founding Fathers spoke of the right of freedom of speech they were concerned mostly with the right of a citizen to stand up in the town square and speak his mind to every citizen in the community, for generally by doing that he could reach every citizen in the community. Basically what he was guaranteed by the Constitution was the right to use the most effective means available to get across his message and, in doing so, he was free to attack his Government's policies, laws and leaders with impunity and immunity.

Today both the electorate and the elected have become so large and diffuse that such limited personal appeals would have small impact. Today only through paid advertising and publicity, employing the most far-reaching media, can the citizen's rights be expounded adequately and brought to the attention of even a limited segment of the community, local or national. To deny the citizen the right to employ the public press, radio and television to express his grievances to his fellow countrymen, except at prohibitive cost, is to deny him both the right of freedom of speech and the right to effectively petition for a redress of grievances.

And when you tell a corporate person whose income tax rate is 52 percent of net earnings that he may not deduct the cost of such expression except out of whatever profits are left after the payment of taxes, you are imposing a fearful price on the exercise of these freedoms.

The language of section 3(e) of the proposed legislation is quite specific. The taxpayer has no remedy even though the legislation or referendum he wishes to complain about directly affects his business and what it doesn't say but what is implicit in its bald language is that he has no recourse even though the very legislation he would protest against will destroy him. Here indeed is the fulfillment of the prophesy inherent in the warning, "The power to tax is the power to destroy."

Freedom of the press can be attacked in two ways; either by outright censorship or by the more devious method of taxation. Of the two, the latter is unquestionably the greater danger because it is more difficult to recognize for what it is. The present Internal Revenue Service regulation which will become law by the passage of the bill before us is an example of this type of censorship by taxation.

The proponents of this legislation would disarm us by arguing that no direct tax is being levied here, that all this bill does is to disallow institutional advertising as a business expense.

This may not be absolute censorship but it takes no mathematician to realize that is is more than 50-percent censorship. And it may not be direct taxation in the accepted sense but it is painfully evident that the taxpayer who tells the public that he can produce a better and cheaper product than his rival, the U.S. Government, is going to have a much bigger tax to pay at the end of the year than if he confined himself to telling the public that he offers a better deal than his rival, the XYZ Corp. Let us bear in mind that the first amendment does not guarantee that the citizen shall have the right to say one-half of what is on his mind without fear or favor. Freedom of speech is an absolute guarantee of the Constitution. There are no degrees of freedom of speech spoken of in

the Constitution. You either have it or you don't have it. Under this bill we will have it at a price and, if only those who can afford it can enjoy it, then we as a nation haven't got it at all.

Gentlemen, we all know that our democratic system of government is based on the premise that given a free forum for all opinion, truth will inevitably prevail over error, but we know too that for this system to work, there must be complete freedom to speak for all. If we limit this freedom by either absolute prohibition or by the placing of obstacles in its path in the form of burdensome taxation or restrictive licensing, we will destroy this system of democracy.

Hard cases make hard laws, we are told. And perhaps hard times make for hard taxes. But, however great the need for tax money, it should never be procured at the cost of the sacrifice of the liberties of any of our citizens.

The CHAIRMAN. The next witness is Mr. Paul Manns, the Press Committee To Eliminate Censorship by Taxation.

STATEMENT OF PAUL MANNS, PRESS COMMITTEE TO ELIMINATE CENSORSHIP BY TAXATION

Mr. MANNS. Mr. Chairman, Senator Bennett, my name is Paul Manns. I live in Bowling Green, Va. I am editor and publisher of weekly newspapers in three adjoining counties in Virginia about midway between Washington, D.C., and Richmond. My three newspapers are: The Caroline Progress of Bowling Green, the King George News, of King George; and the Westmoreland News of Montross. A few years ago I was president of the Virginia Press Association.

The Press Committee to Eliminate Censorship by Taxation, for whom I am appearing here today, was organized just over a year ago in the spring of 1961. It is a very informal organization with 205 editors and publishers from 42 States who signed up as members. With the chairman's permission, I will furnish a list of the names of the newspapermen who signified their desire to serve on this Committee.

(The list referred to follows:)

PRESS COMMITTEE TO ELIMINATE CENSORSHIP BY TAXATION

Alabama: Dick Smith, publisher, Sumter County Journal, York, Ala.

Alaska:
- George C. Anderson, publisher, the Alaska Spotlight, Box 116, Anchorage, Alaska.
- Theodore O. Schmidtke, the Frontiersman, Box D, Palmer, Alaska.

Arizona:
- James A. Hamra, publisher, Peoria Times and Valley Farm News, Peoria, Ariz.
- Warren E. Morrell, publisher, the Glendale News, Glendale, Ariz.

Arkansas:
- R. W. Chowning, editor, Banner-News, 537 East Main, Magnolia, Ark.
- W. M. Courtney, editor, Wynne Progress, Post Office Box 310, Wynne, Ark.
- H. H. Harris, editor, Courier-News, Box 380, Blytheville, Ark.
- Perrin Jones, publisher, Searcy (Ark.) Daily Citizen, Searcy, Ark.
- Ray Kimball, publisher, De Queen Daily Citizen, DeQueen, Ark.
- Calvin Mannen, editor, the Daily Leader, Stuttgart, Ark.
- John R. Newman, editor, Harrison Daily Times, Harrison, Ark.
- Laud Payne, editor and publisher, the Piggott Banner, 123 South Second, Piggott, Ark.
- Ellis W. Ramsey, publisher, Beebe News, 207 North Main, Beebe, Ark.
- Van A. Tyson, publisher, the Atkins Chronicle, Atkins, Ark.
- Fred A. Wulfekuhler, editor and publisher, Paragould Daily Press, Paragould, Ark.

California:
Herbert L. Beierle, editor-publisher, the Newark Sun, 54 Lewis Center, Newark, Calif.
Mark H. Edwards, editor-publisher, Santa Paula News, Post Office Box 390, Santa Paula, Calif.
Mark H. Edwards, editor-publisher, Santa Barbara Star, Ventura County News, Galeta Valley Times, Oxnard News, Post Office Box 390, Santa Paula, Calif.
R. Robert Evans, publisher, Shafter Press, Post Office Box A, Shafter, Calif.
Norman B. Foster, Barnes Chase Co., San Diego, Calif.
Max Goodwin, publisher, Lemon Grove Review, 7834 Lester Street, Lemon Grove, Calif.
Francis E. Howard, publisher-printer, Inter Mountain News, Post Office Box 295, Fall River, Mills, Calif.
John Hudson, publisher, Lucerne Valley Leader, Post Office Box X, Lucerne Valley, Calif.
Hal W. Hunt, editor-publisher, Shasta County Chronicle, Box 677, Burney, Calif.
Carlyle Reed, Union-Tribune Publishing Co., 919 Second Avenue, San Diego, Calif.
Hamilton V. B. Riggs, publisher, Fillmore Herald, Post Office Box 727, Fillmore, Calif.
Frank H. Wisner, editor and publisher, Tri-Valley Newspapers, Inc., 99 Glenn Drive, Camarillo, Calif.

Colorado:
Milton H. Booth, Arkansas Valley Journal, La Junta, Colo.
Frank S. Hoag, Jr., publisher, Star-Journal Chieftain, Pueblo, Colo.
John Jameson, publisher, Englewood Herald, Box 89, Englewood, Colo.
Walt McKinstry, Jr., publisher, Grit-Advocate, Julesburg, Colo.
Bus Tarbox, Golden Transcript, Golden, Colo.
Preston Walker, publisher, Sentinel Publishing Co., Grand Junction, Colo.

Connecticut:
Myles Standish, Norwich Morning Bulletin, 66 Franklin Street, Norwich, Conn.
Luis J. A. Villalon, editor, the Town Crier, Box 30, Westport, Conn.

Delaware:
Ralph Grapperhaus, Delmarva News, Selbyville, Del.
W. Wright Robinson, Leader-News, Post Office Drawer 771, Seaford, Del.
Jack Smyth, editor-publisher, Delaware State News, 10 North Street, Dover, Del.

Florida:
Jack W. Gore, Fort Lauderdale News, Fort Lauderdale, Fla.
Sam D. Melson, publisher, Chronicle, Chronicle Building, Box 4607, Jacksonville, Fla.

Georgia:
M. R. Ashworth, publisher, Ledger-Enquirer, Columbus, Ga.
DuPree Jordan, Jr., president and chairman, Jordan Enterprises Weekly Newspapers, Atlanta, Ga.
E. W. Mathews, publisher, Cordele Dispatch, Cordele, Ga.
Homer M. Rankin, publisher, Daily Tifton Gazette, Tifton, Ga.

Idaho:
Everett A. Colley, publisher, Owyhee Chronicle, 20 East Idaho Avenue, Homedale, Idaho.
Adam J. Kalb, publisher, Free Press, Post Office Box 111, Nampa, Idaho.
Harry N. Nelson, editor and publisher, American, Weiser, Idaho.
L. E. Pietsch, copublisher, Sandpoint News-Bulletin, Sandpoint, Idaho.

Illinois:
Martin Brown, manager, Cairo Evening Citizen, Cairo, Ill.
John Kilpatrick, publisher, Industrial News, 3304 West 63d Street, Chicago, Ill.
Donovan M. Kramer, publisher, Fairbury Blade, Fairbury, Ill.
Frank R. Mills, editor, Chronicle-Herald, Hoopeston, Ill.
Roy R. Rucker, editor-publisher, Leader, Bridgeport, Ill.
Robert E. Shaw, co-publisher Dixon Evening Telegraph, Dixon, Ill.
Edward A. Taylor, publisher, the Pulaski Enterprise, Mounds, Ill.
Joseph G. Velna, editor, Community Reporter Newspapers, 4072 West 26th Street, Chicago, Ill.

Indiana:
- John Backes, managing editor, the Washington Daily Times, Washington, Ind.
- Claude Billings, publisher, the Akron News, Akron, Ind.
- George L. Carey, publisher, the Daily Clintonian, 422 South Main, Clinton, Ind.
- Chester W. Cleveland, publisher, Indiana Business and Industry, Culver, Ind.
- Artley D. Cullum, publisher, Mentone News, Mentone, Ind.
- Robert G. Huneke, editor, the Herald-Tribune, Post Office Drawer 89, Batesville, Ind.
- Eugene N. Marten, president, LaGrange Standard-LaGrange News, Box 148, LaGrange, Ind.
- James T. Neal, editor, Noblesville Daily Ledger, Noblesville, Ind.
- W. A. Vance, publisher, Journal-Review, Crawfordsville, Ind.
- Everett White, publisher, the Richland Press, 813 East Summit, Attica, Ind.

Iowa:
- John D. Baldridge, publisher, Chariton Leader, 815 Braden Avenue, Chariton, Iowa.
- J. R. Gallagher, editor and copublisher, Belmond Independent, Belmond, Iowa.
- Henry B. Hook, publisher, the Morning Democrat, Davenport, Iowa.
- M. P. Kruse, editor, Cedar Valley Daily Times, Vinton, Iowa.
- J. W. McCutcheon, editor, Hawkeye-Record, Mt. Vernon, Iowa.

Kansas:
- Frank D. Boyd, publisher, the Citizen, Overbrook, Kans.
- Jess Denious, Jr., publisher, Daily Globe, Dodge City, Kans.
- Dwight Payton, publisher, Ellsworth Messenger, Ellsworth, Kans.
- Sam Shade, editor and publisher, Sedan Times-Star, Box F, 117 North Chautauqua, Sedan, Kans.
- Park Wilcox, publisher, the Democrat, 101 West Central, Wichita, Kans.

Kentucky:
- W. T. Davis, editor-publisher, Lyon County Herald, Eddyville, Ky.
- Douglas Galbraith, publisher, the Paintsville Herald, Inc., Paintsville, Ky.
- Alfred Jones, editor, News-Democrat, Main Street, Carrollton, Ky.
- Percy H. Landrum, publisher, the Ohio County News, Box 45, Hartford, Ky.

Louisiana:
- Marcel M. Bienvenu, publisher, Tache News, Post Office Box 31, St. Martinville, La.
- Nathan Bolton, publisher, Bastrop Daily Enterprise, Bastrop, La.
- Robert D. Miller, publisher, the Jennings Daily News, Post Office Box 910, Jennings, La.
- John R. Thistlethwaite, editor-publisher, Daily World, Opelousas, La.

Maryland: Dr. John R. Steelman, publisher, Suburban Record, Silver Spring, Md. (Cochairman of press committee.)

Massachusetts:
- William G. Coulter, Clinton Daily Item, Clinton, Mass.
- Leonard D. Wood, Arlington Advocate, Arlington, Mass.

Michigan:
- Jackson C. Gorlsby, publisher, Antrim County News, Bellaire, Mich.
- Walt Rummel, publisher, Blade-Crescent, Sebewaing, Mich.

Minnesota:
- W. S. Adams, editor, the Roseau Times-Region, Roseau, Minn.
- Elmer V. Engberg, manager, the Progress-Register, 417 Hennepin Avenue, Minneapolis, Minn.
- Lem Kaercher, publisher, Ortonville Independent, Ortonville, Minn.
- Mrs. Frieda J. Monger, editor and publisher, Duluth Publicity, 409 Lyceum, Duluth, Minn.
- Claude N. Swanson, Box 422, Fairmont, Minn.

Mississippi:
- Powell Glass, Jr., editor, Sea Coast Echo, Box 280, Bay Saint Louis, Miss.
- Charles R. Jacobs, publisher, Leader-Times, Post Office Box 551, Brookhaven, Miss.

Missouri:
- C. L. Blanton, 205 South New Madrid, Sikeston, Mo.
- Frank W. Farmer, publisher, the Sweet Springs Herald, 205 Lexington Avenue, Sweet Springs, Mo.
- Frank H. Hollmann, editor and manager, the Warrenton Banner, Warrenton, Mo.
- Phil Shade, publisher, Advertiser-News, Lexington, Mo.
- T. Ballard Watters, editor and publisher, the Marshfield Mail, Marshfield, Mo.
- Stanley E. White, manager, Lamar Democrat, Lamar, Mo.

Montana:
- K. A. Eggensperger, publisher, Sanders County Ledger, Thompson Falls, Mont.
- Sam Gilluly, publisher-manager, Montana Citizen, Helena, Mont.
- Chet F. Kavanagh, publisher, Independent-Observer, Conrad, Mont.
- R. E. Poe, editor, Yellowstone News, Billings, Mont.
- Frank A. Whetstone, Cut Bank Pioneer Press, Cut Bank, Mont.

Nebraska:
- Jerry Huse, publisher, the Norfolk Daily News, Norfolk, Nebr.
- Mrs. E. C. Leggett, publisher, Ord Quiz, Ord, Nebr.
- W. H. Plourd, publisher, Nance County Journal, Fullerton, Nebr.
- J. Hilton Rhoades, editor and publisher, Enterprise, Blair, Nebr.
- Richard J. Sheehan, editor, Bellevue Press-Sarpy County Gazette, 2217 Franklin Street, Bellevue, Nebr.
- W. A. Stauffer, editor, News-Times, York, Nebr.
- Floyd C. Wisner, Daily Star-Herald, Scottsbluff, Nebr.
- Warren C. Wood, publisher, Gering Courier, Gering, Nebr.

New Hampshire:
- Edward S. Seavey, Jr., editor, Hampton Union, 575 Lafayette Road, Hampton, N.H.
- Harry B. Thayer, Jr., Exeter News Letters, Exeter, N.H.

New Jersey:
- Chris M. Parson, editor and publisher, the Observer, 44 West Church Street, Blackwood, N.J.
- Don Robinson, editor and publisher, American Press, Stanton, N.J.

New Mexico:
- Orville E. Priestley, editor, the Sun-News, Las Cruces, N. Mex.
- Edwin M. Stanton, News Chieftain, Albuquerque, N. Mex.
- The Torrance County News, Mountainair, N. Mex.
- The Catron County Reporter, Reserve, N. Mex.
- The Sandoval County Journal, Bernalillo, N. Mex.
- Robert L. Summers, publisher, Hobbs Daily News-Sun, Hobbs, N. Mex.

New York:
- Frank C. Forbes, president, Weekly Newspaper Representatives, Inc., 404 Fifth Avenue, New York, N.Y.
- Mrs. Denny S. Griswold, editor and publisher, Public Relations News, 815 Park Avenue, New York, N.Y.
- Robert Hall, publisher, Warrensburg News, Warrensburg, N.Y.
- Edward M. Herrschaft, publisher, Kings County Chronicle-Queens County Post, 175 Shepherd Avenue, Brooklyn, N.Y.
- Howard E. Silberstein, editor and publisher, Catskill Daily Mail, Catskill, N.Y.
- A. J. Smitherman, editor and publisher, the Empire Star, 234 Broadway, Buffalo, N.Y.

North Carolina:
- David E. Gillespie, editor, Shelby Daily Star, Shelby, N.C.
- L. Barron Mills, Jr., editor and publisher, the Randolph Guide, Post Office Box 511, Asheboro, N.C.
- Spencer Murphy, editor, the Post, Salisbury, N.C.
- J. Mayon Parker, editor, the Herald, Ahoskie, N.C.

North Dakota:
- Grant M. Helgeson, publisher, Hankinson News, Hankinson, N. Dak.
- Harry E. Polk, editor and publisher, Williston Herald, Williston, N. Dak.

Ohio:
- Clarence J. Brown, Jr., publisher, Urbana Daily Citizen, 225 South Main Street, Urbana, Ohio.
- M. M. Ferguson, editor-publisher the Sentinel Herald, 5716 Summit Street, Sylvania, Ohio.
- Frank W. Spencer, editor and publisher, The Advocate, Newark, Ohio.
- Robert B. Wallace, editor, The Tribune, Coshocton, Ohio.

Oklahoma:
- Brooks H. Bicknell, editor and publisher, The Alva Review-Courier, Box 331, Alva, Okla.
- Ed Burchfiel, Daily Democrat, Pauls Valley, Okla.
- Bruce Carnett, publisher, Sand Springs Leader, Box 397, Sand Springs, Okla.
- Billy W. Denson, publisher, Ellis County Capital, Arnett, Okla.
- Wayne S. Jefferies, owner and publisher, Dewey Herald-Record, Box 339, Dewey, Okla.
- J. L. Jennings, editor, Examiner-Enterprise, Bartlesville, Okla.
- W. D. Little, editor, The Ada (Okla.) Evening News, Ada, Okla.
- Ed Livermore, editor, Sapulpa Daily Herald, Sapulpa, Okla.
- Perry E. White, publisher, the Big Pasture News, Box 328, Grandfield, Okla.
- David L. Wire, news editor, Northwest News, Box 186W, Oklahoma City, Okla.

Oregon:
- Philip N. Bladine, publisher, the News-Register, Post Office Box 510 McMinnville, Oreg.
- Morgan Coe, publisher, Astorian-Budget, Post Office Box 210, Astoria, Oreg.
- Elmer R. Price, Lincoln County Leader, Post Office Box 816, Toledo, Oreg.
- Tom Straub, publisher, the Lane Reporter, Fall Creek, Oreg.
- L. T. Ward, publisher, Benton County Review, Post Office Box 518, Philomath, Oreg.

Pennsylvania:
- John A. DeRenzo, editor-publisher, Altoona American, Post Office Box 47, Altoona, Pa.
- S. Victor Freeston, editor, Easton Road Guide, 128 South Keswick Avenue, Glenside, Pa.
- W. M. Likins, editor, Coraopolis Record, 1000 State Avenue, Coraopolis, Pa.
- Mrs. W. D. Lillich, publisher, City and Suburban Life, 647 California Avenue, Avalon, Pittsburgh, Pa.
- Guy W. Paul, editor and publisher, the Courier, 605 Main Street, Bentleyville, Pa.
- James B. Werner, publisher, Somerset Democrat, Post Office Box 187, Somerset, Pa.
- A. S. Wilder, editor, Daily News, Lebanon, Pa.

South Carolina:
- Thomas P. Davis, editor and publisher, the Georgetown Times, Georgetown, S.C.
- J. L. Wiggins, editor and publisher, the Hartsville Messenger, Hartsville, S.C.

South Dakota: Donald Johannsen, publisher, Winner Advocate, 125 West Third, Winner, S. Dak.

Tennessee:
- John W. Finney, editor, the Daily Herald, Columbia, Tenn.
- W. T. Franklin, Jr., publisher, the Lexington Progress, 211 Broad Street, Lexington, Tenn.
- John Helms III, Daily Gazette-Mail, Morristown, Tenn.

Texas:
- LeRoy M. Anderson, Sr., editor, Denison Press, 926 West Sears, Denison, Tex.
- J. L. C. Beaman, publisher, the Duval County Facts, Gonzalez Building, San Diego, Tex.
- W. E. Berger, publisher, Hondo Anvil Herald, Box 218, Hondo, Tex.
- Joe R. Compton, publisher, Mount Enterprise Progress, Mount Enterprise Tex.
- James R. Dennis, publisher, Jacksboro Gazette-News, Box 578, Jacksboro, Tex.

Texas—Continued
- Gabe Garrett, publisher, Voice-Chronicle-Nueces Co. News, Flour Bluff Reporter, 1115 Kinney Avenue, Corpus Christi, Tex.
- Jack Howerton, publisher, Daily Record, Cuero, Tex.
- W. W. Kittley, editor, the Kerens Tribune, Post Office Box 188, Kerens, Tex.
- Fred C. Latcham, Jr., publisher, Beeville, Bee-Picayune, Beeville, Tex.
- J. O. Mahaffey, Texarkana Gazette and News, Texarkana, Tex.
- B. J. Morgan, Advertising, Manager, the Orange Grove Observer, Schmidt Building, Orange Grove, Tex.

Utah:
- C. W. Claybaugh, publisher, News & Journal, Brigham City, Utah.
- George E. Jones, publisher, San Juan Record, Box 428, Monticello, Utah.

Virginia:
- Richard F. Beirne, the Virginian, 311 Monroe Street, Covington, Va.
- Charles M. Keen, Jr., publisher and editor, News-Journal, Chester, Va.
- Paul W. Manns, editor and publisher, the Caroline Progress of Bowling Green, the King George News of King George, the Westmoreland News of Montross, Bowling Green, Va.
- E. Walton Opie, publisher, the Staunton Leader and Sunday News-Leader, Staunton, Va.
- A. Robbins, Jr., publisher, the Hopewell News, Hopewell, Va.
- Louis Spillman, editor and publisher, News-Virginian, Waynesboro, Va.
- W. L. Willis, Jr., editor, Henrico Herald, Box 340, Richmond, Va.

Washington:
- Ashley E. Holden, Sr., publisher, Tonasket Tribune, Post Office Box 518, Tonasket, Wash.
- J. Clifford Kaynor, publisher emeritus, Ellensburg Daily Record, 1003 Fourth Avenue, East Ellensburg, Wash.
- Bill Wilmot, Colfax Gazette, Colfax, Wash.
- Walt Woodward, publisher, the Bainbridge Review, the North Kitsap News, Post Office Box 147, Bainbridge Island, Wash.

West Virginia:
- Samuel D. Mason, editor and publisher, the Sentinel, Post Office Box 448, White Sulphur Springs, W. Va.
- Thomas W. Russell, the Daily Sentinel, Grafton, W. Va.

Wisconsin:
- William E. Branen, editor, Standard-Press, Burlington, Wis.
- Paul J. Creviere, general manager, De Pere Journal-Democrat, 126 South Broadway, De Pere, Wis.
- W. B. Chilsen, publisher, Daily Herald, Merrill, Wis.
- Walter E. Gleason, publisher, Clintonville Tribune-Gazette, 13 11th Street, Clintonville, Wis.
- Elmer S. Haumant, editor, Inter-County Leader, Oak Street and First Avenue, Frederic, Wis.
- Fritz Rathmann, publisher, Milwaukee County News, 4124 South Austin Street, Milwaukee 7, Wis.
- Francis F. Schweinler, editor and publisher, Times, Mosinee, Wis.
- John J. Shinners, editor and publisher, Times-Press, 730 Center Street, Hartford, Wis.
- Arnott Widstrand, Jr., editor and publisher, La Farge Enterprise, La Farge, Wis.

Wyoming:
- Lee R. Call, editor and publisher, Star Valley Independent, Afton, Wyo.
- Jack W. Perry, Casper Tribune Herald & Star, Casper, Wyo.

Mr. MANNS. The co-chairmen are Alex H. Washburn, editor of the Hope Star of Hope, Ark. and Dr. John R. Steelman, publisher of the Suburban Record of Silver Spring, Md. I was aked to testify because I am an editor and publisher who has been honored for many years by being privileged to serve in the Virginia House of Delegates. This experience has given me the opportunity of observing the problem we are considering from two different viewpoints. It is on this basis that I hope the testimony I shall give today will be helpful to the chairman and the members of the Senate Committee on Finance.

My appearance here is the result, in part, of professional interest in the subject I am prepared to discuss, but it is also inspired by strong personal convictions as a Jeffersonian Democrat. With such convictions it becomes a matter of duty to fight in defense of liberty, free speech, and the right of petition wherever these rights are endangered.

Section 3 of H.R. 10650 is certainly one of the least publicized portions of the 240-page bill now before you. Yet, the issue which it raises—the matter of a price tag on the right to petition—is as fundamental to the future of our country as any of the economic provisions of this legislation.

As it is now, the language of section 3 of the bill concerns itself with only one phase of the problem. It deals with the tax deductibility of expenses incurred for appearances in connection with the promotion or defeat of legislation. It does not establish deductibility for what the Internal Revenue Service chooses to call—

carrying on propaganda (including advertising) to influence the public with respect to the desirability of proposed legislation.

Section 3 authorizes deductions for all ordinary and necessary expenses in direct connection with appearances before, submissions of statements to, or sending communications to committees or individual members of any legislative body with respect to legislation of direct interest to the taxpayer.

It further allows a similar deduction for expenses in direct connection with communication of information between the taxpayer and an organization of which he is a member with respect to legislation of direct interest to the taxpayer and such organization. Deductibility also is provided for that portion of the dues paid to any organization of which the taxpayer is a member and which is attributable to the activities I have just described.

The passage of section 3 by the House of Representatives marks a step forward. It authorizes the tax deduction of all the ordinary and necessary expenses involved in bringing to the legislators information relative to legislation of direct interest to the taxpayer. Incidentally, the House quite properly prohibits the deduction of any amount paid or incurred for participation in any political campaign. Unfortunately section 3 goes on to prohibit, also, the deduction of any amount paid or incurred in connection with any attempt to influence the general public or segments thereof with respect to legislative matters or referendums. In other words, informing legislators is deductible but informing the general public or, more importantly, correcting misinformation to which the general public has been exposed is not deductible.

I am here today to support the idea behind section 3 of H.R. 10650 except for the very last limitation contained in subparagraph (B) which I have just discussed with you and to ask you to consider expanding on that idea. I urge that the provisions of this section be amended to include the provisions of the bill, S. 467, introduced jointly by two distinguished members of this great Senate Committee on Finance: Senator Hartke of Indiana and Senator Kerr of Oklahoma.

The Hartke-Kerr bill is essentially the same as H.R. 7123, originally introduced in the House during the 86th Congress by Representative Hale Boggs of Louisiana. You will remember that this legislation

was amended by the House Committee on Ways and Means and reported unanimously on July 1, 1960. Unfortunately it was too close to adjournment for further action and the bill never reached the floor of the House.

In the 87th Congress, legislation similar to the Boggs bill or the Ways and Means Committee bill has been introduced in the Senate by Senator Hartke and Senator Kerr and by Senator Capehart of Indiana. In the House, eight Members have recently introduced legislation to accomplish this same purpose. They are: Representative Teague, Democrat, of Texas, Boggs, Democrat, of Louisiana, Byrnes, Republican, of Wisconsin, Miller, Republican, of New York, Wilson, Republican, of California, Dooley, Republican, of New York, Pelley, Republican, of Washington, and the late Overton Brooks, Democrat, of Louisiana.

The need for legislation in this area is emphasized by the fact that there is at present no duly enacted law on the books to guide the taxpayer, the courts, or the Internal Revenue Service. Congress has never adopted any measure to lay down exact limits as to the deductibility of expenditures made to influence the passage or defeat of legislation.

All Congress has said—and the latest version appears as section 162(a) of the Internal Revenue Code of 1954—is:

There shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred * * * in carrying on any trade or business * * *

To the layman it might seem logical that a businessman who spends his business's money to oppose passage of legislation which would damage or destroy his business would be allowed to deduct as an expense the cost of fighting this battle for survival. This might even seem to be the intent of Congress.

But for many years, the Internal Revenue Service has disallowed deductions of gross income for expenses made for the purpose of influencing legislation even when the legislation affected the income and the continued existence of the business itself. Through stepped up enforcement and a succession of Treasury Department rulings culminating in an IRS regulation in December 1959, the Federal Government has imposed what amounts to censorship by taxation a price tag on the right to petition.

In the *Cammarano* and *Strauss* cases, decided jointly by the U.S. Supreme Court in 1959, the Treasury Department won a test of its regulations. Cammarano, a wholesale beer distributor in the State of Washington, contributed to defeat a referendum on the 1948 ballot which would have created a State monopoly, driving private businessmen completely out of the beer and liquor business. Strauss, a liquor wholesaler in the State of Arkansas, participated in organizing an association to oppose a statewide prohibition law which was voted on in the 1950 election. The Internal Revenue Service disallowed any deduction in either case and the Supreme Court upheld the IRS. There was no question in either case that the proposed legislation would have eliminated the business of the firms fighting the legislation. The Supreme Court decision did not dispute that point. Rather, it ruled against both taxpayers on the grounds that the failure of Congress to enact legislation correcting the succession of in-

terpretations given the law by the IRS was tantamount to congressional approval.

Actually, this could have happened to any business facing adverse legislation. I understand, for example, that the Italian Government has just banned all tobacco advertising. Could it happen here?

At a public hearing in November 1959, held at the request of some 50 organizations, representatives of newspaper associations, labor unions, business groups, legal organizations and medical groups opposed the proposed regulations. The rules were adopted as proposed without change despite virtually unanimous opposition during the hearings.

This, the current Internal Revenue Service regulation on the subject, 1.162–15(c), issued in December 1959, provides that—and I quote:

Expenditures for lobbying purposes, for the promotion or defeat of legislation, or for carrying on propaganda (including advertising) related to any of the foregoing purposes are not deductible from gross income, even though the legislation may directly affect the taxpayer's business.

Mr. Chairman, it is not fair to deny a businessman deductibility on expenses he must incur to save his very business. When the Supreme Court goes so far as to authorize a mail-order dentist to deduct as ordinary and necessary business expenses the legal costs of defending himself against a charge of postal fraud why shouldn't a businessman have a right to defend his business against unfavorable legislation which might ruin him. Are we to believe that if you defraud the public your defense costs are tax free but if you inform the public on a legislative issue you must pay a tax on your expenditure?

These tax penalties against freedom of expression and the right to petition were never enacted by Congress. Incidentally, I feel strongly that the right to enjoy a free press is the right of all the people, including advertisers. It should certainly not be subject to a tax penalty when exercised by others than editors, publishers and newsmen.

In the few minutes left to me I shall point out, first, why Congress should act by including the provisions of the Hartke-Kerr bill in the tax legislation now before you. Second, I shall try to answer, briefly, critics of this legislation who have developed two or three standard arguments which they usually advance to justify Congress in remaining mute on this subject.

Early in 1960 I was especially impressed with the plight of a fellow newspaperman, Alex H. Washburn, editor of the Hope Star, of Hope, Ark., and cochairman of the Press Committee To Eliminate Censorship by Taxation for whom I speak today. Alex Washburn started a vigorous crusade against an amendment to the State sales tax law which extended its provisions to apply to livestock and poultry feed. His campaign was motivated by a desire to protect his community and his own newspaper against possible loss of income resulting from the extension of the sales tax to a point where business would be driven across State lines to escape taxation. His expense for promoting a petition campaign for a popular referendum, about $6,000, was disallowed as ordinary business expense by the Internal Revenue Service. The Tax Court and the Eighth Circuit Court of Appeals both ruled against him and the Supreme Court, which has been acclaimed by some as a champion of individual liberty in other cases, refused to hear Alex Washburn's appeal.

The committee is undoubtedly familiar with the difficulties of the Timken Roller Bearing Co. which was informed by the Internal Revenue Service that it could not deduct as a business expense more than $1 million spent for institutional advertising. The advertising in question contained copy dealing with public issues, in some cases, but not with specific legislation. The series dealt with such matters as inflation, the menace of communism, and governmental spending.

Essentially the company used these ideas to attract attention to the advertisments, to build good will and to secure favorable notice. Yet, the IRS ruled that such public relations copy could not be published as a reasonable and necessary business expense. Had they used pictures of attractive girls to secure attention for their advertising everything would have been all right. But ideas—they were ruled nondeductible. Doesn't this suggest that if Congress fails to take affirmative action now, the Internal Revenue Service will feel constrained to act as a censor of advertising as well as a collector of taxes?

The Public Relations Journal, the monthly magazine of the Public Relations Society of America, carried an effective editorial in the August 1961 issue titled "Censorship by Taxation" which discusses in some detail the *Timken Roller Bearing Co.* case. The editorial concludes—and I quote:

> The Public Relations Journal sympathizes with the budget problems of the Treasury Department and its need to develop new and ever larger sources of revenue. But we believe Congress must make certain, by adequate legislation, that in the IRS zeal no inequities are created and no regulations interpreted in such a manner as to stifle freedom of expression.

Mr. Chairm[illegible] shall not take the valuable time of the committee to read this c[illegible] editorial but I would appreciate it if you would have it printed in full in the record of these hearings since it does represent the thinking of the major professional organization in the field of public relations.

The CHAIRMAN. Without objection.

(The document referred to follows:)

CENSORSHIP BY TAXATION

Of vital interest to all corporate advertisers, media advertising personnel and public relations practitioners is the suit recently filed by the Timken Roller Bearing Co. against the U.S. Government.

This suit is an attempt to recover $1,283,000 in taxes paid under protest as the result of the disallowance by the Internal Revenue Service of certain plant city advertisements as deductible business expense.

In the main these ads dealt with economic and political subjects which affect the welfare of the company, its employees and their communities. They did not advocate special legislation. They were disallowed under IRS regulations adopted less than 2 years ago after brief hearings at which virtually every witness testified against them.

The *Timken* case seems to confirm the doubts expressed at that time by C. James Proud, president and general manager, Advertising Federation of America, who described the proposed regulations as "loosely and ambiguously worded." Mr. Proud was especially farsighted when he observed, "almost every [institutional] advertisement could be considered as politically controversial if it happens to deal with any subject under the sun on which any member of government or a politician outside of government has uttered a single word."

IRS regulations presently in force and the rulings which stem from them may be interpreted to prohibit the deduction of any advertising expenditure which directly or indirectly tends to influence legislation.

Those who disagree with these regulations believe that Congress should pass definitive legislation to spell out clearly what sort of advertising or other activity is considered as directly influencing legislation and what is institutional or "good will" advertising and therefore a deductible expense.

For the public relations profession, the *Timken* case is an important sign-post, for the decision—and implications flowing from the decision—may have far-reaching effects upon activities other than advertising. Alarm has been expressed in some quarters that the IRS rulings as presently constituted might conceivably be applied to render the total cost of a public relations program non-deductible as a business expense.

While the Public Relations Society of America has been keeping its membership informed on this matter for over 3 years, other groups, including the Advertising Federation of America, American Association of Advertising Agencies, American Newspaper Publishers Association and the Chamber of Commerce of the United States have been equally interested in the 2 bills on this subject before the Senate and the 10 before the House, the best known of which is the Boggs bill, H.R. 640.

One group doing especially effective work in this field of securing legislation to offset the IRS rulings is the Press Committee To Eliminate Censorship by Taxation. It is composed principally of 250 grassroots newspaper editors and publishers. Its cochairmen are Alex H. Washburn, editor and publisher of the Hope (Ark.) Star, and Dr. John R. Steelman, publisher and owner, Suburban Record, Silver Spring, Md.

Some advocates of definitive legislation believe that the action of IRS amounts to censorship, since the disallowance of advertising for income tax purposes is an effective way of preventing it from being run. True, such ads may be run, entirely at the company's own expense. But in the opinion of many this puts a premium or penalty on free expression. Still others think there is an even larger question involved. They say that a business should have the right to speak out for or against proposed legislation, directly affecting that business, and have the action considered a legitimate and necessary cost of doing business.

At any rate, it seems evident that the present regulations lack clear-cut guidelines. This and the *Timken* case have made business extremely cautious about exercising a prerogative to speak on public issues.

G. D. Crain, Jr., president and publisher, Advertising Publications, Inc., writing in Industrial Marketing, pointed out that, "Until recently, political ads were defined to mean those which opposed or favored pending legislation, or opposed or favored candidates running for office. * * *

"To say that advertising which expresses an opinion on a subject of importance from an economic, social, or political standpoint is not a proper use of company funds in an arbitrary decision, but unfortunately, opposition to it requires long and expensive litigation.

"For that reason Congress should approve legislation, now pending, which OK's for income tax purposes, the use of advertising dealing with public affairs."

The Public Relations Journal sympathizes with the budget problems of the Treasury Department and its need to develop new and ever-larger sources of revenue. But we believe Congress must make certain, by adequate legislation, that in the IRS zeal no inequities are created and no regulations interpreted in such a manner as to stifle freedom of expression.

Mr. MANNS. Our committee is concerned primarily with the principles of individual liberty, free speech, freedom of the press, and the constitutional right to petition which are involved in this controversy. These principles are much more important than the impact of the economic penalties imposed on any business which tries to preserve its existence against crippling legislation. They far transcend the dollars-and-cents effect of such a regulation on the revenues of small newspapers, magazines, and trade associations.

In his great defense of Thomas Paine, Thomas Erskine pointed up these real issues when he warned:

The liberty of opinion keeps governments themselves in due subjection to their duties.

What is the ultimate danger if this regulation is carried to its logical end? It can become, as Fortune magazine called it, "a tax on criticism."

This taxing power can be used to prevent citizens from using mass media to inform their neighbors about governmental actions which threaten their very economic existence. This regulation actually gives to the Government the power to censor political views, or any views which the bureaucracy may construe as being political.

Institutional advertising will then deteriorate to the point where it dares only to be against sin and it had better be a nameless sin at that. As a witness pointed out at the Internal Revenue Service hearings, anti-inflation ads could be interpreted as being against new public works legislation; advertising on racial tolerance could be construed as being in favor of the passage of civil rights legislation.

Editor & Publisher sums up the danger well in their editorial of January 9, 1960:

> The free press guarantee of the Bill of Rights was designed to give everyone equal opportunity to write as they pleased and to use a printing press to disseminate those opinions about public affairs, legislation, etc. The guarantee no longer is operative if the Government can rule that the expression of certain opinions is taxable and the utterance of others is nontaxable. Once the precedent is established there will be nothing to prevent an extension of the ruling to enlarge the "taxable opinions"—those opinions about public affairs, governmental procedure, and legislation which may not be uttered without penalty of taxation by the Government.

Mr. Chairman, would it be possible to have that editorial from Editor & Publisher and its sequel on January 16, together with their editorial of March 19, 1960, entitled "Where There's Hope"—based on the decision in the *Alex Washburn* case—included in the record of this hearing?

The CHAIRMAN. Without objection.

(The documents referred to follow:)

[From Editor & Publisher, Jan. 9, 1960]

CENSORSHIP BY TAXATION

As predicted by the Advertising Federation of America (Editor & Publisher, Dec. 19, p. 68) the Internal Revenue Service has adopted a rule making expenditures for lobbying, political campaigns, and other "propaganda" advertising nondeductible as business expenses for income tax purposes. This has been done arbitrarily by IRS without waiting for the requests of congressional hearings on the subject or the fate of several bills pending before Congress.

In our opinion this ruling is un-American if not unconstitutional. Because of our severe income tax laws it gives the Government the power to censor political views by taxation. Only the wealthy will be able to express views on pending legislation through mass media even if the proposed statute means financial disaster to them.

The free press guarantee of the Bill of Rights was designed to give everyone equal opportunity to write as they pleased and to use a printing press to disseminate those opinions about public affairs, legislation, etc. The guarantee no longer is operative if the Government can rule that the expression of certain opinions is taxable and the utterance of others is nontaxable. Once the precedent is established there will be nothing to prevent an extension of the ruling to enlarge the "taxable opinions"—those opinions about public affairs, governmental procedure, and legislation which may not be uttered without penalty of taxation by the Government.

[From Editor & Publisher, Jan. 16, 1960]

CENSORSHIP BY TAXATION

The Internal Revenue Service ruling prohibiting as deductible business expenses any advertising expenditures for the promotion or defeat of legislation or other "propaganda" purposes is clearly censorship by taxation.

IRS says "sure, you can spend your money for such advertising but you can't deduct it as a business expense even if the Government action or the legislation discussed in the advertising threatens to put you out of business."

We would like to propose a test case. Let's get some fearless Congressman to introduce a constitutional amendment to change the Bill of Rights. Every publication in the country, in fact all media, would hop on this and oppose it editorially and probably in display space. This opposition to legislation would cost money for publishers and broadcasters. It is the same as if an advertiser bought time or space to oppose legislation affecting his business. Would this opposition of media to legislation be considered "propaganda" by IRS?

[From Editor & Publisher, Mar. 19, 1960]

EDITORIAL: WHERE THERE'S HOPE

In all of the discussion on the Internal Revenue Service rulings which result in curbing business expenditures for opinion advertising, nothing has hit home with such impact as the Tax Court's decision against A. H. Washburn of the Hope (Ark.) Star.

Mr. Washburn crusaded to obtain a vote by the people on a question of a State sales tax—only to find that he must write off the expense (about $6,000) as a bread-and-butter item. He can't charge it up to "ordinary business expenses" and claim it as a deduction in figuring his income tax.

The editor's campaign was prompted by a desire to protect himself and the newspaper against possible loss of income if a higher sales tax were imposed to make up for what he considered an unjustifiable exemption on a certain group of producers. He was right, too; the tax was hiked. The court record does not show any evidence of harm to the Star, up to this point, but that's immaterial now. In the opinion of the judge, the editor's fears of depreciation or hopes of an enhancement in income were too remote to be considered.

Since the Supreme Court had spoken on such matters in the *Cammarano* case, the Tax Court relied on the precedent which grew out of a claim by liquor dealers for deductibility of expenses in seeking a referendum on legislation affecting their business. This is the same authority cited by IRS in defending its regulations which declare that advertising expenditures of public utility firms, for example, when they oppose public ownership plans, are not ordinary and necessary business expenses.

The entire question of tax allowance for "lobbying" expenses, including advertising costs, is on the agenda of the House Ways and Means Committee which has already held hearings. The American Newspaper Publishers Association argued that nondeductibility amounted to censorship of ideas.

Our advices from Washington this week were that a floodtide of grassroots pressure will be needed to get any of the corrective bills—six in the House and one in the Senate—out onto the floor before adjournment of this session. Representative Hale Boggs, Louisiana Democrat, has made a strong plea for his bill on the ground that Congressmen rely on opinion ("lobby") advertising for indications of back-home sentiment.

We're glad the *Washburn* case decision came at this time. The Star's predicament throws new light on a good cause. Where there's Hope, Congress won't let democratic ideals die.

Mr. MANNS. Those who oppose legislation to remove the price tag from the right to petition generally base their argument on the premise that substituting a bill such as S. 467 for section 3 of H.R. 10650 would give business or other fully taxable profitmaking organizations an advantage over the ordinary citizen insofar as opposing or supporting legislation is concerned. This argument is not valid when directed against such legislation for several reasons.

First, the average citizen does not ordinarily oppose legislation by taking advertisements in a newspaper. He can organize committees, recruit volunteers, circulate petitions and organize protest meetings which will be of sufficient news value to be well covered by the press. Many of these avenues of expression are not directly open to the busi-

ness corporation in the same degree even when the business itself is threatened by legislation.

Second, neither an individual nor a business can deduct any expense not directly related to the production of taxable income. The Federal income tax law taxes the net income of a business operation arrived at by deducting from gross income the cost of raw materials, reserves for depreciation and bad debt, and all ordinary and necessary business expenses. Personal expenses are not deductible for income tax purposes.

For example, under existing tax law, a corporation or an individual owning rental housing may deduct the cost of repainting one of these rental houses. A poor widow may not deduct the cost of repainting the house which she owns and occupies. It is not a business expense. Deductibility does not depend entirely on whether something is good or bad for society but whether it is an ordinary and necessary business expense. In this regard the provisions of S. 467 are entirely consistent with existing tax law and do not penalize the individual.

Another argument which is frequently raised is that such legislation will lead to excesses and abuses. I am sure this committee can write this legislation so the flood gates will not be opened wide to result in unreasonable deductions or deductions for expenditures not directly concerned with the production of revenue for the business involved. To be deductible, the expenditures must be ordinary, necessary, related to the business activities of the enterprise involved, and must be reasonable. And remember, please, every dollar spent still comes out of profits at the end of the year.

Incidentally, the press of the Nation, working with their advertisers, have done an outstanding job for the Federal Government and for many worthwhile nonprofit foundations and civic causes. Newspapers have played, in cooperation with business and industry, a great part in helping to promote Government-sponsored programs during World War II and since through institutional advertising.

It seems to me that one of the crying needs of our country today is to stimulate more interest in the workings of our Government at all levels, more citizen participation in public affairs, more awareness of the great decisions facing the American people in this critical hour of human history. As Senator Hartke has pointed out so effectively, our legislators want and need the opportunity to receive information on both sides of every issue on which they vote. Regulation that tends to stifle freedom of speech and place a price tag on the right of petition renders a disservice to the Nation and its legislators.

May I add one further observation: By all odds the most active, most influential, aggressive and persistent lobbying in this country today is being carried on by the Federal Government and its multitudinous agencies. The 50 State governments, the counties, and municipalities are also increasingly vocal when it comes to agitating for what they want from Congress and State and local lawmaking bodies. This intensive and tireless governmental lobby is financed by the Nation's taxpayers—no one else. Is it proper that these same taxpayers—if they happen to disagree with the objective of some tax-financed lobbying campaign being waged to the detriment of their own business—should not enjoy the right of rebuttal without paying a tax penalty?

Mr. Chairman, as a newspaperman and a legislator at the State level, I join with the 205 editors of the press committee to urge that the Hartke-Kerr bill be substituted for section 3 of the tax bill now before your committee.

If I may make just one brief addition to my statement, Mr. Chairman, I would like to point out that in 1961 American industry spent $225,400,000 at the national level to support the American Red Cross, E bonds, better educational facilities and other programs in which the Government and the entire public are so interested. In the period from 1942 to 1961 industry, business, and the newspaper publishers themselves, spent over $3 billion in these programs.

I think it is a very impressive figure, indicating the scope of this public service institutional advertising. It certainly will be more difficult to promote certain advertising in the future if the status of such advertising is not clarified by congressional action.

The CHAIRMAN. I want to congratulate you on a very able statement.

Mr. MANNS. Thank you, sir.

The CHAIRMAN. Any questions?

Senator BENNETT. I would just like to ask the witness, Mr. Manns. I would like to discuss the problem of Alex Washburn of the Hope Star in Hope.

If he had used the news columns of his paper for the campaign to the point where he had lost $6,000 in the operation of his paper, would he have been able to take advantage of that as a proper deduction in his business?

Mr. MANNS. You mean if it had resulted in a loss for his year's operation?

Senator BENNETT. Yes. Your information, of course, is limited. I assume that Washburn bought advertising space probably in his own paper, in trying to sell this idea of a petition.

Mr. MANNS. Senator, I believe most of Mr. Washburn's $6,000 went for canvassing, circulating petitions, postage, printing, legal fees, etc. I do not know the amount of lineage that he ran in the advertising or news columns of his own newspapers.

Senator BENNETT. Let us put it this way: If he had used news lineage and had given up therefor $6,000 worth of advertising in order to provide the news lineage, that would have reduced his income by that amount, and if it had amounted to a loss or he would—it would have reduced his tax by that amount by reducing his income.

Mr. MANNS. That is true.

Senator BENNETT. But because he chose apparently to use advertising this did not become deductible.

Mr. MANNS. That was the ruling.

Senator BENNETT. Yes.

Mr. MANNS. And the Supreme Court would not even hear the case.

Senator BENNETT. This is the thing that bothers me a little bit about this situation. You touched on it at another point in your statement. You say on page 10:

> The average citizen does not ordinarily oppose legislation by taking advertisements in a newspaper. He can organize committees, recruit volunteers—

et cetera, et cetera—

> which will be of sufficient news value to be well covered by the press.

To put it another way, any individual or group that can command press coverage, for a point of view, gets that valuable coverage for free.

Mr. MANNS. That is exactly right, and the industry or business which is concerned with a matter of favoring or opposing legislation to protect its very life often cannot get such coverage.

Senator BENNETT. This might affect the well-being of a particular business, and if it came to you and tried to get news space as a business, to oppose the news space you have given to an organization, a committee, or the statement of their members, it probably would not have been able to get equal news space.

Mr. MANNS. That is correct.

Senator BENNETT. So when it takes this space and pays for it it must then pay for it at a terrific cost because such expense is not deductible under IRS rulings and court decisions.

Mr. MANNS. Advertising is often the only avenue of appeal for businesses, because their plight is often not newsworthy, it may concern only one business that——

Senator BENNETT. Even though the attack on it may be newsworthy,

Mr. MANNS. Even though the legislative attack on the business may be unjustified, yes, sir; the example is so often cited about a referendum on the sale of alcoholic beverages. Well-meaning citizens often feel the brewers and distillers have virtually unlimited funds. But, they say, who is going to speak for the citizens? The citizens have the loudest voice of all and get the most news coverage on such an issue. It is not usually necessary for them to resort to paid advertising. They have a more emotional appeal and prominent citizens on their committees. The news columns in which their cause is featured are far better than the advertising space, I hate to admit it.

Senator BENNETT. They get on the front page.

Mr. MANNS. That is right. That is certainly true. If anyone has an advantage it is the people who are fighting such an issue.

Just last week the Italian Government banned all types of tobacco advertising in Italy. If such a bill came before Congress, the tobacco industry, which depends on advertising to sell its products would have to fight for its very life. The tobacco industry would certainly be entitled to protect itself.

I think there is something so basic here that I do hope you gentlemen would look with favor on the substitution of S. 467 for section 3 of H.R. 10650.

The CHAIRMAN. Senator Hartke.

Senator HARTKE. Mr. Manns, assuming this situation stands as it is on the books at the present time, suppose that in the field of education we hear some of these ads on the radio, you know, about better schools and things of that sort, better education for your children, just suppose, assuming the Internal Revenue Service kept the present ruling that a group of business or industrial people decided they wanted to do something to help out some private institution, such as in my home State, of Evansville College, and in your State, William and Mary, by working for better salaries for the teachers or to acquire better qualified personnel, what would be the effect under the present situation, assuming you did not correct the legislation?

Mr. MANNS. It would depend, of course, Senator, on whether IRS interpreted the ad as dealing with legislation. It obviously would not

be deductible based on, well, if they felt as they did in one of the cases which I have cited, the *Timken Roller Bearing Co.* case. When it comes right down to it, there has been no hard and fast guide given the Internal Revenue Service by Congress on such matters.

The I.R.S. apparently allows one deduction and disallows another. But they are allowing fewer and fewer all the time. They follow this precedent and not allow any institutional advertising to be deductible as a business expense.

Senator HARTKE. What the Supreme Court has said is if Congress wants this type of item deductible it has got to spell it out.

Mr. MANNS. That is right.

Senator HARTKE. And they failed to spell it out, so in the face of these decisions by the Internal Revenue, if we do not like them, why, we have to correct them; isn't that right?

Mr. MANNS. That is certainly true. The Supreme Court was basing its decision on the precedent set by the rulings of IRS, which have no foundation in law at all.

Senator HARTKE. Well, as far as they are concerned they are not going to try to legislate—they have said in this system, at least, for the benefit of what we are talking about, they have said, "We are not going to legislate."

Mr. MANNS. They said they were following a precedent established by IRS. If your bill S. 467, is not substituted for section 3 in H.R. 10650 this confusion and injustice will continue, indefinitely.

Senator HARTKE. In the same field we have some problems in some areas about teenage drinking, and the question of temperance. Now, some efforts are being made by some temperance groups. Could they be permitted to deduct, if you do not change the law?

Mr. MANNS. This would of course be straight institutional advertising in that it does not attempt to influence the general public concerning pending legislation.

Senator HARTKE. One think I am very definitely not interested—I am interested in not having happen—is the fact that we permit a deductible item as far as partisan politics are concerned. But let us get off into the situation at the present time. We do have a lot of so-called civic organizations like the Jaycees, who go out into society and say, "Tomorrow is election day. Vote for the man of your choice, but be sure and vote." Or, "Let's go out and register. You cannot exercise your influence on election day unless you are registered to vote."

If these provisions as now are unchanged what would be the effect of the deductibility of these type campaigns?

Mr. MANNS. Well, if the Jaycees used sponsored advertising, I means encouraged local business firms to underwrite the advertising, it might or might not be deductible as a necessary business expense.

If they paid for it themselves, why, they are nonprofit anyway. These advertisements would not, apparently seek to influence legislation.

Senator HARTKE. They are a nonprofit organization, there is no question about that.

Mr. MANNS. But certainly if they got sponsors, as they usually do——

Senator HARTKE. The same field, so far as municipalities are concerned. Frequently they go on the question of a referendum for a bond issue, for expansion, as we see practically every city now, which has a committee for attracting new industry. They go out and they put out brochures and they get a group of the people together who go over the countryside and even buy land.

What about expenses involved in conducting these campaigns to attract new industry to their town? What is the deductibility of those items?

Mr. MANNS. The public utility companies have done a terrific job in that field. I mean over the whole country they have advertising space, they have advertising contacts, and they devote a lot of it to just such a thing, attracting industry.

Senator HARTKE. Take some of the railroads.

Mr. MANNS. The railroads, too.

Senator HARTKE. They say, "Get on our railroad line. We have industrial space. We will help you."

Mr. MANNS. That is right.

Senator HARTKE. Of course, they expect to get the railroad business, we understand what they were trying to do. But they are also trying to develop something for the communities along those lines, are they not?

Mr. MANNS. Yes, it is actually institutional advertising. I think it is one of the best kinds, but it is doing a public service, too.

Senator HARTKE. To reemphasize a little bit what you said before, suppose the State legislature, forgetting us in the Senate and Congress, here, suppose they did propose to enact some legislation which would just wipe business off the map for all intents and purposes, just destroy it. What recourse would you have so far as deductibility is concerned under the House bill?

Mr. MANNS. The cost of contacting your legislators would be deductible. You would not have any deduction for any advertising or public relations program developed to educate the public to oppose such arbitrary legislation.

Senator HARTKE. None whatsoever.

Mr. MANNS. None whatsoever.

Senator HARTKE. Is that right?

Mr. MANNS. None whatsoever. This policy is becoming more firmly established every year.

Senator HARTKE. You are going to have to admit that the word "lobbying" has a very bad connotation.

Mr. MANNS. Lobbying and propaganda, I think, are two things that are used in an unfriendly connotation. I notice that the Internal Revenue Service delights in using both of them.

Senator HARTKE. When lobbying becomes education then it sounds wonderful.

Mr. MANNS. That is right.

Senator HARTKE. But still under the Constitution, we all know that there are certain limitations on certain rights under the Constitution. We all realize that really if you want to tax sufficiently, the power to tax is still the power to destroy, and that is the power to exercise, wtih the good judgment of Congress. But one of the first things the founders of this country did was to institute a Bill of Rights, and the

first one of those statements, the first statement in the Bill of Rights, the first quotation there, the first amendment, said that Congress shal make no law abridging the freedom of speech or of the press or of the right of people peacefully to assemble and petition their Government for the redress of grievances.

Do you feel this is in any way a limitation upon this amendment in this statement of the Bill of Rights?

Mr. MANNS. I think that Congress now should act now to preserve and protect exactly the principles of the Bill of Rights you were speaking about.

Senator HARTKE. Well, in effect, Congress has acted by acquiescence, has it not?

Mr. MANNS. Yes, I would say so.

Senator HARTKE. The ruling was made as though it were an interpretation of the law, and since there has been no corrective action in face of the ruling it has the actual and full effect of law.

Mr. MANNS. Congress, in effect, has acted to that extent, by not acting.

Senator HARTKE. Congress has, in effect, acted to that extent.

Mr. MANNS. Yes, they certainly have.

Senator HARTKE. That is all.

The CHAIRMAN. Thank you very much.

Mr. MANNS. Mr. Chairman, here is a copy of over 50 programs that business and industry have sponsored. They are primarily of a government nature, I mean suggested by the U.S. Government. In a very short period of time they amounted to $98 million, of which the Government paid only $2 million. Here is $96 million worth of advertising that business, industry, the press paid for. The press probably secured paying business sponsors for most of the advertising. It just shows how interested business and industry are in public affairs and our way of life. If we stifle institutional advertising I am afraid it is going to have an unfortunate reaction.

I mean if you take my bread and butter away from me, I am going to have to be a little bit more conservative with what I have left. I cannot then afford to be as helpful as I have in the past. It has tremendous implications all the way through.

The CHAIRMAN. You have made a fine statement.

Mr. MANNS. Excuse me. I did not mean to take so much time Mr. Chairman and I appreciate your hearing me, very much.

The CHAIRMAN. We will recess and adjourn until 10 o'clock tomorrow morning.

(By direction of the chairman, the following is made a part of the record:)

THE COLUMBIA GAS SYSTEM, INC.,
New York, N.Y., April 5, 1962.

Subject: Revenue Act of 1962; legislative expenses.

The Honorable HARRY F. BYRD,
Chairman, Senater Committee on Finance, Washington, D.C.

DEAR SENATOR BYRD: Section 3 of the Revenue Act of 1962 (H.R. 10650), as passed by the House of Representatives on March 29, 1962, would amend section 162 of the code to specifically allow a deduction from gross income of costs directly related to appearances before and communications with a legislative body or a committee thereof or individual members thereof. This amendment is a step in the right direction. It would not, however, permit the deduction of expenses lawfully incurred by a taxpayer in presenting his position to the public

with respect to issues raised by initiative or referendum, whether on the Federal, State or local level. This means that deductions for expenditures incurred in connection with any submission of proposed legislation in a referendum would be disallowed; for example, a referendum to the voters on changes in gas rates in a particular city served by a Columbia System company.

As you know, with the economic system under which we live today being in large measure shaped by political action through legislation, many important legislative changes are first considered in referendums, and it is essential that corporate taxpayers convey their views regarding all proposed legislation to individual legislators, legislative bodies, employees, customers, stockholders and to the public in general.

We believe Congressman Hale Boggs of Louisiana aptly summed up the situation when he said:

"Mr. Speaker, no tax law, or administrative interpretations should be permitted to stand that would impair the ability to communicate freely to all sections of the public or elected representatives, views on legislation affecting the economic lives of our citizens, either through advertising, membership in an organization, distribution of literature or any other form of lawful communication.

"If we dilute the right of our citizens to petition for good laws by punitive taxation we deny them the right of self-protection from damaging and destructive legislative action."

We strongly urge you to carefully consider S. 467 now pending before your committee as a substitute for section 3 of H.R. 10650. The amendment proposed by S. 467 would allow the deduction of lawful expenditures incurred in providing information to the public on legislative issues. The bill was introduced by Senator Hartke (Senator Kerr has asked and received permission to have his name added as a cosponsor of the bill the next time it is printed).

We request that this letter be included in the record of any hearings your committee may hold on the question of legislative expenses.

Respectfully submitted.

JOHN W. PARTRIDGE.

BEACON MILLING CO.,
Cayuga, N.Y., April 12, 1962.

Hon. HARRY F. BYRD,
U.S. Senate,
Washington, D.C.

DEAR SENATOR BYRD: The Senate Finance Committee has under consideration a bill (H.R. 10650) to amend the Internal Revenue Code of 1954. Part of this bill deals with the taxation of cooperative businesses and their patronage dividend receiving members.

In the interest of moving toward equality of corporate taxation, I would urge you to support this bill and strive for its adoption by the Senate.

A survey made by the USDA in 1953 disclosed that the 25 principal regional cooperatives had total sales of $1,332,406,868 with net earnings of $37,057,483. Fifteen of these co-ops paid no Federal income taxes. The rest paid only 6.5 percent of their income, or $2,379,196. If these co-ops had been taxed, as were corporations, they would have paid $19,045,948 in Federal income taxes or 52 percent of their earnings. Cooperatives are now big business and should pay their fair share of government.

Tax advantages held by co-ops have enabled them to force their taxpaying competitors out of business. Private business cannot survive with this unequal taxation.

It is my understanding that the present bill provides for taxing the undistributed earnings of the cooperative corporation and, in addition, provide for deducting and withholding from the amount of each member's cash or scrip patronage dividend, a tax equal to 20 percent of such dividend, and pay the same to the U.S. Treasury. This is a move in the right direction but is still far from equality.

It is clear that co-ops are vigorously opposing the retention of this 20 percent of dividend for tax purposes. I would vigorously urge you to retain this provision in the bill. The tax should be levied where the income is, not somewhere else.

Private business can successfully compete with co-ops only if equally taxed. I would ask you to support this objective by reporting the bill out of committee and endorsing it with your favorable vote.

Very truly yours,

L. S. MIX, *Vice President.*

THE CHICAGO BAR ASSOCIATION,
Chicago, Ill., April 6, 1962.

Hon. HARRY F. BYRD,
U.S. Senate, Washington, D.C.

DEAR SENATOR BYRD: There is nothing so important to the administration of justice in Illinois as the adoption of the modern judicial article to our State constitution, which will be submitted to referendum at the November 1962 general election. Our hope for success is slim unless Congress acts at once to provide for deductibility for Federal income tax purposes of contributions for support of passage. In recognition of the urgency of this matter, the board of managers of the Chicago Bar Association, on March 29, 1962, adopted the enclosed resolution urging that section 3 of H.R. 10650, the Revenue Act of 1962, be amended to provide such a deduction.

The draft of amendment approved in the resolution conforms with S. 2716 (by Senator Dirksen) and H.R. 10080 (by Congressman Yates). We hope you will give highest priority to acceptance of this proposal by the Committee on Finance as a part of H.R. 10650.

Sincerely yours,

R. NEWTON ROOKS, *President.*

THE CHICAGO BAR ASSOCIATION

RESOLUTION OF THE BOARD OF MANAGERS, MARCH 29, 1962

Whereas the organized bar of Illinois and civic groups throughout the State of Illinois, through an organization known as the Committee for Modern Courts, are engaged in a campaign for the adoption of a proposed revision of the present judicial article of the Illinois constitution; and

Whereas sustained efforts over a long period of years to obtain the adoption of a modernized judicial article resulted in failure by a narrow margin in 1958 to obtain the required two-thirds vote in the general election, even though contributions toward support of the campaign for its passage were then ruled to be deductible as charitable contributions for Federal income tax purposes; and

Whereas the Internal Revenue Service has ruled, in reliance upon recent court decisions and revised Treasury regulations, that contributions for such a purpose are no longer deductible; and

Whereas past experience in Illinois indicates that adequate funds for the educational program for judicial reform cannot possibly be raised without the stimulus of deductibility of such contributions; and

Whereas the urgency of the need for constitutional authority for improvement of the administration of justice in Illinois is so great that a contribution to an organization dedicated solely to this cause is well nigh equivalent to the payment of taxes to State and local governments, which are fully deductible; and

Whereas section 3 of H.R. 10650, the Revenue Act of 1962, would expressly deny deductibility of a contribution with respect to the forthcoming referendum on the revised judicial article for Illinois, even though it might otherwise be an ordinary and necessary business expense: Be it

Resolved, That the Chicago Bar Association recommends that section 3 of H.R. 10650 be amended by adding thereto a new subsection (in conformity with S. 2716 (87th Cong., 2d sess.) introduced by Senator Dirksen and H.R. 10080 (87th Cong., 2d sess.) introduced by Congressman Yates) to amend section 170 (c)(1) of the Internal Revenue Code of 1954 (relating to charitable contributions) to be effective with respect to taxable years ending after December 31, 1961, and to read as follows:

"(1) A State, a territory, a possession of the United States, or any political subdivision of any of the foregoing, or the United States or the District of Columbia, *or any nonprofit organization created and operated exclusively to consider proposals for the reorganization of the judicial branch of the government of any of the foregoing, to provide information, to make recommendations, and to seek public support or opposition as to such proposals,* but only if the contribution or gift is made for exclusively public purposes."

PUBLIC SERVICE CO. OF INDIANA, INC.,
Plainfield, Ind., April 17, 1962.

Hon. HARRY F. BYRD,
Chairman, Senate Finance Committee,
Washington, D.C.

DEAR MR. CHAIRMAN: In connection with the hearings now being held by your committee on H.R. 10650, we respectfully request that this letter stating our views concerning section 3 relating to the deductibility of certain expenses incurred in connection with legislative matters be included in the record of such hearings. For the convenience of the committee, 20 copies of the letter are enclosed.

Section 3 of H.R. 10650 amends section 162 of the Internal Revenue Code so as to provide Federal income tax deduction as ordinary and necessary expenses of costs incurred by a business in direct connection with (1) appearances before, submission of statements to, or sending communications to, the committees, or individual members, of Federal, State, or local legislative bodies with respect to legislation or proposed legislation of direct interest to the taxpayer, and (2) communication of information between the taxpayer and an organization of which he is a member with respect to legislation or proposed legislation of direct interest to the taxpayer and to such organization. It also provides that dues paid to a trade organization incurring expenses attributable to legislative matters referred to in (1) and (2) above also are deductible provided the taxpayer is a member of such trade organization.

However, section 3 as it now stands, specifically provides that amended section 162 shall not be deemed to allow deductions for any amounts paid in connection with any attempt to influence the general public, or segments thereof, with respect to legislative matters, elections, or referendums. We believe that the proposed legislation as so limited would not adequately provide fair and equitable relief from the limitations of present code section 162, and we therefore urge that proposed section 3 of H.R. 10650 be revised to provide specifically that the cost of advertising or otherwise expressing its views, incurred by a taxpayer in the ordinary course of his business, is deductible for Federal income tax purposes even though such advertisements or expressions of views deal in whole or in part with such matters, elections, or referendums. Where the owners or those responsible for the management of a business believe that a Government policy, actually existing or prospective, is or would be either detrimental or beneficial to the public interest and does or would adversely or beneficially affect the business in which the organization is engaged, it should not be subject to tax penalty in making known its views and pointing out its conclusions as to the effect of such policy or prospective policy upon the public and upon the business. It seems to us clear that business management has a right and a responsibility so to do, and that the tax laws should not penalize the fulfillment of that responsibility.

In this connection may we point out that the House report on the bill suggests in support of section 3 the desirability of encouraging taxpayers, who possess information bearing on the impact of existing laws or proposed legislation on their businesses, to make such information available to legislative or other governmental bdies. We submit that it is at least equally desirable that such views affecting the taxpayer's business should be made known to the public by the affected taxpayer. If section 3 of the bill is so revised that it will permit this without tax penalty resulting from such action, the public will be more fully informed on matters of real concern to it, and the good of the Nation as a whole will be served.

The enlargement of the scope of the tax exemption under section 3, which we are urging, would harmonize with the purpose of the section as it now stands since it would provide, as a deductible expense, costs incurred in informing the public with respect to a referendum submitted to the vote of the public on matters which concern the taxpayer's business. The presently proposed section 3 specifically allows deductions for expenses incurred in connection with communicating one's views to a legislator, and there can be no justifiable reason for distinguishing between tax treatment in the case of such a communication and tax treatment in the case of communicating one's views to the public where the public is, in essence, acting as a legislature in a referendum or an initiative matter.

Nothing that we have said above is intended to indicate in any degree a disagreement with the limitation now provided in section 3 that any amounts paid or incurred for participation or intervention in any political campaign of any candidate for public office should not be allowed as a tax deduction expense. We are in agreement that such limitation should be retained in any revision of the section.

We appreciate the consideration given by you and your committee to this request.

Very truly yours,

CARROLL H. BLANCHAR.

EL PASO ELECTRIC CO.,
El Paso, Tex., April 17, 1962.

Hon. HARRY F. BYRD,
Chairman, Senate Finance Committee,
Washington, D.C.

DEAR SENATOR BYRD: It has just come to our attention that your committee is considering H.R. 10650 and instead of appearing we respectfully request that this letter be entered in the record of the hearings on H.R. 10650.

We sincerely believe that section 3 of the bill should be amended to allow an investor-owned electric utility company like El Paso Electric Co. to aggressively compete with other utility operations, be they gas, electric cooperative, municipal or governmental, by advertising with the cost of such advertising recognized as a legitimate business expense and deductible as such before income taxes. We also feel that advertising deductions should be allowed in regard to legislative matters when such advertisements are required to permit business survival.

It has been said by some that the operation of an electric business is a monopoly, but in practice that is far from being true. Some of our competitors have tax advantages, the availability of money for construction at low interest rates, and other subsidies, which are not available to us. Unless we can tell our side of the story, as a business expense, we are put unfairly to a still greater disadvantage in the competition.

Respectfully submitted.

W. V. HOLIK, *President.*

WASHINGTON, D.C., *April 18, 1962.*

Hon. HARRY F. BYRD,
Chairman, Senate Finance Committee,
Washington, D.C.

DEAR SENATOR BYRD: At the suggestion of your staff, I am submitting herewith, for the record, certain views of the Magazine Publishers Association, Inc., with respect to the Internal Revenue Act of 1962, H.R. 10650, which is now pending before your committee.

The Magazine Publishers Association, Inc., represents 96 publishing companies which publish 250 weekly, monthly, or quarterly periodicals. Magazines now enter 44 million American homes where 125 million readers over 15 years of age rely upon them as a vital factor in adult education. Certainly, our publications carry a tremendous impact on the cultural, economic, and political course of the country.

Our industry is concerned with the limitation contained in that portion of section 3 in H.R. 10650 which disallows the deduction of amounts paid or incurred "(B) in connection with any attempt to influence the general public, or segments thereof, with respect to legislative matters, elections, or referendums." This prohibition would seem to be broad enough to strike a mortal blow to highly desirable public service and institutional advertisments. Rulings of Internal Revenue in recent years have disallowed, as ordinary business expenses, institutional advertising concerned with employee morale, the evils of communism, and general support of Government improvement.

Furthermore, over the years magazines have contributed space worth hundreds of millions of dollars in national programs. For example, sales of war and savings bonds alone committed almost one quarter billion dollars' worth of adver-

tising space. In addition, worthwhile nationwide programs have had comparable support, such as

National blood program
Ground Observer Corps
Forest fire prevention
Aid to higher education
United Nations
Radio Free Europe and others.

While space for these worthwhile projects has been donated, the costs of printing and distributing these pages have been proper deductions as ordinary business expenses.

In the crises of recent decades, four President—Roosevelt, Truman, Eisenhower, and Kennedy—have paid great tribute to the public services of magazines. It is conceivable, however, under the provision of H.R. 10650 cited above, that a national campaign on prevention of forest fires might well occur at a time when an agency of Government is seeking an increased appropriation on this item. Could we possibly be faced with a disallowance of the expense, because the campaign could be interpreted as bringing pressure to bear on Members of Congress? I appreciate this is an extreme example, but it certainly illustrates one of the dangers inherent in the provision above cited. Free speech is a basic element of American democracy and we feel the right to speak out, for or against Government action, even in advertisements, is fundamental and should be encouraged rather than impaired.

In 1958 an editorial published in the Saturday Evening Post, under the caption "Should the Power To Tax Include the Right To Censor Advertising?" stated:

"For example, it is hard to believe that the Nation's lawmakers meant to give tax collectors the right to decide that American business or industry should be penalized for stating its case and defending its right to exist, in the face of Government-sponsored competition, by means of paid advertisements. But that is what the tax authorities are doing, acting under a new interpretation of one of their own regulations, which declares that money spent on advertising 'for lobbying purposes, for the promotion or defeat of legislation or for the development or exploitation of propaganda' cannot be considered 'ordinary and reasonable expenses' deductible for tax purposes."

While this dealt with rulings of the Internal Revenue Service, it nevertheless seems to be pertinent with respect to the proposed section of the Internal Revenue Act of 1962.

The Magazine Publishers Association, Inc., endorses S. 467, which we understand is pending before your committee as an amendment to the legislation now under consideration. S. 467 contains the following allowance:

"(4) Expenses lawfully incurred in supporting or opposing or otherwise influencing legislation in the Congress or in a State legislature or in the legislative body of a county or other local governmental agency or in any submission of proposed legislation to the voters."

We believe this affords a proper solution to the problems raised by that provision contained in section 3 of H.R. 10650 and urge the committee to give it its very careful consideration.

Respectfully,

FRANCIS R. CAWLEY,
Vice President, Magazine Publishers Association, Inc.

SOUTHWESTERN ELECTRIC POWER CO.,
Shreveport, La., April 17, 1962.

Hon. HARRY F. BYRD,
Chairman, Senate Finance Committee,
Washington, D.C.

DEAR MR. CHAIRMAN: We should like to submit for your serious consideration some suggestions for changes in section 3 of H.R. 10650, on which measure your committee is now conducting hearings. We trust this letter may be entered in the record in lieu of personal appearances.

While we are in agreement with the general objectives sought in section 3, we feel that business in general, and our business in particular, will be done a grave injustice unless this section is amended. To put a business in a position where it cannot use accepted means of communicating information about its

product as a normal expense of doing business is certainly not in the American spirit of fairplay.

In recent years, our company has had the experience of having certain advertising, pointing to proposed Government competition with our business, disallowed as a business expense. In our opinion, this advertising was vital to the very existence and expansion of our company. It was just as important and necessary to our company as is any product advertising by business that has merchandise or services to sell.

Keeping the public in general, and our customers in particular, informed on some of the threats to our business, and to their ultimate welfare, in our opinion, is not only our privilege, but our obligation. It is an obligation we feel as keenly as we do the obligation of informing our customers of new uses for electric service.

For instance, we have vigorous competition from the natural gas companies. Our company advertises in all media in an effort to meet this competition and to get our share of the consumer dollar spent for utility service. We owe this to our customers, to our employees, and to our stockholders.

Competition from various Government projects, seeking to take away from us existing and prospective electric customers, is just as real as gas competition. Unless we are able to use available means of communication to inform people about this competition, how are we to meet it? Obviously, the people are going to make up their minds about how to react, but we must give them the information. We are the only ones who have it.

In our considered opinion, there is a necessity for advertising to meet this threat, which is a real one. It is imperative to the survival of our business. In the last quarter of a century, the record of Government encroachment in the electric business is stark evidence of the need for meeting this competition by all legitimate means available.

With the scope of Government extending more widely into all areas of business operation, it would be difficult indeed to do much advertising that could not in some way be interpreted as touching on legislative matters. As it now stands, section 3 would impose a severe and unwarranted handicap on the American tradition of free speech and the right to petition, which our Nation's people hold so dear. Therefore, we sincerely ask that section 3 of H.R. 10650 be modified or amended by your committee so that ordinary and necessary business expenses of advertising will be deductible even though a portion of such expense might be interpreted as touching a legislative matter.

Sincerely yours,

E. F. GRAHAM,
Executive Vice President.

CAROLINA POWER & LIGHT CO.,
Raleigh, N.C., April 18, 1962.

Hon. HARRY F. BYRD,
Chairman, Senate Finance Committee,
Washington, D.C.

DEAR SENATOR BYRD: In the interest of the time of your committee, I would like to request that this letter be entered on the record of the hearings you are now conducting on H.R. 10650. I would personally prefer to appear and testify in person but I realize that the time of this committee is limited.

With respect to tax credits for new investment in industrial plant, let me simply say that there can be no economic justification for treating public utilities any differently than any other industry. We are in the market competing for our share of the consumers' dollars just like the manufacturer of automobiles, furniture, or food.

Section 3 of this bill specifically disallows as an operating expense or tax deduction the expenses of informing the general public with regard to legislative matters. I want to illustrate how unfair and unsound such a proposal would be from our own recent experience. I am attaching hereto a pamphlet that we recently distributed to our 85,000 customers in South Carolina. This was a part of our effort to expose to the public the attempt of rural electric cooperatives to get the South Carolina General Assembly to adopt legislation which would have prevented us from building lines within certain stipulated distances of their lines. This means that the law would have prohibited us from serving customers in various areas of South Carolina which represented literally thousands of square miles of our service area in South Carolina.

We pointed out on page 13 of the pamphlet how that when the co-op takes a customer that could be served by us the State and local governments lose 11.7 cents out of every revenue dollar and the Federal Government loses 13.2 cents out of every revenue dollar.

This was an attempt to acquaint the taxpayers of South Carolina in our service area with the fact that the growth of the federally subsidized and tax exempt (at all levels) rural electric cooperatives meant a diminution of the local, State, and Federal tax base and could only result in the ultimate increase of taxes upon what is left in the tax base.

Under the present provisions of section 3 of H.R. 10650, the expenditure of printing and distributing this information among our customers apparently would be disallowed as a business expense in the ordinary course of business. If our competitor had been some other form of private enterprise, the expense would have been deductible for income tax purposes. But, because the only way that this competition can be dealt with happens to require the defeat of unfair, unsound, and discriminatory legislation, the Congress is being asked to tax a penalty against free enterprise.

We respectfully request that your committee rewrite section 3 so as to allow reasonable expenses to disseminate information to the general public with regard to legislative matters as deductible business expenses.

Most respectfully yours,

SHEARON HARRIS,
Vice President and Associate General Counsel.

UTAH POWER & LIGHT CO.,
Salt Lake City, Utah, April 17, 1962.

Hon. HARRY F. BYRD,
Chairman, Senate Finance Committee,
Washington, D.C.

DEAR SENATOR BYRD: It is respectfully requested that this letter of comment on certain provisions of H.R. 10650, now being considered by your committee, be entered in the record of hearings.

Section 2 of H.R. 10650 provides for a tax credit for investment in certain depreciable property. As passed by the House this section provides for a deduction credit of 7 percent on new investment for industry in general and of only 3 percent for regulated public utilities. Without entering the controversial area concerning the relative merits of the investment incentive credit versus other means of stimulating capital expenditures (depreciation reform, etc.), we believe that equitable tax treatment demands that the regulated public utilities be included along with all other industry at a uniform credit allowance. Any other action would discriminate against a large and important segment of the Nation's industrial complex and result in the regulated utilities bearing a disproportionately heavy share of the tax burden. We earnestly request that the investment incentive credit, if enacted, be made fully applicable to the regulated utilities at the same credit percentage granted other industry.

We believe that the provisions of section 3, which provide for Federal income deduction for business expenses incurred for legislative activity, is a tentative step in the right direction but we feel that the proposal does not adequately fulfill the full need for legislative reform of Code section 162. At present, ordinary and necessary expenses incurred in legislative activities, even if essential to the very survival of the taxpayer's business, are not deductible. The investor-owned electric utility industry is a classic example of existing discriminatory tax deductibility treatment in this particular regard. Our industry is, in a most real sense, confronted with tax-subsidized competition from Federal Government power agencies and other federally financed public power organizations. Yet any factual advertising devoted to explaining the unfair competitive advantage enjoyed by these public power agencies due to tax inequities and cost of money subsidies, or for that matter the cost of any advertisement which reflects unfavorably upon public power, is interpreted as a form of "lobbying" and is therefore not deductible.

This tax treatment, in view of the unrestricted advertising (or propagandizing) permitted governmental and quasi-governmental competitors, is unjustified and discriminatory. We therefore urge that section 3 be broadened to allow deductibility of ordinary and necessary business expenses incurred in advertising

related to pending or prospective legislative matters, but including a special exception disallowing deduction of expenses used for participation or intervention in any political campaign in support of or in opposition to any candidate for public office.

In our opinion, section 4 of H.R. 10650 would result in repeal of the time-tested "ordinary and necessary" business expense concept. It would substitute statutory judgment for business judgment as to allowable expenses and would also unnecessarily complicate administrative procedures relating to enforcement. We urge that section 4 be eliminated from H.R. 10650.

We also urge that a noticeable inequity contained in section 17 be rectified by making rural electric cooperatives subject to the tax treatment provision of this section to an equal degree accorded other cooperative businesses.

Sincerely,

E. M. NAUGHTON.

HOUSTON LIGHTING & POWER CO.,
Houston, Tex., April 16, 1962.

Hon. HARRY F. BYRD,
Chairman, Senate Finance Committee,
Washington, D.C.

DEAR MR. CHAIRMAN: With respect to section 3 of H.R. 10650, concerning the deductibility of certain expenses incurred in connection with legislative matters, we wish to have your committee consider carefully the matters set out in this letter and make such a part of the record of the hearings now in progress on said H.R. 10650.

Because of the staggering impact of governmental regulation, taxation, and competition, private companies like ours find it increasingly difficult to survive and to perpetuate the free, private enterprise which has been the lifeblood of this Nation's economy. The influence of government is felt at all levels—Federal, State, and local. It seeks through taxation and regulation to reduce or eliminate the profits which make dynamic expansion possible—then it seeks to seize upon this handicap to thrust forward with more and more tax-supported competition which could, if allowed to progress unopposed and unchecked, result in the eventual demise of all free enterprise.

The machinations of those pressing such policies, and the results of their implementation, must be made known to the legislators who are responsible for making and changing our laws. Both must also be made known to the electorate which selects legislators. The informational expenses incurred in making such known are the ordinary and reasonable expenses of survival—of our company and of our Nation. They should not be given the discriminatory tax treatment presently afforded (and proposed for extension by H.R. 10650).

Thus, it is our purpose in writing this letter to implore that any amendment to the Internal Revenue Code should make clearly deductible for Federal income tax purposes all lawful expenses which are ordinary and necessary to inform the legislators (and the general public by whom they are elected) at all levels of the facts and ramifications thereof, including the taxpayer's recommended position with respect thereto, relating to legislative, initiative or referendum proposals.

In our opinion, a substitution of S. 467 (introduced by Mr. Hartke on January 17, 1961) for the present section 3 of H.R. 10650 would be a step in the right direction. Proposed section 3 of H.R. 10650 permits the deduction of expenses incurred in directly communicating with legislators, or communicating with them through industry organizations, but denies the deduction of expenses incurred in getting facts before the general public.

This is indeed a anomoly. That in a nation such as ours, where the ultimate power is in the people and where government has only such powers and pursues such purposes as the people will, an attempt should be made to impede and shackle the dissemination of information to the electorate which exercises the ultimate discretion and which, meantime, selects the legislators who are the instrumentalities of the electorate's will.

Accordingly, we request that your committee modify H.R. 10650 to include the deductibility of all lawful expenses necessary to the preservation of our economic system.

Yours very truly,

T. H. WHARTON.

TEXAS POWER & LIGHT CO.,
Dallas, Tex., April 17, 1962.

Hon. HARRY F. BYRD,
Chairman, Senate Finance Committee,
Washington, D.C.

DEAR MR. CHAIRMAN: This is a respectful request that this letter be entered in the record of the hearings now being held by the Senate Finance Committee on H.R. 10650 with particular reference to section 3.

Our company is in agreement with the proposal to allow as a tax deduction, certain ordinary and necessary business expenses incurred in connection with legislative matters, but feels that section 3 should not specifically disallow advertising expense in connection with any attempt to inform the general public with reference to legislative matters, elections or referendums.

Our industry in general and our own company in particular are engaged in competition with rural electrification cooperatives which are largely tax exempt in supplying electrical energy. We are presently negotiating with a municipality in north Texas in competition with such a cooperative for a wholesale supply of power to the municipally operated distribution system. Furthermore, an agency of the Federal Government (Rural Electrification Administration) is presently urging our competitors to seek legislation at State levels which, if secured, will greatly increase the severity of such competition.

The cooperatives continue to promote their industry by full-scale advertising in national magazines, in local newspapers, on TV and radio. No tax costs are involved for them in doing so. We deem it a necessary business expense to meet such competition by use of similar media, and it appears only reasonable that such expense should be allowed as a deduction for tax purposes.

Our own Texas Congressmen tell us repeatedly that it is not enough to keep them advised concerning our problems and the issues before Congress which affect our business, but also that we should and must keep the folks back home informed so that voters whom they represent in Congress will likewise understand the issues, thereby achieving the result of truly representative action on their part in Congress. If we are to do this and thereby attempt to meet competition and preserve the income and property value of our own company, we must utilize the media available for communication with our own patrons.

We, therefore, respectfully request that section 3 of H.R. 10650 be amended to include as deductible, ordinary and necessary business expenses incurred in advertising even though such expenses be interpreted as relating to a legislative matter.

Yours very truly,

W. W. LYNCH.

CHAMBER OF COMMERCE OF THE UNITED STATES,
Washington, D.C., April 17, 1962.

The Honorable HARRY F. BYRD,
The U.S. Senate, Washington, D.C.

DEAR SENATOR BYRD: In accord with your kind permission, granted when Walter A. Slowinski testified on our behalf before your committee, we are submitting herewith a supplemental statement for inclusion in the record.

This statement deals exclusively with section 3 of H.R. 10650, relating to the deductibility of expenditures made to influence legislation.

Sincerely yours,

THERON J. RICE, *Legislative Action General Manager.*

SUPPLEMENTAL STATEMENT, CHAMBER OF COMMERCE OF THE UNITED STATES, ON SECTION 3, H.R. 10650

APPEARANCES, ETC., WITH RESPECT TO LEGISLATION

Under existing income tax law, deductions are allowed for ordinary and necessary expenses paid or incurred in carrying on a trade or business.

However, a problem has arisen over the deductibility for income tax purposes of business or trade expenses incurred to influence action by Congress or other legislative bodies with respect to legislative or constitutional proposals.

Section 3 of the bill under discussion (H.R. 10650) deals with the problem.

The national chamber contends that approval of section 3 would not remedy the problem.

In lieu of section 3, the chamber urges that section 162 of the Internal Revenue Code of 1954 with respect to legislative proposals be amended, either as provided by S. 467 introduced by Senator Hartke or H.R. 640 as introduced by Representative Boggs.

The language of the latter bill is that of a bill as amended by the House Ways and Means Committee in action taken in 1960; at that time, the amended bill was approved unanimously by the committee. However, final action was not completed during the 86th Congress.

Senator Hartke's bill contains the language of the unamended 1960 House bill. The problem will best be met by congressional approval of the provisions of one of these bills as a part of the current tax bill (H.R. 10650) rather than by approval of section 3 as now written.

The nature of the problem: the means for its solution

The Internal Revenue Code does not now and never has contained any provision prohibiting the deduction of an expense because it is incurred for the promotion or defeat of legislation or for lobbying purposes.

Prior to the enactment of the 1954 code, Treasury regulations disallowed deductions for expenditures incurred in making appearances, submitting material, or communicating with respect to legislative matters. (See regulations 118, secs. 39.23(o)-1(f) and 39.23(q)-1(a)). However, the regulations were not enforced uniformly.

Largely, then, the problem arose in 1959. In that year, the Supreme Court, in two companion decisions (*Cammarano* v. *U.S.* and *F. Straus & Sons, Inc.* v. *U.S.* (358 U.S. 498 (1959)), upheld the validity of the regulations. It should be noted that the Court felt itself bound to follow the regulations—in the absence of legislative action by Congress. In the decisions, the Court held that the amounts expended for legislative matters were "ordinary and necessary"; indeed, they involved the very survival of the taxpayer's business. Further, the Court recognized that the law contained no provisions specifically supporting the regulations. The Court ruled primarily on the debatable or at least dubious ground that the Treasury regulations had acquired the force of law because of congressional reenactment of the underlying statute. Exhibited strongly here was the lack of any firm knowledge of congressional intent; in effect, the Court decision sought to fill the vacuum of this intent.

Later in 1959, the problem was complicated further. New regulations, relating to deductions incurred with respect to legislative matters, spelled out more specifically deductions which would be disallowed. For instance, the new 1959 regulations require disallowance of a deduction for the portion of dues and other payments to any organization, a "substantial part" of the activities of which consist of efforts to influence legislation to the extent that such amounts are "attributable" to these activities. Likewise, the new regulations state that expenditures for the promotion or defeat of legislation include expenditures for the purpose of attempting to influence legislative members directly or indirectly, by urging or encouraging the public to make their views known to the members.

Uncertainties have plagued taxpayers and Federal employees as a result of the new Treasury regulations promulgated in 1959 on the heels of the Supreme Court decisions.

Section 3 of H.R. 10650: General provisions and reasoning

If in all other respects they qualify as trade or business expenses, certain types of expenses incurred with respect to legislative matters would be deductible under section 3.

Two categories of expenses would be recognized as deductible under the provisions of section 3:

> Expenses in direct connection with appearances, submission of statements or sending of communications * * * presented to committees, individual Members of Congress, or to committees or individual members of State or local governmental legislatures.
>
> Expenses in direct connection with the communication of information between the taxpayer and an organization of which he is a member either from the organization to the taxpayer or vice versa.

With regard to these two categories of deductible expenses, the legislation or proposed legislation must be of direct interest to the taxpayer and organization.

Further, where the taxpayer is an organization member and the organization pays or incurs expenses of the type referred to in section 3, dues which the taxpayer pays would be deductible to the extent that they are used for such purposes.

