REVENUE ACT OF 1963

1616

HEARINGS

BEFORE THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

EIGHTY-EIGHTH CONGRESS

FIRST SESSION

ON

H.R. 8363

AN ACT TO AMEND THE INTERNAL REVENUE CODE OF 1954 TO REDUCE INDIVIDUAL AND CORPORATE INCOME TAXES, TO MAKE CERTAIN STRUCTURAL CHANGES WITH RESPECT TO THE INCOME TAX, AND FOR OTHER PURPOSES

OCTOBER 28-31, NOVEMBER 1, 4-8, 1963

PART 3

Printed for the use of the Committee on Finance

U.S. GOVERNMENT PRINTING OFFICE

24-532 WASHINGTON : 1963

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REVENUE ACT OF 1963

MONDAY, OCTOBER 28, 1963

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 (presiding), Douglas, Talmadge, Bennett, and Dirksen.

Also present: Elizabeth B. Springer, chief clerk.

The CHAIRMAN. The committee will come to order.

The first witness is Mr. Donald C. Slichter of the American Life Convention, Life Insurers Conference.

Please proceed, sir.

STATEMENT OF DONALD C. SLICHTER, PRESIDENT, THE NORTHWESTERN MUTUAL LIFE INSURANCE CO., MILWAUKEE, WIS., ON BEHALF OF THE AMERICAN LIFE CONVENTION, THE LIFE INSURERS CONFERENCE, AND THE LIFE INSURANCE ASSOCIATION OF AMERICA

Mr. SLICHTER. Mr. Chairman and members of the Senate Finance Committee, I am Donald C. Slichter, president of the Northwestern Mutual Life Insurance Co., Milwaukee, Wis. My testimony is in behalf of the American Life Convention, the Life Insurers Conference, and the Life Insurance Association of America, three associations with a joint membership of 359 life insurance companies which have 98 percent of the total assets of all U.S. legal reserve companies. I am chairman of the Joint Economic Policy Committee of the American Life Convention and the Life Insurance Association of America.

In brief, our position regarding the rate reduction provisions of H.R. 8363 is as follows:

(1) We favor such provisions in principle, subject to three qualifications I shall describe later.

(2) We favor the net tax reduction provided in the bill of approximately $11 billion to be phased over a 2-year period.

(3) We favor a tax rate revision of this magnitude to lay the foundation for vigorous and sustained economic growth over an extended period, not as a cyclical measure to give the national economy "a shot in the arm" to accelerate business recovery.

We have reached these conclusions because we are convinced that our Federal tax system—both the high level of taxation and the struc-

ture of the tax rates—reduces incentives to work harder, to save and invest, to innovate and to assume risks.

The impairment of these incentives seriously restricts the ability of our economic system to achieve high employment and faster growth on a sustained basis.

Since the trough of the last recession in early 1961 we have had a favorable expansion of business activity but our economy is still characterized by excessive unemployment and slack in the use of productive facilities.

We are convinced that one of the underlying causes for the failure of or economy to achieve its potential is our current tax system, with its steeply graduated personal income tax rates and high corporate income tax rates.

However appropriate such rates may have been under the wartime conditions in which they were enacted, they are poorly suited to our country's current economic need to stimulate enterprise, innovation, risk taking and capital spending.

We made our decision to support a tax rate reduction program only after lengthy study and consideration of the risks involved. We realize, of course, that unless proper precautions are observed a tax cut of the magnitude provided in H.R. 8363, at a time when a large Federal deficit is already in prospect, might revive inflationary pressures and undermine confidence in the value of the dollar both at home and abroad.

Such a result would be highly damaging to our economy and would be particularly unfortunate from the standpoint of life insurance policyholders who rely on our fixed-dollar commitments. Consequently our support of tax reduction at this particular time is subject to several qualifications.

First, determined action must be taken by the administration and the Congress to avoid further rise in aggregate Federal spending, and the budget must be carefully scrutinized to reduce spending wherever possible. We urge that such steps be taken promptly. A rigorous control of expenditures is imperative at this point in the Nation's economic development. A halt to continual increases in Government spending is essential in itself. If taxes are reduced expenditure control becomes doubly necessary.

Second, the Government must be prepared to use monetary, debt management, and other policy measures to avoid building up inflationary pressures and to protect the international value of the dollar.

The continued slack in our economy and the discipline of foreign competition provide assurance that a marked rise in the general price level is not at present a serious threat.

At the same time we cannot ignore the price increases of individual products which are cropping up in the news with greater frequency. For this reason we believe that if a tax reduction bill is enacted, the monetary authorities must, if conditions require, curb excessive liquidity in the economy.

It also means that the Treasury must redouble its efforts to finance the deficit in a noninflationary manner.

Finally, it is our position that the individual income tax rate reductions contained in the bill should be revised to give more equitable treatment to middle-income taxpayers.

And, while we support the corporate rate reduction in the bill, we favor a further reduction in this rate to 42 percent as soon as budgetary conditions permit.

The new individual income tax rates should be directed to achieving a balance between stimulating consumption, on the one hand, and providing stronger incentives to work, save, invest, innovate, and assume risks, on the other.

The tax rate reductions in H.R. 8363 do not, in our opinion, achieve this balance. They are directed too strongly toward stimulating consumer spending and not far enough toward the other objectives I have mentioned.

Relatively small reductions are granted to the middle-income brackets. As a result, although all income levels would receive some tax reduction, the program in H.R. 8363 would actually make graduation in the middle ranges of the rate structure relatively steeper than it is now. Thus it falls short of achieving the beneficial effects on incentives that would be possible under a tax program that spreads the relief more evenly among taxpayers at all income levels. We therefore urge that the individual income tax schedule in H.R. 8363 be amended to provide more equitable terms to the middle-income groups.

The reason why we urge more equitable treatment for the middle-income brackets is that these are the brackets in which there is an especially great potential for stimulating the incentive to save and invest.

The savings dollars of these individuals are not put into a sock, as seems to be assumed sometimes.

Rather most of them go into savings institutions and are made available immediately for the building of homes, farm structures, industrial plant and equipment, public utilities, and many other capital goods.

As they flow into investment spending they expand job opportunities, wages, and consumer expenditures. They contribute directly to the growth of our economy.

The weak link in our overall economic expansion since early 1961 has been a lagging rate of capital spending by business and industry. A few figures will illustrate this.

In the third quarter of 1963 the GNP was running at an annual rate of $588.5 billion, or 33 percent higher than in 1957.

Despite this rise in GNP, and despite a doubling in privately financed industrial research and development expenditures in the past decade, the annual rate of business expenditures for plant and equipment in the third quarter of this year was only 8 percent higher than the level in 1957.

Annual investment in fixed capital in relation to GNP has fallen from an average of 10–11 percent in the 1949–57 period—and from 12 percent in 1947–48—to an average of only 9 percent in the past 5 years.

Because we believe that direct encouragement to capital spending is so important for high employment and faster growth on a sustained basis, we strongly approve the tax relief to corporations in H.R. 8363, and we urge that the corporate rate be further reduced as budgetary conditions permit.

It is precisely for this reason also that we urge larger tax reductions for individuals in the middle-income brackets.

The direct encouragement this would give to saving and investment, to the willingness to assume risks and to innovate, and to the spirit of enterprise would also aid to stimulate a higher rate of capital spending, particularly by comparatively small unincorporated business concerns.

In summary then, we favor the rate reduction principles of H.R. 8363. Our support for these principles, however, is subject to several qualifications.

We believe that there would be a determined effort by the administration and Congress to avoid further rise in aggregate Federal spending.

We think the Government must be prepared to use its monetary and debt management powers to avoid inflation and to protect the value of the dollar.

Finally, we are of the opinion that the individual income tax rate schedule in the bill should be amended to afford more equitable treatment to the middle-income brackets, and that the corporate rate should be further reduced as soon as budgetary conditions permit.

My testimony has been confined to the rate reduction principles of the bill. Another witness will appear at a later date to testify on behalf of the life insurance associations with regard to certain structural changes proposed in the bill.

The CHAIRMAN. Thank you very much, Mr. Slichter. Senator Douglas?

Senator DOUGLAS. No question, Mr. Chairman.

The CHAIRMAN. Senator Bennett?

Senator BENNETT. Mr. Slichter, earlier in the testimony we have had some interesting remarks about the Harris poll, and it is interesting that in this morning's Post there is a Harris poll report which show that only 30 percent of the American people feel that the administration has done a good job in keeping spending in line.

This is a very interesting, and as far as the Senator from Utah is concerned, an unexpected revelation of a point of view which he has suspected for a long time.

You testify in your statement that one of the conditions you make with respect to your support of the tax bill is that there be a detemined effort by the administration and Congress to avoid further rise in the aggregate Federal spending.

Would you regard this report of the Harris survey as having significance in view of your position?

Mr. SLICHTER. Well, I assume it has some significance but I would not be able to appraise it completely.

I think that progress has been made to some extent in the reduction of expenditures, but I would expect and hope for very substantial further progress, particularly as we run into the year 1964.

Senator BENNETT. Well, we have been led to believe that we must have the tax reduction now, and many business groups whom we expected to make the same kind of qualifications you have made, have more or less retreated from these qualifications.

Some witnesses have said, "Well, this isn't the President's responsibility. This is the responsibility of the Congress." It is interesting

that this survey is a survey of support of the President's policies, a survey aimed at the popularity or the support of the President, not the Congress, and apparently the feeling is greater that he has failed in keeping spending in line than that he has failed in any other respect about which the Harris survey asked the people whom it interviewed.

So, I hope this will give groups like yours more courage to come up and tell the committee that we want a tax bill, as you have done, but we should only have a tax bill if we do a better job of keeping spending in line.

Maybe it isn't fair to ask you, would you prefer to have a tax bill passed if there were no reduction in spending or would you prefer to have it deferred until we can get some evidence of a determination to reduce spending?

Mr. SLICHTER. I would prefer to have a tax bill passed and progress made in correcting some of the inequities in the tax structure, so we can induce further growth in this economy and at the same time move along and get reduction in expenditures.

I believe it is highly important, as I pointed out in this testimony, that we stimulate, particularly, business investment expenditures, which is the area that creates jobs and expands markets, and makes, and always has made, this economy more vigorous and productive and efficient; that we get on with a tax structure that gives this country the opportunity to make that progress and get off this slow rate we have been growing at.

Senator BENNETT. But you said in your answer, "at the same time." Do you mean at the same time or do you want the tax cut now and you will take your chances on reduction or control of Federal expenditures? That is one of the basic problems we in this committee must face.

Mr. SLICHTER. I would certainly expect Congress to scrutinize with great conscience and care and assign high priorirty to carefully examining the expenditure requests that come in.

But I would not expect this tax bill to be held up until that is accomplished.

Senator BENNETT. I have no further questions, Mr. Chairman.

The CHAIRMAN. Senator Douglas?

Senator DOUGLAS. May I enter the lists, Mr. Chairman?

The CHAIRMAN. Yes.

Senator DOUGLAS. I hadn't intended to make any comments but since my friend from Utah has introduced the Harris poll which appears in this morning's Post, I think it should be noted that 76 percent of those polled approved the President's policy in keeping our military defense strong.

Sixty-nine percent approved the space program. I am not personally too keen about that, but that shows public opinion.

Now, the increase in the governmental budget has been primarily due to the increase in defense expenditures, and to the space program. Both are costly affairs. I believe the expenditures on national defense have increased by approximately $10 billion, space expenditures have been increased $4 or $5 billion. That accounts for almost the entire increase in the budget.

Senator BENNETT. Mr. Chairman, will the Senator yield?

Senator DOUGLAS. I will finish the sentence and then I will be glad to yield to you, but I would like to finish the sentence.

At the same time, 30 percent approve of the President's policy in keeping spending in line, presumably 70 percent do not approve of the President's policy. This is a common tendency of mankind to favor specific programs which create great expenditures, and then to quarrel about the totals and the taxes required to maintain them; and personally, as there is an inconsistency in the public attitude in this matter, and as long as the public approves of keeping military defense strong, and approves of the space program about which I have my own reservations, I don't think that the Senator from Utah can say this is convincing proof that expenditures have risen further than public opinion justifies.

Now, I will be glad to yield.

Senator BENNETT. I was asking you to yield so that I could ask the Chairman permission to put into the record figures which will show that the administration has actually spent as much or more outside of the defense—that the cost of Government under this administration has been increased by spending which is as great or greater outside of defense and space than it is inside of those two very important areas.

It is a common offense to focus attention immediately on defense and space, and we ignore the fact that there has been a tremendous increase in Government spending in other areas, and I ask permission, Mr. Chairman, I don't have those figures with me.

The CHAIRMAN. Without objection.

(The figures referred to follow:)

Expenditures by fiscal year

[In millions]

	1961	1962	1963	Change, 1961-63	
Nondefense:					*Percent*
International affairs	$2,500	$2,817	$2,874	+$374	+14.9
Agriculture	5,173	5,895	6,731	+1,558	+30.1
Natural resources	2,006	2,147	2,380	+374	+18.6
Commerce transportation	2,573	2,774	3,325	+752	+25.3
Housing and community development	320	349	525	+205	+64.0
Health, labor, and welfare	4,244	4,524	4,915	+671	+15.8
Education	934	1,076	1,361	+427	+45.7
General government	1,709	1,875	2,041	+332	+19.4
Interest	9,050	9,198	9,782	+732	+8.0
Veterans benefits	5,414	5,403	5,545	+131	+2.4
Nondefense total	33,923	....	39,479	+5,556	+15.9
Defense	47,494	51,103	53,004	+5,510	+11.6
Space	744	1,257	2,400	+1,656	+222.5

Senator DOUGLAS. Mr. Chairman, I also ask permission to present an analysis of the budget figures.