It is presumed that the remainder of the dues is likely to be deductible as ordinary and necessary business expenses. It is presumed sufficient if all the organization's legislative activity is related to the trade or business of a significant number of its members.

Two limitations would be placed under section 3 on deductions:

No deduction would be allowed for amounts paid or incurred for participation or intervention in political campaigns of any candidate.

No deduction would be allowed for expenditures to influence the general public, or segments thereof, with respect to legislative matters, elections or referendums. No deduction is intended to be allowed for expenses incurred in connection with what is usually called "grassroots" campaigns intended to develop a point of view among the public generally which in turn is directed toward the legislators.

The chamber agrees that the regulations issued in 1959 by the Treasury Department brought to a head many administrative and enforcement problems and uncertainties which have plagued both the Government and taxpayers.

But difficult as are the administrative and enforcement problems, even more important are the policy considerations involved in denying expenses with respect to legislative matters. Also, it is inconsistent to make nondeductible the expenses incurred in appearing before legislative bodies or legislators, while appearances before executive or administrative officials with respect to administrative matters, or before courts with respect to judicial matters, are deductible, where the expenses otherwise qualify as trade or business expenses, i.e., lawful expenditures.

The existing bar on deductions with respect to legislative matters must be changed. Presentations to the legislative branch should be on substantially the same footing in this respect as that with the other branches of government.

It is highly desirable that taxpayers who have information as to the impact of existing or proposed laws on their trade or business not be discouraged in making this information available. This information is necessary if citizens are to be able properly to evaluate the proposed legislation. Deduction of such expenditures by business is necessary also to determine clearly their real income for tax purposes. Making sure that others are aware of the effect of proposed legislation may be essential to the very existence of a taxpaying business.

Analyzing the content and reasoning of section 3 of H.R. 10650

The chamber believes that careful analysis of section 3 of H.R. 10650 will establish that it is neither an adequate nor proper solution to the problem which it is intended to resolve.

The chamber is in accord with the statement expressed by authors of the House report who maintain that policy considerations in the problem are paramount even to the administrative and enforcement considerations. Indeed, in this matter policy is an overriding and even overwhelming consideration.

The chamber urges that expenses incurred should be fully deductible alike, whether before executive-administrative, judicial or legislative bodies or officials, where such expenses otherwise would qualify as trade or business expenses, i.e., lawful expenditures.

Obviously, as the authors of section 3 and the chamber agree, change in the law emphatically is required here to rectify this disproportionate situation; whatever branch of government is involved, the general principle on deductions should apply. It should not be one thing for the legislative branch, and something different for the executive and judicial branches, as the existing situation admits.

Likewise, the chamber agrees that it is "desirable that taxpayers who have information bearing on the impact of present laws, or proposed legislation, on their trades or businesses not be discouraged in making this information available to the Members of Congress or legislators at other levels of government."

The chamber further heartily supports the statement by authors of the report that "The presentation of such information to the legislators is necessary to a proper evaluation on their part of the impact of present or proposed legislation."

In addition, the chamber agrees as to the difficulty in allowing trade or business expenses generally, while segregating expenses relating to legislative matters and denying deductions for them. Many expenses may be incurred primarily to inform a business itself as to the application of certain proposed legislation. But when such information also is made available to legislators, it is difficult to determine how expense allocations should be made between legislation and mere company planning. Also, where an organization is involved,

it is difficult to determine whether or not expenses involving legislation are substantial.

If anything, this is a serious underestimation of the difficulties, and it appears insufficient attention has been given to the obvious futilities involved in requiring taxpayers to undergo these difficulties as a part of compliance with the Federal taxing system. The chamber suggests the difficulties will be avoided if there is enactment of a general rule on the problem. This would have the added advantage of helping to maintain clarity in our tax laws and do away with the existing Treasury regulations which have led to the current problem.

As presently written, section 3 of H.R. 10650 would not reduce significantly the problem for the taxpayer presented by the existing situation; in some ways section 3 would serve to further complicate the taxpayer's problem.

In effect, the wording of section 3 sets up a principle: It permits deduction in direct dealings with Federal, State, and local legislators, singly or in groups; however, the wording specifically denies deductibility to the taxpayer where there is any indirect connection with these legislators.

In a democratic form of government such as ours, the chamber regards this direct-indirect distinction affecting deductibility as essentially improper.

On the other hand, the general legislative rule that would be provided on deductibility by S. 467 or H.R. 640 makes no distinctions, particularly between direct and indirect communication with legislators. These bills hold firmly to the principle that deductions should be admissible without regard as to whether or not they involve legislation. The principle would make certain that business expenses involving legislation, if otherwise ordinary and necessary, are lawful deductible expenditures. This is a clear statement of principle which a taxpayer may easily understand; it is not a principle founded upon arbitrary distinctions, such as section 3 contains.

To meet the problem created by the existing situation, a clear statement of principle is needed. In brief, its effect would be to eliminate any Federal tax on the taxpayer's right to petition legislators and their official bodies, Federal, State and local, or to make public views on issues pending before these members and their legislatures.

Establishing a policy on the right to speak out

A firm and clear legislative policy should be enacted which adequately and properly protects the rights of Federal taxpayers to speak out and speak up on legislative and constitutional issues as good public-minded citizens without being taxed for their words.

The United States is a vast country; its many diverse interests are all representative of the Nation. In this democracy, people must speak for groups locally and at State and local levels. To deny such speech, to put a tax literally upon it, is to deny the very essence of the democratic processes.

Better than most individuals, legislators know that spokesmen for groups, lobbyists, whether they work for profit or nonprofit organizations, by and large are straightforward, honorable, and intelligent.

Any policy in a democracy of taxing free speech will be seriously detrimental. With individuals, whether they be business executives, professionals or others, the existing Federal tax structure plays a large role indeed in decisionmaking. Under the current individual and corporate income tax system especially with its steeply progressive rates there is a growing sentiment that in this field we have reached, or are reaching, a point of diminishing returns which is reflected in turn in loss of potential for economic growth.

A long history supports the view that a policy of taxation which protects the right of taxpayers to speak out is encouraging to the economy and to the well-being, industry and initiative of its individual citizens. Throughout this century surely, and most particularly from the inception of the 16th amendment until 1959, it has been accepted generally that expenditures for presenting points of view were legitimate business expenditures and, consequently, deductible items. This general acceptance should now be given positive affirmation in our statutes; it should be made the law of the land.

Certainly, the existing situation is incapable of being defended. It also is all pervasive, reaching into the highest and lowest levels of government.

On the local as well as the Federal and State levels, governmental action may be of vital interest, even affecting the ability of a business to continue and its employees to retain their jobs. Today, we talk much about growth. One phase of growth is industrial development. Let us say, for example, that a community proposes growth-inspiring action. This may involve opening a new area,

provision of new or improved streets, additional sewers, more school facilities. This action all adds up in most cases, to the need for a bond issue. Facing such situations, communities seek to raise campaign funds to encourage more widespread public support. The purpose is therefore legislative, in effect. Legislative action, that is, in support of community growth and the creation of additional or improved jobs. Yet, under a literal interpretation of the existing Internal Revenue Service ruling, funds expended by businessmen or owners of firms, relative to such legislative action (a referendum, for example), would not be deductible. Obviously, continuance in effect of such a ruling puts an effective damper on community efforts toward growth; without business support of local public education for community development, community progress is jeopardized. At the very least, the cause of education for local development is seriously weakened.

Or take an example at a State level; a legislature proposes a regulatory tax, or other action. Again, expenses incurred in presenting business-employer viewpoints would not be deductible. And this remains true whether or not the viewpoint is individual, corporate, that of a chamber of commerce or trade association.

There are other implications arising from the existing situation. For example, the current Internal Revenue Service ruling, in effect, permits individual Internal Revenue agents—operating in various regions of the United States—to determine individually whether or not taxpayers are engaged in influencing legislation.

Or take the case of those who operate newspapers, radio, or television stations; all are closely involved in matters of advertising. An Internal Revenue Service agent in one place might rule this to be legitimate public relations with an advertising purpose and therefore a deductible expense. Elsewhere, however, another agent might rule—from similar evidence—that what is being done constitutes lobbying and therefore is not deductible.

In endorsing—without dissent—the bill as amended by its staff, members of the House Committee on Ways and Means emphatically expressed their favor of a general legislative rule on deductibility involving legislative or legislatively related activity.

Concluding remarks

We should remain mindful that the Constitution of the United States guarantees to citizens of this country certain rights. Men have always respected these rights—as the mark of a free people. Among these rights are those of freedom of religion, of assembly, of speech, and of freedom to petition the Government for a redress of grievances. Specifically, these four freedoms are spelled out in the first amendment to the Constitution.

Of these rights, perhaps the most important is that of freedom of petition—the right to speak out.

Strangely, it is necessary again to reaffirm this right—with proper and adequate legislation. The right to speak out has been threatened by court decisions and administrative regulations, arrived at in the absence of a firm statement of law by Congress.

It is time for Congress to set the record straight.

This can be done by enactment of a general rule respecting the deductibility of ordinary or necessary expenses in reference to legislative and legislatively related actions; that is, by declaring them to be in law as well as in fact truly admissible and lawful expenditures.

SUPPLEMENTAL STATEMENT OF THE NATIONAL ASSOCIATION OF MANUFACTURERS ON SECTION 3 OF H.R. 10650 ON TAX STATUS OF EXPENSES IN CONNECTION WITH APPEARANCES, ETC., WITH RESPECT TO LEGISLATION

The National Association of Manufacturers appreciates the opportunity to file an expanded supplemental statement on this very important, but widely misunderstood, question of the tax status of expenditures for legislative activities. It is submitted in a dual capacity. First, as a representative of the manufacturing companies making up the membership of the association, and, secondly, on behalf of the association, as an entity, since the dues payments it receives to support the services and representative voice it provides its member companies may ultimately be affected. This question, which has become so be-

clouded by confusion as to the nature of the "public policy" involved, is important to the operation of our representative form of government and congressional declaration of the public policy is urgently needed for the guidance of both the Government and affected taxpayers.

ROLE OF GOVERNMENT

Recognition of the scope of the present-day role of government—at all levels—and its impact on economic and business affairs of the Nation is essential to the formulation of a realistic and equitable public policy respecting the deductibility of amounts expended on legislative proposals bearing on business enterprises.

Our system of government is founded upon and our basic strength results from concepts of freedom: freedom to vote, freedom of expression, freedom of religion, freedom of the press, freedom of petition and the freedom from undue and unwarranted governmental restraint. The growth, expansion, and encroachment of government always involves balancing the necessity for government action for the common good against the possible impairment of some of these freedoms. Properly to achieve and maintain this balance, it is essential to representative government that freedom of speech and freedom to petition the government not only be preserved and protected but actively encouraged.

Government not only regulates business but competes with business; thus, in an era of ever-widening range of governmental activities there is a resulting impact on industry and business in particular and our economic structure in general. Consequently expenditures to provide information, whether to a legislative body or to the public generally, on matters of consequence to such business enterprises are in fact and should be treated as ordinary and necessary business expenses in the same context as are other costs of doing business such as wages, heat, light, etc. Absent such treatment, there is an effective curtailing of the right of expression by business concerns through proscription under the tax laws. This is especially important when the matters at issue involve policies or actions of the government—at all levels of the government—that can have an effect on a business enterprise and its right to do business or stay in business.

The purpose of the income tax law is to derive funds to support essential government services. The tax laws should be utilized solely for this basic purpose. The taxing power should never be used as a means of censorship; nor should it be used to establish a moral code which substitutes government judgment for the sound judgment of business management.

The question before you has two basic aspects. One has to do with the expenses of business taxpayers who participate in varying forms of legislative activities at the different levels of government as a means of protecting or preserving their economic interests. An equally important aspect involves the purposes and activities of business organizations or associations.

With the ever-expanding role and impact of government over business and economic affairs the services and information provided by such organizations have served a useful, if not essential, purpose in the structure of our complex society. The dues paid to such organizations are therefore a component of this issue.

Generally speaking, business organizations provide their members with a variety of technical reports, educational material, economic information, legislative status reports and analyses, and a representation of common interests which would otherwise not be available or would be prohibitive in cost. This cost factor is especially an element of consideration in the case of small business firms.

The banding together of persons to promote or protect common business interests through multipurpose organizations is a legitimate function that is encouraged by an express policy of Congress providing tax exemption for such organizations. The complexities of our legal, economic, and governmental structure have made the joining together, either in business or labor union organizations, a necessity in order to present a common spokesman for the views and interests of the members. Legislative activities and the dissemination of information on legislative developments are only one aspect of the services provided by business associations but these are important functions. To directly or indirectly proscribe such activties by tax sanctions on the dues paid to such organizations would be an effective means of silencing an integral part of our free enterprise society.

PRESENT LAW AND REGULATIONS

We have sought briefly to put this issue in perspective by referring to the present day ever-expanding role of government and how these issues are interwoven with the interests of business taxpayers and their organizations. The present regulations, with the inconsistent and admittedly uneven application which give rise to this issue warrant analysis.

The Internal Revenue Code has since its inception permitted a deduction for income tax purposes for ordinary and necessary expenses paid or incurred in connection with carrying on a trade or business. The Congress, through the Internal Revenue Code, has never specifically prohibited a deduction of such business expenses incurred for legislative or "lobbying" purposes, for the "promotion or defeat of legislation or propaganda relating thereto."

Prior to the enactment of the 1954 Revenue Code, Treasury Department regulations had dealt with this subject through provisions of administrative regulations which related to the deductibility of charitable contributions by individuals and corporations. The Supreme Court of the United States, in the case of *Textile Mills Corp.* v. *Commissioner*,[1] upheld application of these regulations, which were promulgated under the charitable contributions provisions of the code, to ordinary and necessary business expenses. Subsequently, in 1959 the Supreme Court rendered a further decision in companion cases which again sustained application of these administrative regulations. In *Cammarano* v. *U.S.* and *F. Strauss & Sons, Inc.* v. *U.S.*,[2] deductions were disallowed for amounts paid by the taxpayers to business organizations for the purpose of defeating proposals submitted to the voters of the respective States in initiative measures. The Supreme Court determined that the amounts were "ordinary and necessary" and met the requirements for deductibility as business expenses; nevertheless the Court upheld application of the regulations so as to bar the deduction of such expenses as being for "lobbying" of legislative purposes. The Supreme Court recognized that there were no statutory limitations on deductibility of such expenses but stated that the administrative regulations had acquired the force and status of law as they "constitute an expression of a sharply defined public policy" in light of the doctrine of statutory reenactment.

Whether such public policy has been sharply defined is a basic point of contention. It is a fundamental rule of law that public policy can be formulated only by the Congress. But Congress has never defined public policy in connection with business expenditures for legislative activities.

The regulations which were approved in the *Cammarano* case were those relating specifically to charitable contributions[3] and not to deductions under section 162 of the Internal Revenue Code. However, based upon the rationale of the *Cammarano* case, the Internal Revenue Service, on September 19, 1959, published proposed regulations under the ordinary and necessary business expense section (section 162) dealing with the deductibility of so-called lobbying expenses. Public hearings were held and the testimony of many spokesmen for business, labor unions, and professional groups were in accord that the regulations as so proposed were unwarranted, not based upon sound public policy and were so ambiguous in language as to be impossible of effective application. Notwithstanding this reaction, the regulations were published in final form on December 29, 1959, to become effective immediately and set forth the current enforcement policy of the Treasury Department on so-called lobbying expenditures.

Such regulations[4] provide that expenditures for "lobbying purposes, for the promotion or defeat of legislation, for political campaign purposes (including the support of or opposition to any candidate for public office), or for carrying on propaganda (including advertising) related to any of the foregoing purposes are not deductible from gross income."

The regulations further provide that dues or other payments which qualify as business expenses if paid to an organization such as a labor union or trade association are deductible in full unless a "substantial part" of the organization's activities consist of the activities enumerated in the above quotation.

While recognizing that precise and absolute definition of terms may not be attainable, we respectfully suggest that broad and ambiguous terms such as "lobbying purposes," "promotion or defeat of legislation," "propaganda," and

[1] 314 U.S. 326 (1941).
[2] 358 U.S. 498 (1959).
[3] Regulations 118, chs. 39.23(o)-1(f) and 39.23(q)-1(a).
[4] Regulations, ch. 1.162-15(c) (1), (2), (3).

"substantial part" are impossible of evenhanded administrative application by the Government and cannot constitute adequate guides for affected taxpayers. The Internal Revenue Service appears to have recognized its inability to define such terms with the result that the enforcement of this regulation has led to uneven application by various revenue agents. This is true with respect to the direct activities of the taxpayer, as well as the tax status of dues paid by a taxpayer to an organization of which he is a member. This fact has been recognized by the Treasury Department in a letter of February 26, 1960, to the chairman of the House Ways and Means Committee, which stated, in part, as follows:

"Legislative reappraisal of the present law and the proposed legislation will necessarily take account both of the practical administrative problems which now exist in this area as well as those which might develop under the proposed modification. Present law, particularly as it relates to the dues paid to trade associations, institutional advertising, and the grassroots type of lobbying expenditure, is difficult for the Internal Revenue Service to administer. It is difficult, *if not impossible*, for the Internal Revenue Service, with its present manpower, to 'censor' or 'monitor' lobbying of the advertising or grassroots variety. Indeed, it has been the general position of the Internal Revenue Service that it is not only impracticable but undesirable to attempt to substitute the judgment of the tax collector for that of the businessman in determining the character of the advertising appropriate for the business as long as it may reasonably be expected to increase the patronage of the business.

"It is only realistic to recognize that many of the expenditures in these areas which have passed the permissible borderline under the existing regulations have doubtless escaped detection in the audit of tax returns. Unless the Internal Revenue Service were to devote disproportionate manpower from its basic collection function to policing this difficult and controversial area, *it would seem that uniform enforcement would be an unattainable goal.* If there were to be a modification or relaxation of the existing rules, therefore, it would appear to be a desirable objective that it should help reduce, rather than aggravate, the practical administrative problems which are inherent in this area, and at the same time reduce to a minimum whatever inequalities among some taxpayers result from unavoidable imperfections in the administration of the law.

* * * * * * *

"The present rules have created problems of enforcement since it is difficult to 'police' advertising campaigns and expenditures by unions or trade associations in an effort to identify degrees of attempts to influence legislation and, with respect to taxpayers generally, it is difficult to make certain that expenditures definitely in the lobbying area are not in fact deducted in the guise of legal expenses, advertising, or the like." [Italics supplied.]

This administrative enforcement problem was forcefully and effectively set forth by the House Ways and Means Committee when it unanimously recommended to Congress, in July 1960, that remedial legislation be enacted in this area.[5]

This enforcement problem was again reviewed by the Committee on Ways and Means as a part of its hearings and studies which resulted in H.R. 10650. The Ways and Means Committee Report[6] also pointed out the anomoly under the present law that expenses incurred in appearing before legislative bodies are not deductible, while appearances before executive or administrative officials or before the courts are deductible where the expense is otherwise qualified as being related to the trade or business of the taxpayer. The Ways and Means Committee specifically noted:

"Your committee believes that the present bar on deductions with respect to legislative matters must be modified to place presentations to the legislative branch of Government on substantially the same footing in this respect as that with the other two coordinate branches of Government."

The Supreme Court, in the *Cammarano* case, also sought to justify the conclusion reached on the basis of the legal theory of statutory reenactment. This theory of reeactment is based upon the presumption that the Congress, in reenacting a statute, does so with the implied knowledge of administrative interpretations placed upon the law. The Congress, so the theory goes, having this implied knowledge, would have changed such administrative construction if it had deemed it to be erroneous or in conflict with its intent. However, as the

[5] H. Rept. 2077, 86th Cong., 2d sess.
[6] H. Rept. 1447, 87th Cong., 2d sess., p. 17.

Supreme Court has recognized in another decision,[7] reenactment * * * is an unreliable indicium at best."

In disposing of a constitutional question raised in the *Cammarano* case, the Supreme Court indicated that persons engaging in legislative activities must pay therefor without "public subvention." While not relevant to the question before the committee, it is contended by some that to allow business concerns to deduct legislative expenditures made for a business purpose would be to authorize a public subsidy for such expenditures. Such contention misconceives basic principles. It seemingly proceeds on the theory that all business income is Government property and that relinquishment of any degree of ownership of such income is a grant or gift of Government money to the taxpayer. The true principle, of course, is just the opposite, that is, all business income is private property subject to taking only through due process of law.

It is a basic principle of our income tax law that all ordinary and necessary expenses for the earning or production of income are to be recognized as an offset or deduction in determining net income subject to tax. Are not expenses to preserve the right to stay in or do business essential to the prdouction of income for a business enterprise? As a matter of logic, there is not more subvention or subsidy for legislative expenses than there is in the case of other lawful business expenditures.[8] There is certainly no congressional policy to justify such statement with respect to the tax status of legislative expenditures.

These cases and anlysis of the shifting and inconsistent legal theories of what is or is not public policy in connection with certain tax deductions point up the need for congressional disposition of this issue.[9]

ANALYSIS OF PROPOSED LEGISLATION

Section 3 of H.R. 10650, as passed by the House of Representatives, moves toward a solution of the problem but we respectfully submit that it does not come to grips with the full scope of the problem.

Section 3 permits deduction by a taxpayer for expenses which are ordinary and necessary to the conduct of his business in connection with appearances before or communications to committees or Members of the Congress or of a legislative body of a State or political subdivision of any State or possession of the United States with respect to legislation or proposed legislation of direct interest to the taxpayer. The bill also permits deduction of sums spent in connection with communication by a taxpayer and an organization of which he is a member with respect to legislation or proposed legislation of direct interest to the taxpayer and such organization.

This proposal recognizes and clarifies an important aspect of the problem as reviewed above. However, some of the limitations on the above general rule, set forth in section 3 of the bill, are unrealistic and would permit continuation of much of the confusion and uneven enforcement existing under the present situation.

Under the first limitation no deduction could be had for expenses in connection with political campaigns of candidates for public office. With this we concur and recognize that it is based upon an expressed public policy of the United States, as evidenced by the Congress in the Corrupt Practices Act.[10]

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[7] *Commissioner* v. *Glenshaw Glass Co.*, 348 U.S. 426, 431 (1955).

[8] An illustration of the inconsistencies of the purported public policy and unsound philosophy underlying the present law can be found in related Supreme Court cases reaching different results. In *Commissioner* v. *Sullivan*, 356 U.S. 27 (1958), the taxpayer ran an illegal bookmaking operation but the Supreme Court permitted a tax deduction for rent and wages on the theory that if they were to deny deduction "we would come close to making this type of business taxable on the basis of its gross receipts, while all other business would be taxable on the basis of net income. If that choice is to be made, Congress should do it." Equally striking is *Lilly* v. *Commissioner*, 343 U.S. 90 (1952), where the Court found that the taxpayer-optician could deduct as "ordinary and necessary" the amounts paid to physicians as kickbacks on the price of eyeglasses. The Court stated that the ethics of this practice were questionable but there was not frustration of a declared public policy.

[9] The Federal Regulation of Lobbying Act, 2 U.S.C., chs. 261–270, is the only expression of congressional policy on so-called lobbying. This law merely requires that those who engage in defined activities must only register with the Congress. To suggest that legislative activities which are otherwise lawful under express congressional policy but are against public policy for tax purposes is incongruous.

[10] 18 U.S.C., sec. 610.

The limitation to which we take exception is that which disallows deductions "in connection with any attempt to influence the general public of segments thereof, with respect to legislative matters, elections, or referendums."

These sweeping limitations, in our view, are arbitrary in character and inconsistent with the bill's general principle of permitting deductions for legislative activities. We can see no logical reason for permitting taxpayers, or their organizations, to communicate views to legislative bodies on pending or proposed legislation and at the same time to deny tax deductibility for expenses in connection with informing the public. For example, in both the initiative and referendum the voters are performing a legislative function—they are the legislators, as the following definiton and explanation shows:

"The initiative is the power reserved to the people to propose laws and amendments to the Constitution and to enact or reject the same at the polls, generally independent of the legislature; the referendum is the power reserved to the people at their own option to approve or reject at the polls any act of the legislature. The referendum as thus defined is limited to the power of the people to approve or disapprove legislative acts at their own option and excludes the power to approve or reject legislation which has been referred to them by the legislative assembly. *Both the initiative and referendum are legislative in character.*" [11] [Emphasis added.]

If the initiative and referendum are "legislative in character" and the expression of views to legislators is recognized, we deem it illogical and inconsistent to limit the deductibility of expenses for informing the electorate. The *Cammarano* case, cited previously is an illustration of how important the issues involved in initiative matters can be to taxpayers. The economic effect on taxpayers involved in these cases was fully recognized by the Supreme Court and yet the basis of disallowances was upheld on grounds of purported public policy. If an informed electorate is an enlightened electorate, we submit that a public debate of the issues and dissemination of information on these issues should not be arbitrarily precluded by operation of sanctions under the tax law.

Another inconsistency in section 3 is that expenditures for "any attempt to influence the general public, or segments thereof" on legislative matters would be disallowed. The report of the Ways and Means Committee indicates that it is aimed at "what is usually called grassroot campaigns intended to develop a point of view among the public generally which in turn is directed toward the legislators." On a technical basis the use of phrases such as "any attempt," "general public, or segment thereof" and "legislative matters" are so incapable of precise definition that their use can only result in continued uneven administration, and certainly do not provide uniform criteria for the guidance of affected taxpayers. However, more important is the inconsistency in concept of precluding tax deductibility for expenses of this type.

In a recent case involving the Sherman Act, the Supreme Court stated a principle of law that seemingly creates a double standard in that the right of petition is to be treated one way under the antitrust laws and differently under the tax law. In this case the Supreme Court said:

"The right of petition is one of the freedoms protected by the Bill of Rights, and we cannot, of course, lightly impute to Congress an intent to invade these freedoms." [12]

With this statement we heartily concur. However, we find that under the present tax laws there appears to be just such imputation and a practical invasion of such freedoms so far as businesses are concerned.

In this same antitrust decision, the Supreme Court went on to say:

"The right of the people to inform their representatives in government of their desires with respect to the passage or enforcement of laws cannot properly be made to depend upon their intent in doing so. It is neither unusual nor illegal for people to seek action on laws in the hope that they may bring about an advantage to themselves and a disadvantage to their competitors."

Thus, the double standard. For tax purposes the right of businesses to inform their representatives in government is proscribed for practical purposes. However, in the instance of an antitrust statute, which also expresses public policy, it is deemed to be a preservation of a basic freedom for businesses to inform their

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[11] 28 Am. Jur. sec. 2, p. 437.
[12] *Eastern RR. Conf. v. Noerr Motor Freight, Inc.*, 365 U.S. 127 (1961).

representatives of their views on matters governmental. Such double standard is difficult to reconcile.[13]

There is a further double standard that points up the discriminatory aspects of the present situation. It is common knowledge that the executive branch of the Government extensively engage in "lobbying" activities. Almost every executive department in the Government has a high-level official charged with responsibility for congressional liaison. The activities of these officials in support of the various administration programs are well known. The views of these officials, and their colleagues, are solicited by congressional committees and Members. Are we to have the unfair situation whereunder only tax supported Government views are to be heard and the business taxpayer with an economic interest in legislative issues is to be curtailed through tax sanctions.

It is also well known that the Government also is in direct competition with proprietary business. This direct competition is supported by Government funds raised through taxation.

An instance of such competition, as well as the discriminatory treatment, is the disallowance of advertising costs to certain privately owned public utilities in their efforts to inform the public of the direct competition they are suffering from the Government. These investor-owned companies are not permitted to deduct such advertising expenses because, according to the Internal Revenue Service, the subject matter is one involving a "political controversy." Thus such companies are discriminated against for engaging in constitutionally protected freedom of expression.

Had such competition come from other private sources, there is little question that the advertising expenses involved would have been found deductible costs of doing business. Where the Government conducts business in a proprietary capacity, it would seem only fair that they do so in full competition in the marketplace. And yet, under the disposition reached in this illustration, the Treasury Department appears to be aiding a government sponsored function to the detriment of its private competitors by disallowing advertising expenditures as deductions. Thus, again, we find a double standard.

We submit that the Congress should thoroughly review the underlying public policy, as well as the tax philosophy involved in such discriminatory distinctions. It should be recognized that free speech or the free expression of views by business enterprises can be effectively limited or denied through the exercise of the taxing power. This principle was well stated in a recent decision by the Supreme Court of the United States[14] wherein the Court stated:

"It cannot be gainsaid that a discriminatory denial of a tax exemption for engaging in speech is a limitation on free speech. * * * It is settled that speech can be effectively limited by the exercise of the taxing power. *Grosjean* v. *American Press Co.*, 297 U.S. 233. To deny an exemption to claimants who engage in certain forms of speech is in effect to penalize them for such speech. Its deterrent effect is the same as if the State were to fine them for this speech. The appellees are plainly mistaken in their argument that because a tax exemption is a 'privilege' or 'bounty' its denial may not infringe speech. * * * [The] denial of a tax exemption for engaging in certain speech necessarily will have the effect of coercing the claimants to refrain from the proscribed speech."

Or, as Mr. Justice Black phrased it in his concurring opinion in this case:

"California, in effect, has imposed a tax on belief and expression. In my view, a levy of this nature * * * constitutes a palpable violation of the first amendment, which of course is applicable in all its particulars to the States. * * * I am convinced that this whole business of penalizing people because of their views and expressions concerning government is hopelessly repugnant to the principles of freedom upon which this Nation was founded and which have helped to make it the greatest in the world."

In the *Cammarano* decision, the taxpayers sought to rely on the *Speiser* case, but this contention was summarily rejected by the Court on the basis of the following rationale:

"Petitioners are not being denied a tax deduction because they engage in constitutionally protected activities, but are simply being required to pay for those activities entirely out of their own pockets, as everyone else engaging in similar activities is required to do under the provisions of the Internal Revenue Code. Nondiscriminatory denial of deduction from gross income to sums expended to promote or defeat legislation is plainly not 'aimed at the suppression of danger-

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[13] For a more extensive discussion respecting the "double standard" see speech of Congressman Thomas M. Pelly of Washington, 107 Congressional Record, Mar. 20, 1961, p. A1910.

[14] *Speiser* v. *Randall*, 357 U.S. 513 (1958).

ous ideas.' 357 U.S., at 519. Rather, it appears to us to express a determinatio by Congress that since purchased publicity can influence the fate of legislation which will affect, directly or indirectly, all in the community, everyone in the community should stand on the same footing as regards its purchase so far as the Treasury of the United States is concerned."

We respectfully submit that this rationale is fallacious and is not sound as a matter of tax policy with respect to businesses which can exercise the right of petition only through methods of communications which require expenditure of funds. In support of our contention that this statement by the Court does not represent sound tax policy we submit not our justification but the answer to the argument, as advanced by the House Committee on Ways and Means in its recent report in connection with H.R. 10650, wherein the committee stated:

"It also is desirable that taxpayers who have information bearing on the impact of present laws, or proposed legislation, on their trades or businesses not be discouraged in making this information available to the Members of Congress or legislators at other levels of government. The presentation of such information to the legislators is necessary to a proper evaluation on their part of the impact of present or proposed legislation. The deduction of such expenditures on the part of business also is necessary to arrive at a true reflection of their real income for tax purposes. In many cases, making sure that legislators are aware of the effect of proposed legislation may be essential to the very existence of a business. *The deduction of legislative expenses for those who incur them for personal reasons is not proposed here, since such expenses are not deductible with respect to administrative or judicial presentations and have no bearing on the determination of true taxable income of a business.*" (H. Rept. 1447, p. 17.) [Emphasis added.]

Thus, the Congress should not be misled by emotional and superficially persuasive arguments that everyone in the community should stand on the same footing for tax purposes insofar as this tax issue is involved. It has been made abundantly clear in the Internal Revenue Code that business taxpayers are permitted many deductions that are not permitted taxpayers not engaged in a trade or business and eligible for deductions under section 162 of the Internal Revenue Code. For example, the costs of heat, light, wages, insurance, and related items of expense are fully deductible if incurred in a trade or business but are nondeductible to a taxpayer not so engaged. The real discrimination, as is noted earlier, and as the Ways and Means Committee report points out, is that a business taxpayer can deduct his cost of presenting views affecting his business to the courts or administrative agencies but is illogically precluded a tax deduction for the presentation of similar views to legislative bodies or its members.

Ordinary and necessary business expenses are such that they must be based upon the business judgment of the taxpayer and not the hindsight judgment of government officials. Further, the effective administration of the tax laws can prevent any abuses which may arise in this area, for it is fundamental that such expenditures must not only be ordinary and necessary but must also be reasonable in amount, related to the business of the taxpayer and lawful in purpose. Disallowance of certain categories of expenses based upon a nebulous "good" or "evil" standard distorts the basis of the internal revenue laws, encourages discriminatory enforcement, and raises serious constitutional questions.

If a business taxpayer deems it appropriate to attempt to inform the public, or segments thereof, and such expenses meet the other criteria for tax deductibility, they should be recognized and permitted, regardless of the media by which such taxpayer makes his views known and to whom those views are directed.

CONCLUSION

The fact that the House Ways and Means Committee has twice reported and the House has now passed legislation in this area is a significant recognition of the importance with which that body views section 3 of H.R. 10650. The solution adopted and now before this committee is not a full solution of the problem.

Clearly, the time has come for the Congress to formulate public policy for the guidance of the Treasury Department, the Internal Revenue Service, and all affected taxpayers. The time is past for improvising with regulations unsupported by an expression of congressional policy. The Congress should act forthrightly to insure that the right to communicate with the elected representatives in government is not infringed or abridged in any way by operation of the tax laws.

An adequate legislative solution of this problem is embodied in the proposal cosponsored by your colleagues, Senators Hartke and Kerr (S. 467). This proposal, or a proposal similar to that approved by the Committee on Ways and Means in July 1960, H.R. 7123 of the 86th Congress, or H.R. 640, and companion bills of the 87th Congress are more effective legislative remedies than section 3 of H.R. 10650. They would make clear the congresssional intent that no tax penalties should be imposed as a deterrent to the exercise of the right lawfully to participate in the legislative processes of government, local, State, or Federal.

WISCONSIN POWER & LIGHT CO.,
Madison, Wis., April 18, 1962.

In re section 3 of H.R. 10650

Hon. HARRY F. BYRD.
Chairman, Senate Finance Committee,
Washington, D.C.

DEAR MR. CHAIRMAN: We respectfully request that this letter be entered in the record of the hearings now being held on H.R. 10650.

We urge that section 3 be modified to make it clear that the cost of advertising incurred by a taxpayer in the ordinary course of his business is deductible, Federal income taxwise, even though the advertisement may have some general reference to pending or prospective legislative matters.

It appears quite anomalous to us that certain expenses may be deductible if incurred in connection with appearances before and submission of communications to legislative committees or individual members, and also incurred in communication of information between taxpayer and an organization of which he is a member, while on the other hand other expenditures which may be incurred making the taxpayers' views known to legislators through public advertising will not be deductible. Consistency would seem to require the allowance of both types of expense as tax deductions and we urge a consistent treatment of this matter, and that section 3 be broadened so as to permit deduction in either view.

Furthermore it appears that the proposed section will present administrative problems. It would appear that it would require the Internal Revenue Service to determine or monitor what expenses are made for appearances before, communications to, individual members or committees of legislative bodies, and what expenses are made for communication between the taxpayer and an organization of which he is a member with respect to legislation as contrasted with expenses for advertising which advertising may have some attempt to influence the general public or segment thereof with reference to legislative matters.

There can be no well-defined line. Furthermore the apportionment of expense items as between the purposes for which the expenditure may be permitted and the purposes for which it may not be permitted, certainly will be difficult and most probably would require frequent or annual negotiations to determine the proper allocation.

It would seem to us that a modification of the section so as to make it clear that cost of advertising incurred by a taxpayer in the ordinary course of business should be deductible, even though some part of the cost of advertising might have some general reference to pending or legislative matters. Of course, we recognize that advertising or expenditures relating to participation in political campaigns or on behalf of any public office would not be deductible in any case.

Sincerely,

CARL J. FORSBERG, *President.*

TRANSPORTATION ASSOCIATION OF AMERICA,
Washington, D.C., April 16, 1962.

Hon. HARRY F. BYRD,
Chairman, Committee on Finance,
U.S. Senate, Washington, D.C.

MY DEAR MR. CHAIRMAN: Your committee currently has under active consideration H.R. 10650, entitled "Revenue Revision Act of 1962." On behalf of the board of directors of the Transportation Association of America I would like to urge the enactment of section 3 of the bill, pertaining to appearances, etc., with respect to legislation.

We believe the background of this section and the justification for its inclusio in H.R. 10650 is clearly set forth in the report of the House Committee on Way and Means and will be further amplified by supporting witnesses schedule to testify before your committee on April 17, 1962.

We think that our position endorsing such provision would be better understoo by a brief description of TAA. This association is a nonprofit research an educational organization devoting its efforts to the development and implementation of sound national policies which will assure the Nation of a strong transportation system under private ownership and operation. TAA is comprise of representative users, investors, and air, freight forwarder, highway, o pipeline, rail, and water carriers, all of whom work cooperatively to carry out this basic objective.

Our policy positions are developed by eight special permanent advisory panels of experts in the user, investor, and carrier fields. They are thereafter reviewed and acted on by our 100-man board of directors.

The end result of such activities is that by the process of study, discussion, and compromise we are frequently able to resolve existing differences between carrier modes or among the users, investors, and common carriers as to problems affecting the national public interest. These views are then presented in public hearings to congressional committees. You can readily understand and appreciate the value of such a process in facilitating the enactment of needed legislation, otherwise impeded by differing and conflicting views within the transportation industry.

Our principal concern is that the Treasury Department regulations adopted in 1959 have subjected to question the possible disallowance for Federal income tax purposes of membership dues payable to associations. Our feeling is not only that the legislative activities under challenge by the Treasury Department are legitimate and proper but also that such dues should not become subject to possible disallowance by the Internal Revenue Service.

Accordingly, we urge your committee to report favorably section 3 of H.R. 10650 for recommended approval by the U.S. Senate and respectfully request that this letter be made a part of the official record of the hearings thereon.

Sincerely yours,

HAROLD F. HAMMOND.

SOUTH CAROLINA ELECTRIC & GAS CO.,
Columbia, S.C., April 23, 1962.

Hon. HARRY F. BYRD,
Chairman, Senate Finance Committee,
New Senate Office Building, Washington, D.C.

DEAR MR. CHAIRMAN: I am writing you this letter concerning section 3 of H.R. 10650 (deductibility of expenses incurred in connection with legislation). I respectfully ask that this be made part of the permanent record of the hearings on this measure.

While this section of the bill provides that ordinary and necessary business expenses may be deducted, certain instances in computing Federal income taxes would obviously obviate an allowance for a deduction for any amount paid or disbursed in an attempt to influence the general public, or any given portion thereof, on elections, referendums, or matters before State or the National Legislatures.

Certainly, this company concurs wholeheartedly in the proposal to allow as a tax deduction ordinary and necessary business expenditures involved in appearances before, or statements to, committees of individual members of legislative bodies in relation to legislature of direct interest to the taxpayer, and the other deductions enumerated in the bill. However, we believe that the bill does not go far enough. We feel strongly that code section 162 should provide that the costs of advertising intended to present the taxpayer's viewpoint to the public or any segment thereof on proposed legislation should be deductible as an ordinary and necessary business expense. We feel that the same should be true of expenses involved in what, for want of a better term, is commonly known as lobbying.

In its letter of February 26, 1960, to the chairman of the Ways and Means Committee, the Treasury Department pointed out a fact of which we are all thoroughly aware: the growing impact of Government in all its subdivisions upon

all individuals and businesses. Surely, it is not only proper, but vitally necessary that the taxpayer fully present his views to his elected representatives, or the appointees thereto, on issues which vitally affect him. I have had no little experience in this field, and know that quite often legislative officials have said that they find such expositions on proposed legislation helpful. I feel particularly strongly about this inasmuch as I represent an industry which is closely regulated by both Federal and State Governments, and which is vigorously and keenly competed with by tax-free rural electric cooperatives and agencies of the State and Federal Governments. Quite naturally, we wish to make our case known to our customers and the voters. There is no difference between this particular facet of the public versus private power controversy and two grocery stores putting the respective merits of their products and services before the public.

At the present high tax rate, industry and business could be well-nigh silenced if it is not accorded tax treatment of the kind I herein request. Further, the public would be denied vital information in a controversy which, we believe, goes a long way toward deciding the fate of our private enterprise system—the system which has undergirded our political freedom. This is particularly important when our opponents are able to advertise—and they do it lavishly—with income dollars upon which practically no tax dollars are paid. We, therefore, earnestly request that your committee modify section 3 of H.R. 10650 so that expenses of this type may be deductible as ordinary and necessary business expenses.

Cordially yours,

ARTHUR M. WILLIAMS, JR.

NEW YORK FARM BUREAU,
Ithaca, N.Y., April 23, 1962.

Senator HARRY F. BYRD,
Chairman, Senate Finance Committee,
Senate Office Building, Washington, D.C.

DEAR SENATOR BYRD: We are somewhat disturbed over some of the provisions of H.R. 10650, the proposed 1962 Revenue Act. Since this bill has passed the House, the Senate now has an opportunity to correct some of its disturbing features.

Among those which bothers us mostly in New York State are section 2 having to do with investment credit, section 17 on cooperative tax treatment, and section 19 with regard to withholding taxes from interest and dividend payments.

We believe that the credit for investment against taxes due rather than against income subject to taxation, might have some undesirable effects. Certainly in the beginning it would be discriminatory against those who for example had kept their plants in modern condition as against those who had delayed expenditures. The latter would be rewarded for such delays. We can also visualize investment for things of lesser importance because of its resulting in practically no net cost to the investor. We believe that the best method to promote investments is to have a tax structure which will permit an income out of which investments can be made.

Most farmers are members of one or more cooperatives organized for the marketing of agricultural products or purchasing of supplies needed in the production of agricultural products. Farmers are keenly interested in having successful cooperative organizations and having tax laws which will promote cooperatives and at the same time be equitable. Double taxation at the cooperative level and also at the patron level is not in the best interest of all concerned. It is best that all cash and noncash distributions be taxable at the patron level rather than at the cooperative level. However, it is important that responsibility for paying tax on taxable distributions should be firmly established in the statute.

The third matter on which we wish to comment has to do with the proposed withholding tax on dividends and interest. We can see no validity for such a proposal, particularly in view of the data processing equipment that Internal Revenue Service is getting into operation. It would be a tremendously expensive method of tax collection, the burden of which would be placed on private industry. It would also be a great burden on our senior citizens, many of whom depend to a considerable extent on income from interest and dividends. In

most instances such persons would have little or no legal tax obligation but they would hesitate to go through the difficult procedures to obtain a refund and would thus be deprived of income that they need and that is rightfully theirs. This section of the proposed bill should be deleted without question.

Yours sincerely,

C. K. BULLOCK,
Director, Commodity Department.

(Whereupon, at 4:25 p.m., the committee adjourned, to reconvene at 10 a.m., Wednesday, April 18, 1962.)

REVENUE ACT OF 1962

WEDNESDAY, APRIL 18, 1962

U.S. SENATE,
COMMITTEE ON FINANCE,
Washington, D.C.

The committee met, pursuant to recess, at 10 a.m., in room 2221 New Senate Office Building, Senator Harry F. Byrd (the chairman) presiding.

Present: Senators Byrd (chairman), Kerr, Anderson, Douglas Gore, Williams, and Curtis.

Also present: Elizabeth B. Springer, committee clerk; and Colin F. Stam and L. M. Woodworth, Joint Committee on Internal Revenue Taxation.

The CHAIRMAN. The committee will come to order.

The first witness is Mr. Carmin C. Saccardi, of the Association of Stock Exchange Firms.

Will you take a seat, sir, and proceed?

STATEMENT OF CARMIN C. SACCARDI, REPRESENTING THE ASSOCIATION OF STOCK EXCHANGE FIRMS; ACCOMPANIED BY BRITTIN C. EUSTIS, PRESIDENT, ASSOCIATION OF STOCK EXCHANGE FIRMS; MILTON A. SPEICHER, FRANCIS I. du PONT & CO.; AND FRANCIS J. HUGHES, GENERAL COUNSEL OF THE ASSOCIATION OF STOCK EXCHANGE FIRMS

Mr. SACCARDI. Thank you.

Mr. Chairman and members of the committee, my name is Carmin C. Saccardi. I am an officer with the title of cashier and a voting stockholder of Merrill Lynch, Pierce, Fenner & Smith, Inc.

Today I am speaking as a representative of the Association of Stock Exchange Firms. With me are Brittin C. Eustis, president of the Association of Stock Exchange Firms, and a partner at Spencer Trask & Co.; Milton A. Speicher, on my left, a partner of Francis I. du Pont & Co.; and Francis J. Hughes, general counsel of the Association of Stock Exchange Firms.

The Association of Stock Exchange Firms is a trade association representing 525 New York Stock Exchange member organizations located all over the United States. There are over 5,000 security dealers in the securities industry who are represented by organizations like the association, the New York Stock Exchange, American Stock Exchange, various regional exchanges, Investment Bankers Association of America, and the National Association of Securities Dealers.

The committee will undoubtedly hear directly from a number of these organizations before the hearings conclude. In many cases there is an overlapping membership among these organizations; for example, my firm is a member of most of the associations and exchanges. Although I only speak for the Association of Stock Exchange Firms, in my judgment, all securities dealers handling customers' securities will encounter the same administrative difficulties that I am about to discuss.

I wish to thank the Senate Finance Committee on behalf of the Association of Stock Exchange Firms for the opportunity we have received to present our views on dividend withholding as it appears on the revenue bill of 1962.

Our statement today concerns itself solely with the serious administrative problems faced by the securities industry if 20-percent dividend withholding at the source is enacted into law.

The various proposals in regard to exemptions, including those in the present bill, pose difficulties of an extreme nature insofar as dividend processing is concerned throughout the entire securities industry.

In order to support this contention, it may be useful to explain the industry's present problems in the dividend area and those that might be expected.

By its very nature, dividend processing undergoes very heavy seasonal peaks of activity. The activity means periods of heavy payroll overtime; night and even weekend work. The seasonal peak is particularly burdensome in the fourth quarter of the year. During December many companies pay regular quarterly and extra dividends. In other instances, companies that pay only once a year seem to prefer December. Naturally, quarterly payers of dividends also remit in December.

Receiving and crediting dividends to individual accounts is an important service function of our business and one that represents a very heavy cost without any offsetting income.

The processing cost is increased as some of the "claims" for dividends due an individual broker prove to be uncollectible. These claims represent payments that are due to an individual or a broker, but that are actually paid because of an unavoidable time lag to a third party who is not entitled to such payment.

Here is a typical example: A customer in Oklahoma sells 10 shares of American Telephone & Telegraph. He sells prior to the ex-dividend date. Because of the time lapse in delivery and mailing, the certificate for 10 shares of stock does not reach the broker's home office in time for him to get it to the transfer agent by the record date. As a consequence, the dividend is paid to the former shareholder in Oklahoma. It now becomes necessary for the broker to claim the dividend paid to the seller in order to credit the buyer who is properly entitled to the dividend.

Almost all mechanical equipment in the brokerage industry is gaged to provide sufficient excess capacity for dividend processing peaks. Thus the cost of processing dividends must include not only overtime wage payments but excess machine capacity as well.

All of these factors have been further complicated by the passage last year of a bill requiring that all reports submitted on dividend payments must include the individual's social security number or tax iden-

tification number. Our industry has not yet fully experienced the difficulties that will result from this added and cumbersome requirement in handling dividend reports.

During the 1961 calendar year it is estimated by Standard & Poor's dividend service that approximately 8,300 companies declared and announced approximately 24,900 dividends. Depending on the size of a brokerage firm, it is likely that a broker will have customers' positions necessitating the processing of anywhere between 10 to 100 percent of these individual, published company declarations.

Many other companies pay dividends but make no published announcement. As an illustration, Merrill Lynch, Pierce, Fenner & Smith, Inc., is holding for customers approximately 14,000 different common and preferred stocks upon which we received 45,590 dividend payments in 1961. These payments necessitated the crediting of approximately 7 million separate dividend payments to individual customer accounts last year.

It may prove useful to recount the work involved in the processing of a single dividend in one brokerage firm. I hesitate to take the commitee's time on such minor processing details. But unless the present complications that exist in dividend computations are understood, it is difficult to appreciate our strong objections to the mechanical and administrative problems that would be posed by dividend withholding and particularly the use of exemptions.

On March 1, 1962, the American Telephone & Telegraph commonstock holders of corporate record were entitled to receive the payment of a quarterly dividend of 90 cents per share to be remitted on April 2.

Obviously, on the payable date a broker must credit each customer holding A.T. & T. on his accounting books with a dividend of 90 cents per share.

On the same day, April 2, the broker receives a check from American Telephone & Telegraph which only in rare instances would equal the amount paid to the customers.

In order to create a balanced position, action prior to the payable date is necessary. The broker has to do the following things: Prior to the record date a major effort must be made in the home office and branch offices of the broker to place all of the shares of American Telephone & Telegraph into the broker's nominee name so that the dividends will be collected on behalf of the customers holding A.T. & T. shares with the broker.

No matter how determined this effort is, there are delays that prevent some transfers from being made. These delays can be due to mail delays and to processing difficulties in the brokerage office and at the transfer agent.

Further, the broker is in a position of having to make an educated guess as to whether certain stock cetrificates were processed in time by the transfer agent in order to be in the broker's name by the record date. Subsequently, all shares coming out of transfer are checked to determine whether this educated guess was right or wrong. If transfer was not made into the name of the broker in time, it often will be necessary to make a "claim" on the registered holder as in the previous illustration.

The home office operation of this step in involved, but it is not nearly as difficult as securing a report from the various branch offices by wire,

providing the name of the registered holder of A.T. & T. stock held by them on the record date.

Any delay in securing a prompt and accurate report means involved work in reconstructing the situation that existed on a prior day. Here, again, many of these shares are registered in the name of individuals who have already sold the stock and are not entitled to receive the dividend. The broker must collect this dividend in order to balance the amount he has already paid to other customers.

In other cases, the individual registered holder of A.T. & T. is entitled to the dividend and the record must be so noted that he will not receive two dividends—one at the broker's expense.

In summary, a broker may hold A.T. & T. shares on the record date for an individual that could represent one of three situations:

1. A claim results from an individual who appears as a registered owner on the corporation books but who in actuality is no longer the owner, as in the case of the Oklahoma seller of 10 shares of American Tel. & Tel.

2. The individual is entitled to a dividend but he will receive it direct as a record owner on the company books. A broker must be accurate and careful to avoid duplicating this payment.

3. The individual looks to the broker for dividend as the shares he owns are held in the broker's name. In this instance, the broker must be sure to avoid underpaying a customer.

High accuracy is essential because the money values being balanced amount to millions of dollars, and any loss because of improper balancing or uncollectible claims becomes a very expensive current cost in relation to the broker's capital funds.

In the case of my company, our capital funds of $90 million are considered more than adequate by all Government and stock exchange regulations, but our potential liability is also great, since each year we process $200 million in customers' dividends.

On a single day, April 2, 1962, we processed dividends in the amount of $5,585,713. Obviously, even a minute discrepancy represents an amount of money that looms large in relation to other expenses and the company capital. The proportional rate of expense would be the same for any adequately financed broker and be more of a problem for a smaller security company with less capital.

If this complex dividend equation, that I have just outlined, were further complicated by a withholding system of exempt items being treated at a 100-percent rate and nonexempt items at 80 percent of the dividend rate, significant administrative problems would arise. If exemptions were broader than they are in the present bill, operating conditions would approach chaos. I think it appropriate at this point that we give the drafters of this bill considerable credit for having limited the exemptions in the dividend area in recognition of problems that would be created for brokers by broad exemptions.

The dividend withholding exemptions at present apply only to issuing corporations, and a broker is not required to handle such exemptions.

As for bond interest, no exemptions are allowed except for bonds with tax-free covenants, foreign bonds, and the constitutional exemption provided municipal bonds. The interest on corporate bonds and on U.S. Treasury bonds is not exempt from the withholding features.

The problems of the brokerage industry with the present limited exemptions arise from the fact that certain certificates will be processed in the general industry flow of securities that will be in the names of individuals collecting dividends, in some instances, at the 80-percent rate, and in others at the 100-percent rate.

When a broker attempts to make claims on some individuals to balance his dividend account, he will find that in some cases he will secure 100 percent of the dividend when he is only claiming 80 percent.

The reverse is also true. Again, he will find that he must become involved as the withholding agent on the 20 percent. Exempt individuals will look to the broker for 100 percent collection on the dividend. We will have to advise such customer that we can only provide 80 percent of the dividend; and further inform the customer that the 20 percent must be reclaimed from the Government.

Obviously, if exemptions are broadened, the problems become far more severe because a greater number of exempt dividends will be subject to claim and in the flow of securities in the workable supply in the industry.

Frankly, we are uncomfortable in the position of stating that additional exemptions are unworkable. We all realize that social necessity and fairness to many taxpayers would indicate broadened exemptions to prevent overwithholding.

It is the recommendation of the Association of Stock Exchange Firms that in the dividend area, exemptions be completely eliminated to solve the administrative problems. To accomplish the objective of fairness, for the individual with a low-tax liability, we propose that the bill be amended to provide for an immediate refund for overwithheld individuals, for example, by application and certification at the local post office. We feel this would be far more in keeping with the interest of millions of retired people who use their dividends as a source of retirement income and, in fact, are apt to owe far less than 20 percent as a year-end tax liability, especially since individuals over 65 are entitled to double personal exemptions.

It should be remembered that the present generation of retired people predates the era of widespread pension plans and the broadened coverage of social security. It would seem especially unfair if the provident individuals who have taken care of their retirement through the systematic purchase of interest-and-dividend-producing investments should be deprived of any of their income, even for short periods of time. It would seem unusual to us that Congress, having accommodated the interest of older people by allowing double personal exemptions, would undercut this legislative consideration by excessive withholding on dividend income.

Under the bill personal exemptions on dividends can only be used by making a certification that during the following year the individual will have no tax liability whatsoever. An individual who owes as little as $2 in tax may find that all his dividends and interest are withheld at the rate of 20 percent.

We recognize that dividend and interest withholding cannot be as sensitive to individual exemptions and tax rates as the salary-withholding system. An immediate refund would appear to be the answer. Under immediate refunds, additional policing work by the Treasury Department will be necessary if individuals claiming re-

funds "gross up" on their returns and take credit for taxes already refunded. Such taxpayers' actions could result from either ignorance or intent. Nevertheless, the policing problem, as the bill now reads, exists in two areas: (1) The validity of exemption certificates; (2) the claims made on quarterly refunds.

There does not appear to be any need for the exemptions on institutions and charitable funds because the bill does provide them with reasonably prompt relief by allowing a credit on withheld dividends to be applied to their employee salary-withholding liability. However, where the offset is inadequate, we propose that instant refunds be made available to institutions and funds. Exemptions for these institutions would be a particularly serious problem for the securities industry, insofar as the funds and foundations very often buy and sell large blocks of stock. The resulting claims would represent substantial amounts that the broker would have to recover in order to balance his dividend account.

In summary, may I state that it is our view that the use of an immediate refund in the dividend withholding area would result in two major benefits:

1. A system more sensitive to the income and personal budget problems of overwithheld individuals.

2. The elimination of serious administrative problems that result for our industry by the use of exemptions.

Mr. Chairman, I deeply appreciate the committee's courtesy in hearing this testimony and I am ready with my associates for any questions you may have. Thank you.

The CHAIRMAN. Mr. Saccardi, you have made a very strong statement, in the opinion of the chairman, as to the complexities of the withholding of dividends. I would like to ask you a few questions.

On page 3 you state that your company, which is one of the largest brokerage companies in the country——

Mr. SACCARDI. Yes, sir.

The CHAIRMAN (continuing). Has approximately 14,000 common and preferred stocks for your customers. Is that stock issued in the names of the customers?

Mr. SACCARDI. The overwhelming majority—probably 99 percent of it—is held in our nominee names.

The CHAIRMAN. Held in your name?

Mr. SACCARDI, In some instances we make exception to the general policy and may hold certain stocks in the names of customers, for example, for qualifying shares for directorships and that type of situation and also in certain special instances.

The CHAIRMAN. What is the advantage of that practice?

Mr. SACCARDI. Well, I think the easy way to explain it is that it allows us great latitude in the processing of business, because we can keep shares in large denominations.

For example, we keep large denominations of American Telephone & Telegraph. We have 10,000-share pieces in some instances, but I can assure you we have very, very few customers that hold over 100 shares. So if we didn't bulk this up in an overall position, unrelated, shall we say, to an individual's account, on the securities side, we have specific records showing exactly what the customer owns, and we are subject to segregation regulations to make sure we do not give fully paid securities the same treatment of a margin account that is not fully paid.

This gives us great latitude, similar to a bank keeping money for individuals.

The CHAIRMAN. I can see some advantage when the company sends a check for that stock owned by others, but in your name. It is withheld in your name; it is withheld from the dividend check that comes to you?

Mr. SACCARDI. That is correct. We will have——

The CHAIRMAN. You have to distribute that proportionately to the stock that you hold for your different customers. You think it is difficult to arrive at the correct amount; you indicate that in your statement.

Mr. SACCARDI. If we were able to get all of the shares in our name on the record date, there obviously would be a very small problem. But this is virtually impossible in view of time factors and processing delays, and this opens up the problem of making the claims at different rates.

The CHAIRMAN. I know you have studied this. I wish you would state clearly the exemptions. What are the exemptions in the House bill, and how are they——

Mr. SACCARDI. Well, the exemptions that I have listed here and believe to be correct are that if the exemptions were broader than they are in the present bill, operating conditions would approach chaos. And further on I give the dividend withholding exemptions which apply presently only to issuing corporations, and a broker is not required to handle such exemptions.

As for bond interest, no exemptions are allowed, except for bonds with tax-free covenants, foreign bonds, and the constitutional exemption provided municipal bonds. The interest on corporate bonds and U.S. Treasury bonds is not exempt from withholding features. Is that the summary that the chairman wished?

The CHAIRMAN. Then there is an exemption certificate applied for by the owner of the stock, I assume. Is the certificate issued by the Internal Revenue as to a certain person who would not be subject to withholding?

Mr. SACCARDI. That is correct, if he can certify he will have no tax liability whatsoever in the coming year.

The CHAIRMAN. I assume that can be checked by the Internal Revenue later on.

Mr. SACCARDI. I would say so.

The CHAIRMAN. That would create additional work. I don't understand exactly what you mean by "immediate refund."

Mr. SACCARDI. Well, the use of an exemption automatically means that in order to create a balanced dividend position we are treating some items on an 80-percent and some of a 100-percent basis. Now, if this were broadened by the exemption, then we would have great difficulty in handling it, and we feel that the immediate refund from the individual standpoint comes very close to an exemption. It eliminates quite a considerable problem for the individual having a delay in securing his quarterly refund, or in the case of an exemption, an individual may be on a 5-percent tax rate. He can't honestly claim an exemption certificate. This represents an overwithheld position.

The CHAIRMAN. Suppose a stockholder gets a dividend of $100 from which 20 percent is withheld. You say that you favor an immediate refund. What do you mean by that?

Mr. SACCARDI. Well, we suggest in the statement here that it be processed at some convenient facility such as, say, the post office. It is familiar with handling money, is convenient, and it could verify the claim. I would say that the individual would state he was the owner of 50 shares of General Motors, and on such and such record date and payable date the amount was withheld. He would make a certification or claim that he will not have a liability as a result of the recovery of this money, and this would allow him to secure the funds in a prompt way. Any other way that would be prompt, I would say, would be suitable. The post office——

The CHAIRMAN. It isn't clear to me as to how the immediate refund is made. Suppose there is $20 withheld under the proposed withholding plan.

Mr. SACCARDI. On the payable date——

The CHAIRMAN. You say that that should be an immediate refund on the assumption that their tax bracket is such that they are not subject to income taxes.

Mr. SACCARDI. Well, this—I follow the Chairman——

The CHAIRMAN. Maybe I am confusing it.

Mr. SACCARDI. I follow the Chairman's point. It is possible that the individual would be claiming all refunds when actually he does have some tax liability.

The CHAIRMAN. The individual can get a tax exemption, can he not? What is the difference between that and immediate refund?

Mr. SACCARDI. I think the immediate refund is more sensitive to the individual's requirements.

The CHAIRMAN. Does the immediate refund mean that the Treasury sends a refund check immediately, or on a quarterly basis or what?

Mr. SACCARDI. Our suggestion here is it would be done through the post office, which is familiar with handling funds, and in many cases——

The CHAIRMAN. I am interested in your suggestion because I think there are a lot of complexities in this refund question, especially on interest and on dividends. What machinery would be necessary to accomplish this?

Mr. SACCARDI. I can honestly state that I couldn't answer that.

The CHAIRMAN. I would like to know exactly what you mean by "immediate refund" in the operation of it. Give me a sample of it.

Mr. SACCARDI. Well, an individual with either no tax liability or rather a low one——

The CHAIRMAN. Well, no tax liability in his own estimation?

Mr. SACCARDI. Correct, sir.

The provision of the exemption is what causes quite a problem for us in processing the administrative aspect of our business, but if we have the immediate refund the individual gets his money without the need of complicating the clearance of securities and the claiming of dividends.

Senator WILLIAMS. As I understand, if you will yield, you are suggesting a refund principle rather than an exemption?

Mr. SACCARDI. Yes, Senator.

The CHAIRMAN. That wouldn't apply to all holders of stock, would it?

In other words, if they are in the 20-percent tax pay the 20 percent, they would have to pay it in a regular income tax return then, of course, there wouldn't be any refund.

Mr. SACCARDI. That is correct. But let's say——

The CHAIRMAN. You are referring only to those that will not pay taxes to the extent of 20 percent?

Mr. SACCARDI. This would be partly contingent, as I see it on the number——

The CHAIRMAN. Explain the actual operation of your plan.

Mr. SACCARDI. In summary may I state that it is our view the use of the immediate refund in the dividend withholding area would result in two major benefits:

(1) A system more sensitive to the income and personal budget problems of overwithheld individuals.

(2) The elimination of serious administrative problems that result for our industry by the use of exemptions.

The CHAIRMAN. Give me an example.

Mr. SACCARDI. Well, let's say that a stockholder owns five securities, which we find is a typical figure among our accounts, which represent diversification. This, in most cases, represents 20 dividends a year.

The individual, if he had no tax liability whatsoever, could make an immediate refund claim on the payable date for each of the dividends. If, perhaps, his tax liability was half, he would then be in position of claiming those that would create a correct withheld position as far as he could estimate, or as far as he wished to correct in his quarterly estimate of tax.

This could be incorporated into the form. I think we think of one dividend. It is hard to imagine how we could apply it, but if we visualize that individuals usually have different stocks, then its application is closer.

The CHAIRMAN. Then the individual determines the amount of the refund rather than the Internal Revenue?

Mr. SACCARDI. That is correct, Senator.

The CHAIRMAN. Wouldn't that lead to still further confusion because the individual has the right now to get an exemption by filing an exemption certificate. I am disturbed about your plan because the amount of the refund is determined by the individual. He may underestimate his income.

Mr. SACCARDI. Well, in this instance, there are many individuals who would fail to file a return—who, I doubt, would present a fraudulent or inaccurate statement. This was our thinking, that in many cases an individual may forget a return, will have to make an overt act.

The CHAIRMAN. The point I make is the individual can get an exemption certificate. Isn't that about the same as this immediate refund?

What is the difference?

Mr. SACCARDI. Well, the real difference is that we have looked at our own administrative problem, and we feel that the administrative problem with exemptions is very real because of the dividend processing, and our own discussion was such that we felt that the immediate refund would be more sensitive to the individual needs as I have outlined——

The CHAIRMAN. Is your suggestion offered as a substitution for the exemption certificate plan?

Mr. SACCARDI. Yes, sir; the substitution, the elimination of the exemption in point 2.

The CHAIRMAN. In other words the stockholder would determine for himself whether he has a tax to pay, is that right?

Mr. SACCARDI. Yes, Senator.

The CHAIRMAN. But then the withholding had already occurred, hadn't it?

Mr. SACCARDI. Yes.

The CHAIRMAN. The exemption certificate is recorded with the company that issues the stock and exempts that particular person from the withholding tax. Is that right?

Mr. SACCARDI. That is correct.

We feel that those individuals have a need—who have a need—will seek immediate refunds. It is doubtful that the average individual will go through the trouble of claiming every $20 or $30 withheld, and will probably, where the money is of no particular significance to him, wait for a quarterly readjustment of his figure.

The CHAIRMAN. I agree with you on that; but it still is not clear to me the difference between an "immediate" refund and asking for a certificate which prevents the withholding by the company that issues the checks.

Mr. SACCARDI. With the Senator's permission, I would like to see if maybe one of my associates here might clarify it.

The CHAIRMAN. I am deeply interested in it because I can see tremendous complexities about it and I want to understand it and I haven't heard before the suggestion of an "immediate" refund, I just don't know what it means.

Mr. SACCARDI. Perhaps, Mr. Speicher can assist in it.

Mr. SPEICHER. Mr. Chairman, the idea of an immediate refund doesn't mean within 5 minutes, but rather a few days for processing, if necessary.

The CHAIRMAN. Wait a minute.

Let's start with the withholding. The withholding has occurred.

Mr. SPEICHER. No.

Mr. Chairman, if we had what we had in mind we would eliminate the exemption certificate first.

The CHAIRMAN. That wasn't clear.

Mr. SPEICHER. That is what Mr. Saccardi has in mind, the elimination of the exemption certificate first.

The CHAIRMAN. How is A.T. & T., for example, to know—when they send out a check for dividends—whether there should be withholding or not on that particular check?

Mr. SPEICHER. Well, our idea is that it should have withholding on all items to all stockholders rather than an exemption.

The CHAIRMAN. Then how are you going to get the refund except by the method that they outlined in the bill which I think is once in 3 months, isn't that what they propose?

Mr. SPEICHER. Once every 3 months, sir.

The CHAIRMAN. Then you want to make it immediate.

Mr. SPEICHER. Rather faster than the outlined repayment; yes, sir.

The CHAIRMAN. What is immediate? It must be, if you write it into law you have to define "immediate." Would it be 10 days, 30 days, or what?

Mr. SPEICHER. We thought if the individual went to the post office, or to the Internal Revenue office, or some similar governmental organization, and presented his claim—which would clearly show his social security number or his tax identification number, and the dividend on which withholdings had been made—that he would then sign his name, identify himself properly, and the post office would either immediately refund to him or within several days send a check to his house.

The CHAIRMAN. Then all that would have to be checked by somebody, would it?

Mr. SPEICHER. Eventually it would, yes. But we believe this could be centralized under this new ADP, and all of these pieces of paper would come together in the Treasury Department's files, and then they would have to cull through them and eventually see that they are either correct or incorrect.

The CHAIRMAN. The only justification for paperwork involved in withholding of interest and dividends is the fact that a great deal of income is ecaping taxation. There would be no other justification of this because it's going to be a vast cost, in my judgment, to the corporations. It is going to be a great cost to the Government checking on all these refunds and so forth.

In your judgment, how much of the dividend income escapes taxation as of today? Of course, every company is required to report the payment of all dividends to the Treasury. I have been hopeful that this number system, that this committee was instrumental in having adopted by the Senate, could be so worked out so as to avoid the complexities of withholding tax on dividends and interest because if that could be done it would be a great saving to everybody concerned providing that if it brought in the collections which are now escaping taxation.

Personally, I feel there is a greater tax loss on interest income than there is on dividend income, because the Treasury has the informational reports on dividends paid. And if the numbering system works accurately, as I understand it, it consolidates under one number, the income of one individual, which would automatically determine his total income.

Is that right or not?

Mr. SPEICHER. I understand so, too, Mr. Chairman.

The CHAIRMAN. That is the theory of it.

Do you think dividends to any large degree are escaping taxation now?

Mr. SPEICHER. We are not usually in position to see how much of it can escape. We report to the Treasury the amount of dividends for each of our customers.

The CHAIRMAN. Your companies get how much in dividends?

Mr. SPEICHER. Mr. Saccardi's company gets about $200 million in a year.

The CHAIRMAN. Is that reported in the names of individuals to the Internal Revenue?

Mr. SPEICHER. Yes, sir; and the law now requires that we include the social security number, the law passed last year.

The CHAIRMAN. The social security number?

Mr. SACCARDI. With the report to the Government of the individual's name.

The CHAIRMAN. Mr. Stam says the law requires only amounts over $10 to be reported.

Is that correct?

Mr. STAM. The information returns.

The CHAIRMAN. Information returns over $10.

Mr. SACCARDI. It is far simpler for us to make a full report, because this $10 represents a cumulative cutoff, and I think it is the practice of industry generally to make a complete report because of the simplicity. It is a cumulative figure, and you never know whether to accumulate it because you may run over the $10 at the end of the year.

The CHAIRMAN. I repeat that if there is a large amount, what is the amount that they claim?

Mr. STAM. $85 million.

The CHAIRMAN. It is approximately $800 million covering both dividends and interest.

Do you have any thoughts as to how that loss would be prevented without the withholding?

Mr. SACCARDI. With the chairman's permission, I think that Mr. Eustis can give some general comments on the position that we have in the area of the principle of withholding. I don't feel I have been authorized to talk about the principle.

The CHAIRMAN. From my standpoint I repeat the withholding is only justified in order to make to make tax collections which we cannot make otherwise by reason of the alleged diversion of the payment of dividends and interest.

Isn't that a fair statement?

Mr. SACCARDI. Our organization, in some respects, has, shall we say different opinions on the general overall question of withholding as a matter of policy. But we stand united on the administrative policy.

The CHAIRMAN. A great many people in my judgment would welcome the withholding, those that do not need the income currently, and actually have to pay the tax.

Take my case. I would welcome the withholding for myself, but what I am concerned about are those large numbers of people that will not pay the 20 percent or pay any tax at all, who, because of the withholding tax, would be denied the use of their money for a certain time. I understand the Treasury plan is to make the refunds every 3 months, yet that is going to be difficult, in my opinion, because the income varies in the quarters, and you pay your tax on an annual basis.

Therefore, it may be that the refund for the first three quarters will be proper, but the fourth quarter may be entirely out of line. As you mentioned in you statement, there are a great many more dividends paid in December than any other part of the year. If you take it on an annual basis it is possible there wouldn't be a refund but would be a refund on a quarterly basis, in certain quarters. Isn't that right?

Mr. SACCARDI. That is right. The quarterly refund is obviously the means probably many or most people would use at least in some quarters. At least with the immediate refund we do have a remedy for

the people who have a real hardship because their money is being withheld.

The CHAIRMAN. Your immediate refund proposition is not to have a certificate issued by the Internal Revenue but it is to have the taxpayer go to the Post Office and say, "I will not pay any tax and this has been deducted." For example if they have a dividend of a thousand dollars, the withholding tax would be $200 and the taxpayer would say: "I want you to give me in cash $200 just on my word." Is that right?

Mr. SACCARDI. Immediate would mean that or any reasonable time after. I don't think we are knowledgeable of what their problems would be.

The CHAIRMAN. With all justice to you, I don't think that it is logical to permit an individual to go to the post office and say: "Here, I have had this withholding from my dividend check but that is not correct and I want you to give me this money back." Again I go back to the fact that the final income tax payment of a taxpayer is on a yearly basis, not on a daily basis, not on an immediate basis, as you say here. The income he receives is taxable for the entire 12 months, isn't that right?

Mr. SACCARDI. That is correct.

The CHAIRMAN. How would that work out when you permit a stockholder to go and collect from the post office the amount withheld for quarterly taxes? It has nothing to do with the internal revenue, nothing to do with taxes, that I have ever heard of.

The post office would need hundreds of tax experts, I reckon in addition to I don't know how many thousands of postal employees they already have. A special appropriation would be needed because the post office operates on a segregated basis by reason of the postage returns and so forth. So what you would have would be internal revenue agents in every post office. Certainly a clerk of the post office ought not be permitted to refund money which would have to be appropriated separately from the Post Office appropriations, and give it to anybody who comes up and says: "I want it. I deserve it."

Mr. SACCARDI. This was given as a suggestion, and it occurred to us to our mind logically because we figured it is a ready source of funds to individuals, but any sort of system that would return the money a lot more rapidly.

The CHAIRMAN. With all respect to you, and I do respect you, I think this turning over to the post office the responsibility of making such refunds is not logical. The post office has nothing to do with the question of collecting taxes, so you would have to build up another department within the post office to do that and that would be just one more department of the Government.

I don't know how many we have now. It is impossible to keep track of them. Anyway, what the Treasury says is we lost $500 million in interest and $350 million in dividends, and this withholding plan will close that gap, so to speak.

The only thing I am concerned about is whether the numbering business which I would have much more faith in than the plan you have suggested, can be made operative in time to make these tax collections so that we would not have to resort to this very complex and difficult matter of having the withholding and then making the re-

funds and avoid doing an injustice to people who live on a very limited income from stocks. As I said, somebody with $200 would depend on that for a living. If $40 is taken off and they don't get a refund quickly it might be a great hardship to them. I never heard of this suggestion before, I can't conceive that Congress is going to pass a law whereby anybody could go to a post office and say: "Here I have had $40 withheld from my check and now I want you to give me the $40." They couldn't even identify the people. They wouldn't have any means to do that.

Am I right or wrong?

Mr. SACCARDI. That could be. I feel that the basis of the claim would be largely a verification, as I would visualize it.

In other words, an individual presents himself, he could present a social security number for correct copying of the number, and then this would tie in with the automatic processing systems.

That was the thought: At some convenient place he would prepare this claim——

The CHAIRMAN. The stockholder would have to prove to the post office clerk that he owned the stock, that a certain amount had been withheld and that a refund was due. I just don't see how it can work.

Mr. SACCARDI. There would be a policing problem, admittedly.

The CHAIRMAN. I think that would add to the complexities of the whole business. It is bad enough as it is. But your plan would let them go to the post office and on their own volition without getting any statement from the Internal Revenue, collect money from the Treasury. That just wouldn't work in my opinion.

Senator Douglas.

Senator DOUGLAS. Mr. Saccardi, I regret I was not able to come to the hearing earlier to hear your main testimony because I have been busy dealing with mail on the withholding provision. I received 5,000 letters on Monday protesting against the withholding provisions, 2,000 letters yesterday, and a preliminary count indicates we have received approximately 2,000 this morning, but the mail is not——

The CHAIRMAN. I would say to the Senator of Illinois, as chairman of this committee, I have exceeded his numbers. [Laughter.]

The CHAIRMAN. I have had to get special clerks in my office to open up the mail.

Senator DOUGLAS. We estimate by the end of today we will have over 10,000 letters. We have made a sampling of these letters. By sampling every 50th letter approximately, in a very large proportion of the cases, I would say perhaps from a third to a half, the people who write speak of this as a new tax, and complain that Congress is imposing a new tax on them.

They give every evidence of thinking that while wages and salaries may be taxed as income, that dividends and interest are not taxed as income.

Of course, this is not correct, and it indicates that these people have in the past not paid the tax, and that they have either avoided or evaded the tax. And I believe there are some figures somewhere indicating that the percentage of evasion seems to be greater for those with over $5,000 of income a year than those under $5,000. I believe the Treasury has such figures.

As I hastily read your statement, and I agree with the Senator from Virginia that your remedy is far too complicated, but as I hastily read your statement, it seems to me you were centering your objections more against the exemptions from withholding than against the withholding principle itself. And I wanted to ask whether that impression of mine is correct, or whether it is a result of the fact that I was not able to give your statement the attention it deserved.

Mr. SACCARDI. That is correct, Senator. We felt we were authorized by our membership to talk solely in the area of administrative problems which we are all united in as being a very, very serious problem.

Senator DOUGLAS. And your problem would be simpler if there were not exemptions.

Mr. SACCARDI. That is right.

We also recognize, as you do and by your mail as well, that this represents in many cases a real problem.

Now, I think some of the individuals that you referred to in that one-third category may be over-withheld individuals, who just object to paying 20 percent on a withholding, or maybe their tax liability is 5 or 6 percent. And this could be the nature of the complaint.

Senator DOUGLAS. Of course, you know that the original bill, which the administration submitted to the House last year, did not provide for these exemptions—it provided for a straight 20 percent withholding.

The exemptions were only put in at the plea, in many cases of financial interests who said that the old, the young, the nonprofit institutions, should be exempt. You realize that, don't you?

Mr. SACCARDI. Yes, Senator.

Senator DOUGLAS. So what you are really saying is that the administration was more correct than the critics. Isn't that true on this point? I know that comes hard. [Laughter.]

Isn't that true?

Mr. SACCARDI. I think we see the problem and that is one reason we came up to what the Senator appears difficult——

Senator DOUGLAS. And the administration was more correct in the beginning than the critics.

Mr. SACCARDI. But only, I would say, purely in the administrative and mechanical area.

Senator DOUGLAS. I understand.

Mr. SACCARDI. But we, as I say in my statement, we feel very uncomfortable criticizing the exemptions because if anything the exemption is not that sensitive to the people's needs. You would have no tax whatsoever in order to claim an exemption, yet the withholding rate is 20 percent.

Senator DOUGLAS. Now, just a minute, people who receive dividends and interest have higher incomes than those who receive wages and salaries.

Mr. SACCARDI. I am not sure.

Senator DOUGLAS. Oh, Mr. Saccardi, you know that is true. That recipients, the statistics of income published by the Treasury Department, are just literally full of figures year after year showing that that is true.

Mr. SACCARDI. I think that is true, Senator, generally, but there are certainly a large number——

Senator DOUGLAS. Of course, there are exceptions. And a much larger proportion of recipients of wages have less than $1,200 or less than $2,400 a year, than the recipients of dividends and interest.

Yet there is withholding on wages and salaries, and they get a refund only once a year. Only once a year. We are providing quarterly refunds for those who receive dividends and interest.

Mr. SACCARDI. I follow what the Senator states there, but I do feel there is a very large number of individuals who really have a relatively small tax liability who have dividends. We have made surveys in our company and found that our average customer has an income of $7,000 a year.

Senator DOUGLAS. That is above the income of the wage earner. You represent Merril Lynch, Pierce?

Mr. SACCARDI. Fenner & Smith.

Senator DOUGLAS. And Ungeleider, in other words, "We, the people." I can't get it all, I believe Smith has come into the picture.

Mr. SACCARDI. That is correct.

Senator DOUGLAS. A very good firm, I may say.

Mr. SACCARDI. Thank you, sir.

Senator DOUGLAS. Well, you probably have a lower income group of patrons than the ordinary brokerage houses because you have gone into the mass distribution of securities. I would doubt if the depositors from Morgan Stanley & Co. would have as low an average as $7,000.

Is that true?

Mr. SACCARDI. That is right. But we have a goodly number, a total of 600,000 customers.

Senator DOUGLAS. I understand. You have gone into this, and I think it is a fine thing you have done and are doing, more than any other firm in the country. This is not a commercial plug—but you have gone in for the sale of securities to moderate-income folk, isn't that true?

Mr. SACCARDI. I believe that is correct.

Senator DOUGLAS. That is true, so that your sample is not a fair one. Even though it shows an average income of $7,000, whereas the average weekly earnings of workers are, I suppose, around $90 a week. Assuming 50 weeks of employment during the year this is $4,500 of income during the year.

If there were not these exemptions do you think you could lick the problem of the 20 percent withholding?

Mr. SACCARDI. If there were not the exemptions.

Senator DOUGLAS. If there were not the exemptions for the young, the old, and the nonprofit institutions, could you lick it?

Mr. SACCARDI. From our administrative problem standpoint?

Senator DOUGLAS. Yes, just from an administrative standpoint.

Mr. SACCARDI. Yes, but it would not solve the problem.

Senator DOUGLAS. But you could lick it?

Mr. SACCARDI. Yes, it is for us but it is rather a selfish answer.

Senator DOUGLAS. I am very glad you said that because you have given us the best testimony and most honest testimony in favor of eliminating the exemptions we have.

I want to thank you, Mr. Saccardia, and Merrill Lynch, Fenner, Ben Ungeleider & Smith. It increases my regard for the firm.

Mr. SACCARDI. Thank you.

The CHAIRMAN. I would just like to say he said some of the letters thought it was an increase in taxes; I have had samples taken of the enormous mail I have received and not much mention is made of that, but unless these refunds are made promptly, there will be an increase in taxation for some, for instance two people above 65, who have an exemption of $2,400. It may be that is all the income would be, yet they would have 20 percent taken off the $2,400 and if they don't get that 20 percent back, then it will be an increase in taxation to them, of course.

Now, they pay no taxes assuming they are over 65, and their income is $2,400, isn't that correct?

Mr. SACCARDI. That is correct.

The CHAIRMAN. So it is readily and easily possible by reason of the complexities of this refund that there will be an increase in taxes on the people who are least able to bear it.

Mr. SACCARDI. That is correct.

The CHAIRMAN. I think that is the point that disturbs me very much, and I am hoping that in some way, somehow, that this numbering system can be worked out and I believe in the end it can be worked out. Whether it can be worked out in a year or 2 years I don't know. But if you can consolidate all of your income by this computation of these numbering machines that gives to the Internal Revenue all the information necessary to see whether your returns are correctly reported or not.

Mr. SACCARDI. It certainly appears so. It would give complete reports now and the law could be amended to include it.

Senator Williams?

Senator WILLIAMS. Mr. Saccardi, a suggestion has been made that withholding on dividends would work the same as the withholding provision on wages. There would be this difference, however, would there not? An employee can list his dependents with his employer, and claim his deductions and if he is not eligible for any tax there is no withholding in that instance. Therefore, while you might say it is not a refund, he never pays the tax in the beginning.

Mr. SACCARDI. That is correct.

Senator WILLIAMS. I don't know of any way you could write a similar provision in this bill either, under the House proposal or under your formula.

Now, in connection with your prepared statement, you suggest you have 14,000 different common and preferred stocks upon which 45,590 dividend payments were made in 1961.

Now, under the present law, how do you handle those dividend payments primarily? Do you credit those to your customers' accounts?

Mr. SACCARDI. Correct.

Senator WILLIAMS. Rather than mail them a check?

Mr. SACCARDI. Yes.

Senator WILLIAMS. Do you file an information return with the Treasury Department on the amount which is credited to each individual customer's account?

Mr. SACCARDI. Yes, Senator.

Senator WILLIAMS. That is filed in the Internal Revenue?

Mr. SACCARDI. Yes, and a provision of the law now envisions the social security as well, and regulations are being worked on as to when it will commence. It is already the law, but regulations are to be established for providing the information.

Senator WILLIAMS. Under existing law the Treasury Department does get prompt information on all of the dividends or interest which is received in the customers' accounts and credited to that account?

Mr. SACCARDI. That is the practice of most of them. As was pointed out here by one of the staff members, the law does not require that, but I think almost every broker that I know does so as a matter of simplicity.

Senator WILLIAMS. The law does require that you report all amounts in excess of $10?

Mr. SACCARDI. That is correct.

Senator WILLIAMS. As a matter of practice you report practically all of them?

Mr. SACCARDI. All of them, even if it is 2 cents, are reported because it is much simpler to provide such a report than it is to try to keep the information on any other basis.

Senator WILLIAMS. I think you have made an excellent statement here in pointing out some of the complexities of the provisions in the House bill, although I must say I agree somewhat with the chairman that the alternative plan which you suggested may be equally complex.

Just suppose for a moment, though, we adopted your plan in lieu of claimed exemptions in the beginning, that there would be no exemptions of these dividends paid directly to each recipient or each stockholder. If I were to go to the post office and claim a refund on a dividend which I had received a couple of days before, how could I prove the amount of that dividend?

Would I have to present under your plan the dividend check? Would the clerk of the post office have to take the number and name and description, or could I just go into the post office under that plan and say I received a check for $40 from the American Telephone & Telegraph Co., and $10 has been withheld and I want $10. Would you not have to have some proof somewhere of the amount that you had received, an identification of the individual as well as the establishment of a refunding system or another agency to make those refunds?

Mr. SACCARDI. Senator, I believe you have come up with an excellent suggestion there of presenting the dividend check as evidence of withholding. Most of these will indicate on the check that 20 percent has been withheld under the law, I would say any issuing agent is going to include that. If there were no exemptions, then obviously everyone would be issuing such a check. This is a practical illustration of how the information can be funneled into Internal Revenue. If they presented the check, their social security number, this would seem to, as I think you are suggesting, seem to tie in directly with the methods of the machine matching out on the individual's report from the corporations and ourselves with his evidence of a check.

Senator WILLIAMS. But, as I say, I sympathize with your problem and the complexities of the present plan. I am not at all sure that the numbering system which we approved last year won't do the job. Assuming that I go to the post office, and it is a large city where it would be physically impossible for the postmaster or the employees in the post office to identify me as an indivdual.

I present myself to this post office with my social security number, and with my check. I would then collect my refund under your plan; is that correct?

Mr. SACCARDI. As you have extended it so well, yes.

Senator WILLIAMS. But I would then depart with my check, my refund, my social security number. What would hinder me from, in conspiracy with another individual, going into another post office and collecting another refund? There are several branch offices in a city.

Would there not be, under that plan, a possibility for someone who wished to develop a racket to collect a refund from each branch office in the city?

Mr. SACCARDI. This has possibilities, but I think it is the same with an exemption certificate.

An individual may file an exemption certificate fraudulently.

Senator WILLIAMS. You pointed out——

Mr. SACCARDI. That is a good question.

Senator WILLIAMS. You pointed out some excellent reasons why the present bill may be somewhat complex. I concede that.

But speaking of your own plan, we wouldn't want to substitute a complex plan with another one that may be equally complex, and I am wondering if, under this plan of yours, it wouldn't be possible for an individual to take one $40 check and collect 30 or 40 refunds before he could ever be picked up.

Mr. SACCARDI. It may be that some notation could be put on the check indicating that one item had been processed. This is something——

The CHAIRMAN. Put on what?

Mr. SACCARDI. A notation could be placed on the check that one claim had been filed so that when any effort was made——

The CHAIRMAN. How are you going to identify the individual? How do you know it is Jim Smith or John Jones?

Mr. SACCARDI. I think the social security number would give reasonable assurance. I don't think we could come up with a complete system.

The CHAIRMAN. You could pass that number all around.

Mr. SACCARDI. I feel under the present system many people are not declaring income as they should, and are not paying the proper taxes. They just are not doing anything. They should be paying and they are not. Under this system, at least the average person would be pretty hesitant about duplicating claims against the Government when he has to sign his name and give some evidence of what proof he has. I grant you the possibility of mistaken identity or incorrect identity exists, but I would say in almost any policing problem we would have that.

Senator WILLIAMS. Again, I recognize the difficulties that would be experienced under the provisions of the House bill and I was not finding fault with your proposed plan on that basis.

But I thought it would be well to point out that there would be problems presented to the Government in connection with the plan you suggest.

To go back a moment to the House bill and assume that the House bill became law in the manner in which it is presently before us. Just let's proceed on that assumption for the moment. On a Government

bond, the interest would be withheld by the U.S. Government on the amount of interest due on that bond, would it not?

Mr. SACCARDI. Right.

Senator WILLIAMS. And we will assume that it is a $1,000 Government coupon bond. Those coupons would then be worth, when cashed at the bank, 80 percent of the present face value.

Mr. SACCARDI. That is correct.

Senator WILLIAMS. Now, we will assume for the moment a Government bond issue, a 4-percent Government bond with the interest dates of January 1 and July 1, semiannually. Suppose I, as an individual, were to buy a $5,000 4-percent Government bond from you on June 25. Interest is not due until July 1.

The coupon as I understand it must remain with the bond as you deliver it to me. Where is the interest withheld on that coupon? How would you bill that bond to your customer?

We will assume the bond is selling at par. Under the provisions of the House bill would you have to add on the approximate $200 interest to the bill as you presented that bond to me?

Mr. SACCARDI. We have discussed that some. In this area where there are no exemptions, what would happen here is whenever there is a transaction between the interest date, as you are suggesting here, the interest on the coupon is primarily that of the former owner, the man who held it for the 5 months plus.

Senator WILLIAMS. Yes.

Mr. SACCARDI. In the case of a coupon bond, the coupon does not become cash until it is presented via the banking system.

Actually the collection is very similar to a check; it goes through the same collection system, and at that time the agent would only pay 80 percent. So in the meantime, in any transaction it would just be as though there was a brand new coupon on the bond. All transactions would take place figuring out the interest owed buyer to seller on an 80-percent basis during the whole period, so the effect would be the same as though the bond had been changed and reduced 20 percent, and the buyer and seller would remit interest to one another based upon whether the buyer was entitled to 3 months, and the seller 3 months, on an 80-percent basis.

Senator WILLIAMS. That is the question.

Let us suppose the bond changes hands on April 1, which is halfway between. The interest would be $50 for the old owner and $50 for the new owner on July 1 in that instance.

Mr. SACCARDI. That is right.

Senator WILLIAMS. You would bill the new customer for the price of the bond and the $50 interest, minus the 20 percent, is that correct?

Mr. SACCARDI. That is correct, Senator.

Senator WILLIAMS. I was wondering how you would handle that particular situation.