(The following was later received for the record:)

EXPENDITURES UNDER KENNEDY ADMINISTRATION LESS FOR FUNCTIONS OTHER THAN DEFENSE, SPACE, AND INTEREST IN FIRST 3 YEARS THAN LAST 3 YEARS OF EISENHOWER ADMINISTRATION

While total budget expenditures will increase more during the first 3 years of the Kennedy administration than they did during the last 3 years of the Eisenhower administration, the difference is more than accounted for by increases in expenditures for defense, space, and interest.

As shown in the attached table, budget expenditures for programs other than defense, space, and interest increased more during the last 3 years of the Eisenhower administration (nearly $5 billion) than they will during the first 3 years of the Kennedy administration (less than $4 billion).

Moreover, during the two periods of comparison, the proportion of budgetary increases going for defense, interest, and space programs compared with all other programs will be much higher in the first 3 years of the Kennedy administration (74 percent) than in the last 3 years of the Eisenhower administration (52 percent).

This demonstrates beyond any question that the program of expenditure restraint which has been followed by the Kennedy administration has achieved significantly greater economy than was achieved by the Eisenhower administration in expenditures for programs not related directly to the national defense, the space effort, and the fixed charges in the public debt.

Changes in administrative budget expenditures, fiscal years 1958–61 and 1961–64

[In millions of dollars]

	Budget expenditures			Increases (+) or decreases (−)			
				1958–61		1961–64	
	1958	1961	1964	Amount	Percent	Amount	Percent
National defense	44,234	47,494	(1)	3,260		(1)	
Space research and technology	89	744	(1)	655		(1)	
Subtotal	44,323	48,238	58,793	3,915	8.8	10,555	21.9
Interest	7,689	9,050	10,583	1,361	17.7	1,533	16.9
Subtotal	52,012	57,288	69,376	5,276	10.1	12,088	21.1
All other functions:				[2] 52		[2] 74	
International affairs and finance	2,231	2,500	(1)	269		(1)	
Agriculture and agricultural resources	4,419	5,173	(1)	754		(1)	
Natural resources	1,544	2,006	(1)	462		(1)	
Commerce and transportation	1,631	2,573	(1)	942		(1)	
Housing and community development	30	320	(1)	290		(1)	
Health, labor, and welfare	3,059	4,244	(1)	1,185		(1)	
Education	541	943	(1)	402		(1)	
Veterans' benefits and services	5,184	5,414	(1)	230		(1)	
General government	1,284	1,709	(1)	425		(1)	
Subtotal, all other functions	19,923	24,882	28,728	4,959	24.9	3,846	15.5
Allowances undistributed:							
Comparability pay adjustment			200			200	
Contingencies			175			175	
Interfund transactions (−)	−567	−654	−879	−87		−25	
Total, administrative budget expenditures	71,369	81,515	97,801	10,146	14.2	16,284	20.0

[1] Not available.
[2] Percentage of total budget expenditure increase.

NOTE.—Figures may not add to total due to rounding.

Source: Office of the Secretary of the Treasury, Office of Debt Analysis. Oct. 28, 1963.

The CHAIRMAN. Senator Talmadge?

Senator TALMADGE. No questions.

The CHAIRMAN. There has been one conflict so far this year, direct conflict between the Congress and the President. The House reduced the foreign aid about a half a billion dollars, I think.

The House was then denounced by the President as committing an irresponsible act, an outrageous act, and generally was given a good dressing down by the President.

Which side would you take?

Do you think the House did the right thing or that the President did the right thing?

Mr. SLICHTER. Well, I must admit that I am not an expert on the foreign aid budget and the expenditures included in the foreign aid. But I would also say that the foreign aid budget like all other budgets should be carefully scrutinized and perhaps the conclusion of the House was right.

I also agree with Senator Douglas, that the space program, it is an immense program, a difficult program to administer, $5 billion and over, that is an amazingly large research program to administer, and we must understand that there are great difficulties in handling amounts that large and deriving efficient and excellent results particularly when you have a problem of reaching an area that you don't know anything about; that is the moon.

The CHAIRMAN. I simply say that is one of the difficulties confronting the Nation at this time, of having the executive and legislative branch agree.

I think the legislative branch was absolutely right in cutting the foreign aid. I think it is infiltrated with waste and extravagance all up and down the line. I am a little surprised that you haven't taken the side of Congress in unequivocal language because you base the tax cut upon cutting expenditures.

Mr. SLICHTER. Well, I recognize, Senator, that Congress, both the House and the Senate, have the complete power and the responsibility and they have been delegated that power, through the electorate, and we rest our expectations on the ability of Congress to make discerning judgments on the proper, desirable priority expenditures.

Obviously, first things must come first.

The CHAIRMAN. The President has the power to veto, you know, if he chooses to use it.

Thank you very much, Mr. Slichter.

I will now ask the Senator from Georgia to present the next witness.

Senator TALMADGE. Mr. Chairman, it is a privilege indeed for me to welcome to the committee one of my State's most distinguished citizens, Floyd Newton, who has been a warm personal friend for many, many years.

Mr. Newton, will you come around, please and proceed?

STATEMENT OF FLOYD C. NEWTON, JR., CHAIRMAN, TAX COMMITTEE, AMERICAN TEXTILE MANUFACTURERS INSTITUTE, INC.

Mr. NEWTON. Mr. Chairman and gentlemen, I wish to thank you for the privilege of appearing before this committee to present the views of the textile industry on H.R. 8363, the proposed Revenue Act of 1963.

My name is Floyd C. Newton, Jr., and I am vice president and treasurer of Dundee Mills, Inc., of Griffin, Ga. I am appearing today

as chairman of the Tax Committee of the American Textile Manufacturers Institute, Inc.

American Textile Manufacturers Institute, Inc., is a national trade association which represents approximately 85 percent of the mills in this country that spin and weave textiles from cotton, manmade fibers, and silk.

The textile industry is basically a complex of small, intensely competitive plants—with no single company representing more than approximately 5 percent of the total textile production. The aggregate magnitude of the industry is large, however, consisting of more than 8,000 plants employing approximately 1 million workers.

The Tax Committee of the American Textile Manufacturers Institute, Inc., has made an intensive review of H.R. 8363 during the short time since it was passed by the House Ways and Means Committee. The views which I shall present to you represent those positions determined after full discussion by our tax committee.

At this point, I would like to present for your information the basic policy recommendation of our tax committee which has been approved by the board of directors of the American Textile Manufacturers Institute, Inc.

The tax committee unanimously recommends that the textile industry support a balanced and fair reduction in the rate structure across the board for both individuals and corporations. This should be accompanied by a reduction in Government expenditures, or at the very least by a holding of the line on further increases, with the goal being a balanced budget and a reduction of our national debt. This committee believes that by a substantial reduction in corporate and individual tax rates the economy of our country will be stimulated and will thus provide increased tax revenue.

This policy declaration was just recently reaffirmed at a 2-day meeting of our tax committee which was called for the specific purpose of considering H.R. 8363.

The textile industry feels that the Federal tax program has a highly significant effect on the economic life of our country. We feel that the existing tax system has reached such proportions that it is a definite hindrance to economic growth and well-being.

The excessive progression of rates of individual income taxes and the present high rates of individual and corporate income taxes are serious deterrents to initiative, savings, and risk taking. This results in the stifling of investment in plant renewal and expansion, both of which are so necessary for a healthy economic growth and for the maintenance of a high level of business activity.

Under this situation, several basic courses of action present themselves:

1. Do nothing and face a declining economic situation and continually mounting Government deficits.
2. Stimulate the economy through increased massive Government spending and further extension of Government controls.
3. Stimulate the economy by encouraging private initiative and encouraging business growth and expansion.

We feel very strongly that the third alternative presents the only reasonable approach to a satisfactory solution of our present problem.

Any program of action to accomplish this objective must meet certain standards or criteria, and the following standards are those by which we have tried to measure each of our recommendations.

Any program of action to accomplish this objective must meet certain standards or criteria, and the following standards are those by which we have tried to measure each of our recommendations:

A. Will it increase individual initiative and permit reasonable capital accumulation?

B. Will it encourage business investment for plant renewal and expansion?

C. Will it provide increased purchasing power through lighter tax burdens and through higher employment?

I would like to comment here parenthetically that we feel the increased purchasing power alone resulting from a reduction of individual income taxes will not provide sufficient stimulus to the economy to raise revenues equal to the present level on the reduced rates within any reasonable period of time.

It is essential that changes in the tax program be handled in such a way that business enterprise and activity will be effectively stimulated. The purchasing power plowed back into our economy from reduced taxes alone would be very small as compared to the total purchasing power which would result from fuller employment and from the payment of salaries, wages, and so forth, resulting from the expansion of business activity to a level appreciably higher than that at present.

It is our view that the modifications made by the House Ways and Means Committee and adopted by the House of Representatives go a long way toward achieving the ends which we have just outlined. But, we feel the bill contains certain self-defeating provisions and certain inequities which require further revisions.

The most important of these are the proposed acceleration of corporate tax payments over a 7-year period and the proposed rate revisions for individuals, which, we submit, give excessive reductions to taxpayers in the highest and lowest brackets and not enough in between—especially when considered in conjunction with certain of the so-called structural changes.

We believe that both of these provisions will serve to defeat the basic purposes of the income tax reduction and, unless revised, may nullify to a large extent the stimulative effect of tax reduction on our economy.

I would like now to review in more detail the position of our industry on these and other specific provisions of the pending bill.

The textile industry feels that corporate rate reduction is an appropriate method of stimulating investment, consumption, and incentive.

Accordingly, we are in favor of the reduction in the corporate rate to 50 percent on January 1, 1964, and to 48 percent on January 1, 1965.

In addition, we favor the reversal of the normal and surtax rates and the elimination of the 2-percent penalty tax on consolidated returns.

Although not a part of the present bill, we would recommend that further consideration be given to the elimination of the intercorporate dividend tax on dividends from controlled subsidiaries.

If this change is made and the committee approves the reversal of the normal and surtax rates, a corresponding change limiting surtax exemptions and other tax benefits in the case of related corporations may be necessary.

On this basis, ATMI would have no objection to the multiple surtax exemption proposal included in the House-passed bill.

The textile industry strongly supports the repeal of the provision in the present law requiring that the depreciation base for property eligible for the investment credit must be reduced by the amount of the credit. Simplification of the investment credit is of pressing importance.

In our judgment, the one change that would help the most would be the repeal of the basis adjustment provision which, while logically sound, adds enormously to the burdensome recordkeeping requirements of the new investment credit law.

Let me add that the application of the basic adjustment rules, when taken in conjunction with the rules relating to recapture of the credit on early disposition of an asset and to the selection of used property, frequently give rise to almost impossible accounting problems. Because of its complexities, we would urge the elimination or modification of the used property provision—particularly in the area of affiliated corporations—as well as a sharp curtailment of the area of application of the mandatory recapture rules.

The textile industry favors the proposed clarification of the eligibility for the credit of elevators and escalators and the two changes in the bill which pertain to the lessor-lessee election.

ATMI is strongly opposed to the President's proposal to accelerate the payment of corporation taxes. Our study of the problem indicates that the acceleration of "pay as you go" over a 7-year period ending with 1970 for corporations having estimated tax liability in excess of $100,000, largely eliminates any benefit from rate reduction that might otherwise go to such corporations for a period of approximately 5 years.

The obvious result of this proposal, if enacted, will be to reduce the cash flow of many members of our industry. The expansion and modernization of industrial plant and equipment are major objectives of the proposed tax rate reduction this year and of the investment credit and depreciation revisions made effective last year.

In our opinion, acceleration of the payment of corporate taxes will not only go a long way toward defeating these objectives, but will also largely eliminate the stimulus to industry which is necessary to increase long-term revenues, and will hamper the ability of our domestic industry in preparing to meet increasing foreign competition.

If I might digress for a moment, the shorter depreciation lives announced by the Treasury in late 1961 for the textile industry and in July of 1962 for industry generally have, in our opinion, been quite helpful to the economy of our country.

It is unfortunate, however, that these new lives will apply as a matter of right for only 3 years and that at the end of such period the complicated reserve ratio test developed by the Treasury economists will come into operation.

While this matter may not be germane to the present hearings, we would urge that your committee and its staff, during the next few months, examine closely the justification for the reserve ratio.

The feeling of the textile industry is that the reserve ratio tests are overly complex and seriously discriminate against American industry in comparison to foreign competition.

We would recommend that the Congress enact legislation which will permit taxpayers as a matter of right to use the useful lives and guideline classes specified in the Treasury's depreciation guidelines, without regard to whether the reserve ratio tests are satisfied. The reserve ratio tests should then be permitted as a basis of justification for the use of even shorter lines by those concerns whose replacement practices actually provide such a basis.

Since the preparation of this testimony we have learned that Senator Hartke has introduced Senate bill 2231 which would accomplish this, and needless to say, this bill has our wholehearted support.

Under individual income tax rates and related matters, ATMI recommends that the Congress approve an approximate 15-percent across-the-board reduction in individual rates over a period of 2 years with the lowest income bracket split.