Mr. SACCARDI. We looked into that and we felt there would be more problems in this area than in the other but, as you probably know, in the case of the bond area the exemptions have not been provided.

May I volunteer something in this area which may clarify it?

We have been thinking of various investors, I think, as being compartmentalized—an average investor who makes all his money in interest or puts it all in stocks and interest. I think the typical investor has some money in interest, probably owns some U.S. Treasury bonds, may own some series E, and he may also own some preferred, or common stock.

This is the recommendation of many investment firms, that a balanced portfolio is a sound thing. You see, under this bill he is treated in a rather fragmented way. In his ownership of Treasury bonds he is not allowed an exemption certificate, even though he has no tax liability. However, in the case of dividends, he is allowed a tax liability, an exemption certificate, because here a provision has been made. So, if we look at the typical individual having a diversity of income and dividend-producing securities and investments, we find the law tends to handle one way in one instance and one in another, even where the individual has no tax liability.

Senator WILLIAMS. Well, the reason I asked this other question is, it has been raised that perhaps it was not taken care of under the provisions of the bill. It is your opinion that the allocation of the interest in the situation which I described would be taken care of under the provisions of the bill.

Mr. SACCARDI. Yes.

We don't think it would create any problem, as we discussed it, because the problem was taken care of.

Senator WILLIAMS. Yes, I appreciate your suggestion and I have no further questions.

The CHAIRMAN. To indicate the complexities, the staff has just handed me a statement here that a retired couple, both over 65, husband entitled to maximum retirement income credit, one-half from income from dividends, one-half from income from interest and 20 percent withholding on $5,000 income, they will have a liability of $87, but the withholding would be $1,000.

So the excess withholding in that case is $813.

Mr. SACCARDI. That is why the quarterly refund to us appears to be a hardship, even though the immediate refund has its obvious problems.

The CHAIRMAN. I want to put that into the record. It goes up from $5,000 to $20,000. In the case of $20,000 under the same conditions the amount withheld is $4,000 and the excess withholding is $546. If you had $10,000 the excess withholding in that case is $1,000, $1,061.80 and you can't get a quarterly refund where your income exceeds $10,000. I mean the complexities of this refund are very great as you have brought out. I don't think it is without criticism. I don't think your suggestion is a correct one, but I want to thank you for your testimony.

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(The statement referred to follows:)

Retired couple, both over 65, husband entitled to maximum retirement income credit one-half of income from dividends, one-half from interest (20 percent withholding)

Income	Tax liability after retirement income credit and dividend recorded credit	Amount withheld	Excess withholding	Excess as percent of spendable income after tax
$5,000 [1]	$87.00	$1,000	$913.00	19
$6,000 [1]	226.00	1,200	974.00	17
$7,000 [1]	386.00	1,400	1,014.00	15
$8,000 [1]	560.20	1,600	1,039.80	14
$9,000 [1]	738.20	1,800	1,061.80	13
$10,000 [1]	916.20	2,000	1,083.80	12
$11,000	1,114.00	2,200	1,086.00	11
$12,000	1,331.00	2,400	1,069.00	10
$13,000	1,574.00	2,600	1,026.00	9
$14,000	1,814.00	2,800	986.00	8
$15,000	2,054.00	3,000	946.00	7
$16,000	2,314.00	3,200	886.00	6
$17,000	2,594.00	3,400	806.00	6
$18,000	2,874.00	3,600	726.00	5
$19,000	3,154.00	3,800	646.00	4
$20,000	3,454.00	4,000	546.00	3

[1] Married individuals whose gross income for the year will not exceed $10,000 may use the quarterly refund procedure to be provided by sec. 3484 (pp. 200-203 of bill).

The CHAIRMAN. The next witness is Mr. Edwin S. Cohen, Investment Company Institute.

STATEMENT OF EDWIN S. COHEN ON BEHALF OF THE INVESTMENT COMPANY INSTITUTE; ACCOMPANIED BY EUGENE F. BOGAN, ATTORNEY, AND JOHN L. COOPER, TRUSTEE, MASSACHUSETTS INVESTORS TRUST

Mr. COHEN. Mr. Chairman and members of the committee, my name is Edwin S. Cohen. I am a member of the law firm of Root, Barrett, Cohen, Knapp & Smith, of New York City, and am of counsel to the Investment Company Institute.

On my right is Mr. Eugene F. Bogan, of Washington, D.C., also of counsel to the institute; and on my left is Mr. John L. Cooper, a trustee of Massachusetts Investors Trust, one of the member companies of the institute.

The membership of the Investment Company Institute consists of 171 regulated investment companies, frequently referred to as mutual funds. These companies provide a medium by which investors may pool their resources and have the funds invested collectively in the securities of other corporations. They offer the investor of moderate means an opportunity to obtain diversification of risk and experienced investment management which might otherwise be available only to persons of substantial means.

These companies have more than 5 million shareholder accounts. The average size of each account is about $4,000. The Institute's studies indicate that the family income of the median shareholder is about $7,000.

The companies recognize their obligation to assist the Government in improving the collection of the revenue. A fair and effective Federal revenue system is vital to these companies and their shareholders, as well as to all Americans. The problem we all share is that of finding the most effective and fairest means of accomplishing this end with respect to each type of income.

For some time these companies have given the most serious consideration to various methods of improving the collection of tax on dividend income. They have strongly supported the introduction of a system of taxpayer account numbers, despite the considerable expense which it will entail for them; they have been in the forefront of companies furnishing detailed information to shareholders as an aid to them in the preparation of their tax returns; and they have cooperated in a general educational program to bring home to each shareholder his duty to report his dividend income.

We would point out that the Secretary's recent statement before this committee showed that some 92 percent of taxable dividends were voluntarily reported by shareholders in their 1959 tax returns—even without the presence of Treasury data processing machines and taxpayer account numbers, which are soon surely to produce further improvement.

Senator ANDERSON. Was this the Secretary's testimony, you say?

Mr. COHEN. Yes, Senator.

I would refer to the figures therein, exhibit II to his statement, in table 1 of that exhibit, where he showed that $840 million of dividends, by the Treasury's estimates, failed to show up in the returns of what would have been taxable filings. This is shown in the last line of that table, appearing on page 148 of the printed transcript of the hearings.

It is my recollection that it showed $950 million for all unreported dividends, but $110 million of this, it was estimated, would not have been taxable anyway.

Senator ANDERSON. Where did you say that was, what table?

Mr. COHEN. It is in exhibit II, table 1, of the Secretary's statement.

In the middle of that page it shows dividends includable on individual returns——

Senator ANDERSON. I want his statement that 92 percent—never mind your figures, I want his statement about 92 percent, sir.

Mr. COHEN. Dividends includable on individual tax returns are $10,660 million. The amount which was not reported and which were attributable to taxable filings—that is, the amount that would have borne tax, had it been reported—is on the bottom line, $840 million.

If you take the relationship of those two figures, it is approximately 8 percent of dividend income which was attributable to taxable filers and did not show up on their returns. The percentage is as little as 8 or 9 percent, obtained from using the figure of $10,660 million and the figure of $840 million.

I think that this has been generally conceded to be the case with respect to dividend income.

There are arguments as to whether the dividend reporting gap is 8 percent, 9 percent, or 10 percent. All of these are estimates which are extremely difficult to work out, but I think the statement that I have made is a fair one, sir. I think it is derived from this table.

Shall I continue?

Senator ANDERSON. We had a figure somewhere of $500 million and $650 million involved in these two things.

Mr. COHEN. Yes.

Senator ANDERSON. Will the two tables the Secretary submitted add up to anything like that?

Mr. COHEN. The figures are very confusing, Senator, because at some time people are talking about the amount of dividends which do not show up on any tax returns, and at other times about the amount of dividends which would have been taxable had everyone who received dividends reported them.

A lot of people are not required to report dividends because they have income less than their exemptions. I think the only figure of significance is what would have borne tax, had it been required to be reported, and had it been reported, and, similarly, with respect to interest.

The figures I think the Senator is referring to are the figures of the amount of revenue which it is now estimated by the Treasury is being lost by reason of the failure of these dividends and interest to be reported. That is shown in the Secretary's exhibit II, in table 3 where the Secretary estimated that, based upon the failure of $840 million of dividends and $1.9 billion of interest to be reported, there was now being lost in revenue $350 million in dividend taxation and $500 million in interest taxation, a grand total of $850 million which the Secretary estimated was not now being collected.

Senator ANDERSON. That came out finally after another figure of $650 million was what he thought was revenue gain if we had withholding on dividends and interest.

Mr. COHEN. I am going to discuss that later in my paper, Senator, but I would be glad to take it up now at this point, if you would like.

May I continue with it at this point and depart from my statement, since we are on table 3 at the moment?

Senator ANDERSON. Surely.

But you would agree there is nothing in here where the Secretary himself says that 92 percent of all taxable dividends are now paid?

Mr. COHEN. Well, I am not quoting the Secretary's statement, but using the Secretary's figures from his exhibit II.

Senator ANDERSON. I understand the use of the figures.

Mr. COHEN. Yes.

Senator ANDERSON. All right.

Mr. COHEN. As I say, I would not expect that statement to be challenged, Senator, except——

Senator ANDERSON. It was not in your prepared statement, was it?

Mr. COHEN. Pardon me?

Senator ANDERSON. It was not in your prepared statement, was it?

Mr. COHEN. These figures?

Senator ANDERSON. Yes, the statement about 92 percent.

Mr. COHEN. Is in my prepared statement. It is repeated elsewhere.

The CHAIRMAN. When did the Secretary make the statement?

Mr. COHEN. Pardon me, Senator?

The CHAIRMAN. When did the Secretary make the statement that 92 percent of dividends were voluntarily reported?

Mr. COHEN. Senator Byrd, I said in my prepared statement that in the Secretary's recent statement before this committee, in that statement he showed that some 92 percent——

The CHAIRMAN. Well, the staff confirms that; he did make the statement.

Mr. COHEN. It was before the committee in the form of an exhibit which was attached and submitted at that time.

The CHAIRMAN. Senator Anderson?

Senator ANDERSON. That is all right. I wondered where he got it. He takes some figures and says these figures come up with 92 percent. I do not know whether the Secretary made that statement or not.

The CHAIRMAN. The staff has confirmed that he did make the statement of 92 percent.

Senator ANDERSON. The staff does. Where is the Secretary's statement, where is that?

He produced some figures and from those figures they have interpolated a statement that means 92 percent; that is all I was objecting to, the question.

The CHAIRMAN. Then the Secretary did not say 92 percent, is that right?

Mr. COHEN. No, sir, I did not—I am sorry, my statement did not say that the Secretary said that 92 percent of dividends were reported.

The CHAIRMAN. That was your interpretation of his table?

Mr. COHEN. Yes, of his figures. I said that the Secretary's statement shows that 92 percent of the taxable dividends were reported.

The CHAIRMAN. I think it ought to be cleared up, and I will ask—will it be all right to have the staff make a memorandum?

(The following was later supplied for the record:)

(Staff memorandum)

In exhibit II submitted by the Secretary of the Treasury in table 1 at page 146 of these hearings it is estimated that for 1959 the dividend reporting gap attributable to taxable filers is $840 million. In the same table it is estimated that the dividends includible on individual tax returns amount to $10,660 million. Reducing this amount by the $110 million estimated as attributable to nontaxable filers leaves $10,550 million of dividends which should be reported on taxable returns. This latter figure is 8.05 percent of the $840 million, the dividend gap attributable to taxable returns. Therefore according to the Treasury figures 91.95 percent (or 92 percent in round numbers) of dividends which should be reported on taxable returns are reported.

Senator ANDERSON. Surely.

The CHAIRMAN. It is an interpretation, as I understand, of his table?

Mr. COHEN. Yes, sir.

If I may, I will return later, then, to the revenue loss and revenue gain.

The companies have also made extensive studies of various forms of proposals for withholding of tax on dividend and interest income. We have had various conferences with Government representatives and have prepared a number of studies, some of which appear in the transcript of the hearings of the Ways and Means Committee at pages 2395–2496.

THE BASIC PROBLEM IN DIVIDEND AND INTEREST WITHHOLDING

While there are many difficult aspects of dividend and interest withholding, our studies lead us to this conclusion: the hard core of the problem lies in the matter of exemption certificates. Dividend and interest withholding confronts one with this perplexing choice:

(1) Shall we have a rigid, outright withholding of 20 percent of all dividends and interest, regardless of its harmful effect upon many payees, including the widowed, the retired, the ill, and others of our less fortunate citizens—but a system which has some reasonable chance of administrative feasibility; or

(2) Shall we be humane, provide a means for recognizing personal exemptions and deductions in determining the tax to be withheld—and inevitably leave payors, payees, and the Internal Revenue Service in a maze of confusion, complexity, and redtape?

We believe, regretfully, that the answer to both questions is "No." If forced to choose between the two alternatives, we would choose the humane system, with all its inherent defects. But the nature of the choice leads us to urge you strongly that means other than withholding are available and should be used.

THE COMPLEXITIES OF EXEMPTION CERTIFICATES

In wage withholding, since a person normally has only one employer, every employee is allowed to certify to his employer the number of his personal exemptions; and the amount of tax withheld takes into account his exemptions and the standard deduction. If wage withholding did not do this—if, instead, it took out 20 percent of all wages across the board—it would clearly be a harsh and unreasonable system.

In dividend and interest withholding, the administration's proposal last May provided for no exemption certificates being filed by any payees other than foreign persons. At that time the Secretary said:

> Any further extension of exemptions would complicate the withholding procedure and would be burdensome for payers (hearings, p. 277).

Published statements of the Ways and Means Committee of the House show that it vacillated a number of times as to the extent to which these certificates should be permitted. The bill now before you provides generally for exemption certificates:

(a) for all children under 18, and

(b) for all individuals over 17 who certify to the payor that they reasonably believe they will owe no tax for the year.

In the debates on the floor of the House it was said that under the pending bill some 8 million persons would be eligible to file exemption certificates (Congressional Record, Mar. 29, 1962, p. 4966). Since a large number of these persons will receive dividends and interest from several payors, it is obvious that many millions of exemption certificates would be filed. Moreover, except to the extent otherwise permitted in regulations, new certificates would have to be filed and processed annually for persons over 17.

In wage withholding, the direct personal contact between employer and employee permits consultation and correction of errors regarding exemption certificates. But in dividend and interest withholding, the certificates would have to be handled principally by mail, without oral

discussion, with inevitable errors and substantial clerical time and expense.

In wage withholding at the end of the year the employer gives the employee an information slip on form W-2, showing the amount of his wages and the amount of tax withheld, and the employee attaches a copy of this slip to his tax return. This permits him to fill out his tax return simply and gives the Internal Revenue Service a quick and ready means of verifying his return.

But the pending proposal for dividend and interest withholding does not provide for such information receipts to be given to payees of dividends and interest. How, then, after the end of the year will the 8 million persons, other than the most meticulous recordkeepers, know for what items of income exemption certificates were filed? Consider the following illustrations, for example:

(1) A person may file an exemption certificate with one payor and overlook filing it with another. He may file such a certificate for his 10 shares of General Motors stock but not for his 5 shares of A.T. & T.; he may file a certificate with his savings bank and forget to file it with his mutual fund.

(2) He may fail to file an exemption certificate for the first one or two quarterly dividend or interest payments in the year, either because of oversight or because he is ineligible at that time, but may file a certificate with respect to subsequent quarterly payments.

(3) He may file exemption certificates at the beginning of the year when he reasonably believes he will owe no tax, and yet later, because of some unexpected income, he may no longer be eligible to use an exemption certificate.

(4) He may file exemption certificates with respect to shares registered in his own name, but he cannot, except as may be permitted by regulations, file them for shares registered as a matter of convenience or necessity in the name of his broker, his bank, or other nominee.

When the payee sits down to make out his tax return or his refund claim, neither he nor a person assisting him will have an information receipt, such as a form W-2 to aid in the preparation of his tax return. Despite the lack of such receipts, he will be expected to report separately in his return the withheld dividends and interest and the nonwithheld dividends and interest; then he must "gross up" the withheld items to add back the tax withheld, total the two types of income and his other income, compute his tax and claim credit or refund for the tax withheld.

The tax forms, already bewildering to many, must become even more complex.

When these returns are reviewed by the clerical staff of the Internal Revenue Service, there will be no ready means of knowing which items of income were received without withholding because of the filing of exemption certificates or otherwise, and which were subjected to withholding. There will be no ready means for the Service to verify, as it can in wage withholding from the Form W-2, that a person filing a refund claim for tax withheld actually had the tax withheld. This bids fair to produce an administrator's nightmare, if not administrative chaos.

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THE LIMITED SCOPE OF EXEMPTION CERTIFICATES

Yet, if we were to have exemption certificates—as we think should be the case if we were to have dividend withholding—we strongly believe that they would be far too limited in their scope under the present bill. For individuals over 17, they would be restricted to persons who are able to certify they reasonably believe they will owe no tax whatsoever.

Aside from the limited amount of quarterly refunds, to which I shall refer below, what is to be done for the person who conscientiously realizes that he may owe some small tax—$1 or $5 or $100—and who under this bill will experience withholding of 20 percent across the board on all his dividend and interest income—a withholding which may amount to $500, $1,000, or more?

Consider, for example, the case of persons who have substantial deductions for medical expenses, yet may owe a small tax. Wage withholding is not required for sick pay under wage continuation plans, nor for certain disability benefits; nor is it required for pension payments from qualified pension trusts or annuity programs to retired persons, who are particularly likely to incur substantial medical expense.

Are not these persons entitled to adequate protection in dividend and interest withholding? The persons who owe a small tax, but far less than that which would be withheld, will be an even larger group than those who owe no tax whatsoever, and they are deserving of consideration.

In addition, no provision is made for exemption certificates to be filed with respect to:

(1) Dividends and interest received by estates of deceased persons;

(2) Dividends and interest received by lifetime or testamentary trusts;

(3) Interest received on interest-bearing obligations of the U.S. Government;

(4) Interest on corporation bonds or notes;

(5) Dividends and interest received by charities, pension trusts and other exempt organizations, except with respect to interest on deposit in banks or savings institutions and on certain U.S. discount obligations;

(6) Dividends and interest on stocks or bonds registered—as is often the case for reasons of convenience or necessity—in the name of a broker, bank, custodian or other nominee, except as may be permitted by regulations;

(7) Dividends and interest received by regulated investment companies, although—as noted further below—the filing of exemption certificates by investment companies would be essential to permit investment companies to pay out full dividends to shareholders who file exemption certificates with the investment companies.

THE LIMITED SCOPE OF QUARTERLY REFUNDS

Much emphasis has been placed upon the quarterly refund provisions of the bill as providing relief from hardship. Obviously quarterly reporting of dividend and interest receipts, followed by a final annual reporting, will entail considerable inconvenience both for payees and

the Internal Revenue Service. But, far beyond that, it should be understood that the quarterly refund relief furnished by this bill to individuals is severely limited.

Let me illustrate by taking the case of a widow under age 65 with $3,000 of dividend and interest income, who, because of substantial medical expenses or other deductions, may owe a tax for 1963 of $100. She would have $600 in tax withheld. The maximum amount of total quarterly refunds she would be entitled to receive during 1963 would be $132. She would be required to wait until after filing her final 1963 return in 1964 to receive the balance of $368 due her.[1]

The reason for this is that in the pending bill the maximum total quarterly refund allowance does not take into account deductions other than the standard deduction, nor even (save to a negligible extent) the standard deduction applicable to income above the personal exemption. The quarterly refund procedure in this bill is not designed to work as the converse of the present system of quarterly payment of estimated tax. It is limited in its scope and arbitrary in its application.

In sum, we raise with you the most serious question whether an exemption certificate procedure for dividends and interest is administratively feasible, and whether, even with the quarterly refund procedure, the provisions therefor in the present bill are sufficient to prevent hardships and inequities for the large number of taxpayers of limited means.

SPECIFIC MATTERS AFFECTING INVESTMENT COMPANIES

Before leaving the subject of exemption certificates and interim refunds, may I call to the attention of the committee the urgent need for certain amendments and clarifications of the procedures affecting investment companies and their shareholders in the event withholding is enacted:

(1) Filing of exemption certificates by investment companies: Investment companies act essentially as "conduits" for their income. They receive dividends and interest from other corporations, and after reduction for operating expenses, pay out the net amount currently to their shareholders. Since eligible shareholders of investment companies are permitted to file exemption certificates with the investment companies and receive their investment company dividends without 20-percent withholding, the investment companies will not be able to distribute more than 80 cents on the dollar to their own exempt shareholders unless the investment companies can in turn file exemption certificates with respect to the dividends and interest which they receive.

We have no accurate way of estimating the number of persons who may file exemption certificates with investment companies, but it may well be 1 million persons or more. To accommodate these persons, the investment companies should be permitted to receive dividends and interest without having 20 percent withheld at the source.

Since there are already under the bill and estimated 8 million persons eligible to file exemption certificates, it would cause substantially no

[1] The maximum "refund allowance" permitted to her prior to the close of the year would be 22 percent of her personal exemption of $600, or $132.

administrative burden for payors to accept exemption certificates from the less than 200 regulated investment companies. The Treasury would be protected since the investment companies would be required in any event to withhold 20 percent from their nonexempt shareholders.

A brief form of amendment to accomplish this is attached as appendix A.[2]

(2) Large refunds: It should be made clear, at least in the committee report, that the special requirements of section 6405 regarding reports to the Joint Committee on Internal Revenue Taxation of refunds in excess of $100,000 do not apply to refunds to investment companies and others due to overwithholding of tax on dividends and interest.

(3) Fourth quarter refunds: Provision should be made for making prompt refund of tax overwithheld from investment companies and others during the fourth quarter prior to the filing of the final income tax return.

(4) Periodic investment and dividend reinvestment plans: Shareholders of investment companies have in force more than 1,650,000 periodic investment plans and more than 930,000 dividend reinvestment plans. These are basically thrift programs for family savings and retirement, and we think should not be disturbed except to the extent essential to protect the revenue. The amount of the dividends involved in any one account is generally small, but in the aggregate the dividends reinvested in additional shares of investment company stock in 1961 amounted to some $214 million. Aside from those shareholders able to file exemption certificates, 20-percent withholding would have withdrawn $43 million from these programs. Since 92 percent of dividend income is already reported, some method should be found so that the persons now paying their proper tax on these reinvested dividends could continue doing so without reduction by reason of withholding.

EFFECTIVENESS OF WITHHOLDING IN ATTACKING THE DIVIDEND REPORTING REVENUE GAP

Even beyond the inherent infirmities in the system of exemption certificates and interim refunds, there is a serious question whether withholding provides the means best calculated to close the estimated revenue gap, at least in the dividend area. The Secretary's statement before this committee showed for 1959 a failure of $840 million of taxable dividends to be reported (Secretary's statement, exhibit II, table 1). From table 3, which he presented, it can be seen that the Treasury estimates the resulting revenue loss from nonreporting of dividends at $350 million and the effect of 20-percent withholding as follows:

	Millions
1. Revenue gain from 20-percent withholding only (slightly less than 20-percent of $840,000,000)	$150
2. Estimated improvement in reporting in brackets above 20-percent	130
3. Loss still remaining	70
Total	350

[2] It should be noted that securities owned by regulated investment companies are required under the Investment Company Act to be held by banks or trust companies, and thus normally are registered in the names of nominees. Provision should be made for filing of exemption certificates by the nominees for these securities.

As to the $130 million estimated revenue from improved upper-bracket reporting, it seems questionable indeed whether the proposed withholding tax system—which takes out only the bottom 20 percent and gives out no information receipts on form W-2—will cause presently nonreporting upper bracket taxpayers to come forward voluntarily to report their income and pay the tax they owe in their brackets above 20 percent. They may well do so because of fear of the coming use of taxpayer account numbers and data processing machines, but it is not likely that they will do so because of an anonymous withholding system which takes out only 20 percent at the source.

Taking into account the fact that the $150 million derived from 20-percent withholding also includes the bottom 20 percent to be obtained from upper-bracket taxpayers, it seems clear from these figures that the bulk of the revenue gap in the dividend area must lie in the relatively small group of defaulting upper bracket taxpayers.

In the light of these estimates the aim should be to concentrate on the defaulting upper bracket taxpayers rather than saddle the expense, inconvenience, and hardship of withholding on the mass of bottom-bracket taxpayers.

AN ALTERNATIVE ATTACK

For more than 10 years every corporation paying dividends has been required to report to the Government on form 1099 any payment of dividends to a shareholder receiving more than $10 in a calendar year. On the other hand similar information reports are required for payments of interest and other types of investment income only if the payments to the individual during the year exceed $600 in the aggregate.

Assuming a 4-percent yield, this means that these information returns are filed where a stock investment amounts to $250 or more, but are filed for interest-bearing investments only where they exceed $15,000. Under these circumstances, most corporations file information reports on all dividend payments rather than incur the expense of separating out the small accounts; but savings institutions are required to file information returns on the relative handful of persons who have some $15,000 or more in a single account.

Last fall the Congress passed a much heralded bill providing for taxpayer account numbers. On the floor of the Senate, on September 23, 1961, Chairman Byrd stated:

> This legislation, the Treasury testified, would result in closing loopholes so that those who are now avoiding the payment of taxes would be compelled to pay by operating this new number system through computing machines. The tax revenue, the Treasury testified, would be increased by $5 billion * * *.
>
> This is the biggest loophole-closing bill, if the Treasury is correct, which has ever been presented to the Congress, * * * (Congressional Record, Sept. 23, 1961, p. 19703).

Among other things, the bill requires that every payor filing an information report on form 1099 secure from the payee his account number and set forth that number on the form 1099 filed for that payee in order to facilitate the use of the form by the Internal Revenue Service in checking the payee's tax return.

It is estimated that there are more than 40 million shareholder accounts in public corporations in the United States. Account numbers

will have to be obtained from the shareholders, recorded, and reported by the corporations for substantially all of these accounts at much cost and expense.[3]

The Service is currently installing automatic data processing machines to make use of these information returns and account numbers. The Commissioner recently stated publicly that these machines are expected to be operating in all nine service centers by January 1, 1965. It would seem obvious that the fear of these machines and numbers will lead many presently defaulting taxpayers to report their dividend income, particularly so in the case of the upper bracket taxpayers who may expect particularly to be checked upon. And the machines will inevitably single out those who still fail to report.

We would suggest, as we did before the Ways and Means Committee, that two additional weapons be used against the nonreporters: (*a*) The imposition of a special penalty of 15 percent of any tax which is due to failure, without reasonable cause, to report dividend or interest income; and (*b*) an extension of the normal statute of limitations from 3 years to 6 years for the collection of the tax. The penalty would compensate the Treasury for added expense in dealing with nonreporting of known income; and the extension of the statute of limitations would permit correction for prior years when the cases of nonreporting are ferreted out in the future by the new automatic data processing machines. These amendments were provided for in H.R. 7925, introduced on June 20, 1961, in the House of Representatives, and we commend it for your consideration. Copy of the bill is attached as appendix B.

CONCLUSION

In summary, we believe that the problem of designing a dividend and interest withholding system which is both humane and administratively feasible has not been solved and is unlikely to be solved; that it fails of solution now, as it always has in the past, because of the inability to cope with the matter of exemption certificates; and that on this score, and because it provides no information receipts on form W-2 for payees, it differs fundamentally from wage withholding. Now that we are on the threshold of a new electronic era in tax administration, we should use the taxpayer account numbers and automatic data processing machines, together with the threat of penalties and a lengthening of the statute of limitations, to cause tax evaders to pay their fair share of the tax burden without visiting their sins and omissions upon the bulk of the loyal and law-abiding investors in America.

Thank you, Mr. Chairman.

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[3] If withholding were to be enacted for dividends, we believe that in order to reduce the expense of processing the account numbers, the $10 dividing line for filing information returns on dividends should be raised to a substantially higher level, and the dividing line for information reporting of interest payments should be lowered, so that the rule would become the same for dividends and interest. But we believe it preferable to handle this enormous task of reporting account numbers for dividend payments as low as $10 under the present rules rather than have them subjected to withholding with all its attendant problems.

(The appendixes to Mr. Cohen's statement follow:)

APPENDIX A

PROPOSED AMENDMENT TO H.R. 10650, SECTION 10, TO PROVIDE FOR FILING OF EXEMPTION CERTIFICATES BY REGULATED INVESTMENT COMPANIES

On page 109, after line 3, insert the following:

"(4) REGULATED INVESTMENT COMPANIES.—

"(A) Any regulated investment company subject to the provisions of Subchapter M of Chapter 1 may file with any withholding agent an exemption certificate on which it certifies that it is a regulated investment company subject to the provisions of Subchapter M of Chapter 1. If such certificate is filed, all amounts payable by such withholding agent to such company during the period such certificate is in effect shall be exempt from the requirement of deducting and withholding under this Chapter.

"(B) An exemption certificate filed by a regulated investment company under subparagraph (A) shall cease to be effective on the thirtieth day after the day on which the withholding agent, with whom such certificate was filed, is notified by either the company or the Secretary or his delegate that the company is no longer a regulated investment company subject to the provisions of Subchapter M of Chapter 1. If a company ceases to be a regulated investment company subject to the provisions of Subchapter M of Chapter 1, it shall, within the time specified in regulations prescribed by the Secretary or his delegate, so notify each withholding agent with whom it has an exemption certificate in effect."

APPENDIX B

87TH CONGRESS—1ST SESSION
H.R. 7025

IN THE HOUSE OF REPRESENTATIVES

JUNE 20, 1961

Mr. BETTS introduced the following bill; which was referred to the Committee on Ways and Means

A BILL To provide a 6-year statute of limitations for assessing tax on omission of dividends or interest from gross income reported on tax return, and to provide a special penalty for such omission

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That section 6501(e)(1) of the Internal Revenue Code of 1954 (relating to extending the period of assessment for omission from gross income) is amended by adding at the end thereof the following new subparagraph:

"(C) DIVIDENDS AND INTEREST.—If the taxpayer omits from gross income an amount properly includible therein representing a dividend (as defined in section 316) declared and paid as such or interest paid or accrued as such, and if neither subparagraph (A) or (B) is applicable, the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time within 6 years after the return was filed, but only as to the amount of deficiency attributable to such omission. For purposes of this subparagraph, in determining the amount of dividends or interest omitted from gross income there shall not be taken into account any amount which is disclosed in the return, or in a statement attached to the return, in a manner adequate to apprise the Secretary or his delegate of the nature and amount of such item."

SEC. 2. (a) Subchapter A of chapter 68 of the Internal Revenue Code of 1954 is amended by adding at the end thereof the following new section:

"SEC. 6660. PENALTY FOR OMISSION OF DIVIDEND OR INTEREST INCOME.

"If any part of any underpayment (as defined in section 6653(c)(1)) of any tax imposed by subtitle A (relating to income taxes) is due to omission from gross income of an amount or amounts properly includible therein representing a dividend (as defined in section 316) declared and paid as such or interest paid or accrued as such, and if section 6653(b) (imposing fraud penalties) is not applicable, there shall be added to the tax, in addition to any other penalty or penalties, an amount equal to 15 per centum of the amount of that part of the underpayment attributable to such omission, unless it is shown that such omission was due to reasonable cause and not to willful neglect."

(b) The table of sections for such subchapter A is amended by adding at the end thereof the following:

"SEC. 6660. Penalty for omission of dividend or interest income."

SEC. 3. The amendments made by this Act shall apply to amounts received or accrued after December 31, 1961, in taxable years ending after such date.

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

Any questions?

Senator KERR. I want to ask a question.

How much money do mutual investment companies have invested in municipal and State bonds with reference to which the income is tax exempt?

Mr. COHEN. Substantially none, Senator Kerr. I believe that it would probably be less than a tenth of 1 percent of their assets, the reason being that that tax-exempt interest, while it is tax exempt to the investment company, when it is distributed currently to the shareholders, is transmuted into taxable dividend income to them and, therefore, loses its tax-exempt status. So at present, unless the yield on tax-exempt municipal bond interest exceeds the yield on taxable corporate bond interest, it would not be worth while for an investment company to invest in tax-exempt income.

We submitted several years ago a request for an amendment of the statute to permit the tax-exempt interest to flow through tax free to the shareholders, but no action has been taken by the Congress on that provision. It was adopted by this committee, it is my recollection, in 1958 but eliminated in conference.

Senator KERR. You are aware that the Commissioner of Internal Revenue tells us that there are between $800 million and $900 million of unpaid taxes on dividends and interest income.

Mr. COHEN. Yes, sir.

Senator KERR. The Commissioner tells us that a withholding procedure, such as that provided in the bill as passed by the House, would collect about three-fourths of this $850 million, and that it would do so at about two-thirds of the cost of the ADP information return system.

Mr. COHEN. I am aware of that statement, sir.

Senator KERR. I understand your position is that you don't agree with that.

Mr. COHEN. Yes, sir. In the sense of the general conclusion as to what should be done at the present time, I am disagreeing with the Commissioner. I am not in position to question his figures and do not. I can explain his figures, but I do not have the basic information on which to judge the figures, and I have the utmost respect for the Com-

missioner and the highest regard for him, having known him for many years and having lectured in his classes before he took office.

Senator KERR. Well, I appreciate that statement about the Commissioner, because I have the very highest respect for him.

You are aware of the fact that the recommendation of this legislation in its sum total amounts to an effort on the part of the Internal Revenue Service to collect taxes due the Government not now being paid?

Mr. COHEN. Yes, sir.

Senator KERR. You think that is a worthy objective?

Mr. COHEN. By all means, sir. We have——

Senator KERR. You pay your taxes, I presume?

Mr. COHEN. Yes, sir. I do.

Senator KERR. The Senator from Oklahoma thinks he does. He pays all the taxes that his bookkeeper say he owes, and then usually the additional ones that the representatives of the Internal Revenue Service who have picked him out as one of those with whom they like to live, indicate that he owes, and convinces the accounting service that he does owe. So you and I have one thing in common: We at least think we pay the taxes we owe the Government.

Mr. COHEN. Yes, sir.

Senator KERR. I wonder if we share the feeling that everybody who owes taxes also should pay them?

Mr. COHEN. Indeed, I am confident we do, Senator Kerr.

Senator KERR. Now, the Commissioner for whom we both have the very highest of regard, tells us that the method outlined in this bill is the best means that he and his department have been able to devise to give his department the best chance it can have to collect taxes which otherwise have not been collected and are not being collected, and will not be collected by the Government.

Mr. COHEN. Yes, sir.

Senator KERR. Now, if you were on this committee, wouldn't you be disposed to be persuaded by this recommendation unless you could come up with an equally effective means of collecting those taxes?

Mr. COHEN. Well, Senator, I think that I would take into account, on the one hand, the need for the revenue; on the other hand, the hardship that I might impose upon people who do not owe the tax, and the man-hours and expense which would be involved in trying to work out and operate an effective withholding system for dividends and interest. I think this is a matter of balance.

Senator KERR. In order that we might intelligently discuss that answer, let's take it one at a time.

Mr. COHEN. Yes, sir.

Senator KERR. What did you say was the first thing you would take into account?

Mr. COHEN. Well, obviously, not only the need for revenue, but the desirability——

Senator KERR. Let's talk about the need for revenue. In the first place there is no dispute about that, is there?

Mr. COHEN. No, indeed.

Senator KERR. And if the provisions in this bill are enacted which forgive or reduce certain taxes that would increase the need for revenue, wouldn't it?

Mr. COHEN. Very much so.

Senator KERR. I say to you quite frankly that the need for revenue is not very persuasive with me insofar as my attitude on this provision in this bill is concerned.

I believe in attacking or in meeting the need head on, and I do not believe that the need for revenue should be the controlling motive behind an effort to secure the collection of taxes which taxpayers owe the Government and are not paid.

It would seem to me that one of the most impelling considerations, that could be contemplated by a member of this committee, is and would be the result of a sense of equity which would persuade us that even though the Government had a balanced budget from the taxes being paid by a substantial percentage of those who owe it, we should take whatever reasonable means are available to us to bring about a situation where all who owe taxes pay them. Simple justice, it seems to me, is outraged by contemplating a situation where even 95 percent of those who owe taxes pay them, and 5 percent don't, even though we have enough revenue to meet our expenditures. It would seem the least we could do would be to make every effort we could to cause everybody who owes taxes to pay them, feeling that if, by so doing, we secured more revenue than we needed, we could make an equitable reduction in taxes which would give the 95 percent who are honestly paying the taxes a part of the relief that would be available through the fact that if a hundred percent paid their taxes we would have more than we required.

It doesn't seem to me to be an equitable or worthy approach to say that, as long as there are enough honest taxpayers to pay their tax to get the revenue we need, we should not make the best effort we could to get the rest of the taxpayers to pay theirs because by their failing to pay they are getting 100-percent tax relief, and the 95 percent who pay get no relief. Does that meet a responsive reaction in you?

Mr. COHEN. I am in full agreement with that, Senator Kerr.

Senator KERR. Then it would seem to me that the need for revenue would not be the compelling or should not be the compelling urge behind an effort which is calculated to bring about a situation where everybody who owes taxes pays them.

Mr. COHEN. I would be in agreement with that. I believe that there is a need for revenue, that there are great needs for revision in tax structure to reduce the tax in all brackets, and that to the extent that we can cause this gap in the reporting of income to be decreased, we can all benefit from a reduction in the rates. It is highly to be desired.

Senator KERR. That was the first reason you gave. Do you remember what the second one was?

Mr. COHEN. Well, I was saying, I think, Senator, that I thought there were two reasons why——

Senator KERR. Well, you gave three.

Mr. COHEN. Well, the third one was not a reason for the withholding, if I recall corectly.

Senator KERR. We will let the reporter read back.

Mr. COHEN. Yes, sir.

(The record was read by the reporter.)

Senator KERR. Now with reference to that one, do you think that the Government in its effort to bring about a situation where everybody pays their taxes should be restrained or persuaded to make less effort than they should because the effort to collect the taxes from those that don't pay it costs money?

Mr. COHEN. I think, Senator, that the real question is whether withholding is the method to reach the desirable objectives that we agree upon.

Senator KERR. Let's talk about what you said there. You said the cost of it.

Mr. COHEN. I said the hardships upon the payees and the man-hours and——

Senator KERR. That was one part.

Mr. COHEN. The expense.

Senator KERR. The next part was the cost.

Mr. COHEN. Well, I said expense.

Senator KERR. Well, that is cost, isn't it?

Mr. COHEN. That is right, sir.

Senator KERR. If you would rather use the word "expense" we will use expense.

Mr. COHEN. It doesn't matter. I just don't want to be forced into a position, if I can avoid it, of placing my objection to witholding on the matter of expense.

Senator KERR. I don't want to put you in any position at all. All I am trying to do is to talk to you on the basis of the position I thought you put yourself in. You were the one who said, what was it he said about the expenses?

Mr. COHEN. I said, Senator——

Senator KERR. Let's read what you said.

(The reporter read the record.)

Senator KERR. You mean the man-hours and expense that would be involved on the part of the revenue department in collecting it?

Mr. COHEN. Upon the payors——

Senator KERR. Well, didn't he say the payee there? You didn't finish the statement. I understood you were referring to the Revenue Service.

Mr. COHEN. No, sir; I had in mind as I said in my prepared statement the man-hours of time and the expense to the payors, to the payees, and to the Internal Revenue Service, because I think we are all together in this problem of trying to stop the nonreporting of income. I think we have to take this all into account.

Senator KERR. I agree with that.

Mr. COHEN. We shouldn't be divided into classes.

Senator KERR. But I am not impressed by the argument that if a taxpayer makes it expensive enough for the Government to collect his tax that the Government ought not to make the effort to do it. It would seem to me that in a situation of that kind it would reinforce the determination of the Government to collect tax due it.

Mr. COHEN. I am fully in agreement with that, sir.

I might just explain, if it is in order at this stage to talk about it, that there is a question whether withholding is going to accomplish this objective—the extent to which it will accomplish the objective of

seeing that people pay their fair share of taxes on the one hand——

Senator KERR. This isn't a question of their fair share.

Mr. COHEN. I thought it would be, sir.

Senator KERR. I don't know anybody who pays taxes who is entirely convinced that he pays just his fair share.

Mr. COHEN. Right.

Senator KERR. That is a matter by which this committee has been advised by innumerable witnesses, and I have yet to hear the first one who has come here and said, "I do not believe that I pay my fair share of the taxes and I want to show you how to fix it so I can."

And I don't remember anyone being here who says that, "I am entirely satisfied that I am now being required to pay only my fair share of the taxes."

So my concept of this bill is not to bring about any situation where taxpayers pay their fair share of the taxes, that was a consideration when the tax structure was written, when the graduated skill was put into effect, when the tax liability was fixed.

My concept of this legislation is to secure the payment of taxes which people under the law owe even though it may be more or less than what they themselves think is their fair share.

Mr. COHEN. Well, I agree again with the Senator, and I would change my statement so that instead of saying whether withholding is the means best calculated to make people pay their fair share of tax—whether it is the means best calculated to make them pay the tax which is due under the present Internal Revenue Code.

Senator KERR. Which under the law they owe.

Mr. COHEN. Yes.

Senator KERR. That is an appropriate subject of discussion.

Naturally, I go on the theory that those charged with the responsibility of collecting the taxes that people owe are in position to know what could be done to better equip them to collect the taxes that people owe.

Mr. COHEN. Mr. Chairman, I would agree with that, except for this: I think it is a fair comment to say that the present Assistant Secretary of the Treasury, Mr. Surrey, for whom I also have the highest regard——

Senator KERR. I think it is nice that you pay tribute to these men.

Mr. COHEN. I would like the record to show, if I may, that I do have the highest regard for the intelligence and capacity of these two gentlemen. I have known them for years.

Senator KERR. Mr. Surrey is two gentlemen?

Mr. COHEN. Mr. Surrey and Mr. Caplin.

Senator KERR. Oh, all right. [Laughter.]

Mr. COHEN. Mr. Surrey made a statement in an article in the Columbia Law Review, as I recall it, in June 1958, before he had become Assistant Secretary of the Treasury, in which he said in two sentences that withholding on interest and dividends should be enacted, and that the means for doing so had been worked out and were publicly available, citing an article by Mr. Pechman, who also wrote a similar article which appeared in the compendium of the hearings before the Ways and Means Committee.

Mr. Surrey, therefore, I think it is fair to say, had concluded that interest and dividend withholding was desirable and feasible before

he became Assistant Secretary of the Treasury, and before he had the particular information and data available to him which comes to a person in the Government.

Senator KERR. Well, you know that this committee had asked the Internal Revenue Service, before the man that appointed Mr. Surrey got into office, to advise this comittee on the feasibility of a system of interest and dividend withholding, didn't you?

Mr. COHEN. Well, I knew, Senator, that 2 years ago, a study was initiated with respect to dividend withholding and a report was requested.

Senator KERR. By this committee?

Mr. COHEN. By this committee.

Senator KERR. Now, that I must say to you in all frankness, although I also hold Mr. Surrey in high regard, our request was before I had ever been advised of his existence, and the Harvard Law Review is not among the list of current reading material which I have the degree of familiarity to be aware of the fact that either they had had the judgment or lack of it to publish his remarks in that regard.

Mr. COHEN. The only point of my remarks, Senator, that I was trying to make is that I do not believe that the conclusion that has been reached by Assistant Secretary Surrey or Commissioner Caplin is a conclusion which they have come to independently by reason of their studies which they have made since they have joined this administration, but represents a conclusion which they, at least Mr Surrey, had come to before they joined the administration; and hence while I understand that this is a debatable problem that has many difficult aspects, and I respect the judgment of others, I do not necessarily now defer to Mr. Surrey and Mr. Caplin because they now hold the offices which they hold.

I feel that we——

Senator KERR. You have made that quite apparent.

And I find no fault with that failure on your part. But neither do I hold it against the opinion because they might have had it before they got into this position.

Mr. COHEN. I quite agree, Senator.

Senator KERR. The problem of collecting taxes due and unpaid on interest and dividend income did not arise simultaneously with their becoming occupants of their present positions.

Mr. COHEN. No, Senator.

May I point out, Senator, that the problem of closing the gaps in the reporting of revenue is not related solely to dividends and interest. There are many other items which go into the gap in reporting of income that has been estimated, according to the best studies that are available, at some $25 billion, and 20 percent of that or $5 billion is the figure which the Treasury used in indicating that the bill for account numbers might produce $5 billion, as Senator Byrd stated when he spoke of the bill last September.

Now, dividend income is calculated to be unreported to the extent of less than $1 billion out of this $25 billion, interest income to the extent of less than $2 billion out of the $25 billion. Unreported salaries and wages are estimated at more than $5 billion.

The bulk of the balance is in entrepreneurial income.

Senator KERR. I wonder now if you would reduce that to words that I could understand?

Mr. COHEN. The bulk of the gap in the $25 billion of unreported income? What it means, I think, is the income of businesses—sole proprietorships, the fellow who runs a store or his own business.

Senator KERR. We refer to them as the self-employed.

Mr. COHEN. A much simpler term, Senator.

Senator KERR. If it means the same thing.

Mr. COHEN. I think it does, but this is a matter of statistics and I am not a statisticians, so I use the statistician's phrase, and in the statistics it is referred to by a name—which we will call the self-employed. [Laughter.]

Senator KERR. All right.

Mr. COHEN. It is my recollection that the figure of the revenue gap in that type of income is over $10 billion, and that there is also unreported income with respect to rents and other types of income. But the biggest category is that of the entrepreneurial—I am sorry, of the self-employed income. [Laughter.]

Now withholding, which is proposed with respect solely to dividend and interest income, and which will attack a gap totaling maybe $3 billion out of this $20 or $25 billion withholding is designed, according to the Secretary's statement, to pick up from the 20 percent to be taken out from dividend and interest, revenue of $470 million, out of what the Treasury figures is a total of $850 million of revenue that would be gained by full reporting of dividend and interest income. The reason for this difference is that the Treasury figures estimate that if dividend income were fully reported—the portion that is not being reported now, if it were fully reported—would bear an average tax rate of 41 percent.

Now, that is a high bracket for the average rate on this unreported dividend income of some $840 million.

Now, the 20 percent would take out only 20 percent of that. It is less that half of the tax due from those who owe the tax and should be paying it, according to their figures.

Now, they say, that—

> if we have dividend and interest withholding, we estimate that a great many of those who are not now reporting their income are going to come forward voluntarily and include that dividend and interest income in their returns and pay the tax above 20 percent.

But I fail to see why merely taking 20 percent off at the source—no information receipts going to the recipients and no way to check whose money the 20 percent was taken out of—why this will lead the nonreporting high bracket taxpayer to come forward and now include his dividend and interest income in his tax return.

So I say the witholding at 20 percent is taking only a relatively small amount of the tax that is really due from the people at whom the Congress should be pointing its finger.

Senator KERR. Then maybe we ought to make it 40 percent.

Mr. COHEN. That is a possible solution, Senator, but of course, as soon as you move in that direction, I need not tell you, you are increasing the hardships upon the mass of taxpayers who are now reporting their dividend and interest, upon the people who are not subject to tax.

So the problem is indeed an extremely difficult one.

Senator KERR. Do you have accurate figures on how much interest is paid annually in the United States?

Mr. COHEN. I have the figures which the Treasury has used. These are extremely difficult to determine, Senator.

Senator KERR. Do you know how much the total public and private debt is?

Mr. COHEN. No, but I made an estimate 2 years ago, based upon studies of the Department of Commerce, that the total interest paid in the United States was in excess of $23 billion. A large part of that I might say is received by corporations, you see, so we may not be talking about that received by individuals.

Senator KERR. Let's go to the basic figure.

In order to find out how much interest is being paid we have got to know something about how much it is being paid on and something about the rate, don't we?

Mr. COHEN. Yes.

Senator KERR. Do you know what the total public and private debt in the United States was December 31, 1961?

Mr. COHEN. I am sorry, Senator, I do not have the figure in terms of principal.

Senator KERR. Would you make an estimate?

Mr. COHEN. Well——

Senator KERR. You said 2 years ago that your figures indicated there was a total of $23 billion interest paid annually.

Mr. COHEN. Yes, and if you would take 5 percent, this would be something on the order of $400 million, I believe.

Senator KERR. Would it surprise you to know that the total public and private debt in this country of December 31, 1961, was a trillion sixty-some billion dollars?

Mr. COHEN. Well, Senator, it would not for several reasons. I obviously am not including in my interest figures tax-exempt interest, which would involve all the debts of States and municipalities.

Senator KERR. Well, you know what that total is?

Mr. COHEN. I would guess $60 billion.

Senator KERR. That wouldn't be too far off. That would leave then as of December 31, 1961, public and private debt of a trillion dollars with reference to which the interest paid is taxable.

What would that be at 5 percent?

Mr. COHEN. I am sorry, sir.

Senator KERR. On a trillion dollars?

Mr. COHEN. On a trillion dollars it would be $50 billion.

Senator KERR. Now, you estimate that $48 billion of that reported by the recipient and taxes paid on it?

Mr. COHEN. Senator, the effort has been made in working up these figures to try to arrive at what interest is received by individuals, because the gaps that we have been talking about are the gaps in the reporting by individuals, not the gaps in the reporting by banks, insurance companies, corporations, and so forth. No one has estimated that there is any substantial underreporting for incorporated persons.

Senator KERR. Nobody has certified that there wasn't.

Mr. COHEN. No, indeed.

I have no means of knowing.

The figures, the statistics of income for corporations in 1956–57, showed total taxable interest received by corporations of $14 billion—14.5 billion roughly.

Senator KERR. Now, in 1900 when?

Mr. COHEN. 1956-57.

Senator KERR. At that time there was about $800 billion of debt, so that if the average interest rate were 5 percent, which it was not, but probably more near 4.5, the corporate income being how much?

Mr. COHEN. $14,456 million.

Senator KERR. Would be less than a third of the interest paid.

Mr. COHEN. And I have an estimate by Mr. Holland, who is an eminent economist, made before the Ways and Means Committee at its hearings in 1959, of total taxable interest received by individuals and tax exempt organizations of $8.7 billion and that made up my total of $23,158 million.

Senator KERR. According to your figures it would be that much received by tax exempt identities and corporations.

Mr. COHEN. It was the aggregate of individuals and tax exempt entities which totaled $8.7 billion.

Corporations received $14.5 billion.

Senator KERR. Making a total of $23 billion?

Mr. COHEN. Yes, sir.

Senator KERR. When the cold fact is that there was in the neighborhood of twice that much interest income by individuals and tax exempt organizations and corporations or by somebody else?

Mr. COHEN. Senator, is it possible that the figures—well no, I was thinking that there is a peculiarity about these figures because the Department of Commerce, which gives the figures on which a great many economists and statisticians rely, has included a figure of so-called imputed interest.

Senator KERR. I don't know what kind that is. Is that a kind of a form of deterioration that sets in?

Mr. COHEN. My understanding is, for example, that they regard a bank account in which you may have a thousand dollars on deposit as deriving imputed interest, say, of $40 a year to an individual which you don't collect because the bank pays you no interest on your account since it handles your account without any charge. They build up an imputed interest figure for the interest that you really ought to derive on your money on deposit, and these figures lead to great difficulty in producing estimates based upon interest.

I might say that in the studies that were made—which I tried to make and which the American Bar Association tried to make—one of the points that I tried to drive home is that I think it is terribly difficult to get any reliable statistics that enable one to determine what is the revenue gap in this field, and what withholding would accomplish on various bases.

Senator KERR. I think that is a sound statement. In that connection, I want to say to you that I think that the estimate that the Department has given us of the amount of interest that is collectible and unreported is very much on the low side, because I think in an economy where there is something like $50 billion of taxable interest, to estimate that the taxes are paid on 96 percent of it, is a very optimistic estimate.

Mr. COHEN. We don't know whether the interest is being received by the individuals or whether it is being received by corporations or charities.

Senator KERR. I presume that you had some accurate source of information on what the corporations were receiving.

Mr. COHEN. Well, I took it out of the Statistics of Income for Corporations that are published by the Interial Revenue Service.

Senator KERR. Well, you evidently had some respect for them or you wouldn't have quoted it.

Mr. COHEN. Well, it is the best information I have, Senator.

Senator KERR. I take the Federal Reserve figures as to the total public and private debt which I quoted to you.

Mr. COHEN. I might say, Senator, that I think that one of the greatest helps that we could have in trying to decide the best system of seeing that the revenue is collected that is due, would be to have some group of persons who have worked diligently in this field in trying to develop the best system of solving this problem, agree upon the figures that are available as the most reliable.

I find it extremely difficult to locate the flugres, in particular with respect to withholding.

The Treasury Statistics of Income are diversified entirely from tax returns actually filed. The Treasury has no statistics of income with respect to income from dividends, interest or other sources that is received by persons who are not required to file.

This is a very large group of people, who have income under $600 or $1,200 and are not required to file. There are others who are technically required to file because they have gross income in excess of $600 but who owe no tax and, therefore, in all probability don't go through the trouble of doing so.

There aren't any statistics, at least, that are publicly available, and I doubt if the Treasury has any figures, as to the impact of this withholding on people who are not now required to file returns or who do not now owe any tax.

Senator KERR. You know the statements you are now making seem to me to justify legislation such as we are contemplating.

What you say amounts to telling me that you don't think there is any way of knowing how much interest and dividends are being received by people on which taxes are not paid.

This sure would identify some of that, wouldn't it?

Mr. COHEN. No, sir; I would like to point out one thing with respect to withholding: I don't believe that withholding identifies anything.

Withholding doesn't determine anyone's tax liability. All withholding does is to put money in the hands of the Government instead of in the hands of the payee, but it does not determine what that payee owes.

My point is that as was said earlier this morning, the public seems to have the impression this is a new tax, Senator Douglas earlier said that his mail indicated in many cases a belief that this is a new tax, and he said, and he is correct, that it is not a new tax.

But I can also understand why the person in a small town who is not subject to tax, and who is going to have 20 percent taken out at the source unless he does something to file exemption certificates, which he has read about in the newspapers but which he does not understand, considers this a new tax, even if he gets it back the following April. I think it is fair to understand why some people regard this as a new tax.

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But you will never know whether he owes a tax or not just because 20 percent has been lopped off at the source.

You have got to go through the filing of a tax return, making this person report all his income, all his deductions, calculate his tax after grossing up his dividend and interest income and so forth, in order to determine that he owes no tax and gets the money back.

Now, this is going to bring onto the record books of the Internal Revenue Service and the payors and the payees with exemption certificate programs and so forth, a very large number of taxpayers who owe no tax whatsoever.

Now, it may be that the Statistics of Income will be better if we have withholding in 1965, but I hardly think that that is a reason for going through this.

I believe that all of this complexity of exemption certificates is a terribly difficult thing, and is going to cause manifold problems for everyone in the making out of tax returns for the small person who will not understand, will not remember, whether he filed an exemption certificate for this item or that item. Nor will the Internal Revenue Service know whether or not he filed an exemption certificate for a partciular item of interest or dividend income.

But it isn't going to catch more than 20 percent of the top bracket man, who is the person that we should be concentrating on. We can concentrate on those high bracket people by using the automatic data processing machines and these information reports.

You can set those machines to collect the items that total more than a certain amount, and go after those persons. But withholding isn't going to do that.

Senator KERR. I want to thank the witness for his patience, Mr. Chairman, and I express my appreciation to him for his frankness.

I must say to him, though, that I am not impressed by the zeal with which he espouses the proposition that the Internal Revenue Department go after these fellows that pay more than 20 percent more vigorously than they are already going after them. [Laughter.]

The CHAIRMAN. The Chair would like to say I think the witness has made one of the best statements that has been made before this committee on this question.

Mr. COHEN. Thank you, Senator.

May I say that I had the privilege of growing up almost in your shadow while you occupied the Governor's chair in Richmond. I was born and raised there.

Senator KERR. That statement is not going to hurt you. You couldn't figure out some association with me. [Laughter.]

If you can figure out any association with the Senator from Oklahoma, don't fail to make a note of it for the record. [Laughter.]

The CHAIRMAN. That accounts for this excellent presentation.

Mr. COHEN. Thank you, sir.

The CHAIRMAN. We have heard a good deal; I have a couple of questions.

You have heard a good deal about Mr. Mortimer Caplin this morning.

Mr. COHEN. Yes, sir.

The CHAIRMAN. And I can agree with what has been said he is a great man and he is a greater man because he is a Virginian. We also have heard some talk about Mr. Surrey. Well, Mr. Surrey was exam-

ined at great length by this committee and with respect to his philosophy of taxation, and the Secretary of the Treasury then wrote the chairman of this committee a letter which was inserted in the Congressional Record at the time he was confirmed in which the Secretary said that he had notified Mr. Surrey that he, the Secretary, would be the tax policymaker of the Treasury.

I say that without reflection upon Mr. Surrey, because he had previous views which he had expressed some time ago, when he was younger, I assume, and he indicated that there was some change in those views.

Now, I want to ask you this, Mr. Cohen, for the purposes of the record: The staff advises me that the Treasury has estimated that the withholding on dividends and interest will increase revenues by $650 million; $280 million from dividends and $370 million from interest. However, the supporting documents submitted by the Secretary show that only $470 million will be collected by direct withholding. $150 million from dividends, and $320 million from interest. The remaining $180 million are supposed to result from improved reporting.

I want to ask you this question: Isn't it likely that the new, automatic, data-processing program will lead to improved reporting, even if the withholding is not enacted?

Mr. COHEN. I think it is inevitable, Senator. I think a very real effort is being made by the best minds in the Internal Revenue Service, and by the best minds among the major payers of income, to make that system work. I attended yesterday a conference at the Internal Revenue Service about the proposed regulations. I think that the effort to put that program into operation is going forward with speed—I would say with all reasonable speed that it might have, and I have the highest hopes for it.

I made the point yesterday, on behalf of the investment companies whom I represent, that we are extremely anxious to cooperate and make that system work, and I think that is the attitude of all who are participating in it.

The CHAIRMAN. How long do you think it will take to make it operative to the point where it would be reasonably effective in collecting the taxes that are not now being paid?

Mr. COHEN. Senator, I think that it is going to have an effect, an effect of very large proportions, even before it becomes operative, because of the publicity which is being given to it. I think the man who is not reporting his dividend and interest income is going to realize that his days are, so to speak, numbered, and that he will be uncovered sooner or later, and that, therefore, it is time to come forward before those machines go into operation.

I would like to point out one thing that came out of the studies before the Ways and Means Committee 2 years ago, and that is that when withholding on salaries and wages went into effect in 1944, it was only 93 percent effective; 92 percent of dividends are being reported today. Even now, withholding on wages and salaries is only 97 percent effective, and I think automatic data processing in the dividend field can acomplish the same thing.

The CHAIRMAN. Do you agree with this statement which the staff has given to me as coming from the Treasury that only $470 million will be collected by direct withholding?

Mr. COHEN. That is entirely correct, sir.

The CHAIRMAN. That the balance will come from improved reporting?

Mr. COHEN. Yes, sir. I might also add——

The CHAIRMAN. That will be due a good deal to publicity which has been given this number proposition.

Mr. COHEN. Yes. If I might add one other thing, Senator, I believe that those figures of the Treasury, according to the statement made, also assume the concurrent repeal of the dividend credit and exclusion, and if the dividend credit and exclusion were not repealed, the revenue again from the withholding alone would be less.

The CHAIRMAN. You quoted the Chairman as saying on the floor when this number bill was passed, as I recall it was about midnight, on the last day of the session and I quoted the Treasury exactly, they said this numbering system would bring in increased tax revenue of $5 billion and that has been repeated time and time since then. Certainly progress is being made, people are being given social security numbers now.

Mr. COHEN. Yes, indeed.

The CHAIRMAN. And the very effort to do that, and the taxpayer knows it is being done, is going to make them more careful and more desirous to make the returns in a way that will not impose upon them some criticism. I was somewhat impressed by the bill that you had at the back of your statement in regard to the legislation that was enacted in the House proposing a severe penalty on those who did not make reports on interest and dividends.

Mr. COHEN. It was introduced in the House, Senator.

The CHAIRMAN. It was introduced in the House; yes, that is right. That was in 1961. Was any action on it ever taken by the committee?

Mr. COHEN. I do not believe so, sir.

The CHAIRMAN. What disturbs me is the terrifically complicated fashion in which these refunds have to be made. As I said earlier in the day, for myself especially, and people who make their regular returns and have no refund of any kind, I think withholding is desirable, but there are millions of people, who make tax returns. Aren't there 80 million? Isn't that correct?

Mr. COHEN. Sixty-some million, I think file returns, there may be a hundred million people, taking into account joint returns.

The CHAIRMAN. So there may be many of those people who, when withholding is made, have to get a refund.

Many citizens will be unable to make the applications correctly.

I don't want to keep you any longer, Mr. Cohen, but here are a series of questions—five questions—I would like you to answer for the record. I want you to furnish an answer to the record for those questions.

Mr. COHEN. Thank you, sir.

(The questions and answers referred to follow:)

ANSWERS TO FIVE QUESTIONS ASKED BY CHAIRMAN BYRD OF EDWIN S. COHEN, APPEARING APRIL 18, 1962, ON BEHALF OF INVESTMENT COMPANY INSTITUTE

Question No. 1. Proposed section 3484 provides for quarterly refunds to individuals under certain prescribed conditions and limitations. Will you comment further on the fairness and adequacy of this provision?

Answer. I believe that there are serious limitations in section 3484 regarding quarterly refunds of tax overwithheld on dividend and interest income, and that these limitations materially restrict the relief which the section is supposed to

provide from the hardships of overwithholding. Among these limitations are the following:

(*a*) The maximum aggregate amount of quarterly refunds is determined by a method which takes into account the standard deduction, but not itemized deductions. This may produce hardship for persons (particularly the elderly) who have substantial medical deductions, or other deductions substantially in excess of the standard deduction.

(*b*) The maximum aggregate amount of quarterly refunds takes into account even the standard deduction only to a limited extent. The standard deduction is permitted in a final tax return to the extent of 10 percent of adjusted gross income up to $10,000, but the peculair formula of section 3484 restricts the standard deduction for its purposes to 10 percent of the total of (1) personal exemptions and (2) retirement income (which is in itself limited to $1,200 per person).

(*c*) Section 3484 does not take into account the dividend exclusion or the dividend credit.

(*d*) Quarterly refunds are not permitted if the gross income of a single individual exceeds $5,000 or that of a married individual exceeds $10,000. Not only will this rule operate in an unfair and arbitrary manner but being based upon gross income it will leave substantial problems of interpretation and application. Apparently it would include the gross amount of a capital gain without reduction for the fact that only 50 percent of a long-term capital gain is taken into account for income tax purposes, and without offset for any capital loss. Thus a single person entitled to a quarterly refund under section 3484 in the early part of a year may become ineligible for future quarterly refunds if on a relatively minor change in investments he realizes a capital gain which causes his gross income to exceed $5,000.

(*e*) The peculiarities in the formula for refunds under section 3484 will make it difficult for individuals to understand, particularly since the results under the provision bear no necessary relationship to the tax which the individuals actually owe or the final refund to which they may be entitled for the year. The provision would graft a further complication onto the tax law, applicable especially to low-income and elderly individuals.

(*f*) Because of normal fluctuations in dividend and interest income, it would require in many cases recalculation of the permissible refund from quarter to quarter and a final recalculation after the end of the year.

(*g*) It makes no provision for prompt refund of tax withheld in the fourth quarter of the year, but requires that refund for that quarter await the filing of the final return. In many cases where information must be awaited from trustees or others to permit the preparation of the individual's final tax return, the actual refund for the fourth quarter may be delayed for several months after the close of the year.

My effort to study the matter of withholding on dividends and interest, and the differences between such withholding and that on wages and salaries, leads me to suggest that serious consideration be given to revision of the procedures relating to wage withholding in order to permit interim refunds of tax withheld on wages from persons who suffer from unemployment during part of the year. For example, persons who are subjected to withholding on wages received in the early part of the year, but who lose their jobs during the year and remain unemployed for a specified period, should be permitted to receive interim refunds of the previously withheld tax. At present such refunds cannot be obtained until after the close of the year, and such an amendment of the law might be of material help to those who are unemployed.

Question No. 2. The proposed withholding of tax on dividends and interest is proposed to be made without requiring receipts to be issued to payees. It has been suggested by some that this is an inducement to fraudulent practices. Do you share this concern?

Answer. There is a serious problem involved in the possibility of erroneous refunds being allowed under the type of withholding proposed for dividends and interest. No information receipts, such as are issued on form W-2 for withholding on wages and salaries, would be issued to recipients of dividends and interest, and hence none would be available for attachment to their tax returns. This is an especially serious problem in view of the fact that the proposed law would permit a substantial number of persons to file exemption certificates with their payors and thus obtain payment of dividends and interest

without withholding. Payees may file such certificates with some payors and not with others; or file them with a particular payor for only part of the year.

Since dividend and interest income so frequently represents an aggregation during the year of a number of separate small items of income, the absence of information receipts will create much difficulty for the recipient, and for the person assisting in the preparation of his tax return, in making out a correct return or claim for refund; and the Internal Revenue Service will have manifold problems in ascertaining the correctness of a large volume of refund claims.

One need not point particularly to the possibility of fraud in the filing of refund claims; even without regard to intentional fraud, it is obvious that many errors in claiming and allowing refunds will be made as a result of inadvertence and mistake under a system in which no information receipts are available. On balance, experience indicates that taxpayers' mistakes tend to favor the taxpayers rather than the Treasury.

The risks to the Treasury in permitting refunds without information receipts are discussed at some length in my letters appearing in the printed transcript of the hearings of the Ways and Means Committee in May 1961 on pages 2431–2435 and 2470–2485.

Question No. 3. Under the proposed legislation (sec. 3484(a)) a refund of tax will be made only if the amount claimed and allowable exceeds $10. Will you comment on this?

Answer. The $10 minimum refund requirement is apparently designed to reduce the expense to the Treasury in processing small refund claims, and to mark a line below which the amount involved for the recipient is not likely to produce hardship. The postponement of the refund, however, beyond the time when the matter is fresh in the mind of recipients may lead them to neglect the filing of refund claims at a later date, and produce an unjust enrichment of the Treasury at the expense of low-income individuals.

Question No. 4. The Treasury Department has stated that it will use spot checks, on a postrefund basis, of the quarterly refund claims. What problems do you see in this?

Answer. It has been proposed, as I understand it, that in order to minimize the making of excessive refunds for tax allegedly withheld on dividends and interest, the Internal Revenue Service would investigate a limited number of the cases after the refunds have been granted. I do not know of any statement as to the number of refunds which would be so investigated. Obviously if they were few in number, this technique would not be effective; and if the number were large, it would be expensive and time consuming. Presumably this would be done by the Internal Revenue Service checking with the payors of dividends and interest as to the amount of the payments made to the recipient, and ascertaining whether an exemption certificate was filed and the amount of tax withheld.

In most instances this would have to be handled by correspondence between the Service and the payers. There would be difficulties in matching the name and address of the taxpayer on the records of the Internal Revenue Service with the name and address of the registered owner of the stock or bond on the records of the payer. The process would seem relatively expensive and time consuming for the payers, the payees, and the Service. In most instances the amounts of adjustments required would be so small, and so likely to be due to inadvertent mistake, that spot checks would seem to provide relatively little protection to the Treasury against a substantial volume of erroneous refunds.

On the other hand, without withholding, the automatic data processing machines could aggregate the amount of dividends and interest received by each individual according to his taxpayer account number, and enable the Service to concentrate upon those taxpayers who, in the aggregate, have substantial amounts of dividends and interest omitted from their tax returns. The machines would also furnish the Service with a ready means for automatic billing of individuals in lower brackets who omit from their returns interest, dividends, and other income reported to the Service on information returns. The knowledge of the existence of the machine operation and of the coming use of taxpayer account numbers, and the imposition of a penalty and extension of the statute of limitations as proposed in my statement before the committee, would, I think, cause a large number of presently nonreporting taxpayers to come forward and voluntarily report their dividend, interest, and other income.

Question 5. What problems do you see where dividends or interest are paid to a trustee who is required to currently distribute all trust income?

Answer. Under the proposed withholding system in the pending bill, neither a trustee nor an executor is permitted to file an exemption certificate with his payer or obtain a quarterly refund. It is apparently intended that the beneficiary of a trust could obtain a quarterly refund, subject to the substantial limitations on quarterly refunds mentioned in my answer to question No. 1. Except to the limited extent that a beneficiary of an estate or trust could obtain a quarterly refund, the provisions of the bill could impose a substantial hardship upon low-income beneficiaries of estates or trusts. This would be particularly true where the trustee has no power to invade the principal of his trust to finance the beneficiary during the period from the withholding of the tax until the allowance of the refund.

For example, if an elderly person has no independent means but is the sole income beneficiary of a trust, she may owe no tax because of medical deductions or otherwise; but she could not file an exemption certificate and for various reasons she might be ineligible to file a quarterly refund claim. Under these circumstances in the first year of operation of withholding, her income would be reduced suddenly by 20 percent, and the trustee might be unable to distribute to her any of the principal of the trust as an advance against the refund which would be allowable to her in the following year.

Some of the hardship that might be involved for low-income beneficiaries might be reduced for the future by providing in trust agreements that the trustee may advance to the beneficiary out of principal of the trust an amount equal to the withholding tax on the income of the trust; but this solution would not be available under most trusts now in existence which do not permit distribution of principal.

It might also be noted that the proposed legislation would substantially complicate the administrative and accounting work of trustees and executors, particularly so with respect to the giving of information to beneficiaries to enable the latter to prepare their tax returns correctly.

The CHAIRMAN. The committee will recess until 2:30.

(Whereupon, at 12:50 p.m., the committee stood in recess until 2:30 p.m., the same day.)

AFTERNOON SESSION

Senator CURTIS (presiding). Our first witness this afternoon is Senator Hiram L. Fong of Hawaii.

Please proceed Senator Fong.

STATEMENT OF HIRAM L. FONG, A U.S. SENATOR FROM THE STATE OF HAWAII

Senator FONG. Mr. Chairman and members of the committee, I deeply appreciate your courtesy and kindness in affording me the opportunity to present a statement on the withholding provisions of the tax bill before you, H.R. 10650.

At the outset, may I say I oppose the plan to withhold a flat 20 percent of dividends and interest as provided in section 19. In my judgment, such withholding will work great hardship and deprivation on millions of people with small incomes—the small saver, the retired individual, the widow living on annuities. The cumbersome and tardy partial remedies provided in the bill are insufficient to protect these individuals.

Moreover, the redtape involved in the withholding, exemption, and refund procedures of this bill will not only add immediately to the operational cost of dividend- and interest-paying institutions, but also may have far-reaching adverse repercussions on our Nation's economy. It is quite conceivable the withholding program may discourage savings and discourage investment on the part of millions of Americans.

Should that occur, the cumulative impact could seriously inhibit the economic growth of our Nation.

Mr. Chairman, there is no question about it, the withholding plan has created widespread alarm. I have received more mail from the people of Hawaii protesting the administration plan to withhold 20 percent of dividends and interest than on any other issue before the Congress.

Most of my protesting constituents say they are of modest means and depend upon interest on savings and dividends to build up a little nest egg or to supplement their social security or private retirement or pension annuities in order to pay for the necessities of life.

So great is the concern of the people of Hawaii regarding dividends and interest withholding that I have made a personal study of the privisions in the bill passed by the House now pending before your committee.

What I discovered dismays me. Billed as a "simple withholding device to catch tax dodgers by collecting in advance taxes that will be due anyway," H.R. 16050 is quite the contrary.

One, it is anything but simple. Forty-six pages of complicated, technical language are required to write the plan into statutory form.

Two, it will collect millions of dollars in taxes that will never be due the Government.

Three, it will not catch tax dodgers.

As for its alleged simplicity, one need not be a tax expert to foresee that execution of this withholding proposition will be nightmarish—to each of the millions of Americans affected, to each of the thousands of banks, corporations, savings and loan associations, and other payers of dividends and interest, and to the Government itself which must administer this tax monstrosity.

It is difficult to exaggerate the added burden on people and business and Government that will result if the withholding proposal becomes law. The difficulties and drawbacks are readily apparent to anyone who looks behind the advertising claims on behalf of the administration's dividend and interest withholding plan.

Just what does the plan provide?

This so-called simple plan requires that payers of interest, dividends, and patronage dividends must withhold one-fifth, or 20 percent, of each and every dividend or interest payment they would otherwise make.

With this requirement, once more business is made tax collector for the Federal Government. Every business, every bank, every cooperative paying dividends or interest will need to compute 20 percent of every separate dividend or interest entitlement, subtract this 20 percent amount, and derive the net amount to remit to stockholders, shareholders, savings account owners, and so on.

To make the plan more palatable to payers, the bill does not require the payer to furnish the recipient a statement of the gross amount of dividend or interest due him, the amount withheld under the 20-percent rule, and the net amount remitted.

Neither is the payer required to furnish to the Internal Revenue Service a list of the names and addresses of those to whom dividends or interest were paid nor a statement of gross amounts due, amount withheld, and net amount paid.

Under the present withholding of wages and salary, every employee is furnished a statement of gross wages, Federal tax withheld, and net wages. Copies are furnished for the employee to attach to his Federal income tax form.

But under the dividend- and interest-withholding plan, instead of having receipts showing this breakdown for income tax purposes, every taxpayer will have to compute the amount of withholding and the gross amount due him as interest or dividend.

Obviously, the Federal income tax form is going to be made more complicated, and the American people are going to have further complicating rules and regulations to confuse and confound them.

OVERWITHHOLDING

But this is not the total story, by any matter of means. The bill recognizes that a straight 20-percent withholding will result in massive overwithholding—in other words, will collect taxes from great numbers of people and organizations who either have no tax liability whatsoever or who have less than 20 percent tax liability.

Therefore, the House bill provides two features in an attempt to soften the impact: exemption certificates and quarterly refunds.

Certificates exempting dividend and interest payments from 20 percent withholding may be filed by persons under 18 years of age, and by persons 18 and over provided they anticipate no tax liability for the year.

EXEMPTION CERTIFICATES

Thus, to avoid withholding on dividends and interest, persons under 18 years of age are required to file exemption certificates with each payor—that is, with each bank, each savings and loan association, and each company paying dividends.

Persons 18 years or older who do not expect to owe any Federal income tax whatsoever and who therefore wish to be exempt from the automatic 20 percent withholding must file an exemption certificate each and every year with each and every payor from whom they anticipate receiving dividends or interest.

Even if this were not enough to deter the average man who is neither a lawyer nor tax expert, there is further deterrent in the penalties provided: persons filing exemption certificates may later find themselves subject to $500 fine or 1-year imprisonment if they are found willfully to have filed false information.

I have not yet exhausted the drawbacks of the withholding plan. Exemption certificates are available only for certain kinds of dividends and certain kinds of interest. The bill provides exemption certificates are no good in the case of (1) "bearer" or registered corporate bonds; (2) transferable bank or savings and loan certificates; and (3) U.S. Government bonds other than series E, for which special provision is made in the bill.

In the case of a $75 series E bond which a person seeks to cash at maturity, expecting to receive $100, only $95 would be paid him under the 20 percent withholding plan. The bondholder would not receive a withholding certificate but only assurance that if his $5 is not subject to Federal income tax, he can file claim for a refund. Or, if he does not expect the $5 would be subject to income tax, he can sign a cer-

tificate to that effect and receive the full $100. Again, there is no reporting by the cashing agency to the Internal Revenue Service as to the person from whom funds were withheld in redeeming series E bonds.

In the case of churches, charitable foundations, labor unions, and other organizations now exempt from Federal income taxes, they will be unable to exempt themselves from dividend withholding. They are entitled to use exemption certificates only in the case of bank interest.

As to joint accounts, the bill is not explicit. A Treasury regulation must be forthcoming to see if and how exemption certificates will work in the case of joint accounts and joint ownership of stocks and bonds on which interest or dividends may be paid.

It takes little imagination to see the flood of papers and redtape involved in withholding and exemptions, to say nothing of the confusion all around. It is significant that last year in public hearings before the House Ways and Means Committee the administration opposed exemption certificates as making the withholding plan "unduly complex." Pages 11, 89, and 2779 of the printed hearings last year reveal the administration's opposition.

This year, Treasury officials sanction exemption certificates although nothing has happened in the interim to render the system any less complex.

QUARTERLY REFUNDS

Now to continue explaining the so-called simple 20 percent withholding plan on dividends and interest. In another effort to relieve hardship caused by Government withholding, the House bill provides for quarterly refunds in cases where the Government withheld too much tax.

Since persons expecting some tax liability may not file exemption certificates, they are permitted to apply for quarterly refunds provided they expect their tax liability to be less than the amount of the withholding.

Now the plot thickens. Three and one-half pages of complex language govern refunds.

First, the Internal Revenue Service will refund only amounts exceeding $10.

Second, refunds are not available for a child "unless at the time the claim for refund is filed, he reasonably expects that no deduction would be allowed for him under section 151(e)(1)(B)." This section consists of two long pages of fine print in the statute.

Third, in order to claim a refund, each individual must compute the refund to which he is entitled. Remember, he has no receipt from those who paid him dividends or interest showing the gross amount, the amount withheld, and the amount remitted to him.

The bill spells out what his refund allowance is, as follows:

The refund allowance of an individual as of the time the claim for refund is filed is an amount equal to the excess, if any, of—

(1) an amount equal to 22 percent of—

(A) the total of the deductions which, on the basis of facts existing at the time the claim for refund is filed, such individual would be allowed for the taxable year under section 151 (relating to deductions for personal exemptions), plus

(B) in the case of an individual who, at the time the claim for refund is filed, reasonably expects that he will be allowed a credit under section 37 (relating to retirement income) for the taxable year, the amount which, at such time, such individual reasonably expects to be the amount of his retirement income (as defined in section 37(c) and as limited by section 37(d)) for the taxable year, less

(C) the amounts (other than amounts on which tax is required to be deducted and withheld under this chapter) which, at the time the claim for refund is filed, such individual reasonably expects to be includible in his gross income for the taxable year; over

(2) the amounts of tax with respect to which an allowable claim for refund has been previously filed under this section during the taxable year.

With that simple little provision, I believe we can safely say we have bewildered the individual on his quarterly refunds.

In the case of corporations and tax-exempt organizations subject to withholding of dividends or interest due them, there is provision allowing the organization to calculate its current refund entitlement and subtract this amount from money it is withholding on dividends, interest, or wages due to others.

Those corporations or tax-exempt organizations subject to withholding on dividends or interest they receive who do not withhold from dividends, interest, or wages they pay out, could not avail themselves of this fast bookkeeping refund. They would have to file for a quarterly refund from the Internal Revenue Service.

Even if Internal Revenue Service refunded to them within 1 month after the end of the quarter, this would mean colleges, churches, hospitals, labor unions, pension funds would lose 1 month's use of this money. In other words, they would lose 1 month's interest or other revenue produced by investing their funds. And there is no assurance refunds would be made as promptly as 1 month.

MOUNTAINOUS PAPERWORK

The administration estimates more than 350 million dividend and interest accounts will be affected by the 20 percent withholding plan, assuming withholding applies only on quarterly dividend or interest payments of $10 or more.

If we add to this all the other holders of Federal savings bonds, the patrons of cooperatives, those receiving interest or dividends from insurance companies and so on, where the amount of withholding is less than $10—there will be at least 500 million accounts involved in withholding. The bookkeeping and paperwork involved in the plan would be astronomical in volume.

OVERWITHHOLDING

There is no question but that the Government will collect great sums of money to which it is not entitled. Administration witnesses readily admit there will be overwithholding. But they excuse this on the ground that there is even greater overwithholding in the existing system of withholding from wages and salaries.

At present, some 9,300,000 tax returns reflect dividend and interest income. According to administration estimates, some 22,500,000 returns ought to show receipt of interest and dividends. Of the 22½ million, the administration concedes there may be overwithholding in 2 million cases.

Overwithholding is defended in part by pointing out that 37 percent of tax returns where wages are withheld require a refund. In many cases, however, wage earners voluntarily wish to have the Government withhold more tax than due so as to receive a refund for the year. This is a kind of self-imposed savings system. Then when April 15 rolls around each year, the wage earner does not have to pay additional taxes.

Moreover, withholding of wages relates to income and applies only after deductions and exemptions are considered. Withholding of interest and dividends will be at a flat 20 percent irrespective of income and without allowing for deductions. Exemptions will be allowed only in cases where persons are eligible to file exemption certificates.

It sounds fair for the Government to take 20 percent from every interest and dividend payment, but it is not actually fair to take 20 percent from persons who have no tax liability. It is not fair to take 20 percent from persons who have less than 20 percent tax liability. It is not fair to take only 20 percent from persons who have greater than 20 percent tax liability.

Exemption certificates and quarterly refunds only partly alleviate the unfairness inherent in the 20 percent withholding plan. Exemption certificates are available to a limited number and quarterly refunds involve delays and redtape. Where the sums to be refunded are small, many people will not go to the bother of filing refund claims and the Government will receive a windfall.

In the case of larger refunds due, the cumbersome refund process will work real hardship on many persons relying on dividends and interest to help pay their current bills for food, clothing, shelter, and other necessities. It will work real hardship on small savers putting some funds aside for that rainy day when calamity may strike.

As for catching tax dodgers, we must all understand that the proposed withholding system will not add the name and address of a single tax dodger to the tax rolls for the simple reason that the payers are not required to furnish the names and addresses of those to whom they paid dividends and interest. Without this information, Internal Revenue Service has no way of matching the tax returns of individuals and organizations against listed dividend and interest payments of banks, corporations, savings and loan institutions, and the like.

Without such information, Internal Revenue Service will not be able to check the claims for refunds. The door is wide open for fraudulent refund claims.

A tax dodger liable for more than 20 percent Federal income tax would be very happy to have only 20 percent withheld, knowing how difficult it would be for Internal Revenue Service to ascertain how much additional he owes on dividends and interest.

No one condones the failure on the part of anyone to include taxable dividends and interest in tax return. The withholding plan will not catch the tax evaders, however.

In fact, dividend and interest withholding will be a hit-or-miss operation until the internal revenue system becomes more fully automated—in 1966 under current plans. Then the automatic data processing system will be able to match names and addresses of those to whom dividends and interest are paid from form 1099 now filed by payers with tax returns filed by the recipients. This will locate the tax dodgers, and withholding will be unnecessary.

SUMMARY

To sum up my objections to this ill-advised withholding plan:

First, it hurts most the little man depending on dividend and interest income to pay his daily sustenance or to build rainy-day savings. This is about as close as Government can come to robbing a man of the wherewithal for his bread and meat. By applying a constant 20-percent rate to people regardless of whether they are in the zero to 91 percent bracket is grossly unfair.

Second, withholding would rob tax-exempt institutions like hospitals and colleges as well as pension funds of one or more months' usage of this large part of their income.

Third, it will result in a tax windfall to the U.S. Government because people entiled to exemptions and refunds will not know they are so entitled or will be unable to figure their status or claims or will be discouraged by the multiudinous forms to be filed.

Fourth, withholding may very well build up resentment both against investing in interest- or dividend-producing enterprises and against the Government tax system. Small investors might turn away from savings accounts, stock purchases, savings and loan accounts, mutual savings, banks, and cooperatives. Withholding may very well encourage people to withdraw their savings and put them into tax-exempt bonds or keep them in a safety deposit box or under the mattress or in an old sock.

Fifth, the withholding plan proposed carries with it operational and clerical problems to paying banks and corporations, to recipient individuals and organizations, to say nothing of the redtape for Government. It would produce one gigantic headache from Maine to Hawaii and Alaska to Florida.

Sixth, it would greatly complicate the already complex Federal income tax form by adding more items to be reported. It would greatly increase the number of computations each taxpayer must make. It may well jeopardize voluntary compliance with the self-assessment features on which the success of our tax system so heavily depends.

Seven, it will not add to the tax rolls the name of a single tax dodger. In 4 years, a much better checking system than withholding will be in full operation to uncover those failing to report dividends and interest. Once that is fully effective, withholding will be unnecessary. Why saddle the Nation with withholding redtape, inconvenience, and in many cases—real hardship—when a better remedy is at hand.

Moreover, proponents claim withholding will bring in $650 million of so-called lost revenue of $850 million a year. How much of the so-called lost revenue the Government is entitled to, no one can say for sure. Neither do they estimate how much of the $650 million will be money to which the Government is not entitled.

Surely a better way to raise $650 million revenue can be found than this one which will confuse and harass millions of American people and add greatly to the cost of business and savings institutions and tax-exempt organizations in America.

There are still tax loopholes that could be closed to produce revenue. More internal revenue agents could be hired to go after tax dodgers. We have not by any means exhausted the revenue-producing possibilities—possibilities which would be far more equitable and less bur-

densome than the proposed 20 percent withholding of dividends and interest.

I strongly urge the Senate Finance Committee to reject the withholding portion of the House bill and write a better bill for Senate action.

Senator CURTIS. Thank you very much, Senator Fong.

Is Mr. Magovern here?

STATEMENT OF JOHN J. MAGOVERN, JR., ON BEHALF OF THE AMERICAN LIFE CONVENTION, THE LIFE INSURANCE ASSOCIATION OF AMERICA, AND THE LIFE INSURERS CONFERENCE

Mr. MAGOVERN. Mr. Chairman, my name is John J. Magovern, Jr. I am executive vice president of the Mutual Benefit Life Insurance Co.

I appear today as chairman of the Joint Legislative Committee of the American Life Convention and the Life Insurance Association of America, and on behalf of the Life Insurers Conference. These three organizations have a membership of 355 life insurance companies in the United States and Canada, representing 94 percent of the legal reserve life insurance business in the United States.

My statement will deal with section 19 of H.R. 10650, relating to withholding of income tax on interest and dividends. Under this section, as explained on page A141 of the House committee report, life insurance companies would be required to withhold on (1) interest on the proceeds of an insurance policy which are held by an insurer under an agreement to pay interest thereon; and (2) interest with respect to policyholder dividends held by an insurance company.

In the case of life insurance companies, these provisions would result in serious administrative difficulties, as well as burdensome expenses which must be borne ultimately by policyholders and beneficiaries.

There are approximately 120 million policyholders in the United States. The policies they hold involve millions of individual interest items each year, many of them quite small. A majority of these interest commitments are inherently more complex than those in other types of business where the interest is payable at fixed rates and at stated dates, and is readily separated from the principal on which the interest is based.

The interest items under a life insurance policy arise from a series of related contractual provisions, many of which are interdependent. Other and different benefits may depend upon this interest.

Senator CURTIS. I would like to ask you a question right there. According to the House bill, would you have to withhold interest that by contract you were not obligated to pay at that time?

Mr. MAGOVERN. We would have to withhold on interest to the extent that we are obligated to pay or credit according to the House bill.

Senator CURTIS. Even credit?

Mr. MAGOVERN. Yes, sir. And I will deal with that subject under the question of policyholder dividend accumulation accounts where we credit it; the interest item does not go to the policyholder, but it is just credited to the dividend accumulation account. I will deal with that at some length, Senator, because of the real problems that are

involved in such a withholding, legal as well as practical, and the business practicalities.

Senator CURTIS. That involves a tax on, an income tax on, the proceeds of life insurance.

Mr. MAGOVERN. These are dividends received by policyholders on policies which have not yet matured.

Senator CURTIS. I understand that.

Mr. MAGOVERN. Yes.

Senator CURTIS. But a contract for life insurance is one where the insured agrees to pay so much and agrees to credit him with certain things, that is the company does, that go into the mechanism of compound interest, which is part of his purchase price, and it is paid as a death benefit, and he has no income or he receives nothing, we will assume it is that type of policy that he pays on, and a death benefit is paid. On the paying side, that is not income to him.

Mr. MAGOVERN. This could have a very serious effect on the amount, proceeds, and method that would be available upon the death of the insured, and the bill, so far as it relates to the amount that is to be paid out to beneficiaries under interest options, would also require withholding on that.

There are two main facets of this bill as it hits the payments being made by life insurance companies.

Senator CURTIS. It involves a number of dollars that the insured has to pay to the company.

Mr. MAGOVERN. That is right; yes, sir. It could do just that.

Senator CURTIS. Which is certainly not income to him when he buys it.

Mr. MAGOVERN. That is one of the legal questions that is involved here and that we are disturbed about, Senator.

Senator CURTIS. Go ahead. Excuse me for interrupting.

Mr. MAGOVERN. We think there is a very serious question involved here, and it will probably have to go to the courts; you are quite right.

Consequently, any attempt to apply withholding to this interest may have a detrimental effect beyond the mere subtraction of the amount withheld.

INTEREST ON POLICYHOLDER DIVIDEND ACCUMULATIONS

Nowhere is the problem of withholding more acute than in the area of policyholder dividends left with life insurance companies to accumulate at interest. There are millions of such dividend arrangements and the average interest added to each is only a few dollars a year. Actually, many of these interest additions amount to only a few cents each. One company alone holds over 2 million such accounts and the average withholding in this instance would be 75 cents. Even if there were no complications or individual variations in handling, it is obvious that the cost of withholding would be high in relation to the amount collected.

The application of withholding to dividend accumulations also involves a serious legal problem as to the time this interest becomes taxable.

This is the point, I think, you asked me about. Since the interest is accumulated rather than paid, it is taxable at the time of crediting

only if it has been constructively received by the taxpayer. The doctrine of constructive receipt applies only if the income may be obtained by the taxpayer without the loss of substantial rights. The application of this doctrine to interest on accumulated policyholder dividends is by no means clear under the decided cases.