In effect we favor a rate structure revision for the calendar years 1964 and 1965 in line with the first two columns of table 2 attached to Secretary Dillon's statement before the House Ways and Means Committee to be found on page 61 of the committee hearings of February 6, 1963. Our recommendations would thus call for rates ranging from 18.5 to 84.5 percent in 1964 and from 15.5 to 71.5 percent beginning with 1965.

Our recommended tax table differs from that in the pending bill in that we would cut back by 1.5 percentage points the tax cuts given in the bill for both the bottom and top brackets.

In general, we believe that the package of tax cuts for individuals in the bill is weighted too much in favor of the very low bracket and the very high bracket taxpayer, and that not enough attention is being paid to the middle income brackets.

This is particularly true because certain of the so-called structural changes proposed would deny deductions and add heavier tax loads to those same individuals who are given the least percentage rate reductions.

It is our firm conclusion that fiscal responsibility requires a somewhat smaller reduction in rates than the President has recommended, and that the appropriate area for adjustment would be in the bottom and top brackets where proposed cuts are somewhat out of line with the across-the-board rate reduction that we feel to be the fairest and most equitable.

With some misgiving, ATMI is willing to support the provision in the bill denying a deduction for certain State and local taxes other than property, income, and general sales taxes.

We dislike cutting back on long-established deductions, but because of the need for raising revenues and because of the complexities involved in administering the deduction for the taxes in question, ATMI has reluctantly concluded that the giving up of this deduction is a reasonable price to pay if our suggested rate table is adopted.

We would urge that the committee reject the proposed minimum standard deduction, because of its revenue cost, because it runs contrary to the recommended across-the-board approach to tax reduction, and because it represents an inequitable allowance in cases where income has not been expended for deductible purposes.

We feel that only those income earners and producers who expend their income for deductible purposes should be allowed to take such

deductions and we disagree with the principal of eliminating a large number of small taxpayers from the effects of the Federal income tax. It is our strong belief that the vast majority of our citizens who benefit from the operation of our Government should participate on a fair basis in the payment of its cost.

The textile industry continues to oppose the elimination of the 4-percent credit for dividends received by individuals. The compromise proposal included in the House-passed bill which would repeal the credit over a 2-year period and increase the $50-dividend exclusion to $100 fails to meet the problem of double taxation of corporate earnings, except to a very limited degree.

ATMI recommends an increase in the credit rather than its repeal, or, in the alternative, the substitution of a "gross up" provision similar to that in effect in Great Britain.

ATMI is opposed to the provision requiring employees to include in income for tax purposes, the premiums paid by their employer with respect to group term life insurance furnished to the employee to the extent the insurance coverage exceeds $30,000.

Such a proposal will make broad based group insurance plans less attractive, not only to employees, but to their employers as well.

We are particularly concerned about the costs of administering the proposal, and fear that such costs may well equal or even exceed the taxes likely to be collected.

In this regard, it should be noted that the Treasury itself estimates that the group term insurance proposal will pick up only $5 million of revenue annually.

ATMI favors restricting the sick pay exclusion as provided in the bill to employees who are out of work for more than 30 days. We feel that the present law put undue emphasis upon the requirement of hospitalization and also tends to make it more profitable for a worker to be sick than on the job. The longer waiting period should solve these problems and yet still provide adequately for the true hardship case.

The textile industry favors the employee moving expense proposal included in the bill. However, the provisions are limited to new employees, and those not reimbursed for their move.

We would strongly urge that the committee give consideration to the problem of the old employee who is reimbursed for moving expense items in categories not covered in the bill.

The President's moving expense proposal, which is incorporated in the House bill, would treat as moving expenses only the bare bones cost of transporting an employee, his family, and his household and personal belongings to the new job locations.

As you are aware, a move dictated by the necessities of business frequently involves a much more drastic expenditure than simply the cost of moving an individual, his family, and his goods.

Such items as "Forced sale losses on the disposal of the employee's old home," "Selling commissions connected with the sale," "Living expenses at the new location while seeking a new home"—all are directly attributable to the move. Under the House-passed bill, items of this sort are left in a state of confusion, with old employees who are reimbused facing the unhappy prospect of prolonged litigation as to the consequences of such reimbursed items.

In order to stimulate the mobility of the labor force, and to make employees whole without adverse tax consequences, we would recommend that the definition of moving expenses in the bill be liberalized to include items of the type suggested above.

We would like to register our opposition to the revisions in the House bill relating to employee stock options and purchase plans. We feel some changes may be needed to correct certain existing abuses, but the proposed changes go entirely too far. It is highly desirable that a reasonable degree of flexibility be left in this area so as to meet the needs of corporations in acquiring and retaining topflight executives.

We support the proposal to include only 40 percent of long-term capital gains realized on certain capital assets held for more than 2 years. We believe that this change will encourage taxpayers to turn over their capital assets and thus provide a freer flow of investment funds.

We also support the proposal for an indefinite carryover of capital losses incurred by an individual.

Our experience has shown that individuals in the past frequently have been forced to forfeit tax reductions from such losses because of their inability to offset the losses against capital gains within the 5-year period now specified in the code.

We support the proposal to tax gains from the sale of real estate in certain cases as ordinary income to the extent of depreciation taken in excess of that allowable under the straightline method.

We feel that this is a reasonable compromise of a difficult problem area. We are particularly gratified to note that a building held as long as 10 years will not be subject to the recapture rules.

If the depreciation recapture provision for real estate is enacted, consideration should be given to making buildings and their structural components eligible for the investment credit.

In this regard, let me say that, whatever the reasons may have been for excluding buildings and structural components, this decision has given rise to a whole host of definitional problems that may take years of litigation to resolve.

Consequently, we believe that the Congress should consider eliminating the troublesome line-drawing problem, which exists under the present statute, by extending the credit to investment in buildings and their structural components.

ATMI supports the proposal for the averaging of fluctuating incomes as a step in the right direction. However, we believe that the present relief provisions of sections 1301–1307 also should be retained in the law in order to prevent serious inequities from arising.

We support the casualty loss proposal in the bill. It closely corresponds to the recommendation which we made in this area before the House Ways and Means Committee.

We support the changes involving charitable contributions. In particular, we are gratified to see the extension to 5 years of the present 2-year carryover period for excess charitable contributions.

However, we would recommend that the effective date of this proposal be changed as to apply to gifts made in taxable years beginning after December 31, 1961.

In other words, the carryover period should be extended in the case of any gift where the existing 2-year carryover period has not yet

expired. Such a change would bring the effective date in this area into line with that provided in the bill for unlimited loss carryovers in the case of capital losses.

In addition to our comments on the specific provisions of H.R. 8363, we would like the committee to know of our strong support for the Senate bill 2068, which is the Long amendment to section 274 relating to travel and entertainment expenses deductions. This amendment will go a long way toward relieving the harshness and uncertainty found in section 274 as it is presently worded.

In conclusion, I would like to reemphasize the importance which the textile industry places on rate reduction applied in such a way as to stimulate consumption and investment.