This uncertainty arises because the interest so credited becomes a part of the policy and may be utilized in a number of ways for the policyholder's benefit. Even though the amounts of interest in some cases may be small, over a long period of time they can have an important bearing on the rights of the policyholder.

One of the most important rights is the application of these amounts to keep the policy in force on nonpayment of premiums and to increase the duration of extended term insurance available in the event of premium default. Alternatively, the accumulated dividends and interest may be used at the time of settlement to provide benefits under policy settlement options at guaranteed rates.

Senator CURTIS. Let me ask you this: Was it the intent of the House of Representatives to impose a tax not now imposed or was it the intent of the House of Representatives merely to deal with the mechanics of collecting a tax on items of income that are now subject to reporting?

Mr. MAGOVERN. I would say that the House of Representatives in this case, in the enactment of this bill, assumed that the interest items on these accumulated dividends were subject to tax, because the policyholders may have been free to withdraw them as they would in a bank account. But I think this is a failure to understand precisely what is involved.

Senator CURTIS. Do you know of anybody who reports the interest accumulations on his life insurance currently, annually?

Mr. MAGOVERN. I would say that there are—we furnish that information on occasion to policyholders, and they may well report that.

Senator CURTIS. It is on matured policies.

Mr. MAGOVERN. No; oh, no. On matured policies we are more sure. But this is the policy that is still in effect. The accumulated dividend is kept with the company, interest is credited.

Now from correspondence we have had, indications are that the Treasury has felt that this is subject to income tax and, as I will explain in the statement, they have not yet really, we do not feel they have, clarified the situation.

Senator CURTIS. All right, proceed.

Mr. MAGOVERN. Because of these valuable rights, which are forfeited if the policyholder withdraws the account, there is serious doubt that the interest is constructively received when it is credited. This question has not to date been satisfactorily answered. The Treasury Department is reported to have been working for some time on either a ruling or a proposed regulation on this subject, but nothing has as yet been issued. In any event, a controversial issue of this sort can be settled only by the courts. Since there are variations in contract provisions, court decisions interpreting what is a "valuable right" may not be uniform. This further underlines the difficulty of applying the withholding procedure to these interest accumulations.

Aside from the legal question involved, if it is assumed that the interest is taxable when credited, withholding would irrevocably impair valuable policyholder rights. This accumulation is not a deposit

account in which amounts once withdrawn can be replaced. Withholding would operate as an automatic and involuntary withdrawal by the policyholder.

The funds would not be available, for example, to support any of the rights previously mentioned. It would seem that policyholders should be permitted to pay their taxes from other funds in order to preserve these valuable rights. They should not be forced into a withholding system which automatically destroys those rights.

If a determination should eventually be made that the interest is taxable at the time the accumulation account is actually distributed, withholding at that point imposes even more serious problems. On the life insurance company's books, once interest is added it becomes merged with the past accumulations and loses its identity. To take each account back and reconstruct the history of interest credits over a period of many years, possibly the lifetime of the policyholder, would involve almost insuperable burdens and expenses to the company. The policyholders, of course, do receive an annual statement from which they can maintain a record of the interest accumulations.

The difficult and costly problems inherent in a withholding system applicable to interest on dividend accumulations would be further increased and made even more unworkable by a system of exemption certificates as contemplated by section 19 of the bill. This proposal completely departs from the principle of a simplified withholding system originally announced by the Treasury Department, particularly when applied to millions of these small dividend accumulation agreements.

Fully automated life insurance companies will not be able to establish within their systems a procedure for handling withholding with exemption certificates. There are three different types of exemption certificates, each with its distinctive problems. In the ordinary case, the annually filed exemption certificates would have to be handled manually each year. In the case of individuals under age 18, the exemption certificates would normally be handled manually only twice, once when filed and again at age 18. A third form of exemption certificate—that which the Secretary may administratively keep in effect for an indeterminate period until such time as the individual expects once again to pay a tax—involves further problems which cannot now be predicted. These manual processes would be expensive, and would defeat many of the cost savings and other benefits anticipated by the companies in their large investments in automation.

Exemption certificates filed annually would often come in after the dividend accumulation punchcards had been run and would cause another dislocation in administrative handling. Premium notices with which accumulations and interest are associated are normally made up by life insurance companies some 6 or 8 weeks before their due dates. The laws of many States require that the notices be mailed a stipulated period in advance of due date. If an exemption certificate came in after the notice was printed or mailed, it would require additional individual attention and manual processing.

Moreover, many life insurance companies do not have automatic data processing machines. For them the problem of handling exemption certificates would be even more serious.

If the committee does decide to impose withholding on interest on policyholders' dividend accounts, we strongly urge that the exemp-

tion certificate system not be extended to this interest. Such an exception is justified not only by the unusual difficulties and expense that would be involved in this particular instance, but also by the fact that the very reasons for the certificates do not apply since the policyholder clearly is not relying on this income for his current needs.

INTEREST PAYABLE UNDER POLICY SETTLEMENT OPTIONS

The application of the proposed withholding system (with provision for exemption certificates) to interest payable to beneficiaries and retired individuals under policy settlement options would add substantially to the administrative difficulties and expense. A relatively high percentage of these individuals have no income tax liability. The resulting administrative expense would be abnormally high for the group, since life insurance companies would be handling a relatively large volume of exemption certificates.

On the other hand, withholding on settlement option interest without exemption certificates hardly seems to be the answer. In the case of a widow receiving $300 of interest each quarter, withholding would deprive her of $60 for a period of 3 months, at the end of which time she would be required to file a claim with the Government for a refund. This could create a serious hardship to the individual in many cases. Moreover, if an exemption certificate procedure is to be adopted for other institutions, life insurance companies would want to operate under the system with respect to these settlement option payments.

The position of the life insurance business with respect to interest payments under settlement options is unique in that it would be dealing almost exclusively with a group composed of widows and elderly people, many of whom do not have taxable income in excess of exemptions. The question arises as to whether it is practicable or socially desirable to apply withholding to a group of this kind. Some of the hardships which might result from withholding would, of course, be overcome by a system of exemption certificates, but the processing of such certificates would involve substantial expense, which would reduce the interest payable to the settlement option payees. We question whether the improvement in revenue collection from this group through the application of a withholding system would be sufficient to justify the additional expense together with the hardship and inconvenience that would be imposed on these individuals.

WITHHOLDING ON INVESTMENT INCOME PAYABLE TO LIFE INSURANCE COMPANIES

The withholding of 20 percent of investment income payable to life insurance companies would produce an income loss to the companies without commensurate benefit to Federal revenues. Although the quarterly refund provision of the bill would help to reduce the reinvestment loss, it would still be substantial in the case of most companies. It is also apparent that the purposes of the withholding legislation certainly do not apply here since there has been no problem in collecting taxes from life insurance companies. We hope that your committee will carefully review the justification for applying withholding to the investment income of life insurance companies.

One other point requires comment. The bill provides for withholding on interest on corporate bonds, debentures, notes, and certificates with interest coupons or in registered form. We interpret this language and the Ways and Means Committee report to mean that interest on direct placement loans would not be subject to withholding. The associations have received a number of inquiries on this point, however, and we therefore suggest that, should the bill be reported favorably, your committee confirm this interpretation in its report.

SUMMARY

To summarize our position:

(1) The proposed withholding procedure should not be applied to interest on dividend accumulation accounts. If applied to such accounts, exemption certificates should not be made available.

(2) Withholding should not be applied to life insurance policy interest options. If applied to such accounts and an exemption certificate procedure is adopted, such certificates should be available to interest option payees as now provided in the bill.

(3) Withholding should not be applied to investment income payable to life insurance companies. If applied, the status of interest on direct placement loans should be clarified in the committee report.

Recommendations (1) and (2) can be achieved by eliminating subparagraph (4) from proposed section 3452(a) thus excluding from withholding—

Interest on amounts held by an insurance company under an agreement to pay interest thereon.

Recommendation (3) can be achieved by excluding life insurance company income from the provisions of proposed section 3452(a)(1).

Thank you very much.

Senator CURTIS. We thank you, Mr. Magovern, and you have made a distinct contribution to our record here.

Any questions? If not, that is all. Thank you.

Mr. MAGOVERN. Thank you, sir.

Senator CURTIS. Mr. R. Stewart Rauch, Jr., Council of Secretaries of State Savings Banks Associations.

Mr. Rauch, where do you reside?

Mr. RAUCH. Philadelphia, sir.

(Discussion off the record.)

Senator CURTIS. You may proceed, Mr. Rauch.

STATEMENT OF R. STEWART RAUCH, JR., COUNCIL OF SECRETARIES OF STATE SAVINGS BANKS ASSOCIATIONS; ACCOMPANIED BY JOHN T. SAPIENZA, TAX CONSULTANT

Mr. RAUCH. Thank you, sir.

Mr. Chairman and Senator Williams, my name is R. Stewart Rauch, Jr., and I am president of the Philadelphia Saving Fund Society, Philadelphia, Pa., the oldest, and largest in number of depositors, of the Nation's mutual savings banks. I appear on behalf of the Council of Secretaries of State Savings Banks Associations, which represents most of the Nation's 514 mutual savings banks having 23 million savings accounts.

John Sapienza, our special counsel, is here with me at my left.

We urge the Committee on Finance to delete from H.R. 10650 section 19 thereof, which would require withholding of tax at the source on interest paid or credited on bank accounts and on other forms of investment.

We share the belief of Government leaders that the Federal Government is entitled to all taxes due on interest and dividends received by taxpayers, and we support realistic and reasonable steps to collect such taxes. Withholding, however, creates more problems than it solves because it will result in millions of small, burdensome transactions for taxpayers, the majority of whom report their income conscientiously, and it could have a disrupting effect on established savings patterns and capital formation. We believe it should not be imposed until the other untried means of collecting taxes are thoroughly tested.

Our position may be summarized as follows:

(1) Full use of information returns, at lower limits than $600 in the case of interest, now made possible by taxpayer numbering and automatic data processing, is a far more effective answer to the problem of underreporting than is withholding; and it will be less costly than withholding if the deterrent effect of the former and the cost of the latter to the public are properly taken into account;

(2) Withholding on wage and salary income is no precedent for withholding on investment income;

(3) Withholding could produce substantial shifts of funds to tax favored investment media; the loss of funds to mutual savings banks which could result from withholding would adversely affect the supply of mortgage credit and capital formation.

That the majority of taxpayers report honestly and pay their taxes is substantiated by the Commissioner of Internal Revenue Mortimer M. Caplin. With respect to the minority who, because of ignorance, neglect, or willful deceit, do not report accurately and truthfully, rigid enforcement efforts should be consistently applied. In doing so, however, the majority of taxpayers whose affairs are beyond reproach should not be subjected to suspicion and inconvenience under a tax system which is grounded on the principle of voluntary compliance.

Substantial efforts have been made during the past 2 years by mutual thrift institutions to acquaint depositors and the general public with their responsibilities in the field of Federal income taxation. Attached is an exhibit which shows one of the numerous ways in which the Philadelphia Saving Fund Society has assisted in this educational program.

We are confident that these efforts will show a significant improvement in compliance when the 1961 returns are tabulated. We believe that a greatly increased rate of improvement will result from the recent adoption of the taxpayer numbering system, to which this committee had a very significant contribution to make.

Furthermore, the Internal Revenue Service, in the most significant and constructive advance in enforcement and collection techniques since adoption of the income tax, is installing automatic data processing equipment throughout the Nation. The expected benefits from this program, coupled with the numbering system for taxpayers which

will enable accurate identification, can hardly be exaggerated. These new means of collecting taxes should be fully tested before resorting to the withholding procedure contemplated by H.R. 10650.

I. INFORMATION RETURNS ARE A MORE EFFECTIVE ANSWER TO THE PROBLEM

Withholding is not only burdensome to those who pay and those who receive interest, but in our judgment is a less effective solution to the problem of underreporting than an efficient use of information returns would be.

Withholding at 20 percent does not prevent underreporting by taxpayers whose effective rate is above 20 percent. It withholds excessively on, and creates paperwork for, taxpayers with effective rates below 20 percent. Withholding will bring money to the Government, but not necessarily the correct amount from those taxpayers owing the money.

Information returns, on the other hand, enable accurate determination by the Service of the income received. If the payee knows the information return has been filed with the Internal Revenue Service, he knows that failure to report the receipt correctly on his tax return exposes him to the penalties of the law. It is for this reason, we believe, that underreporting of dividends has been smaller than that of interest, even in years when the Revenue Service lacked adequate means of matching information returns to tax returns.

Effective use of information returns would, obviously, require a lowering of the $600 limit presently in effect, beneath which interest payments need not be reported. This can be done by regulation under existing law. Since the Service, with taxpayer numbering, will soon be able to match information returns to tax returns, the time has come when the $600 limit should be reduced to such lower limit as may be desirable and usable.

A system of withholding of tax on interest income would be, we believe, more expensive to the Treasury and to the country at large, if the cost to both is considered, than would be a forceful and well-publicized program of collecting taxes on such income through the methods now becoming available. The contrary views of proponents of withholding, we believe, underestimate the deterrent effect which would follow from widespread knowledge that the Treasury is at last in a position to enforce the law in this area.

The Commissioner has said that "taxpayers, in overwhelming majority, report true incomes and pay proper taxes." In these circumstances it appears grossly unfair to impose the costs and inconveniences of withholding on an "overwhelming majority." As to the evading minority, it should be made clear to taxpayers that the Treasury will undertake to use the information returns energetically, and systematically to search out unreported income that is subject to tax. Sample audits and selected deficiency assessments should be used to make sure that interest is fully included in tax returns. If these steps were taken, an improvement in reporting of interest income could be expected which would be far out of proportion to the costs of the enforcement efforts.

The recordkeeping required of the millions of Americans who have savings accounts will be very considerably increased under the withholding system, particularly for those taxpayers who would be compelled to file exemption certificates or claims for refund. Under the withholding system proposed, many savings bank depositors, having relatively small accounts, will be compelled to come in person to the banks, not merely to ascertain the amounts of interest credited to them, but additionally the amounts of interest withheld; and to obtain assistance in claiming refunds, in filing exemption certificates, and in securing the withholding tax credits provided for in the bill.

Complicated as withholding and the "grossing up" problem would be at a 20-percent first bracket rate, the whole problem would be complicated further if the long awaited income tax revision promised by the Treasury resulted, hopefully, in a reduction of the first bracket rate to, say, 18 percent. In the "grossing up" process, the recipient, instead of multiplying his interest after withholding by 25 pecent, as under H.R. 10650, would use a factor of 21.951 percent.

The bill does not require banks to notify depositors of the amounts withheld, but practical business considerations may make this unavoidable. Thus, it is unrealistic to assume that the withholding system will be effected simply by each bank's drawing and mailing one check in each tax quarter. The additional recordkeeping and information-supplying services that will necessarily have to be performed by the banks, especially those services required by the processing of exemption certificates, will increase substantially the operating costs of the Nation's thrift institutions, particularly that large majority which does not have punchboard accounting. Only about 10 percent of the savings banks, for instance, have such equipment.

The disadvantage of withholding as a means of improving collection of tax on investment income is clearly indicated by the experience of the Dominion of Canada. During World War II, withholding was applied by the Canadian Government to certain types of investment income but was abandoned after a short period as administratively impractical. In explaining the decision to drop withholding, Finance Minister J. L. Ilsley stated before the House of Commons on October 12, 1945:

> It is proposed to drop the requirement by which those disbursing dividends, registered interest, and royalties are required to deduct at the source 7 percent on behalf of the taxpayer. This requirement is of little value in obtaining current payment of taxes which the taxpayer himself is required to pay in installments. The requirement that the disbursers of these payments must report the amount of the payments to the inspector of income tax will, of course, be retained and it is this which is the important provision as far as insuring the reporting of income is concerned. The elimination of the 7 percent deduction at the source will save a very considerable amount of clerical work and some confusion to small taxpayers.

II. WITHHOLDING ON WAGES AND SALARIES IS NO PRECEDENT FOR THE WITHHOLDING SYSTEM H.R. 10650 PROPOSES

Proponents of withholding taxes on interest and similar income have sought to justify such a measure by referring to the existing withholding tax on wages and salaries. For a number of reasons, however, such withholding is fundamentally different from withholding on interest income.

Initially, it should be recalled that withholding on wages and salaries was introduced to eliminate the lag between tax liability and tax collection in a period of rapidly rising wages and salaries as we moved from substantial unemployment to full employment early in World War II. It was also designed to collect, in part, 2 years' taxes in 1 on wages and salaries to bolster total Federal revenues needed to finance World War II. With respect to those interest and dividend recipients who estimate their taxes and pay quarterly installments, collection of taxes already is on a current basis.

In addition, there was the fear that taxpayers would find themselves without funds to pay income taxes at the high rates of the World War II period if taxes were not withheld as wage and salary income was earned. This fear was, perhaps, justified as to such income, but has no application as a basis for withholding taxes on bank interest income. Income and tax per taxpayer on salaries and wages are generally much larger than is the case with bank interest. Bank accounts do not tend to be dissipated through spending as do the funds received as salaries and wages. A withholding system applicable to interest income is not necessary to assure that the taxpayer will have funds to pay the tax, and would be operated at a far greater cost for each dollar of taxes collected.

There are further significant reasons why the wage and salary withholding precedent is inapplicable to withholding of interest income. With interest income there is no way to take into account personal exemptions to which taxpayers may be entitled, or otherwise to adjust the withholding rates to the probable tax liabilities of the taxpayers. Those who receive wages and salaries ordinarily have tax liabilities on such income. By contrast, of the persons receiving interest on savings deposits, the number who would not be subject to the beginning 20 percent withholding tax rate on such income is proportionately very much higher. This observation applies particularly to minors, widows, and retired persons. Data from a sample of mutual savings banks indicate that about one-quarter of their regular accounts are owned by persons over 65 years of age.

Although H.R. 10650 attempts to deal with these fundamental distinctions between withholding of taxes on the two types of income, it cannot avoid being burdensome to those who are taxed at effective rates below 20 percent or who will owe no tax at all. First, the provision for filing exemption certificates each year by persons, 18 years of age and over, who anticipate no tax liability, will be burdensome to the taxpayers, especially if they are credited with interest from—and therefore must file certificates with—a number of payers such as savings banks and life insurance companies. In contrast, with withholding on salaries and wages is governed by the facts set forth by employees in form W-4, which remains in effect until changed by the employees.

Second, a conscientious taxpayer in the lower income group will find it extremely difficult to comply with the complicated provisions allowing quarterly refund based upon his anticipated tax in a given year. The result will be that such taxpayers will be deprived of amounts withheld until and unless they seek annual refunds or credits. Furthermore, the proposed claims for refund and the exemption certificates will be very difficult in practice for the Revenue Service to

audit and control. They will be based upon what taxpayers "reasonably believe" or "expect" will be their income in any given year. Accordingly, they will constitute an open invitation to taxpayers who are not conscientious to file unwarranted claims.

Therefore, a very real possibility exists that the underreporting which is now given as the reason why withholding on interest income is necessary will be transformed into an equivalent evil—the filing of false or mistaken claims for refund or credit, and exemption certificates. An illustration of this would be the case of a taxpayer, who, even though he had filed exemption certificates with the payers of interest, took credit for nonwithheld sums in preparing his annual estimates and final tax returns.

III. WITHHOLDING WILL REDUCE THE EFFECTIVENESS OF MUTUAL SAVINGS BANKS IN PERFORMING THEIR BASIC THRIFT AND MORTGAGE LENDING FUNCTIONS

We believe that withholding on interest income will discourage new savings, the importance of which to the noninflationary growth of the Nation's economy cannot be overstated. In addition, it will encourage the flow of existing savings from banks to investment sources the income from which is not subject to current withholding.

The recipient of wages and salaries, confronted with withholding, has for practical purposes no escape; but the holder of investable funds has a variety of alternatives, and the savers in the lower income group may even stop saving. Rather than cope with the complicated refund, exemption, and grossing-up provisions of H.R. 10650, many such depositors may consider withholding so onerous as to justify their withdrawal and spending of those funds which they formerly would have saved.

There is one form of savings investment which competes directly with bank savings and which will be highly favored—and with a resulting adverse impact on housing—under H.R. 10650. That favored investment is the series E savings bond. Under existing law savings bonds already have a tax advantage over bank savings; even though accrued, interest on the bonds is not mandatorily taxable until the bonds are redeemed. H.R. 10650 would magnify this advantage by requiring withholding of tax on such interest only upon redemption. Because the interest on series E bonds is not taxable until the bonds are redeemed, because the maturity date of outstanding series E-bonds has in practice been extended indefinitely, and because a tax-free exchange of such bonds into series H-bonds has been encouraged, the result of withholding would be that many savings depositors will resort to the purchase of series E-bonds and thereby postpone withholding until they decide to redeem the bonds. By doing so they would be empowered to select redemption dates in a year when they may owe no tax, or, at the very least, be taxed at a lower rate than would otherwise be the case. In a year in which no tax was payable, withholding on redemptions could be avoided by use of exemption certificates.

Ideally, of course, holders of savings bonds should be required, rather than permitted, to report the interest as income in each year as it accrues, so that such investments would be on the same footing for tax purposes as bank savings. At the very minimum, tax-free ex-

tensions of the maturity dates for series E bonds and tax-free exchanges for other series should no longer be permitted. The interest thereon should be taxed at the first maturity date or when such bonds are exchanged for any other Government obligations.

If withholding were enacted and the tax treatment of E-bonds remained unchanged, we believe that investments with tax advantages similar to those of E-bonds would become widespread, with adverse effect on Treasury revenue. Indeed, as indicated in newspaper advertisements and stories—and, Mr. Chairman, I would like to offer for the record two of these, one being an ad from the New York Times of December 27, and the other an article by J. A. Livingston in early January.

Senator KERR (presiding). They may be filed with the record.

Mr. RAUCH. With the record; thank you, sir.

Senator KERR. Not made a part of the record.

Mr. RAUCH. Thank you, sir, very much.

(The documents referred to will be found in the files of the committee.)

Mr. RAUCH. These indicate that several commercial banks have already offered to the public such investment instruments. Under withholding many more financial institutions could be expected to offer similar tax-deferred instruments. Since the withholding of tax could be deferred until such time as the holder is in a lower bracket, a revenue loss to the Treasury would result. This revenue loss would offset in part the revenue gain anticipated from withholding. Moreover, pages 86 and 87 of the House Ways and Means hearings indicate that these commercial bank obligations will not be subject to withholding at all even when redeemed. This should and, we trust, will be corrected. But it reinforces our fear that the effect of withholding will be the creation of new savings media not subject to withholding.

We believe that by bringing about a reduction in new bank savings, in the form both of interest credited and loss of additional deposits, and by causing some withdrawals of existing savings, the withholding provisions of H.R. 10650 will reduce the effectiveness of mutual savings banks in performing their basic thrift and mortgage lending functions.

In 1959–61, about 81 percent of the increase in deposits of these banks reflected interest credited to the savings accounts of depositors. If the tax on such interest is to be paid out of these funds rather than from funds that would otherwise be spent currently, as is now ordinarily the case, deposit growth of mutual savings banks could be reduced by as much as 16 percent. This could represent an annual decrease of up to $300 million in funds available for mortgage lending and other long-term investment by mutual savings banks alone.

An additional loss of funds available to the savings banks for investment in mortgages, moreover, could result because of uncertainty regarding potential withdrawals. Savings banks would then have to place funds which would otherwise be invested in mortgages in more liquid assets. Reduced mortgage lending by mutual savings banks and other lenders would have an adverse effect on homebuilding. This in turn could result in reduced income and taxpayments in the construction industry.

Finally, there is the imponderable effect that H.R. 10650 could have upon the savings habit itself, at a time when more, rather than less, savings are required for sound economic growth. The shift of funds from savings institutions to forms of investment not subject to withholding, and shifts in habits from savings to spending, are likely to be among the undesirable results of the enactment of a system of withholding. In sum, the overall effect of the withholding provisions of H.R. 10650 on the thrift and mortgage lending function of mutual savings banks could adversely affect the Nation's economy.

We respectfully urge, for the foregoing reasons, that the Finance Committee delete section 19 of H.R. 10650 which would impose the withholding of taxes on interest paid or credited on savings accounts.

I appreciate your courtesy, sir, in permitting us to permit our views to this committee.

Senator KERR. Well, Mr. Rauch—is that your name?

Mr. RAUCH. Yes, sir; it is just like ouch with an R in front of it.

Senator KERR. Mr. Rauch, thank you for your statement.

I have been thinking about it as I listened to you. Now, I developed with one witness this morning, in response to his suggestion, the thought that one of the purposes of this provision, of course, the primary purpose is to secure the payment to the Government of the taxes that are due it.

You think that is a wholesome objective?

Mr. RAUCH. I concur entirely, sir.

Senator KERR. Another, he indicated, was the need for revenue, which I was not in position to dispute.

Now, can you tell me the difference between the amount of revenue this bill as it is now written, would provide in taxes from savings banks and the amount that would be secured if the legislation recommended by the Secretary were enacted?

Mr. RAUCH. No, sir; I cannot.

Senator KERR. There is a very substantial difference.

Mr. RAUCH. Because of the exemption certificates that have been incorporated by the Ways and Means Committee.

Senator KERR. There is a very substantial difference in the amount of revenue that would be raised by this bill in its present form in taxes of mutual savings banks and in the amount that would be raised by taxes on mutual savings banks if the recommendations of the Secretary were followed.

Mr. RAUCH. Sir, you are referring to the corporate tax situation or the withholding?

Senator KERR. Corporate.

Mr. RAUCH. Yes, sir.

Mr. SAPIENZA. The difference is $165 million, sir.

Senator KERR. This bill would raise $165 million less in taxes of the mutual savings banks.

Mr. SAPIENZA. And savings and loan associations.

Senator KERR. And savings and loan associations.

Well, my understanding was that with reference to the two groups the difference was in the neighborhood of $350 million.

Mr. SAPIENZA. Well, sir, as we understand it, the bill would raise approximately $200 million from the mutual thrift institutions. The Secretary of the Treasury suggested raising that amount to $365 million, so there would be a difference of $165 million.

Senator KERR. I was advised by members of your association and of the savings and loan associations that the recommendations of the Treasury, when fully implemented, would produce in the neighborhood of $500 million.

Mr. SAPIENZA. That would be if the recommendations of the Treasury Department last summer were put into full force.

Senator KERR. That would have been what it would have raised.

Mr. SAPIENZA. Yes, sir.

Senator KERR. Would you recommend that we delete section 19 and replace it with language implementing that recommendation of the Secretary, thereby alleviating the dire consequences which you and others have portrayed here for us if this withholding system is enacted, and thereby doing what the commercial banks have sought to establish as an equitable position as between them and other financial institutions?

Mr. SAPIENZA. No, sir. We think that the $200 million which the House bill would raise is a very heavy tax, and we are going to have trouble paying that.

What we are suggesting as to withholding is that the Government collect that money by use of automatic data processing and by information returns rather than doing it by withholding. We think you can get approximately the same results.

Senator KERR. Well, now, I am interested in that statement. Of course, I am confronted with the positive testimony of the Commissioners of Internal Revenue, that withholding would collect more than three times as much of the unreported tax as the automatic data processing information return system would.

Mr. RAUCH. Sir, I think the direct answer to that is we have no way of analyzing the figures that are in the hands of the Commissioner, so we cannot take a firm position as to the accuracy of those figures.

From some things that have been stated in the hearings before the Congress and the statements which have been made elsewhere, we have the impression that these latest figures of the present Commissioner which he has been relying upon are significantly different than some that were put together by his predecessor.

His predecessor took the position that a combination of ADP and an educational campaign over a period of, a reasonable period of, years would close this gap effectively, and deserved a trial.

We share that belief in the mutual savings banks and we have spent considerable time and effort and money in trying to implement an educational program, as this exhibit at the end of my statement shows we have done at the institution where I work.

This is just coming to fruition. It was only commenced at the end of 1959 and did not really get underway in any significant form until 1960.

But we do know from the number of inquiries that have come to our 20 banking offices that a great many people honestly believed that the interest credited to their accounts, savings accounts, was not subject to Federal income tax until such time as they withdrew it, and they were relying on the analogy with the E-bond situation where that, in fact, is the case.

We have explained this to them. I have had one estimate that since the educational program started there have been 50,000 people in our 20 offices who have had this explanation offered to them, and that they have gone away with the comment, "Well, now that we know what the facts are we are going to correct this situation."

So that I think the cumulative effect of this educational program, plus the impact of the Treasury's announcing the use of information returns, and the start of the ADP program, the cumulative effect of these three elements will produce a very significant improvement which already has started in this area.

Senator KERR. But, you see, the Ways and Means Committee had before it the recommendations of the Treasury Department, No. 1, as to how to collect taxes due that were not now being paid; No. 2, as to how to secure additional revenue to offset the loss that would be entailed in the event the tax credit provision was passed.

Your association and the savings and loan associations made a very vigorous case, and I thought a case that was well founded, to the effect that the recommendations that would equalize the tax on your organizations and the savings and loan associations with that of the commercial banks, would entail hardships and, therefore, the Ways and Means Committee followed the recommendation that you made to them and put a provision in here that would secure, they tell me—you have indicated some different version, but the difference is only as to amount—that their provision would secure less than 40 percent from the mutual savings banks and savings and loan associations as would be secured if the Treasury recommendations were implemented. They did that upon your strong urgings.

Now, due to the vigor with which you and others in your group are urging that the provision in the bill as put there by the Ways and Means Committee make it possible to collect taxes which the Treasury and Internal Revenue Service Commissioner tell us are not being paid, it just occurred to me as one solution to the problem in view of the fact that you feel so strongly that another method would eventually secure the payment of the tax, but being confronted with the feeling of necessity that an adequate amount of revenue would be secured under this bill to offset the loss by reason of the tax credit, we might just follow your recommendation with reference to deleting section 19 from the bill and the Treasury's recommendation with reference to the tax rate to be applicable to the savings and loan associations and the mutual savings banks.

Mr. RAUCH. Well, sir, I do not think there is any difference between you and me as to the question of the person who has the taxes due having an obligation to pay them, and pay them promptly.

It is merely a question of whether the Treasury, which has information not available to us, is correct in saying that it is so much cheaper to collect them by withholding, and there will not be the significant amount of confusion and expense and the passing back and forth of papers that we believe is the case, or whether promptly—I am not talking about 1965, but promptly, this year—through the combination of the educational program started 2 years ago, the account numbering which this committee wisely put through at the last moment of the session last summer, and the ADP program which, I understand, will be fully operative about the first of January 1965, the publicity

regarding those steps, plus some strenuous enforcement action with a few violators who are in substantial brackets and are not paying on savings account interest, we are told, although we have no knowledge of this, a combination of these, it is my conviction will produce this revenue that is due admittedly now, not some years off, sir, so I do not see any reason to shift this corporate question over into this arena. The corporate issue ought to be separated from it.

Senator KERR. I would appreciate your giving a little thought to my suggestion and filing an additional statement with reference to it.

Mr. RAUCH. I would be happy to.

Senator KERR. Thank you very much, Mr. Rauch.

Mr. RAUCH. Thank you, sir.

(The memorandum referred to follows:)

THE PHILADELPHIA SAVING FUND SOCIETY,
Philadelphia, Pa., April 23, 1962.

Hon. HARRY F. BYRD,
Chairman, Committee on Finance,
U.S. Senate, Washington, D.C.

DEAR SENATOR BYRD: When I appeared before your committee Wednesday, April 18, on behalf of the Council of Secretaries of State Savings Banks Associations to urge the deletion of section 19 of H.R. 10650, the withholding proposal, Senator Kerr, who was presiding in your absence, asked me to file for your record an additional statement with respect to a suggestion which occurred to him during the course of our discussion. I shall appreciate your treating this letter as the additional statement requested.

As I understand his suggestion, he asked, if Congress should enact the proposed 7-percent credit for business investment (as to the desirability of which we had expressed no opinion), and if, as I was urging, withholding were eliminated from the bill, whether it would not be desirable for Congress to obtain more revenue from corporate taxation of savings banks and savings and loan associations than the House bill would provide. His comment was, "We might just follow your recommendation with reference to deleting section 19 of the bill and the Treasury's recommendation with reference to the tax rate to be applicable to the savings and loan associations and the mutual savings banks."

We have two comments with respect to Senator Kerr's suggestion.

First, the essence of our objection to withholding is that effective use of information returns, now possible with automatic data processing and taxpayer numbering, and the massive educational campaign with respect to the reporting of dividends and interest begun by the Treasury in 1960, will do the job more fairly and efficiently, without distortion of traditional investment and savings patterns and at no greater expense. There will, therefore, be no real loss of revenue by deleting withholding from the bill if there are continuing educational efforts and energetic use of information returns with the new equipment; we believe the so-called interest gap can be closed by these means fully as soon as by withholding.

The deterrent effect of these new Revenue Service enforcement tools is, in our opinion, already bringing about a very substantial improvement which will be apparent, I am sure, in the statistics before long. Further publicity as to automatic data processing, continued education and a determined effort by the Treasury, with a lower reporting limit on interest than the $600 presently fixed by regulation, can close the gap in a very short time. In this connection it should be noted that the Treasury's forecast shows that withholding will not collect more than 56 percent of the $850 million estimated by it to represent the revenue loss from interest and dividend nonreporting. In exhibit II to Secretary Dillon's testimony (hearings, p. 146) it is stated that only $470 million of the $850 million will be collected by withholding. Parenthetically, it should be added that this estimated gain from withholding will be offset by the substantial added cost of withholding to the Treasury and, more so, to payors of interest and dividends. According to the Treasury an additional $180 million will be collected, "if in addition to withholding there is an improvement in tax compliance by persons subject to individual income tax rates above the 20-percent bracket." Thus, the Treasury concedes a substantial amount of the estimated total revenue gain will result not from withholding itself, but from improved tax compliance

by persons in the above 20-percent bracket. We think there is good reason to expect a substantial improvement in tax compliance by all taxpayers below and above the 20-percent bracket in their 1961 tax returns as a consequence of the educational efforts in 1960 and 1961 and the publicity given to the adoption of account numbers and automatic data processing. We believe this improvement will continue and render withholding unnecessary. As the Commissioner of Internal Revenue has stated, "taxpayers, in overwhelming majority, report true incomes and pay proper taxes."

Second, how much corporate income tax mutual savings banks and savings and loan associations can safely be called upon to pay without discouraging savings; without diverting savings from home mortgage lenders to short-term business lenders or speculative credit generally; without placing a tax premium on operating with inadequate reserves; and very possibly rendering the specialized savings and mortgage lending institution unable to perform its functions effectively is one question. Savings banks foresaw adverse consequences of this character from the drastic reduction in the allowable bad debt reserve proposed last year by the Treasury. Whether it is fair or practical to impose withholding on bank depositors and other recipients of dividends and interest, at a time when less onerous means of tax collection have just become available, is an entirely different question. Each question should be considered on its merits.

The coincidence that withholding and increased savings bank taxation are under consideration at the same time, and that both (at the levels of corporate taxation once proposed by the Treasury) are objected to strongly by mutual savings banks, should not create the impression that they are in some way alternatives. Neither Congress nor the savings banks can practically or properly be asked to choose between one and the other.

Sincerely yours,

R. STEWART RAUCH, Jr., *President.*

Senator KERR. Mr. C. C. Cameron of the Mortgage Bankers Association of America.

STATEMENT OF C. C. CAMERON, CHAIRMAN, LEGISLATIVE COMMITTEE, MORTGAGE BANKERS ASSOCIATION OF AMERICA; ACCOMPANIED BY MILES L. COLEAN, ECONOMIC ADVISER

Mr. CAMERON. I am C. C. Cameron, president of the Cameron-Brown Co. of Raleigh, N.C., a mortgage banking firm.

I have with me here Miles Colean, economic adviser to the Mortgage Bankers Association of America.

I am here in my capacity as chairman of the Legislative Committee of the Mortgage Bankers Association of America in order to present to you the view of this association in respect to the withholding of taxes by savings institutions on interest and dividends payable to their depositors and account holders. I shall say, at the outset, that neither I nor the association I represent has an argument to make against the payment of any taxes that are properly due. We do, however, believe that it is appropriate to raise a question as to the method through which taxes are to be collected, in this case, whether from the investment stream or from the stream of current income.

This association is composed of over 2,000 corporate members. These include life insurance companies, savings banks, and commercial banks, which are the main suppliers of funds in the interstate mortgage market, and the mortgage companies which provide the channel for the distribution and administration of these funds. The primary purposes of this association are to encourage the maintenance of institutional savings in order that the mortgage investment needs of the country may be met without inflation, and to make constant improvement in the distribution process so that borrowers in all parts of the

country will have access to the accumulation of savings on as nearly equal terms as possible.

The reason for our concern in this matter is the impending problem of providing sufficient resources to meet the growing investment needs of an expanding economy. Much of the growth requirement will be met by mortgage financing for homes and farms and for mercantile, industrial, and other business property. Consequently, the association must be apprehensive of any development in public policy that might increase the task of providing the level of private investment required for a constant improvement in the Nation's productive capacity and the standard of living of its people. It believes that the proposal to withhold taxes on interest and dividend income at the source, instead of relying on payment by the recipients, is such a development.

The reasons why withholding will curtail the funds available for investment have been ably presented to you by representatives of the groups of financial institutions that would be most directly affected by the enactment of this proposal. The extent of the investment loss has also been or will be explained to you by the spokesmen for these institutions. Accepting as we do the validity of their statements, we do not wish to impose upon the committee's time by the further elaboration of these points.

We do, however, ask your consideration for the broader question of policy involved. At the present high level of taxation in this country, no measure such as the one before you can be safely considered solely as a revenue measure. It must also be examined from the point of view of its effects on the economy and of its long range, as well as its short range, bearing on the fiscal position of the Government.

If, as we believe, the effect of withholding will be to shrink the stream of private investment, then two choices must be faced. One is a reduction in the volume of new housing and of business plant and, consequently, in the rate of economic expansion.

The other is a compensatory increase in the volume of Government spending for the purposes that have been deprived of private funds, in the effort to maintain a satisfactory rate of economic expansion.

We do not believe that the first choice—an acceptance of a lower total volume of investment—will ever be taken as a matter of public policy. On the contrary, the experience of the last several decades demonstrates convincingly that every real or assumed short fall in private endeavor and every obstacle that is placed in the way of private economic expansion, will be countered by an expansion of Government activity.

In no area of public policy has this been more true than in mortgage finance. In this area, the impatience of Government with the working of the forces of the market is outstanding. The Government's assumption of responsibility over the past generation has brought it to a point where it is subsidizing nearly half a million units in public housing, and where, through the operations of the Federal National Mortgage Association and the direct lending program of the Veterans' Administration, it is the holder of $7.7 billion in residential mortgages.

Senator KERR. Did you read the testimony of the banker from Michigan the other day about his bank and another bank in Michigan in the last few months acquiring $100 million worth of mortgages in the

secondary market; that is, out of this backlog owned, that had been the result of direct lending programs?

Mr. CAMERON. No, sir. I do know that the Veteran's Administration is presently planning to sell, in fact I believe the bids have been sent out already, have been accepted, on certain loans that were foreclosed and were owned by the Government, by the Veterans' Administration.

These were not necessarily initially direct loans of the Veterans' Administration, though.

Senator KERR. This gentleman assured this committee that by reason of the fact that the savings accounts in commercial banks were increasing by such tremendous volumes, that he felt that all the commercial banks in the country would be in the secondary market acquiring residence mortgages which would result in private lending agencies becoming the owners of very substantial, if not the principal portion of this backlog of residential mortgages that you are talking about.

Mr. CAMERON. Well, sir, these mortgages, both the VA, direct loans and FNMA loans are available to private industry at any time.

Senator KERR. And private commercial banks are buying them now by the hundreds of millions of dollars worth.

Mr. COLEAN. Senator, as of the last month, FNMA still was buying about 3 million more than it was selling.

Mr. CAMERON. The VA direct loans are sold on a par basis. The FNMA loans are sold at different prices, and these prices vary from time to time. In fact, they have just recently been increased by half a point.

In 1961 alone, these activities of FNMA and VA accounted for 14 percent of all FHA and VA mortgage financing.

Existing authorizations already allow for a vast expansion of this load on the Federal Treasury. To meet the deficiencies already assumed to exist in private mortgage financing, last year's legislation provided $1.2 billion for direct Treasury financing of mortgages for veterans and over $1 billion of Treasury funds for special assistance lending by the Federal National Mortgage Association. In addition, FNMA has authority to borrow about $1 billion in the private financial market to purchase insured and guaranteed mortgages in direct competition with the Treasury's own financing as well as with the claims of private borrowers.

In the light of this history, it is certain that any default in the supply of funds from private resources will only too eagerly be matched by extensions of public resources. Government policy is too firmly set to permit the assumption of any other outcome. This in turn will cause greater demands for revenue, just as past excursions in this direction have contributed to the present demands for revenue with which this committee is now endeavoring to cope.

It is for these reasons that we contend that a revenue measure cannot be considered apart from its effect on other areas of public policy. If the outcome of withholding is, as seems likely to be the case, a disproportionate increase in the fiscal load of the Federal Government, then the anticipated gain in revenue will soon be dissipated. Withholding, therefore, in this situation may be self-defeating in fiscal terms. Beyond this, it may contribute to the weakening of the private credit system and to the supersession of that system by one fully under governmental direction and control.

While not assuming that the tax proposal is designed to that end, we cannot avoid an uneasiness over the apparent direction of Government policy. As an illustration, on page 11 of its 1961 report to the Ways and Means Committee of the House, the Treasury, in recognizing the loss in private investment resources that might result from its recommendations, commented:

It is better accomplished by such provisions as were included in the Housing Act of 1961, primarily the special assistance program, provision of more liberal terms, and flexibility in setting insurance premiums.

Dedicated as this association is to the expansion of the economy by private means, it shrinks from accepting this suggestion as the solution for the problems that this bill may create.

It is generally agreed that the direct payment by the recipients of taxes due from the recipients of dividend and interest income will not result in the loss of investment potential that will be produced by withholding the tax at the source. Consequently, we urge that the withholding provision be stricken from the bill and that, instead. through the medium of the new electronics auditing system, the Treasury be instructed to pursue the collection of tax obligations directly from those from whom the taxes are due.

While it was our understanding that in testifying on this bill it was the committee's request that our remarks be limited to the particular section of the bill which concerned us the most, there are two other matters concerning which I would like permission from the committee to touch upon very briefly.

The first provision is covered in a statement this association filed last year with the House Committee on Ways and Means, and which sets forth our serious objections to the proposal for changing the method of taxing gains on the sale of depreciable real estate. We thought this matter had been laid to rest when there was no such provision in H.R. 10650, as it was reported and passed by the House of Representatives, but, of course, this matter has again been introduced by Secretary Dillon.

We would like to register with this committee the same opposition we expressed last year, and which I have included as exhibit A to this statement.

I would also like to file as exhibit B the statement we made last year before the House Ways and Means Committee relating to proposals in last year's tax bill for taxing thrift institutions, since H.R. 10650, as it is before you, does contain such provisions. Our statement of last year on this subject is pertinent, and expresses the conclusions of this association.

Thank you, sir.

Senator KERR. Thank you very much, Mr. Cameron.

(Exhibits A and B referred to follow:)

EXHIBIT A

STATEMENT BY THE MORTGAGE BANKERS ASSOCIATION OF AMERICA RELATING TO THE PRESIDENT'S MESSAGE ON THE FEDERAL TAX SYSTEM, DATED APRIL 20, 1961

The pending proposal for changing the method of taxing a gain on the sale of depreciable property fails to take into account the peculiar nature of real estate as an admixture of depreciable and nondepreciable assets, and hence involves a fundamental inequity. The proposed change will add to the illiquidity

of investment in income-producing real property and hence will discourage the flow of funds into this area of activity. It negates the incentives to investment in new apartments, office buildings, and the like, and hence is in direct conflict with the President's policy to encourage housing and advance economic growth.

A piece of income-producing property is not like a tool or a piece of machinery for which a salvage value may be reasonably calculated. It is also unlike a tool or a piece of machinery in that it is much more frequently desirable to sell real estate prior to the time that a purely salvage value is reached. The salvage value of a fully or partially depreciated building may, moreover, be a negative quantity because of the usual net cost of demolition. The residual value of the land as of some future date is not calculable, and may be either greater or less than original cost depending on the vicissitudes to which it may be subject in the course of time because of its location.

The value of a piece of income-producing property at any given time results in part from advantages or disadvantages of the particular location as well as the value of the structure. It may also in part result from the quality of the service performed by the property management and from the prestige that has accrued therefrom.

From a practical as well as from a legal point of view these elements of value are inseparable. It is possible that an increase in the value of the total could take place because of the attractiveness of the site and the quality of the management while the structure itself was actually losing value due to deterioration or obsolescense. Under such not infrequent circumstances, to deny capital gains treatment to the depreciation deduction is in effect to deny the benefit of the capital gain on the nondepreciable elements of the property.

The longer the property is held, the more severe will be the effect under the proposed change—so severe, in fact, that the long-term investor may be frozen into an investment from which he cannot escape except at a harsh penalty. In face of this prospect, an incentive will be created for a divestment of the property at the earliest feasible date. Sound construction, careful maintenance, and long-term investment will alike be discouraged since the advantage of building up value over a period of time will be largely lost.

In the testimony of the Secretary of the Treasury, the justification for the change is stated as follows:

"Moreover, the proposed withdrawal of capital gain treatment from gains on disposition of depreciable property that reflect prior depreciation would eliminate much of the present tax advantage attaching to investment in so-called depreciation shelters, which exist primarily in the real estate area. For example, during the first few years after acquisition of a building by a real estate syndicate, the total of depreciation allowances and mortgage interest will often exceed the rental income, so that distributions of income during this period are tax exempt in the hands of the investor. When the distributions substantially cease to be tax exempt, the building is sold, a capital gains tax paid on the gain attributable to the depreciation allowances, and another building is acquired to provide another depreciation shelter. Withdrawal of capital gain treatment from the gain on sale of the building, to the extent of prior depreciation allowances, will substantially eliminate this kind of tax trafficking."

The so-called depreciation shelter may be more illusory than real. If it is a shelter at all, it is a protection against the very real hazards of the enterprise rather than, as implied in the testimony, an opportunity for a "slick deal." The first years of an income-producing property are likely to be the most risky in its economic existence. These are the testing years for income and they are also the testing years for the acceptability and practicality of the structure itself. Any such property is certain to be more valuable after passing these tests than before.

The capital gain that may result from a successful outcome is a necessary reward for taking the attendant risks. Without the possibility of such a reward, in the form now available or in some other form, the risk is much less likely to be taken. The increase in the building of apartments and other income-producing property, especially since the enactment of the accelerated depreciation provisions of the 1954 act, is evidence of the importance of this inducement. Its removal would certainly discourage this most hazardous type of investment and consequently would probably result in a loss of tax revenue rather than a gain as claimed.

In view of the administration's interest in stimulating urban renewal activities, it is contradictory for it to be sponsoring at the same time a tax change which would substantially nullify the program by discouraging the investment of private

capital in such developments. The Government has recognized that high percentage financing is necessary in order to make investment in urban renewal areas attractive. High percentage financing means, in turn, that almost the entire net income is required for debt service. Thus, in turn, forces the sponsor to use some plan of accelerated depreciation in order to have the cash available to make the loan payments. Otherwise, this cash would be depleted by income taxes. Since the sponsor is likely to get little, if anything, in the way of current income over and above debt service, his only inducement to take the risks and undertake the arduous labors of project approval, construction, and establishment as a going concern is the possibility of a profitable sale after 8 or 10 years.

Except for some additional hazard, this situation is fairly typical of the prospects in any investment in income-producing property. At present, the ultimate profit, if any, is taxed at the favorable capital gains rate. Under the proposed plan, however, whatever portion of the gain represented an offset to depreciation previously taken would be taxed as ordinary income in the year in which the property was sold. In this connection, it is particularly significant to note that while the depreciation deduction is credited over a period of years, the tax on the amount taken in deprication is levied in a single year, and that consequently the rate applicable to the tax would be greater than that which had been charged in connection with the deduction.

The result of the proposed change would be that almost no equity money would be available for urban renewal and other such special programs, and that the amount of equity or risk capital going into other types of income property development would be sharply reduced.

Exhibit B

Statement of Robert Tharpe, President, Mortgage Bankers Association of America, on Various Tax Proposals Affecting Mutual Savings Banks

Mr. Chairman and members of the committee, my name is Robert Tharpe. I am president of the Mortgage Bankers Association of America and president of Tharpe & Brooks, Inc., Atlanta, Ga. I appear before you today to discuss the various tax proposals before your committee affecting mutual savings banks.

The more than 1,000 mortgage companies, which mainly compose the membership of the Mortgage Bankers Association of America, provide the principal channel for the distribution of home mortgage funds from areas of capital surplus to areas of capital shortage. Consequently, the association is vitally concerned with any proposal that would diminish the supply or increase the cost of these funds for the Nation's homebuilders and home buyers.

The association is convinced that pending proposals relating to the taxation of thrift institutions would do just this. The proposals in question are these:

1. To increase the taxload on these institutions by reducing the size of tax deductible additions to reserves.
2. To exclude from the computation of deductible reserve additions all investment in mortgages insured by the Federal Housing Administration or guaranteed by the Veterans' Administration.

Mortgage companies originate and service the bulk of the mortgage investment made by mutual savings banks in States other than that of their domicile. Therefore, because of the close relationship between these two groups of institutions, this testimony will be directed to the potential effects of the proposed legislation on the lending policies of mutual savings banks.

Of the total mortgage investment of mutual savings banks, well over one-third or about $9.1 billion is placed in other than their home States. Most of the out-of-State placement in mortgage funds is in the Southeast, the Southwest and the Far West—in short, in the areas of most rapid economic growth and of greatest need for outside capital.

Mutual savings banks are the heaviest investors of all types of institutions in mortgages insured by the Veterans' Administration and, second only to life insurance companies, the heaviest investors in mortgages insured by FHA. As of December 31, 1960, mutual savings banks held $9.1 billion or 31 percent of all outstanding VA guaranteed mortgages and $7 billion or 21 percent of all outstanding FHA insured mortgages. The total investment in these types of mortgages is 60 percent of all savings bank mortgage investment. Because, however, with minor exceptions, savings banks cannot invest out-of-State in other than insured or guaranteed mortgages, practically all out-of-State mortgage

lending is in these categories. It may also be noted that, since 1952, mutual savings banks have placed more funds in FHA and VA mortgages than any other type of lender.

The impact of the proposed legislation must be considered in the light not only of these facts but also of the housing policies of the administration. The premises implicit in the recent housing legislation are that there is a shortage of mortgage funds, especially for insured and guaranteed financing, and that the funds that are available are excessively costly. To overcome these deficiencies, recent housing legislation would provide $1.2 billion for direct Treasury lending on mortgages for veterans and over $1 billion of Treasury funds for special assistance lending by the Federal National Mortgage Association. In addition FNMA has authority to borrow about $1 billion in the private financial market to purchase insured and guaranteed mortgages.

In view of this obvious concern over the supply of mortgage funds, it might be assumed that all governmental policies would be consistently directed to augmenting and facilitating the flow of private credit into the mortgage area and to seeking means for relieving an already overburdened Treasury of the added load which the recent statute imposes. It is reasonable to surmise that, if the proposed taxes were in effect, one of the first means to be considered for this purpose would be tax relief of savings institutions. This is in fact the policy that has been followed in several western European countries as a way to encourage savings and investment.

The potential loss of funds to the mortgage market cannot be measured by any such neat calculations as the Treasury arrives at on page 10 of its report to your committee where the final conclusion appears to be that the net result would be a reduction of 35,000 housing units from the current level of annual production. Serious as even this would be, the loss could be far greater than this, because of the ability of mutual savings banks to shift readily into other types of investment, including tax-exempt securities. Furthermore, no one can estimate what volume of savings might be diverted from thrift accounts to savings bonds (one of the best available tax havens for persons approaching retirement), to mutual funds or other savings alternatives as a result of the lower dividends that thrift institutions might be forced to pay under an altered tax structure.

Moreover, the loss would be heavily concentrated in insured and guaranteed mortgages—the volume of which the Government is willing to burden itself to enhance. The loss would also be concentrated in those parts of the country which, because of shortages of local conventional loan funds, have been most dependent on the insured and guaranteed mortgages which are virtually the only media for the interstate flow of home mortgage funds.

The reasons for this are twofold. Since mutual savings banks consider their primary obligation to be to their own States, out-of-State lending represents a marginal use of funds and is certain to bear the brunt of any curtailment. The exclusion of insured and guaranteed loans from the bad debt reserve can only result in a shift of funds and a deprivation of the types of borrowers and the areas of the country that are dependent on this financing. The assumption that FHA and even VA mortgages are beyond possibility of loss can be made only by those unfamiliar with these activities. Furthermore, State supervisory authorities make no distinction among types of mortgage investments in establishing reserve requirements. The main point, however, is that the exclusion of any important area of investment from the reserve calculation will, we fear, be certain to diminish interest in that area of investment.

But whatever the loss of housing production may be, the undisputed fact is that there will be a loss where all evidence points to the need for a gain. There will be a curtailment where there should be an expansion. The assumption that the loss will be made up by increased mortgage investment by other types of institutions cannot be substantiated and is dubious at best. The two possible sources mentioned in the Treasury report are commercial banks and pension funds. The first group already has sizable mortgage holdings roughly equivalent to those of mutual savings banks. There is little reason to believe that these will be measurably increased because difficulties are placed in the way of savings banks; and there is even less reason to believe that any imaginable increase would be placed in insured and guaranteed mortgages or distributed geographically so as to compensate for the curtailment of savings bank lending.

At the present, pension funds have only a small fraction of their funds in mortgage investment—about $758 million out of the $28.7 billion of corporate pen-

sion funds—and only a small proportion of this is in home mortgages. While some increase is certain, it is unlikely that, in spite of their tax-exempt status, pension funds will make up the losses which the proposed legislation would cause elsewhere. Moreover, since pension funds are the most untrammeled and yield-conscious investors in the field, their mortgage purchases are marginal, erratic, and undependable. Currently almost no pension fund money is going into the FHA-VA area.

As a final suggested substitute for the expected curtailment of mortgage lending by thrift institutions, the Treasury report (p. 11) states: "It might be, for example, that the goal of a high level of housing construction is better accomplished by such provisions as were included in the Housing Act of 1961, primarily the special assistance program, provision of more liberal terms, and flexibility in setting insurance premiums."

This is strange reasoning. Besides implying a preference for Government over private action, the Treasury ignores, or is indifferent to, the fact that the FNMA special assistance program will require an outlay several times over the additional revenue anticipated from the enactment of its proposals. As to the other items in its suggestion—the more liberal terms and the reduced insurance premiums—these may increase the demand for mortgage money but they cannot add $1 to the supply, while, at the same time, they would increase the contingent liability of the Treasury.

While this association is convinced that taxing thrift is not a way to promote economic growth, it recognizes the soundness of the principle of equality in taxation. To that end it would see good reason for taxing at full corporate rates any income derived by thrift institutions from originating and servicing mortgages for others. Moreover, it would consider as equitable the granting of the same tax treatment to income derived from time deposits of commercial banks as is granted to the investment income of thrift institutions.

In summary, the proposals before your committee would to an incalculable degree curtail the availability of funds for home mortgages and, in so doing, would surely raise their cost—both of which results are contradictory of the expressed objectives of the administration. They will increase pressure for Government outlays for housing in excess of any potential gain in revenue. To adopt them in face of an impending housing demand that will require for its satisfaction a greater marshaling of resources than anything we have previously provided, would be to put at risk the future welfare of the segment of the Nation's economy.

Senator KERR. Mr. George W. Pohlsen.

STATEMENT OF GEORGE W. POHLSEN, ON BEHALF OF UNITED GARMENT WORKERS

Senator KERR. You have a prepared statement, Mr. Pohlsen?

Mr. POHLSEN. Mr. Chairman and members of the Senate Finance Committee——

Senator KERR. Would you have a seat?

Mr. POHLSEN. I prefer to stand.

Senator KERR. Very good.

Mr. POHLSEN. Thank you.

Senator KERR. Very good.

Mr. POHLSEN. I represent the clothing, the Garment Union, Local Union 110 of the United Garment Workers of America, in Philadelphia, affiliated with the AFL-CIO.

Our union takes exceptions to the bill that is before the committee for several purposes or several reasons.

One is we are opposed to the bill on account of the bill provides an enormous overhead expense on the part of corporations and banks who would be subjected, or, not "subjected," but who would be called upon not to pay the income tax that they now pay.

The Government would be deprived of that revenue by imposing this overhead cost.

We are opposed to the bill, too, because the bill does an injustice on the old people, who are not obligated to have any withholding taxes withheld from their income. I had an occasion on Monday, April 2, to visit one of the homes of our members who just recently died and, here, his wife had two checks that morning from the A.T. & T., one for $9.81. They own nine shares.

She also had a check there for $22 from the Wellington Mutual Fund.

Now, if this law or if this bill was the law the A.T. & T. would be required to hold $1.60 out of that $9.81 check, and the Wellington Mutual Fund would be obligated to pay—or, rather, withhold $4.40 out of that $22 check.

It has been my observation—I am the business agent of my union, and I come in contact with a lot of people both in my own union and throughout other organizations, and I generally find that old people have a fixed budget, just how to live: "I am going to get this money today and I am going to do this with it, and next week I will get that," and so forth.

To disturb that, I think it would be an injustice.

Another point that our organization has objection to and, incidentally, everybody that came here before the committee opposes anything being withheld, but they never pass an opinion on something that is in this bill that is going to be given out.

There is $1⅓ billion to be given to corporations to improve their plants so they can get greater production on the pretense or the assumption that it is going to create employment.

Our union thoroughly investigated this and we are of the opinion that, if that is permitted to pass and these firms can get greater production, then it consequently follows that they need less workers.

The reaction of the bill would be to throw people out of employment and, God knows, members of the committee, we know or our organization knows that next to the international problem the next problem of America is the unemployment problem.

We contend that it can be solved. The Government has an agency already. It does not need to provide another agency.

We contend the social security agency is that agency. Congress should give these trustees power to take any action they desire in order to reduce the unemployment or to solve it.

In other words, if these trustees had this power and authority they could invoke the same thing that was invoked under the NRA. There, industry, labor unions, were called together and it was stated, "Here is the problem in your industry; what is the solution?"

And the members of my union, we sure did profit by that. We are reaping the benefits today. We reduced the hours of employment from 44 down to 36. That is the basic hours of our employment, and today in Philadelphia, our industry—I speak for the wholesale clothing industry—has no unemployment problem. In fact, we are short of men in the industry.

Our members are not only working 36 hours, but 40, and as high as 50 hours.

We cannot get anybody to come in, and yet the pay in the industry is for 36 hours, or $121 a week, and yet we cannot get them to man the industry.

Furthermore, we are very fearful about the Common Market. Of course, our Nation, I guess, is forced into the position. We need allies and maybe they will have to go along. But we are very fearful what the Common Market is going to do to our industry.

I lived through the common market during the 1890's. We did not call it common market. We called it free trade.

We were also confronted with unrestricted immigrations, Chinese coming in here by the thousands and others. Yet we had to first get exclusion under the Chinese Act of 1890.

Then when we began to try to restrict other nations, all the nations of the world ganged up on us and even threatened us. They contended that immigration was an international problem. We contend that it was domestic and, thank God, our Congress had the courage, in view of all of these threats, to pass the restricted immigration laws.

We are very fearful, after the Common Market gets operating, that these Asiatic countries, and others, will ask us to repeal the immigration laws. I may not live to see it. I am in my 89th year but, nevertheless, you will in a few years hence that that is going to follow.

Now, then, our union feels we have not the right to come here and oppose this legislation or to criticize it without offering something better in its place.

We favor the enactment of legislation making it mandatory for all corporations that pay dividends, banks and others who pay interest, to issue dividend statements and interest statements in triplicate.

One goes to the Internal Revenue Bureau; two go to the taxpayer, one for his own record and one he must turn in when he makes his next return.

I will just use myself as an example. I hold stock in A.T. & T. I hold stock in Philadelphia Electric and Broad Street Trust.

I also have a savings account in the Philadelphia Saving Fund. Now, when I make my return, Mr. Chairman and Senators, here, the Internal Revenue Bureau has my four statements.

The Government examiner, he adds up my four statements. What does it total, $3,000?

He looks at my tax return and sees only $2,500. Then he checks up with A.T. & T. and Philadelphia Electric and says, "Oh, this guy held out on Broad Street Trust." And then the Bureau sends for me.

And the Bureau shows me that and says, "Here we have a different dividend statement from the Broad Street Trust. How is it you did not include it in your return?"

That way all the redtape and all the paperwork that this bill before you here has is all done away with. The injustice to all people is done away with and a very simplified form is that you get your revenue at the top by not imposing this overhead on corporations and you get an honest return from the taxpayer at the bottom.

We contend the revenue to the Government would far exceed anything that is in this bill, and I am hopeful, Mr. Chairman, in conclusion, that the committee will give our proposals or suggestions consideration, as in our opinion we think it is a simplified form and it is easily understandable by all.

Thank you.

Senator KERR. Thank you very much, Mr. Pohlsen.

Mr. Paul R. Fitchen, for the New York Clearing House Association.

Proceed, please.

STATEMENT OF PAUL R. FITCHEN, ON BEHALF OF THE NEW YORK CLEARING HOUSE ASSOCIATION; ACCOMPANIED BY CLEMENT A. BRAMLEY, JR., SENIOR VICE PRESIDENT AND TREASURER OF THE CHASE MANHATTAN BANK; AND MYRON M. ZIZZAMIA, VICE PRESIDENT OF THE FIRST NATIONAL CITY BANK

Mr. FITCHEN. Mr. Chairman and gentlemen of the committee, my name is Paul R. Fitchen. I am executive vice president of the New York Clearing House Association. I have with me Mr. Clement A. Bramley, Jr., senior vice president and treasurer of the Chase Manhattan Bank, a member bank of the Clearing House Association, and Mr. Myron M. Zizzamia, vice president of the First National City Bank, also a member of the association.

We are appearing for the New York Clearing House Association which at present consists of 11 member banks, listed in appendix A attached to my prepared statement.

All of us, as taxpayers, have a substantial stake in the proper reporting of income and heartily support the objective of collecting all taxes owing the Federal Government. We are concerned, however, about the withholding provisions contained in section 19 of H.R. 10650. Our member banks are affected in more than one capacity. The bulk of the dividends and a large portion of the interest paid in this country are handled by banks as disbursing agents. Moreover, our member banks would be very much affected by withholding at the receiving end as well, through personal trusts, pension trusts, and many capacities in which the banks serve as trustees or custodians.

We fear the withholding plan on dividends and interest is not going to work effectively and that it will prove to be troublesome for the Internal Revenue Service as well as for our member banks. We fail to see how the Internal Revenue Service will be able to handle the massive volume of refunds in the absence of receipts; but the bill properly omits a requirement for receipts.

We suspect that under the proposed bill the Treasury will retain many small amounts to which it is not entitled because of the ignorance and inertia of many small savers, and will be in no better position to collect tax above the 20 percent rate from those persons who are not now properly reporting dividend and interest income.

Contrary to many statements that have been made on this subject, withholding on dividends and interest is not the same as withholding on wages. The 18 percent rate of wage withholding has built into it the standard deduction. Each wage earner, in adjusting the amount of withholding to be applied to him individually, may take into account his personal exemptions, including his exemptions for dependents. There seldom exists, in connection with wage and salary withholding, the problem of multiple payers. Under the procedure for receipts which are practical in connection with withholding on wages

and salaries, the propriety of refunds may be easily and promptly checked by the Internal Revenue Service.

We are now about to undertake considerable additional expense in adopting the new taxpayer identification number system. When automatic data processing and the taxpayer identification number system are in full swing, the Interal Revenue Service will or should be in a position not only to detect underreporting of income but also to check, within the period of time accorded to the Internal Revenue Service to assert additional deficiencies, the propriety of prompt refunds that have been made. We believe, if withholding subsequently proves necessary, that a withholding system without the use of taxpayers' receipts would be a less dangerous innovation after the taxpayer identification number system and ADP are in full operation. Hopefully, however, the inequity of mass overwithholding and the expense of imposing a withholding system at such time will prove to be unnecessary.

The original Treasury withholding proposal submitted to the Ways and Means Committee was the simplest from the standpoint of payers. The Treasury recommended a flat 20 percent across-the-board withholding, without exception. As presented by the Secretary of the Treasury—

> The withholding agent would be asked to withhold on a simple flat fee rate basis without exemptions.

Under that scheme, the payers would merely pay 20 percent of the total dividend and interest payments to the Internal Revenue Service. With exemption certificates added, the gross amount of dividend and interest payments must be adjusted in order to take account of each exemption certificate that has been filed.

Obviously, withholding can be less expensively handled by payers in the absence of exemption certificates. However, to the extent exemption certificates are permitted to enter the picture, we fail to understand why they are not permitted for tax-exempt organizations at least to the same extent as they are permitted for individuals. For example, under the bill, individuals (who are not subject to tax) are entitled to file exemption certificates for dividend income, but tax-exempt organizations are not. Moreover, if exemption certificates are permitted for dividend income, they should logically be permitted for interest on registered bonds.

Admittedly, exemption certificates complicate the system and are burdensome to payers, but if permitted at all, they should be permitted on a nondiscriminatory basis for all exempt persons. In this connection, it should be made clear in the bill that tax-exempt organizations include pension, profit sharing, and other employee benefit funds that are exempt from tax.

The most serious problem for our member banks with respect to exemption certificates arises from the fact that individuals over age 17 must file them on an annual basis. Such a system means that the withholding agent must annually classify all his payees according to whether they are or are not exempt. Each change of status must be reflected in the paying system, with the technique varying according to the system and equipment used. We strongly urge that if withholding is to be adopted with exemption certificates, an exemption certificate be treated as permanent, until revoked by the person that

filed it. The exemption certificate should have the taxpayer's identification number and a copy should be filed with the Internal Revenue Service for its records.

To conclude, we recommend that action on withholding on dividends and interest be deferred until the identification number system is in full use and automatic data processing is in full operation. We understand that ADP and the taxpayer's identification numbers will provide the Internal Revenue Service with a consolidated tax account for each taxpayer that will reflect his correct tax status at any given point in time. Thus, the Service will have the needed equivalent of receipts to permit prompt refunding and adequate policing of millions of returns. Until the Service is thus armed, prompt refunds must be made solely on faith, and the Service will be in no better position to collect tax above the 20-percent rate from those persons who fail to report all their income.

If withholding is to be adopted at this time, however, we agree with the Treasury and the House Ways and Means Committee's decision that the system should not be burdened with receipts. Provision for exemption certificates should either be eliminated or, if retained, an exemption certificate should be treated as permanent until revoked by the person that filed it. Tax-exempt organizations, including pension funds, should be permitted to use exemption certificates to the extent such use is extended to others, and no distinction should be made in this connection between dividends and interest on registered bonds.

I thank you for this opportunity to present the view of the association.

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

(App. A follows:)

APPENDIX A. MEMBER BANKS

The Bank of New York.
The Chase Manhattan Bank.
First National City Bank.
Chemical Bank New York Trust Co.
Morgan Guaranty Trust Co. of New York.
Manufacturers Hanover Trust Co.
Irving Trust Co.
Bankers Trust Co.
The Marine Midland Trust Co. of New York.
United States Trust Co. of New York.
Grace National Bank of New York.

The CHAIRMAN. The next witness will be Mr. G. Edward Cooper, of the Pennsylvania Bankers Association.

STATEMENT OF G. EDWARD COOPER, ON BEHALF OF THE PENNSYLVANIA BANKERS ASSOCIATION; ACCOMPANIED BY BELDEN L. DANIELS, EXECUTIVE MANAGER, PENNSYLVANIA BANKERS ASSOCIATION

Mr. COOPER. I am G. Edward Cooper, senior vice president of the Philadelphia National Bank, Philadelphia, Pa., and today I am appearing before you as a representative of the Pennsylvania Bankers Association.

Mr. Belden L. Daniels, executive manager of the Pennsylvania Bankers Association, is to my left.

With your permission, sir, I would like to have this statement filed in its entirety and just talk with you about the highlights. It will save time and probably clarify some of the points.

The CHAIRMAN. That will be satisfactory. The statement will be printed in its entirety.

(The statement referred to follows:)

STATEMENT OF G. EDWARD COOPER ON BEHALF OF THE PENNSYLVANIA BANKERS ASSOCIATION

My name is G. Edward Cooper. I am a senior vice president of the Philadelphia National Bank, Philadelphia, Pa., and I am appearing today as a representative of The Pennsylvania Bankers Association to comment on the dividend and interest withholding provisions of H.R. 10650. In my capacity as chairman of the Bank Management Committee of the American Bankers Association, I testified on withholding before the House Ways and Means Committee on May 26, 1961. For the past year I have been one of a group of bankers brought together by the A.B.A. to consider withholding and, along with other members of that group, have met on several occasions with Treasury officials and staff.

The Pennsylvania Bankers Association opposes enactment of section 19 (the withholding provision) in its present form because it is neither practicable nor workable. Further, we believe there are alternative procedures available to the Treasury Department which will obtain the same objectives as are sought by this bill without subjecting millions of individuals, along with payers of interest and dividends, to the burdens and costs of a massive and cumbersome withholding system.

I should like to emphasize at the outset that our position on this section should in no way be interpreted as condoning the failure of any recipient of interest or dividend income to report such income where applicable for tax purposes. Commercial banks have expended considerable time and money to assist the Treasury in obtaining all of the revenue which is due and payable from these sources. We pledge ourselves to continue full cooperation with the Treasury in this matter.

To appreciate the impact which mandatory withholding of interest and dividends will have on the Nation's commercial banks, it is necessary to keep in mind the magnitude and variety of bank operations affected by this bill. Commercial banks now hold more than 60 million savings and time accounts, almost all of which are interest bearing. It is quite possible that there are more savings and time accounts in commercial banks than there are individuals now subject to wage withholding; certainly if we add to the accounts in the commercial banks those in mutual savings banks, in savings and loan associations, and in credit unions the number of accounts far exceeds the number of persons from whom income tax is presently withheld.

The great bulk of commercial banks' savings and time accounts are of very small size. According to a survey conducted by the American Bankers Association several months ago, approximately 32 million of our regular savings accounts receive interest of less than $12 a year, with some so small as to receive no interest at all. A significant fact developed with respect to these small accounts is that although they comprise approximately two-thirds of all savings accounts in commercial banks, they receive less than 5 percent of the total interest paid. It is probable that, as the Treasury points out, some of this interest is not reported, largely because of carelessness, but whatever the extent of this nonreporting it is also clear that the increased revenue to the Treasury from withholding will be small in the case of these 32 million accounts.

Deposit accounts are not the only facet of bank operations which will be affected by withholding. For example, commercial banks will be affected with respect to dividends paid to their stockholders, dividends on the stock and the interest on obligations of other corporations for which they act as paying agents, interest coupons on Government and corporate bonds which are presented to banks for collection, redemption of U.S. savings bonds, and the receipt and distribution of income to trust beneficiaries and to religious, charitable, and educational organizations for whom banks act in a fiduciary or custodial capacity. In short, commercial banks will become a major tax collector for the

Treasury under any system imposing a withholding tax on dividends or intere[st] at the source. And, of course, they will be blamed along with the Treasury an[d] the Congress for any hardship or inconvenience caused the dividend and intere[st] recipients against whom this tax is withheld.

A major operational difficulty, which cuts across all phases of bank operations stems from the exemption certificate provisions of section 10. When withholdin[g] was first proposed it was in the form of a flat 20 percent against all payments of taxable interest or dividends, without exemptions or exceptions. This w[as] vigorously opposed because of the many inequities and difficulties imposed on the average taxpayer in filing tax returns and, where necessary, in claiming refunds. The same considerations were apparent to the House Committee on Ways and Means, and that committee therefore sought to relieve these inequities by introducing exemption certificates for certain types of income. While this was of some help, it was only partially successful. At the same time, it created still more difficulties for commercial banks and other payers of interest and dividends.

Let me note, first, several examples of inequities remaining under the exemption certificate procedure: A minor under 18 years of age and an individual who expects to have no tax liability for the year may file an exemption certificate with an interest paying agent, a dividend paying agent, and at the time of redeeming series E-bonds. However, the minor or individual could not file such a certificate as a beneficiary of a trust fund. Another example: A tax-exempt organization may file an exemption certificate and avoid the withholding on deposit or share-account interest and on interest on Government saving[s] bonds but on nothing else. Thus churches, charities, pension trusts, and other tax-free entities will be deprived of income for a period of time and be required to file claims for refunds. Still another illustration is found in the fact that the exemption privilege is not available for any holder of bearer bonds with taxable interest coupons.

Turning to the effect of the exemption certificate procedures on payers of interest and dividends, the operational problems concerned can best be illustrated with respect to savings accounts. Obviously, to process, file and maintain exemption certificates and to keep exempt accounts segregated from other accounts will be a major problem for commercial banks. Further, section 10 provides that in most instances exemption certificates must be filed annually, thus compounding these difficulties. The task arising from the continuous filing of new certificates, canceling old certificates, and attempting to keep track of customers who may have forgotten to file their certificates (and who will blame the banks if not reminded) is indeed formidable. Thus, the exemption certificate procedures of section 10 fail to remove all inequities but, at the same time, impose an immensely complicated system upon commercial banks and other payers of interest and dividends.

Let me turn now to another area in which withholding will introduce confusion in bank operations. I refer to the payment and collection of interest-bearing coupons which are cashed or deposited at commercial banks. All bank tellers handling coupons as well as all transit clerks and employees of paying agents will have to be trained to handle these coupons at 80 percent of face value. The possibility of error at one of the many stages of the handling of coupons would be increased. Each person so engaged will have to be furnished with a table showing amounts ranging from a few cents to many dollars in order to readily determine 80 percent of all coupons of every possible value. This cannot be a one-page table or even a simple pamphlet because coupons are no longer issued in even amounts, but may well be odd amounts such as $1.81, $10.33, or $22.68. The problem will be complicated by the fact that coupons on tax-exempt bonds will continue to pass through the banking system at face value.

Operational problems caused by withholding are necessarily reflected in deteriorated customer relations. This is probably more evident in the case of savings bonds than in any other area. These bonds are discount bonds, sold primarily to people of moderate incomes, many of whom are not sophisticated in investment procedures. A basic selling point has always been the promise that by payment of a certain sum now the bond will be redeemed within a given number of years at its face value. No amount of advertising is going to repair the adverse effect upon many individuals when they find that their $25 bond is redeemed by the bank at $23.75. Not only is the bank the loser in this transaction, since a customer or potential customer will be irritated, but the Federal Government also will be hurt as savings bonds lose some of their appeal.

Withholding will result in many complications for trust departments. I am sure that the difficulties and inequities involved in this area will be presented to you in detail by representatives of trust institutions.

Some of the operational difficulties to which I have referred could be alleviated by amending section 19. For example, the exemption certificate problem would be considerably eased if the bill were to provide that, once filed, such certificates could be relied upon by banks until revoked by the individual. Other helpful amendments would be: (*a*) to provide for consistent usage of exemption certificates, i.e., tax-exempt organizations should have the same privilege as individuals with respect to exemption certificates; (*b*) a bank or trust company—or one of its nominees—should be permitted to file exemption certificates with payers of interest or dividends and, in turn, be responsible for withholding in the case of trust beneficiaries.

In addition, your committee can do much to ease the impact of withholding if the bill is amended to exclude withholding on marketable governmental and commercial securities. Great as the problems are with respect to withholding on dividends and on interest on savings accounts, they are very much greater when applied to the coupon and other interest payments on securities which are bought and sold in the market from day to day. The operation of our modern markets in governmental and commercial securities is now quite complex, and to subject the interest on these securities to withholding will further complicate the consummation of transactions in these markets. These securities are held largely by institutional investors (including foreign and domestic governmental units) and in trust for individuals, and we believe that there is little, if any, failure to pay proper taxes on interest from this source of income.

Although I earnestly recommend these amendments for your consideration, their adoption would not make the withholding system proposed in section 19 fair or workable; it would simply ease some of the burdens. Despite this, I would personally endorse a withholding system—and I am sure the overwhelming majority of bankers would do likewise—if we were convinced that withholding were the only way to assure full reporting of interest and dividends on tax returns. However, we do not believe this to be the case. On the contrary, we are convinced that the Treasury can collect the amounts due by making use of procedures already available to it. In this connection the use of automatic data processing equipment should be of great assistance. Certainly so long as there is a possibility that the Treasury will be able to accomplish its objectives without imposing withholding on the Nation, an opportunity should be given for this to be done.

I would suggest a four-point program to the Treasury which will, we believe, constitute a fully satisfactory alternative to withholding.

1. Continuation of the taxpayer educational program that has been underway for just a few years, the objective of which is to alert taxpayers to the requirement of reporting all income from interest and dividends.
2. More effective enforcement of tax laws and active prosecution of offenders.
3. Revision of tax forms to more clearly emphasize taxpayers' obligations and to require response to questions that would deter fraudulent or careless completion.
4. Effective and extensive use of electronic data processing equipment, perhaps combined with expanded requirements for information returns from banks and other payers of interest.

With respect to the last suggestion, it should be noted that account numbering will soon be a fact, which should greatly facilitate the use of automatic equipment. Let me quote from an article in the March 31, 1962, issue of *Business Week*, describing an appraisal of automatic data processing equipment by Mortimer M. Caplin, Commissioner of Internal Revenue:

"Back in January, Caplin described the advantages of the ADP system. Within a few years, the master file at Martinsburg will hold records on 78 million taxpayers. These accounts can be matched against returns or can be sorted out by any of a wide variety of criteria. The tapes, printed at 600 lines per minute, will run off the name, address, and pertinent information from any return that seems to bear auditing. The system will automatically put the finger on those who fail to file returns, who owe taxes for previous years, who file duplicate claims for refunds, whose returns show 'discrepancies or unusual characteristics' that warrant investigation."

Although commercial bankers believe that a withholding system is unnecessary in view of alternative procedures available to the Treasury, as realists we recognize that such a system may be enacted into law. If this is done, it is essential that the commercial banking system be given sufficient time to prepare for this monumental task. Existing equipment in many instances will have to be altered and, in some cases, be replaced. Procedures will have to be devised to split all accounts into exempt and nonexempt accounts. Countless other arrangements will have to be made if this job is to be accomplished at all. Many of these arrangements cannot be made until regulations based on the act itself are issued by the Treasury Department, and such regulations may be issued considerably later than the date at which the bill becomes law. Accordingly, if this bill is enacted into law, I strongly urge that banks be given at least 1 full year to prepare for withholding.

This concludes my testimony on section 19 of the bill before you. There is not sufficient time for me to comment on other sections, but I should like the record to show the following resolution adopted by the Pennsylvania Bankers Association with respect to section 8 of this bill:

"The Pennsylvania Bankers Association Council of Administration reaffirms its position that the present condition of Federal tax inequity between commercial banks, savings and loan associations and other mutual organizations should be corrected without further delay. The association is convinced that the present draft of H.R. 10650, as passed by the House of Representatives on March 29, does not represent a proper correction of this tax inequality upon financial institutions. The present provision which would accord savings and loan associations a tax free gift of 60 percent of net earnings is intolerable and is not in keeping with the American heritage of fair play. We agree with the position of U.S. Secretary of the Treasury Douglas Dillon in his testimony before the Senate Finance Committee on April 2 on H.R. 10650, with regard to the taxation of savings and loan associations. We urge the U.S. Senate to amend the 60 percent of net earnings provision of H.R. 10650, in the manner suggested by Secretary Dillon."

Mr. COOPER. Also for your information, I am presently chairman of the Bank Management Committee of the American Bankers Association and, in that capacity, appeared before the House Ways and Means Committee in May of 1961.

Since that time, along with some associates in the American Bankers Association, we have been working with the official staff of the Treasury and the Internal Revenue on the many complexities and the technical details of this proposed bill.

As a matter of fact, we spent most of this morning working with that group which, we hope, indicates that we are trying to be cooperative.

The Pennsylvania Bankers Association as of this moment, through action of its executive committee and council of administration, oppose the bill on the ground that as it is written it is neither practical nor workable, and I would devote my time to discussing with you some of the operational phases that are very difficult as it is now written.

With reference to exemption certificates, exemption certificates were added to the bill after the House Ways and Means Committee had considered the matter.

As you will recall, the Treasury first proposed that only a straight 20 percent flat withholding would be imposed. This was considered not equitable and exemption certificates were provided.

However, this only partially solved the situation and, as a matter of fact, added many other complications. For example, a minor, one under age 17, or an individual who has no tax liability is permitted to file an exemption certificate with respect to interest on deposits, and with respect to dividends and with E-bonds.

But he does not have the privilege of filing an exemption certificate where a person is a beneficiary through a trust department of a bank.

Also, for a tax-exempt organization, the bill provides that such an organization may file an exemption certificate with respect to interest on deposits and E-bonds, and that is all. We question this because churches, charities, and other types of tax-exempt organizations would be deprived of dividend income for a period of time.

Still another illustration is found in the fact that the exemption privilege is not now accorded to anyone with respect to interest on coupons on bearer bonds.

Now, again with regard to the exemption certificates, the bill provides that those that are filed by minors are good until the first of the year in which the minor reaches the age of 18. In all other instances they are filed to be good annually, and it must be renewed on an annual basis.

This will entail a considerable amount of detailed work in setting up records, receiving these certificates each year, and, as you can well imagine, many individuals will be slow and tardy in filing, and it will create substantial customer relations problems, we feel.

Therefore, while the exemption certificate procedures as set up in section 19 fail to remove all of the inequities, we feel they do impose a complicated system upon commercial banking and other payers of interest and dividends.

There is one other area in which we are very much concerned about the detailed handling, and that has to do with coupons from bearer bonds.

Provisions at the moment provide that the paying agent must set aside 20 percent of the total amount of the coupons due on the date they are due and payable. This means that in the hands of an individual owner of a bond, who clips a coupon as of a certain date, the coupon is good for only 80 percent of the amount shown on the face of the coupon, which could mean that whatever rate he disposes of it, either by cashing it in his town or depositing it in a bank, is good, or it is good for only 80 percent of the figure that is printed on the face, and it must be processed that way through the entire banking system and through the Federal Reserve System.

At the same time, those bonds, the interest of which are tax free, will be processed at 100 percent of the face value.

With millions and millions of these little pieces of paper flowing through the banking system, at an amount different from that printed on them, we envision quite a bit of trouble in the proper handling and settlement features.

We are concerned so far as the E-bonds are involved because so many customers have for so long a time been purchasing them. They come in to cash or redeem them, and they expect to receive the amount shown on the back of the bond.

We expect quite a public relations problem here, to satisfy them first that they are not entitled to the amount that is printed on the bond, but then to explain to them the reasons for the reduced amount that is paid to them.

In considering all of these problems we would suggest that section 19 of the bill, with regard to the certificate problem—conditions, we suggest, would be considerably eased if it would be provided that once

the certificates are received by payors of interest and dividends, they would be good until revoked. It would then not be necessary to have this constant turnover each year in the filing of the certificates and in the adjusting of our various records.

We would also say that consideration should be given to provide for a consistent usage of the certificates. If a tax-exempt organization or nontaxable individual is entitled to file in any instance, he should be entitled to file for all.

Also, we would suggest, and this will be covered in greater detail by someone from the trust end of the banking business, that a bank or trust company, or one of its registered nominees, should be permitted to file exemption certificates and, in turn, be responsible for the withholding in the case of the trust beneficiaries. The trustee is in a good position to decide and make exemption certificates effective to the extent they are applicable to trust beneficiaries.

Now, going back to the question of the coupons on the bonds, there are several alternatives, and at this point it is our recommendation that this committee consider excluding withholding on marketable Government or corporate securities.

As great as the problems are with respect to withholding on dividends and on interest on savings, they are much greater when applied to the processing of these coupons and other interest payments on securities, including adjusting for the 20-percent withholding in the case of transactions, sales, and purchases, where the accrued interest must be adjusted for this withholding.

The operation of our foreign markets in the securities is now quite complex and to subject the interest on these securities to withholding will further complicate the consummation of these many transactions.

As a matter of fact, these securities are largely held by institutional investors, including foreign and domestic governmental units, in trust for individuals, and we believe there is little, if any, failure to pay the proper taxes on this interest.

Although we earnestly recommend the amendments for your consideration, we still feel that their adoption will not make the withholding system, as proposed in section 19, fair or workable.

It will simply ease some of the burdens.

However, we are convinced that the Treasury can collect the amount due them, and we certainly do not condone the failure on the part of any individual to not pay taxes, either deliberately or fraudulently, but we do suggest that there are means available to the Treasury to accomplish the objectives with which we all agree, and we suggest for your consideration a four-point program:

(1) Continuation of the taxpayer educational program that has been underway for just a few years, the objective of which is to alert taxpayers to the requirement of reporting all income from interest and dividends;

(2) More effective enforcement of tax laws and active prosecution of offenders;

(3) Revision of tax forms to more clearly emphasize taxpayers' obligations and to require response to questions that would deter fraudulent or careless completion of the form; and

(4) The effective and extensive use of electronic data processing equipment, perhaps combined with expanded requirements

And with respect to this fourth point, it should be noted that account numbering will soon be a fact which should greatly facilitate the use of automatic equipment.

I might say, Senator, in addition to our cooperation in this field, banking is being called upon to handle a very heavy job, time consuming, costly in implementing this taxpayer number system, which we believe to be logical, and we have cooperated so far and will do so until it is fully implemented.

It as quite interesting for us to note in the Business Week magazine of March 31 of this year a quotation from the comments by the Commissioner of Internal Revenue, Mr. Caplin, which in part says that he described the advantages of the automatic data processing system, and that within a few years the master file at Martinsburg will hold records on 78 million taxpayers.

The system will automatically put the finger on those who fail to file returns, who owe taxes for previous years, who file duplicate claims for refunds, whose returns show "discrepancies or unusual characteristics" that warrant investigation.

All of that adds up to what would be a very effective tax collection system.

Now although the commercial bankers believe that a withholding system is unnecessary, in view of the alternative procedures available to the Treasury, we, as realists, recognize that such a system might be enacted into law. If this is done, it is essential that the commercial banking system be given sufficient time to prepare for this monumental task. Existing equipment in many instances will have to be altered and in some cases replaced. Procedures will have to be devised to split all accounts into exempt and nonexempt. Countless other arrangements will have to be made if this job is to be accomplished at all.

Many of these arrangements cannot be made until regulations, based on the act itself, are issued by the Treasury Department, and such regulations may be issued considerably later than the date on which this bill becomes law. Accordingly, if the bill is enacted into law, we strongly urge that banks be given at least 1 full year to prepare for withholding.

We feel that this is certainly within the realm of reasonableness, because of the length of time it has taken the Internal Revenue to set up their electronic data processing system. We, too, in the banking system need time to set up what would properly be necessary under withholding.

That, sir, concludes my remarks on section 19.

Before closing, however, I would like to have included in the record the following resolution on another subject in the tax bill which was adopted by the Pennsylvania Bankers Association with respect to section 8:

The Pennsylvania Bankers Association Council of Administration reaffirms its position that the present condition of Federal tax inequity between commercial banks, savings and loan associations, and other mutual organizations should be corrected without further delay.

The association is convinced that the present draft of H.R. 10650, as passed by the House of Representatives on March 29, does not represent a proper correction of this tax inequality upon financial institutions.

The present provision which would accord savings and loan associations a tax-free gift of 60 percent of net earnings is intolerable and is not in keeping with the American heritage of fair play.

We agre with the position of U.S. Secretary of the Treasury Douglas Dillon in his testimony before the Senate Finance Committee on April 2 on H.R. 10650, with regard to the taxation of savings and loan associations.

We urge the U.S. Senate to amend the 60 percent of net earnings provision of H.R. 10650 in the manner suggested by Secretary Dillon.

Thank you.

The CHAIRMAN. Thank you very much.

Mr. COOPER. Thank you, sir.

The CHAIRMAN. The next witness will be Mr. Cecil Bronston, representing the Corporate Fiduciaries Association of Chicago.

STATEMENT OF CECIL P. BRONSTON, ON BEHALF OF CORPORATE FIDUCIARIES ASSOCIATION OF CHICAGO

Mr. BRONSTON. Mr. Chairman, my name is Cecil P. Bronston. I am a vice president in the trust department of the Continental Illinois National Bank & Trust Co. of Chicago and I appear here today in representation of the Corporate-Fiduciaries Association of Chicago, of which I am currently the secretary-treasurer. The regular and associate membership of this association is comprised of the major banks and trust companies engaged in the trust business within Chicago and Cook County, Ill. Customers and beneficiaries served by our, and similar, trust institutions of the Nation constitute a full cross section of our citizens—taxpayers and tax exempt, individual and corporate.

Pursuant to the time schedule of these hearings, my remarks will be limited to the subject of withholding taxes on interest and dividends, with special emphasis on the inequities of such withholding affecting fiduciaries and trust beneficiaries. We favor the collection of taxes in full from all citizens from whom taxes are justly due. But as to the method of enforcing collection of taxes due on interest and dividends, we stand unequivocally opposed to withholding such taxes at the source. May it please this committee, in its wisdom, to bar from further progress this completely vexatious piece of legislation.

Viewed from a distance, especially through the eyes of officials responsible for the collection of taxes, it is understandable that tax withholding of dividends and interest presents a rosy dream. Taxes can be collected in large chunks from a comparatively few sources. The Treasury will get its money immediately—in some cases, perhaps even before the taxpayer received the income on which the tax is based. And, superficially, at least, with one big "pouff," withholding will even eliminate the cash requirements for payment of approximately one-fifth of the interest burden of the national debt. But withholding, viewed close at hand through the eyes of those who must carry out the detailed work involved, is a terrible nightmare.

Major decisions must be made by the administration and congressional policymakers here in Washington. Broad-scale, big thinking is necessary. One can appreciate how the seeming major benefits of tax withholding would cause an official to favor it, unless he has been adequately informed of its intolerable burdens and cost to that section of our citizenry and business which will be adversely affected. But thinking has to be followed by doing and I know this committee

will not consider it small of me if I speak out on how the doing involved in this tax withholding will adversely affect our trust institutions and trust beneficiaries. If we do not explain our plight, who will?

Our trust institutions are caught on all sides. On the one hand, we are dividend paying agents, we are interest-coupon-paying agents, and we are processors, recordkeepers, and forwarders of interest coupons en route to collection; on the other hand, we receive interest and dividends in behalf of estates, trusts, and custodianships we handle as stewards for taxable and nontaxable persons, pension and other employee welfare funds, churches, colleges, charities, and other entities.

Under tax withholding, merely our accounting work will be at least trebled. Take, for example, each stock held in trust for a beneficiary. Today, for each stock, we record and report in one figure the receipt of a dividend, the tax withheld, the net sum received, and then practical necessity will require that we report all to the beneficiary in such way that the withheld amount can either be grossed up on a tax return or a claim for refund of taxes can be made.

Under H.R. 10650, a tax-exempt person who received dividends direct can claim exemption from withholding, but that exemption is denied to a trust beneficiary. Time consuming explanations will be the rule and will add their intangible measure to the cost. Recoupment of the overall expense will be virtually impossible, although such expense thus falling on our banks and trust companies will naturally be reflected in their own tax returns.

Government warehouses are full of the tax and information returns trust institutions now file in behalf of their trusts and customers. Representatives of the Treasury Department state frankly that such information is little used because to do so would develop a greater administrative cost to the Government.

Yet there appears to be no hesitation in casting upon our trust institutions witholding costs which may well bear more heavily on us than would be the relative cost to the Government in using its available information. The Wall Street Journal of April 6 featured an article showing that the Internal Revenue Service is on the threshold of making this information usable through data processing and the new taxpayer account numbering system which Congress adopted last year.

It will be an economy to all if, in lieu of tax withholding, we bend our every effort to put the new system into effect with the greatest possible dispatch so that presently available and even augmented information will be fully brought to bear on tax collections.

This is a time for plain talk. The Government, which receives the taxes, should be its own collector, so that the burdens of the collection fall upon the body politic as a whole rather than on any small segment of that body.

It is clear that if the least cumbersome and least burdensome methods of tax withholding on interest and dividends are used—that is, across-the-board withholding without exemptions—injustices and inequities will inevitably result among those citizens who receive the interest and dividends. On the other hand, if measures are included to remove the injustices and inequities—thereby permitting exemp-

tions to nontaxpaying citizens—the administration of the law becomes increasingly and unfairly burdensome on those charged with the withholding or collaterally affected by its provisions.

We would prefer to limit our case to flat opposition to the withholding on interest and dividends. But, since the House of Representatives has passed the bill, our duties to our customers require that we deal with the subject on the premise that if tax withholding on interest and dividends is to be made effective in some form, there should be eliminated the unjust discrimination now present in H.R. 10650 against otherwise tax-exempt citizens who are trust beneficiaries.

Senator KERR (presiding). Now, do you make that clear in your following language?

Mr. BRONSTON. Yes, sir.

Senator KERR. All right.

Mr. BRONSTON. If, despite the cogent reasons against withholding, we must nevertheless suffer its enactment, we seek your favorable consideration for these two suggestions:

(1) That banks, trust companies, and other responsible trustees, as designated under regulations of the Secretary of the Treasury, be made the withholding agent for registered interest payments and dividends payable to them in their fiduciary capacities.

In short, if this suggestion were adopted, responsible trustees would be permitted to file exemption certificates with the registered interest and dividend payers. Such trustees would receive the registered interest and dividend payments in full and would, in turn, become responsible to the Government for withholding and payment of the withholding tax in behalf of their trust beneficiaries pursuant to the individual taxability or tax exemption of such beneficiaries.

This procedure would reduce and in many cases eliminate the tax withholding hardships on nontaxpaying individuals who receive their support through trusts. It would also eliminate tax withholding on dividends collected in behalf of pension and other employee welfare funds, churches, colleges, charities, and other tax-exempt entities with income through trust funds. Not only would it permit these tax-exempt organizations to continue to use their financial resources in full for the work which has heretofore justified their tax exemption in the eyes of the Congress, but it would eliminate the expense of bookkeeping and refunds which the present bill places upon them and, indeed, upon the Government itself; and

(2) The second suggestion is that tax withholding on coupon interest from bearer bonds be eliminated from the bill. Bearer bonds tend to be held by individuals most knowledgeable concerning securities and by institutional investors—business concerns, insurance companies, college endowment funds, foundations, pension funds, and trusts—all of whose tax returns are most likely to be complete.

Although the fact cannot be documented within my personal knowledge, it seems a reasonable assumption that the tax gap from unreported coupon interest is of limited significance. Further, withholding on coupon interest involves special complexities not only in the coupon collection process but also in every bond transactions. So involved it is that the technical planners have been unable to suggest any workable method by which to alleviate inequities that will exist among citizens of different tax status, such as the exemption certificates pro-

vided for tax-exempt individuals in connection with savings account interest and dividends.

If this second suggestion is not acceptable, then as a less desirable alternative but still better than the present terms of H.R. 10650, it is suggested that tax withholding on coupon interest be made the responsibility of the bank at which the coupon is first presented for collection so that the coupon can flow through the banking system at par.

Finally, I cannot stress too earnestly that in our opinion tax withholding on interest and dividends is undesirable in any form. Information brought forth through these hearings clearly shows that it is not necessary, that it has distinctly questionable value as a revenue producer for the Government, and that there are preferable ways now equally available to enforce collection of the taxes sought—all to the greater good of our Treasury, our general economy, and our citizens.

Thank you.

Senator KERR. Thank you very much, Mr. Bronston.

The committee will recess until 10 o'clock tomorrow morning.

(By direction of the chairman, the following is made a part of the record:)

THE PAUL REVERE LIFE INSURANCE CO.,
Worcester, Mass., August 4, 1961.

CHAIRMAN SENATE FINANCE COMMITTEE,
U.S. Senate,
Washington, D.C.

DEAR SIR: I have been reading many things about the withholding tax placed on dividends and wondering if the people who advocate that sort of thing are aware of the following:

Certainly the withholding is a bookkeeping procedure that can't be done for nothing. Those moneys withheld and forms mailed to the Government with copies to the stockholder, can't be done for nothing. Obviously the cost has to be passed on in the form of increased price at the consumer level which has to be borne by the general public and in turn promotes inflation. The Government in turn hires more people to process these payments and to refund promptly those payment withheld from stockholders who owe no tax (because of age or income). The stockholder undoubtedly mails a form and waits while that is processed by the additional help hired. The Post Office Department is losing money every year and this deficit would then be increased by compounding our mailings. The dollars collected from those dividends not being reported will be offset by the negative inflationary aspects, increased Post Office deficit, delay of sorely needed income by older people, and last but far from least, bigger government.

I further would like to state that the heritage of individual enterprise and freedom is being sorely tried when a businessman could be restricted on business expenditures. Probably there are some cases of "excessive entertainment charges" being charged off as a business expense, yet in this inflationary age, I wonder if we aren't judging the whole barrel by one apple. In a very competitive business where knowledge is equal, product differences few, the sale is many times made because of the congeniality of the businessman—this involves home entertainment and outside entertainment. I am certain that very few are going to spend more on a customer than that customer's business merits. Let's not be bamboozled by a lot of bookkeeping figures prepared by theorists.

I sense a swing toward conservatism—people are tired of having nothing left after taxes and living expenses. Congressmen who advocate an adequate follow-through on reduction in Government forces and expenditures may not endear themselves to those dislocated from Government employment, but they certainly will be doing that which the Founding Fathers had in mind 174 years ago—government for the people, individual liberty with rights to pursue same. After all there is more at stake than favoring the requests of a few—something much

larger and dearer to us all—the continuation of our system of government with continued emphasis on the concepts handed down by the Founding Fathers. These are the thoughts we are trying to sell the undecided countries of the world.

Thank you for giving this your consideration.

Respectfully yours,

HOWARD GREENWOOD, *General Agent.*

RECIPE FOODS, INC.,
Baltimore, Md., August 3, 1961.

Senator HARRY F. BYRD,
Senate Finance Committee,
Washington, D.C.

DEAR SENATOR BYRD: We desire to go on record as being opposed to the Federal withholding tax on dividends and interest payments now being proposed and studied by Members of the House and Senate.

Our reasons for this opposition are attached.

Sincerely yours,

Office Employees of Recipe Foods, Inc.

ARGUMENTS ADVANCED AGAINST WITHHOLDING TAX ON DIVIDEND AND INTEREST INCOME

1. Since no simple and equitable method of withholding taxes on dividend and interest payments can be devised, such a system would create new inequities and discriminations.
2. The withholding of taxes on dividend and interest payments would have the effect of a revolving loan to the Government by the taxpayer.
3. It would increase the amount of recordkeeping by the taxpayer, such as filing requests for exemptions, applications for refunds, and in the preparation of the annual income tax return.
4. Exemption certificates would have to be filed annually with each company or financial institution from which dividend or interest income is received. As it would be difficult for the Government to check on a huge number of exemptions, there would be new opportunities for tax evasion.
5. Application could be made for a refund on overwithholding but no one can say how long a person would have to wait for his refund, which would be made without interest. Meanwhile, new withholdings would continue to be made on current receipts of dividends and interest.
6. In cases where the tax would be overwithheld, the Government would be depriving taxpayers of the current use of some of their dividend and interest income.
7. A taxpayer may be eligible for an exemption at one time of the year but not at another. He would have to keep the paying agencies informed as to his changing status.
8. Some individuals would not know until the end of the year whether or not they were tax-exempt for that period.
9. Charitable and religious institutions operating on investment income would have to notify paying agents each year as to their tax-exempt position.
10. The arbitrary withholding rate of 16⅔ percent has no relation to the expectation of tax liability in the individual case.
11. There is no assurance that the withholding tax would produce any substantial revenue in excess of the new administrative costs.

AUGUSTA BUILDING AND LOAN ASSOCIATION, INC.,
Baltimore, Md., August 3, 1961.

Hon. HARRY F. BYRD,
Senate Finance Committee,
Washington, D.C.

DEAR MR. BYRD: Our association is very much distrubed about pending legislation of a Federal withholding tax on dividends and interest.

The association has many small accounts of minors and if this money is withheld, then we would be put to the additional expense of reinstating this when the parents of the child write the tax department relative to this money not being taxable due to the account's being those of minors.

We have been reporting to the Government for years on form 1099, dividends above a certain amount, and why could not that form be used to cover all dividends, provided this would meet with the approval of the Government?

The effect of the system proposed by the Federal Government would not catch tax evaders; it would only be added expense, inconvenience, and confusion that would not justify such a drastic change in our present method of taxation. However, it can be solved by the matching information being sent the Government as per form 1099 which is being used now.

With kindest regards and assuring you of our appreciation of your consideration of the terrible burden which would be placed upon the association should the Federal bill be passed, believe me.

Yours sincerely,

CHARLES C. COUNSELMAN,
Executive Vice President.

THE EMPIRE CONSTRUCTION CO.,
Baltimore, Md., August 2, 1961.

Subject: Proposed Federal withholding tax on dividends and interest.

Senator HARRY F. BYRD,
Chairman, Senate Finance Committee,
Washington, D.C.

HONORABLE SIR: Very few people or for that matter, few lawmakers, have a clear idea of what is involved in connection with the above proposed bill except that it is like most bills expected to solve all problems in its area. The bill would require greatly increased recordkeeping on the part of the taxpayers, the corporation, or institution who is required to withhold the taxes, and on the part of the Federal Government. Furthermore, in view of the many complications, an equitable or simple method of compliance with the proposed law cannot be devised.

At the present time information returns of interest and dividend payments are filed with the Federal Government annually, and if properly used by the Federal Government they can increase tax compliance to such an extent that the cases where this method may not be effective are reduced to a minimum in which the costs of obtaining compliance and collection are greater than the results obtained. The most effective tool the Federal Government has is the law already on the books which only requires that the Government enforce compliance and then make use of the information it has thus obtained.

The inequities of this method of withholding, and its discriminations will result in greatly increased work, hardships, and delays in operation that are unusually burdensome. In the end the net increase of revenue would be exceeded by administrative costs.

We urge you to do everything in your power to have this bill defeated in the best interests of our voters and taxpayers. Your recording of our opposition to this bill will be greatly appreciated.

Very truly yours,

HARRY W. GRELL, *President.*

SUMTER, S.C., *March 7, 1962.*

Senator HARRY F. BYRD,
Chairman, Committee on Finance,
U.S. Senate, Washington, D.C.

DEAR SENATOR BYRD: The Ways and Means Committee of the House will, I understand, shortly introduce a bill there aimed at withholding 20 percent on dividend and interest payments. I am sure that your Senate Committee on Finance will give this bill thorough study before taking legislative action, whatever may be its final form in eventual passage by the House. May I make the following comments on this particular legislation?

1. Withholding of 20 percent is excessive for the average recipient of dividends and interest. Fifteen percent should be the maximum, and 10 to 12 percent would be more equitable.

2. Provision for speedy recovery (within 30 days) of excessive amounts withheld should be incorporated in the legislation. Failure to do this will result in financial hardship for a great many people.

3. Dividend exclusion and credit should be raised from $50 and 4 percent to $100 and 10 percent because of present discriminatory taxation against the common stock form of private ownership.

4. The Federal budget should be balanced, and our entire fiscal policy and posture should be thoroughly reexamined. Please let me congratulate you on your heroic efforts in this direction. In a separate letter I am urging Senator Strom Thurmond of South Carolina to lend his support and cooperation in this urgent endeavor.

Sincerely,

THOS. WILSON III.

ANCIENT AND ACCEPTED SCOTTISH RITE OF FREEMASONRY, SOUTHERN JURISDICTION, U.S.A.,
Washington, D.C., March 13, 1962.

Hon. HARRY F. BYRD,
U.S. Senate, Washington, D.C.

MY DEAR SENATOR BYRD: I have just been reading in the papers about the President's program to require the withholding of dividends and interest by the various corporations. It seems to me that this would cast an unnecessarily heavy burden upon all institutions such as ours. Our Supreme Council and also our Scottish Rite foundations, as well as our subordinate bodies, hold securities bearing interest and/or paying dividends, and, as I understand it, the proposed law would impose upon all these organizations the labor and bookkeeping involved in making proof that we are entitled to these dividends as exempt from taxation. Of course I am personally opposed to the whole idea of the withholding of dividend and interest from the taxpayers, but in the case of funds and other organizations that are exempt from the payment of income tax, it seems to me that if the law is going to be passed, a special provision should be inserted exempting such institutions as ours from the unnecessary labor and expense involved in making proof of the fact that such dividends and interest due to our institutions are exempt.

I am sure that I speak for a large number of institutions situated as ours is, in urging your favorable consideration of the ideas herein expressed.

With all good wishes,

Sincerely,

LUTHER A. SMITH,
Sovereign Grand Commander.

FIRST PARISH CHURCH IN DORCHESTER.
Dorchester, Mass., March 16, 1962.

Senator HARRY F. BYRD,
Washington, D.C.

MY DEAR SENATOR BYRD: I am not a Virginian, but you and Senators Dirksen and Saltonstall being some of the more conservative and able Members of the Senate, I should like to point out several faults anent Mr. Kennedy's proposed 20 percent withholding tax on all income.

First, the administration announces that they expect to get $2 to $3 million in presently evaded taxes. Doubtless there are some, but by the time the expenses of the additional collecting facilities are set up, plus the expenses to the many companies, banks, etc., I believe it would boil down to two to three hundred thousand dollars. I have previously written to Senator Saltonstall and to Speaker John McCormack on this subject and pointed out that the Government requires reports on all company dividends of $10 and over, and that most probably the fellow that gets less than $10 has little to tax at any time.

Secondly, how will this proposition affect the several million elderly folk that depend on their small dividends for at least part of their living expenses, also the various tax-free institutions who would be hit very hard in the first year? My own church (the First Parish Church in Dorchester, 1630) would have some $3,000 withheld, completely upsetting the budget. These things apparently mean little to Mr. Kennedy.

Third, and finally, I have been studying the Constitution of these United States and would call attention to the amendments (Bill of Rights), article IV and V. Article IV says: "The right of the pepole to be secure in their persons, houses, papers, and effects, against unreasonable searchers and seizures shall not be violated, and no warrants, etc." Certainly one's money is an effect. Again article V at its end says "nor shall private property be taken for public use, without just compensation." I have had a refund on my tax each year since

1958 since retiring and have yet to see the "just compensation"; so has everyone else. I would judge that on this account alone, the gentlemen that set this up could all be considered for possible impeachment, as the Bill of Rights cannot be changed.

Some of our legal lights may say on article V that it means your house or land rather than money, but serving on jury here, Judge Fosdick who was one of our most able judges (now deceased) stated explicitly that it did not matter as to what was meant, but strictly what was said.

Before closing I might suggest—Why not have the banks and various companies declare all interest paid out and to whom. It might burden the Internal Revenue Service somewhat in comparing returns, but would not deprive so many other folk and would also show up those who tried to evade taxes.

I believe this letter states the matter concisely, and there should be much thought on this proposal before passing it.

Most sincerely,

FRANK GEROERER
(For the Financial Advisory Committee).

CAMDEN, N.J., *March 19, 1962.*

To Hon. Harry F. Byrd.
Hon. Clifford P. Case.
Hon. Harrison A. Williams.
Hon. William T. Cahill.

I see from newspaper and magazine reports that Congress has underway proceedings to extend to dividends, interest, etc., the advance withholding of income taxes thereon.

From what I read, it seems to me that certain aspects of the proposed law penalize the honest taxpayer.

First of all, suppose a taxpayer has 10 building and loan shares maturing in January or February of a particular year. These shares usually mature in the amount of $200 each, so the taxpayer ordinarily would be entitled to receive from the building and loan association the sum of $2,000. After paying monthly installments into the association for approximately 12 years, the taxpayer's profit would be approximately $560. Instead of paying the entire $2,000 to the taxpayer, the association would withhold $112 thereof, or 20 percent, and remit the balance to the taxpayer. Ordinarily, the taxpayer would not be obliged to pay his income tax to the Government until April 15 of the following year, or approximately 15 months later. The taxpayer in the meantime could have invested his $112 and without any trouble at all obtained 4 percent interest on his money, or approximately $5.60, during the 15 months' period. In other words, he is not only deprived in advance of his 20 percent, but he is also deprived of the additional $5.60 which his money would have earned had it not been seized by the Government in advance of the income tax payment date.

The same principle applies to interest credited by financial institutions and dividends paid by corporations.

What I have said above, of course, applies to a taxpayer who will have to pay an income tax.

I am aware that some procedure is to be instituted whereby young people of 18 years and under and persons who expect to pay no income tax may secure some sort of a continuing exemption, whereby the 20 percent will not be deducted from interest due to them.

However, I also understand that there is no such provision with respect to dividends, but that persons who expect to pay no income tax may apply four times a year for a refund of the 20 percent deducted from their dividends. It seems to me that this is an undue burden on such individuals, where they will be obliged to file applications four times a year ad infinitum for the payment to them of their own money. I do not see why the same provision with respect to a continuing exemption cannot be made with respect to corporate dividends as is to be provided with respect to interest payments.

I know some elderly people who do not have to pay income taxes and who are living off social security and a few small dividend checks. Having 20 percent of their dividends withheld, if even for a 3 or 4 months' period, will work a definite hardship on them.

With respect to the taxpayer who is obliged to pay an income tax, I would also point out that the fact that his own money is being withheld for up to a 15 months' period before he would ordinarily have to pay it over to the Government

is in a sense triple taxation so far as corporate dividends are concerned. The corporation pays income taxes on its earnings before dividends are paid over to the taxpayer, then the taxpayer's dividends are taxed, and finally the taxpayer is subject to a third tax because he loses the interest on his own money between the time when it is seized by the Government until April 15th of the following year when he ordinarily would be obliged to pay his income tax.

This, I feel, is unfair to the great mass of honest taxpayers.

I see that the House Ways and Means Committee has approved this law, and it seems to me that some provision should be added which would permit the taxpayer to get a credit of say 4 percent on the amount which has been withheld from his interest and dividend payments, in order to offset the loss to him in the interest which his money would have earned up until income tax-paying time.

Respectfully yours,

THOMAS F. SALTER.

PRITCHARD PAINT & GLASS CO.,
Charlotte, N.C., March 21, 1962.

Hon. HARRY F. BYRD,
Senate Office Building,
Washington, D.C.

DEAR SENATOR BYRD: I am writing to express the hope that you will vigorously oppose bill H.R. 10650, in the national interest. One of the most objectionable effects of the program is the requirement that 20 percent of dividends and interest income be withheld and turned over to the Government. The withholding of interest and investment income would deprive individuals of the full use of their funds, and would constitute an arbitrary and unjustified frustration of the thrift objective. This bill proposes to impose unwise tax restriction upon industry and unnecessary complicated bookkeeping requirements upon individuals.

I am sure that if the millions of persons that would be affected by the requirements of this bill, if enacted, were aware of the enormous complicated recordkeeping involved there would be a tidal wave of protest.

Please devote the time that it would take to answer this letter to vigorously opposing the enactment of this legislation.

Respectfully yours,

T. W. PRITCHARD.

HAGAN CHEMICALS & CONTROLS, INC.,
Pittsburgh, Pa., March 20, 1962.

Re proposed tax legislation, H.R. 10650.

Hon. HARRY FLOOD BYRD,
Chairman, Senate Finance Committee,
Washington, D.C.

DEAR SIR: Our company and its several thousand employees, as well as its retired employees, urge you to most strenuously oppose the pending tax revision bill which we understand will shortly be presented to the House of Representatives.

While we oppose such piecemeal legislation in principle, our objections are directed chiefly to the following:

1. Withholding tax on dividends and interest.
2. Immediate taxation of foreign profits.

Withholding tax.—The purpose of this step has been designated as a "loophole closer" to catch those who deliberately or negligently fail to report dividends and/or interest received. Added revenues are estimated by Treasury to be "in the billions."

It is well known that virtually all dividend paying agents report their dividends to the Treasury Department on Treasury form 1099, except where dividends are less than $10 per year. With the new IRS computer operations going into service, the so-called loophole which now exists will be closed anyhow. Furthermore, the anticipated revenue gain by withholding from dividends has been grossly inflated by Treasury and the tremendous expense and hardship created will far outweigh the benefits.

Most preposterous of all, and really the cruelest of all, is withholding from dividends and interest paid to pension or other welfare fund trustees. In every case, refunds will be sought and paid but not before a lapse of months which

will deprive the funds of earnings on that portion withheld. We understand that one large insurance company alone estimates the loss of over $2 million earnings per year due to idle money withheld and in process of being refunded. Obviously, this will affect every retirement plan and will deprive millions of employees of full earnings from their portion of every employee welfare fund in the Nation. It follows that insurance companies will raise their rates or lower their dividend payments to policyholders to compensate for this loss.

Additionally, there are literally hundreds of thousands of persons who are completely unfamiliar with requests for tax refunds and will lose what may be due them.

Taxation of foreign profits.—This proposal stems from the politically attractive slogan of "Don't Export Jobs Abroad," which seems to have appeal to large voting groups. Yet the same Government which is encouraging tariff reductions and eventual participation in the EEC has been urging American business to expand overseas and compete with foreign companies on their own ground. Having done this, our Government now proposes to tax our foreign operations at the U.S. rate of 52 percent, when most smaller American companies such as ours have been operating at only a marginal oversea profit and are plowing what little profit we get right back into our oversea business. Taxation of profits at 52 percent will definitely cause many firms to close down their foreign operations.

Certainly, as Mr. Henry J. Taylor recently reported in his column, there are a few who are taking advantage of the present tax laws to conduct worldwide operations from a foreign-based office primarily to avoid the high U.S. tax rate. While this operation is entirely within the present law, Mr. Taylor and others seeking to influence public and congressional opinion seem to be proposing that you root out a few questionable cases even though a thousand bona fide oversea subsidiaries of U.S. companies will have to suffer. Such reasoning, in our opinion, is completely illogical, could be ruinous to our growth, and should not be followed.

We sincerely urge you to vote against the proposed tax bill and urge you to consider only a true tax reform bill. The hour is growing terribly late to start working on this much needed legislation.

Very truly yours,

JAMES K. EVERHART, Jr., *Secretary.*

DIGIORGIO FRUIT CORP.,
San Francisco, Calif., March 20, 1962.

SENATE FINANCE COMMITTEE,
Washington, D.C.
(Attention: Mrs. Elizabeth B. Springer).

GENTLEMEN: I have reviewed the proposed dividend withholding provisions of the revenue bill recommended by the Ways and Means Committee to that body.

Since this is now being considered by the Senate Finance Committee and will eventually be considered by the entire Senate, I would like to make the following comments.

I do not believe that the withholding provisions will be necessary to avoid tax losses in view of the fact that the Bureau of Internal Revenue will be requiring detailed information reports on such dividend payments. This is paticularly true in view of the fact that such reports will be keyed to all taxpayers in a highly efficient manner under the new data processing system of the Bureau.

Granting however, that such a system of withholding is imposed, I would like to further comment on the exemption provisions provided under that system. Under the proposed House bill, it is provided that individuals under 18 may file exemption certificates with dividend paying agents. It further provides that these must be filed once a year. The necessity of processing and accounting for exemptions will impose an intolerable burden on the payment of dividends in view of the constantly fluctuating list of stockholders who would be entitled to such dividends and such exemptions. In addition, such exemptions would provide a device under which a considerable amount of tax avoidance would be generated. Doubtlessly, many people seeking to avoid the withholding tax would transfer their stock to minors under the age of 18.

For these reasons I respectfully recommend that the Senate, in considering this bill, eliminate these exemption provisions.

Thanking you for your consideration of these points.

Sincerely,

N. P. ADLER, *Secretary.*

THE ABE MEYER CORP.,
Shreveport, La., March 21, 1962.

SENATE FINANCE COMMITTEE
Washington, D.C.
(Attention: Mrs. Elizabeth B. Springer, clerk).

GENTLEMEN: With regard to the revenue bill of 1962 (H.R. 10650) there are many objections to the 20-percent withholding tax on interest and dividends, from the view point of a small close-held corporation such as ours.

The purpose of this measure is to "close the door on tax avoidance" by dividend recipients. In our case each year the appropriate form is submitted to the Internal Revenue division, showing the exact amount of dividends each owner has received, and a cross check is readily available against the corporation's tax return. There are four principal stockholders, and one small block of stock in a trust. All of the stockholders have different deductions, and different amounts of non-Abe Meyer Corp. derived income. Our operations are of such a nature that a reasonable quarterly dividend is paid, with a year-end dividend based on the year's operations.

Requiring payment by the corporation of a 20-percent tax to the credit of the owners at once creates an inequity situation in that one owner may be in a 20-percent tax bracket, another in a higher, and another in a lower. In the case of the recipient of the proceeds from the trust, a specially serious situation arises, in that she is in the lowest tax bracket, the number of shares placed in trust were designed to furnish a specific flow of income, and although the bill provides for claims for relief, the cost of processing same will add to the administrative cost.

This particular measure hits especially hard at a close-held family corporation such as this, which, because of a peculiarity in the current tax laws, we cannot avail ourselves of the option to elect to be treated for Federal income tax purposes as a partnership in view of an inconsistency in the law, which we have called to the House Ways and Means Committee's attention. The chairman, Mr. Mills, in reply to our letter of January 8, 1962, recognized the existence of this situation, but indicated that due to the press of getting the present proposed law through, little could be done on this. He further indicated the situation was the result of the action of the Senate in amending the bill as initiated.

In essence, the problem is the situation wherein under one portion of the Internal Revenue Code a real estate operating company deriving the majority of its income from rents is not a "personal holding company"; but in a later enacted portion such a corporation is considered in the same category as a "personal holding company" and is thereby denied the privilege of being treated for Federal income tax purposes as a partnership.

More specifically, section 543(a)(7) provides that if over 50 percent of a corporation's income derives from rent, such income is not personal holding company income. On the other hand, the later provision of section 1372(e)(4) prohibits a corporation having over 20 percent of its income from rents from the partnership election.

Of special concern in this is the fact that the referenced section 543 includes "rents, interest, dividends, annuities, and gains from sales and exchanges" as personal holding company income (unless rents exceed 50 percent), but section 1372 makes all these fall into personal holding company status.

A contradiction thus exists. On the one hand a corporation owning real estate and in the business of offering it for occupancy and obtaining income thereby is not a personal holding company. Under another provision of the same law, that company is denied access to a proviso available to others, by being classed as a personal holding company. A corporation is a legal entity, and it should not be forced into a split personality. Either it is the one or the other.

Possibly this situation has arisen, as we pointed out to Mr. Mills, and he tacitly agreed, as an unintended situation, rather than the singling out of a particular class of taxpayer for special penalties against action available to others.

At any event, the requirement that we pay a 20 percent tax on each dividend in addition to our 52 percent corporate tax, places us in the position of paying on our owners' account a 72 percent tax on our net earnings..

We respectfully request that the Senate Finance Committee carefully consider the impact of the 20 percent dividend withholding tax on small close-held corporations whose gross income is less than $250,000 (ours is considerably less). We further urge that action be taken to bring section 1372 in consonance with section 543, and thereby provide for consistent and equitable treatment.

Sincerely yours,

ALVIN F. MEYER, Jr., *Vice President.*

TACOMA, WASH., *March 10, 1962.*

HON. WARREN G. MAGNUSON,
U.S. Senate,
Washington, D.C.

DEAR WARREN: A great number of people are concerned over proposed legislation which will involve the withholding of an estimated amount of tax on all dividends. While the avowed purpose behind the law, namely to assure collection of taxes from all receivers of dividends who should pay taxes, is perfectly proper, I would like to respectfully submit that this is not the way to do it, and that the Government today has within its power the means of making such collections.

To elaborate on the foregoing, you will recall that presently all dividend paying organizations are required to furnish the Government annually with form No. 1099. This is an individual and separate form setting forth the amount of dividends paid to each shareholder during the year. It is my understanding that these forms, which contain the name and address of the shareholder are, when received, distributed by the Government people to the particular Internal Revenue District where the shareholder's check is mailed to him, i.e., his registered address, and that the form is then used locally to verify the dividends reported by the individual shareholder in his return.

Under current regulations, corporations and other business enterprises are required to file this form for all dividend payments of $10 or more, with the following exceptions:

1. Only dividends in excess of $100 need be reported in the case of national farm loan associations, production credit associations, certain benevolent life insurance associations, certain mutual insurance companies, or associations other than life or marine, and farmers' cooperatives.
2. Only dividends in excess of $600 need be reported in the case of savings and loan associations, cooperative banks, homestead associations, credit unions, and building and loan associations.

The preparation of these forms is now entirely a routine procedure and it would not, in my judgment, add materially to the burden of business if it were required to furnish these forms with respect to all dividends paid. This would provide a simple and practical answer to the problem that the Government is trying to solve, although it would tend to increase somewhat the amount of paperwork handled by the Internal Revenue Service. The additional tax collected, based on administration estimates, would still make this a very productive undertaking.

I understand that the Internal Revenue Service now has the authority to require the additional information returns in most cases. Where it does not have this authority, it would be a simple matter for Congress to provide it.

If, on the other hand, the suggested administration program is followed, corporations and other business organizations would be compelled to collect, account for, and remit all of these withheld sums. This would require additional staffing in many cases and would substantially increase costs of operation without any offsetting advantages whatsoever. In my judgment this involves the placing of an added and unnecessary burden on business and is grossly unfair.

In addition to the foregoing, there are other elements of injustice involved. Many dividend checks are received by taxpayers who, by virtue of their own personal situations, either will owe a lesser amount of tax than will be withheld, or, in a good many cases, will not owe any tax at all. These are the smaller taxpayers and retired people, and they will be put to the added burden of preparing and filing claims for refunds in order to recover taxes collected which they did not owe. In the majority of these cases the amounts will be extremely small, but the effort will still be the same. Furthermore, the Internal Revenue Service will have to process each such claim and thus will be put to considerable added costs.

In addition, the early collection of these funds will be giving the Federal Government the earlier free use of huge sums of money to the detriment of the taxpayers. There is a real question as to the propriety of this.

May I respectfully request that you call this problem to the attention of your colleagues and urge that, if steps are to be taken the simpler process suggested above of requiring form No. 1099 in every case be adopted in lieu of the proposed withholding arrangement.

Very truly yours,

NORTON CLAPP.

NEW YORK, N.Y., *March 26, 1962.*

HON. HARRY F. BYRD,
Chairman, Senate Finance Committee,
U.S. Senate, Washington, D.C.

DEAR SENATOR BYRD: I have recently written to Congressman Mills regarding the proposed withholding tax on interest and dividends as set forth in section 19 of the revenue bill of 1962, which was reported to the House of Representatives on March 12. This matter has recently been given a lot of publicity and the New York Times printed a lengthy article today.

Section 19 of the bill provides for quick refunds of withholding tax in cases of married couples with less than $10,000 gross income and single individuals with less than $5,00 of gross income. Apparently the only people who will fall in this category are salaried people and wage earners. In most cases, businessmen will not come within these income groups since they are unable to anticipate profits and losses at the beginning of a tax year. Many people who incur substantial interest expense which offsets dividend income will be unable to obtain quick tax refunds. This will affect most of the people who own securities in margin accounts. Nor will the benefits of quick refunds be available to people with low net incomes where the gross income, in the case of married couples, is $10,000 or more, and $5,000 or more in the case of single persons. As you know, income tax is levied upon taxable income and gross income can be drastically reduced by deductions for interest, taxes, medical expenses, and casualty losses as well as personal exemptions.

I respectfully recommend that the Senate Finance Committee consider changing section 19 of the House bill to provide for quick refunds in cases where taxable income is below $10,000 in the case of married people and $5,000 in the case of single individuals. This provision will not discriminate against business and investment people in favor of labor and will help to expand the economy of the country by making more capital available for investment. I realize the purpose of the bill is to increase revenue, but I see no reason why taxes should be withheld during the year only to be refunded when the tax returns are filed.

Respectfully yours,

MILTON M. BERNARD.

THE FRANKLIN SAVINGS BANK,
New York, N.Y., March 26, 1962.

HON. HARRY F. BYRD,
Chairman, Senate Finance Committee,
Washington, D.C.

DEAR SENATOR BYRD: It is my understanding that the Senate Finance Committee will shortly commence hearings on the omnibus taxation bill which is about to be reported out of the Ways and Means Committee of the House of Representatives.

One of the proposals is, as you know, the requirement of a 20 percent withholding of interest-dividends on all savings accounts. It is my sincere hope that this proposed form of withholding will not become law. The following are a few of my reasons for opposing this proposal:

The annual filing of several exemption certificates by millions of people is a staggering burden for all concerned. Neither the Revenue Service nor the payees will be able to keep the necessary records. What is more, auditing by the Revenue Service will be next to impossible. Abuse of the exemption certificate provision may also greatly diminish revenue.

This bank has been wholeheartedly participating in the Treasury's taxpayer education program which, the record shows, has already resulted in improved reporting of interest. What is more, taxpayer account numbering with electronic data processing is the real solution to the problem of underreporting. The Commissioner of Internal Revenue has recently stated that the new data processing equipment will enable the Service "to determine the tax status of any taxpayer at any time" and that with this equipment, the Service will "systematically and rapidly uncover who has failed to file returns and who owes taxes for previous years." Certainly this new equipment should at least be tried before so drastic a technique as withholding is attempted.

Withholding on income from investments was once adopted in Canada but later abandoned as administratively impractical.

The impact of withholding on savings bank interest will fall on capital formation since it will collect the tax from savings rather than from current funds. The effect will be most severely felt in areas where capital is needed, such as housing.

There will be substantial shifts of savings from savings institutions to savings bonds where liability for tax can be postponed almost indefinitely. This bank has already experienced withdrawals for this purpose. Also, the public will be prone to shifting from savings into tax-exempt municipal securities.

Many depositors of modest means have already expressed fear regarding the proposed withholding and, our own experience to date has indicated that depositors will hoard cash rather than submit to withholding and, of course, nothing could be more harmful to our economic system.

Sincerely yours,

STUART A. LYMAN, *President.*

HARTFORD HOSPITAL,
Hartford, Conn., March 26, 1962.

Senator HARRY F. BYRD,
Senate Office Building, Washington, D.C.

DEAR SENATOR BYRD: I understand from the newspapers that the Ways and Means Committee has voted out a change in the tax laws which provides for withholding at the source on dividends and interest. I am at a loss to understand why we further complicate our tax structure and place a hardship on retired people, hospitals, universities, and other charitable institutions. I am particularly at a loss to understand this when it is also reported that the Government is allegedly, through electronic computers, prepared or nearly prepared to verify whether adequate reporting has been made by the individual on dividends and interest.

It seems to me it is going to cost individual corporations and the public as a whole more than the $600 million which is claimed now is lost because of inadequate reporting. In the case of the individual who is living on dividends and interest in retirement, as I understand the proposed law, they may have to wait as much as 3 months to get their money and due to their own business knowledge may have to hire accountants to make out the reports in order to get a refund.

In the case of hospitals, universities, and other charitable institutions this act can prove very costly in withholding operating cash which in some cases means the institution will have to borrow money while waiting to get a refund and others will be unable to invest their endowment income in short term Treasury notes and bills because it has been withheld by the Government. This can also apply to those who are retired and are depending on their dividends to live.

I urge that you vote against this proposed change.

Sincerely yours,

ASA R. CRAWFORD.

Please let those of us who have tried to be thrifty; have used our money by investing in capital of American industry, have our full dividends when due.

CENTRAL SAVINGS BANK,
New York, March 27, 1961.

Hon. HARRY F. BYRD,
Chairman, Senate Finance Committee,
Washington, D.C.

DEAR SENATOR BYRD: Before your committee votes on the 20-percent interest/dividend withholding bill, we implore you to consider the effect it will have on many business firms and banks in particular.

If the proposed bill passes in its present form, providing for annual filing of exemption certificates by millions of people, it will be an abomination to put into effect, and an almost impossible procedure to carry out.

This bill does not actually provide for any additional taxes, but merely for a very expensive method of collecting taxes, that will become totally obsolete and unnecessary in a very short time, when the planned improvements in the reporting of interest/dividends are made. Surely easier and simpler methods of tax collection and enforcement can be worked out.

The present bill, for example, does not specifically require that the amount withheld be reported to the taxpayer, but that is not very practical in actual operation, because most taxpayers will want to know and would ask for the information—and who will have to provide it? We would have to do so as a matter of good public relations.

The additional burden imposed by the provisions of this bill cannot be accurately weighed, but it will be unquestionably much greater than the cost of tax withholding on wages and salaries, because of the complexities of the problem of interest/dividend withholding, and the number of people involved—many of whom are not taxable in the first place, but would be required to apply for refunds—adding more work on all concerned, including the Government agencies and themselves.

As conscientious and capable legislators, all we ask your committee to do is to get all the facts regarding the ultimate effects of this self defeating bill before you put your stamp of approval on it.

Millions of small savings bank depositors will be hoping your committee is on their side on this legislation. We hope so too.

Sincerely yours,

LEE J. MARINO.

BIRMINGTON, ALA., *March 28, 1962.*

Hon. HARRY F. BYRD,
U.S. Senate, Washington, D.C.

DEAR SENATOR: The Congress now has before it a bill which would require corporations to withhold and pay over to the U.S. Treasury 20 percent of all dividends payable to individual stockholders. I wish to register my disapproval of this proposed legislation for the following reasons:

1. The cost to the corporations is a business expense, and for some it will be a large one. This expense is deductible from the income tax paid by the corporation, thereby reducing the net received by the Government.

2. Many stockholders will be due refunds, having deductions which will offset the 20 percent of dividends withheld. These people will be deprived of the use of their money until a refund can be made by the Internal Revenue Service. It has been the experience of many of us that, although we must pay our taxes on or before the date due or else suffer penalties, the IRS gets refunds out to taxpayers at its own convenience.

3. By the paying over to the Treasury of dividends that ordinarily would have gone to the taxpayer, the taxpayer is caused to suffer a loss regardless of whether he later has to pay the amount to the IRS in taxes. For example, if I am to receive $100 in January I have the use of this $100 until the following year when I file my tax return. If that same $100 is paid to the Treasury, then it receives the use of my money. This is obviously unfair.

4. We have read much in the papers lately about the new system being set up by the IRS for collecting taxes. We all have our numbers. The dividends paid to us are reported to the IRS. They now have computers which can check the returns to see if we reported on our returns the same amount which the corporations paid us. Is this expensive new system so faulty or worthless that its failure is to be acknowledged before its first year of operation?

We all know that taxes are necessary. We might disagree that the purposes for which our confiscated income is spent are all good purposes. But it does seem unfair for the Government to deprive the taxpayers of even the chance to make a little income off their money before it has to be remitted. I would suggest that you, as a Senator, might well be taking a hard look at some of the places our money is being spent. After all, though it may be unfashionable in the ranks of the present administration to say it, there are two ways of relieving pressure on the budget. One way is to squeeze the taxpayer. The other is to cut expenditures, which, no matter how desirable, can be deferred or cut out entirely.

It is appalling to consider the rate at which we are spending our grandchildren's income and birthright.

Sincerely yours,

JOSEPH W. SIMPSON.

THE GREENBURGH SAVINGS BANK,
Dobbs Ferry, N.Y., March 27, 1962.

Senator HARRY F. BYRD,
Chairman, Senate Finance Committee,
Washington, D.C.

DEAR SENATOR BYRD: On behalf of our depositors and the bank, I very strongly urge that you oppose the pending legislation to withhold taxes on dividends and interest.

From the view of our depositors, the annual filing of exemption certificates and the calculation of taxes or refunds will involve a tremendous burden for all concerned. The majority of our depositors are not sophisticated in tax and accounting procedures. The resulting errors from the proposed method of reporting and calculating tax liability will inevitably result in hardships and inequities among the taxpayers.

From the view of our bank, a $9 million institution, the resulting workload will be staggering. We now operate with a staff of four clerks and two officers, all of which are working at their maximum workload. The withholding proposal will increase work beyond the ability of our staff to handle it and increase our labor costs a minimum of 12½ percent.

We feel that this is an unjust burden to the bank and ultimately to our depositors, for we, as are most savings banks, are a mutual institution with all profits accruing to the depositors, thus this cost must be distributed to the depositors.

The passage of the withholding act will put a multiple burden on the depositors, that of filing exemptions, claims, calculating tax and rebates, and in addition, paying the costs of clerical detail at the bank and ultimately at the Internal Revenue Department which too will be heavily burdened with additional detail.

In addition, the measure will have wide economic repercussions. We have already observed transfer of funds into other channels by depositors in anticipation of the tax. We most certainly will see much more, all of which must come out of funds usually available for mortgages. The passage of the measure most certainly will result in wide curtailment of mortgage lending, affecting the homebuilding industry and the resale market for homes.

We are very happy to share an equitable portion of the national burden and have participated extensively at our own cost in the program of educating depositors in the reporting of dividends on their tax returns. We do not feel that the heavy burden of withholding is fair to either the payer or payee of dividends and interest.

We count heavily upon your good judgment and hope the majority of the Senate will see as we do.

Sincerely,

ROLAND E. BURGESS.

WEST ACTON, MASS., *March 28, 1962.*

Senator HARRY F. BYRD,
Washington, D.C.

DEAR HONORABLE SIR: As you are the chairman of the Senate Finance Committee, I am writing to ask that you will do what you can to kill the withholding of interest and dividend tax bill as I know you will.

I am 78 years old and my wife is 80. I retired 12 years ago with a company pension of $1,440 and social security income of $1,710.

After raising four girls I have been able to accumulate enough to return me about $1,000 a year in dividends. Including wife's blindness I have exemptions enough in excess of my total income and therefore have paid no income tax for the last few years.

If this proposed law goes through I will not only be deprived of needed income, but will lose the use of income which is mine, and does not belong to the Government, but also loss of interest on the sum withheld of my money and not the Government's. If the Government wants to make crooks of us all they are going about it the right way.

Yours truly,

HENRY F. LAWRENCE.

STATE STREET BANK & TRUST CO.,
Boston, Mass., March 30, 1962.

Senator HARRY F. BYRD,
Chairman, Senate Finance Committee,
Washington, D.C.

DEAR SENATOR BYRD: Now that President Kennedy's tax bill has reached your committee, I would like to bring to your attention my feelings as a banker, as an investor, and as a participant in many civic affairs on the 20-percent withholding tax:

The investor

(1) The low-bracket owner of a few shares of American Telephone & Telegraph, mutual funds, etc. would be penalized. The majority of these would not know where or how to collect his refund. If he hired someone to do it for him, it would cost more than the tax involved, so he will probably curse the Government but do nothing. For these individuals the tax becomes confiscatory. Also, for these persons, charities, and other nontaxable investors they will be deprived of a portion of their income for many months.

(2) Hundreds of thousands of investors both through misunderstanding, ignorance, or desire to cheat in brackets higher than 20 percent will decide they have paid their just due on this portion of income and leave it out of their final returns.

Banks and other transfer agents

(1) A tremendous clerical burden to collect, control, and turn over the tax funds to the Treasury Department. Banks cannot absorb this cost, so it will be passed on to the corporations who, in turn, will make up for it through higher prices for his product—the consumer always pays in the long run.

(2) For many years dividend disbursing agents have been supplying the necessary information to the Government on dividends and interest paid so that the Treasury might cross-check against returns. Apparently, these have either been scrapped or used to fill newly built warehouses. Despite this, I understand these reports are to be continued.

(3) Aside from transfer agents currently on a computer operation neither the equipment nor the clerical force is available to do the job. Despite the large percentage of unemployed, a critical shortage exists in the area of clerical workers.

Banks, brokers, etc., using nominees

(1) With the multiplicity of transfers today, it is a near impossible task to settle dividend payments. This task will become impossible if it must also be determined from which shares a tax was withheld and from which they were not.

Professional tax advisers

(1) Preparation of final returns, estimates, etc. will involve additional time and effort. An individual's tax liability would consist of three parts: withholding tax on earned income, withholding on dividends and interest, and an estimate of income from other sources. Again, we are in another area of labor shortage.

For the above and many other reasons, I urge you and your committee to defeat this portion of the tax program.

Sincerely yours,

JOHN A. PERKINS, *Trust Officer.*

BROADWAY ASSOCIATION, INC.,
New York, N.Y., March 30, 1962.

Re revision of income tax laws.

Hon. HARRY FLOOD BYRD,
Chairman, Senate Finance Committee,
Senate Office Building,
Washington, D.C.

DEAR MR. CHAIRMAN: The administration bill to amend the income tax laws, which the House of Representatives recently approved, will soon be considered by the Senate Finance Committee. The Broadway Association believes two of its sections to be unjust, unrealistic and overly troublesome.

The provision to withhold income taxes on the interest paid on savings accounts and corporate dividends will cause a tremendous amount of unnecessary clerical

work and correspondence by savings institutions, banks, corporations, the Internal Revenue Service, taxpayers and persons who are not taxable, but whose money has been unjustly impounded. In New York State the average tax retention on savings will amount to $4.40 per quarter, per account. The vast majority, greater than 50 percent of these accounts would produce less than the average mentioned above and refunds would have to be made in many, many instances. Every financial institution now files IRS form 1099 which is a listing of each savings account being credited with interest amounting to $600 or more per year. Instead of producing additional tax revenue this withholding provision could very well result in a loss due to the additional costs of collection and refunding.

Dividend withholding, while not identical, is reasonably parallel to the savings interest situation. One big difference however is the fact that all corporations must report to the IRS the amount paid to each stockholder, together with the name of the recipient.

The other unjust section is the one which would tax as ordinary income the profit from the sale of real estate, the amount of depreciation that has been taken, applying the capital gains tax only to the remainder. Adoption of this proposal could and probably will cause heavy selling of depreciated properties prior to the effective date. After the effective date the reverse would be true, as owners would hold to avoid paying the high rate on ordinary income. Both conditions would be harmful to real estate financing and the replacement of old buildings. The Treasury Department's premise that a building sold for more than its book value did not depreciate is a false one. Time depreciates all material things and in the case of buildings the only real difference is caused by depreciation.

The Directors of the Broadway Association strongly urge the members of the Senate Finance Committee to drop these two sections from the tax bill approved by the House of Representatives.

Very truly yours,

GODFREY A. STAMM,
Managing Director.

THE BOWERY SAVINGS BANK,
New York, N.Y., March 29, 1962.

Hon. HARRY F. BYRD,
Chairman, Senate Finance Committee,
Washington, D.C.

DEAR SENATOR BYRD: Observing your public career prompts me to appeal to the strong sense of fairness and practicability, which you have shown in your past efforts in behalf of the public interest, when you consider your position on the proposed legislation for withholding taxes on interest and dividends.

Many individuals, who have no tax liabilities, particularly older people and widows, will have another burden added to their hardships, the filing of exemption certificates. If studies of our depositors are representative, and I believe they are, almost 40 percent of savers will be harassed by the changed tax processes.

Further, in this one institution of savings, approximately 200,000 exemption certificates will have to be processed annually. The cost of such processing plus the harassment of individuals will, in my opinion, seriously handicap our ability to encourage thrift, so urgently needed for housing and economic growth, now and in the foreseeable future.

From a practical viewpoint, there are three points which suggest at the very least a further delay before acting favorably on the proposed withholding legislation. First, Canada tried it and abandoned it as impractical. Secondly, all citizens were assured by a public announcement of Commissioner of Internal Revenue that the installation of costly data processing equipment will greatly aid in the enforcement of tax laws and the collection of unreported taxes. Last, the taxpayer identification number and education program, in which we have been participating and will continue to participate wholeheartedly, has improved the reporting of interest and dividends.

In the light of Canada's experience and the excellent tax collection improvement processes already successfully in motion, there is no justification for imposing further hardships on so many people, particularly those least able to bear them. Therefore, I urge you to oppose the withholding legislation.

Very truly yours,

E. B. SCHWULST.

RICHARDSON-MERRELL, INC.,
New York, N.Y., March 23, 1962.

Hon. JOHN SHERMAN COOPER,
U.S. Senate, Washington, D.C.

DEAR SENATOR: Thank you very much for your letter of March 19 and the enclosed information about the tax revision bill which will be very helpful to me in understanding this extremely complex piece of legislation.

Although I have been working on some aspects of the bill I have not paid as much attention to the withholding proposal as some of the other provisions because that is not of such crucial importance to us. However, I am generally familiar with the arguments on both sides, and wish to be of some help to you on the questions you raised, if I can.

You suggest it might be beneficial to the business community, and the individual investor, if the withholding provision on dividends and interest were to be applicable on an annual basis. No doubt it would be helpful in some cases—particularly in the case of the smaller or medium-size withholding agents—if they could handle the matter only once a year instead of periodically during the year. However, in talking to some of the people who will be concerned with this on a very large volume basis which will be handled by automation, they feel that the clerical work would be simpler if it were done periodically instead of accumulating the information on an annual basis. It is on a periodic basis, for example, that the large dividend-paying agents now prepare information returns because these are turned out automatically by the processing machines when the payments are made.

It probably would not be feasible to have the actual withholding made at the end of the year instead of periodically. For example, if I receive three General Motors dividends during the year without any withholding and then sell the shares, GM could not very well withhold the tax from the fourth dividend. It would seem necessary, therefore, for the actual withholding to take place at the time the income payment is made by the withholding agent. If the payment of the withheld tax to the Government were to be made only once a year, instead of quarterly, the withheld tax funds would not be available during the year to the recipient of the income but instead would be available to the withholding agent. This would be somewhat of a windfall to the withholding agent which is not now enjoyed and would, of course, be beneficial to the agent who would have these funds to invest until they were paid over to the IRS. However, I think it would be very difficult to convince the Treasury Department that this deferral of remittance of the withheld funds should be allowed. Under the present pay-as-you-go system requiring the filing of estimated returns and payment of estimated tax during the year the income is earned, the Treasury Department now has these tax funds (to the extent dividends and interest are honestly reported) during the year and therefore deferral of remittance by the withholding agent would delay the receipt of these taxes by the Treasury Department—a delay which it seems would be hard to justify.

If withholding is to be required and some exemptions are to be allowed, such as for aged or young people, I suggest you might consider whether it would be practicable to also exempt payments to corporations. The present provisions regarding the filing of information returns exempt payments to corporations and it would seem similarly justifiable to exempt payments to corporations from the withholding tax. Corporations generally keep accurate records upon which basis tax returns are filed; their returns are generally audited by competent Internal Revenue agents and there would seem to be little or no opportunity for dividends and income to be omitted from their tax returns. The exemption from withholding would mean that they could continue to enjoy the use of the full income from interest and dividends until the regular date for payment of the tax thereon to the Internal Revenue Service.

I would like to add a few general remarks about the withholding and other provisions of the bill. It does seem to me there is a pattern in the proposals of the bill which deserves careful scrutiny. In effect, the Treasury Department has said to the Congress that "we are having various audit problems and we need a new law to overcome them; we are having audit problems in the field of business expenses and we need a law to avoid the chargeoff of personal expenses in the guise of business expenses; we are having trouble auditing foreign operations and we need a law to prevent tax avoidance in this field; we are having trouble auditing dividends and interest and we need a law to prevent the avoidance of taxes in this area."

From our study of the business expense and foreign income areas, it is my conclusion that the Treasury Department has exaggerated the need for legislation in these fields and I suspect that the same may be true in the field of withholding on dividends and interest. In any event, it seems to me that at this point in time, legislation would be premature in all three fields.

As you know, the IRS has only within the last 2 or 3 years publicized the business expense problem, increased its audit procedures, and changed its tax return forms so as to counter the efforts of some taxpayers to exaggerate their business expense deductions. The effects of this audit program can hardly be fully seen at this early date and until they are I think it should not be concluded that legislation is required. Similarly in the area of foreign income, the IRS has only recently stepped up its audit of these transactions and I believe is in no position to conclude that legislation of such an extremely radical nature as proposed in H.R. 10650 should be enacted. Some of us have suggested to the Service on several occasions in the past that guidelines and rules be issued to explain the Service's position under section 367 which is the section of the code concerned with transfers of assets to foreign corporations, foreign reorganizations, etc. We have always been told that it is impossible to issue guidelines under this section because each case depends upon its own peculiar facts. However, early this year the Commissioner announced that guidelines would now be issued. I can only add that if this course had been followed several years ago, businessmen would have had better guidance as to what was permissible in this area and much of the present concern of the Service as to what may have happened in some instances in this field might have been avoided.

As to the proposal for withholding I must say I was shocked when I learned that automatic data processing would not serve as a check on the reporting of interest and dividends by taxpayers. The ADP is a complex and expensive undertaking and if it cannot perform this service, we are left wondering whether it is worth the cost. Many businessmen and advisers who have studied the problem more than I have are persuaded that it should be given a chance, before legislation as radical as the withholding provisions are seriously considered to be added to the code. Of course auditing procedures in this field are expensive for the Service but similarly the provisions in the bill if enacted would cause very considerable expense to the business community. The compliance problems of the IRC as it stands, are a very substantial burden to business and this burden has increased materially over recent years. The number and variety of tax forms that have to be filed and special accounting concepts worked out today by business organizations—both large and small—to satisfy tax and other governmental requirements, is frightening to contemplate. Certainly any increase in this burden should be undertaken only after full proof that it is necessary.

I feel sure that the Senate will carefully consider the arguments of the large banks, insurance companies, and other taxpayers who would be heavily burdened by this legislation, as well as the arguments of the Commissioner of Internal Revenue and come to a fair solution of the problem.

I hope the foregoing is of some help to you in formulating your recommendations and if I can be of any further assistance, I will be only to happy to do so.

Sherry and I send our best regards to you.

Sincerely yours,

FRANK C. WOLPERT, *Tax Manager.*

F.I.F. MANAGEMENT CORP.,
Denver, Colo., March 28, 1962.

Hon. HARRY F. BYRD,
Chairman, Committee on Finance,
U.S. Senate, Washington, D.C.

DEAR MR. BYRD: I am in favor of the principle of a withholding tax whether it is on wages or on interest or dividends. I am absolutely opposed to the provision for withholding incorporated in the tax bill which will come before you in the near future.

The provision as it has been drafted is both unnecessary and illogical. It is unnecessary because the Treasury Department has made little if any use of Form 1099 which is prepared at great expense by tens of thousands of corporations in order that the Government may be informed as to those individuals who have received payments of various kinds from these corporations. It is self-evident that the expense that the Treasury Department would incur in the

utilization of this information is substantially less than in the joint costs c business and Government to establish and maintain the fantastically complicate and expensive bookkeeping records that are necessarily concomitant to livi within the proposed law.

It is illogical and, I believe, unconstitutional because it forces shareholder. regardless of their income tax bracket, to give money to the Federal Governmen regardless of whether they ultimately owe the money or not. It is almos unbelievable that you are being asked to vote for a bill that is so obviousl inequitable to the majority of your constituents who receive normal incom in the form of dividends from common stocks or mutual funds or interest from savings accounts or bonds.

I am employed by a mutual fund that has approximately 115,000 shareholders. Eighty percent of these people automatically reinvest their quarterly dividends. At the end of the year, we prepare Form 1099 for every one of our shareholder and send one copy to them and one copy to the Internal Revenue Service; i.e., under the present law, we prepare 230,000 forms for the Government. If this new bill were to be passed by Congress, we would have to make an additional 115,000 accounting entries each quarter or a total of 460,000 per year. The burden would be intolerable.

Moreover, the 80 percent of our shareholders who automatically reinvest their dividends and pay their taxes from their wages or other sources of income will be denied the advantages of compounding the income from their investments. I cannot believe that the lawmakers who drafted this bill could have been cognizant of the far-reaching effects of the legislation that they have submitted for your approval. The costs, both direct and indirect, in time, effort, and money will be enormous—they have been estimated from a minimum of $400 million to well over $1 billion. These would be pretax business expenses and would, therefore, cost the Government approximately 50 percent of these amounts which would otherwise be received in the form of corporate income taxes. All departments and agencies of the Federal Government give lipservice to the necessity of increasing our efficiencies and improving our abilities to compete in worldwide trade. I am certain that you will agree that our high-cost price structure constitutes one of our principal economic problems and yet this ostensibly innocuous provision will increase the cost of American industry by an amount equivalent to anywhere from 10 to 30 percent of the $3.6 billion of U.S. exports to the Common Market for the year 1961.

It is a shame that the rest of the tax bill should be burdened by a thoughtlessly conceived provision which would be totally unnecessary if the Treasury were to utilize the information already provided them by the multitudes of businesses which pay interest and dividends to their creditors and shareholders.

I am enclosing a copy of a recent memorandum on this general subject which we sent to our shareholders. You will note that we offer constructive suggestions in addition to our valid criticisms.

In view of the extreme importance of this matter, I hope that you will give my letter and its enclosure your most serious consideration.

Very truly yours,

C. FREDERIC MEYER.

FOR THOSE WHO BELIEVE IN DIVIDEND AND INTEREST WITHHOLDING TAX

Tax evasion is an evil which impairs the economic strength of our Government and diseases the moral fiber of our Nation's citizenry.

Salary and wage withholding has proven itself to be highly practical, equitable, and convenient from the point of view of both the majority of taxpayers and the Government itself. If it overtaxes at all, withholding immediately overtaxes salary and wage income of middle and lower income tax payers to such a relatively minor degree as to be an insignificant factor. The nature of salary and wage withholding does not remove and permanently separate the taxpayer from realizing advantages which he might otherwise realize by paying his tax out of the particular income or resources he might choose. He has to pay the tax anyway, and it is not less convenient or detrimental to any privilege which is his right to have the tax removed specifically from salary and wages. In fact, it is more convenient and it is fair. Above all, it is simple.

Will dividend and interest withholding prove itself to be even reasonably practical, equitable, and convenient from the point of view of both the majority of taxpayers and the Government itself? Will it overtax and, if so, to what degree? Which group—middle, and lower income or higher income—will be penalized to

sacrifice beyond their share of the burden rightfully due? Do the very nature of saving and investing, and the features inherent thereto, lend themselves to being partly, but importantly, destroyed by direct withholding? Is direct withholding convenient and fair, like salary and wage withholding? Is it simple like salary and wage withholding?

SALARY AND WAGE WITHHOLDING TAX

The broad base of salary and wage income rests in our middle and lower income groups. Here is the greatest number of taxpayers. Here is the greatest amount of salary and wage income.

Of the 43.5 million salary and wage taxpayers in 1959, 39.5 million (or 91 percent of all salary and wage taxpayers) had adjusted gross income of less than $10,000. Thus, in number, this group is the broad base of salary and wage earners and taxpayers.

Of the $233.8 billion of salaries and wages earned by taxpayers in 1959, $183.8 billion (or 79 percent of all salary and wage income of taxpayers) was earned by taxpayers who had adjusted gross income of less than $10,000. Thus, this group is the broad tax base of salary and wage income in terms of total amount of taxable salary and wage income.

DIVIDEND AND INTEREST WITHHOLDING TAX

The broad base of dividend and interest income does not rest in our middle and lower income groups. In terms of number of taxpayers, yes; but in terms of amount of income and amount of tax, no.

Of the 4 million dividend taxpayers in 1959, 2.3 million (or 59 percent of all dividend taxpayers), and of the 7.8 million interest-reporting taxpayers, 5.5 million (or 71 percent of all interest taxpayers), had adjusted gross incomes of less than $10,000. Thus, in the middle and low income group, we have the greatest number of dividend and interest taxpayers.

Of the $12.8 billion of dividends and interest reported by taxpayers in 1959, $3.6 billion (or only 28 percent of all dividends and interest income of taxpayers) was reported by taxpayers who had adjusted gross income of less than $10,000. Thus, this group is not the broad tax base of dividend and interest income in terms of total amount of taxable dividend and interest income; 72 percent falls into the higher than $10,000 income group.

This broad base of salary and wage income, as well as the entire spectrum of salary and wage income, has been exceptionally well covered by salary and wage withholding (for taxpayers earning salaries and wages of more than $600) and by quarterly estimates (generally, for all income, including salary and wage, of taxpayers earning more than $10,000).

Taxes withheld in 1959, from taxpayers with adjusted gross income of less than $10,000, amounted to $22.1 billion. This compares to total income tax for the same group of $21.3 million. Thus, the bulk of income from all sources of this less than $10,000 income group appears well covered by withholding from salaries and wages which form the broad numerical taxpayer base and preponderant sources of taxable income.

The broad base of dividend income, and possibly interest income also, as well as the entire spectrum of dividend income is exceptionally well covered by extensive dividend reporting (over $10 a year) and fairly well covered by interest reporting (over $600 a year), and by intensive and extensive audit of higher income taxpayer returns.

If 20 percent of dividends and interests of middle and lower income group (less than $10,000 adjusted gross income) had been withheld in 1959, almost twice the tax they would owe would have been taken initially from them.

Yet, the higher income group (more than $10,000 adjusted gross income), the main source of dividend and interest tax, because of (1) both large absolute and relative amounts of dividend and interest income, and (2) higher tax rates, would have been missed had 20 percent of such income been withheld.

SALARY AND WAGE WITHHOLDING TAX

Evasion of taxes on salaries and wages would seem to be effectively met by our system of salary and wage withholding. Equally important to the objective and result of a high collection ratio to total tax due are the equity and simplicity of our salary and wage withholding system.

> Our salary and wage withholding system has built-in features which make it fair, equitable, and workable for the greatest number of taxpayers.
>
> The shining key of our salary and wage withholding tax system is its "custom tailored" or "individualized" nature. Without this outstanding feature of equity, salary and wage withholding would be a national travesty and scandal, evoking continuous protest and inflicting personal hardship and discrimination well beyond the merits of its contribution to effective tax collection.
>
> The employee and employer can work together, along with their Government, on tax collection, because they are together. The line of communication is both direct and continuous. Individual exemptions are taken individually into account: the employee advises the employer. Then, too, most taxpayers with less than $10,000 income use the standard deduction. Hardship and discrimination are avoided because the "custom" or "individual" differences are recognized and protected.

DIVIDEND AND INTEREST WITHHOLDING TAX

Evasion of taxes on dividends and interest would not seem to be effectively met by tax withholding. Equally important to the objective and result of a high collection ratio to total tax due are the equity and simplicity of our collection system respecting taxes applicable to dividend and interest income.

> The proposed system of tax withholding from dividend and interest income is, by its impact, unfair, inequitable, and unworkable for not only the greatest number of our taxpayers, and those citizens in nontaxable brackets, but it is particularly inequitable and unworkable for an even higher proportion of our middle and lower income groups who would be disserved and disadvantaged by the inequities inherent in the proposed system. Its potential naked truth: "We'll take it away, even though you don't owe this much or owe nothing at all; now it's up to you to get it, if you can do the figuring of how, when and where"—hits the clear majority of all citizens and the overwhelming majority of lower income groups.
>
> The basic injustice of dividend and interest withholding is its blanket application which, while unavoidable regardless of the rate of withholding, would stab at the middle and low income groups, extracting more taxes than due from the very returns on those resources that help build what little they are able to build for themselves and that go to help underwrite capital investment in the Nation's economic strength and in its ability to finance continued growth. Since the withholding rate cannot be "custom tailored" or "individualized" for each taxpayer and nontaxpayer, the middle and lower income groups would (1) be overtaxed; and, perhaps even more importantly, they would (2) be "penalized out of" effectively compounding the full amount of the earnings of their already relatively small, but more needed, savings. While they would prefer to pay their tax from the sources of their choice, the withholding would pull away funds from the very savings and investment programs they are trying to build and would impair their gaining the privileges that are their right in such programs. As

SALARY AND WAGE WITHHOLDING TAX

DIVIDEND AND INTEREST WITHHOLDING TAX

well, every dividend and interest recipient in the middle and lower income group would (3) be personally burdened, and further burden governmental facilities, with the cost, complexity, and inconvenience of refunds. This is not to mention those who have lesser income and no tax due at all and who look to the dividends and interest they receive as being a part, the main, or only source of whatever "living" they have. Thus, all income groups, except the highest, are going to be drawn into the net of having money taken from them and having to arrange for its return, raising greatly the level of their personal confusion and inconvenience and adding substantially to the burdens on governmental facilities to verify and issue requested refunds.

Yet the high-income groups, with their higher than 20 percent tax rates, with the large proportion of their personal income flowing from dividend and interest income, with the large total of all dividends and income in the country, yet they will not be penalized to any degree. At least 55 million taxpayers and nontaxpayers, plus unnumbered more people could be hurt, while only 5 million taxpayers will not be adversely affected to any degree. Unlike salary and wage withholding, dividend and interest withholding cannot be individualized. It cannot "give back" compounding and other saver and investor privileges inherent in the majority of programs designed for small savers and investors. It cannot escape, regardless of rate, taking away money from the lower tax bracket and no tax bracket income groups. It cannot help but add complexity to an already complex tax report form. So it cannot be fair and effective. Rather than the vast majority of people being treated fairly, as is the case under salary and wage withholding, the dividend and interest withholding is fair only to the minority and unfair to the vast majority where their income, savings, and investment privileges, and where simplicity are most needed.

RECOMMENDATIONS FOR CONSIDERATION

1. Tax return: A larger bold face statement that dividends and interest, cash or compounded, must be reported. Proper qualifying explanations about tax-free dividends and interest can be made elsewhere. (Term "taxable dividends and interest" is misleading. Some dividend recipients and many interest recipients believe accrued or compounded interest and reinvested dividends are not currently taxable.)

2. Income and tax advices: Dividend and interest payers (except "municipalities") should be required to notify savers and investors of the amounts thereof accrued or paid, and that their interest and dividends are to be reported.

3. Penalty: Set forth on tax return, payer supplied advices and official tax explanation publication a penalty of, possibly, at least $100 if all interest and dividends, whether cash or compounded, required to be reported are not reported on tax return.

4. Payer interest information reports to Government: Reduce to $10. A greater proportion of low income bracket taxpayers receive interest than dividends. Average interest received, based on tax returns in 1959 amount to approximately $300 for interest recipients with adjusted gross income of less than $10,000. Present "$600 or more" payer reporting requirement is very inadequate, particularly with taxpayer confusion about tax status of compounded interest.

5. Punched cards: Dividend and interest payers, at least those with certain minimum number of payees, might be required to furnish Government with punched card. As a further step to assist Government economy in verification, the saver or investor could be given a duplicate punched card (along with printed advice) which he would be required to forward with his tax return. The two punched cards (or card and tape) would tremendously assist Government accounting and verification.

6. Use of existing withholding machinery: The bulk of individual income tax tax collections comes from withholding on wages and salaries. By making fuller use of this existing system, individual taxpayers could have, in effect, customized withholding on dividends and interest. Each year, every employer would determine with his employees the amount of their estimated interest and dividends for the coming year. Using precalculated tables, the employer would increase salary and wage withholding accordingly. At yearend, this estimate would be included on the employee's W-2 form. This approach would seem to have several desirable effects:

(*a*) At least twice each year, the employee's attention would be called to the necessity of taxpayment on interest and dividends.

(*b*) The withholding would eliminate or alleviate the chances of the employee owing additional taxes at yearend.

(*c*) The W-2 form, giving the estimate (and attached to the tax return) would put the Treasury Department on notice to check the tax return for actual interest and dividends against those estimated.

(*d*) The entire system could easily and simply be attuned to the particular tax situation of each individual taxpayer.

(*e*) Any employee who felt that such a disclosure would represent an invasion of privacy could inform his employer that he wished to file and pay taxes by use of the estimate form. This would be noted in some manner on the W-2 which would indicate the need to check this particular person's tax return for dividend or interest income.

7. Government data processing equipment and numerical identification: While the effect of these steps has yet to be determined, it is to be assumed that they, along with greater publicity, will be more effective, less complicating, and will not generate serious inequities in increasing the collection ratio. Payer reporting to both individual and Government would have to parallel any withholding system. It is the reporting and verification, as well as publicity—it is not withholding—than can reduce evasion. Yet, it is withholding that would work serious, widespread inequities and burden those who could least afford these consequences. Certainly, new equipment and the numerical identification system should be given the chance to prove themselves. If these are actually found to be, or seriously estimated to be, insufficient, then the more promising and equitable advantages of fuller interest reporting, penalties, clearer instructions, greater publicity, more extensive verification, an extension of wage-and-salary withholding, and, possibly, punched card reporting should have their obvious merits more fully investigated rather than traded for the dubious advantages

and clear disadvantages of taking a flat rate of tax directly and indiscriminately from everyone's dividends and interest, as well as robbing a portion of their rights to building easily and less expensively what they can in a way that they can.

The only similarity between salary and wage withholding, on one hand, and dividend and interest withholding, on the other hand, is the word "withholding." Shining benefits characterize the former; glaring injustice and ineffectiveness of purpose would be the result of the latter. The middle and lower income group need a lobby in their behalf. Whom should they look to now, and whom will they have to look back to if they have been unfairly treated and lightly considered? The soundness of their case has to be understood by their Congressmen and Senators.

TESTING THE CONCEPT OF DIVIDEND AND INTEREST WITHHOLDING

In summary then, and before calling "withholding at the source" the best answer to a complex problem, we might test the withholding concept against four basic questions and see how it meets these various tests in light of the information given earlier.

(1) Will withholding of dividends and interest result in a greater net collection of revenues?

Answering this question in early 1962, the answer is probably "Yes." Two years ago, it would have definitely been "Yes." Two years hence it may well be "No."

The Treasury Department, with cooperation from private business, has done a great deal in recent years to educate the public to the fact that dividends and interest are currently taxable—even when such income is not currently received in cash by the taxpayer. A continuation of this educational campaign should result in an increasingly higher percentage of income being reported. In a few short years, tax evasion based on ignorance should largely disappear.

Insofar as willful tax evasion is concerned, the improved data processing techniques being adopted by the Treasury Department will soon make tax evasion on dividends and interest a practical impossibility (or at the very least, a highly dangerous practice). As the public is educated to the sophistication of tax accounting by the Government, those who may have purposefully avoided reporting taxable income will feel compelled to do an accurate job of tax reporting.

(2) Will withholding impose any undue or excessive hardship on taxpayers?

The proposed legislation would appear to create a tremendous amount of complications for taxpayers. It might be argued that one of the reasons many low-bracket taxpayers do not report dividend or interest income is because of the difficulty of coping with even the present tax form. Yet the new regulations would add greatly to the problem of filling out the form and reporting dividend and interest income accurately. The taxpayer must first "gross up" his dividend and interest income and then take a credit for the taxes withheld at the source. Since the low-bracket taxpayer will usually be entitled to a refund, he is, in many cases, going to overpay his tax through being unable to complete his form properly (certainly not the intent of the legislation) or, in many cases, he is going to complete the form in error.

Many exempt taxpayers—profit-sharing and pension trusts, tax-exempt institutions, etc.—are going to lose the results of valuable compounding and increase their and the Government's administrative workload while, at the same time, losing the advantage of the amounts withheld. According to estimates of the American Bankers' Association, this loss for pension trusts alone will exceed $50 million.

(3) Will withholding create an unreasonable burden for the Treasury Department?

The answer to this would seem to be an unqualified "Yes." There will be literally thousands of transactions in which money is collected by the Treasury Department and then returned in full to the taxpayer. This would be true of pension trusts, profit-sharing trusts, bank common trust funds, as well as millions of middle and lower income taxpayers. The Treasury Department would have added, in respect to these institutions and individuals, an enormous amount of dollar trading and accounting transactions without adding 1 cent to revenues.

By far the largest problem would probably be generated by low-bracket taxpayers filing for refunds. According to statistics, the average under $10,000 taxpayer tends now to overpay his tax. This is supported by the 1959 income tax

figures which show 27 million refunds going to the 42.7 million taxpayers in the under $10,000 bracket. Since they are already filing for refunds, these taxpayers will attempt to recover any overwithholding which occurred in respect to dividends and interest. The opportunities for error on the part of the taxpayer in "grossing up" his dividend and interest income and then indicating the proper tax credit have been pointed out earlier. But from the standpoint of the Government, every one of these taxpayers' errors represents added work, added correspondence, and added field checks on the part of the Internal Revenue Service.

(4) Will there by any side effects which might act to the eventual detriment of our overall economic and fiscal goals?

This is an area where the bill could act to stifle rather than encourage our Nation's stated economic goals. Despite differences in opinion as to the rate of growth, there is general agreement among all responsible persons that our economic growth rate must be accelerated if we are to absorb the unemployed into the economy and compete successfully with the Soviet bloc in the cold war.

One of the reasons cited for our relatively low growth rate as compared to other nations in the last 10 years has been our lower rate of capital investment. A part of this stems from the fact that, by and large, we are a nation of consumers rather than savers or investors. To tax interest and dividends at the source is to tip the balance further away from savings and investment. Every dollar of interest or dividends which is now compounded—as opposed to being taken in cash—will be reduced to 80 cents under the proposed bill. Whereas the tendency has been to meet taxes on accrued interest or dividends with dollars over and above those already saved or invested, in the future these dollars will be drained from a savings or investment base already insufficient to meet the needs of a growing America.

The proposed legislation will also tend to drive tax-exempt dollars toward nonwithholding investments where income will not be subject to a tax, and where, even though the tax would be recoverable, it would be a burdensome and irritating process. Our immense pension and profit-sharing trusts represent a tremendous potential source of equity dollars, and it would appear against the best interests of the Nation to stifle this source. The same thinking might lead many taxpayers whom withholding would cause to overpay to direct their dollars into other channels and away from sources of capital investment.

UNION DIME SAVINGS BANK,
New York, N.Y., March 28, 1962.

Hon. HARRY F. BYRD,
Chairman, Senate Finance Committee,
Washington, D.C.

DEAR SENATOR BYRD: The purpose of this letter is to supplement with figures derived from our records the many communications which you have received in opposition to the withholding provision contained in the tax bill reported by the House Ways and Means Committee. I feel certain that the House Ways and Means Committee's illogical approach to this loophole problem will be more clearly demonstrated by these figures.

This bank services approximately 150,000 savings accounts with an aggregate balance of $480 million; 27 percent of these accounts receive 73 percent of the interest paid ot depositors, and on the basis of the presentation of their passbooks and their requests for interest statements, we can say with assurance that the vast majority of these larger depositors report the interest received.

The great majority of our depositors receive less than $60 in interest per annum. Approximately 30,000 receive less than $2, 20,000 receive between $2 and $5, 13,000 receive between $5 and $25, and 23,000 between $25 and $60. Even though the bill does not require that a listing of interest withheld be sent to the Internal Revenue Bureau, it will be necessary for us to calculate the net amount of interest for each of these relatively small accounts. As a very large percentage of these small depositors are not subject to tax, it is quite doubtful that they will apply for refunds and thus, in effect, they will be unfairly penalized.

In addition to this unfair and un-American approach to the small depositor, the bill provides that various types of depositors, such as children, shall be exempt from withholding and those who are exempt from taxation may file certificates for the purpose of eliminating withholding. Can you imagine the clerical costs which will be incurred to trace the age of our depositors and to

follow a procedure designed to eliminate certain thousands of accounts affected by the filing of certificates? Even though the most modern electronic systems do not provide that degree of flexibility which would allow the recording of data to handle these exceptions.

Through one of the Canadian chartered banks, we have been informed that these very objections to withholding on savings account interest were the cause of the abandonment of such withholding in the Dominion of Canada during the late 1940's.

Withholding on salaries and wages is a logical means of assisting both the taxpayer and the Treasury. But the withholding of 20 percent of the interest on savings accounts is not only illogical from the administration and operating standpoints, but it is unfair to the small depositors, to the depositors of modest means who use the interest for living expenses, and to the savings institutions charged wih the responsibility of encouraging thrift.

We earnestly request that you use your good offices to eliminate the withholding provision from the proposed tax legislation.

Very sincerely,

WALTER R. WILLIAMS, Jr.

PAWLING RUBBER CORP.,
Pawling, N.Y., April 28, 1962.

Senator HARRY F. BYRD,
Chairman, Senate Finance Committee,
Washington, D.C.

DEAR SENATOR BYRD: As a trustee of a small savings bank, I would like to go on record as opposing the proposed withholding tax on interest and dividends. First, I think that there will be a substantial shift in savings from savings institutions to savings bonds where liability for tax can be postponed indefinitely. This in turn will result in savings banks reducing commitments for mortgages.

The work of setting up this withholding system is an unfair burden to small institutions and also it seems to me will affect a large number of recipients who have no tax liability. This, of course, will result in hardships to them.

It is my understanding that the Treasury's taxpayer education program has already resulted in improved reporting of interest. This, plus the new data processing equipment of the Service, will enable the Service "to determine the tax status of any taxpayer at any time" as recently stated by the Commissioner of Internal Revenue.

These considerations, plus many others, I know you are considering before giving your approval to this bill.

Very truly yours,

HOWARD W. SMITH, *President.*

THE BERENS COS.,
Washington, D.C., April 4, 1962.

Hon. HARRY FLOOD BYRD,
U.S. Senate, Washington, D.C.

MY DEAR SENATOR: I am writing to you regarding H.R. 10650, Revenue Act of 1962, which contains as part of its provisions the establishment of a withholding tax on interest and dividends of savings institutions and increases in corporate income taxes of mutual savings banks and savings and loan associations.

The following facts are submitted in an earnest solicitation of your opposition to the passage of this legislation.

Withholding tax on interest and dividends would reduce incentives to save by making the thrift process inconvenient and burdensome to depositors and savings institutions alike. This inconvenience would lead to a shift in the flow of savings from mutual savings banks and other mortgage lenders to tax-exempt State and local government bonds and other tax-exempt securities. This would curtail sharply one of the primary sources of mortgage funds and substantially increase the cost of obtaining mortgage loans for home borrowers and real estate developers. I am sure you realize the damaging effect this would have on the already flagging homebuilding industry, with the further effect this would have on the overall economy of the Nation.

I would also like to point out that by instituting a withholding program the volume of savings would be reduced since taxes now paid on interest by individuals from their out-of-pocket funds would instead be paid out of savings held in the banks, thereby further reducing the funds these institutions would have available for mortgage lending by many millions of dollars annually.

Increased taxation would compel savings institutions to reduce rates of interest paid to their depositors since they would be required by State laws to add to their reserves for the protection of depositors. These institutions would be less able to attract and channel into mortgage funds the public's savings. The savings banks are one of the primary sources of out-of-State mortgage funds and hold over $7 billion worth of mortgages on properties in nonsavings bank States which are mainly rapidly growing areas with an inadequate supply of local savings for mortgage demands.

We believe that it is important for the continued prosperity of this country that the savings capitalization of our country not be decreased as it would have an adverse effect upon the housing industry and the general economy of the whole Nation.

We urgently request your opposition to the passage of any legislation to provide for the withholding tax on interest and dividends and the increase in the taxes on mutual savings banks and loan associations to the end that the Nation's supply of home mortgage funds not be reduced.

Respectfully,

GEO. W. DEFRANCEAUX,
President, Frederick W. Berens, Inc.

BALTIMORE, MD., *April 18, 1962.*

Hon. HARRY F. BYRD,
Chairman, Committee on Finance,
U.S. Senate, Washington, D.C.

DEAR SENATOR BYRD: Allow me to make a few comments with respect to withholding tax from interest and dividends.

I was very much impressed this morning by your statement that withholding is justified only if there is no other solution to collecting tax on unreported income and that you hope the numbers system could be made effective and avoid withholding. I agree most heartily with your thought, but I disagree, as you and Senator Williams did, with the "post office refund suggestion."

You have heard and will hear a great deal of protest and complaint about administrative problems should a withholding tax such as proposed come into being. These arguments I heartily endorse, because in my work as income tax officer of the Mercantile Safe Deposit & Trust Co., of Baltimore, I have been closely associated with bank and trust company tax associations in the New England area, New York, Philadelphia, Chicago, and elsewhere. The problems complained of and anticipated are very real. Also, our own company files over 8,000 returns a year and gives tax service to approximately 12,000 people, and we are not the largest trust company with fiduciary powers, but are in the middle class. To give you an idea of the taxes we pay, I sent checks to the Director this past Monday totaling approximately $6 million.

I firmly believe, as do many of my associates, that the tax evasion alleged can be overcome through the use of the taxpayer's number system (and I am working, along with others, with the Internal Revenue men in trying to get this system going) and the continued use of publicity regarding the taxing of interest and dividends.

However, there is another item about which I feel very strongly and think it should be given consideration along with the foregoing before entering into this horrendous withholding procedure. From experience and observation I think much more effective tax enforcement and collection can be had through the use of additional revenue agents. There is not an agent worth his salt who will not bring in more in the way of additional revenue than his cost to the Government. Also the moral effect upon people when they know revenue agents are checking up is tremendous. For example, years ago it used to be the practice to send agents into neighborhoods and they would check the corner grocery store; and, needless to say, everybody in that vicinity knew the agents were around and what they did. Also, the agent has an opportunity to talk with the taxpayer, observe his style of living, his recordkeeping, etc., and form a pretty good opinion of whether he is making an honest tax return. I know this would swell the ranks of Government employees, but in this case I think it would be justified and worth while.

To sum up then, I believe and earnestly urge your committee to consider holding off on withholding for another year or so and try the foregoing suggestions which I believe will produce the desired results. If within a couple of

years they do not produce the results, then I will be among the very first to recommend withholding without any exemptions.

This withholding situation and tax evasion are very serious problems in two different areas. We, of course, want everybody to pay their fair share of taxes, but at the same time I feel most strongly that the impact upon business, our citizens, and our economy will be so serious under withholding that every possible avenue should be explored before such a drastic tax collection law is enacted.

I also endorse the idea of putting a question on the tax form asking, Did you receive interest or dividends; if so, have you included them in your return? This, I think, would also be very helpful.

Respectfully,

WADE HAMPTON CRESWELL,
Chairman, Special Committee on Withholding Taxes, Maryland Bankers Association.

AMERICAN NATURAL GAS SERVICE CO.,
Detroit, April 16, 1962.

Re H.R. 10650—Revenue Act of 1962 effect of tax withholding provisions on retirement and savings plans.

Hon. HARRY F. BYRD,
Chairman, Senate Finance Committee,
Washington, D.C.

DEAR SENATOR BYRD: The proposed "Revenue Act of 1962," as adopted by the House of Representatives (H.R. 10650) and now pending before your committee, provides among other things for withholding of portions of interest and dividends (sec. 19, setting forth proposed new chapter 25 of the Internal Revenue Code). It is not the purpose of this letter to discuss the merits of withholding generally, but to comment upon the effect of the provision as now drafted on retirement and savings plans of the type used by the American Natural Gas Co. system.

Our system companies have a retirement plan under which both the employer companies and the employees contribute to a fund which is held by the First National City Bank (of New York) as trustee. The trustee invests the funds in securities, and the fund is used ultimately to pay retirement benefits to eligible employees. Our system also has a savings plan under which employees have an opportunity to contribute specified amounts which are, in turn, matched by the employer company; these amounts are also paid to and held by the same bank as trustee and invested either in senior securities, equity securities, or in American Natural stock, as designated by the participating employee. These plans have the approval of the stockholders.

Both the American Natural Gas system companies' retirement plan and the savings plan have been approved by the Internal Revenue Service as qualified plans and are, therefore, exempt from taxation under section 401 and related provisions of the Internal Revenue Code of 1954. Accordingly, all of the earnings or securities held by the trustee are reinvested in order to provide the benefits to our employees contemplated by the plans. At the present time there are over 7,000 participants in the retirement plan and over 2,000 participants in the savings plan.

Under the proposed withholding provisions of H.R. 10650, payments of interest and dividends to individuals who certify that they do not anticipate being subject to income tax for the current year are exempt from the withholding requirements (proposed new sec. 3483(a) of the Internal Revenue Code, set forth in sec. 19 of H.R. 10650). There is also an exemption from withholding for interest paid to the United States or its agencies, at the discretion of the Secretary of the Treasury (sec. 3452(c)). However, there is no exemption for tax-exempt pension and profit-sharing plans (except for certain limited situations such as bank deposits and U.S. savings bonds, provided in sec. 3483(3)). Accordingly, plans such as our retirement and savings plans would be subject to the withholding and would be required to file quarterly applications for refunds of all amounts withheld. Not only would this deprive our funds and their beneficiaries of the use of the money while refund claims are prepared and processed and until refunds are made, but it would also create a substantial burden of administration on the committees administering the fund and on the trustee in accounting for and preparing the necessary claims. Similar un-

necessary burdens would be imposed on the Government in processing such refund claims as well as making the payments and auditing the whole process. The funds covering the various American Natural system companies hold bonds and stocks in more than 100 corporations.

Proponents of the original withholding procedures contemplated that no exemptions would be permitted in the interests of simplicity of administration of the withholding by the corporations and others paying interest and dividends. However, the House committee, recognizing the hardships involved, has very properly granted exemptions for individuals in the categories mentioned. Since some exemptions are being granted, it would seem reasonable and fair to grant similar exemptions to those payees of interest and dividends which are clearly tax exempt under approved pension and profit-sharing plans. Such exemptions would seem to be not only in the interests of the plans themselves and their many beneficiaries, but also in the interest of the Government in reducing unnecessary processing and auditing of refund claims.

Our system companies urge that your committee, in considering H.R. 10650, provide appropirate exemptions from any withholding provisions which will protect the interests of pension and profit-sharing plans, and thereby both assist the beneficiaries of these plans and facilitate orderly administration of the tax laws.

It should be emphasized that our situation is not an unusual one in that there must be literally thousands of companies with pension and savings plans who would be similarly affected under the proposed withholding provisions in the House bill.

Employees of the American Natural Gas Co. system who are beneficiaries of the plan and would be affected by the provisions discussed above are located in the States of Illinois, Indiana, Iowa, Kansas, Kentucky, Louisiana, Michigan, Mississippi, Missouri, New York, Ohio, Oklahoma, Tennessee, Texas, Virginia, and Wisconsin. Accordingly, we are sending a copy of this letter to the various Senators from these States.

Very truly yours,

WILBER H. MACK,
Executive Vice President.

REFINED SYRUPS & SUGARS, INC.,
Yonkers, N.Y., April 2, 1962.

Hon. HARRY F. BYRD,
Chairman, Senate Finance Committee,
Washington, D.C.