As noted earlier, we believe that rate reduction should be accompanied by a reduction in Government spending or at the very least by a holding of the line on further increases.

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

Senator Douglas?

Senator DOUGLAS. I have no questions.

The CHAIRMAN. Senator Bennett?

Senator BENNETT. If none of your amendments are adopted, would you suggest that the committee approve or reject the House bill?

Mr. NEWTON. Frankly, Senator, we would like to see some of our suggestions adopted.

Senator BENNETT. I am sure you would, and so would I, but suppose none of them are adopted?

Mr. NEWTON. If we were forced to make a decision on a yes or no basis, I think we would prefer the tax bill.

Senator BENNETT. You prefer the tax bill without the amendments?

Mr. NEWTON. We would prefer it with the amendments but if we couldn't get it with the amendments we would prefer to have it without the amendments rather than not to have it at all.

Senator BENNETT. Thank you.

The CHAIRMAN. Senator Talmadge?

Senator TALMADGE. Mr. Newton, I want to congratulate you on your statement. It is completely germane, forthright, brief, and I think you have made a very fine statement, and rendered a service to the group you represent here today.

Thank you very much. I have no questions.

The CHAIRMAN. Senator Dirksen?

Senator DIRKSEN. I have no questions.

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

Mr. NEWTON. Thank you, sir.

The CHAIRMAN. The next witness is Mr. Charles W. Stewart, of the Machinery & Allied Products Institute.

Mr. Stewart, take a seat, sir, and proceed.

STATEMENT OF CHARLES W. STEWART, PRESIDENT, MACHINERY & ALLIED PRODUCTS INSTITUTE

Mr. STEWART. Mr. Chairman and distinguished members of the committee, I am joined at the witness table by our legal associate and staff counsel, William Healy, and George Terborgh, MAPI research director.

I should like to ask, if the committee pleases, that the full text of our statement including the appendix be placed in the record and I shall attempt to hit some high spots without reading the entire document.

The CHAIRMAN. Without objection.

Mr. STEWART. In brief, our position on H.R. 8363 is as follows: Tax reduction, and indeed, restructuring of the U.S. tax system, are both urgent business.

We favor the tax cut proposed by H.R. 8363 although we feel the overall bill can and should be greatly improved. It is our judgment, however, that any decision to cut taxes must be accompanied by a firm congressional determination to limit future Federal spending and, further, must include some means to carry out that determination.

Our statement develops this position in some detail, and offers specific and, we trust, constructive suggestions for modification of the bill.

I should like to turn now to a few points which in our judgment deserve underlining.

First, a few background observations.

We have been somewhat concerned about certain portions of the argumentation being made directly or indirectly in connection with this bill. It has been suggested, for example, by the administration that this bill represents and reflects adoption of the economic tool of tax reduction to stimulate the economy as a preferred mechanism over increased spending.

The corollary that is at least implied and has been perhaps more directly suggested is that if a tax reduction bill is not enacted promptly then we will be compelled as a goverment to resort to greatly increased spending for antirecession or countercyclical purposes.

A current editorial in the press refers to this as the device or the reasoning of "false alternatives," perhaps inappropriate alternatives would be a better description.

I have never been enamored of labels but I must confess I don't like this argumentative device and I don't believe the technique is good public policy or sound government.

I should like to suggest further that the argumentative technique has been employed before in this area of tax policy.

For example, I can recall that when the administration first proposed radical surgery with regard to taxation of foreign earnings it was then suggested if the patient did not accept this surgery the only alternative would be the more extreme device of direct foreign investment controls.

Another illustration: The Secretary of the Treasury recently has testified with regard to another bill, H.R. 8000, the proposed Interest Equalization Tax Act of 1963, to the effect that unless this measure is adopted more direct investment controls must be employed.

It is my feeling that this type of argumentation or persuasion does not go to the merits of the particular proposal that is being offered. In one case that I have referred to the real question is whether the change in the taxation of foreign earnings is sound tax, economic, and commercial policy for the United States to embrace.

In the other case the question is whether or not the national interest will be served and whether the announced objectives will be accom-

plished by the enactment of the proposed Interest Equalization Tax Act of 1963.

The current question before this committee, as we see it, is whether a tax reduction in all of its aspects is a sound move for the United States to undertake at this time.

We think it is. But we feel it should and must be accompanied by expenditure control. But our judgment on the merits is not influenced and in our view should not be influenced by the suggestion that if we do not accommodate ourselves to the thinking on tax reduction in the current economic framework that has been offered in support of this bill then the only alternative for the Government to consider is increased deficit spending.

In brief, we feel that tax reduction is urgent, irrespective of any current countercyclical objective. Our tax system and high rates almost seem to have been contrived to blunt incentive.

In the corporate rate area, for example, the high rates, as Mr. Terborgh has demonstrated on a number of occasions, hold what we call an umbrella over obsolete equipment.

If you will turn to our statement without my taking the time to read it in detail, you will note an extensive quotation from a pamphlet which we published in 1959 entitled "The Effect of the Corporate Income Tax on Investment," and there the peculiarly deadly effect of high corporate rates on investment decisions is illustrated and spelled out.

May I say another word about urgency of tax reduction. We are now experiencing, apropos the area that Senator Douglas referred to earlier, a leveling off of defense expenditures and as I read Secretary McNamara's forecast for the next 5 years, even if the moon program is carried forward, it would appear that at worst there will be a leveling off and at best some reduction in defense expenditures.

Some consideration has been given in high policy circles to the possible impact of some form of limited disarmament. Some consideration is now being given very directly on related points as indicated by Under Secretary of Defense Gilpatric's recent important policy presentation.

We need to think now, I believe, as a government, as industry, and as labor, in terms of what needs to be done to cushion the economic effect of a leveling off or reduction in defense expenditures.

Now, it is our judgment that tax reduction is a major tool for this purpose and should be brought to bear now for this reason, among others.

We don't need another Government bureau for the purpose of planning in this area, but we do need to remove the roadblocks to industrial flexibility in tax and other areas, so that business may carry without subsidy the major load of adjustment to any economic impact which may flow from reduced expenditures for defense.

This brings me to another part of the perspective or framework relative to consideration of this bill.

We have made it clear in our statement in detail that we favor combining expenditure control with current tax reduction. Moreover, we not only espouse this view in generalized terms but we encourage implementation of it by the strengthening of section 1 of the bill, if at all possible.

The economic issue as to whether or not tax reduction, assuming it is sound, should be accompanied by expenditure restraint or reduction, in our view, is a fundamental economic question.

We should not run away from the issue as a Congress or as a country: We should face up to it as individuals in our own personal lives. We should not "sweep it under the rug," giving lipservice to certain expressions of restraint but without accepting the discipline of some means, soundly conceived, of implementing that expression.