DEAR SENATOR BYRD: The administration's tax bill H.R. 10650, on which your committee is now holding hearings, provides for the withholding of a 20 percent tax on interest and dividends payable to qualified trusts even though such trusts are tax exempt.

As chairman of Refined Syrups & Sugars, Inc., employees' profit-sharing plan, approved by the U.S. Treasury Department as a tax-exempt plan, I want urgently to protest that provision in the bill.

Our trust fund is a small one, as such funds go, with a total value of less than $700,000 and with participants totaling 107, but all of its income is derived from bond interest and common stock dividends. While the bill under consideration would presumably refund the withholding, provided quarterly requests for it were made, nevertheless, each withholding would be without earning power for at least 3 months.

Since the earnings of our profit-sharing fund are tax exempt by law, it would seem not only unjust but contrary to law to withhold a tax on the income of this fund. On behalf of the participants in this fund and as chairman of its administrative committee, I respectfully urge that the provision referred to be deleted from the bill by your committee.

Very truly yours,

HUGH M. MCKAY,
Chairman, Profit Sharing Committee.

PEOPLES NATIONAL BANK & TRUST CO.,
Lynchburg, Va., April 4, 1962.

Re House tax bill (H.R. 10650).

HON. HARRY F. BYRD,
Senate Office Building,
Washington, D.C.

DEAR SENATOR BYRD: It is with some reluctance that I write to you regarding House tax bill (H.R. 10650). I know we must have appropriate tax laws in this country to defray the expenses of government and to support the various programs which are originated by the Government.

In spite of the necessity to raise tax funds, the provision in the above mentioned bill, which calls for a withholding tax of 20 percent on dividends and interest is an unreasonable provision or expectation. From my observation, banking institutions, of which I am familiar (and they are many) have always been ready and willing to carry their fair share of the tax burden, and they have evidenced over and over many times their willingness to assist the Government in the sale and conversion of savings bonds, and render numerous other governmental services, usually for gratis.

This iniquitous provision in the proposed tax law H.R. 10650 regarding withholding tax on dividends and interest is unfair, in my opinion, and will be quite cumbersome to implement and carry out. The officers and directors of this bank join me in urging you to do all things possible to delete this section from the bill.

Respectfully yours,

L. D. HORNER, Jr., *President.*

GRISWOLD, STREPPA, FERRIS & OSGOOD,
Rochester, N.Y., April 3, 1962.

HON. HARRY F. BYRD,
Senate Office Building,
Washington, D.C.

MY DEAR SENATOR: As counsel for the Community Savings Bank and a member of the advisory council of the board of trustees of said bank, I am writing you relative to the tax bill which recently passed the House of Representatives and particularly in reference to the provision for the withholding of 20 percent of interest and dividends.

I feel that unless this withholding provision is eliminated from the tax bill, that it will cause injustice to many groups who are now depositors in the savings banks of New York State, particularly older people, who because of exemptions, even allowing for interest on their savings accounts, are subject to no income tax, also the great majority of accounts held for minors and all accounts of nonprofit organizations. I believe the bill provides for an annual exemption certificate for the above and in my opinion, this would be most cumbersome both in handling by the bank and the Internal Revenue department, and would be subject to abuse by those who feel that by requesting an exemption certificate they can escape payment of the tax which they might owe. Also there are undoubtedly a great number of individuals who might be entitled to such a certificate but who through ignorance may fail to obtain the same and would therefore be paying a tax which they do not owe, and might later when advised of this right file a claim with the bureau for refund of the tax withheld.

I further feel that this bill would make it possible for people with no savings accounts to claim that certain amounts had been withheld from nonexisting savings accounts and claim a credit for such claimed withholding against the tax due.

As one who has been in close touch with the savings bank system in this State for years, I also feel that this bill may cause substantial shifts of savings from savings banks to U.S. bonds where the liability for the tax can be almost indefinitely postponed and/or into tax exempt securities. Certainly the savings banks in New York State are the backbone of real estate financing and if such a shift in savings were made, it might seriously affect the building industry in this State or in any State where there are savings banks.

I feel that during the last year due to new processing equipment in the Internal Revenue department and the program of education, to which program the savings banks have given full cooperation, that there has been a great improvement in reporting of interest and dividends and that this educational program together with the new system of processing and accounting in the Internal

Revenue department should be given a chance to prove their value before such a drastic step as withholding of dividends and interest is adopted.

It is my earnest hope that you will use your influence to have the withholding provision stricken from the tax bill.

Sincerely yours,

HAMILTON C. GRISWOLD.

THE PEOPLES NATIONAL BANK,
Farmville, Va., April 4, 1962.

Re House tax bill H.R. 10650.

Hon. HARRY F. BYRD,
Chairman of the Senate Finance Committee,
Washington, D.C.

DEAR SENATOR BYRD: We are particularly concerned with the section which calls for a withholding tax of 20 percent on dividends and interest. Institutions which pay interest and/or dividends will have to deduct this 20 percent before making payment. In our opinion this is a bad principle in that taxes are levied first and those not owing the tax are put to the trouble of proving their tax exemption. The additional work to which banks will be subjected is tremendous. Great confusion will result.

We hope you and your committee will use your influence and efforts to delete this section from the bill. Thanks.

Sincerely yours,

ISAAC C. GLENN, *President.*

DESTINY,
Merrimac, Mass., April 3, 1962.

Hon. HARRY FLOOD BYRD,
Senate Office Building,
Washington, D.C.

DEAR MR. BYRD: Surely there is a way for the United States to obtain revenue without penalizing the widows and fatherless. There are a great many older citizens living in our land who must depend upon a meager income for the necessities of life. The proposed plan to withhold tax on interest at the source, which would affect many who no longer earn a taxable income, would certainly work a hardship on them even though they would be entitled to a refund a year later.

Why add to the burdens of men and women who are already the victims of an inflationary cycle in an effort to reach those who fail to list taxable interest? Would it not be far better to require all institutions paying interest to file with the Bureau of Internal Revenue all names of those to whom interest is paid? If suitable penalties were exacted for the failure to list taxable interest, this fact alone would correct the situation for fear of detection. Also, when properly worked out, such a method would be far less expensive to administer.

This procedure would exempt from further harassment the widows and fatherless in our midst who are finding it increasingly difficult to make ends meet. Many in this class would not know how to proceed to secure refunds for unwarranted assessments against their small incomes. The divine injunction is: "Ye shall not afflict any widow, or fatherless child. If thou afflict them in any wise, and they cry at all unto Me, I will surely hear their cry; and My wrath shall wax hot" (Exodus 22: 22–24).

The United States cannot afford to be a party to such injustice.

Yours sincerely,

HOWARD B. RAND, *Editor.*

RICHLAND, WASH., *March 23, 1962.*

Re proposed 20-percent withholding on certain type of income for Federal income tax purposes.

Hon. CATHERINE MAY,
House of Representatives,
Washington, D.C.

DEAR MRS. MAY: I wish to draw your attention to the fact, that, if such a plan is adopted, there would be a considerable sum (for me) of money which the Government would receive from me in overpayments which I would never get back. I mean just that. My estate would probably get it but I would not get it.

I have gone to the trouble to set up several cases to illustrate. My calculations

are enclosed. At my age, 77, I believe you will clearly understand the possible injustice involved.

If you do not wish to take the time to examine my figures carefully I hope you will submit them to someone who can advise you as to the merits of the points I raise.

Yours very truly,

ROBERT W. FRENCH.

A discussion of the proposed new 20-percent withholding provisions for payment of Federal income tax in the case in which the withholding is consistently more than the tax and refund actually reaches the taxpayer several months after the close of the tax year:

This discussion applies to my own case. I am 77 years old. My tax runs about $150 for a normal year or at the rate of $12.50 a month. If I understand the proposed plan correctly $576 of my income would be withheld in a year or at the rate of $48 a month. To simplify the figures let us say $48.50 a month.

Actually withheld each month	$48.50
1/12 of my $150 tax would be $12.50 or the ideal amount to withhold to take care of tax, if withheld monthly	12.50
Overpayment each months $48.50—$12.50	36.00

To see how this would work out in my case, begin with January 1963 and assume that the overpayments claimed on return made in April 1964 were actually made 6 months later or October 1964.

First let us consider a matter of inconvenience to taxpayer. In January 1963, through withholding I would have overpaid $36. This would be returned to me in October 1964 or 21 months later. In February 1963 I would overpay another $36 which would be returned to me 20 months later. The March 1963 overpayment would be returned to me 19 months later, etc.

IMPORTANT

More important are the results shown in cases A, B, and C below.

Case A

By October 1964 or 21 months after January 1, 1963, the overpayments would be 21×36	$756
Refund to taxpayer in October 1964 for 1963 would be 12×36	432
Balance due taxpayer for overpayments but still unpaid after refund of October 1964 would be $756—$432	324
By October 1965 there would be 12 more overpayments of $36 each, or 12×36	432
Total overpayments made by taxpayer and not refunded to taxpayer before refund of October 1965 would be $324+$432	756
Refund to taxpayer October 1965 for tax year 1964 would be 12×36	432
Balance still due taxpayer for overpayment of taxes after refund of October 1965 would be $756—$432	324

And so on year after year. In other words, refunds would always be 9 months behind during which time 9×$36=$324 if overpayments would have accumulated.

To state it another way the taxpayer would overpay $324 at the start of the plan which he never would get back.

Inherent in the situation described in case A above is the fact that the taxpayer would never get back the overpayments for the number of months elapsing between the end of the tax year and the date on which he received his refund for that tax year.

Case B

If refunds for overpayment were made promptly at the close of each 3-month period the following comments would apply. I will again assume on overpayment of $36 a month.

$36 due me on January 1 would reach me 3 months later.

$36 due me on February 1 would reach me 2 months later.

$36 due me on March 1 would reach me 1 month later.

In other words $432 of my annual income would reach me on a quarterly basis and in arrears instead of on a monthly basis. In my case this would be a definite inconvenience.

Furthermore, in the end there would be up to $108 I would never get.

Case C

Also, if 3 months overpayment of taxes were refunded to me 1 month after the close of the 3-month period, 1 month's overpayment or $36 would never reach me as pointed out in case A.

LOS ANGELES CHAMBER OF COMMERCE,
Los Angeles, April 2, 1962.

Hon. HARRY FLOOD BYRD,
Chairman, Senate Finance Committee,
Washington, D.C.

GENTLEMEN: We ask your consideration of the views of the Los Angeles Chamber of Commerce on the proposal included in the current tax legislation providing for a tax withholding system for income from interest and dividends.

We believe this feature would increase the complexity of our income tax system which is already overcomplicated and confusing. It would hike the cost of tax administration and impose a heavy burden on those paying interest and dividends as well as those receiving them. It appears to be purely a convenience for the Government and a costly inconvenience not only for taxpayers but for hundreds of thousands of people on whom the Government has no claim for taxes.

Many exceedingly serious problems are inherent in the withholding plan. Hundreds of thousands of the Nation's stockholders are 65 years of age or older, a substantial portion of whom are removed from tax liability because of their augmented personal exemption. While last-minute changes on the House side provided that persons who expect no tax liability could file exemption certificates, the burden of filing such certificates or of applying for refunds would be on the taxpayer who might or might not be familiar with the withholding practice. Millions of dollars which otherwise would be paid to their rightful owners would be retained by the Government by default under such a plan. The complications which would beset investment companies (mutual funds) would be enormous. Thousands of taxpayers would suffer loss of earnings from the investment of their own funds.

We appreciate the difficulties involved in efforts to "improve" the tax system and of making sure that all taxable income is reported. As to the withholding feature, it seems obvious that the disadvantages would clearly outweigh the advantages. Stepped-up efforts toward voluntary compliance are helping to narrow the revenue gap which the Government is attempting to close. And with the wizardry of automatic data processing, other means should be devised to seek out the offenders.

Respectfully submitted.

HAROLD W. WRIGHT, *General Manager.*

NEW YORK, N.Y., *April 9, 1962.*

Hon. HARRY FLOOD BYRD,
U.S. Senate,
Washington, D.C.:

In behalf of 225,000 investors with an average investment of $2,400 you are urged to vote against the bill to withhold taxes on dividends and interest as it would be impractical and a hardship on the large number of small savers and investors in the United States.

H. J. SIMONSON, Jr.,
Chairman and President, National Securities & Research Corp.

FIRST FEDERAL SAVINGS & LOAN ASSOCIATION,
Statesboro, Ga., April 9, 1962.

Senator HARRY F. BYRD,
Washington, D.C.

DEAR SENATOR BYRD: I am enclosing a copy of a resolution adopted by our board of directors at their regular monthly meeting Friday, April 6, 1962.

As chairman of the Senate Finance Committee, we urge you to give much thought and due consideration to the overall structure of this legislation proposed and, of course, we are vitally concerned with that portion of the bill which affects the many thrift institutions in the Nation. I believe that the 12 percent reserve now authorized is the minimum that it should be, while on the other hand, I think that 15 percent would not be excessive.

That portion of the proposed legislation dealing with withholding of dividends and interest not only affects thrift institutions of our type, but all stock companies, banks, and other institutions paying dividends or interest, and it is my personal opinion that this legislation is most uncalled for and unnecessary and that the additional expense of administering will be excessive for the small amount gained, aside from the fact that it does not appear to be fair that the many business institutions of the Nation should be drafted as Government agents to collect income taxes. I realize, of course, that some will say, "Well, we have to withhold from payroll," which is true, but withholding from payrolls is a more or less uniform proposition and does not fluctuate like interest and dividend on the many accounts.

I realize that for me to go into detail explaining my views would be too lengthy a letter for you to take the time to read as busy as you are in your capacity as chairman of the Finance Committee; therefore, I respectfully request, if it is possible for you to do so, that you use your influence to defeat that portion of the legislation dealing with withholding of dividends and interest, as it will work an extreme hardship not only on the businesses required to withhold the funds but on those that will not be liable for the tax and will have to spend time and effort trying to get it reimbursed.

Respectfully,

JAMES B. AVERITT.

Whereas we feel that H.R. 10650 as approved by the House is unfair to the many savers and homeowners in the Nation; and

Whereas this legislation tends to penalize thrift; and

Whereas we feel that our reserve should be not only 12 percent, but increased to 15 percent before we should be required to pay income tax in order that we have ample reserve to protect our investors; and

Whereas the withholding of dividends and interest is most unreasonable and uncalled for and will result in much confusion and hardships on both the individual investor and the payor and further results in our becoming a compulsory Federal agent for the purpose of collecting taxes, which will put us in an unpleasant relationship with our investors and will, in our opinion, be disastrous to our business: Now therefore, be it

Resolved, That the Board of Directors of the First Federal Savings and Loan Association of Statesboro, Statesboro, Ga., composed of L. M. Durden, Charles M. Robbins, Sr., Jack N. Averitt, H. P. Jones, Jr., Geo. M. Johnston, James B. Averitt, H. Z. Smith, Jr., L. E. Tyson, and H. Z. Smith, Sr., go on record as vigorously opposing this legislation with specific emphasis on the withholding feature of the bill as being the most unreasonable and unnecessary legislation ever proposed, and that a copy of this resolution be sent to Senator Harry F. Byrd, Chairman of the Senate Finance Committee, and to Senator Herman E. Talmadge, of Georgia, a member of the Finance Committee, both with a covering letter urging them to use their influence to defeat the withholding feature of the bill and that a copy be furnished each of the other members of the Senate Finance Committee as follows: Robert S. Kerr, Oklahoma; John J. Williams, Delaware; Russell B. Long, Louisiana; Frank Carlson, Kansas; Wallace F. Bennett, Utah; George A. Smathers, Florida; Clinton P. Anderson, New Mexico; Paul H. Douglas, Illinois; John Marshall Butler, Maryland; Albert Gore, Tennessee; Eugene J. McCarthy, Minnesota; Carl T. Curtis, Nebraska; Thruston B. Morton, Kentucky; Vance Hartke, Indiana; J. W. Fulbright, Arkansas.

THE PRINCEVILLE CANNING CO.,
Princeville, Ill., April 9, 1962.

Hon. HARRY F. BYRD,
Senate Office Building,
Washington, D.C.

DEAR SENATOR BYRD: I must ask your support of the omnibus bill, H.R. 10650. We annually spend two and three times our yearly depreciation of capital items and I feel the administration's 8 percent credit would help us and other small businesses like ourselves to acquire additional capital equipment designed to let us operate more efficiently.

I also feel that the measure to withhold income tax at the source on interest and dividends would be desirable. I can't help but believe that a good share of this income now goes tax free and this measure would make this income as readily taxable as all other income.

Business expenses and business gifts are usually overdone.

Capital gains taxation is desirable but can be an unfair advantage and it is my understanding this bill proposes to tax some income previously or presently allowed as long-term capital gains as ordinary income and, from what I know of this provision of the bill, I would assume this measure would be desirable, too.

I am a lifelong Republican, a businessman, and have taken advantage of the present capital gains savings available under the Internal Revenue Code. Thank you.

Very truly yours,

ROBERT H. TRUITT.

FIRST FEDERAL SAVINGS AND LOAN ASSOCIATION OF GREENE COUNTY,
Waynesburg, Pa., April 5, 1962.

Hon. HARRY FLOOD BYRD,
U.S. Senate,
Washington, D.C.

DEAR SENATOR BYRD: We write to urge with all possible emphasis that the Senate eliminate interest and dividend withholding provisions from the proposed Revenue Act of 1962 and to urge instead that the act be amended to provide for broader use of information returns such as form 1099. It is our considered judgment that the use of such information returns at a much lower level, such as $10 to $50 instead of the present $600, will prove almost as effective as the proposed withholding provision. Such an amendment will save a great deal of time, expense, and embarrassment for paying corporations, small savers, and the Treasury. The overall cost of carrying out the withholding provisions of the House bill might well offset any revenue advantage because of increased operating expenses all along the line, and any minor differences in revenue will be quickly eliminated through the use of data processing equipment now being installed by the Internal Revenue Service.

We do not believe that opposition to the withholding provisions of the bill is based on any desire to avoid, or help avoid, taxes; rather it is based on the opinion that it is impractical, unrealistic, and an unnecessary nuisance, and that it should not be inflicted on the public when an alternative which will avoid widespread resentment is available. We therefore urge you to support the effort to eliminate the withholding provisions from the proposed Revenue Act of 1962.

Very truly yours,

RICHARD L. BAILY, *President.*

THE BOWERY SAVINGS BANK,
New York, N.Y., April 4, 1962.

Hon. HARRY FLOOD BYRD,
Chairman, Senate Finance Committee,
Washington, D.C.

DEAR SENATOR: I am taking the liberty of writing to you concerning the withholding provisions of the tax bill (H.R. 10650), which is now before the Senate Finance Committee for hearings. I do this because I sincerely believe that the passage of this withholding legislation could be extremely damaging to the thrift industry of this country and may severely impair the ability of that industry to provide the necessary capital funds for the future growth of our economy.

I can well appreciate the concern of the Government that all taxes due it should be collected. We, and many of our depositors, seriously question, however, the proposed method of collection of taxes on interest and dividends. For several years, this institution and, in fact, most thrift institutions have, at the request of the Treasury Department, engaged in a program of public education concerning the reporting of dividends and interest credited. The continuation of this program, together with the reporting of dividends by account number which will be possible in a few years when the Treasury has adequate equipment to handle such reporting, would seem to us to be the proper way to solve the problem of underreporting to the extent that such underreporting exists.

The amount of hardship that will be visited upon the holders of thrift accounts by withholding is, of course, impossible to estimate. The possibilities of hardship are great. The mail which I have received from older depositors since the passage by the House of this bill indicates that this is more than a possibility. A recent analysis of the accounts in this bank has revealed the very startling fact that approximately 100,000 of our depositors are 65 years of age or older. It is to be expected that many of these depositors are living solely upon social security and savings. Since social security payments are tax exempt, it is likely that in many cases, after normal exemptions and the special exemption for persons 65 years of age or older, many of these people are not subject to the Federal income tax. It is equally likely that for many of these people every penny of their dividends and interest is of crucial importance to them. Just today I received two letters from depositors in their midseventies. These depositors demonstrated a very decided misunderstanding of the proposed law, although it has been very simply described in current articles in the newspapers. I can well imagine that when they are told that they must, if they are unlikely to have a net taxable income, file certificates of exemption or, in the alternative, seek refunds each quarter, their confusion will be complete. Delays in the realization of income (where refunds are involved) and confusion with respect to exemption certificates should not, in my opinion, be visited upon the many depositors of advanced age, who lack sophistication in this regard, unless it is absolutely necessary. It would seem that in view of the plans of the Treasury for account numbering, which plans should come into effect in a very short time, there is no imminent necessity.

There are many other valid arguments against withholding, with which I am sure you are already familiar as a result of presentations by the various trade organizations, etc. I can well appreciate the enormous amount of correspondence that you and others in the Senate have already received with respect to this withholding problem, and I would not wish to add to your burdens by repitition of such arguments. I did think, however, that you would be interested in knowing the very heavy concentration of savings accounts held by elderly people. This bank has about 400,000 depositors; accordingly, about 25 percent of all of our depositors are individuals of 65 years or older. As best we can ascertain, our age distribution is comparable to the age distribution of depositors in other New York State savings banks. I would hope that the problems which might be created for this important segment of our population would be weighed heavily and that the withholding legislation would not become a part of our tax law.

Sincerely,

MORRIS D. CRAWFORD, Jr.

SUPPLEMENTARY STATEMENT ON SECTION 19 OF H.R. 10650 SUBMITTED BY THE AMERICAN BANKERS ASSOCIATION

The American Bankers Association is in complete accord with the objectives of the Treasury to obtain full payment of all taxes that are legally due and owing, and, in particular, to see that taxable dividends and interest are fully reported on Federal income tax returns.

The banks of this country do not condone the failure by any individual or business to report all taxable income and to pay the taxes that are due thereon, whether such failure was intentional or was brought about through inadvertence, carelessness, or ignorance. The Government needs to collect every dollar owed to it and it is the responsibility of every citizen to report all taxable income.

As evidence of this position, the American Bankers Association and the great majority of banks have cooperated fully during the last 3 years with the educational program of the Treasury in bringing to the attention of the public the

obligation to report on income tax returns all dividends and interest whether received or credited. Banks have participated in newspaper advertisements and other programs in other informational media to bring this message to the public and have also sent these notices of tax obligation directly to their customers. Moreover, banks report directly to the Treasury all interest payments of $600 per year or more.

As further evidence of the spirit of cooperation, representatives of the association have had a number of meetings with representatives of the Treasury Department and the Internal Revenue Service to review the various areas of operational problems under a withholding system. Commercial banks are working with the Treasury on the account numbering system, to facilitate the use of electronic data processing equipment.

Nevertheless, the American Bankers Association has reached the conclusion that no practical, workable, withholding system has as yet been proposed which would not contribute to confusion and irritation on the part of ordinary taxpayers and which would not impose unreasonable hardships or inequities upon retired persons; widows; charitable, educational, and other tax-exempt organizations; and foreign and local governments on the one hand, nor be unduly burdensome and costly to banks and other dividend and interest payers on the other. The present proposal imposes burdens and hardships in varying degrees on both sides.

Opposition to withholding by the American Bankers Association is based on three major points: (1) The need for withholding has not been satisfactorily demonstrated; (2) withholding will be burdensome and costly to taxpayers and financial institutions and, in addition, will have serious repercussions on the economy; (3) section 19 of H.R. 10650 contains many provisions which unnecessarily complicate the withholding procedure. Each of these points is discussed below.

I. THE NEED FOR WITHHOLDING

The primary reasons for the adoption of a withholding system for interest and dividends are: (*a*) substantial underreporting of interest and dividends for tax purposes, and (*b*) inability to close an underreporting gap by ordinary methods of collection and enforcement. It is the contention of the American Bankers Association that the degree of underreporting is not so serious as to warrant imposition of withholding, particularly in view of the fact that workable alternatives to withholding are available. Our contention is based upon five major reasons.

First, that the overwhelming percentage of dividend and interest income is fully reported for tax purposes. The evidence for this statement is found in the reports of the Treasury Department. So far as dividend income is concerned, the Treasury testified in May of last year that over 90 percent of dividend income is presently reported on tax returns. Later, a scientific sample conducted by the Commissioner of Internal Revenue, the final results of which were furnished to Senator Byrd in August 1961, showed that 95 percent of dividend income is presently being reported. We cannot presume to say which of these two figures is the more correct, although we would observe that the Commissioner's sample results at least raise the question of whether the Treasury's estimate of the dividend gap—and of the increased revenue to be gained from withholding—may be overstated by 100 percent (5 percent nonreporting in the latter case as contrasted with 10 percent in the former). But in any case, it is apparent that cumbersome and costly system of withholding is to be imposed on all dividend recipients, although 90 to 95 percent of this income is already being reported.

It is probable that, as the Treasury points out, the interest-reporting gap is somewhat larger. It should be noted that in constructing its estimate the Treasury included, as it should, all interest income, even though much of this income will not be subject to withholding as, for example, interest paid on mortgages held by individuals, which accounts for 18 percent of total interest income. Although we cannot determine the proportion of interest reported in each category, with respect to overall payments Treasury officials estimated that about 65 percent of interest income is presently reported. Also, attention should be directed to the fact that the sample survey by the Commissioner of Internal Revenue showed that about 93 percent of interest included in information documents—largely amounts of more than $600 per year—was being reported on tax returns. Thus, even with respect to interest the picture is not

quite as grim as might have been thought and the need for a massive withholding system is therefore open to question.

Second, the educational campaign to make recipients of dividend and interest income aware of their tax obligations has been underway for only 3 years, and we can measure the results against the experience of only 1 year's tax returns to measure its results. Even so, evidence indicates that improvement is underway. In any event, results from such an educational program are bound to be cumulative. We agree with the Treasury and the Commissioner of Internal Revenue that much of the underreporting, particularly with respect to interest, is due to ignorance or carelessness. We believe that this type of underreporting can be overcome by education and constant reminders of the tax obligation.

In this respect it should be noted that certain recipients of dividends and interest may fear that reporting now will subject them to audit of past returns and possible criminal prosecution or penalties for failure to report in prior years. As indicated above, most of the failures to report have been unintentional or inadvertent. Accordingly, if the Treasury were to assure taxpayers who made full disclosure and restitution that they would not be subject to criminal prosecution or civil penalty (except, of course, in the case of fraud), there would probably be a marked increase in the numbers of taxpayers reporting and in the amounts reported.

Third, use of information returns in connection with electronic data processing equipment can be of immense help in closing the reporting gap. Over the next several years, we believe that it would be possible for the Internal Revenue Service to make much more effective use of information returns to prevent underreporting and failure to report dividends and interest. Within the next few years all income tax operations of the Internal Revenue Service are expected to be carried out on computers. With a workable account numbering system, information returns can be programed on the computers. Thus, we believe that effective enforcement of reporting of interest and dividends can be achieved without the necessity of imposing a massive, burdensome, and costly withholding system on payers of dividends and interest and finanncial institutions.

Treasury officials have commented that the use of computers would not be a substitute for withholding; in this respect they refer particularly to the burden of a comprehensive information return system on payers of interest and dividends. Currently, all dividend payments of $10 or more must be reported on information returns and in fact many dividend payers now report all dividend payments. Information returns are now required for most interest payments of $600 or more. It is granted that the continuation of so high a minimum would leave a sizable area for possible noncompliance. However, we are convinced that once an account numbering system had been in operation and made applicable to information returns on interest at the present level, some lowering of the minimum would be much less burdensome to banks and to other payers of interest than the proposed withholding system.

In support of the contention that the use of a taxpayer numbering system with electronic data processing would eliminate the need for withholding, we refer the committee to an article entitled, "Significance of Electronic Data Processing in Income Tax Administration," by Bertrand M. Harding, Deputy Commissioner of the Internal Revenue Service, published in the April 1961 issue of Tax Policy, a publication of Tax Institute, Inc. Mr. Harding has been in charge of Internal Revenue's conversion to electronic data processing.

On the first page of Mr. Harding's article captioned, "An Alternative to Withholding on Dividends and Interest," he says:

"ADP opens up some other views involved with the withholding idea. As you know, the subject of withholding on dividends and interest has gotten quite lively again. Such plans, however, always seem to involve so many serious problems of equity or administration that neither the Treasury nor the Congress has, yet, been willing to embark on such an adventure. In the meantime, ADP gives us a tool for a much more effective matching of information documents (particularly from forms 1099) with tax returns so as to enable us to tighten up enforcement and thereby reduce very substantially the gap between dividend and interest payments, on the one hand, and the amounts of such income reported on returns, on the other hand."

The author continues two paragraphs later with the statement:

"One of the important changes needed to make the information system an *effective substitute for withholding* is to obtain taxpayer account numbers on all forms 1099 and similar documents." [Italic supplied.]

Mr. Harding concludes this section of his article with the statement:

"With this modification and perhaps with some adjustments in the dollar level requirements for 1099's we believe that we shall have a reasonably effective system for the use of information returns and that that system will lessen the need for dividend and interest withholding."

While we recognize that this article is based upon a paper delivered in September 1960 and that the Treasury is now asking for withholding authority, the conclusion that the use of electronic data processing with a numbering system can be an effective substitute for withholding is based upon premises which have not changed.

Fourth, it is understood that as a part of the program of the Treasury to increase reporting of dividend and interest, an effort has been made to increase the number of criminal prosecutions in particularly flagrant cases of violation. Some of these cases have been completed and prosecution has been successful; however, we believe much more could be done particularly with respect to the publicity given to successful prosecutions, with emphasis on the fact that imprisonment can and does result from noncompliance. Widespread publicity of successful prosecutions in other nonreporting areas has resulted in measurable increases in compliance. We see no reason why similar publicity should not have the same result here.

Fifth, progress has recently been made in revising the income tax forms and instructions to clarify and emphasize the obligation to report dividends and interest. We suggest that much additional progress could be made by the inclusion of a few simple questions on the form, such as:

> Have you reported on this return all dividends and interest whether received directly, or credited to your account in a bank, savings and loan association, or other institution?

The Treasury Department has placed great rediance in its withholding proposals on the principle that the great majority of American taxpayers will not make a fraudulent statement and, therefore, the danger of claims for refunds of amounts greater than taxes withheld is not substantial even though receipts are not required to substantiate claims. Following the same principle, while a taxpayer may forget or be ignorant of the need to report dividends and interest, he is much less likely to make a deliberately untrue answer to questions such as the above.

I. IMPACT OF WITHHOLDING

Mandatory withholding of tax on interest and dividends has serious implications for the Nation, for individual taxpayers, and for financial institutions. Several of the more important considerations are discussed below. First, however, it might be helpful to indicate the magnitude of the problem which would confront commercial banks under a withholding system.

As of June 15, 1960, according to FDIC tabulations, there were 52 million regular savings accounts in commercial banks, the great bulk of which (probably more than 90 percent) paid interest. In addition, there were 10 million Christmas club and other club accounts, many of which pay interest. If other accounts, such as certificates of deposit, are included, it is clear that there are well over 60 million savings and time accounts in commerial banks today, of which perhaps 55 million pay interest.

For those who are prone to consider interest and dividend withholding as a relatively minor problem in comparison with wage and salary withholding, it might be noted that the number of savings and time accounts in commercial banks alone is not much below the total number of persons in our civilian labor force today. If we added the millions of accounts in mutual savings banks, savings and loan associations, and credit unions—and even neglecting the dividend side—it is apparent that the proposed withholding plan is much more comprehensive in scope than wage and salary withholding.

It is also significant that the great bulk of savings and time accounts are quite small in amount. For example, of the 52 million regular savings accounts in commercial banks, it is estimated that 32 million receive less than $12 interest per year (including some accounts so small as to receive no interest). Thus, for millions of depositors withholding will be in pennies, and in the many cases of overwithholding the individuals concerned will probably not know or bother to recapture the amounts due them.

Withholding on deposit accounts is only one of the several ways in which section 19 of this bill will affect commercial banks. For example, banks will also be affected with respect to dividends paid to their stockholders, dividends on the stock, and the interest on obligations of other corporations for which they

act as paying agents, interest coupons on Government and corporate bonds which are presented to them for collection, redemption of U.S. savings bonds, and the receipt and distribution of income to trust beneficiaries, religious, charitable, and educational organizations for whom they act in a fiduciary or custodial capacity. Thus, banks would become the major tax collector for the Treasury under any system imposing a withholding tax on dividends or interest at the source. They would be blamed along with the Treasury and the Congress for any hardship or inconvenience caused the dividend and interest recipients against whom the tax is withheld.

Turning now to the principal difficulties which we anticipate from withholding, we would direct your attention to the following points.

1. One of the major objectives in tax legislation and administration is to maintain as simple and understandable a tax system as possible so as to permit the average taxpayer to prepare and compute his own income tax without assistance. Effective tax administration depends upon general taxpayer cooperation under a self-assessment system. Increased complications inevitably make it more difficult for the ordinary taxpayer to participate in the self-assessment procedure.

The withholding plan proposed will create many complications in the report forms applicable to individual taxpayers. There would have to be separate listings for dividends and interest subject to tax withholding and for dividends and interest excluded from withholding. No matter how clear the instructions, examples, and forms used in explaining the "gross up," it will be misunderstood by some taxpayers. There are bound to be many errors on tax returns and much confusion could result. There would also be an increased burden on the Internal Revenue Service in auditing returns and the processing of millions of refund claims.

2. Withholding could have a seriously adverse effect on the Government savings bond program. The major reason for this is the fact that savings bonds are discount bonds and are promoted largely on the basis that a certain sum invested now will, in a fixed number of years, permit the holder to redeem the bond at face value. These bonds were designed to appeal largely to the unsophisticated investor and to persons of moderate or low income. No amount of advertising will repair the adverse effect upon many such individuals when they find that their $25 bond is redeemed by the bank at $23.75. Many such persons are likely to turn to alternative savings media for placement of their funds.

3. Withholding will impair the functioning of the Government bond market. Tax-exempt foreign governments, central banks, domestic government units, and other tax-exempt organizations which are not liable for Federal income taxes are likely to be displeased with the loss of revenue which they would otherwise earn on amounts withheld between the date of payment and refund. This loss will never be recovered. There will probably be continuing dissatisfaction with the paperwork and redtape necessary to be followed four times a year in order to claim refunds for withheld taxes. In this connection, the committee might want to consider the propriety as well as the legality of taxing States, municipalities, and other local government units, even though such taxes are refunded within a reasonably short period of time.

4. The administration is carrying out a comprehensive attack on the balance-of-payments problems of the United States. We suggest that to some extent the proposals for withholding will run counter to the balance-of-payments program. Withholding will deprive foreign governments and central banks of 20 percent of their earnings on investments in U.S. Government and corporate obligations. Even though prompt refund is granted, there will be some loss of income and the inconvenience of claiming refunds will be a continuing one. Consequently, investment in dollar claims will be relatively less attractive.

5. Finally, section 19 of H.R. 10650 would impose substantial costs and inconveniences and create problems of customer relations for banks as well as other payers of dividends and interest. We remind the committee that the collecting of taxes for the Government would be in addition to the numerous services that banks are already performing for the Government without adequate compensation. In support of this statement, we refer to a report of the Treasury Department of June 15, 1960, entitled "Report on Treasury Tax and Loan Accounts, Services Rendered by Banks for the Federal Government, and Other Related Matters." On page 3 of that report the Treasury listed among the more important services rendered by banks the following: issuing savings bonds, cashing savings bonds, handling subscriptions to Government securities, handling matured Government notes, bonds, etc., handling matured coupons on Government bonds, cashing Government checks, handling depository receipts, and reporting

large or unusual currency transactions. That report concluded that for the year under study, 1958, the estimated expenses incurred by banks in rendering services for the Federal Government exceeded the estimated earnings from Treasury tax and loan accounts by over $5 million. Expenses which would result from withholding, which we will now discuss, would significantly increase this figure.

To describe the operating problems which withholding would entail for banks, it is necessary to describe some aspects of bank operations in detail. It is only in this way that your committee can be fully acquainted with the massive impact of withholding. This discussion will demonstrate that withholding is far from a simple matter.

Savings accounts.—The magnitude of the task in the case of withholding on savings and time accounts has already been mentioned. In this connection, the following points should be considered: (*a*) Many banks—as a matter of customer relations—will be compelled to follow the costly and time-consuming procedure of notifying depositors of amounts withheld, despite the fact that one of the alleged "advantages" of the plan proposed is that there will be no statutory requirement for such notification; (*b*) banks will have to devote considerable time to explaining the "gross up" system to their depositors; and (*c*) recordkeeping with respect to exemption certificates will be almost insurmountable under the present plan and banks will be continuously filing new certificates, canceling old certificates, and attempting to keep track of customers who have forgotten to file their annual certificates—customers who doubtless will blame the banks if withholding is suddenly applied to them. Perhaps the best way of illustrating these problems from the point of view of the individual bank is to cite the following passage from the testimony of an officer of a large bank before the Committee on Ways and Means:

"In my bank withholding on interest payments will create particularly difficult operating problems. All of our banking is conducted under one roof as we have no branches. This requires particular attention to efficient operation at our teller windows in order to handle the large volume of transactions. On Monday, January 4, 1960, we processed 30,407 transactions of which 6,500 were interest entries. On any interest payment or tax payment date, we will receive numerous questions about the reason for reduction in amounts paid because of withholding or about the entry of interest on tax returns or a claim for refund. Therefore, our regular banking operations might well be brought to a standstill. Accordingly, my bank feels that it may be essential if withholding is adopted for us to attempt, difficult as it may be, to give notice to each of our savings depositors of the gross amount of interest credited, the amount of withholding tax deducted, and the net amount credited to the depositor. In any event, if our depositors upon presentation of their passbook requested entry of all three items, we would feel obliged as a matter of customer relations to comply. The increase in costs, time spent, and loss of customer good will because of delays appears to us to be a most serious matter."

Trusts.—Some 3,000 banks in the country have trust powers and handle approximately 1 million trusts, providing services for many millions of individual beneficiaries. The beneficiaries of most of these trusts are individuals, widows, children, or other dependents, young and old. Many trust departments also provide services for corporate pension, profit sharing, and welfare trusts, and for charitable foundations and other tax-exempt entities.

With respect to trusts, the first matter to emphasize is the loss of income which would follow from withholding for profit-sharing and pension trusts. The same hardship would be experienced by all tax-exempt entities such as churches, colleges, charitable organizations.

As of the end of the calendar year 1960, according to figures taken from the report of the Securities and Exchange Commission, there were about $30 billion of assets subject to the withholding proposal in trust funds for employee benefit plans. H.R. 10650 specifically excludes trust funds from claiming exemption certificates for dividend income, corporate bond interest, or for interest from most Government obligations—yet almost all of the income of these funds comes from such sources.

The 1960 average earning rate on such funds amounted to 3.64 percent and resulted in income available for immediate reinvestment of more than $1 billion. If a 20 percent withholding rate were applied to this amount on an annual basis, about $54 million of income of pension trusts would be sterilized per quarter. Thus, under a withholding program without exemptions for the types of investment listed, there would be a permanent loss to pension trusts of the earnings on the amounts withheld between the times of withholding and the dates of refunds.

A further reduction in earning power would result from the loss of the compounding effect of interest that would otherwise have been earned on the sterilized funds. Pension trusts and all other organizations, which the Congress for valid reasons has determined should not be subject to Federal income tax, would be forced to make what in effect is almost a permanent interest-free loan to the Government.

The proposal for recoupment of taxes withheld on dividends and interest by offset against amounts withheld for income and social security taxes could not be applicable to tax-exempt trusts held by banks. In every bank, trust accounts must be maintained separate from each other and from the accounts of the commercial operations of the bank.

Although the provision for quarterly refunds to nontaxable individuals and tax-exempt organizations which cannot recoup over withholding by offset or file exemption certificates is intended to be helpful, it will, if adopted, greatly complicate trust operations. If a beneficiary is not subject to tax, he will need information on the amount of dividends and interest subject to withholding and the "gross up" of his claim for refund on a quarterly basis. In order to provide this information to such individuals, who will often constitute a sizable percentage of trust departments' beneficiaries, bank trust departments may find it necessary to convert their reporting to a quarterly basis and to allocate fees and other charges by the quarter. This could quadruple much of the paperwork for reports.

In the past trust departments have seldom been able to match their fees with cost increases. It would be most unlikely that the typical trust department would be able to pass on more than a small amount of such additional costs to trust beneficiaries.

This is only one part of the increase in recordkeeping and income tax computations which would be required in trust operations. Under the Treasury proposal, trustees would be responsible for computing the "gross up" and allocating the withheld tax to each beneficiary and the corpus of the trust in accordance with the terms of the trust instrument. This alone will be a tremendous burden at taxpayment time. When we contemplate the complications of gross and net dividends, the "gross up," the claim for tax credit, and the possibility of quarterly refund claims, even the clearest possible Government instructions to beneficiaries will not prevent bank trust departments from being overrun by beneficiaries with problems in preparing their tax returns.

One New England bank has estimated that refund claims would have to be filed for 25 to 50 percent of its trust beneficiaries who would have no tax liability or who would be subject to overwithholding because of the 20-percent retention.

It is also felt that trust departments will be unable to handle the additional work with present staffs.

Another special problem in trust departments is the handling of nominee accounts. At the present time, trust department nominee accounts hold stock for the accounts of many kinds of shareholders, individuals, tax-exempt organizations, and aliens.

Most of the operating problems already discussed with respect to both interest and dividends will be encountered by banks acting in a custodial capacity. In addition, a limited group of the banks in New York, Boston, and Philadelphia now act as withholding agents for tax on income collected for nonresident aliens holding securities registered in nominee names. While specific statistics are not available, it is possible that investments of nonresident aliens held by custodians registered in nominee names may amount to more than double the amount represented by certificates registered directly in nonresident alien names. Under the bill as presently constituted, tax would be held in excess of liability in all cases involving residents of tax treaty countries. All of the difficulties attendant on obtaining refunds for resident and exempt organizations as previously discussed would be present in the case of aliens to an even greater degree, because they are accustomed by years of experience to having their tax liability satisfied by withholding at the source. In the case of those whose investments are held by custodians, past experience makes it all too clear that in many cases the onus of responsibility for their predicament will be placed on the custodian banks. In addition, the banks will be flooded with requests for statements to be used in support of refund claims.

Interest coupons.—Interest-bearing coupons are clipped by their owners and cashed or deposited at a bank. This bank, which may be any one of the approximately 23,000 banking offices in this country, is responsible for verifying and totaling the coupons and must then obtain reimbursement through banking

channels (either from a correspondent bank or a Federal Reserve bank). The intermediary bank will credit the account of the first bank, again verify and total the amount it has received, and forward the coupons to the paying agent of the issuer of the obligation. In some instances several intermediary banks will be involved. In the majority of cases a bank will also act as paying agent for the corporate obligations. If a bank is a paying agent, it receives the total amount of interest due from the corporation and is responsible for payment of the coupons and final accounting to the corporation.

What would be the effect of withholding on these operations? To begin with, there would be a very serious problem in the processing of coupons. As indicated above, experience demonstrates that it is best to verify and total the amount of interest coupons handled at each stage of the transactions. All of the bank tellers handling coupons, all transit clerks and employees of the paying agent will have to be trained to handle these coupons at 80 percent of face value. Thus, the probability of error at one of the many stages in the handling of coupons would be greatly increased. Each person handling coupons will have to be furnished with a table showing amounts ranging from a few cents to many dollars in order to readily determine 80 percent of all coupons of every possible value. This cannot be a one-page table or a simple pamphlet because coupons are not always issued in even units, but may well be odd amounts such as $1.81, $10.33, or $22.08. Accordingly, this conversion table, if prepared, will be bulky and awkward to use.

Banks will probably request depositors to list coupons on tax-exempt obligations separately. Of course, there will be some uncertainty as to whether certain obligations, such as those which have been assumed by a State or municipal government, are tax exempt. Moreover, the depositors will be asked to list all taxable obligations at face amount and at 80 percent of face and total each set of figures. The time required of tellers and bank officers as well to try to explain to depositors what is needed will undoubtedly delay service at tellers' windows and irritate customers. In many cases tellers will find that they will have to prepare the lists themselves or will have to call upon an officer for assistance. In any event, such lists will have to be verified or rechecked before transmittal to the correspondent bank. It has been said that withholding will require "some explaining by patient bank executives." This is clearly an understatement. Taxpayer confusion will inevitably result regardless of the amount of patient explanation.

The difficulties in separation, verification, and totaling of interest coupons will continue through all intermediary banks. Any adjustments or corrections of errors will, of course, have to flow back through the whole chain of intermediary banks to the point where the error occurred.

Thus far we have discussed only the handling of interest coupons. Banks, brokers, and the investing public also will need to be educated to make the customary adjustments on accrued interest at the time of the sale of a corporate bond in coupon form at 80 percent of face. The disruption in the investment market and the confusion which will continue could be most damaging to investor psychology. It is apparent that adjusting market practices and private investor habits to transactions at 80 percent of accrued interest will be most difficult.

Dividend paying agents.—The work of banks acting as dividend paying agents will be complicated in several ways. Some corporations as a matter of customer relations will insist that the stockholder be informed as to the gross dividend, the amount of withholding tax, and the net dividend paid. Some dividend payers may find that there is no room for this additional information on the equipment they are using. In such cases there will be a substantial cost of redesigning their equipment and changing their methods of operation. Where a dividend is paid partly from income and partly from capital, the Treasury proposes not to withhold on the capital distribution portion of the dividend. In many cases, particularly in the utility field, when such dividends are paid the proportions which represent capital and regular dividend are determined later after consultation with the Internal Revenue Service. In this situation there would be overwithholding if 20 percent of the full amount were remitted to the Treasury.

The Treasury proposes to withhold against distributions of dividends in kind. Some corporations make a practice of dividend distributions of the stock of another corporation. It would be very complicated and difficult to attempt to obtain the cash amount of withholding from the stockholder in advance of distribution. If 20 percent of the stock issue were withheld, there would be no assurance that the value realized upon sale would be equivalent to the value of the stock on the date of dividend distribution.

In summary, the withholding system proposed in section 19 of H.R. 10650 is far more complex and cumbersome than may appear to be the case upon first consideration. Indeed, there is serious question as to whether the system is workable. In this connection it may be significant to note that the Canadian Government experimented with withholding on interest and dividends and within less than 4 years discarded this collection device as unsatisfactory. A 7-percent tax withheld at the source on dividends and interest was imposed September 1, 1942, and repealed December 31, 1945. At the time the tax was repealed, the Minister of Finance stated that the tax was not generating sufficient funds, was confusing to taxpayers, and created too many clerical problems for the Government. It is not impossible that a similar end is in store for section 19 should it be enacted into law.

III. RECOMMENDED AMENDMENTS

It should be clear from the foregoing that a workable and practical system for interest and dividend withholding has not yet been devised. Nevertheless, if H.R. 10650 is to be enacted, several changes could be made which will to some extent lighten the burdens withholding would place upon banks and upon the public. Accordingly, the following amendments to section 19 are recommended:

1. That section 3483(a) (2) and (3) be amended to provide that exemption certificates filed by individuals can be relied upon by the payers of dividends or interest until revoked by the individual or organization.

Although necessary to remove inequities in the withholding system, exemption certificates nevertheless complicate the task from the standpoint of payers of interest or dividends. The burden will be magnified many times if, in addition, such certificates must be filed annually, as presently provided in the bill.

As noted earlier, annual filing of exemption certificates will pose particular difficulties for banks. In addition to the added costs, there will be serious customer relations problems.

It is reasonable to assume that most individuals, who would file certificates would be those for whom no substantial change in income can be anticipated. The revenue loss to the Treasury from those individuals who permit exemption certificates to remain outstanding even after their tax status has changed should be slight. There is always an opportunity to devise methods of detecting and reminding such individuals of their obligations.

In this connection, it should be pointed out that exemption certificates filed under wage withholding are permitted to stand until changed by the taxpayer. We see no reason why the same principle should not apply in the case of dividend and interest withholding.

2. That section 3483(a)(3) be amended to provide that tax-exempt organizations may file exemption certificates for the same types of interest and dividend income as are available to individuals. As presently worded, this section permits such organizations to file certificates only for interest or dividends on savings accounts and on savings bonds.

This amendment is suggested for reasons of equity. We see no justification for discrimination against charities, colleges, pension and profit sharing plans, and other tax-exempt organizations.

3. That section 3483(a)(3) be amended to provide that exemption from withholding is made available to nontaxable organizations and individuals holding investments through the medium of a trust.

As presently worded, exemption certificates will not be available to nontaxable trust bneficiaries. This will cause severe hardship in the case of those trust beneficiaries dependent upon modest incomes from small trusts. In addition, it will discourage the maintenance or creation of trust relationships.

The argument against providing exemption certificates in these cases is the difficulty of matching trust beneficiaries with dividend or interest payers in view of the intervening agency of a trust. To overcome this objection it is further recommended that the trustee be authorized to file an exemption certificate for each type of dividend or interest for which certificates are available, and that the trustee then be authorized to act as withholding agent, empowered to withhold and remit to the Government the withheld amounts with respect to sums payable to taxable beneficiaries but to provide for full exemption for nontaxable or tax-exempt beneficiaries.

4. The provision that the withholding agent may retain withheld funds until the end of the first month after the calendar quarter in which the withholding takes place will by no means approach adequate compensation for the additional expenses of withholding. Provision should be made for adequate compensation

of withholding agents for the additional expenses arising from the new withholding requirements.

In this connection, it should be remembered that the costs of withholding will be inequitably distributed among the commercial banks. Particularly hard hit will be the commercial banks which do a large saving deposit business, a characteristic of thousands of small country banks. These banks will not only be saddled with the task of withholding on millions of savings accounts, but they will be deprived of the use of the amounts withheld for a major portion of each year. While it is true that these sums will remain somewhere within the commercial banking system, withholding will nevertheless result in a redistribution of a portion of the Nation's deposits to the detriment of those banks specializing in accepting savings deposits.

5. Even if all the changes recommended above were adopted, conversion of operations to a withholding system would be complicated, difficult, and time-consuming for commercial banks. In many cases, equipment would have to be altered or replaced in order to handle withholding. It is essential that a reasonable time be afforded payers of interest and dividends before withholding becomes effective. We urge, therefore, that if this legislation must be enacted, the effective date of this section should be made at least 1 year after final enactment.

6. One of the most significant changes which can be made in H.R. 10650 to remove some of the difficulties referred to above would be an amendment to exclude from withholding interest payable on governmental and commercial marketable securities.

We have serious doubt whether adequate consideration has been given to the problems (some of which we have commented on above) that will arise if withholding is applied to marketable securities. The magnitude and complexity of operations in marketable securities are not readily understood by most persons not closely indentified with such operations, and considerable confusion and disruption to ordinary markets could result from withholding in this area. This in turn could result in additional interest costs to the Government and commercial borrowers. The fact that the Ways and Means Committee and the Treasury were unable to devise a means of applying exemption certificates to bond coupons is a further indication of the complexity of withholding on marketable securities.

A review of the classes of holders of governmental and commercial marketable securities will show that all but a small part of them are owned by financial institutions (banks, insurance companies, etc.). State and local government funds, foreign governments, and international institutions, public and private pension funds, trustees, and corporations. Such holders are correctly reporting their interest income on their tax returns. No withholding system will provide more taxes from such holders, and we do not believe they should be subjected to the burdens and expenses of a withholding system to obtain additional taxes from individual holders of such securities—which at most can only be in nominal amounts—and which will result in the problems we have pointed out above.

We are making these suggestions in an effort to make constructive proposals to improve section 19. Even if accepted they do not alter our conclusions stated above "that no practical, workable withholding system has as yet been proposed which would not contribute to confusion and irritation on the part of ordinary taxpayers and which would not impose unreasonable hardships or inequities upon retired persons, widows, charitable, educational, and other tax-exempt organizations, and foreign and local governments on the one hand, nor be unduly burdensome and costly to banks and other dividend and interest payers on the other."

NATIONAL ASSOCIATION OF SUPERVISORS OF STATE BANKS,
Washington, D.C., April 20, 1962.

Re withholding of taxes on interest and dividends, H.R. 10650.

Hon. HARRY F. BYRD,
Chairman, Senate Finance Committee,
Washington, D.C.

DEAR SENATOR BYRD: The National Association of Supervisors of State Banks respectfully presents its views in opposition to that section of the Revenue Act of 1962 relating to the withholding of taxes on interest and dividends.

This association is 60 years old. It represents 52 supervisors who are the banking officials of all the States and of the Commonwealth of Puerto Rico and

of the Virgin Islands. As of December 31, 1961, there were 9,446 State-chartered banking institutions under their jurisdiction, with total deposits in excess of $152 billion.

Your committee has already heard many strong arguments opposing this legislation from the standpoint of the taxpayer, particularly the effect of over-withholding and delayed refunds upon certain classes of taxpayers. The supervisors, however, wish to convey their concern regarding the effect this withholding provision would have upon the strength and vitality of the banks they supervise—and upon the supervisory process itself. This concern, of course, is, and should be, a national concern inasmuch as the State-chartered banking institutions comprise substantially more than half of the banking institutions in the country and hold a majority of the deposits.[1]

We would appreciate your reviewing the table on the succeeding page which sets forth important statistics regarding State and National banks:

	State chartered banks	National banks	Total banks
All banks (as of Dec. 31, 1961): [1]			
Number	9,446	4,513	13,959
Total deposits (billions)	$152	$136	$288
Time and savings deposits (billions)	$76	$46	$122
Percent of time and savings deposits to total deposits	50	33.8	42.4
Insured commercial banks:			
Number of savings accounts [2] as of June 15, 1960 (millions)	23	29	52
Total interest paid on savings accounts in 1960 (millions) [3]	$645	$783	$1,428
Average interest per account (1960)	$28	$27	$27.5
Insured commercial banks with deposits of less than $10,000,000 (1960):			
Number	7,311	3,082	10,393
Net earnings after income taxes (millions)	$205	$118	$323
Average net earnings after income taxes	$28,000	$37,313	$30,700
Estimate of number of banks with predominantly manual recordation procedures			[4] 12,000

[1] National and State (Federal Reserve member, insured nonmember of the Federal Reserve, and nonmember uninsured). Also includes mutual savings banks.

[2] Excludes some 10 million Christmas savings accounts.

[3] Total interest on time and savings accounts in 1960 in State banks was $806,000,000, national banks $979,000,000, and total $1,800,000,000. There are no figures available to show interest on savings accounts alone. It is estimated, however, that 80 percent represents interest on savings accounts.

[4] "Banks of this size (the 8,000 or so with less than $5,000,000 in deposits) and even those considerably larger do not have automatic equipment. In at least 12,000 of the 14,000 commercial banks withholding operations would be handled on a manual basis with the help of such tables and charts as are furnished by the Government or are available at reasonable cost." Testimony of Blaine H. Wiseman, president of the Old Capital Bank & Trust Co., Corydon, Ind., appearing on behalf of the American Bankers Association, before House Ways and Means Committee, May 26, 1961.

The following conclusions can be reached from these statistics:

(1) There are numerous small banks in this country, predominantly State banks, with modest earnings.

(2) State banks have a higher percentage of time and savings deposits to total deposits than do national banks.

(3) Most of the small banks are lightly mechanized and therefore most recordation is done manually.

The adoption of this withholding proposal would impose a tremendous increase in activity on these small banks which have a modest earnings level, and would compel them to employ additional personnel. This activity will be of many kinds:

(1) To record withholding of interest, at least four recordations per year will be required for each nonexempted deposit.

(2) Quarterly tax returns will have to be prepared and filed for all interest deposits withheld.

(3) At tax time, the number of inquiries as to the whys and hows of tax withholding will burden the staff. Public relations will require more than just a pink slip explaining the process. A patient, courteous answer to each inquiry will be required. Indeed, even though the proposed bill does not so require, many banks will consider it necessary, in the interest of good public relations, to furnish their depositors a statement on full interest, amount of deduction taken, and a detailed explanation of tax procedure to be followed by the depositor on his own individual return.

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[1] As of Dec. 31, 1961, there were 4,513 national banks holding $136 billion in deposits, as compared to the 9,446 State banks with $152 billion in deposits, referenced above.

(4) Many depositors will have to be acquainted by the bank with the procedures and availability of exemptions and refunds.

We have conducted a survey of all the State bank supervisors regarding the effect this proposal could have on bank supervision and the banks they supervise. There are set forth below a few of the comments submitted by them:

"Of the 40 State-chartered banking institutions currently operating in this State, 31 have total resources of less than $10 million each. These smaller banks generally do not possess elaborate bookkeeping equipment, and none has yet entered the data processing field. I sincerely feel that the imposition of 'withholding' would inflict a real hardship on such banks in the areas of time consumption, enlargement of staff, and additional expense." J. F. M. Slade, superintendent of banks, State of Oregon, Banking Department, March 26, 1962.

"The volume of detail involved will add to the cost of operations and will be a matter of great concern to our commercial banks and savings banks. The increase in costs in operations is a burden now due to the recent increase in interest rates being paid on time and savings deposits. This proposed additional burden will be material as there are 21 savings banks and 92 commercial banks in New Jersey. For the banks, time deposits average 44.9 percent of the total deposits, so that many banks will have a much higher proportion in time or savings deposits." Charles R. Howell, commissioner of banking and insurance, New Jersey, Department of Banking and Insurance, April 6, 1962.

"We feel that the withholding provision of H.R. 10650 would create an undue administrative workload on banks because of the large number of accounts involved; also to be considered in this regard is the probability of the customer requesting information for income tax purposes as to the amount of interest paid and taxes withheld." Joseph C. McMurray, supervisor of banking, State of Washington, Division of Banking, March 23, 1962.

We would also like to quote the testimony of the president of a small State Bank before the House Ways and Means Committee, which we believe to be highly typical:

"My bank has total deposits of less than $6 million. The bank I represent is typical of the great majority of commercial banks in the United States. As a matter of fact, there are 8,000 banks in this country which have total deposits of less than $5 million. These banks have a small number of employees who are required to handle all phases of the banks' many operations. In many cases the president or cashier of the bank is the only active banking officer. He and his small staff will have to absorb the additional duties and burdens of withholding which have been discussed by my associates." Blaine H. Wiseman, president of the Old Capital Bank & Trust Co., Corydon, Ind.

Our comments have been limited entirely to the matter of withholding of taxes on interest. We have not endeavored to discuss in detail the effect of withholding of taxes on interest on debt securities, or the substantial additional activity that will be required in trust departments of small banks in implementing withholding of taxes on interest and dividends. We are sure these matters have been more than adequately handled by other witnesses before your committee.

In view of the foregoing, the supervisors wish to register with the committee their very deep concern that the adoption of this withholding proposal will increase the function of small banks with a concomitant requirement for additional personnel and expense. It is their concern that this additional imposition of expense could, in many instances, cause a drain on the already narrow profit level of these banks so that, in the aggregate, the net effect will be a weakening of the vital segment of the banking industry represented by small State banks.

There is one other matter which we would like to discuss. It relates to the elimination of any possible contingent liability on a bank's part in the implementation of the withholding measure.

It is our understanding that if a bank is presented an exemption certificate, it has to accept it at face value, whether it is or is not, in fact, accurate. The report of the House Ways and Means Committee so states.[2] We hope that the withholding proposal in H.R. 10650 is not adopted. However, if it is, we want it to be made absolutely clear that a bank does not have any liability arising

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[2] "Withholding agents are required to honor an exemption certificate which on its face indicates that the person filing it is entitled to exemption, regardless of whether such person is in fact entitled to file it." P. A149, H. Rept. No. 1447 on H.R. 10650, Committee on Ways and Means, Mar. 16, 1962.

from the failure to withhold taxes because of the presentation of an exemption certificate.[3]

Of course, even with the foregoing exemption immunity, there is still the possibility for a contingent liability arising by reason of the withholding provision. This point is well stated by Mr. Slade, the superintendent of banks for Oregon:

"Of necessity, the discharge of the withholding responsibility would be largely manual in these lightly mechanized banks and the chances of error or miscalculation would, as a result, assume important significance. I do not find it difficult to imagine how a contingent liability would be incurred by a bank by virtue of damages suit brought by a customer, whose savings or other time account interest had in error been subjected to faulty and excessive tax withholding. In certain instances, I would think that a claim by a customer that the excessive deduction had deprived him of an opportunity to make a profitable investment could involve a bank in quite substantial damages."

Conversely, underwithholding subjects the banks to the penalties provided in the proposed bill.[4]

The National Association of Supervisors of State Banks appreciates this opportunity to present its views to the Senate Finance Committee on H.R. 10650. We sincerely hope the matters set forth above will lead this committee to recommend against the adoption of the provision of H.R. 10650 relating to the withholding of taxes on interest and dividends.

Sincerely yours,

CHARLES R. HOWELL,
Commissioner of Banking and Insurance, New Jersey;
Chairman, NASSB Legislative Committee.

STATEMENT OF G. KEITH FUNSTON, PRESIDENT, NEW YORK STOCK EXCHANGE

The New York Stock Exchange welcomes the opportunity to comment on those provisions of section 19 of H.R. 10650 which would set up withholding of taxes at the source on dividend income. This issue has been debated in Congress many times in the last two decades. The reasons which prompted rejection of withholding in the past are even more relevant now.

The exchange recognizes the underreporting problem and the Government's understandable wish to do something about it. But, withholding is not only or the best solution. The committee should turn down the present proposal for the following reasons:

1. Its impact is harshest on those who can least afford to be hurt or inconvenienced.
2. The bill as written is administratively unworkable.
3. Better alternatives are available.

HARSH IMPACT

Dividends are already on a partial pay-as-you-go basis, through the requirement that they be included in quarterly estimated tax returns. Many stockholders also adjust their wage withholding upward to cover dividend income. Withholding a flat percentage of dividends at the source of payment would impose unnecessary hardships on most lower income investors who are not now subject to the quarterly estimating requirement.

Wage withholding poses no comparable problems, because the employer can usually base the appropriate amount on the employer's marital and dependency status. Serious overwithholding rarely results. A flat 20 percent withholding rate on dividends, on the other hand, would create susbtantial overwithholding. The paying corporation cannot possibly adjust to the tax status of the recipient.

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[3] Under sec. 3481 of H.R. 10650, subch. D, this general rule is stated: "The withholding agent shall be liable for the payment of the taxes required to be deducted and withheld under this chapter, and shall not otherwise be liable to any person for the payment of any such payment."

[4] Par. (b) of sec. 3481 of subch. D, H.R. 10650, states as follows: "If the withholding agent, in violation of the provisions of this chapter, fails to deduct and withhold any tax under this chapter, and thereafter the tax against which such tax may be credited is paid the tax so required to be deducted and withheld, shall not be collected from the withholding agent, but this subsection shall in no case relieve the withholding agent from liability for any penalties or additions to the tax otherwise applicable in respect of such failure to deduct and withhold."

Since most stockholders are in income brackets with an effective rate of less than 20 percent, perhaps 8 million stockholders will experience overwithholding.

For 1959, the latest year for which income tax statistics have been published, two-thirds of the returns reporting dividends showed adjusted gross income of less than $10,000. As the average effective tax rate for all returns in this income group is slightly below 10 percent, a 20 percent withholding rate would clearly mean massive overwithholding for taxpayers receiving dividends (and interest).

Plight of the small stockholder

Low-income stockholders by the hundreds of thousands—elderly, retired, widowed—rely wholly or partly on dividend income to pay for their daily essentials: for their food, their rent, their electricity, their medical bills. Because of deductions, exemptions, exclusions, and credits, many of these people have little or no tax liability. Yet, these thrifty people would have to file exemption certificates or suffer at least a temporary loss of 20 cents out of every dollar of dividend income. For those not alert to the need for filing refund claims, the loss would be permanent.

This is not a theoretical problem. Investors from various parts of the country have written to the exchange asking us to point out to Congress the practical difficulties dividend withholding would create for them. A retired Californian, for example, writes:

"I am one of the many millions of older people who are living on a more [or] less fixed income, and depend on my dividends for my living, and even this 20 percent means a great deal to me."

A Fort Lauderdale, Fla., widow declares:

"I am a widow and am one of the small investors who depend on my dividend checks to get along, but with 20 percent withholding tax, I could not make ends meet."

An elderly stockholder in Westchester, N.Y., echoes this concern:

"There are probably several hundred thousand elderly people like myself who have no income whatsoever except the dividends from the small investments in stocks of a few companies. If these dividends are reduced in that manner [through withholding] their means of support will be lessened * * *."

Public opinion on withholding

The widespread opposition to withholding undoubtedly reflects public awareness of these facts. About a year ago, the exchange measured the extent of public feeling on the subject through an independent research firm—Sindlinger & Co., of Philadelphia. Here are the two basic findings of that survey:

> Three out of four shareowners expressing an opinion were against a withholding tax on dividends.
>
> Eight out of ten nonshareowners expressing an opinion opposed a withholding tax on savings account interest.

Public resentment

A recurring theme in the letters received at the exchange is this one, from a Boston man:

"* * * Why should 95 percent of us be penalized, when there may be 5 percent who don't report their dividends. I'm strongly opposed to it * * *."

An Illinois woman feels that, "To penalize the many honest people who report for the minority who do not, seems unjustifiable." A woman in California suggests, "Let our Government spend the money it will cost to administer this collection program to catch evaders and quit penalizing the honest taxpayers."

In short, these people—the vast majority of whom pay their taxes—resent the implication, the insult to their thrift and honesty, involved in a withholding proposal. But, more than that, they object to the unfairness of special inconveniences and even hardships. "Why," they ask, "should we be put to the bother of trying to get back money we should have not been deprived of in the first place? And why should we lose the current use of that money?"

ADMINISTRATIVE DIFFICULTIES

The withholding proposal originally submitted by the administration last year was bad enough. In a misguided effort to make the plan palatable and modify some of the harsh impact of overwithholding, the House bill creates a mechanical monstrosity. To those who would have to handle the 45 million stockholder accounts under this fantastic creation, the plan is simply unworkable.

In fact, the very nature of withholding on dividends and interest makes it impossible at one end or the other. The more workable withholding is made at the payor level, the more burdens and hardships it creates for the dividend recipients. And paradoxically, the more that is done to minimize these hardships, the more unworkable the plan becomes at the payor level.

Exemption certificates

The latest version of the tax bill provides a system of exemption certificates in certain circumscribed situations. Children under 18 may be exempt from withholding. Investors who "reasonably believe" they will have no tax liability may file for exemption annually. In the case of savings bank interest, this may be relatively easy to administer. Presumably the depositor files his exemption certificate with the bank.

But where does a stockholder file—with his stockbroker, the paying agent, or the corporation? The stockholder's only contact has been with a broker when he first bought the stock and the shares were mailed to him. That may have been many years ago. The broker no longer has anything to do with the dividend payment, and the corporation's address is not readily known. Moreover, the individual who owns stock in four different companies will have to file four separate exemption certificates each year. These millions of exemption certificates and refund claims will certainly keep the postal people busy.

Finally, above age 17 the bill limits exemptions to the less than 10 percent of all stockholders who expect no tax liability of any kind. The millions of people with a small tax liability, but well under 20 percent, will suffer overwithholding. If these people do not file quarterly estimated tax returns, their only recourse is to seek refunds four times a year. In borderline situations, they may be unwilling to risk the severe penalty for filing an erroneous "pauper's oath." They must simply suffer the loss of current income and make do as best they can.

Refund procedure

It is difficult to believe that the so-called "quick refund" procedure would ever live up to its promise. To the millions of average modest owners of stocks, the need to file refund claims and check records back and forth would be a constant harassment.

But, if a stockbroker's refund would be less than $10, he may not apply for it under this procedure. This means a stockholder would have to receive $50 per quarter (or $200 a year) to be entitled to file. The limited exemption provisions would take care of part of this group. But the rest—with an effective tax liability of less than 20 percent—would have to wait to get back the money "wrongfully" withheld from their small dividend checks.

Processing millions of refund claims would inevitably create delays in reimbursing withheld taxes that would work a hardship on lower income groups. As a man from a small New Jersey town noted, "* * * small stockholders who will be entiled to refunds will get discouraged and/or disgusted by the paperwork involved in efforts to get the refunds." This may indeed be one of the revenue-producing elements the Treasury is counting on—a withholding windfall from those unwilling to be bothered or too uninformed to claim refunds.

In any event, the potential inundation of Internal Revenue district offices under the flood of refund claims four times a year staggers the imagination. The likelihood of the complicated computation of millions of refunds being error-free is remote enough to cast doubt on the Service's ability to process these claims at low cost. The promise of "quick refunds," too, would quickly fade. There is even some danger that the efficiency of refunds on wage withholding might be impaired.

Temptations for fraud

The proposed withholding plan does not require information statements in support of refund claims to substantiate amounts withheld. This could be an open invitation to fraud. The policing problem involved here has been conveniently ignored by proponents of withholding.

Some individuals would have tax liabilities above the 20-percent withholding rate. Certain people might assume—inadvertently or intentionally—that the 20 percent represented their total tax liability on dividend and interest receipts. The Internal Revenue Service would have to rely on regular audit procedures in these instances and then locate the taxpayers to collect the difference between the withholding rate and the taxpayer's actual bracket.

The only effecive control over these areas would come through an electronic data processing system. And once such a system is in operation, withholding itself becomes unnecessary.

BETTER ALTERNATIVES

Although the tone of this memomorandum has been critical, the exchange does have some constructive suggestions. As long as dividends remain taxable, steps to assure complete taxpayer compliance are, of course, necessary. Withholding, however, is not the best approach. The alternatives involve a continuation of the educational campaign and more effective use of the information already available to the Government. These are admittedly temporary solutions. The final and permanent answer lies in linking up the recently enacted numbering system with the advanced electronic processing facilities rapidly being developed by the Internal Revenue Service.

Educational campaign

Government officials have recognized the basic cause of underreporting of dividends (and interest) as inadequate information and carelessness. In the summer of 1959, a voluntary cooperative educational campaign was inaugurated to correct this situation. Although the effectiveness of this campaign is not known for certain, the present administration must have been satisfied with the program's success. Several months ago the administration again asked business to carry on a similar campaign this year.

The financial community, although willingly cooperating, is unable to understand the continued insistence on withholding if the educational program is effective. The cumulative impact of a sustained educational effort could produce dramatic improvement without the burdens, complexities, and other shortcomings of a withholding system.

Better use of information

The Internal Revenue Service already receives information returns (form 1099) on virtualy every dividend payment made. More efficient use of this information through stepped-up sampling of tax returns, auditing, and enforcement procedures could improve matters. In fact, these processes are applicable to all areas of missing income—even areas for which withholding has not been proposed.

Numbering system and data processing

The long-range solution to underreporting of income lies in the automatic data processing system the Service has inaugurated. Electronic equipment will permit cross-checking of information returns with tax returns on the basis of matched taxpayer account numbers.

The numbering system has already been enacted into law and will go into operation next year. The same account number which appears on an individual's tax return will appear on each information document filed by payors of income paid to him. Matching these electronically is the most efficient approach—without the hardships of withholding. This possibility is not a dream; the electronic system is proceeding on schedule.

In fact, the danger is that the institution of a withholding system at this point would divert manpower and effort and thus throw the program off schedule. Government and industry still have to gear themselves for operation under the electronic processing and numbering systems. It would be most unwise to imperil the progress that has already been made and is now in prospect by trying to graft withholding onto these systems.

CONCLUSION

Withholding is unjust, unworkable, and unnecessary. Unless the data processing and numbering approaches fail to correct the problem of underreporting of dividend and interest income, the withholding proposal should be abandoned

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STATEMENT OF CHARLES MATTHEW UNKOVIC, REGISTERED REPRESENTATIVE, BACON, JOHNSON & ASSOCIATES, INC., WASHINGTON, D.C.

Mr. Chairman and members of the U.S. Senate Committee on Finance, it is my intention to inform you of my opposition to certain provisions of H.R. 10650 which I deem to be grossly inequitable. It deals specifically with the section on withholding of tax on dividends and interest.

I strongly feel that every true American can be proud of the fact that the doors are always open to him to become a shareholder in American industry. The number of shareholders having a stake in American industry has more than doubled in recent years. There are many millions of Americans who own shares in our leading corporations either through individual securities or through investment trusts, commonly known as mutual funds. Many of them are shareholders with small incomes, for whom relief from double taxation of their dividend income makes the investment of their savings in securities worth the risk. The proposed bill would nullify that exemption as to these small shareholders. Regarding the first $50 of dividend income, the bill would levy a withholding tax of 20 percent even though the law says that the income is exempt. With reference to the withholding of $10 or less the small shareholder is required to wait until the end of the year and file a claim for the refund to receive back his money.

It should be brought to your attention that there are hundreds of thousands of shareholders of investment trusts, who have either cumulative or systematic investment programs with free reinvestment (i.e., no sales charge) of their dividends into additional shares on a quarterly basis. Assume you receive $1,000 annually on dividends to be reinvested in additional shares. Under the proposed tax plan 20 percent or $200 would be immediately withheld and the investor would not gain the benefit of having his money compounded while working for him. In most cases he would be required to pay an extra sales charge of around $16 to have this specified amount reinvested at a subsequent date. Thus you are further penalizing the investor who is attempting to build capital for his retirement, education of his children, or other long-term objective. The investor will also lose the benefits of "dollar cost averaging" which assures that if you regularly invest a fixed number of dollars over a period of time in a fluctuating market your cost will be less than the average price of the shares during that period.

Thus proposed legislation will bring about a great amount of overwithholding. The procedures required to administer this withholding plan are very intricate and will only introduce into the lives of our taxpayers, especially the smaller taxpayers, a new storm of complicated tax forms, exemption certificates, and the like. Depriving our population of every cent of their income, especially the older and retired senior citizens of our population, or any part of that income for periods of a month or more cannot be justified and is strictly inhuman.

Canada has repealed a law requiring tax on withholding dividends and interest because it was impossible for the Government to administer the law fairly and adequately. As an alternative to the withholding tax we should enforce with greater vigor the existing tax law respecting dividends and interest. We must remember that it is the duty of our American Government to encourage more and more people to become new shareholders in our American industry. This can be accomplished simply by making the tax alternatives attractive to the prospective and small investor. As an incidental factor we would probably benefit immensely if small shareholders were allowed an exemption of $100 instead of $50 on dividend income.

The millions of people may not know today what is about to happen to them. In fact, many will not know until this withholding tax monstrosity starts grinding at them in the year 1963—when the 1962 elections are safely behind. Beginning then, these Americans who total in excess of 30 million tax wounded persons are going to make their feelings felt at the polls at every opportunity. That will amount to a lot of votes. There's a famous axiom in which I single out for your benefit, "Action speaks louder than words."

Memorandum Re Supporting Evidence on Information Returns and Automatic Data Processing

Appearing before the Senate Finance Committee on April 11, 1962, Mr. Joseph C. Welman, testifying on H.R. 10650 on behalf of the American Bankers Association, made the following statement: "We believe, however, that automatic data processing, together with taxpayer account numbers, will enable Internal Revenue to make effective use of information returns, supplied by payers of interest and dividends, and that such use will obviate the need for withholding." In the subsequent questioning, Senator Byrd requested the submission of a supplementary memorandum elaborating on this statement.

The issue posed by Mr. Welman's statement can best be discussed in terms of three questions:

(1) Assuming sufficient data, can automatic data processing identify individuals who fail to report some or all dividend or interest income?

(2) Assuming the answer to No. 1 is "Yes," is it possible to provide Internal Revenue with the necessary information?

(3) Assuming the answers to both No. 1 and No. 2 are "Yes," can an information return-automatic data processing system obtain sufficient additional revenue to substantially close the estimated reporting gap?

This memorandum dicusses each of these questions and, in addition, comments briefly on the psychological impact of an expanded information return system.

1. *Assuming sufficient data, can automatic data processing identify individuals who fail to report some or all interest or dividend income?*—There would seem to be no question that, under the assumption included above, automatic data processing would give the Treasury Department all of the relevant information it would need with respect to underreporting of interest or dividends. This is perhaps best illustrated by a description of the data processing procedures attributed to Mortimer M. Caplin, Commissioner of the Internal Revenue Service, by Business Week in a recent issue:

"Within a few years, the master file at Martinsburg will hold records on 78 million taxpayers. These accounts can be matched against returns or can be sorted out by any of a wide variety of criteria. The tapes, printing at 600 lines per minute, will run off the name, address, and pertinent information from any return that seems to bear auditing. The system will automatically put the finger on those who fail to file returns, who owe taxes for previous years, who file duplicate claims for refunds, whose returns show 'discrepancies or unusual characteristics' that warrant investigation."

The major advantage in the area of interest and dividend reporting would be the ability of the system to identify "those who fail to file returns," as indicated in the above quotation, or those who file returns but fail to report some or all interest or dividend income. Such identification is feasible only with account numbering, making it possible to match information returns against tax returns, thus determining precisely the extent of underreporting and the individuals involved.

Perhaps the most authoritative pronouncement on the technical capacity of automatic data processing to do the job once an account numbering system is developed was made last year by Bertrand M. Harding, Deputy Commissioner of the Internal Revenue Service:

"Automatic data processing gives us a tool for a much more effective matching of information documents (particularly from forms 1099) with tax returns so as to enable us to tighten up enforcement and thereby reduce very substantially the gap between dividend and interest payments, on the one hand, and the amounts of such income reported on returns, on the other hand."

* * * * * * *

"One of the important changes needed to make the information system an *effective substitute for withholding* is to obtain taxpayer account numbers on all forms 1099 and similar documents." [Italic supplied.]

* * * * * * *

"With this modification and perhaps with some adjustments in the dollar level requirements for 1099's, we believe that we shall have a reasonably effective system for the use of information returns and that that system will lessen the need for dividend and interest withholding."

2. *To what extent can all necessary information be made available to the Treasury?*—It is clear from the foregoing that what is required for effective closing of the interest-dividend gap is a workable account numbering system and an expanded information return system. Provision for account numbering is now being made. Although it will be a complicated and costly operation for commercial banks, it can be accomplished. When completed every taxpayer will have a specific number which can be matched against other information, similarly identified, which the Treasury can obtain.

Information documents are now furnished to the Treasury Department for virtually all dividend payments. In the case of interest, reporting is less complete because payers are not required to furnish information returns for interest payments of less than $600 per year.[1] Some interest payments, such as interest

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[1] These returns include all interest payments of the requisite size, whether paid in cash to depositors or credited to their accounts.

on mortgages held by individuals, are not subject to information return requirements. However, with some exceptions, most of this interest would not be subject to withholding.[2]

Where information returns are now required, they can be significantly expanded. If the present requirement for information returns were lowered from $600 a year to $50 a year, the Treasury could be provided with information documents relating to about 80 percent of the total interest paid on savings and time deposits in commercial banks, yet commercial banks would have to prepare such returns for only about 20 percent of the total number of accounts. This is because of the very heavy concentration of small accounts in commercial banks. Tables 1 and 2 show distributions of accounts and deposits held by a representative group of commercial banks surveyed by the American Bankers Association.

It may be helpful to consider the magnitudes involved in an expanded information return system. On June 15, 1960, there were 51,809,785 regular savings accounts in insured commercial banks, according to an official report by the Federal Deposit Insurance Corporation. It will be seen from table 2 that for the banks included in the ABA survey only 19.2 percent of the regular savings accounts paid interest of $48 a year or more, but these accounts received 83 percent of the total interest paid. Applying these percentages to the total number of savings accounts in all commercial banks, it can be seen that of the approximately 52 million regular savings accounts, about 10 million received more than four-fifths of the interest. Accordingly, if information return requirements were lowered from the present $600 to $50, banks would have to submit documents on only about one out of every five accounts, yet the Treasury would be provided with information on four-fifths of the interest paid.[3]

It will also be noted from both tables 1 and 2 that if information return requirements were lowered still further, say to about $10 or $12 per year, the Treasury could be provided with information on virtually all interest payments (approximately 95 percent) but the banks would only have to submit such documents for about one-third of their accounts. In terms of regular savings accounts as shown in table 2, banks could submit information documents on about 20 million accounts (or two-fifths of their total savings accounts) and still provide the Treasury with information on virtually all interest payments.[4]

In exhibit II of the documents accompanying the Secretary's statement, the Commissioner of Internal Revenue stressed the vast number of information returns which would be generated if an information return-ADP system were to be substituted for withholding. However, with reasonable minimum reporting figures it should be possible, as already indicated, for the Treasury to get the bulk of the interest information it needs without the necessity of accumulating and processing the volume of information documents described by the Commissioner.

Providing additional information documents would be an expensive and time-consuming task for the commercial banks. Nevertheless, most commercial banks believe that the costs and burdens involved would be preferable to a withholding system, which also would bring substantial costs and difficulties and, in addition, give rise to serious customer relations problems.

In an effort to determine the attitude of commercial banks toward an expanded information return system as an alternative to withholding, the American Bankers Association polled the banks which provided the savings account data prescribed earlier. Table 3 summarizes the results of that poll.

It will be noted that the banks were asked to decide whether providing annual cumulative information returns to the Treasury for all interest payments of $10 or more would be less difficult or more difficult than a withholding system. About three-fifths of the banks (59.3 percent) answered that such a system would be less difficult, while about 30 percent believed it would be more difficult. The remaining banks could see no difference between the two systems. It is, of course, quite probable that if the question had been phrased in terms of a $50 minimum reporting figure, a still larger percentage of the banks would have

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[2] One exception would be interest coupons on bearer bonds, for which information returns are not available but which would be subject to withholding under present provisions of H.R. 10650.

[3] For simplicity, no change in the structure of accounts is assumed. Turnover in accounts, as some are closed out and others opened, would increase to some extent the number of returns required.

[4] For simplicity, no change in the structure of accounts is assumed. Turnover in accounts, as some are closed out and others opened, would increase to some extent the number of returns required.

answered that an expanded information return system would be less difficult than withholding.

3. *How much additional tax revenue could be obtained from an expanded information return system combined with taxpayer account numbering and automatic data processing equipment?*—It should be clear from the foregoing discussion that there is no question of the technical capacity of automatic data processing equipment to handle the task of matching information returns against tax returns so as to enable the Treasury Department to identify individuals who have not reported the correct amount of interest or dividend income. Neither is there any question about the ability or willingness of commercial banks generally to furnish the necessary information on deposit interest to the Treasury. However, as the Commissioner of Internal Revenue has pointed out, simply feeding the information into an automatic data processing system does not provide any additional tax revenue; the additional revenue depends upon the extent to which the information obtained is utilized by the Treasury.

In theory, the interest and dividend gap could be largely eliminated once the processed information is available to the Treasury; and could be completely eliminated with respect to interest and dividends for which information returns are available. However, the Commissioner of Internal Revenue foresees great difficulties with complete enforcement and concludes that use of the data provided through ADP would have to be handled within "realistic, manageable limits." With this qualification, he estimates that full reliance upon an information return-ADP system would close the dividend and interest revenue gap by only about 25 percent. Specifically, he estimates that the Treasury would recover approximately $200 million of the estimated $850 million of revenue loss on interest and dividends presently unreported, whereas withholding would recover approximately $650 million of the $850 million revenue gap.

Unfortunately, we have not seen any data to support the Commissioner's estimate to the effect that only 25 percent of the revenue gap can be closed through Treasury utilization of an information return-ADP system. Nevertheless, several general comments might be made.

First and most important, it is obvious that the extent to which the gap can be closed by Treasury utilization of information documents and automatic data processing equipment depends to a great extent upon the use which Internal Revenue makes of the data. Without questioning the Commissioner's judgment as to what constitutes "realistic, manageable limits," it is nevertheless a fact that 25 percent does not represent all of the gap that could be closed, but only that portion which the Internal Revenue Service feels it is practicable, within budgetary and other limits, to close.

Presumably there is some point at which the cost of enforcement exceeds the amount collected. However, the magnitudes estimated by the Commissioner (i.e., collection of $200 million at a cost of $27 million) would not suggest that the limit has been reached.

With respect to comparisons of the amounts which can be obtained respectively from withholding or from full reliance on an information return-ADP system, it should be noted that the $650 million frequently cited as the amount which will be recovered through withholding is not the amount which will be recovered by a simple withholding system; it is (1) the amount which it is estimated would be recovered by withholding plus (2) an estimated amount to be recovered through "improvement in upper income brackets due to withholding" plus (3) an amount reflecting the assumption that there will be withholding against amounts presently excluded under the dividend exclusion and dividend credit.

Withholding alone, according to Treasury estimates, will yield only $470 million, and even this is somewhat overstated since it incorporates the assumption that the dividend exclusion and dividend credit will be repealed. The remaining $180 million usually attributed to withholding is actually an estimate by the Treasury of the improvement which will occur in upper income brackets as a consequence of withholding. Thus, if comparisons are to be made between the amount to be recovered by withholding and the amount to be recovered by reliance upon an information return-ADP system, the $650 million estimated to be obtained from withholding should be contrasted with the $200 million estimated to be obtainable from enforcement of an information return system plus an estimated amount due to improvement in reporting because of the adoption of the system. Such an adjustment might well be larger than the $180 million of estimated improvement, now incorporated in the withholding estimate.

In the materials accompanying the Secretary's statement, the Commissioner of Internal Revenue described in some detail the hardships and costs to the Treasury of making complete or virtually complete use of information returns and automatic data processing in an effort to close the dividend-interest gap. He stressed the difficulties in handling the millions of information returns which would be sent to the Treasury, discussed administrative problems, noted the huge correspondence which would result, and commented upon the need for additional personnel. There is no question that if extensive use of information returns were depended upon to close the dividend-interest gap the Internal Revenue Service would be faced with many or all of these problems. Again, we would not question either his judgment or conclusion on this score, but we would note that under a withholding system commercial banks would be faced with problems of the same type and of the same order of magnitude. Indeed, many of the problems would be identical, and the real question is who should assume the burdens and costs of this collection problem: payers of interest and dividends or the Internal Revenue Service?

The commercial banks are presently being told by the Commissioner as well as by other proponents of withholding that these problems are exaggerated, and that even if real they will largely disappear after the banks have adjusted to withholding. But if this is so, the argument cuts both ways and commercial banks could as well maintain that many of the difficulties foreseen by the Commissioner may be illusory or, if real, will work themselves out after the Treasury becomes accustomed to handling information returns.

Psychological effects.—As already noted, in preparing its estimate of the additional tax revenue which can be obtained through withholding, the Treasury relies to some extent upon the psychological effects of withholding. Specifically, $180 million of the $650 million estimated additional tax revenue from withholding represents an assumed improvement in reporting in the upper income brackets, which improvement is presumably to come about (in part, at least) because of the psychological effect of withholding. Thus, it is equally important to note that there will be a significant psychological effect if an information return-ADP system is adopted in place of withholding. Indeed, the additional income may be greater in this case than the $180 million assumed by the Treasury in the case of withholding.

Under the withholding system as presently proposed, the Treasury does not require that the bank provide the names of the individuals from whom taxes are withheld. Thus an individual in the 30-percent tax bracket and currently underreporting interest income may or may not be prompted to pay the additional tax due over that which will be withheld. Under an information return-ADP system, on the other hand, this particular taxpayer's certain knowledge that the Treasury will be able to tell precisely whether he has reported all of his interest income is much more likely to induce that individual to report fully.

It should be noted that the Commissioner of Internal Revenue called attention to this possibility in his speech before the New York State Bar Association, portions of which were included with the documents accompanying the statement of the Secretary of the Treasury: "We could, however, expect the psychological effect of broader information reporting and electronic matching to bring about some improvement in voluntary compliance." When it is considered in addition that leading popular journals have been carrying extensive articles on the ability of the automatic data processing equipment to pinpoint every dollar not reported by each individual, it would seem particularly appropriate to assign considerable dollar value to the psychological effects of a full information return system.

Summary and conclusions.—The basic issue is whether an information return-ADP system incorporating taxpayer account numbers would do the job that the Treasury anticipates will be done by withholding. There are many possible answers. At the one extreme full utilization of information returns may go only part way toward closing the dividend-interest gap. At the other extreme, the cumbersome withholding system now proposed may turn out to be so ineffective and so difficult to operate that a complete information return system might do a far better job than withholding. At the present time neither the commercial bankers nor the Treasury can provide the final answer, which must await experience. Present conclusions are, at bottom, simply based on judgments. But so long as it is technically feasible for the Treasury to close a major portion of the gap through extensive use of information return data, commercial banks see no reason why this system should not be given a fair trial.