Moving from that proposition to the more direct comments that we make in our detailed statement on expenditure control, you will note that our suggestions run from page 2 to 11. I am not going to try to cover it in complete fashion, but merely suggest that we point out, first, that in our view the responsibility for effective expenditure control cannot be properly placed on either the Executive or the Congress alone.

It is a responsibility that must be shared.

Indeed, it is the responsibility of all of us as individual citizens, in terms of the views that we express to our Congressmen and our Senators, and the public positions which private institutions take on subjects such as the ones which have been addressed by questions this morning.

In terms of a specific means of implementing the generalized expressions of interest in expenditure control we have suggested a double-barreled approach.

As discussed in our statement we call attention to Chairman Byrd's suggestion with regard to unexpended balances of appropriations which amount to more than $87 billion as of the beginning of the fiscal year 1964 and those same departments and agencies requested new obligational authority of about $107.9 billion in the current fiscal year.

Mr. Byrd has suggested in another context that some of these balances could, and should be, rescinded.

We think this approach should be thoroughly explored.

Secondly, we suggest that section 1 of H.R. 8363 can be made more definitive. For example, the section might conceivably be strengthened by direction that future annual appropriations are not to exceed the sum appropriated in fiscal year 1963 until Federal revenues have equaled the amount collected in that fiscal year.

Now, we are aware of the extensive debate which took place in the House on the proposed amendment of Congressman Byrnes. We felt that there was merit to some of the criticisms of the particular mechanical device that was suggested to implement and make more definitive the broad statement contained in section 1.

We do feel, however, if I may say so, that it may be the responsibility of this committee, and of the Senate, to attempt to put some meat on the bones as far as section 1 is concerned, and through some means, by applying brains much more experienced than ours, to develop a formula, a technique, of making that section 1 talk with more firmness than in our view it does at the present time.

As a matter of fact, it would appear, if we read the President's statements, if we read the statement of Congressman Mills on the floor, if we read the House committee report, this bill reaches this committee with a commitment on the part of the House of Representatives that expenditure control shall accompany tax reduction.

The question is how to implement that commitment.

One further observation on expenditure control, which is not wholly germane to tax policy but one which I feel constrained as a citizen to make: I feel that there is another reason for urging further exercise of expenditure control.

With constantly increasing Government expenditures it has always been my feeling that we have increased Government control and intervention and I think we need to turn our minds on this subject to the question of whether or not private rights and individual freedom are being encroached upon.

As previously indicated we support tax reduction at this time with coincident expenditure control. We do feel, however, that it is important to be a little cautious about economic forecasts based on the rate reductions which have been offered in the current bill.

Particularly is this the case with regard to the corporate rate reduction schedule.

The committee will recall, of course, that the tax bill in its present form involves a two-staged, four-point corporate rate reduction, accompanied by acceleration of corporate tax payments.

As indicated in the Treasury's own tables and as spelled out in our statement, analysis shows that in terms of cash flow for 7 years after enactment of this bill there will be no benefit to corporations earning in excess of $100,000 of income annually. Beyond the restriction that this places on the economic potency of the tax cut under consideration, there are certain technical deficiencies in the acceleration schedule which we discuss beginning at page 15 of our statement.

I should make it clear, however, that we do not oppose acceleration in principle. We think that in principle acceleration is appropriate. It is a question of how to bring it about without blunting the stimulative and healthy effect of a tax reduction, and without engaging some of the technical difficulties that are discussed in detail in our statement.

Further, as the committee has observed, in rationalizing the tax package, the administration lumps the proposed four-point reduction in the corporate rate with benefits previously addressed to the corporate sector through the investment credit provisions of the 1962 Revenue Act and the advantages flowing from the new depreciation guidelines. First I should like to make it clear we supported the investment credit in the first instance. Also, we have had the privilege of attempting to be of assistance to the Treasury Department and Internal Revenue Service on the depreciation guidelines and we commend Government for the proposal and finalization of both of these efforts toward strengthening capital investment in the United States.

However, if the reasoning of the administration in lumping the tax cut with these other two changes, of which the corporate sector is the beneficiary, is carried to its logical extension, if there are major deficiencies existent with regard to the investment credit and/or the depreciation guidelines, then those deficiencies should be dealt with and corrected promptly.

Now, the bill before the committee undertakes to deal with a central deficiency in the case of the investment credit, namely, the reduction in basis amendment. It also broadens "eligible property" to include elevators and escalators and we suggest further there might be broadening to cover central air-conditioning equipment as eligible property.

Indeed, the prior witness suggested a cleaner answer which would make realty and structures and components thereof eligible for the credit.

No proposal, however, is contained in this bill as to the depreciation guidelines and we would like to suggest, as did the previous witness, that the guideline lives as promulgated by the Treasury Department in their Treasury regulation, be offered taxpayers as a matter of right without resort to the so-called reserve ratio test.

The Institute has dealt with his so-called reserve radio test in more detail in a critique identified in our statement prepared by Mr. Terborgh. It is available to the staff of the committee if it would like to have the study.

At this juncture I would like to enter what I consider to be a terribly important suggestion which needs to be weighed in action on this bill. There is, with the exception of the question of expenditure control that has been dealt with directly and I think appropriately so by questions this morning, extraordinary agreement among Government, business, labor, and the general public that tax reduction is necessary in the national interest.

As part of this concurrence of view there has developed, at least in the business community, a certain tone of expectation, and this expectation has come to accept, at least for purposes of business planning, not only a tax cut of some magnitude but also a tax cut that would be effective January 1, 1964.

The January 1 date is built into the bill which is before this committee particularly when related to the psychological aspect of business planning, including business planning for capital expenditures.

In this connection, therefore, a particular effective date takes on great importance, and we should like to suggest that in view of the heavy element of psychology, the heavy element of the need for business planning on a long-range basis, particularly when you are talking about the subject of capital formation, that the importance of a particular date is even more to be underlined.

This is not to suggest, however, that we recommend that this committee not give all of the portions of this bill the great care and scrutiny which they deserve.

There is brief coverage on page 11 of our statement of a subject which we call contingency tax planning.

Two points are made, which can be restated briefly, because I think they deserve reemphasis to the Committee. We feel that the bill is meritorious in terms of direction of tax reduction, even though, as in the case of the corporate rate cut, it barely scratches the surface for a 7-year period as we have indicated—that is, in light of the accompanying acceleration of tax payments.

The bill does not undertake, therefore, the complex job which really faces this country in the long run, namely restructuring of our tax system.

We feel this task is urgent and that task should be underlined and recognized by the committee.

Second, in a limited degree the bill does, however, deal with some discriminatory matters including extreme rates on high bracket personal income. This is restructuring to a degree.

I think it would be a salutary action on the part of the committee, assuming it reports out a bill, to report its view that to the extent this

bill moves a small way in the direction of restructuring and reform, that in the event we should confront in the near future, either because of an emergency or because of a failure of certain economic forecasts to jell, a need for additional revenue, that we should then turn to the broader job of attempting to find new sources rather than merely tacking on where we have taken off.