TABLE 1.—*Savings and time deposits of individuals, partnerships, and corporations, 208 commercial banks, mid-1961—Number of accounts, amount of deposits, and amount of interest paid distributed, by size of interest payments*

[Numbers and amounts in thousands]

Item	Number of accounts		Amount of—			
			Deposits		Interest paid	
	Number	Percent	Amount	Percent	Amount	Percent
All accounts, total	15,489	100.00	$19,955,434	100.00	$495,840	100.00
Accounts paying interest of—						
$0 to under $12	10,136	65.44	1,290,017	6.46	22,405	4.52
$12 to $23.99	1,322	8.53	800,127	4.01	20,793	4.19
$24 to $47.99	1,279	8.26	1,494,087	7.49	37,490	7.56
$48 and over	2,752	17.77	16,371,203	82.04	415,152	83.73

TABLE 2.—*Regular savings deposits, 199 commercial banks, mid-1961—Number of accounts, amount of deposits, and amount of interest paid, distributed by size of interest payments*

[Numbers and amounts in thousands]

Item	Number of accounts		Amount of—			
			Deposits		Interest paid	
	Number	Percent	Amount	Percent	Amount	Percent
All accounts, total	14,138	100.00	$17,487,978	100.00	$459,770	100.00
Accounts paying interest of—						
$0 to under $12	8,853	62.62	878,450	5.02	20,646	4.49
$12 to $23.99	1,311	9.27	793,058	4.53	20,570	4.47
$24 to $47.99	1,267	8.96	1,479,028	8.46	37,065	8.06
$48 and over	2,707	19.15	14,337,442	81.99	381,489	82.98

TABLE 3.—*Percentage distribution of answers to a survey question on a comparison of an expanded information return system with withholding, 177 responding banks*

Question: If interest withholding were not adopted, but instead annual cumulative information returns were required by the Government for each account paying interest of more than $10 per year, would this be: more difficult than withholding; less difficult than withholding; make no difference?

[In percent]

	All reporting banks	Reporting banks with savings and time deposits of—		
		Less than $10,000,000	$10,000,000 to $100,000,000	$100,000,000 and over
More difficult than withholding	29.6	25.3	31.0	38.5
Less difficult than withholding	59.3	61.3	56.3	61.5
No difference	10.5	12.0	12.7	
No answer	.6	1.3		

Source: The American Bankers Association, Department of Economics and Research.

CRUTTENDEN, PODESTA & MILLER,
Chicago, Ill., April 23, 1962.

Hon. HARRY F. BYRD,
Chairman, Committee on Finance,
U.S. Senate, Washington, D.C.

MY DEAR SENATOR BYRD: During Secretary Dillon's appearance before your committee, on April 2, you remarked that you have known him personally for many years, and have great respect for his wisdom and ability. You said also that you "must confess to some amazement," to hear him in the role of special pleader for the so-called investment credit.

Let me say that I share both your respect for Mr. Dillon and your grave concern over his blanket endorsement of what you described (aptly and graphically) as "this gimmick." More specifically, and in terms of the pending tax bill as a whole, I am also deeply disturbed by the administration's seeming rejection of certain basic facts of economic life—certain verities that the Secretary must have seen in practical operation many, many times, in the course of his extended, management-level experience in our business.

This rejection is implicit in H.R. 10650 itself, and in the vacillating legislative course it has steered. The bill passed the House, as you know, by an extremely narrow margin, on an all-or-nothing basis, and only after literally tremendous pressure from the leadership. Now, after warmly commending Ways and Means for its efforts, the administration is asking your committee—in bald effect—to strike out everything after the enacting clause, and reinstate or broaden certain features that the House, in its wisdom, declined to accept.

The rejection is also dramatically evident in Secretary Dillon's insistence on three specific proposals: the investment credit; the 20 percent withholding tax on dividend and interest income; and repeal of the dividend tax and credit exclusion. Taking up these proposals in order:

1. You, Mr. Chairman, and an impressive variety of witnesses—from both sides of the political fence, and representing every shade of the economic spectrum—have stripped the tax credit for investment in certain depreciable property of its fancy nomenclature. It stands revealed as nothing more or less than a discriminatory, completely unnecessary, out-and-out subsidy. And no amount of administration pressure, however, or wherever applied, should justify its enactment.

2. Hundreds of pages of the current committee record have been filled with the dubious pros and demonstrable cons of dividend and interest withholding. But I find the most convincing and eloquent argument of all in these extracts from an earlier record [emphasis mine]:

"While your committee recognizes that there may well be substantial underreporting of such (dividend and interest) income, largely through carelessness on the part of the taxpayers * * * (it) believes that the (20 percent *withholding* provisions of the House bill *would work a great hardship upon many taxpayers* and *impose expensive administrative burdens upon the withholding agents.*

"*The most obvious inequity * * * would, of course, be that withholding would be applied to many taxpayers who, in fact, have no income tax liability.* * * * Your committee also fears that *many taxpayers, especially those in the lower income brackets, would*, either through misunderstanding or carelessness, *fail to apply for the refunds due them, thus being deprived permanently of a portion of their income.* * * *"

Mr. Chairman, I am sure you recognize those excerpts. They are from the report (No. 781, 82d Cong., 1st sess.) of the Committee on Finance, rejecting certain House-approved provisions of the Revenue Act of 1951. And you and Senators Kerr and Williams (the only still-in-harness survivors of the committee headed by the late, great Walter George) will remember that the 1951 committee's views prevailed.

At the time, the Treasury Department was estimating (for calendar 1951) that underreporting of certain dividend, interest and royalty income "may reach as much as $3 billion." It was said that a 20-percent withholding tax would recoup $323 million. Eleven years later, Secretary Dillon tells your committee that there is a $3 billion of unreported dividend and interest income, whereon a 20-percent withholding tax will recoup $650 million.

I submit that these and other Treasury estimates were open to question then, and they are open to serious question now. Additionally, and as you have recalled during the current hearings, the Treasury last year was authorized to proceed with a numbered-account system for taxpayers. We heard a convincing

argument then that this system, combined with automatic data processing, would subject some $5 billion of unreported income (including, presumably, dividend and interest income) to electronic scrutiny. Now, the Department says blandly that the automatic data processing enforcement approach alone, "as compared to withholding, would be burdensome and expensive to business and Government, out of all proportion to the effect it would have on the reporting gap." Such arguments, like certain of the statistics we are asked to accept, must also be subject to challenge.

3. During Mr. Dillon's appearance, Mr. Chairman, you recalled that he is the only Treasury Secretary, in your long experience, to press for retroactive income tax legislation. He is also—as I am sure you know—the only Secretary to invest the double tax on dividend income with the authority of a legitimate, revenue-producing arm of the basic tax law, and to argue that it is not contributing its full share of tax revenue.

Every Secretary before him—from the time of the legislative oversight that produced it—has conceded both the existence and inequity of this vicious double tax. Indeed, until the advent of the present administration, the recurrent trend was toward liberalization of the present, all-too-modest credit and exclusion. And here, again, no amount of oratory, pressure, or glib statistics can or should change this committee's finding (in 1954) that the credit and exclusion principle "confers partial relief for double taxation in the most administratively feasible manner. Moreover, the method of adjustment adopted affords greater relief for the low-income investor than for those at higher income levels. * * *"

Mr. Chairman, we are a great Nation, not least because our Government, from its beginning, has attempted to administer our tax laws for the honest, and to enforce them against the dishonest. Further, the Government has always recognized the need for a strong, continuing flow of growth capital, and—on occasion—has demonstrated its ability to move constructively to encourage that flow. Now, we are being asked, in effect, to dilute—even discard—both of these premises. With one hand, the pending bill professes to encourage investment incentive (via the "gimmick"); with the other, it moves to destroy that incentive (via 20-percent withholding, plus a complete return to double taxation).

It is my strong and earnest conviction that this approach constitutes needless and (to a measurable degree) irresponsible tinkering with the very vitals of our economic system. By the same token, I believe that its incorporation into our tax structure will speed the eventual and complete collapse of that structure.

I hope very much that you and your distinguished fellow-members of the Committee on Finance will reject these proposals, and that your views prevail both on the Senate floor and in conference.

Sincerely,

ROBERT A. PODESTA, *Managing Partner.*

(Whereupon, at 4:30 p.m., the committee recessed, to reconvene at 10 a.m., Thursday, April 19, 1962.)

REVENUE ACT OF 1962

THURSDAY, APRIL 19, 1962

U.S. SENATE,
COMMITTEE ON FINANCE,
Washington, D.C.

The committee met, pursuant to recess, at 10 a.m., in room 2221, New Senate Office Building, Senator Robert S. Kerr presiding.

Present: Senators Kerr (presiding), Douglas, Williams, and Carlson.

Also present: Elizabeth B. Springer, committee clerk; and Colin F. Stam and L. M. Woodworth of the Joint Committee on Internal Revenue Taxation.

Senator KERR. William Jackman, Investors League.

All right, Mr. Jackman.

STATEMENT OF WILLIAM JACKMAN, PRESIDENT, INVESTORS LEAGUE, INC.

Mr. JACKMAN. I am William Jackman. I am president of the Investors League of New York.

The Investors League is a nonprofit, nonpartisan voluntary membership organization of thousands of individual investors, small and large, residing in the 50 States of the Union.

Mr. Chairman and members of the committee, speaking on behalf of the thousands of investor members of the Investors League and the millions of other investors and savers with savings accounts in banks and savings and loan associations, I am grateful for the opportunity of expressing their feelings on the withholding of tax on interest and dividend payments.

Withholding of tax on dividends and interest is equivalent to the Federal Government ordering the millions of shareowners in the American economy and even greater numbers of people with savings in savings and loan associations and banks to lend it money without even one red cent of interest.

Dressed up in any fancy language you like, this proposal smacks of police state methods inasmuch as those who are not liable to pay any taxes are being forced to give the Government money which, in a great many instances, at the expense of a great deal of effort on their part, the Government's and the paying corporation's will be refunded to them, if they are lucky. It is in a sense burning down the house to catch the mouse.

Saddest of all is the fact that these investors and savers would have to wait a considerable time to recover the money withheld. Many of our thrift-minded citizens could use such funds to buy needed groceries during the year.

On the other hand, gentlemen, everyone who makes an innocent mistake in filing an income tax return is charged interest on any extra tax that he owes.

One wonders about our elected representatives when such events take place like the "distinguished" Representative from Maryland who apparently developed a prodigious appetite for food when traveling abroad at taxpayers' expense. As I recall, he spent something like $33 a day for his meals and some other idiotic figure for lodging.

Senator KERR. Mr. Jackman, if you want to take your time and criticize the individual Members of the Congress, you can do so. I fail to see any connection between that and the merit of the matter you are discussing. But you may devote your time to it if you like.

Mr. JACKMAN. The only point I want to make there, Senator, is the fact this same gentleman was in favor of these taxes but he doesn't seem to give much consideration when he is on a job like that, so we will skip it.

The argument has been advanced that there is now withholding from wages, so why not a withholding of dividend income and interest? There is a vast difference, not the least of which is this: Wage withholding considers the payee's tax bracket and the income from wages is not taxed twice as is the case of the small investor's dividends: (1) the corporation is taxed and (2) the recipient of the dividends is taxed on the same money.

Furthermore, when wages are spent there is nothing left to pay additional tax with, while in the case of stockholders and savings bank depositors, the capital stands as security for the additional tax payment.

Believe me, investors and those with savings accounts are as fair-minded as anyone else and this withholding infers that all investors and people with savings accounts are a bunch of crooks.

Actually, all stockholders should now know that they must include dividends in their taxable income. We believe practically all of them do so. Those few who do not should be penalized, and the Government has, in its possession, returns from all corporations, the evidence to convict them.

The forthcoming automation of income tax returns is a step in the right direction. A good public relations job by the Treasury Department would bring to the attention of all taxpayers that when this automation is in effect, all dividends and interest receivers will be known and that those who have not reported such income will suffer the consequences.

Much has been said and written about the dividend gap. There is no way of knowing now what the dividend yield will be for 1962 or for subsequent years, of course. Nor is there any way of determining now how much interest on savings will be paid out in the ensuing years.

While the totals may grow annually, is it not a justifiable conclusion to expect that much of the gap will be closed as a result of the Treasury's intensified information program? Add to this the publicity given the subject through the Nation's banks and savings and loans and the fact the public grows more enlightened every day on matters financial.

Why, I ask you, must there be such a frantic rush to institute a system of withholding of taxes on dividends and interest? The Treasury's vast and ever-growing family of electronic sentinels is just now beginning to earn its keep.

Within the next few years, these mechanical monsters will wield even greater power as tax collectors. The very fear of these almost infallible electronic sentries should be sufficient to bring in the amounts rightfully belonging to the Terasury.

A program of withholding of taxes on dividends and interest can only bring about a chaotic situation, touch off a wave of resentment, and heap an avalanche of paperwork on banks, savings and loan associations, corporations, and millions of persons.

The plan would be a headache to everyone involved and, make no mistake, it would be costly—costly to government, private business, and the banking community. It would be costly, too, to the taxpayers, who would find some of his reinvestable funds in someone else's hands for as long possibly as a year. How, I ask you, can the savings depositor obtain the loss of the compound interest on the 20 percent withheld?

Why, in heaven's name, must every person, large or small, who receives a dividend from an investment or interest from his savings, be suspect? What has happened to this great Nation that it now feels it must view a man guilty until he proves his innocence?

In addition to the burdens heaped upon the individual by a withholding of tax on dividends and interest payments, what would be the procedure for such organizations as regulated investment companies; these are basically conveyor belts upon which are carried huge amounts of dividend income to shareowners.

Under the proposed withholding of tax on dividends, these investment companies would have a twofold problem: (*a*) taxes would be withheld from them by declaring corporations and (*b*) the investment firms, in turn, would have to withhold tax on basically the same income which they distribute to their shareowners.

Keep this in mind, too. The vast majority of shareowners in investment companies are the smaller investors—the people with little extra money left at the end of a month, but who are determined to buy a stake in American industry through the professional management of the investment companies.

Withhold from these small people the slight amounts in dividends due them and you create a hardship. Not only that, but you go a long way toward killing the incentive to invest. And without investors in private industry, the America as we know it will cease to exist.

We do not believe that any known system designed to ease the apparent hardships upon many persons not subject to tax or are taxable at a rate lower than the withholding rate, is feasible without tremendous expenditures of clerical time and expense to both the Treasury and the dividend and interest disbursing agents. Moreover, a substantial volume of errors will inevitably result, creating considerable confusion and correspondence. Gentlemen, in conclusion, the investors and savers throughout the land should not be subjected to a withholding of the tax on their dividends and interest. If for one moment you believe that I am speaking for a small minority of stock-

holders or a handful of people with bulging bank accounts, I ask you to observe the proof that my feelings echo those of thousands upon thousands of people across the Nation.

Here, sirs, is a picture of a petition that was signed by 7 million people. Had I brought it here there would have been no room in this hall for anything but the petition.

This picture, however, illustrates rather vividly its magnitude and the will of the people, mostly the little people with a few shares of stock or a savings account which a vast majority of them have obtained through frugality and the sweat of their brow to improve their own social security.

These people who back American enterprise with their modest nest egg, represented by a stock certificate or passbook, are the little people, the people whom you would place a tremendous burden on.

In fact, in some instances, it would be necessary to sell or get rid of their savings in order to live while awaiting their refunds. More eloquent than anything I have said, or anything I could say, is illustrated by this picture of petitions representing millions of signatures. Can you, in good conscience, let these people down? Or will you decide not to hurt them all to punish a few evildoers?

This Nation looks to you to make the right decision on this very vital issue. A withholding of tax on dividends and interest, as I have tried to show, is an unjust and impractical innovation and should be defeated.

Thank you very much.

Senator KERR. In your prepared statement you say—

We do not believe that any known system designed to ease the apparent hardships on many persons not subject to tax or are taxable at a rate lower than the withholding rate.

Would you give me the details on those that are taxable at all who would be taxable at a lower rate?

Mr. JACKMAN. There are many people who have a total income, not necessarily by virtue of age. Take a schoolteacher who has retired who has a total income possibly of $2,300 a year. You take 20 percent of that. She has got no tax to pay in the first place. There are many, many thousands and thousands of those kind of people. You have made a provision——

Senator KERR. But if they are taxable, is not the lowest rate 20 percent?

Mr. JACKMAN. They would not be taxable at all.

Senator KERR. I know, but you said, "or are taxable at a rate lower than the withholding rate."

Mr. JACKMAN. Of course, if it is lower than the withholding rate, again depending on the deductions, depending on the income; if they are below the income tax rate the normal rate of 20 percent, that is the picture I mean, I think is in answer to what you say, Senator.

Senator KERR. I am interested in your organization because while I own none of it, I have those which are nonprofit organizations also. Apparently yours was intended to be.

Mr. JACKMAN. Nonprofit?

Senator KERR. Yes.

Mr. JACKMAN. It is.

Senator KERR. Explain to me the basis for its operation.

Mr. JACKMAN. Well, it is a membership organization. I think a very good way, Senator, to express it would be to say it is kind of a union of investors, it isn't a union except that they pay $5 a year to belong to the Investors League.

Senator KERR. You are just a trade association?

Mr. JACKMAN. That is right.

Senator KERR. Well, fine.

Any questions?

Senator CARLSON. No.

Senator KERR. Thank you very much, Mr. Jackman.

Mr. Edward McNamara.

STATEMENT OF EDWARD J. McNAMARA, TREASURER, CORPORATE TRANSFER AGENTS ASSOCIATION

Mr. McNAMARA. My name is Edward J. McNamara; I am treasurer of the Corporate Transfer Agents Association.

The membership of the Corporate Transfer Agents Association includes the major organizations in the United States who act as their own dividend disbursing agent.

Our members are responsible for the issuance of more than 32 million dividend checks each year to approximately 8 million stockholders. On their behalf I wish to state that we are primarily opposed to any withholding particularly in view of the additional work and expense imposed on us by the recently enacted bill requiring account numbers for stockholders.

Further, our members have given a great deal of cooperation to the recent campaign by the Treasury Department to inform taxpayers of the necessity to report dividends and interest. We believe that if this educational campaign is continued and in addition we furnish the stockholders account numbers to Internal Revenue, the unreported dividend income will be materially reduced.

Consequently, there will not be any need for the proposed withholding program which will be expensive and cumbersome to administer for both the Treasury Department and the individual corporation.

In addition many of our stockholders will be seriously inconvenienced by having part of their dividend withheld and then having to file a complex report of the withholding in their tax return. We are afraid the regulations under the bill as proposed would result in considerable misunderstanding by stockholders as to the proper amount to be reported in their tax returns which we believe will cause a considerable amount of additional correspondence with the corporations.

If exemption certificates are to be included the only practical way that dividend checks may be properly drawn is to provide for them on a permanent basis so that the corporation will not have to continually change their records if the stockholder overlooks the renewal of their exemption at the year end.

From an operating standpoint the part which is particularly objectionable to us is the inclusion of exemption certificates for minors and other groups with expiration dates which would be a burdensome and costly plan to carry out.

We believe that the institution of withholding at this time is premature as the Internal Revenue Service has not had time to measure the effectiveness of the identifying numbering system which has recently been instituted.

In view of the additional costs which the corporations will incur in connection with the numbering program it does not appear to be equitable to impose upon them the additional costs and administrative problems which the withholding program will entail.

Senator KERR. Thank you, sir, for your statement, Mr. McNamara.

Mr. John Sadlik?

Mr. Rowland A. Robbins, Association of Mutual Fund Plan Sponsors, Inc.

STATEMENT OF ROWLAND A. ROBBINS, PRESIDENT, ASSOCIATION OF MUTUAL FUND PLAN SPONSORS, INC.; ACCOMPANIED BY ANDREW B. YOUNG, ATTORNEY

Mr. ROBBINS. My name is Rowland A. Robbins. I am president of the Association of Mutual Fund Plan Sponsors, Inc. on whose behalf I speak to oppose the withholding of income tax on dividends as it affects contractual planholders.

I am also chairman of First Investors Corp., one of the largest and oldest sponsors of contractual plans for the accumulation of mutual fund shares, or regulated investment companies as they are defined in the Internal Revenue Code.

Basically, the mutual fund provides full-time professional supervision of a deversified investment account. Our plans are a means whereby shares of mutual funds may be systematically accumulated by people who can afford to save $15, $20, $25 or more a month, for investing—after providing for their other basic financial needs.

Contractual plans are created under custodian agreements between plan sponsors and large, established banks or trust companies. The custodian bank receives payments made by planholders. It invests the net payment, after fees and charges, in shares of a specified mutual fund at net asset value and without further sales charge. The custodian bank maintains an individual account for each planholder. It holds the mutual fund shares purchased for the account of planholders. It receives the dividends and capital gains payments made on these shares.

In almost every case, the custodian bank is instructed by the planholder to reinvest those distributions in added shares of the mutual fund in order to compound the growth of the plan.

Close to 1½ million people, residing in almost every State of the Union, hold contractual plans. They are, by and large, people of modest means who are building equity investments through these plans out of their savings. The term "thrift plans" once used to describe contractual plans, is a very apt description of what these plans mean to the people who have them.

The plans represent hopes for the achievement of future family goals—such as education of children, retirement, or home-purchasing—out of savings. The dividend reinvestment privilege, used by virtually all contractual planholders, is a vital element in the success of their plans, especially as this is done for them without cost.

It enables the planholder to reinvest and thus compound the dividends payable to him—dividends which consist of interest and dividends paid by a hundred or more corporations, and such capital gains as may have been made by the underlying investment company. The planholder needs all the help he can get to beat inflation and achieve financial security for his or her old age. The compounding of his share account through full reinvestment of his dividends in thus one of the most important features of the plan.

Thus, the usual connotation of the term "dividend" as a spendable increment on investment, just does not apply to the contractual planholder.

For the plan to work as it was intended, the continuous compounding of these dividends is essential. The ultimate source of an income dividend of a planholder is the company that issued the security held in the portfolio of the mutual fund.

When the mutual fund receives dividends from the issuers of its portfolio securities, it passes them through to its shareholders as taxable dividends, as provided under subchapter M of the Internal Revenue Code.

They are received in a lump sum by the custodian bank, and credited to and reinvested for the individual accounts of the planholders. Planholders receive accurate statements of all reinvested distributions for the very specific purpose of helping them to make out full and accurate tax returns.

They do not, like bank account holders, have to bring in their passbooks, to have accumulated interest recorded as a step in filling out their tax returns.

Because of the nature of the contractural plan, the planholder is penalized by the withholding in a way in which, I am sure, neither the Internal Revenue Service, nor the Congress intended. The tax that is to be withheld is a tax on working money of small investors, not spending money. No procedures for permitting the planholder to receive a repaymnet of the withholding can restore to him the full and automatic benefits of his plan.

Senator KERR. I want to interrupt you for just a moment.

Mr. ROBBINS. Yes, sir.

Senator KERR. You say you are a regulated investment company?

Mr. ROBBINS. Yes, sir, under the Tax Code, we are.

Senator KERR. In order for your company to not be liable for tax on the dividends it receives or its holdings earned, those dividends have to be passed through to the shareholders, do they not?

Mr. ROBBINS. Correct.

Senator KERR. When?

Mr. ROBBINS. May I pass this on to counsel here who is a tax expert, and has lived with these plans for many years, sir?

May he be permitted to answer the question?

Senator KERR. Who is he supposed to be?

Mr. ROBBINS. Mr. Andrew Young.

Senator KERR. You identify yourself.

Mr. YOUNG. I am Andrew B. Young, attorney from Philadelphia.

Senator KERR. A Philadelphia lawyer?

Mr. YOUNG. Yes, sir. [Laughter.]

Senator KERR. I have heard about you all my life. I am glad to see you.

Mr. YOUNG. I might add that perhaps the proposed legislation is confusing enough to confuse even a Philadelphia lawyer. That is not what I am here to say.

Senator KERR. I would say that you are confused, indeed, if you understood me to be asking about the proposed legislation.

Mr. YOUNG. No, sir.

Senator KERR. The question I asked was whether or not the earnings of a regulated investment company must be passed through to the shareholders in order for it not to be taxable to the investment company.

Mr. YOUNG. Yes, sir.

Mr. Robbins answered that in the affirmative, yes, sir.

Senator KERR. Then I asked him when they should be passed through.

Mr. YOUNG. Yes, sir.

Senator KERR. Is the practice the year they are earned, 10 years after they are earned, the year after or when?

Mr. YOUNG. All right, sir.

Senator KERR. I am talking about the law.

Mr. YOUNG. I am talking about the law and then explaining the law as it has been applied by the Internal Revenue Service.

My understanding of the law is that the regulated investment company must, in order to relieve itself from the obligation to pay tax, distribute the earnings that it receives to or for the account of its shareholders.

Senator KERR. When?

Mr. YOUNG. And those distributions must be made on or before the 15th day of the third following month and with respect to capital gains dividends the declaration of capital gains dividends must be made before the 30th day of the month following the close of the year.

Senator KERR. That amounts then to a current passthrough, doesn't it?

Mr. YOUNG. That is correct, sir.

Senator KERR. Then I want this gentleman to explain to me the plan. The statement says:

> Thus the usual connotation of the term "dividend" as a spendable increment on investment, just does not apply to the contractual plan holder. For the plan to work as was intended, the continuous compounding of these dividends is essential.

How can you compound them if you pass them through?

Mr. YOUNG. Sir, they are passed through by this procedure: When the dividends are paid, they are credited to separate accounts maintained by the custodian bank for each plan holder. The plan holder has the right by either completely terminating or partly terminating his account, to get out all balances including the recently received dividends. He can get that on demand and on the concept of constructive receipt that has been consistently treated the same as though it had been paid out to the plan holder, just the same, if you will, as the interest is credited to the account of a savings bank holder who has the right to withdraw it although he might not have withdrawn it.

Senator KERR. Well, if it is passed through it is his property, isn't it?

Mr. YOUNG. Yes, sir.

Senator KERR. And it cannot be passed through unless and until it is his property?

Mr. YOUNG. That is correct.

Senator KERR. And when he receives it, whether it is constructively or by implication or in a manner that he himself has contracted for it to be, it is after he has received that and is exercising ownership of it.

Mr. YOUNG. That is the philosophy of the law; you have stated it correctly.

Senator KERR. I am not interested in the philosophy of the law. I am asking if that is the reality of it.

Mr. YOUNG. It is the reality in the sense that the man can on demand withdraw the money; yes, sir.

Senator KERR. Well, he can. It is his unless he, of his action, does something else with it, isn't it?

Mr. YOUNG. Yes.

Senator KERR. It isn't passed through to him until he gets it, is it?

Mr. YOUNG. It is passed through to him, sir, in the same sense that a mutual savings bank——

Senator KERR. I am not talking about the same sense as a mutual savings bank. I am talking about a regulated investment company under this tax law.

Mr. YOUNG. That is correct, sir.

It is passed through, whether——

Senator KERR. Well, if it is passed through, it is his, isn't it?

Mr. YOUNG. Yes, sir.

Senator KERR. And title vests in him immediately?

Mr. YOUNG. Well, let's not bother about title, if you please.

Senator KERR. Well, I am bothering about title.

Mr. YOUNG. Well, if you will, title at that particular time happens to be in the custodian.

Senator KERR. Then it hasn't passed through to the beneficiary?

Mr. YOUNG. But it is subject to withdrawal on demand.

Senator KERR. Then it hasn't passed through to him if he has to do something else to get it.

Mr. YOUNG. No, sir; it hasn't passed through any more than the mutual savings bank's interest has.

Senator KERR. I am not talking about the mutual savings bank. I am talking about the law that says the only way that a regulated investment company can avoid paying taxes on its earnings is to pass them through to the shareholders.

Mr. YOUNG. Well, sir——

Senator KERR. And you told me that is the law.

Mr. YOUNG. Yes, sir. That is the— well, go ahead.

Senator KERR. Well, it either is the law or it isn't. Do you know whether it is or not?

Mr. YOUNG. Yes; I do know it is the law.

Senator KERR. Is it the law?

Mr. YOUNG. I believe if you will permit me to say so, that we are quibbling about semantics.

Senator KERR. You are quibbling, and I just want you to answer my questions.

Does the investment company have to pass that earning through in order to pay—avoid paying tax on it?

Mr. YOUNG. Will you permit me to say what the law says?

Senator KERR. Well, if you don't know what it says, just tell me you don't know.

Mr. YOUNG. The law says——

Senator KERR. It happens that I do know what it is.

Mr. YOUNG. I am confident you do, sir.

Senator KERR. I helped write it.

Mr. YOUNG When you are saying "passed through" in the revenue sense, you are saying that appropiate action has been taken so that the shareholder may properly be taxed. That in that sense it has been passed through.

Senator KERR. Have you got the law, Mr. Stam?

Mr. YOUNG. The law actually says that the—the regulated investment company is relieved of tax if it is entitled to the dividend paid credit.

Senator KERR. If what?

Mr. YOUNG. If a regulated investment company in entitled to the dividend paid credit. It is thereby relieved from tax. You then look to the section——

Senator KERR. Now, wait a minute.

Mr. YOUNG (continuing). Which defines the dividend paid credit.

Senator KERR. Come here, Mr. Stam, and show me what the law is. Section 855 of the Internal Revenue Code of 1954.

Mr. YOUNG. Yes, sir.

Senator KERR (reading):

DIVIDENDS PAID BY REGULATED INVESTMENT COMPANIES AFTER CLOSE OF TAXABLE YEAR

GENERAL RULE.—* * * for a taxable year makes a distribution as provided in subsection (a) of this section, the shareholder shall consider the amounts prescribed in section 853 (b)(2) allocable to such distribution as paid or received, as the case may be, in the taxable year in which the distribution is made.

Now, that refers back to 853(b)(2).

Now, the basic section is—staff member tells me is 852(b).

Mr. YOUNG. Yes; and the phrase "shall consider" are the words.

Senator KERR. Taxation of companies and shareholders.

Mr. YOUNG. Yes, sir.

Senator KERR. (reading):

Imposition of normal tax and surtax on regulated investment companies. There is hereby imposed for each taxable year upon the investment company taxable income of every regulated investment company a normal tax and surtax computed as provided in section 11 as though the investment company taxable income were the taxable income referred to in section 11. For purposes of computing the normal tax under section 11, the taxable income and the dividends paid, deduction of such investment company for the taxable year computed without regard to capital gains dividends shall be reduced by the deduction provided by section 242 relating to partially tax exempt interest.

If I understand that law, the investment company is relieved of taxation only if it declares the dividend and distributes the dividend.

Mr. YOUNG. That is correct.

Senator KERR. To the shareholder.

Mr. YOUNG. Distributes is correct.

Senator KERR. If it distributes it to the shareholder that means that title to it has to vest in the shareholder?

Mr. YOUNG. All right, sir—I won't quibble over the amenities of title, if you please. I will accept your statement, Senator Kerr.

Senator KERR. Then that being the case, I want to know how there is continuous compounding of these dividends except with the consent of the shareholder in whom title to that dividend has vested, and a means whereby he returns it to the investment company for further investment?

Mr. YOUNG. There is no question that it is done with his consent. That consent was——

Senator KERR. There is no question first that that has to be done?

Mr. YOUNG. No; there is no question about that, sir. And that consent was given at the time the original agreement was made in advance.

Senator KERR. Well, it can be or it need not be.

Mr. YOUNG. Yes. Well, it happens in this case to have been done that way.

Senator KERR. And if it was, then the shareholder is dealing with his own taxable income?

Mr. YOUNG. Yes, sir. He has a perfect right to possess himself of that income.

Senator KERR. It is his income?

Mr. YOUNG. Sure it is; yes, sir. And we have treated it as such.

Senator KERR. And if he makes a contract with reference to it he is dealing with taxable income?

Mr. YOUNG. That is correct.

Senator KERR. Then it cannot be a situation of continuous compounding of these dividends without the consent and the agreement of the shareholder with reference to his taxable income.

Mr. YOUNG. They could not be compounded without his consent, I agree, Senator.

Senator KERR. Without his consent, concerning income which is taxable to him.

Mr. YOUNG. That is correct. It is given whether it is taxable or not. He has given his consent——

Senator KERR. It is taxable income insofar as he is concerned until he establishes either that his exemptions are such that he doesn't owe any tax on it.

Mr. YOUNG. I won't go into the question of the source of the income.

Senator KERR. It is income to the individual shareholder.

Mr. YOUNG. Yes, sir. And it is treated—it has been treated as that. As you will see, Senator Kerr, by the statement from the paragraph that you are reading is we give him notice as requested by the Secretary of the Treasury.

Senator KERR. I know. But the point I am making is this: If he agrees that a certain amount of money which is taxable to him shall be redeposited with this investment company——

Mr. YOUNG. Right.

Senator KERR (continuing). He is dealing with money with reference to which if he owes taxes, is taxable?

Mr. YOUNG. Yes; that is correct. He has made that agreement.

Senator KERR. And if he does he does so on his own responsibility and the Government isn't responsible for it.

Mr. YOUNG. The Government has no responsibility for that decision.

Senator KERR. Now, the law made a very special provision for these investment companies——

Mr. YOUNG. Yes, sir.

Senator KERR (continuing). At their urgent plea and request. I was here when they made it. They asked Sam Jones how he knew he had religion. He said, "I was there when it happened." I was here when they made that request. We gave them that privilege.

Now, so far as I am concerned that income is going to be taxed to them or if that shareholder is in a bracket wherein any of his income is taxable it is going to be taxable to him.

Mr. YOUNG. Senator, I agree with you and I didn't——

Senator KERR. And he cannot escape that taxation by making a contract to return that amount to that investment company.

Mr. YOUNG. I would agree with you, sir, and I did not understand Mr. Robbins to suggest to the contrary.

Senator KERR. Well, the contrary is suggested in the language; for the plan to work as it was intended the continuous compounding of these dividends is essential.

Mr. ROBBINS. Senator, may I interject a comment if you please, sir?

May I say that perhaps this has been lost sight of. These plans, Senator, offer a method of long-term accumulation and, as such, the reinvestment of compounding and dividends add much in producing the end results after 10, 15, or 20 years.

Senator KERR. I can understand that.

Mr. ROBBINS. These people, sir, do pay income taxes on these dividends. At the time they make the contract, they instruct the custodian bank to reinvest their dividends and apply them to the purchase of additional shares. Each year at the end of the calendar year, the custodian bank and plan sponsor send out 1099 forms to the planholders reporting to them what part of their income should be reported on their individual tax return as ordinary income; what part, if any, is realized security profits and what part return of capital, if any. We do that in order that those people can report that dividend even though they haven't physically taken it, and while they have used it to compound, they still nevertheless have the responsibility of reporting it.

Senator KERR. Well, even if the check had been delivered to them and they took it over and deposited it in the bank they wouldn't have physically taken the money.

Mr. ROBBINS. True, but their responsibility obviously is to report it, and that is why we send this tax information out.

Senator KERR. They have just as much control over that dividend when it is deposited to their credit as though the check had been delivered to them or else it has not been distributed as required by the law.

Mr. ROBBINS. There is no question about that.

Senator KERR. Now, then, the investment company itself has a special tax treatment by reason of the fact that the income earned on its investments is required to be passed through, declared, and delivered to the shareholder?

Mr. ROBBINS. Right.

Senator KERR. What you are asking for is that in order that the investment company may do a better job for him and make a proper attractive proposition to him that not only the investment company

should have a special tax treatment but that the shareholder should be treated differently than a shareholder who received a dividend direct from the company that paid it.

Mr. ROBBINS. No, sir; I am sorry, I cannot agree with you; that is not——

Senator KERR. I understand you can't, but that is the way I interpret it.

Mr. ROBBINS. I am very sorry, sir, those are not the facts.

Senator KERR. Those are the facts. If we were to pass a law that said that the man that received a dividend in the form of a check from the company that paid it would be subject to withholding but that a shareholder who received a dividend passed through by an investment company would not be subject to a withholding then we would be giving the shareholder in the investment company a special tax treatment.

Mr. ROBBINS. We are asking for no special consideration or tax treatment, sir. We are not asking that at all.

We are asking simply—may I, Senator, ask this, please. May I continue my statement because at the end I think if you gentlemen decide there should be tax withholding on dividends as applies to regulated investment companies, the memorandum we are filing with your committee will, I believe, at least outline a method for eliminating the confusion, as we see it, that will be created unless some consideration is given to our problem.

If I may, sir, may I continue my statement and then if you have any further questions——

Senator KERR. You can when I get through talking with you.

Mr. ROBBINS. Yes, sir. Very good.

Senator KERR. We are both here.

Mr. ROBBINS. My only reason for suggesting this, Senator, is that it seems to me, provided you permit me to continue, you will get a clearer grasp of what I am attempting to convey, which is that we are both saying the same thing but in perhaps a——

Senator KERR. Here is what I am saying to you. I am not saying whether I am for a tax withholding on dividends or not.

Mr. ROBBINS. Right.

Senator KERR. I am saying to you if such a principle is written into the law there is no basis for your shareholder to be treated any differently than if he were receiving his dividend check direct from the company that paid it instead of receiving it through you, that is what I am saying.

Mr. ROBBINS All right, sir.

Senator KERR. All right. Now you can go ahead.

Mr. ROBBINS. Thank you, sir. I believe we were——

Senator KERR. You were on the point where you had just said—

withholding can restore to him the full and automatic benefits of his plan.

Mr. ROBBINS. Correct. As I will show, many planholders, as small earners, are exempt from any Federal tax on dividends—and withholding is an utterly unwarranted step for them.

Even if the planholder is subject to tax, the withholding works a hardship on him. Should he attempt to make extra payment out of tax refunds to restore his plan in full, he will be changing the routine

of the plan and would inevitably be charged extra custodian fees which may be prohibitive in view of the small amounts involved. The most likely result in most cases, would be the withdrawal of the withheld amount from the plan.

Let me illustrate how adversely this can work, by showing the experience of a planholder in a conservative and established mutual fund.

If, like many wage earners, he had been able to set aside only $20 a month beginning in 1941 and had completed his payments in 10 years, he would have invested a total of $2,400. Assume that all his dividends and distributions were reinvested—not only during the 10-year payment period but 10 years beyond the payment period; namely, through 1960. He would have built an estate of $9,900. However, the value of his shares at yearend 1960 would have been $1,100 less—just about half of his total payments—if he had been forced to withdraw 20 percent of his dividends from his money at work.

Systematic savings plans like life insurance entail costs in their operation; and the smaller the transaction involved, the heavier becomes the burden of administrative cost. Many custodian agreements make it possible for the custodian bank to increase their charges should duties, in addition to those now devolving on the banks, be imposed.

I am certain that any amendment of current plan procedure to accommodate the operation of plans to the withholding provision will involve material added costs if it involves any added functions for the custodian bank.

I emphasize this point because mutual funds, who are the payors of distributions to custodian banks, do not record individual contractual planholders' accounts. This is done by the custodian banks.

These mutual funds cannot, therefore, receive and honor exemption certificates of planholders who are not shareholders of record.

This will probably have to be done by the banks and will involve added accounting procedures and cross bookkeeping with the mutual funds—which are not present functions of custodian banks.

Further, as I shall show, plan accounts involve multitudes of very small dividend payments. This means that the costs involved by withholding will entail an undue expense upon the structure of the industry as a whole. The net effect will be a serious impairment of a system now carefully designed over these many years to make systematic investing feasible for the small investor.

It should be obvious that while I speak nominally on behalf of the Association of Mutual Fund Plan Sponsors, I speak in fact for close to one and one-half million small investors—small business owners, professional people, and skilled and semiskilled workers throughout the Nation.

These people have already made payments of $1.5 billion on their plans. They are scheduled for the investment, under plans now in effect, of some $4.6 million.

They are important people, and their saved money is vitally important to them. I do not think that they are tax evaders. I do not argue for tax evasion.

Their responsibility for the payment of taxes is clearly pointed out to them each year by the sponsor companies. But the initiative they have shown for thrift by their participation in these plans should not

be discouraged by withholding amounts that at the time seem insignificant but over the years can account for half of their payments.

The refund technique invites enormous administrative complexity and expense for many small payments. The figures for one representative plan sponsor indicate that 53 percent of planholders make monthly payments of $25, or less. It is therefore safe to assume that many of these people are not subject to Federal income tax withholdings on dividend income, as illustrated by the breakdown of a recent quarterly dividend on 117,000 plan accounts: 34,000 of these accounts involved a dividend payment of $5, or less; 28,000 of these accounts involved a dividend payment of between $5 and $12.50.

And here we have accounted for 53 percent of one sponsor's contractual plan accounts—which is representative of the industry's experience.

In 1962, each of these planholders will receive less than $50, the amount of the dividend exclusion under the present law.

Furthermore, figures indicate that over 73 percent receive less than $100 per year in distributions. To the exent these accounts are jointly held, the dividends would be excludable.

In closing, I am not expressing any views on the general subject of withholding. I am not a tax expert and am not attempting to suggest to this committee how to remake the bill. But it should be remade—to avoid the penalties and complications to contractual planholders who do not fit the popular conception of stock market "investors" receiving "dividends."

If, however, it is the opinion of the Senate Finance Committee that withholding is necessary, we respectfully suggest that holders of contractual plans as provided for in sections 26 and 27 of the Investment Company Act of 1940 be fully exempted from section 19 of this bill.

If, however, such exemption is not granted despite the reasons as outlined, I am submitting a memorandum for the record which would accomplish this objective and permit, at least, manageable operation of withholding as applied to mutual funds and contractual plans.

(The memorandum appears at the end of Mr. Robbins' testimony.)

The best solution, however, as I have indicated, is the total exclusion from the withholding requirements of "dividends" paid to mutual funds and contractual plans.

Senator DOUGLAS (presiding). Thank you very much, Mr. Robbins.

While disavowing any position on the question as to whether or not withholding should be practiced on dividends and interest, I take it your testimony is adverse to that?

Mr. ROBBINS. Yes, sir.

Senator DOUGLAS. And constitutes in the main an argument against withholding?

Mr. ROBBINS. Yes, sir.

Senator DOUGLAS. Now, I think you mentioned at one point in your paper that 71 percent——

Mr. ROBBINS. Seventy-three percent appears on page 5, sir; furthermore, these figures indicate that over 73 percent received under $100 per year on distribution; is that the figure, sir?

This percentage does appear at the bottom of page 5.

Senator DOUGLAS. No—oh, yes; 53 percent of planholders make payments of only $25 or less, and you conclude from this that it is,

therefore, safe to assume that many of these people are not subject to Federal withholding tax on dividends and income.

I don't see this follows at all, because in the first place, monthly payments of $25 would be $300 a year. The average savings in American society runs around 8 percent of income, and of course the percentages increase as income increases, and decrease as income diminishes, so even if all the savings were made in the plan, I think this would indicate that a $300 savings, would indicate an income of probably not far from $5,000; it certainly would be subject to income tax under those conditions, and, of course, there is always the possibility of multiple destinations of savings.

So I think you have indulged in a non sequitur in this matter. Do you have any reply to that.

Mr. ROBBINS. We do. Most of the companies at the time application is made by an investor to become a so-called contractual planholder executes a form questionnaire.

Its purpose is to qualify the individual, and establish the fact he has already established his so-called emergency funds like a savings bank account, life insurance and is, therefore, eligible and qualified to initiate an investment account, that is obviously subject to market risks.

I believe it to be a fair statement that in answer to the question appearing on their application, whether you carry other investments, the majority of the people will answer "No," so that in effect these plans do represent to be their only investment.

Senator DOUGLAS. Very well.

You also point out that many individuals automatically reinvest their dividends in a mutual fund and from this you argue that a 20-percent withholding would cut down the amount that is reinvested and that thus reduce the shareholders' investment in the fund.

Of course, this is an affect that naturally calls for withholding. It applies to all savings, not only to mutual funds, and to the degree that most people do not withdraw the interest credited to their savings accounts, withholding will have the same effect on savings accounts.

Mr. ROBBINS. Of course.

Senator DOUGLAS. Now, you are perilously close to taking the position, which you disavow in the succeeding paragraph, that the people who reinvest their interest do not pay taxes upon it, and, therefore, you shouldn't have them pay taxes because this would diminish the cumulative nature of their savings. This is perilously close to a plea for tax evasion—tax evasion as a means of increasing savings.

Mr. ROBBINS. May Mr. Young answer that question please?

Mr. YOUNG. Senator Douglas, although I am here only as a "tax expert" and not as an experienced psychologist I would say from my own observation, and I have been close to the affairs of this type of plan for a long time, these people are no different from anybody else.

Senator DOUGLAS. I am not singling them out for castigation.

Mr. YOUNG. Oh, no.

They are no different from anybody else in the sense that they will not save as much money unless they have to. Do you get the thrust of what I am saying?

Senator DOUGLAS. I don't like to pay taxes, either.

Mr. YOUNG. I am saying merely this: If the choice is to continue to spend money—to pay money because they are obligated to do so, is the experience, let us say of the industrial life insurance business. They will save that money and skimp on something else yet I am assuming in both cases that most citizens do respond to their responsibility to pay taxes.

However, if the spare money comes out it will be spent, it will not be saved, and again that has been the experience.

Senator DOUGLAS. Isn't it more or less boiled down to this: A good many people feel that if they reinvest their interest, and do not enjoy it in the form of present income for it doesn't enter into their bank accounts, so to speak, that they don't have to pay taxes on it?

Mr. YOUNG. Well, I have no opinion on that, I am afraid——

Senator DOUGLAS. I think this is one of the major sources, frankly, of what is avoidance or evasion; I will put it that way.

Mr. YOUNG. Well, at this point, Senator Douglas, I am in complete sympathy with what the Commissioner of Internal Revenue is doing right now, if you will, going to the people and trying to bring to them consciously their responsibility for paying taxes they have not previously paid.

Senator DOUGLAS. You admit this is income?

Mr. YOUNG. There is no doubt about this, sir.

Senator DOUGLAS. I may say, I mentioned yesterday, that in the first 3 days of this week I received 8,000 letters protesting withholding and a sampling of these letters indicates that in about a third of the cases the writer thought that interest and dividends were nontaxable, and this has puzzled me a lot.

I think a large percentage of these cases are people who do not take the interest and dividends into their own bank accounts but reinvest them in the source from whence it came.

Now, this is a mistake. In some cases it is a conscious mistake. In many cases it is an unconscious mistake. And I am ready to believe that in most cases it is an unconscious mistake. But you state very emphatically that it is a mistake.

Mr. YOUNG. There is no question about it, sir.

Senator DOUGLAS. Now, the figures seem to indicate that of the $15 billion distributed in interest and dividends, and we get these figures from independent sources, that close to to $4 billion is not declared by the recipient and therefore avoids or evades taxation and that we are losing not far from $800 million a year in tax revenues which are actually owed.

This means the burdens of those who do pay have to be heavier because of noncompliance on the part of those who do not. So we are dealing with a very real evil here.

Would you say that we should eliminate withholding on wages and salaries?

Mr. YOUNG. Obviously the answer is "No."

Senator DOUGLAS. The answer is "No."

Mr. YOUNG. Obviously the answer is "No."

Senator DOUGLAS. How can you say, it is proper to withhold on wages and salaries but improper to withhold on dividends and interest.

Mr. YOUNG. Let me say this, Senator, and I will accept your major premise, which I think is correct, that a large amount of this un-

reported income that is in the gap has been due to ignorance, inadvertence, or what have you. It is not an indication of a widespread general conspiracy against the Government.

I believe that all of the people who have had the advantages of the advice given by the presiding witness, who was testifying as to what the corporate fiduciaries have been doing by sending out the special notice that the Commissioner has requested, can no longer claim ignorance. I know that every planholder of the association that is represented here, is not only advised as to his requirement to pay taxes, but also the amount he is required to report.

Senator DOUGLAS. Why shouldn't we——

Mr. YOUNG. I believe that the solution is in that direction.

Senator DOUGLAS. All right. Why not scrap the withholding system on wages and salaries and merely have the people who pay wages and salaries distribute slips saying, "This is income which you should report."

Mr. YOUNG. If you please, sir, I think that part of the thrust of this has to do with the establishment of new and complicated and expensive procedures to do this.

In the case of wage withholding, the procedure was established initially when the social security law was passed. The mechanics of the wage payor had been established and it was a problem of putting an extra entry upon his mechanical bookkeeping to do it. I am not saying it was no trouble. But mechanically it was done without starting from scratch.

Senator DOUGLAS. You are aware of the fact that in the vast majority of the cases, even under the bill that the House sent over to us, there would be no itemization of the deductions from individual accounts?

Mr. YOUNG. I realize that.

Senator DOUGLAS. And in the bill which the Treasury sent down last year to the House, there would be absolutely no itemization? All that would happen would be a 20-percent——

Mr. YOUNG. It would be a grossing.

Senator DOUGLAS (continuing). would be a 20-percent withholding without dealing with individuals at all. Now, under the pressure of objectors to the plan—I don't know that you folks testified before the House or not—but under the pressure of objectors to the plan, the people over the age of 65 were exempted from withholding, those under 18, and nonprofit institutions. This does complicate matters, and I think it is very questionable whether those exemptions should be continued.

But certainly this is simpler than the wage and salary deductions, as I understand it, which are individually withheld and tabulated.

Mr. YOUNG. Individually withheld; correct, sir.

Senator DOUGLAS. So there would be much less work administratively, in the withholding of dividends and interest than is now incurred in the withholding of wages and salaries?

Mr. YOUNG. Well, I would merely say when the withholding system was installed, I believe it was in 1942 on wages and salaries, it was——

Senator DOUGLAS. It came in with the Ruml reforms.

Mr. YOUNG. In the Ruml reforms.

Senator DOUGLAS. The forgiveness principles, so to speak, sweetened it all and people were forgiven for half of the year's——

Mr. YOUNG. But the mechanics were impressed upon a system which had been in effect, the names were known, the accounts existed down in Baltimore and had been in effect for 5 or 6 years, and the mechanical problem of putting it into effect was much less. I think we are talking about degree rather than black and white, and so forth.

Senator DOUGLAS. Don't you think it is worthwhile to adopt a system, a simple system, to save the taxpayers of the country $650 million of this $800 million?

Mr. YOUNG. Frankly, Senator, I think that anything that would reduce the burden of tax reporting and administrative burdens both to industry and to the Government is in the public interest. I start with that. That may not be the controlling consideration. I am suggesting that the ADP that is being set up will set up a means of reducing that gap so materially that when you get down to what is left it will not be worth the burden and the overhead you are imposing.

Senator DOUGLAS. If you merely depend on sending information to the recipient, and throw the burden upon the recipient to report, do you not have to extend that privilege to wages and salaries as well. We all know what the difficulties in this connection are; that it is hard for an individual to keep track of what his income is. He can forget it very readily.

Then if the taxpayer is required to pay first, every year, and now quarterly, payments are bulked, and they become very heavy, and it is hard to save in advance for them. But the 20-percent withholding as it comes along, makes it easier and so it has turned out to be a convenience for the wage-and-salary person to have it withheld. This is true even though there is overwithholding rather than to have the tax fall like a dead weight at the end of the year or the end of the quarter.

Mr. YOUNG. Well, Senator, I think I would be doing a disservice to the committee here if I undertook to give testimony on something that Mr. Robbins was not prepared to testify and I am obviously expressing only my own views.

Senator DOUGLAS. I understand that.

Mr. YOUNG. Yes.

Senator DOUGLAS. But you are advising us on a matter of public policy.

Mr. YOUNG. I understand, sir.

Senator DOUGLAS. And your testimony is adverse to withholding and I think it is the privilege of a Senator to question a witness about certain other aspects.

Mr. YOUNG. I am merely suggesting, Senator, you are getting information on this particular narrow subject that could be given much more effectively by people better prepared than I.

Senator DOUGLAS. We are faced with this fact and with this decision. Nobody wants to pay taxes. Everybody fights an attempt to collect more money. On the other hand, everybody is for some specific appropriation. The Congress is then exposed to two built-in pressures, one a continuous drive of people for appropriations for a whole variety of reasons. These are from people who will theoretically object to appropriations but who will give all out support for a particular appropriation. Witness the newspapers and publishers who demand balanced budgets but who don't want to meet the average costs of postal service, or the direct mail advertisers who don't want

to meet average costs but who join chambers of commerce and demand a balanced budget, but support expanding appropriations and creating terrific expenditures in this direction.

And then when you come to the revenue feature, they fight and oppose every attempt even to collect taxes which are already owed. We are not proposing to levy any new tax but some of the savings institutions of this country have spread broad propaganda indicating or suggesting that this is a new tax.

As I say, a third of my 9,000 letters seem to be, and that is only for 3 days, about a third of these letters seem to be saying and take the position that this is a new tax, whereas it is only a better means of collecting a tax already owed, and to do it in the simplest possible way, with 20 percent withholding of gross amounts and then let the individual ask for the refund. Yet you able gentlemen come in and argue against it.

Mr. YOUNG. You have stated your position very eloquently Senator.

Senator DOUGLAS. When we try to draw you into a discussion of the general subject you simply say this is beyond your competence, all we can do is be special pleaders.

Mr. YOUNG. I am sorry I created that impression. I don't want, however, to pose as an expert on this particular subject, I think this would be taking advantage of your committee.

Senator DOUGLAS. Thank you, Mr. Chairman.

Senator KERR (presiding). The Senator from Kansas?

Senator CARLSON. I would like to get into this discussion a little. I think the Senator from Illinois has raised an important point in this withholding.

It seems to me, and I will ask you this question: If there isn't a vast difference between withholding of taxes on salaries than there is on dividends.

Now, an individual sets his own withholding rate. I mean he takes first the salary he is to receive, and he takes his Government exemption, regular Federal exemption, and he takes a number of dependents out and he tells Uncle Sam, "You withhold so much percent of my income."

That is not true in this case, as I see it. If, as I understand your organization, and the people that you do represent, they were going to withhold 20 percent of people who owe no taxes, wouldn't that be true?

Mr. ROBBINS. It would. This is the difficulty. May I illustrate it this way: Suppose, that Du Pont declares a dividend, and that 20 percent of the dividend payment is withheld at the source by Du Pont, and the net thereupon paid, we will say, to X investment company.

So far as X investment company is concerned they have no planholders, they simply have shareholders. But we here are concerned with the planholders position, as opposed to the position of the shareholders of the fund. Let's assume moreover, that from 25 to 30 percent generally of all shareholders like to have their dividends reinvested.

By comparison, 99 percent of the people on whose behalf we are here, and by that I mean planholders we invariably want their dividends compounded, because they are building an accumulation or their own estate planning program.

Take as example, the individual who is exempt from income taxes owing to small size of his account. There is to be no such a thing as is now contemplated under its provisions of the bill for an exemption certificate which the planholder can execute and which the custodian bank, holding the accumulated shares for his benefit can properly recognize.

In this instance, the custodian bank cannot file an exemption certificate with the investment company since the shares are registered in its name and not in the name of the individual planholder, so what is the custodian bank to do? He has but one alternative, to invest but 80 percent of the dividend belonging to Joe Doak, in additional shares, file for a tax refund, and perhaps 90 days or 120 days later have the refund granted.

And what might this amount to? $1.29? 78 cents? $3.03? Certainly, the custodian isn't going to invest this money for no fees. It has to make money so it's going to cost these little people, a lot of whom, as I pointed out, are not subject to income tax on dividend withholding, additional money to reinvest the other 20 percent of their dividends maybe 90, 120, 180 days later, so as to acquire additional shares.

All I am trying to do here is to distinguish and weigh the problems of these little people, who are using this method of building their own estate planning program.

What I have tried to show earlier in my statement is the degree of loss in purchasing power from compounding under a $20 monthly plan on which total payments are limited to $2,400, wherein on the end results there is a difference of $1,100. Those are the people who will be penalized.

Of course, they are upset. I am not trying to use this as an example but already we are getting letters from planholders who say substantially this: "If this legislation is to come about, just wash out my account. I will send in my certificate and cash it in."

Those people lose their savings incentive. This is the problem as we see it. There is nothing in the way the bill was passed by the Ways and Means Committee to protect these little people who will not be subject to income tax withholdings on dividends.

As stated at the end of my statement to you gentlemen, if in spite of all of the arguments and reasons advanced, which I believe should be clear to you, you still feel the bill should be passed, as I said, I would like to submit for the record a memorandum which in our opinion should accomplish our objective by providing a manageable operation for withholdings on dividends as affect mutual funds and contractual plans.

If I may be permitted to state briefly what this method is, I shall be very brief. It is the philosophy, and theory, behind the sales tax such as is followed today.

In each instance, the manufacturer and middleman are exempted. They pass it along to the ultimate consumer, who pays the tax.

Obviously, since the banks and institutions acting as custodian are all responsible institutions, I see no reason, assuming you gentlemen feel this legislation must be enacted in order for the Government to receive the revenue they feel is being lost, and this is not only right, but to this extent I am in sympathy with such steps being taken, then

I say why should not the dividend payor pay out the full 100 cents of dividend payment to the investment company, the investment company in turn pay out the full 100 cents of the dividend payment to the custodian on whom the responsibility will rest for withholdings.

We operate, as I have tried to make you understand, as a conduit, which is what in effect we are.

That is the hub of the problem, Senator.

Senator CARLSON. Mr. Robbins, I think I see your problem and what concerns me is the unfairness of it to people who don't owe taxes.

Mr. ROBBINS. That is right.

Senator CARLSON. I think these people ought to pay their taxes, I certainly want them all to pay.

Mr. ROBBINS. You are correct.

Senator CARLSON. But if we handle it like we handle the dividends and interest and secured statements from these people that they owed taxes then we could withhold it.

But in the State of Kansas the legislature, 3 years ago, enacted legislation that minors are permitted to own stock in our State and hold it.

For instance, in your corporation, many of these young people, children, have small amounts they invest in, for instance, some of your organizations, and they will not accumulate taxable income until they reach 21, maybe, and here you are going to withhold 20 percent, and they will not be permitted to get the benefit of that money which will be accumulating for this interest.

I think it is not unfair, that formula, and if you have some suggestion, I am going to read with interest your suggestion and statement on it.

Mr. ROBBINS. Thank you very much. It is attached to my statement.

Senator CARLSON. I appreciate your appearance.

Mr. ROBBINS. Thank you, sir.

Senator DOUGLAS. Mr. Robbins and Mr. Young, I don't want to let you go until I have a chance to continue this dialog and examination of my good friend from Kansas. I am informed that out of 60 million recipients of wages and salaries each year 37 million are subjected to overwithholding. I have never heard anyone weep about them although they get a refund only once a year instead of four times a year.

I made a hasty calculation, I think of the 71 million people in the work force about 11 million are self-employed, so this leaves approximately 60 million who are in receipt of wages and salaries. So you have at least 60 percent of recipients of wages and salaries who have more taxes withheld from them week by week than they ultimately owe, of course, in some cases this is not their full income.

Now, I think there are at least three points to be considered: The number of recipients of dividends and interest are less than the number of recipients of wages and salaries.

Second, the percentage of these who would be subject to overwithholding is less than the number who receive wages and salaries, because their average income is higher, and third, they would get a refund every 3 months whereas the wages and salary recipients get a return only every year.

I think what we are dealing with here is the fact that a dollar in dividends and interest somehow has a much higher prestige value than a dollar from wages and salaries.

I do not say that it should have any less prestige. I am not arguing that at all. But I would say that a dollar of wages and salaries should have equal prestige. And it is extraordinary to me how people will accept for one group in society something which they shrink from applying to another.

Mr. ROBBINS. Senator, may I say this: Is it not contemplated under the proposed bill, as passed by the Ways and Means Committee, that application for a refund of dividends of less than $10 will only be permitted to be made at the end of the calendar year? Am I wrong about that?

Senator DOUGLAS. Would Mr. Woodworth answer that?

Mr. WOODWORTH. There can be no quarterly refund for an amount of less than $10.

However, if the amount from one quarter plus the amount received in the subsequent quarter adds to $10 between them, then a refund can be made.

Mr. ROBBINS. The point I should like to make is that the dividends of many of these people will be less than $10, particularly during the early years of these plans whose terms vary from 10 to 12½ to 15 years of monthly payment periods. Therefore in many cases, Senator, it will be some time before these people's dividends will reach a point where they will be entitled to file quarterly refunds.

The point on which I would like to get your impression is this: People have become well educated, that is, the wage earner, to salary withholdings and to the W–2 forms now in use.

This is an orderly procedure. The wage earner receives it from his employer, staples it to his tax return, and it is easily processed.

Should he be due a refund, there is a record of his withholding credit. What records, if any, will he be given here? As I understand it, no one expects to furnish the taxpayer a receipt of his dividend withholdings. In the first place, this is going to be costly, and I visualize all sorts of confusion with respect to these people being furnished this information by the custodian banks.

The banks will presumably not render this service for nothing. They are not set up to reinvest the 20 percent of withholdings until they receive the refund, and again they will not render this additional service for nothing. As I see it, there is going to be a lot of guesswork.

Senator DOUGLAS. Are you saying that the wage and salaried workers are more educated——

Mr. ROBBINS. Certainly so, as to the amount that has been withheld.

Senator DOUGLAS (continuing). Than the dividend and interest recipients and better able to handle their income tax?

Mr. ROBBINS. I said, Senator——

Senator DOUGLAS. All the practical experience is to the contrary.

Mr. ROBBINS. I said they are informed to the extent of knowing the amount withheld because they have to retain a duplicate of the withholding form W–2 which they attached to their return.

There has been a lot of talk of the contemplated mechanics to dividend withholdings but as I understand it from everything I have heard, nothing has been planned for giving these taxpayers by way of withholding receipts. What records will these people have?

Isn't it possible that many honest mistakes will be made by people asking for refunds? Is it not also possible that many of these people will be confused and fail to make application?

Senator DOUGLAS. They have drawers in their desks where they can deposit the slips which they get accompanying the checks.

Mr. ROBBINS. You mean——

Senator DOUGLAS. You mean do they light cigarettes with them or throw them out in the garbage can. A person normally has a drawer in a desk or puts it elsewhere and you put them in.

Mr. ROBBINS. I am not referring to a man who receives a dividend check from Du Pont or American Can, I am referring to the little people here using these plans for accumulating invested capital.

Senator DOUGLAS. Don't you furnish them now?

Mr. ROBBINS. We do, sir, now but I have no idea how it is going to be done, nor do the banks should the legislation be enacted. I have had a discussion with one bank, the First Pennsylvania Bank & Trust Co. in Pennsylvania, one of the oldest in the business, they are frankly at a loss to describe how the mechanics will be set up.

Senator DOUGLAS. Let me ask you this: Don't you give them a statement in advance that the interest is to be deposited or is this done in each case?

Mr. ROBBINS. No, sir when a person starts his account he so instructs the custodian.

Senator DOUGLAS. I see.

Mr. ROBBINS. I would like however to make clear for the record, sir, that in the past, as well as currently, these people are getting at the close of each calendar year the amount of dividend income that over the year was reinvested for their account. But physically, they did not receive them since they were reinvested.

Senator DOUGLAS. They get it at the end of a year?

Mr. ROBBINS. They receive a tax information statement.

Senator DOUGLAS. They get a refund or at worst they would get refund each year on the same terms as the recipients of wages and salaries, not quarterly.

Mr. ROBBINS. Senator, it is easy the way it is being done now. There is no problem regarding present procedure.

Where it will become complicated is once withholdings come through, possibly you stepped out of the room, when I explained to Senator Carlson, there will be a serious problem for those people who are not subject to tax withholding, since all the custodian bank will receive for reinvestment will be 80 cents of the dividend dollar.

They will logically claim exemption and since the custodian cannot recognize their claim, they will have to request the Treasury for a refund. Ninety or one hundred and twenty days later, the custodian will receive these refunds, at which time they may have in the case of one planholder an additional $1.23 to reinvest.

The bank will have to charge for this transaction since it has to make money. In some instances, the bank may receive a refund of 89 cents or 72 cents and yet have to charge for its reinvestment service 75 cents.

Imagine the confusion, from part of dividend not being invested until 90 or 120 days later. Also picture the confusion from advising these planholders that while they were exempt from withholding, X dollars by law had been withheld at the source.

Senator DOUGLAS. Perhaps we should abolish taxes, abolish them completely, disband the Army, disband the Navy.

Mr. ROBBINS. This we are not arguing for, sir.

Senator DOUGLAS. Abolish the Central Government, sweep it away, that is what a great many people want.

Mr. ROBBINS. No. This I do feel is true of the average American.

Senator DOUGLAS. This is the whole point. If you take every set of arguments and accumulate them together, that is exactly what is being said. The people who appear before us do not want to pay taxes. The great inarticulate people of the country are willing to pay taxes but the special interests come here and don't want to pay taxes, and if we were to follow your advice we would never introduce any tax reforms.

We would eliminate all taxes. The Appropriations Committees would authorize the spending of enormous amounts of money. We would have great deficits. And then you would all say, "Hang Congress because it is not balancing the budget."

I know you are a good man, but I must say after 4 weeks of this, this is the general impression that I get. I may be too severe in my judgment.

Mr. ROBBINS. I believe, Senator, I have made clear we are not recommending abolishment of taxes. I concur completely with the statement that people who owe the Government taxes should be made to pay these taxes. This is what we are talking about——

Senator DOUGLAS. At present nearly 25 percent of dividends and interest paid out subject to taxation is not paid. Now, we make great complaints about France and the Mediterranean countries, because of their tax collection being very poor. Those countries labor under greater difficulty than we do because a large proportion of their population is self-employed, and a percentage of the evasion and avoidance among the self-employed is greater than among the recipients of wages and salaries.

We send experts over there to revise their tax systems. We try to get them to put in collection at the source. That is the advice we give in Greece. We give the advice to such an extent that some of the wealthy Greek shipowners won't venture on the soil of Greece. When they come to Greece they anchor in the harbors and have their parties out on board ship, but don't dare venture on shore. And they entertain some very notable people, too, I can tell you.

Mr. ROBBINS. Senator, may I say that I believe we are both trying to say the same thing but perhaps differently. Our only point of disagreement seems to be that we are here today to endorse or condone evasion by taxpayers, but solely to request postponement of this proposed legislation pending installation by Treasury of its proposed data and process system.

Senator DOUGLAS. All right. If you do that I am going to propose that we eliminate collection at the source on wages and salaries and put in data processing for those people.

Well, all right. I may have spoken with some heat, Mr. Robbins.

Mr. ROBBINS. Not at all, sir.

Senator DOUGLAS. I have been sitting here for 4 weeks.

Mr. ROBBINS. I don't blame you, it must be very tiring.

Senator DOUGLAS. The words may differ but the tune is always the same.

Mr. ROBBINS. In either event may I thank you gentlemen for being so patient in listening to us.

Senator DOUGLAS. Thank you.

(The memorandum of the Association of Mutual Fund Plan Sponsors, Inc., follows:)

MEMORANDUM OF THE ASSOCIATION OF MUTUAL FUND PLAN SPONSORS, INC., WITH RESPECT TO WITHHOLDING OF INCOME TAX ON DIVIDENDS

THE PROBLEM OF WITHHOLDING INCOME TAX ON DIVIDENDS PAYABLE TO INVESTMENT COMPANIES

This memorandum is concerned with the technical aspect of the proposed bill dealing with the withholding of income tax on dividends insofar as that bill[1] affects the practice of the investment companies registered under the Investment Company Act of 1940.

The proposed bill, as it presently stands, presents unusual and difficult problems to the investment companies and sponsor companies of periodic payment plans, frequently referred to as contractual plans, with respect to the withholding of income tax on dividends which these companies pay to their shareholders or planholders, as the case may be.

To explain the effect of the proposed bill on investment companies, it is necessary to understand exactly how these companies function.

The investment company offers the investor, through its purchase of shares, debentures, and bonds in various corporations, an opportunity to participate in the results of the broadly diversified group of investments the investment company thus makes. The investment company will hold stocks and bonds of a hundred or more businesses and will pass on to its shareholders in the form of distributions the dividends and interest it receives from these corporations and also the net gains it realizes from the sale of the securities it may have held and disposed of at prices in excess of those at which such securities were acquired.

For obvious reasons, the portfolio of securities held by the investment company is placed in the custody of a bank or a trust company, which receives all the dividends and interest payable upon the securities in the portfolio. In turn, the investment company distributes to its shareholders, usually quarterly, the results of these dividends and interest as well as any capital gains that may have been realized. Indeed it must do so to the extent of 90 percent of the net investment income it receives, in order not to be liable for a corporate tax of 52 percent upon the income it receives.

This function of the investment company, in which it serves as a conduit for the receipt of income from its operations and the distribution of those receipts to its shareholders, has always been recognized by the Internal Revenue Code. Obviously, it would destroy the whole purpose of the industry, were these operations subject to double taxation, namely, being required to pay a 52-percent tax on the operations of the investment company in addition to the 52-percent tax paid at the source by the corporations from which it receives its income. The Internal Revenue Code has recognized these facts. Under its provisions, the investment company pays no taxes provided it acts merely as a conduit in the distribution of the income it receives. The individual shareholders are naturally required to pay taxes on the "dividends" they receive from the investment company. Annually, as required by Treasury regulations, they are informed as to how much of these "dividends" represent (*a*) dividends or interest paid by the companies whose securities are held in the portfolio, (*b*) what portion of these "dividends" represent capital gains resulting from the sale of securities in the portfolio, and (*c*) what portion of these "dividends" represent a return of capital. (This return of capital applies usually to periodic payment plan companies.)

To withhold income tax on these dividends paid by the investment company is understandable. But to withhold income tax on the dividends paid to the investment company by the corporations whose securities it holds, which through the

[1] All references in this memorandum to the "proposed bill" relate to the bill as passed by the House of Representatives.

of the investment company, representing a pro rata share after expenses of investment company mechanism are converted into dividends to the shareholders dividends and interest paid by the underlying companies to the investment company, presents complications and tends to destroy the very function of an investment company as a conduit for the transmission of dividends and interest from a group of diversified companies to the individual investor.

This situation is compounded by the existence of the "periodic payment plans" that are widely sold by investment companies or sponsors of such plans. These plans consist of investment contracts whereby the planholder agrees to pay monthly or periodically for a term of 120 months or more, a certain sum, ranging from $10 upward, the net proceeds of which will be utilized for the acquisition of shares of the investment company. As they are accumulated, the shares are held in trust for the planholder by a custodian bank or a trust company as required by the Investment Company Act of 1940. The custodian of these plans pays out "dividends" on these plans to the extent that "dividends" are declared by the investment company. There is usually a 10-percent declaration of such dividends, inasmuch as the custodian of the investment plans is a mere conduit for the transmission of "dividends" to the planholder. Certainly the custodian of these investment plans should not be required to withhold 20 percent of the "dividends" payable by it.

How to deal with these problems and at the same time protect the Government in its efforts to see that "dividend" income is duly taxed, is not too difficult. The custodian of the securities of the portfolio of the investment company and the custodian of the investment company shares held for the benefit of planholders are always reliable institutions. They have to be so pursuant to the requirements of the Investment Company Act of 1940. To place upon them rather than the original dividend-paying corporations, the responsibility for withholding income tax on "dividends" is an answer that the proposed bill fails to make.

The problem of the withholding tax on the dividends thus payable to shareholders of the investment company and to planholders is dealt with in sections 3486 and 3487 of the proposed bill. The import of these sections is set forth in section 7 of the memorandum submitted on May 3, 1961, by the Secretary of the Treasury to the House Committe on Ways and Means. The pertinent provisions of the memorandum read as follows:

"Offset credit provisions would be provided for amounts withheld on dividends and interest paid to regulated investment companies, personal holding companies and real estate investment trusts. Such organizations would count the amounts withheld on dividends and interest received by them as credits against the amount which they themselves are required to withhold from their disbursements to their own shareholders."

The general explanation of committee discussion draft of revenue bill of 1961, released for information and study on August 24, 1961, gives some further light on the problem.

"REGULATED INVESTMENT COMPANIES, PERSONAL HOLDING COMPANIES, AND REAL ESTATE INVESTMENT TRUSTS

"First, in the case of corporations, any amount withheld on interest and dividend payments received by them can be claimed as credits against the tax they are required to withhold with respect to their own dividend and interest payments (sec. 3487).

"Any amount withheld with respect to interest and dividends received by a corporation in excess of the credits it claims with respect to its own withholding on interest and dividends may be refunded to the corporation on a quarterly basis (during the year of liability) (sec. 3486)."

Neither of these explanations of the problem is satisfactory. Assume that in a particular quarter the X investment company is entitled to dividends and interest from the corporations whose securities it holds amounting to $1 per share. Assume again that its expenses in managing its portfolio are 5 cents per share. It is, therefore, ready to declare dividends of 95 cents per share to its stockholders. However, it has only received 80 cents per share from the corporations whose securities it holds, due to their withholding of the "dividend" tax.

The question thus posed is what dividend can be declared by the investment company. By way of "dividends," it has only received 80 cents per share. The dividend normally declarable by the investment company would be 95 cents per share, representing the 100 cents it received minus the 5 cents involved in the

cost of its operations. (To this might be added an additional sum representing realized profits from capital gains. However, no withholding tax is applicable to that portion of the distribution payment it makes to its shareholders representing capital gain, and consequently no question needs to be raised with reference to these capital gains.) The investment company could not declare the full 80 cents it received in dividends to its shareholders and also indicate to them they have a tax credit for the balance, which cannot justifiably be 20 cents per share since all that the investment company earned is 95 cents per share, and 20 percent of 95 cents is only 19 cents. It would, therefore, have to declare a 76-cent dividend per share in cash, and indicate to the taxpayer he has a tax credit on his general tax liability of 19 cents per share. The Government, however, would not be entitled to withhold the remaining 1 cent per share, nor should the investment company, which pays no taxes, be entitled to a refund of that sum. It belongs to the shareholder, but there seems to be no possible way for him to get that sum.

This problem is obviously compounded when we deal with the periodic payment plans where a second conduit for the transmission of "dividends" is added. The problem outlined above is not doubled; it is squared.

There is a simple solution to this entire problem. It has an analogy which is not theoretic but which has worked out very satisfactorily in the sales tax situation. There, the manufacturer who sells to a wholesaler pays no tax; the wholesaler who sells to a retailer pays no tax; however, the retailer who sells to the consumer collects the sales tax. This result is accomplished through the device of a series of exemption certificates filed by the wholesaler and the retailer.

The same exemption certificate device should be applied to the investment company industry. The original dividend-paying corporations should be exempted from withholding any tax on the dividends that they pay to regulated investment companies. The investment company, however, which issues its shares to the public should be required to withhold the necessary tax on the "dividends" it pays. But insofar as its shares are held through the medium of the custodian of a periodic payment plan, it should in turn be exempted from withholding any tax payable on dividends it pays to that custodian, and the responsibility for that withholding be placed upon the custodian bank or trust company which received the "dividends" from the investment company and in turn pays them out to the planholders. All these institutions, as has been stated before, are responsible institutions pursuant to the requirements of the Investment Company Act of 1940.

This approach will achieve the complete objectives of the proposed bill. Withholding will take place, and at a responsible source.

The following amendment to the proposed bill is, therefore, suggested. It has no effect upon the revenue producing possibilities of the proposed bill, but it avoids the seeming necessity for temporary double and triple refunding or tax adjustment credits which seem to be presently proposed.

The suggested amendment to the proposed bill reads as follows:

(A) Section 3483(a) (relating to exemption certificates) is amended—

(i) by striking out "Any individual" in the first line of subsection (a) and inserting in lieu thereof "(1) Any individual"; and

(ii) by adding the following new paragraph at the end of subsection (a):

"(2) Any regulated investment company described in section 851, or trustee or custodian of the securities owned by such company or its shareholders or planholders, may file with any withholding agent an exemption certificate on which it certifies that it intends to conform to the requirements of sections 851 and 852 and will not be liable for the payment of any tax under chapter 1 for each of its taxable years any portion of which is included in the period for which such certificate will be in effect. If such certificate is filed, all amounts payable by such withholding agent to such regulated investment company on and before the beginning of the next calendar year shall be exempt from the requirement of deducting and withholding under this chapter."

(B) Section 3483(b) (relating to exemption certificates) is amended—

(i) by striking out "This section" in the first line of paragraph (1) and inserting in lieu thereof "Subsection (a)(1)"; and

(ii) by striking out "subsection (a)" in the fourth line of paragraph (4) and inserting in lieu thereof "subsection (a)(1) or to regulated investment companies, trustees, or custodian described in subsection (a)(2)."

(iii) by striking out "subsection (a)" in the fifth and sixth lines of paragraph (4) and inserting in lieu thereof "subsection (a)(1)."

Senator DOUGLAS. Our next witness is Mr. Edward W. Hiles, executive vice president of the Georgia Savings & Loan League, Inc.

Please proceed, Mr. Hiles.

STATEMENT OF EDWARD W. HILES, EXECUTIVE VICE PRESIDENT, GEORGIA SAVINGS & LOAN LEAGUE, INC.

Mr. HILES. Mr. Chairman and members of the committee, my name is Edward W. Hiles and I appear today as executive vice president of the Georgia Savings & Loan League whose membership in the State of Georgia includes 95 of the 98 associations domiciled in that State and doing business there, and approximately 96 percent of the total resources of the savings and loan business in that State.

For the information of, and for such value as it might be to the committee, I should like to submit with my statement a file of letters from the members of my organization which give credence to my claim that I am speaking for them at this time.

While my remarks here shall be confined to the withholding tax provisions of this bill, the statement should not be construed in any sense to mean that silence on the subject of section 8 implies an endorsement or approval of that section which very definitely is objectionable to us. We wish to endorse and reiterate the position of the United States Savings & Loan League and other savings and loan spokesmen with respect to the provisions of section 8 of H.R. 10650.

The withholding provision of this bill with respect to dividends and interest goes far beyond its direct effect on the savings and loan association and its operating problems. We believe this is an unnecessarily cumbersome and grossly impracticable approach to the matter of collecting taxes on the interest and dividend income of individual taxpayers.

We believe that the simplest answer to this problem would in the long run prove to be the most effective, and we, therefore, endorse the position taken by the American Bankers Association in recommending the inclusion in the individual tax return form a specific question, in red ink if necessary, to give it emphasis, as to whether or not the taxpayer has included all interest and dividend income of any kind and nature and from any source, in his gross income figure. A taxpayer will think twice before he deliberately signs his name to a tax return in which he has included a false statement in reply to a specific question as simple and as clear as this one could be and involving such a small amount of money.

Under such a provision, no one would dare plead ignorance as apparently has been the case with respect to the voluntary inclusion of such income in the past.

At the risk of repeating testimony already offered, I would like also to state that it is my sincere belief that the determination that a lot of dividend and interest income was escaping taxation was reached as a result of some spot checks which were made 3 or 4 years ago prior to the time that most financial institutions entered into a program of voluntary cooperation with the Treasury Department aimed at educating their customers on this important point. If a more recent spot check has been made to verify no improvement in this situation, I am unaware of it.

I believe every taxpayer should return all of his taxable income and pay all taxes due thereon. I also believe, just as strongly, that the Government should collect those taxes in the manner which will produce the greatest net revenue to the Treasury with the least adverse affect on the taxpayer or the economy. The withholding tax on dividends of savings and loan associations meets none of these conditions.

In the interest of time, I shall not attempt to repeat the many and varied arguments set forth by other witnesses in opposition to the withholding tax feature. The great majority of these arguments are based on problems which would be common to all types of institutions which would be involved in the mechanics of carrying out this withholding program. Increased costs, problems of customer relations, hardships on nontaxable income individuals who may not be fully aware of their right, etc., all would be applicable to our position on this question.

In addition to these objections in which we join with the other witnesses, there is one important and far-reaching objection which I should like to offer together with supporting statistical data and by which I hope to convince you that everybody loses under the withholding proposal—the taxpayer, the dividend or interest payline institution, the economy of the country and—yes—the Federal Treasury.

As of January 1 of this year, the savings and loan association members of the Georgia Savings & Loan League held savings and investment accounts amounting to $1,087,000. We have made a spot check of three urban and two rural area associations and find that of the total dividends paid for the year 1961 in those associations, the amount paid by check mailed to the customer represented from 20 to 28 percent of the total amount of dividends, and the amount retained in the association accounts by posting as a credit to the individuals' savings account ledger cards represented from 72 to 80 percent of the total. Based on these findings we took 75 percent to be a reasonable average figure.

This would mean that approximately $800 million would represent the amount of savings accounts in Georgia savings and loan associations on which dividends were being permitted to accrue or be compounded semiannually as of January 1, 1962.

Let me emphasize here that the figures contained in our conclusions will represent minimum or conservative figures as to adverse effects on the taxpayer, the institution, the economy, and the Treasury for the following reasons:

(*a*) We are making no projection of estimated growth which would be normally experienced above and beyond the accrual or compounded growth.

(*b*) We are using a 4-percent dividend figure for computation purposes when many areas are at a rate of 4½ percent.

(*c*) We are not taking into consideration indirect losses of revenue resulting from the loss of capital funds to the home construction and home financing market.

The application of the withholding tax would result in an automatic withdrawal each year from these accounts of an amount equal to 20 percent of the earnings for that year. I recognize there would be some necessary adjustments for exemptions, etc., but roughly, this would be the case.

It is reasonable to assume also that funds withdrawn from these accounts by this withholding method would not be replaced by the individual saver as such, regardless of whether or not be received the money back in the form of a refund from the Revenue Department.

The rate of return paid by Georgia associations generally in 1961 was 4 percent. The would mean earnings of $32 million and automatic withdrawals via withholding of $6,400,000.

This would mean, first of all, $6,400,000 less money available in the home financing market in this State for that year—a lot of employment, houses, building materials, and so forth.

But this is not all.

A second and grossly undesirable result would be that because of the compounding feature, the saver would be losing each year a greater percentage of the income which he would normally receive if the 20 percent were not taken out. His savings account will grow more slowly (cols. (4) and (6), exhibit A).

But there is still another important point which bears directly on the very arguments for imposing this withholding tax—namely, to increase the flow of revenue to the Federal Treasury.

By reducing the amount of earnings accruing to the account holder due to the compounding feature, you will be automatically reducing the amount of his taxable income thereby reducing the flow of revenue to the Treasury, exactly contrary to the stated purpose of the legislation.

You will note from exhibit A that at the end of 5 years at the rate of 4 percent, accounts in Georgia associations would have generated taxable income of $175,195,000 and savings account balances would have reached $975,195,000. (NOTE.—These projections are based solely on that portion of total accounts in Georgia associations on which dividends are permitted to accrue according to our records at this time and based on an actual sample of five associations.)

Under the 20 percent withholding provision the accounts would have generated a taxable income of $172,022,000 or $3,173,000 less, and savings account balances would have reached only $937,620,000 or approximately $38 million less than if the withholding provision had not been in operation.

The actual effect of this application of the withholding feature would be progressive so that by the end of 10 years as the table reflects, the accounts would have generated taxable income of $15 million less under the withholding provision than if it were not in effect and savings account balances would have been $90 million greater without the 20 percent withholding.

Therefore, it is our contention and we believe it is borne out by these figures that everybody would lose under the withholding proposal. The saver would lose because of the loss in earnings on his savings account balance retarded by the 20 percent withholding; the savings and loan association would lose by virtue of the automatic withdrawal process which would take away funds that would otherwise be available for mortgage financing operations; the economy would lose because of the reduced amount of dollars flowing into the home construction and home financing market, and the Treasury would lose because of the reduced amount of taxable income generated under the compounding feature.

The savings and loan operations in Georgia represent approximately 1.25 percent of the national totals or 1/80th. Therefore, to get an idea of the impact of this proposal on a nationwide basis, we simply multiply the Georgia figures by 80 and we arrive at the following minimum figures:

1. The automatic withdrawal for the first year would be $512 million taken from the home financing market.

2. The loss of capital to the home financing market for the first 5 years would be $3,040 million.

3. The loss of revenue due to reduced income resulting from the automatic withdrawal for the first 5 years would be $50,768,000.

4. The loss of capital to the home financing market for the first 10 years would be nearly $7¼ billion.

5. The loss of revenue to the Treasury for the first 10 years would be $241,760,000.

6. The loss of revenue for the 10th year alone would be $26,848,000 and would get progressively larger each year thereafter.

We believe, therefore, that it would best serve the interest of our national economy, and the Treasury Department in particular, to collect this tax without invoking the automatic withdrawal process which reduces income to the taxpayer, the savings and loan association and the Treasury.

Thank you.

(Exhibit A referred to follows:)

GEORGIA SAVINGS & LOAN LEAGUE, INC.

Comparison of accrual of savings balances and earnings with and without 20 percent withholding tax

[In thousands of dollars]

Semiannual dividend dates	Under withholding provision				Without withholding	
	4-percent dividend	Less 20 percent withholding	Net accrual	Savings balance	4-percent dividend	Savings balance
Jan. 1, 1963				$800, 000		$800, 000
June 30, 1963	$16, 000	$3, 200	$12, 800	812, 800	$16, 000	816, 000
Dec. 31, 1963	16, 256	3, 251	13, 004	825, 804	16, 320	832, 320
June 30, 1964	16, 516	3, 303	13, 212	839, 017	16, 646	848, 966
Dec. 31, 1964	16, 780	3, 356	13, 424	852, 441	16, 979	865, 945
June 30, 1965	17, 048	3, 409	13, 639	866, 081	17, 318	883, 264
Dec. 31, 1965	17, 321	3, 464	13, 857	879, 938	17, 665	900, 929
June 30, 1966	17, 608	3, 519	14, 079	894, 017	18, 018	918, 948
Dec. 31, 1966	17, 880	3, 576	14, 304	908, 321	18, 378	937, 327
June 30, 1967	18, 166	3, 633	14, 533	922, 854	18, 746	956, 074
Dec. 31, 1967	[1] 18, 457	3, 691	14, 765	937, 620	[2] 19, 121	975, 195
June 30, 1968	18, 752	3, 750	15, 001	952, 622	19, 503	994, 699
Dec. 31, 1968	19, 052	3, 810	15, 241	967, 864	19, 893	1, 014, 593
June 30, 1969	19, 357	3, 871	15, 485	983, 350	20, 291	1, 034, 885
Dec. 31, 1969	19, 667	3, 933	15, 733	999, 083	20, 697	1, 055, 583
June 30, 1970	19, 981	3, 996	15, 985	1, 015, 069	21, 111	1, 076, 694
Dec. 31, 1970	20, 301	4, 060	16, 241	1, 031, 310	21, 533	1, 098, 228
June 30, 1971	20, 626	4, 125	16, 500	1, 047, 811	21, 964	1, 120, 193
Dec. 31, 1971	20, 956	4, 191	16, 764	1, 064, 576	22, 403	1, 142, 596
June 30, 1972	21, 291	4, 258	17, 033	1, 081, 609	22, 851	1, 165, 448
Dec. 31, 1972	21, 632	4, 326	17, 305	1, 098, 915	23, 308	1, 188, 757
10-year total	373, 644	74, 729	298, 915		388, 757	

[1] 5-year total, $172,022.
[2] 5-year total, $175,195.

Senator DOUGLAS. Thank you, Mr. Hiles. I understand Mr. Sadlik is now in the room.

Do you wish to come forward, Mr. Sadlik, and testify?

Senator CARLSON. Mr. Chairman, we have a very fine former Member of Congress by the name of Sadlak. I wonder if it is in the family.

Mr. SADLIK. No, I am sorry, but it is not.

Senator DOUGLAS. Proceed.

STATEMENT OF JOHN SADLIK, VICE PRESIDENT AND COMPTROLLER OF THE FRANKLIN NATIONAL BANK OF LONG ISLAND, MINEOLA, N.Y.

Mr. SADLIK. My name is John Sadlik. I am vice president and comptroller of the Franklin National Bank of Long Island, Mineola, N.Y. I appear on behalf of the bank in support of withholding of income tax at the source on interest, dividends, and patronage dividends.

Senator DOUGLAS. Just excuse me. Did I hear this aright?

Mr. SADLIK. You heard me right.

Senator DOUGLAS. Would you repeat it again? [Laughter.]

Mr. SADLIK. I appear on behalf of the bank in support of withholding of income tax at the source of interest, dividends, and patronage dividends.

Senator DOUGLAS. Would someone please get me a pill to avert a heart attack? [Laughter.] My heart is fluttering.

Mr. SADLIK. We have given considerable thought and study to this subject.

Senator DOUGLAS. Good for you.

Mr. SADLIK. As vice president and comptroller of the bank, I am responsible for operations and cost control at the bank.

The Franklin National Bank is the 32d largest commercial bank in the country. It has 46 branch offices. Total deposits amount to $768 million. Sixty-one percent of total deposits are in the savings and time category.

In this respect Franklin has the highest percentage of total deposits in savings and time among the Nation's 100 largest commercial banks. We consider savings and time deposits to be extremely important in serving the needs of our community. Moreover, Franklin handles a high volume of U.S. savings bond redemptions. A reasonable number of dividend paying agency accounts is also serviced.

I have testified previously in support of withholding before the House Ways and Means Committee at hearings in May of last year. At that time a study of costs and operating procedures was presented.

Bringing this earlier study up to date, we now estimate our cost, after taxes, of collecting the withholding tax on savings and time deposits and U.S. savings bonds to be seven-tenths of 1 percent of the amount withheld in the first year, and three-tenths of 1 percent annually thereafter.

In other words, for each $100 in taxes withheld, the cost to us will be 70 cents in the first year and 30 cents per $100 in each succeeding year.

With respect to the effect of withholding on the earnings of the bank, we estimate that the proposed method will reduce earnings after taxes in the first year, from $10,025,000 to $10 million; and,

for the second year, from $10,025,000 to $10,015,000. This amounts to a reduction in earnings for the first, of twenty-five one hundredths of 1 percent; and, thereafter, only eleven one hundredths of 1 percent. This indeed seems insignificant.

In our opinion, data processing by the Internal Revenue Service is not fully the answer to sealing up this loophole of unreported income. The detail required of the banks may be more burdensome than the proposed system of withholding under section 19 of the Revenue Act of 1962.

In preparing the cost of withholding, a further analysis was made of our savings accounts. This produced a revelation, which I feel certain my fellow bankers will also experience, regarding savings accounts at their respective institutions.

We presently have 219,000 regular savings accounts with deposits of over $285 million. In addition, we have 76,000 school savings accounts totaling $3,400,000. These school deposits represent accounts of schoolchildren from 8 to 16 years of age.

Our analysis shows that the average account of a child in our school savings program amounts to $45. We also have discovered that we have 78,000 regular savings depositors over 18 years of age whose average account is only $40. Imagine, 35 percent of our regular savings depositors over age 18 maintain less in their savings account than do the children in our school savings program.

Upon further analysis we learned that many of these 78,000 regular savings accounts were opened as a result of new business campaigns and giveaway programs. These, and many others, are now idle accounts. Apparently these depositors have no intention of using them as true savings accounts.

Although we have not used promotion campaigns extensively to develop savings accounts, we cannot help but wonder what the condition may be in those institutions where promotional campaigns are regularly used to increase savings accounts.

It merits repeating that savings accounts are extremely important to us. Our school savings program is designed to teach youngsters the principles of thrift and to create an incentive to save. Under our program the children make their weekly deposits, usually of small amounts, directly in the school. We then pick up their passbooks and deposits at the school, process them and return the passbooks to the school a few days later. These passbooks are similar to those used for regular savings accounts so that schoolchildren may feel that they have the same type of savings account as their parents.

Although the school savings division operates at a substantial loss (over $100,000 annually), we plan to continue to promote school savings vigorously because of the benefits in teaching children how to save, thereby building a sound financial outlook of these children for the future.

Getting back to our analysis, the total deposits of the 35 percent of our regular savings depositors, who save less than our schoolchildren, represent 1 percent of our total savings deposits. These, in most instances, are the problem accounts. They probably will never become true savers. These accounts are used for pocketbook expenses or remain dormant until eventually transferred to the State under escheat laws.

The proposed withholding plan may very well solve the difficulties of these problem savings accounts by causing banks to realistically evaluate the types of savings accounts on their books, and by adopting measures to reduce their costs, thereby creating an area for better rewards for true savers. This may become a national trend, as in the case of problem checking accounts some years ago. Such checking account depositors were finally encouraged and educated to make proper use of their checking accounts.

In view of our findings, how could our bank, or any other banks, for that matter, justifiably refuse to cooperate with the Treasury in helping to close this important loophole?

We firmly believe that the proposed withholding plan will not be unduly burdensome or costly to the banks. It is to our benefit, moreover it is our duty, to see that all those required to pay taxes pay their fair share, and are not to be permitted to escape their just obligations.

I should like to also add some further information in connection with withholding.

Last night our bank held a regular monthly officer's meeting which was attended by 120 of our executives. These people, most of them, are in constant contact with the public. Our depositors know them. During the meeting the statement I have just presented was read and discussed with them. We then requested those present to note their reactions, questions, and comments to the subject discussed.

Since this is a regular practice at our meetings, we always obtain frank and honest opinions from our executives, particularly since the comments are submitted confidentially and without identification of the individual.

I would like to report to the committee the results of tallying these observations.

First, the responses were grouped as to those in favor and against the proposed withholding of taxes on interest and dividends. All comments, questions, and direct opinions which reflected a position for or against withholding were tabulated. The result was 64 for withholding, and 18 against. The balance of the executives asked questions regarding the procedure of withholding and others of that nature.

I think the committee will be interested to know that this group of bank officers, most of whom favor withholding, are the very men whose responsibility includes supervision of the deposits of the bank, the income, and the operating procedures in the branch offices.

They are the men on the firing line who will be faced with a so-called burdensome procedure and bad public relations.

Yet they frankly expressed their considered opinion that they favor withholding.

In further confirmation of the conclusion reached in my prepared statement, the executive staff and majority of officers in our bank firmly believe that the proposed withholding plan should be enacted.

Senator KERR (presiding). Thank you very much, Mr. Sadlik. If you feel you need police protection to get out of the building safely we will provide it. [Laughter.]

I am particularly interested in the frankness of your statement, in the evidence that it contains of at least a very careful and vigorous

analysis of the proposal, of the problems it would create, of the benefits that you are convinced it would produce.

Senator DOUGLAS. I want to say this is the most encouraging testimony that I have heard in the 4 weeks that I have sat here. I am beginning to think this species of American had vanished, and I can't tell you how moved I am by this statement which represents not only your opinion, but obviously at least three-quarters of the officials of your concern.

I wish there were some tangible way in which I could express my feeling, I feel my words are inadequate. I do want to tell you that I think this is an evidence of the finest type of citizenship and I want to thank you from the bottom of my heart.

Mr. SADLIK. Thank you very much, Senator.

Senator KERR. Senator Carlson?

Senator CARLSON. Just one question, Mr. Sadlik.

You are here testifying with regard to the withholding. There are other sections of the bill. I wonder if your meeting discussed the proposed taxation of savings banks in the House bill? Are you satisfied with that?

Mr. SADLIK. Not entirely.

Senator CARLSON. Do you have some suggestion to make in regard to it?

Mr. SADLIK. No; I think the way it is coming out will be fairly satisfactory although I understand the savings and loan and mutuals are asking for further reductions. The Roth Committee, founded by the chairman of the board of our bank, Mr. Arthur T. Roth, appeared before your committee concerning the taxation of savings and loan associations and mutual savings banks on April 11. Mr. Howard Stoddard of the Michigan National Bank represented the Roth Committee.

Senator CARLSON. You would approve the House bill?

Mr. SADLIK. Yes; to the extent it is better than the 1951 law. We hope the Finance Committee will come closer to our goal of tax equality than did the House.

Senator CARLSON. Thank you. That is all.

Senator KERR. Thank you very much, Mr. Sadlik.

Mr. Carlysle A. Bethel, Wachovia Bank & Trust Co.

Let me announce we are going right through the noon hour until all of the scheduled witnesses have been heard.

Mr. BETHEL. The distinguished Senator from Illinois seems to be happy, Mr. Chairman, I hate to get back over on the other side this morning.

Senator KERR. Well, you don't have to. [Laughter.]

If you do it by reason of inward compulsion and no outward coercion I am sure the Senator from Illinois is just as proud as I am of the privilege of a witness to express his true opinion, and his sentiments, and that he would be just as vigorous in defending your right to come here and oppose this measure as he was enthusiastic in his approval of the evidence of the witness who supported the measure.

STATEMENT OF CARLYSLE A. BETHEL, VICE CHAIRMAN, WACHOVIA BANK & TRUST CO., WINSTON-SALEM, N.C.

Mr. BETHEL. Yes, sir. My name is Carlysle Bethel. I am vice chairman of Wachovia Bank & Trust Co. of Winston-Salem, N.C. I supervise the operations of our trust department of which I have been a member for over 25 years.

May I respectfully submit that the requirement of withholding of tax on interest and dividends payable to corporate fiduciaries is unnecessary, wasteful to the use of funds by such fiduciaries and their beneficiaries, burdensome to manpower and expensive to process.

May I also protest in particular the requirement of withholding of tax on dividends and certain types of interest due tax-exempt entities such as pension and profit-sharing trust, endowment, and other charitable and educational funds.

The time limit on my remarks will permit me to express orally only conclusions concerning the adverse effects of section 19 on the operations of corporate fiduciaries and their beneficiary-customers. I will file a supplemental statement documenting these conclusions, which are as follows:

(1) If section 19 is applied to corporate fiduciaries, it would be the equivalent of using an elephant gun to rid the attic of some rats and in nuclear parlance it is overkill.

There has been no complaint that corporate fiduciaries have failed in any consequential degree to furnish the Internal Revenue Service all figures and information necessary to enable it to collect all taxes due from such fiduciaries or their beneficiary-customers. Wachovia estimates that its accounting costs for fiduciary services will be increased one-third to comply with section 19, which in some instances will wipe out the already low profit margin in the administration of trusts.

Furthermore, the inconvenience and hardship on our beneficiary-customers will be substantial, particularly in the case of those having low incomes who constitute the majority of our customers.

No amount of advance warning or later explanation is going to appease a widow with several children and no income tax liability who has been receiving a monthly check for $100 from dividends in her deceased husband's small estate and who, on February 1, 1963, receives a check for $80. She is living on a tight budget and later refund of the withheld amount will be of little help in her current plight. If she were not receiving her income through a trustee she could file an exemption certificate and receive all her income forthwith. Thus she is penalized by having a trustee.

Also, very serious legal questions will arise and property rights impaired in cases such as an annuitant who is entitled under a will to receive $10,000 a year from a corporate trustee and receives only $8,000.

These situations, in varying degrees, will adversely affect thousands of Wachovia's beneficiary-customers. If it be multiplied by the results in trust institutions all over the country, this harsh treatment will bewilder and hurt millions of people.

All corporate fiduciaries are strictly supervised and examined by the Federal agencies that regulate them such as the FDIC, and the Comptroller of the Currency and the Federal Reserve Board. These supervisory authorities make certain that corporate fiduciaries comply with all laws.

Under this supervision all returns required from corporate fiduciaries are filed with the Internal Revenue Service and are audited whenever necessary. Little, if any, knowledge of taxable income escapes these processes. The tax reporting gap in this area is probably negligible; if it exists to any extent, it is not because of unavailability of information to the Revenue Service.

No significant help to the Federal revenues will result and only additional work will be piled on the Revenue Service to process the additional work required of corporate fiduciaries.

Withholding in the case of corporate fiduciaries may cause them to lose the business of many individuals who because of exemptions and other reasons would be able to file certificates eliminating withholding if their income did not come through a corporate trustee.

(2) (*a*) Exemption from withholding of tax on certain types of interest received by tax-exempt pension and profit-sharing trusts, endowment, and other charitable and educational funds but not on dividends and other types of interest reminds one of the business gag, "There is no reason for it, it's just company policy."

If there is no tax due from these entities on interest or dividends, why in the name of commonsense should everybody concerned go through millions of bookkeeping items that will be necessary to route billions of dollars back to where they should have been sent in the first place. It may be that this was a byproduct of the original concept that these agents would have no serious amount of additional work in simply deducting 20 percent from the grand total of each dividend declared and sending one check for it to the Revenue Service.

However, this simplicity is long departed from in the many exceptions now in the bill. One more exception—permitting tax-exempt entities to have the same privilege as individuals with respect to exemption certificates—would put no additional burden of consequence on the paying agents.

In any event it would eliminate vastly greater work on the part of the Government and others involved in the contemplated circuitous routing of the 20 percent withheld.

(*b*) The above is without regard to the resulting disadvantage to the tax-exempt entities in the continuous loss of use of their money in sizable accounts despite refund provisions of section 19.

In some instances deprivation of income needed to meet tight budgets of colleges and charitable organizations will result. Because each account in a trust department is a separate entity with employees in only rare instances, the privilege of offsetting amounts withheld on wages, et cetera, is no material aid.

Wachovia's Trust Department is not large by big city standards, but we estimate that perhaps as much as a million dollars of our beneficiary-customer's income may be continuously tied up in the circuitous routing of interest and dividends which are not taxable in the hands of the recipient.

Again this may amount to a hundred million dollars or more if multiplied by the tax-exempt income of the beneficiary-customers of corporate fiduciaries throughout the United States which will be involved in this fruitless merry-go-round.

In summary, withholding under section 19 as it applies to corporate fiduciaries and tax-exempt entities is without any material advantages to Federal revenues and adds needless mountains of work for both the Government and others:

(1) In the case of corporate trustees because they file with the Revenue Service all information necessary to enable it to collect all taxes due from the corporate fiduciaries or their beneficiary-customers; and

(2) Withholding is unnecessary and will result in continuous deprivation of substantial amounts of money which otherwise could be used for investment purposes or meeting payrolls and other expenses; and

(3) The exemption procedure in the House bill is needlessly discriminatory.

I would like permission, Mr. Chairman, to file a supplemental statement to the one that I have just delivered.

(The supplemental statement referred to follows:)

SUPPLEMENTAL WRITTEN STATEMENT TO REMARKS BEFORE THE SENATE FINANCE COMMITTEE OF CARLYSLE A. BETHEL

The current version of H.R. 10650 provides for withholding of tax on interest and dividends. Provisions are made for exemption certificates under certain circumstances but apparently exemption certificates will not generally be available to fiduciaries nor to beneficiaries with respect to interest and dividends received by them from fiduciaries. In effect this means that most income received by corporate fiduciaries with the possible exception of certain types of income received in guardianships will be subject to withholding without regard to the taxability of that income in the hands of the ultimate recipient.

In normal trust operations it is estimated that income items which will be subject to withholding represent at least one-third of the total volume of all entries.

Based on our own experience, about 28 percent of our total trust department expense is attributable to the accounting function. Because withholding will at least double the number of bookkeeping entries presently necessary with respect to those items of income which will be subject to the provisions of this legislation, indications are that we will have about a 33-percent increase in accounting costs alone. This does not take into consideration the increased expense which will be involved by reason of the other requirements which will flow from the passage of this act such as, for example, claims for refunds in accounts not subject to income tax.

The present version of H.R. 10650 permits individuals under age 18 to file exemption certificates. Presumably this means that a trust company would be required to file such certificates when acting as guardian for a minor. This will further complicate our task. For example, the ward's estate may consist of U.S. Treasury bonds, stocks, and common trust fund units. Since exemption certificates are not applicable to interest received on obligations of the United States (other than series E bonds) refund claims would have to be filed for any overwithholding of tax on income from this source. As for the stocks, an exemption certificate would be filed with each dividend disbursing agent and remain in effect until the ward reaches age 18. Up until age 18, we would receive the gross dividends due and from age 18 through age 21 dividends would have the tax ducted. Since a number of different types of accounts participate in the common trust fund, nearly all of its income would be received, less the tax, and be distributed to the participating accounts on that basis. For most participating guardianships, this would require refund claims.

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The obvious complications which would result from the above situation will be readily apparent and they will increase substantially our costs for handling this type of account. Compensation for guardianships is controlled by statute and provides little, if any, profit margin in most accounts under present circumstances. The proposed legislation will take the profit margin out of nearly all guardianships and it is likely that few corporate fiduciaries in the future will be willing to undertake this valuable public service when they know beforehand such service will be rendered at a loss to them. In our own case, about 14 percent of our total accounts by number are now guardianships.

In addition to the direct increase in accounting costs which will result from the additional bookkeeping entries, there will be substantial other new costs to trust departments, the impact of which isn't possible to assess with any degree of accuracy at present. For example, trust companies may have the following additional duties among others:

(1) With respect to all charitable, retirement, and other nontaxable accounts, quarterly refund claims probably will have to be filed. It now appears that these claims must show the source, gross amount, and tax withheld with respect to each item from which tax has been withheld. Preparation of such claims will involve almost the same amount of work which would be required for a quarterly statement of the account, whereas under present conditions most accounts have only annual accountings. Failure to file for and collect refunds promptly probably will expose the trustee to surcharge liabilities.

(2) The combination of withholding and the reporting requirements under legislation establishing taxpayer identification numbers likely will require major revisions in accounting systems for most trust companies. This cost alone will be substantial since it could involve revision of forms, new and more expensive equipment, additional personnel, and retraining of present personnel.

(3) Present methods of preparing fiduciary tax returns and furnishing information to beneficiaries as well as to the Internal Revenue Service must be revised extensively.

Aside from the detrimental effect on trustees, withholding will have an adverse effect on the persons, organizations, and accounts that have tax withheld which is refundable. Income of retirement plans, for example, normally is immediately reinvested. Under withholding, reinvestment of 20 percent of a major portion of the income for such accounts will be delayed for periods ranging up to 3 or more months. This will reduce the yield of such accounts by a measurable amount on a permanent basis and thus, in the case of pension plans, increase the cost to employers. In profit-sharing plans, it will reduce the amounts received by the employees. For other types of accounts where income is distributed rather than reinvested, withholding will in many cases delay payments of substantial amounts of income to those entitled to its receipt. Under these circumstances, retirement accounts and other organizations exempt from income tax, as well as some individuals who have limited or no tax liability, will be making involuntary, interest-free loans to the Government for indefinite periods of time.

Because of the quarterly refund provisions which will affect a large proportion of trust accounts and the additional information which must be furnished nearly all trust beneficiaries, it is probable that accountings to persons and organizations having an interest in trust accounts will have to be shifted from a normal annual basis to a quarterly basis. For those accounts under court supervision, it is unlikely that the probate courts will be willing to change from their present annual account basis which means that for a vast number of accounts we must prepare five statements each year rather than the one annual accounting which now serves all purposes. This situation alone could almost quadruple the trustee's costs for statement preparation.

Increasing the cost of rendering trust services will have the effect of substantially reducing earnings in the trust department. Most trust departments in this country operate at only a nominal profit or at a loss and this legislation may force a great many of them to either discontinue trust services or raise charges to the point where they no longer appeal to the mass market. In either event, the public is the loser. The effects of withholding will spread like ripples on the water. They will be infinite and immeasurable and any benefit to the Government would seem to be far outweighed by the increased expense to banks in general and the hardship, expense, and inconvenience which will be imposed upon a major segment of our population.

As income tax legislation over the years has increased in scope and complexity, trustees' problems in furnishing information and assisting beneficiaries have also become more and more burdensome and expensive. The current problems we

may have in dealing with trust beneficiaries will seem insignificant compared to those we will face under the impact of this proposed legislation. The administrative and accounting problems alone are sure to require an expanded staff and when you add to the situation the requirements of additional tax information and assistance to beneficiaries, the outlook becomes grim.

Thus, among other things mentioned above, withholding in the case of corporate trustees whose compliance with tax laws has been and is on the highest plane, in summary will:

(1) Because of great increase of work, narrow or wipe out the trustee's margin of profit in the administration of all trustes; and

(2) Because of the loss of earnings that would otherwise be made on the reinvestment of income continuously withheld—

(*a*) increase the employer's costs in pension trusts;

(*b*) decrease benefits to employees in profit-sharing, savings, and thrift trusts; and

(*c*) Adversely affect the ability of the other tax-exempt entities to meet payrolls and other expenses.

Senator KERR. All right.

In your statement, you say:

All corporate fiduciaries are strictly supervised and examined by the Federal agencies which regulate them such as the FDIC, Comptroller of the Currency, and the Federal Reserve Board.

What supervision of corporate fiduciaries does the Federal Reserve Board have?

Mr. BETHEL. Well, all member banks are examined, at least once a year, sir. They come in with a large group of men who go through all the activities of the trust department including its tax returns, its accounting——

Senator KERR. The Federal Reserve representatives?

Mr. BETHEL. Yes, sir. Hordes of them.

Senator KERR. Hordes of them?

Give the committee some idea of the numbers that you refer to.

Mr. BETHEL. I would say 25. It just seems like more when they descend on you, Senator.

Senator KERR. What is the difference between calling on me and descending on me.

Mr. BETHEL. Well, you never know when they are coming, sir. [Laughter.] There is a real purpose in that, they would lose a lot of their effectiveness if our clerks and accounting people knew when they were coming.

Senator KERR. They would get ready for them.

Mr. BETHEL. That would be unfortunate.

Senator KERR. What would they do to get ready for them they don't ordinarily do in their responsibilities of operating the business?

Mr. BETHEL. Well, they might bring out the other set of books that some of them keep.

Senator KERR. In your bank?

Mr. BETHEL. No, sir.

Senator KERR. Which banks?

Mr. BETHEL. The ones which have been caught embezzling.

Senator KERR. Would you give a list of them to the committee?

Mr. BETHEL. I have not got such a list with me, but I would be glad to prepare a list for you.

Senator KERR. I believe it would be just as justifiable for me to say that you are using a shotgun indictment as it was for you to say that they descended upon you in hordes. I am sure that you wouldn't

want any other banker here making the statement that could possibly reflect on Wachovia Bank & Trust Co., and I am sure in your responsible position of vice chairman of your board you wouldn't want to say anything that would reflect on either trust companies in general or banks in general.

And when you issue a kind of a statement you do, I think you should be definite about its application unless there be those who would feel that it was a blanket indictment. Kind of like an anonymous letter.

So as a responsible witness, and having made a statement, I feel that it would be of service to the committee for you to identify to the committee those to whom you refer.

Mr. BETHEL. Senator, I think it is a matter of public knowledge that there have been an increasing amount of embezzlements in banks in this country in the United States and I was simply referring to that, sir.

Senator DOUGLAS. I understand.

Senator KERR. I don't think he needs any defense. If you want to——

Senator DOUGLAS. Mr. Chairman, may I interrupt? It is perfectly well known that there is an association of bank stockholders which published this year a total on number of bank embezzlements. I think the witness has made honest statements.

Mr. BETHEL. Thank you, Senator Douglas.

(Colloquy off the record.)

Senator KERR. Mr. Bethel, I appreciate men with positive convictions.

I am glad to have positive convictions. But I must say that when you come before this committee, there is always the likelihood that you will be cross-examined by members.

Mr. BETHEL. Yes, sir.

Senator KERR. If I ever saw a man who can take care of himself I believe you are one of them.

Mr. BETHEL. Thank you, sir, you are very gracious.

Senator KERR. Are there questions from the Senator from Illinois?

Senator DOUGLAS. No; thank you.

Senator KERR. From the Senator from Kansas?

Thank you very much, Mr. Bethel.

Senator KERR. Mr. Paul Prior, of the Savings and Loan League of Indiana, has submitted a written statement in lieu of appearing. His statement will be made a part of the record.

(The prepared statement of Mr. Prior follows:)

STATEMENT OF PAUL PRIOR ON BEHALF OF THE SAVINGS & LOAN LEAGUE OF INDIANA

My name is Paul Prior. I am the executive officer of the Cooperative Building & Loan Association in Seymour, Ind., a $10 million institution with seven employees.

I am also the president of the Savings and Loan League of Indiana and as such, speak on behalf of its 215 association members in that State.

The Savings & Loan League of Indiana and its 215 members are opposed to the withholding of taxes on dividends paid to the savers in these institutions and we offer the following testimony in support of our opposition.

The withholding of taxes on dividends and interest serves to add complexity to a tax system which the average citizen taxpayer already finds difficult to comprehend.

It will collect taxes from some who will not owe a tax.

It will deprive millions of savers of the use of dividend money by advancing the effective date of taxation 3 months to a year. There will be many unwary

and uninformed persons who will fail to file the proper exemption certificates and thus be taxed when they do not owe a tax. Some of these people will never even obtain the refund.

Withholding on dividends will be an administrative problem for savings and loan associations. The Treasury Department takes the position that it is simple—you just add up the dividends and send 20 percent of it to Washington. H.R. 10650 does not require an accounting to the individual saver but good public relations do require it. At least in the early stages of withholding we will have to inform each individual of the amount of the withholding. Otherwise we will be swamped with inquiries and complaints that we have reduced our dividend rates or improperly computed the dividend. Some people will not understand that the association was compelled to withhold and others will take out their ire on us simply because we will be the handiest target.

Many associations in Indiana cannot afford the cost of machinery to accomplish the withholding computation and other bookkeeping processes that will be required. These associations will have to make the computations manually and prepare notices to savers on an individual basis. Only the largest associations will have the electronic equipment to handle withholding on a mass basis.

The provision for exemption certificates applies only to a limited number of savers—those under 18, over 65, and those who have no taxable income. The recordkeeping within the savings and loan association of the exemption certificates is complicated and continuous.

Fifty associations in Indiana have assets of less than a million dollars. They are hampered by lack of personnel and cannot justify the cost and ownership of equipment needed to effectuate the withholding.

The community served by the savings and loan association will be faced with a reduction in the amount of funds available for home finance. Some savers, in anger or disgust, will withdraw their savings and invest them elsewhere. Of course, the saver accomplishes nothing by this move except to give vent to his ire. Nevertheless, the funds are withdrawn and are not available for home loans.

The home mortgage money supply will suffer in another way. If taxes are withheld and paid to the Treasury, the money to pay the withheld tax comes out of the association and further reduces the supply of mortgage money. When the tax is paid directly by the saver, he usually remits with a check and the taxpayment is made from a checking account. This does not reduce the supply of mortgage money.

We honestly feel that the objective of obtaining nearly complete reporting of interest and dividends can be accomplished by the alternative method of requiring information returns of all dividends and interest of $50 or more. At least this should be given a fair trial before the withholding tax is enacted.

Information returns on dividends and interest of $50 or more strikes at two of the major causes of underreporting. First, it would largely eliminate underreporting which is caused by the taxpayer not having the exact information as to the amount of his interest and dividends. Secondly, it would eliminate the underreporting that results from the fact that some taxpayers are aware that interest payments of less than $600 are not reported to the Internal Revenue Service.

With respect to point No. 1, a sizable portion of all taxpayers wait until almost the tax deadline before computing their tax. The cartoon version of the harassed taxpayer filling out his tax form at midnight is probably not much of an exaggeration. When the taxpayer comes to the item about interest and dividends, he looks for his savings account passbook. If he has made a deposit or withdrawal since the end of the year, his credited dividends will be posted in the book, but, unfortunately, they are sometimes not clearly identified. If he has not made an entry this year the dividends are not posted in the book. Then he must compute them himself. Computing dividends and interest is sometimes difficult even for our trained staff because of varying practices of daily balance, minimum balance, etc. It is not surprising that some taxpayers throw up their hands and either report nothing or report an inaccurate figure.

If the taxpayer received the 1099 form showing the amount of his taxable dividend for the year, then this problem would be completely eliminated. At the same time, the fact that the association has reported that dividend to the Internal Revenue Service, even if the Internal Revenue Service does not actually audit it, serves as a strong deterrent to underreporting. Incidentally, as demonstrated in the addendum, well over 90 percent of all the dollars of dividends paid to savings and loan savers would be covered by reports of $50 or more.

We feel that the use of information returns and the continuation of the recent educational campaign to the public will result in a collection system almost as effective as withholding, with only a fraction of the burdens of withholding.

Addendum to Testimony Before Senate Finance Committee by Savings and Loan League of Indiana

FACTS SUPPORTED BY TABLES BELOW

Fifty-two percent of all accounts (under $1,000) carry only 6.5 percent of total savings dollars in savings and loan associations.

Eighteen and four-tenths percent of all accounts (over $5,000) carry 63.2 percent of total savings dollars.

If information returns were made for dividends in excess of $400, then 26.5 percent of the dollar amount of all dividends in savings and loan associations would be reported on form 1099.

If information returns were made for dividends in excess of $200, then 63.2 percent of the dollar amount of all dividends would be reported.

If information returns were made for dividends in excess of $40, then 93.5 percent of the dollar amount of all dividends would be reported.

Table A.—*Distribution of savings by size of accounts—A study of 19 Federal savings and loan associations selected at random in 1957*

[Percent]

Account balance	Percent of number	Cumulative	Percent of dollars	Cumulative
0 to $99	18.1		0.2	
$100 to $500	19.6	37.7	2.1	2.3
$500 to $1,000	14.3	52.0	4.2	6.5
$1,000 to $5,000	29.6	81.6	30.3	36.8
$5,000 to $10,000	12.8	94.4	36.7	73.5
Over $10,000	5.6	100.0	26.5	100.0

Note.—See p. 239, "Savings and Loan Annals, 1957."

Table B.—*Distribution of savings by size of accounts in Indiana, projected on basis Dec. 31, 1961*

Account balance	Number of accounts	Cumulative	Dollars	Cumulative
0 to $99	139,900		$3,530,000	
$100 to $500	154,800	294,700	37,065,000	$40,595,000
$500 to $1,000	108,900	403,600	74,130,000	114,725,000
$1,000 to $5,000	232,000	635,600	534,795,000	649,520,000
$5,000 to $10,000	100,000	735,600	647,755,000	1,297,275,000
Over $10,000	38,655	774,255	467,725,000	1,765,000,000

Table C.—*Projected extended to show amount of dividends and percentage of accounts affected if information returns were required on dividends exceeding various amounts*

Account balance	Dividend		Dividend at 4 percent	Cumulative
	Amount	Percent		
0 to $99		100.0	$141,200	
$100 to $500		99.8	1,482,600	$1,623,800
$500 to $1,000		97.7	2,965,200	4,589,000
$1,000 to $5,000	$40	93.5	21,391,800	25,980,800
$5,000 to $10,000	200	63.2	25,910,200	51,891,000
Over $10,000	400	26.5	18,709,000	70,600,000

Senator KERR. Mr. William Neil.

STATEMENT OF WILLIAM J. NEIL, CHAIRMAN, LEGISLATION AND TAX COMMITTEE OF THE STOCK TRANSFER ASSOCIATION

Mr. NEIL. Mr. Chairman, my name is William J. Neil and I am chairman of the Legislation and Tax Committee of the Stock Transfer Association, which is a trade association consisting of 256 members from leading banks and corporations. These members transfer securities, pay dividends, et cetera, involving many millions of stockholders who would be affected by the proposed withholding.

If, as IRS has indicated, there is a yearly loss of over $600 million due to nonreporting of dividends and interest, we agree that the Government should not lose this amount.

However, the means suggested would penalize the honest taxpayer in order to catch the few dishonest or merely neglectful taxpayers. Meanwhile, in addition to the considerable expense involved, a heavy accounting burden would be placed on banks, corporations, and individuals.

For millions of taxpayers, the withholding would be a payment in excess of tax actually owed. This is particularly true for tax-exempt institutions, such as churches, educational institutions, pension funds, et cetera. Instead of losing money to which it is entitled, the Treasury would probably end up keeping a lot of money to which it is not entitled, particularly from small individual taxpayers who, either through ignorance, redtape, or bewilderment, would never claim the refunds at all.

The educational program started only a few years ago and the new ADP numbering system should be given a chance to function before determining that withholding is necessary. Taxpayers identifying numbers and mechanization of audit procedures should be considered sufficient until proved wanting.

Needless to say, payers of dividends and interest are being put to considerable cost and expense in obtaining taxpayer identification numbers for stockholders, et cetera. One payer alone estimates that it will cost between $280,000 to $300,000 to adjust its records to show an account number. The great amount of work this involves is another reason for avoiding withholding at this time and allowing the expensive ADP system to work without adding additional burdens to payers of dividends. It would seem logical that withholding should be adopted only as a last resort.

There is no assurance that the proposed withholding would correct the gap problem, unless it is assumed that those avoiding tax are in the low income tax brackets. Taxpayers in the higher tax brackets who may now be willfully omitting taxable dividends and interest income from their returns will find no reason to report such income and pay tax in excess of the 20 percent withheld. Further, it would not eliminate the audit procedure for those who are taxable in excess of the rate of 20 percent.

The IRS should make better use of the 1099's which are filed covering payments of dividends and interest. With the automatic data processing procedure they should be able to close the gap if, in fact, one exists.

The proposed bill provides for exemption certificates on dividends for minors under 18 years of age, good until the beginning of the year during which the minors become 18 years of age. It also provides for yearly exemptions, on a calendar-year basis, for other individuals not subject to tax. This type of exemption certificate, on a calendar-year basis, will create an almost insurmountable task for payers of dividends.

The method of coping with this will vary, depending on the system used by each payer of a dividend. Along with many other items, it raises the question of how to deal with stockholders so that they will not overlook filing an exemption certificate for the following calendar year. Will it be necessary for payers to send a notice before the end of the calendar year reminding all stockholders, or only those who have filed exemption certificates, of the necessity of filing an exemption certificate each year if they are entitled to do so?

This in itself will create a fluctuating situation from year to year. Based on income tax returns filed in 1959, about 13 percent of those who reported receipt of dividends were not taxable.

Taking this into consideration and including persons over 65 years of age and those who do not file a return due to the fact that their income is under $600 a year, it is conceivable that approximately 6 million exemption certificates could be filed and would have to be processed during each calendar year. We are sure you will realize this is not a simple problem.

Obviously, if withholding is enacted into law, no exemption from withholding would be the least burdensome to payers of dividends. However, if exemption certificates are to be allowed it should not be restrictive, as proposed in the bill, but should also be extended to tax-exempt organizations such as churches, educational institutions, pension funds, bank nominees, et cetera.

We further believe that it is practically impossible to handle exemption certificates on a yearly basis in view of the many and varied problems that would arise. The task of processing and reprocessing yearly certificates would be complicated, confusing, and expensive. This applies even to the proposed exemption for minors.

In order to avoid much of the confusion referred to if exemption certificates are allowed to be filed, we strongly recommend and urge that such certificates, when filed, be good until withdrawn or revoked. In such an event the exemption certificate could be filed in duplicate and provide for an identifying number. One copy would be filed with the Internal Revenue Service who then could make use of the account number and place the information on its records. The tax return on such items could be checked to determine whether or not a tax is in fact payable by the persons involved and, if necessary, invoke the penalty provisions of the bill. This would eliminate a great amount of confusion to payers of dividends and to stockholders and relieve to a great extent the insurmountable burden which yearly exemption would cause.

The Treasury Department has provided for quick refunds which will be a tremendous task and in making the refunds it will have no assurance that the tax has in fact been withheld. The Treasury should take this calculated risk of improper exemption certificates being filed which we feel would be less harmful than overrefunding.

The professional transfer agent acts for many corporations and a stockholder filing one exemption certificate will assume that it covers various issues of stock and will be quite upset when he is asked to furnish an exemption certificate for each class of securities held.

The language in the report of the Committee on Ways and Means on page A149 which reads as follows—

> In general, a person entitled to exemption need file only one exemption certificate with any withholding agent—

will not help this situation. Further, in many cases the certificate will be sent in without reference to the class of stock involved and will necessitate considerable correspondence.

There are many problems if a calendar-year basis is used. One of these might be stated as follows: A corporation pays a dividend early in January and some stockholders have not renewed their exemption certificates prior to the dividend payment date. The payer would be forced to effect withholding of 20 percent. Upon receiving his check, less 20 percent, the stockholder would obviously, through misunderstanding, be very critical and write to the corporation, stating that he has filed an exemption certificate and that no withholding should have been made.

However, the corporation would be forced to tell the stockholders that he must claim the 20 percent from the Government and that a new exemption certificate in the form prepared by the IRS must be filed.

In addition to causing irritation on the particular dividend involved, it will also cause problems at the end of the tax year resulting in a great amount of correspondence being sent to the payers of dividends asking for information. Further, many stockholders will not realize that the 20 percent was withheld and will not make a claim therefor.

The bill, as proposed, seems to ignore the method of handling the situation created when a corporation pays a stock dividend in stock of another company. This is considered income to the recipient.

There appears to be no answer to the question as to how tax is to be computed and withholding effected.

This becomes even more complicated when fractions of a share are not issued, but are adjusted in cash. The fractions may be adjusted in cash based on the average price on a stock exchange, if listed, on the record date.

However, the basis for income tax on full shares issued is usually the average on the payment date. Since these prices may differ it adds to the confusion of the taxpayers.

In one situation the price for adjusting fractions on the record date was $40.95, and on the payment date the average price was $38.68. In order to withhold, would shares have to be sold? If so, the price received could be more than the amount needed for payment of tax and could also be less, depending on the market situation. The market for the shares could be effected and it might also require clearance under the Securities Act of 1933 as amended. How (and at what expense to Government and corporations) is withholding to be handled in this situation? The only practical solution would appear to be the exclusion of this type of transaction from withholding, which we urge be given strong consideration.

Section 19(c)(2) of the bill adds section 1444 to the code providing as follows in section (a):

Under regulations prescribed by the Secretary or his delegate, every person who pays amounts subject to withholding under chapter 25 and who has been notified by a payee thereof that the payee is a nominee required to deduct and withhold on such amounts under section 1441 or 1442 shall, in lieu of the nominee, deduct and withhold from such amounts paid to the nominee the tax required to be deducted and withheld under section 1441 or 1442, in the same manner as if such amounts were paid by such person directly to the beneficial owner thereof.

If the nominee so notifies the payer, the nominee is relieved of responsibility for deducting and withholding tax under section 1441 or 1442.

This new section does not indicate whether this information is to be furnished to the payer for each dividend or whether it is to be on a calendar-year basis or good until revoked.

This language presents a problem to the payer of dividends and the maintenance of its records. There are many situations where the same nominee is used not only for nonresident aliens but also for U.S. citizens.

If a nominee advises the payer that a specific number of shares held in its name represents shares held by nonresident aliens of a specific country, we would have no way of knowing when this position changed.

It would further cause confusion if the shares held in a particular nominee's name were split on the records, with the possibility that cancellation and retirement of shares would be taken out of the wrong account. This is the problem we now face and the practice is to refuse to split accounts on the records for many reasons.

If the bill is adopted with this provision it would change the practice of payers adopted over the years and obviously could cause confusion. This problem could be eliminated by allowing bank nominees to file exemption certificates, good until revoked, for all shares registered in their names. They would then act, as they do now, as withholding agent. This would also apply to shares held in the name of nominees for the account of trusts, pension and profit-sharing plans, charitable organizations, et cetera.

Our comments are predicated on our understanding of the bill as passed by the House of Representatives. We cannot be sure of all the problems of the members until a bill is finally enacted and the Internal Revenue Service has published its regulations.

This will probably be several months after final enactment of the bill and raises a serious question as to whether our members and others will be able to obtain new equipment, where necessary, and change their methods of operation before the proposed effective date of the bill now being considered.

Thank you very much.

Senator KERR. Thank you, Mr. Neil.

The committee will recess until 10 o'clock Tuesday morning.

(By direction of the chairman the following is made a part of the record:)

STATEMENT OF GEORGE E. BARNES, REPRESENTING THE MIDWEST STOCK EXCHANGE

As a student of Federal income tax legislation for the past 40 years, I have never been so gravely concerned as now, over the proposal to withhold taxes on interest and dividends under chapter 25 of H.R. 10650 for the reason that it is

an open invitation to fraud—corporate and individual—would impose completely needless hardships on people who can least afford them, and would be more likely to shrink net revenues to the Government than to increase them. This is why I appreciate very much the opportunity to file this statement. It is based upon long experience in preparation of income tax returns, filing hundreds of claims, and dealing with customers in the banking and investment business and also serving on National and State Federal tax committees. For the record, I am senior partner of Wayne Hummer & Co., Chicago, past chairman of the Midwest Stock Exchange, and a working director and member of the executive committee of the Suburban Trust & Savings Bank, Oak Park, Ill., and I might add that my views have the support of my bank as well. For your information, my first studies of Federal income taxes were initiated in 1918 when I prepared up to 1,000 individual returns as a public service in behalf of the banking institution which I served as auditor. For a number of years, the Chicago collector of internal revenue annually acknowledged by letter my service to a community of 25,000 then without internal revenue agents to help the taxpayers.

I still prepare from 75 to 100 returns each year for friends and business acquaintances in order to keep abreast of the regulations and to be generally helpful in an increasingly complex and complicated field.

It has also been a source of satisfaction to me that the Congress has adopted, on more than one occasion, tax proposals that I submitted, which the record will indicate. I mention my personal interest and experience in Federal tax matters for the reason that only this past week I had an experience with the Internal Revenue Service that vitally concerns the subject at hand in connection with examination and audit of a 1960 individual tax return which I prepared. In a return which reported $31,700.84 in dividend income, the examining agent had no 1099 information returns to audit the dividend items numbering 65. Individual dividend payments ranged from 76 cents to $4,151.25. He asked the taxpayer to produce any copies that had been saved by him from the individual companies. Further, I cannot recall any time in the past 5 years an examining agent having before him for audit purposes Forms 1099 regularly furnished the Internal Revenue Service at great expense by corporations and others. In the reporting of dividends and interest, which all companies so cooperatively carry out, we already have an effective means and basis to collect taxes. In this connection, it is gratifying to know that the Commissioner of Internal Revenue is taking steps to provide improved audit procedures through computer data processing, and I would like to see it extended to interest payments below $600.

May I make very clear to you that since the end of the war, because of what amounts to continuance of an excess profits tax as high as 91 percent on individual incomes (although the corporate excess profits tax was repealed) it has been the practice of parents to make periodic gifts to children and grandchildren to lower the heavy burden of income and estate taxes. This has been facilitated by the passage by every State of the Union of a "gifts to minors act," making it easier for parents to make gifts of securities and cash. But even prior to this innovation, thousands and thousands of transfers were made to children in the form of savings accounts and securities to ease the tax burden and make a better education available. If the facts were known, a good portion of unaccounted-for interest and dividends claimed by the Treasury would not be subject to income taxes. It will be of interest to you that one of our clients recently transferred about $3,000 in stock to each of 21 grandchildren and 5 children. Incidentally, this category alone would create a vast number of taxpayers to whom the Government would be obliged to make refunds under the proposed legislation. There are undoubtedly illegitimate or suspect sources which fail to report certain dividend and interest income. But it will be found that those who are engaged in legitimate businesses and professions generally report these items very conscientiously.

The Treasury's estimate that there is a 91-percent compliance of dividend reporting in income tax returns is highly credible, and when the tremendous volume of dividend payments to elderly people and minors not subject to income taxes is considered, this is a remarkable percentage, probably without equal anywhere else in the world.

Now I would like to list what appear to be from my experience the basic faults of the withholding provision of H.R. 10650.

BASIC FAULTS OF INTEREST AND DIVIDEND WITHHOLDING UNDER CHAPTER 25 OF H.R. 10650

Basic fault No. 1.—Unjustified overwithholding of taxes.

Basic fault No. 2.—Inefficiency, waste, and duplication imposed upon Government, business, and taxpayers to administer withholding.

Basic fault No. 3.—A large segment of interest payments not covered by withholding.

Basic fault No. 4.—Impracticality and complication would cause a multiplication of administrative problems and serious interruption in operations of our security markets.

Basic fault No. 1: Unjustified overwithholding of taxes

From my long experience in dealing with small stockholders and savings depositors, I am confident a large portion of the unjustly withheld taxes under the legislation would not be recovered, because of either ignorance or fear of making out a refund incorrectly, or belief that it would cost more in time than the report is worth. This is something to fear inasmuch as it has been estimated that 8 million stockholders would be subject to overwithholding and the impact would fall most severely on those who can least afford it for these reasons:

Interest on savings accounts.—The American Bankers Association took a sample survey last year of 300 commercial banks which indicated a very large concentration of small savings accounts. It is interesting to note from this survey that two-thirds of the savings accounts in the reporting banks paid less than $15 in annual interest. Still another 15 percent paid annual interest from $15 to $45. If you will project this sampling to the 52 million savings accounts in the Nation, there are close to 35 million savings accounts in commercial banks alone earning interest of less than $15 a year. Need any more be said that this legislation would unjustly deprive thrifty people of their full earnings on their savings and result in untold losses and inconveniences. It is highly questionable whether most of these people would bother about refunds and by not doing so they would incur losses.

Dividends on stocks.—A 20-percent withholding rate is substantially more than the actual tax for the average shareholder for the following reasons:

1. Proposed plan does not consider the $50 annual dividend exclusion. For example, 25 percent of the shareholders of American Telephone & Telegraph receive less than $50 annually and 50 percent of all these shareholders would be ineligible for quarterly refunds and would have to wait up to a year to get their money back.

2. There is no allowance made for the 4-percent dividend credit to individuals which reduces the effective rate from 20 to 16 percent.

3. There is no provision for the 85-percent dividend credit on dividends received by another corporation. In other words, 20 percent would be withheld on dividends to other corporations compared to an actual tax liability of 7.6 percent on large corporations in the 52-percent bracket and only 4.5 percent for the small corporations paying a 30-percent rate.

4. The proposal to withhold on dividends and interest has been confused with wage and salary withholding where proper allowances are made for marital, dependent, and medical deductions as well as age and retirement income credits. Even in the case of prolonged illness, wage withholding payments cease on the first $100 weekly compensation.

5. Tax-exempt organizations such as churches, youth and character-building agencies, welfare agencies, universities, corporate and union pensions funds may not claim exemption from dividend withholding under the plan. In other words, these organizations would be obliged to loan money to the Government without interest return each year by having 20 percent of their payments retained by paying corporations. These organizations which operate on close budgets mainly from contributions and income from their investments can ill afford to have their income reduced. Your attention is called to the fact that 8.7 percent of all ownership in publicly owned corporations is held by tax-exempt organizations such as not-for-profit institutions and corporate pension funds.

6. The 20 percent withholding rate is unrealistic and is not geared to the actual liability of taxpayers of all types or a reasonable approximation thereof. For example, a person receiving $5,500 claiming the "standard deduction" would have a total tax liability of only $800 compared to withholding of $1,100. Retired taxpayers with extra medical deductions would be very adversely affected.

7. Banks, insurance companies, and other financial institutions receiving a high portion of their gross income from Government and corporate bond interest seldom retain 20 percent of their gross income after operating expenses. Consequently, they would be subject to a larger withholding than they could absorb (after credits for wage withholding and social security taxes), without impairment of working funds, and liquidity would thereby be vitally affected.

Basic fault No. 2: Inefficiency, higher costs, waste and duplication imposed upon Government, business, and taxpayers in order to administer withholding

The taxpayer as well as the Government would have no evidence or receipt for payments, which would result in total confusion. There would be required extensive and costly investigations and audits on the part of the Internal Revenue Service of all payers of interest and dividends to verify amounts not withheld as well as records of corporations and banks to verify validity of millions of claims. Therefore, the plan contains many possibilities for loss to the Treasury due to inefficiency and/or fraud on the part of payers of interest and dividends. Recipients could well have a feeling of distrust in the absence of any assurance or notification that tax payments were made. It is claimed that it will be a simple matter for a person to receive a refund by merely filling out a post card or form and sending it to Uncle Sam. This statement is irresponsible inasmuch as all cases where the Internal Revenue Service has no record of income tax filings or payments would require a special investigation before the claim could be paid. Otherwise, it would be the same as giving the public a blank check to draw on the Government which irresponsible people could abuse without detection for the simple reason that it would be impossible under the proposal to support claims with any individual records of amounts withheld. This is the complete answer to quick refund advocates.

It would present a colossal problem for banks and savings institutions to determine the tax status of each depositor, and the execution of this would invade the private affairs of citizens and shift the burden and responsibility of tax collections from Government to private institutions. Eventually, these added administrative costs would be paid by the thrifty. It is estimated that the very minimum out-of-pocket expenses of the bank that I represent to administer the withholding programs would be $1 per account. The postage on one mailing and return to 12,000 depositors carrying savings balances aggregating $17,436,408 would be about equal to the total annual compensation provided of about 10 cents per account for the privilege of holding funds temporarily. It is calculated that indirect supervisory costs to the bank for administering the program would also be substantial. This is contrary to the adequate compensation representations made by the Treasury.

Reporting of income on form 1099 by corporations and individual payers of interest and dividends provides the best means to insure maximum enforcement at minimum costs and confusion to business and Government. In my opinion, the outer limit of responsibility by business should be confined to providing regular informational reports to the Internal Revenue Service. You will always find that business firms are anxious to cooperate. The recent introduction of computer data processing by the Commissioner of Internal Revenue to achieve more efficient audits and enforcement is most welcome in this connection. Withholding would only add waste and duplication to this efficient effort.

Basic fault No. 3: A large segment of interest payments is not covered by withholding

There is no withholding of interest proposed on mortgages and private loans. This represents a much larger amount than interest payments on corporate bonds. The effect of withholding on owners of corporate and Government bonds would be to discriminate against them in favor of private lenders. This would force tax-exempt organizations and many individuals not subject to tax into other forms of investment that may not be so desirable or liquid. There could be a pronounced and adverse effect on the Treasury's savings bond program.

Basic fault No. 4: Impracticality and complication would cause a multiplication of administrative problems and serious interruption in operations of our security markets

The problems of banks, trust companies, and investment firms resulting from elimination or curtailment of use of shares in the names of a nominee or what are known as "street certificates" would be staggering since no exception is made and the full 20 percent is withheld under this legislation. As an example, banks

and brokers acting as nominee usually receive one check from each corporation for a dividend payment and the individual accounts are credited with the proceeds as the ownership appears, largely by automatic computers. If arbitrary withholdings are made irrespective of the tax status of individual accounts, it would be necessary to register each certificate in the owner's name and process a multitude of additional items and checks by manual operations. With added costs to both banks and investment dealers occasioned by tax withholding, there would be no alternative than to increase service and/or commission costs to offset the burden.

Street certificates in many respects are the same to investment dealers and brokers as currency is to banks. Just as banks use currency to make change, so do street certificates facilitate transfers and deliveries of securities to customers or brokers and investment dealers. Also, it is not generally appreciated that street certificates or nominee holdings are used daily to make deliveries and settlements where security items of the seller do not reach the stock exchange clearing corporations on the contract date for one reason or another because of distance or delays. There are also daily instances of street certificate substitutions for "not good delivery" items comprising certificates in the names of corporations, trustees, estates, and other nonnegotiable form, to expedite and facilitate daily settlements between buyer's and seller's broker. It should be obvious that the market machinery would be seriously clogged and impeded in case street certificates were eliminated or curtailed.

Under the proposal, all Government bonds (excluding series E bonds) and corporate bond interest payments would be subject to 20 percent withholding with no exceptions for individual and taxable corporate investors. This means that in the case of bond transactions, it would be necessary for the buyer to withhold from the seller 20 percent of any accrued interest to date of sale since they would be obliged to pay 20 percent of the full coupon or payment on the next interest date. This would impose many problems for bond dealers and banks. Investors would tend to delay transactions until the exact semiannual or annual interest payment date and create an accumulation of transactions with which banks and dealers in bonds could not cope. It should be obvious that these withholding provisions would cause serious interruptions and instability of normal market operations in our bond markets. Even some taxable organizations such as banks and other large bond investors would wish to avoid overpayment of taxes by acquiring bonds between interest dates.

Bond transactions would be further complicated whenever the seller is a tax-exempt organization such as a church, school, or charitable organization inasmuch as buyers would object to making an outlay of 20 percent withholding tax on the full coupon when collected. For example, purchase from a tax-exempt organization of $100,000 par value U.S. Treasury 4 percent bonds 5 days before the interest would mean the buyer would pay the seller accrued interest of $1,956.04, but would collect only $1,600 ($2,000 less 20 percent) on the interest date and would thus be required to resort to claims to recover the funds.

CONCLUSION

I could continue at length in regard to other complications and taxpayer problems to support opposition to withholding provisions of H.R. 10650. On the other hand, there can be no argument with the basic premise that each citizen should carry his fair and equitable share of the tax burden. On that premise, a minority of earlier witnesses have argued—with complete sincerity I am sure—that withholding of dividend and interest income is a desirable step toward tax equality.

Such witnesses, however well meaning obviously have not had an opportunity to study the implications of the pending withholding proposal, or they fail to grasp its destructive potential. On balance, I believe that the principle as proposed is demonstrably inequitable, administratively impractical, and wholly undesirable. Briefly and bluntly, its enactment would not encourage tax equality. But it would take us deep into the area of discriminatory self-defeating taxation in its most virulent form with consequent and perhaps crippling impairment of and respect for our entire basic revenue collecting processes.

TEXAS CHRISTIAN UNIVERSITY,
Fort Worth, Tex., April 11, 1962.

Senator HARRY F. BYRD,
Senate Office Building,
Washington, D.C.

DEAR SENATOR BYRD: Your Senate Finance Committee has a public hearing scheduled for April 18–19 concerning the subject of withholdings on dividend and certain interest payments by corporations. I wanted to take this opportunity to express my opinion as vice chancellor for fiscal affairs of an eleemosynary educational institution.

If this withholding tax proposal becomes law, then it would be most advantageous if tax-exempt organizations could simply file an exemption certificate which would then enable the disbursing corporation to pay the full dividends to the tax-exempt organization. The present proposal to allow the tax-exempt unit to file for a refund or to use the withholding tax as an offset on the quarterly tax payment would work an undue burden on these units. I have noted with great concern the fact that interest is to be treated in a somewhat different manner, except where the interest arises from bonds of commercial organizations. This means, in effect, the dual system of keeping up with these many transactions and, at our own institution, we have projected a full-time employee to keep up with this matter.

I am sure that you will receive many expressions of interest and varying opinions on this subject. This is simply a personal recommendation based on a careful analysis of our own situation, and we would certainly want to urge that the exemption certificate method be given every consideration. Thank you so much for your consideration.

Most cordially yours,

L. C. WHITE, *Vice Chancellor.*

COLONIAL GROUP, INC.,
New York, N.Y., April 12, 1962.

Hon. HARRY F. BYRD,
Chairman of the Senate Finance Committee,
Washington, D.C.

HONORABLE SIR: We are a mortgage company which for many years has been making loans secured by real estate, mostly one-family dwellings, in the State of Virginia.

A substantial portion of our funds are received from savings banks, savings and loan associations, and commercial banks which are all located outside of the Commonwealth of Virgina. We feel quite certain that everyone recognizes the contribution which these institutions have made to the growth of the housing and construction industry not only in Virginia but in the entire country, and we are certain that the present growth in these fields could not have been attained without such funds.

We are writing to you in connection with the proposal to have these institutions withhold tax on interest and dividends. If enacted, this proposal will have an immediate effect of reducing the amount of funds available to invest in mortgages in the Commonwealth of Virginia and other areas. Not only will it decrease the funds, it will inevitably give rise to a substantial shift of individual savings away from such institutions to tax-sheltered investments causing not only a deduction in income to the Government but an uncertainty with regard to the magnitude of such shifts, thus reducing the willingness of these banks to commit to make mortgage money available.

Aside from the costly and complicated bookkeeping involved on the part of these banks the entire procedure of this advance deduction appears to us to be unnecessary in view of the reported mechanization of IRS procedures.

We strongly urge you to vote against this legislation which will have a harmful effect on the homebuilding industry not only in the State of Virginia but throughout the country.

Respectfully yours,

MILTON DORNBUSH, *President.*

AMERICAN SOCIETY OF CORPORATE SECRETARIES, INC.,
New York, N.Y., April 10, 1962.

Hon. HARRY BYRD,
Chairman, Senate Finance Committee,
Washington, D.C.

DEAR SENATOR BYRD: The American Society of Corporate Secretaries, Inc., is a national organization with approximately 1,300 members, representing about 1,000 corporations—large and small—with many millions of the Nation's shareowners. A copy of the latest yearbook showing the membership of the society is attached.[1] This organization has only rarely taken positions with respect to pending legislation and then only in limited circumstances in which it is felt that the expert knowledge of the members of the society can be of clear service to a legislative committee or to legislators.

The society and its committee to review pending legislation have reviewed with concern the difficulties confronting those seeking to draft proposed new legislation to provide for 20-percent tax withholding on dividends and some types of interest income.

Since all fairminded public citizens applaud any efforts to require uniformly impartial collection of taxes and since withholding as applied to all recipients of dividends and interest has on its face an appearance of uniformity and impartiality, the worthwhileness of the objective has tended to obscure the precise issue: (1) Will withholding bring about more net revenue—giving due account to the collection costs applied to the Nation as a whole—and (2) will its side effects be worth the hypothetically expected cure?

It is noted that the joint committee's staff and the Treasury anticipate withholding will yield an additional $550 or $650 million in Federal tax revenues annually. Although we have not reviewed the premises on which these estimates are based, we understand that the estimates are projections from overall figures and are necessarily imprecise because of the variations in taxpayer status, such as substantial recent increases in nontaxable investment funds and the continuing extension of shareownership into the hands of smaller lower income holders. Even if the net increase be effected, there should be considered as offsets the additional collection expense to which the Treasury would be put as well as the substantial though unmeasurable unproductive costs of corporations, transfer agents, banks, trustees, brokers, accountants, and individual taxpayers.

If, as is quite likely, the net increase in revenues has been overestimated, the vast amount of additional bookkeeping, additional refunding, and additional clerical activity on the part of the Internal Revenue Service and taxpayers could very likely bring about a net result to the national economy entirely opposite to that intended.

Failure to report dividends and interest by taxpayers under our voluntary compliance method can be attributed either to (*a*) oversight, or (*b*) intentional nonpayment of taxes.

This society has cooperated with the Treasury Department in the program to remind taxpayers of taxability of income. Since our entire tax collection system rests upon voluntary compliance, we do not believe that failure should be conceded in connection with dividends and interest lest this be a further step in eroding our self-assessment system.

As for intentional nonpayment, we understand that rapid strides are being made by the Internal Revenue Service to correlate forms 1099 with taxpayer returns on an electronic basis and that as all taxpayers are converted to a numbering system, this method of cross-checking should be simplified. Certainly it would appear premature to conclude that voluntary compliance, in conjunction with the other techniques now being instituted by the Internal Revenue Service, is unsuccessful.

A tax withholding system penalizes the small taxpayer who has a small tax to pay arising from dividend and interest income, for withholding covers a considerably larger percentage of his tax than for those in higher brackets. Experience indicates that many taxpayers will receive dividends and interest net of withholding and fail to submit exemption certificates and fail to apply for refunds. Withholding does not appreciably increase the enforcement technique as to those large taxpayers who might choose to continue to understate their income.

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[1] Copy of yearbook placed in committee files.

We believe that those concerned with drafting become only too aware of the many defects necessarily resulting from seeking to establish a withholding procedure that would be administratively feasible and fair to all taxpayers. These very defects have remained in each succeeding draft and evidence, in our judgment, the validity of the following conclusions which, in summary, indicate that the public interest does not now presently require the excess costs, unintended penalization of the small taxpayer, and the other side effects of withholding:

(1) The estimated net increase in revenues has been overestimated when due allowance is made for the continuing change in taxpayer status of shareholdings and to the substantial though unmeasurable costs of collection, refunds, etc.

(2) Our basic voluntary compliance system of taxation by self-assessment is still sound—particularly when joined with the new enforcement techniques being perfected by the Internal Revenue Service.

(3) If there is a substantial enforcement problem in connection with large sums of unreported income, tax withholding does not meet that issue, but instead penalizes large numbers of small taxpayers and diverts into administrative red-tape efforts which could be better devoted to apprehension of those who are failing to report taxable income.

(4) The use of tax withholding would impose substantial unproductive costs throughout the economy when our collective energies and efforts can be better directed in the national interest.

Respectfully yours,

STANLEY A. MCCASKEY, Jr., *President.*

WOONSOCKET INSTITUTION FOR SAVINGS,
Woonsocket, R.I., April 4, 1962.

Hon. JOHN O. PASTORE,
U.S. Senate,
Washington, D.C.

DEAR SENATOR PASTORE: I am writing with reference to the omnibus tax bill recently passed by the House of Representatives, and which, among other things, would require a mutual savings bank such as ours to withhold 20 percent of all interest credited to the accounts of our 35,000 depositors.

This provision unfairly penalizes the small saver and will bring about important changes in savings habits. The withholding requirement will tend to discourage capital formation in thrift institutions and encourage depositors to hoard or shift savings into tax-sheltered investments such as U.S. savings bonds, where the tax liability can be postponed indefinitely.

Moreover, since taxes due at time of reporting are generally paid by the taxpayer out of current income, the withholding of 20 percent of interest credited will take a tremendous amount of money out of the capital stream. In our case alone it will amount to more than $500,000 next year. We believe that money withheld from the saver's account will not be restored and will be lost for investment purposes. On a nationwide basis it is easy to visualize the tremendous impact of withholding on the supply of funds available for home purchasing and the adverse effect this will have on home construction and employment.

We strongly believe that withholding is also administratively impractical and unnecessary, since with electronic equipment and taxpayer account numbering the Treasury soon will have the means of processing the reporting of income and assuring full compliance with the income tax laws.

Because of the traditional method of handling tax bills, it was impossible to amend the bill when it was before the House, despite the great number of protests received by Congressmen from savers, the building industry, and others all over the country. However, as you know, the bill can be amended in the Senate.

I sincerely hope you share our views on this extremely important matter and that you will lend your support to a Senate amendment deleting the withholding provisions at least until electronic data processing and account numbering of tax returns have had an opportunity to be tried. I hope, also, that you will make these views known to the members of the Senate Finance Committee.

Very truly yours,

ALBERT N. PLACE.

THE DAYTON POWER & LIGHT CO.,
April 5, 1962.

To Each Member of the Senate Finance Committee:

H.R. 10650 is now before the Senate Finance Committee. As a member and secretary of the retirement board of the Dayton Power & Light Co. and on behalf of its retirement income fund, I wish to protest the provision of the bill which would apply a 20-percent withholding tax on interest and dividends payable to tax-exempt trusts, thereby requiring quarterly applications to the Treasury Department for refund of the tax withheld.

Every cent of the income of the retirement income fund of the Dayton Power & Light Co. is dedicated to the payment of pensions to retired employees or death benefits to beneficiaries of deceased employees. The unnecessary deprivation of this income for several months will cost the fund each year. In addition, costly and unnecessary procedures will be required to the trustee of the fund to prepare, and to the Government to process, claims for its refund plus further unnecessary accounting expenses.

I urge that the bill be amended so as to permit the exemption from the withholding tax on dividend and interest payments to tax-exempt trusts and tax-exempt institutions who file exemption certificates under the procedure now authorized by the bill for individuals under age 18.

Very truly yours,

J. V. COLLEY,
Vice President and Treasurer.

STATEMENT OF R. C. MORGAN, PRESIDENT, CREDIT UNION NATIONAL ASSOCIATION, INC.

The Credit Union National Association appreciates the opportunity to submit its views on legislation currently before the committee to withhold income tax at the source on dividends and interest. This statement is intended to relate solely to section 19 of H.R. 10650, which deals with this matter.

The Credit Union National Association is a nonprofit association of State credit union leagues representing 18,350 affiliated credit unions throughout the United States comprising approximately 11 million saving and borrowing members. The leadership of the Credit Union National Association has listened sympathetically to the Treasury Department's explanation of why withholding of income tax on interest and dividends is deemed necessary. We recognize that some positive measures must be taken to prevent the annual loss of $850 million of tax revenue through underreporting. This loss of income at a time of grave international crisis is particularly serious for our Government and also places an unjust burden on those taxpayers who have been and are presently paying their taxes on such income, as well as on the general taxpayer who must bear the costs of Government.

However, we do believe that some modification of the measure as passed by the House of Representatives is called for in order to ease the administrative burden on those credit unions that operate with part-time or volunteer help.

As the members of this committee know, credit unions are unique, self-help financial institutions, operating as an observer once remarked, with "one foot in finance and the other in the church." Each credit union serves a clearly defined occupational, associational, or residential group, where individuals pool their savings in order to make loans at reasonable rates to one another for provident or productive purposes. Thousands of persons have been inspired to accept credit union office on an unpaid, volunteer basis because of the compelling appeal of the credit union ideal of service to one's fellow man. It is estimated that some 75 percent of all credit unions in the United States—about 15,000 in all—function with part-time and/or unsalaried help.

Total shareholdings in the 21,000 State and Federal chartered credit unions in the United States on December 31, 1961, were approximately $5.6 billion. Accurate figures for 1961 are not as yet available on the total dividend paid on these shares, but based on previous years' figures, it is estimated that U.S. credit unions in 1961 distributed approximately $210 million to shareholders.

Statistics published recently by the Bureau of Federal Credit Unions, the U.S. Government agency chartering and supervising nearly one-half of all the credit unions in the Nation, underscore the relatively modest size of the typical credit union. The Bureau reports that one-fourth of the 9,905 Federal credit

unions existing on January 1, 1961, had assets of less than $25,000, while one-half had assets of less than $87,100. State leagues of credit unions tell us that credit unions under $87,000 in assets, whether State or federally chartered, operate largely with volunteer or part-time administrative help.

Furthermore, the annual report of the Ohio Division of Securities for 1960 disclosed that of 361,000 share accounts in Ohio-chartered credit unions, approximately 57 percent—206,000 in all—had balances of $100 or less, and some 74,000 accounts—20.4 percent—amounted to less than $10. The average share account in this $100 or less bracket came to $28.60 and, while this category was numerically in the majority, dollarwise it represented but 3.9 percent of the total share balances of Ohio State-chartered credit unions.

If the figures in the Ohio report are representative of credit unions throughout the Nation, and we believe they are, it becomes evident that there is slight tax revenue to be derived from the smaller share accounts in credit unions. Yet, the numerical preponderance of such accounts would impose a heavy workload on the shoulders of already heavily burdened credit union personnel should the withholding proposal be adopted in its present form. Moreover, there are those in our association who fear this additional work might discourage people from volunteering for credit union office, thus inhibiting the extension of credit union thrift and lending service.

There is a basic canon of taxation; namely, that no tax should be significantly more burdensome to those involved in collecting or paying the tax than it is beneficial to the sovereign. We submit that this principle applies very forcefully in the case of withholding on minimal credit union share accounts.

For this reason, we respectfully request this committee to consider amending H.R. 10650 to exclude from withholding of income tax any credit union dividend of $25 or less. Based on our estimate, this would eliminate over 60 percent of all member accounts, but would leave subject to withholding nearly 80 percent of total savings. With such a modification, the workload for credit union officials would be manageable and the tax revenue for the Government substantially intact.

Credit unions throughout the country have displayed a deep interest in this legislation and would very much appreciate favorable consideration of their unique problem.

COUNCIL OF PROFIT SHARING INDUSTRIES,
Chicago, Ill., April 19, 1962.

Hon. HARRY F. BYRD,
Chairman, Senate Finance Committee,
Washington, D.C.

DEAR SIR: The Council of Profit Sharing Industries recommends that H.R. 10650 now pending before the Finance Committee be amended to eliminate the 20-percent withholding tax on dividends payable to profit-sharing trusts which are exempt from Federal income tax under the requirements of the Internal Revenue Code.

The Council of Profit Sharing Industries is the spokesman for profit-sharing companies which have contributed about one-third of the estimated $10 billion of assets which are held in trust for 4½ million profit-sharing beneficiaries. The council is a nonprofit association of employers with profit-sharing plans for their employees. It was organized in 1947 by a small number of employers and has grown to over 800 members having a common interest in profit sharing and the belief that it offers a solution to industrial strife and a means of maintaining the free economy of this country. The purpose of the council is to promote profit sharing and good will and harmony among employers and employees through the development of profit-sharing plans.

THE PROBLEM

Section 19 of H.R. 10650 as passed by the House of Representatives requires a withholding tax of 20 percent on dividends payable to a profit-sharing trust even though the trust is exempt from Federal income tax under sections 401(a) and 501(a) of the Internal Revenue Code. We submit that the imposition of such a tax tends to defeat the purpose of qualified profit-sharing trusts and conflicts with other provisions of the code.

Profit-sharing trusts are, generally speaking, designed to provide long-range benefits for employees in the form of retirement income, payments in times of

unemployment, accident, sickness, death, and other emergencies. In order to achieve these purposes to the utmost, it is essential that the trust assets and the income thereon be invested and kept invested to the fullest extent possible. Ever since the Revenue Act of 1921, Congress has recognized the social desirability of these trusts by granting them income tax exemption, thus permitting them to accumulate income on their investments free from the Federal income tax. As a result some 30,000 profit-sharing trusts have been adopted as of the end of the third quarter of 1961 and new plans were being inaugurated at the rate of approximately 4,500 per year. The present provisions of H.R. 10650 mark an unnecessary departure from the past policy of Congress.

The declared purpose of section 19 of the pending bill is to reduce income loss to the Government (H. Rept. 1447, 87th Cong., 2d sess., p. 84). We submit that this purpose is not served in any way by subjecting qualified profit-sharing trusts to the withholding provisions of the bill. There might be some reason in applying section 19 of the bill to profit-sharing trusts if there was a possibility of their being taxable on dividend income.

However, under the present law a qualified profit-sharing trust cannot incur any income tax liability whatsoever except in the rare instance when it derives unrelated business income and incurs a tax under the provisions of section 511 et seq. of the code. However, even in such a case income in the form of dividends is specifically excluded from such tax under the provisions of section 512(b) of the code.

In light of this complete immunity from Federal income tax it is readily apparent that there is no revenue loss under existing law so far as a qualified profit-sharing trust is concerned and there is no purpose in subjecting such a trust to the proposed withholding tax on dividends.

PROPOSED RELIEF IS INADEQUATE

It is true that the bill makes provision for quarterly refunds of the amounts withheld and permits the use of such amounts as credits against other taxes. This is not a satisfactory solution to the problem for the following reasons:

(1) The trust is deprived of the use of the amounts withheld for as much as 3 months. As indicated above, these employee trusts rely to a large extent upon the receipt of investment income to achieve their objectives. According to SEC statistics for 1960, approximately 45 percent of noninsured pension funds were invested in preferred or common stock and the trend is to ever increasing amounts each year. Comparable figures are no doubt applicable to profit-sharing trusts as well as pension trusts. The refund provisions may afford some meaure of relief where dividend income represents only a small portion of an organization's total income but it does not do so where a large percentage of income is derived from dividends.

(2) The provisions of the bill permitting an organization to offset withholdings against employment taxes or taxes collected at the source on wages is of no material benefit because the vast majority of these trustes have no employees but are administered through corporate trustees. Some large profit-sharing trusts may have regular employees but it is likely that the number is relatively small and, in view of the large amount of dividend income, it is doubtful that the credit provisions of the proposed bill will offer any real solution to the loss of use of amounts withheld.

(3) The filing of refund claims for amounts withheld will unnecessarily add to the cost of administering profit-sharing trusts. Although such claims may become routine, there will nevertheless be some administrative expense. This expense will serve only to reduce further the productive capacity of the trust and result in lesser benefits to the employees and their beneficiaries.

(4) Similarly, the provisions for refund will add to the Government's cost of administering the income tax law. The purpose of section 19 of the bill is to increase revenue and this purpose will tend to be defeated by imposing an additional cost on the Government to facilitate the repayment of amounts which are in no way subject to the Federal income tax and which from the very moment of their withholding are destined to be repaid.

RECOMMENDATION

For these reasons we submit that the only adequate method of treating tax exempt qualified employee trusts is to exempt them entirely from the proposed withholding tax. Such an exemption would be consistent with the present provisions of the bill permitting the use of exemption certificates where interest pay-

ments are concerned. It would be a simple matter to extend this treatment to dividends as well.

It must be noted that the bill allows the use of exemption certificates in the case of certain individuals merely upon the belief that they will not be subject to income tax. If an exemption certificate is valid where the income tax liability is doubtful, we submit that it is perfectly valid where it is known for certain that the recipient of the dividend will incur absolutely no tax liability on the amount being paid.

Moreover, such an exemption is justified in light of the provision of the bill excluding from the definition of "dividend" amounts paid by one corporation to another where both are members of the same affiliated group and where a consolidated return was filed for income tax purposes in the past year. As the House report points out (p. 88), such intercompany transactions are "washed out" for tax purposes. Similarly, a withholding on dividends payable to a qualified profit-sharing trust would be washed out by the immunity of such a trust from Federal income tax.

In short, exemption of dividend payments to a disqualified profit-sharing trust from withholding tax would be entirely consistent with the purpose of the bill, it would avoid unnecessary additional costs to the trust as well as to the Federal Government, and would permit the trust to operate in the manner in which Congress intended.

Respectfully submitted.

JOSEPH B. MEIER,
Administrative Vice President and Secretary.

KAY & KAY,
De Ridder, La., April 9, 1962.

Hon. ALLEN J. ELLENDER,
U.S. Senate, Washington, D.C.

DEAR ALLEN: Myself, as well as all of the savings and loan people in the State, of course, are naturally concerned with the provisions in the current tax bill affecting the interest of their members and their institutions.

We realize, of course, that all persons who are singled out for additional or increased taxes always make a fuss about it and that is natural.

The provisions of the current bill, as I understand it and as it came from the House, will place a tax obligation upon these institutions which they have not previously been required to pay, and of course, while they think it is definitely inequitable because of their particular type service and semipublic character in promoting thrift and homebuilding, they also recognize the practical reality that that the administration is in need of more money to carry on its quite ambitious programs. Therefore although this additional burden will possibly jeopardize the maintenance of dividend rates of some institutions at their present level, it is probable that most institutions can continue to pay modest dividends at the present interest rates under the tax schedule as it is now fixed and in event it is not increased or otherwise made more burdensome.

The withholding of dividends, of course, is something else and when reduced to its basic element, it merely is that the Government is requiring the savings and loans and other dividend paying and interest paying institutions to collect and remit the tax funds in advance on a withholding basis patterned after the wage withholding except that it is much more burdensome than the latter from a bookkeeping and clerical standpoint for reasons that are obvious and I need not burden you with.

On smaller institutions this is going to require additional personnel under conditions where most of them will necessarily have to pass this on in the form of increased interest rate to home borrowers or decreased dividends to investors.

This is going to be a difficult and trying and embarrassing thing for those in the management of these institutions to explain to the depositors and eventually the explanation of the reason caused for such will have to go back to those whose responsibility it is in connection with the tax program.

We do hope that you can realize and consider the problems of these institutions, their investors and borrowers, along with the other complexities of this program, and see that we are protected against an undue and unreasonable burden in connection with this matter.

With regards and best wishes, I remain

Yours very truly,

STUART S. KAY.

COMPTON ADVERTISING, INC.,
New York, N.Y., April 10, 1962.

Hon. HARRY F. BYRD,
U.S. Senate,
Washington, D.C.

MY DEAR SENATOR: All 800 employees of this company are eligible for membership in our pension plan. I am writing on behalf of all of them to protest the withholding of 20 percent tax on the dividends and interest accruing to the trust fund which is being provided to take care of their old age. The trust has qualified for income tax exemption and if certain individuals are to be relieved of withholding there can be no justification for this discriminatory treatment.

More to the point, anything which tends to reduce the fund or to increase its operating expense, even temporarily, reflects directly upon the amount of the benefits which will be available to each in his old age.

I, therefore, urge you to rewrite that section of the proposed revenue act which pertains to this matter.

Respectfully,

HENRY A. HAINES,
Chairman, Compton Pension Plan Committee.

BOARD OF PUBLIC WELFARE,
BUREAU OF OLD AGE ASSISTANCE,
Hingham, Mass., April 10, 1962.

Hon. HARRY FLOOD BYRD,
Senate Office Building,
Washington, D.C.

MY DEAR SENATOR BYRD: As a director of public welfare I would appreciate the opportunity to express a few thoughts concerning the withholding tax business of omnibus tax bill (H.R. 10650).

In my work I come in contact with many elderly persons who have a few dollars saved and depend to some extent on the income they receive from their money.

I am sure that a large number of these people would not understand that something had been taken from their income, and as a result, would take no action to recover it.

Many of these individuals are not subject to income tax, and the enactment of a withholding tax would enforce a real hardship.

It would seem that some other system could be devised to uncover the persons who fail to report taxable income.

There are many of us who sincerely hope that the Members of the U.S. Senate will find other means which will not be burdensome to people who already are faced with many problems.

Sincerely,

GEORGE C. MCKAY.

THE PUBLIC SCHOOL TEACHERS' PENSION
AND RETIREMENT FUND OF CHICAGO,
Chicago, Ill., April 17, 1962.

Hon. HARRY F. BYRD,
Chairman, Finance Committee of the Senate,
Washington, D.C.

DEAR SENATOR BYRD: The trustees of the Chicago teachers' pension fund are greatly concerned about the withholding provision contained in H.R. 10650. Under this bill the bonds of the fund, exceeding $80 million, would be subject to withholding of interest. While a refund would be paid later, the fund would sustain a substantial loss of income each year.

The provision for refund also is impractical for a fund such as ours. The proposal for offsetting income tax withheld from employees' salaries would not compensate for the loss in income because of the small number of employees required to administer the fund.

It is our hope that the Committee on Finance will approve an amendment to the bill which would exclude securities of public pension funds from the application of the bill.

Very truly yours,

EVELYN SJOLUND, *Executive Secretary.*

WAUSAU, WIS., *April 16, 1962.*

SENATE FINANCE COMMITTEE,
Senate Office Building,
Washington, D.C.

GENTLEMEN: I desire to submit the following statement, as evidence before the committee hearing, as my opinion why the 20-percent withholding feature on dividends and interest should not be in the tax-revenue bill, which has just been passed by the House of Representatives:

1. This feature would cause undue burden and needless extra paperwork on all corporations, banks, savings and loan companies, and others who are declaring interest or dividend payments. I do not believe this extra paperwork to send in the 20-percent withholding is justified.
2. Many elderly people would lose this interest because they do not understand the technique of applying for their refund and they could not afford to hire someone to make the application for them. This is an undue burden on elder citizens who need every bit of interest and dividend income for livelihood.
3. Additional Federal help would be necessary to process all the refund checks which would result from this withholding feature. This means additional Federal payroll and I am suspicious that the present administration wants additional captive votes.
4. Present procedures planned in the data processing technique, whereby dividends and interest paid could be identified to the individual by a social security number, would entirely take care of checking the revenue which should be received from this dividend and interest source. The only necessary change in reporting these dividends and interest would be that all dividends and interests below, say, $10 per annum, should be reported on the same forms that the present reporting is done. Since the interest payment would be identified with a social security number the interest declared on an individual's income tax could be easily checked. This would not involve additional payroll at the Federal level and would not involve great burdensome paperwork at the source of interest payment.

Yours very truly,

L. L. SHEERER.

MUNICIPAL FINANCE OFFICERS ASSOCIATION
OF THE UNITED STATES AND CANADA,
COMMITTEE ON PUBLIC EMPLOYEE RETIREMENT ADMINISTRATION,
Chicago, Ill., April 9, 1962.

Hon. HARRY F. BYRD,
Chairman, Senate Finance Committee,
Washington, D.C.

DEAR MR. CHAIRMAN: The tax bill now before your committee is being viewed with considerable concern by the trustees and administrators of public employee retirement systems. The withholdings of interest and dividends on corporate securities, while returnable to the systems as a refund, will create a substantial loss of income to these systems as well as a serious administrative problem.

Under the bill, as we understand it, the systems are exempt as agencies of Government. They would be entitled to a refund of the withholding taxes upon filing an application. However, the unavailability of the proceeds from interest and dividends for current investment would result in a loss of income. The belief of the sponsors of the legislation that the withholding on securities could be offset by amounts normally paid as withholdings from salaries for income tax and other purposes is erroneous. Because of the relatively few employees engaged in administering the retirement systems, the salary withholdings approximate only several hundred dollars per year compared to the thousands of dollars that would be withheld from interest and dividends on the large amounts of securities owned by these systems which constitute their accumulated reserves. Furthermore, the spread between these two items will become increasingly greater with the continued operation of the systems and the increases in their reserves.

The public employee retirement systems now have in excess of $6 billion invested in corporate securities. The investment in these securities is steadily increasing due to the revisions during recent years of the investment authority applicable to these systems. These investments may well double in amount during the next 5 years. Corporate bonds and stocks now comprise a substantial proportion of the investment portfolios of these systems and have become an important medium for the investment of their reserves.

Section 3483 of the bill provides that tax-exempt organizations may submit exemption certificates, but the same section further provides that the exemption shall not apply to: (*a*) interest on evidences of indebtedness; (*b*) amounts on deposit represented by transferable shares; and (*c*) interest on U.S. Government obligations.

These exceptions to the exemptions definitely eliminate any advantages to public employee retirement systems in the use of the exemption certificates because the retirement system assets are all invested in bonds and other evidences of indebtedness, transferable shares and U.S. Government obligations.

Section 3485 provides for quarterly refunds to tax-exempt organizations of the excess of tax withheld over credits for other taxes which may have been withheld by the tax-exempt organization. A tremendous quarterly reporting effort will be required to obtain such a refund. Due to established policy of diversifying their investments, the retirement systems have accumulated a large number of individual securities exceeding several hundred in a single instance on which taxes would be withheld under the bill. Many of the securities are payable to bearer. It is assumed that tax-exempt organizations would be required to submit an exemption certificate each time a coupon is clipped from a corporate bond or a dividend is paid on stocks.

We urge that the committee give careful consideration to the proposed legislation in its application to public employee retirement systems with the view of providing a full exemption for these systems under this legislation. The adoption of the bill in its present form would constitute an indirect tax on these systems because of the large loss of revenue that will be incurred by the retirement systems and the consequent additional burden that will be imposed on the governmental employers through an increase in local taxes to provide for the revenue deficiencies.

Sincerely yours,

A. A. WEINBERG, *Chairman.*

TYER RUBBER CO.,
Andover, Mass., April 24, 1962.

Hon. HARRY FLOOD BYRD,
Chairman, Senate Finance Committee,
Senate Office Building, Washington, D.C.

DEAR SENATOR BYRD: My associates and I are strongly opposed to H.R. 10650 as recently passed by the House of Representatives.

In expressing our oppositions, I am speaking not only for Tyer Rubber Corp. but also our parent company, Converse Rubber Corp., of Malden, Mass., and for its other affiliates including Granite State Rubber Co., of Berlin, N.H. Our companies employ more than 3,000 people in the manufacture of rubber and canvas footwear.

Our industry has been hard hit by foreign competition, with Japanese producers having taken over nearly one-half our domestic footwear markets. We have been seriously concerned at the prospect of further damage to our industry if H.R. 9900, the proposed Trade Expansion Act, were to pass, and had hoped for some assistance from revision of our tax laws.

Unfortunately, we see no chance of benefit from H.R. 10650.

The proposed tax credit cannot help us unless the prospects for profits are improved by making our tax laws less onerous and/or by curtailment of competition from imports so as to justify our investing in new equipment.

But our main concern is the increase in pension costs which would result from the withholding of income payable to Treasury-approved pension trusts which are exempt from income tax. Such withholdings would be the equivalent of an additional tax on contributors to pension trust funds. It would apparently be necessary for the trustee of each fund to apply quarterly for refunds, so that there would be a complete sterilization of 20 percent of the trust's interest and dividend income for more than one-fourth of the time. This delay in the reinvestment of such income would materially increase the contributions required to maintain the funds and would result in a discriminatory increase in the cost of pensions for employees.

We sincerely hope that you and your associates will prevent the enactment of withholding provisions which would penalize, not only beneficiaries of pension funds, but also thousands of nontaxable individuals and organizations from which unjustified withholdings would be made.

Cordially yours,

W. E. BRIMER, *President.*

STATEMENT OF ARNO HERZBERG, NEWARK, N.J., ON PROPOSED CHANGE OF SECTION 1231

The administration's tax program and the bill passed by the House are supposed to promote the expansion and modernization of American industry. But, in its present form, this legislation cannot accomplish its purpose. It is full of contradictions because—

(a) The so-called tax credit would apply only to taxpayers making a profit. If taxpayer has a loss from operations, the tax credit cannot influence him to renew his machinery.

(b) The extent of the tax credit cannot be safely determined if assets are bought at the beginning of the year. Consequently, the tax credit cannot motivate a taxpayer to buy new assets.

(c) The abolition of the capital-gain provision in section 1231 as proposed would act as a further brake on the desire of management to buy new plant or machinery—the old plant or machinery cannot be sold without paying a large tax; new assets cannot be bought without further depleting working capital.

Section 1231 was originally inserted in the code to take care of the rise in prices of used machinery during the war. This problem is still with us in an inflationary period. In addition, there would be no incentive to sell if a large tax has to be paid.

In order to attain the end the administration has in mind, it is proposed—

To maintain the present section 1231 as far as depreciable assets, especially real estate is concerned;

To amend section 1231 as follows:

If assets of like or similar nature are acquired within 1 year of the sale of the old asset, the gain on the sale is figured as heretofore, but the gain is used to reduce the basis of the new asset.

In case of a plant the period of 1 year is to start 1 year before or after erection of a new one.

Such a provision would have these results:

1. Working capital for the purchase of a new asset would be freed,
2. Benefits are not dependent on profits,
3. Further complication of the tax structure, especially elaborate recordkeeping, is avoided,
4. The true meaning of the capital-gain provision—to give recognition to the rise in the economic plateau of the country—is maintained,
5. A problem which surely will change the makeup of the American economy and require changes in the tax structure is anticipated. This problem has to do with the fact that American corporations show reduced profits per sales dollar in the last 10 years. There was a shrinkage of 3 and more percent. This means less capital for investment will be generated within the enterprise itself. There is a point of no return.

TOWERS, PERRIN, FORSTER & CROSBY, INC.,
Philadelphia, April 24, 1962.

H.R. 10650.

Hon. HARRY F. BYRD,
Chairman, Committee on Finance, U.S. Senate, Washington, D.C.

DEAR SENATOR BYRD: As consultants on employee benefit plans, and also as an employer operating a profit-sharing plan for our own employees, we should like to make certain comments and suggestions regarding H.R. 10650, now before the Senate Finance Committee. Our particular interest is in section 19 of the bill, which presumably would exempt from the withholding provision of the bill certain interest received by qualified pension and profit-sharing trusts, but which would not extend a corresponding exemption to dividends received by such trusts.

The withholding of 20 percent of dividends payable to such qualified trusts, even though the withheld amounts may later be recovered by filing quarterly claims for refunds, will, depending upon the type of plan, either increase the cost to employers of administering such trusts, or will deprive employees of some of their intended benefits.

In the case of a pension trust, if assets represented by the 20 percent withholding remain uninvested even for a period of 3 months (on the optimistic assumption that the Internal Revenue Service will be prompt in making refunds) there will be a loss in the fund which the employer will be required to make up

in his future contributions to the fund. Such deficiency contributions will increase the employer's cost of the pension plan. Since pension plans are long-range projects, and their funding depends heavily upon compound interest, such losses over an extended period of time could become very significant.

In the case of a profit-sharing trust, the covered employees bear the loss from any assets remaining uninvested, even for a short period of time. Under the usual profit-sharing plan, the employer has no commitment to make up any losses in the fund. In a qualified profit-sharing plan to which employees contribute, the loss of earnings on any of his contributions has the effect of a hidden tax which the employee pays currently, despite the fact that section 402 of the code intends that earnings on employee contributions be accumulated tax free in such trusts until they are distributed to the employee. Again, over a long period of time, the amounts can be substantial.

The avowed purpose of section 19 of H.R. 10650 is to reduce revenue loss to the Government from failure to pay taxes accruing on interest and dividends. We submit that this purpose is not served by subjecting qualified pension and profit-sharing trusts to any part of the withholding provisions imposed by section 19. Such trusts are completely immune from Federal income tax, and hence there can be no revenue loss under existing law on the interest or dividends payable to them.

In view of the above, we submit that the only equitable method of treating tax-exempt qualified pension and profit-sharing trusts is to exempt entirely from the withholding provisions of the bill any income payable to such trusts. The bill already contains a provision permitting the use of exemption certificates in connection with interest payments. It would be a very simple matter, and administratively feasible, to extend this treatment to dividends as well.

The complete exemption of qualified employee trusts from the withholding provisions of the bill would, in our opinion, be consistent with that provision now in the bill which would allow the use of exemption certificates for individuals merely because they think they will not be subject to income tax. If exemption is justifiable where the existence of a tax liability is doubtful, it is certainly justifiable where it is established by law that there can be no tax liability.

Respectfully submitted.

J. K. DYER, Jr., F.S.A.

COMMITTEE OF BROKERS AND DEALERS ON TAXATION,
New York, N.Y., April 24, 1962.

Hon. Senator BYRD,
Chairman, Senate Finance Committee,
Senate Office Building, Washington, D.C.

DEAR SENATOR BYRD: The Committee of Brokers and Dealers on Taxation goes on record as unalterably opposing the provisions for withholding of dividends and interest as proposed in the Revenue Act of 1962 (H.R. 10650). We believe that the automatic data processing system would achieve the desired result in obtaining revenue lost through unreported interest and dividends.

If the Senate Finance Committee deems it necessary to approve such provisions, then, in the interest of administrative expediency, no exemptions or exclusions to the plan should be made. In lieu thereof, adequate machinery should be set up to issue prompt refunds of overwithholding tax and/or provide for claiming credit for such withholding.

Very truly yours,

EDWARD W. MORRIS, *Chairman.*

STATEMENT OF RHODE ISLAND BANKERS ASSOCIATION, PROVIDENCE, R. I.

The executive council of the Rhode Island Bankers Association, representing all commercial and mutual savings banks in Rhode Island, has just completed a careful study of the withholding provisions of omnibus tax bill H.R. 10650.

We agree with Government leaders that the Federal Government must collect all taxes due on interest and dividends received by taxpayers. However, we feel every effort should be made to collect taxes due through methods which are less burdensome to the taxpayers and the banks than the methods provided in this bill.

We respectfully suggest that the educational program aimed at improving the reporting of interest and dividends be continued. This program has shown good results.

We suggest the inclusion of the following question in future income tax returns beginning with the year 1962:

"Have you reported all dividends and interest received by you from all sources in this return? Yes——. No——."

In our opinion, such a question would greatly increase the reporting of these types of taxable income, especially when considered in the light of the new taxpayer number and electronic computer system.

We suggest the full use of information returns, at lower limits than $600 in the case of interest and dividends as an additional effective answer to the problem of underreporting.

The alternatives mentioned above would certainly be less costly, less confusing, and less inconvenient to all concerned. These alternatives, we believe, are realistic and reasonable and deserve your serious consideration.

While opposed to the principle of withholding we submit that if such a tax law is enacted by Congress many inequities contained in the present bill should be corrected.

We subscribe to the following suggested changes as proposed by Joseph C. Welman, past president of the American Bankers Association (1) Exemption certificates should be good until revoked by the taxpayer instead of being renewed each year; (2) exemption certificates should be available to charities, colleges, and other tax-exempt organizations on the same basis as individuals; (3) exemption certificates should also be made available for tax-exempt organizations and to nontaxable individuals regardless of whether they hold their investments directly or through a trust or other fiduciary relationship; (4) the effective date should be delayed to January 1, 1964, so that banks have at least a year to obtain personnel and equipment and to adjust their operations to handle withholding.

(Whereupon, at 12:30 p.m., the committee stood in recess until 10 a.m., Tuesday, April 24, 1962.)