I should like to close with a brief comment or two about the importance of the investment credit, and the importance of the proposed amendment to the investment credit which is contained in this bill.

Our testimony underlines what we consider to be the very important stimulating and dynamic effects which the investment credit provisions of the Revenue Act of 1962 have brought about. We feel that it is important to recognize that, in the area of plant and equipment decisionmaking, the investment credit is a very skilled tool which moves directly on target and does not fan out completely across the tax system.

We think that in many instances, both marginal projects and projects which are considerably below what normally would be the signal to spend in the corporate sector, decisions have been moved into the capital spending area as a result of the enactment by the Congress, with this committee's approval, of the investment credit.

We bring to you in terms of an organization which specializes in capital investment and represents the capital goods industries of the country, a complete concurrence with the strong affirmations by the administration with regard to the benefits that have flowed from the investment credit.

At the same time, it is appropriate to say that by removal of the reduction-in-basis amendment, those benefits can be further enhanced and we strongly endorse that provision of the bill.

In brief, gentlemen, and in conclusion, we do feel that to make tax reduction economically successful in our economy and economically effective, we do need accompanying expenditure control.

We feel that the responsibility for achieving that is a joint one between the Congress and the executive department, and we would hope that something more definitive and specific can be worked out in section 1 of the bill.

We have suggested, throughout our statement, a number of points on which we think the bill can be improved. I would be obliged to say, however, as I listened to Senator Douglas on radio or television the other night, that in our judgment, with the exception of this one critical factor of expenditure control, there is a good deal more good in the bill than there is bad.

It has been a pleasure to be before the committee, sir.

(The prepared statement of Mr. Stewart follows:)

STATEMENT OF THE MACHINERY & ALLIED PRODUCTS INSTITUTE PRESENTED BY CHARLES W. STEWART, PRESIDENT

Mr. Chairman and gentlemen, the Machinery & Allied Products Institute appreciates the opportunity to offer testimony on the proposed Revenue Act of 1963, H.R. 8363. In the course of our testimony we wish to comment on a number of the bill's specific provisions, including some proposals for amendment, but before proceeding to such comments we think it necessary first to consider the principal question of whether or not a tax cut should be enacted by the Congress.

We favor the tax cut proposed by H.R. 8363 although we feel that the overall

bill can and should be greatly improved. We agree with the administration that tax reduction is urgent. Above all, we favor the clear commitment of the House of Representatives—as expressed in floor debate by Chairman Mills of the Ways and Means Committee—to the tax reduction road rather than the public spending road as the route to increased economic growth and fiscal responsibility.

The very substantial tax cut here under consideration should provide, through personal income tax reductions, a considerable short-term stimulant to economic activity. More importantly, the reductions proposed in corporate taxes will provide a long-term benefit to the economy, although that benefit will be largely deferred for reasons developed later in this statement. By improving the prospect of profitability the corporate rate reduction should induce job-creating capital investment and improve the international competitive position of the United States. The advantages of corporate rate reduction are more fully discussed at a later point in this statement.

We are convinced that any decision to cut taxes must be accompanied by a firm congressional determination to limit future Federal spending, and further, must include some efficient means to carry out that determination. Before proceeding to our discussion of the details of the bill, we think the necessity for coupling the proposed tax cut with effective expenditure control is of such importance as to justify a brief discussion of our position on this point.

Expenditure control

Insofar as this tax bill accepts the proposition that stimulation of the economy can best be accomplished through private rather than public spending, we applaud its underlying philosophy. It seems obvious that the position of the administration in this regard has undergone a significant shift in the course of consideration of this proposal by the House Ways and Means Committee. Originally, it appeared to us that the administration's proposal for a tax cut rested ultimately upon the conviction that the road to prosperity lay along a path of continuing deficits. We objected—and we continue to object—to this philosophy. Indeed, our analysis of what seemed to us the central economic theory of the original proposal was expounded in the institute study, "Fiscal Policy and Economic Expansion: A Critique of the Economics of the Administration's 1963–65 Tax Program." A copy of that study is attached as a part of this statement.

However, as finally adopted by the House of Representatives, H.R. 8363 expressly rejects the theory of increasing our prosperity by continually enlarging our debts in the statutory declaration that—

"It is the sense of Congress that the tax reduction provided by this act through stimulation of the economy will, after a brief transitional period, raise (rather than lower) revenues and that such revenue increases should first be used to eliminate the deficits in the administrative budgets and then to reduce the public debt. To further the objective of obtaining balanced budgets in the near future, Congress by this action, recognizes the importance of taking all reasonable means to restrain Government spending and urges the President to declare his accord with this objective."

Moreover, the President, at the time of the Ways and Means Committee's approval of H.R. 8363, said in a letter of August 19, 1963, to Chairman Mills: "* * * tax reduction must * * * be accompanied by the exercise of an even tighter rein on Federal expenditures, limiting outlays to only those expenditures which meet strict criteria of national need."

On September 16, Chairman Mills released a statement explaining the intent and purpose of section 1 of H.R. 8363. Among other things, Congressman Mills said:

"Section 1 of the bill is a firm, positive assertion of the preference of the United States for the tax reduction road to a bigger, more progressive economy. When we, as a nation, choose this road we are at the same time rejecting the other road, and we want it understood that we do not intend to try to go along both roads at the same time.

"The further meaning of section 1 of the bill is that no Government activity is to depend for its justification on the amount it contributes to the total spending of the economy, because we prefer to reduce taxes and allow individuals and business concerns in their own rights to make that contribution. On the contrary, any and all activities of the Government have to be justified on their importance in serving other essential goals of the Nation. There is no further justification for an indifferent attitude toward wasteful, inefficient Government activities, merely because they incidentally give employment—tax reduction

will also create job opportunities and in lines of activity which better satisfy the character and demands of the people for an enriched life.

We accept at face value these statements of the President and the Congress and we endorse unqualifiedly their recognition of the necessity for expenditure restraint during the transitional period of high budgetary deficits induced by the proposed tax cut. Given such restraint we favor the tax cut because we think the President is right in declaring as he did in his tax message to the Congress of January 24, 1963:

"The most urgent task facing our Nation at home today is to end the tragic waste of unemployment and unused resources to step up the growth and vigor of our national economy; to increase job and investment opportunities; to improve our productivity; and thereby to strengthen our Nation's ability to meet its worldwide commitments for the defense and growth of freedom. The revision of our Federal tax system on an equitable basis is crucial to the achievement of these goals."

Nevertheless, as we consider the startling increase in Federal expenditures over the past decade and the plethora of new and expensive programs which have been proposed to the Congress, we have grave doubts as to whether or not these good intentions can be realized in the absence of a more exacting standard of governmental self-restraint than we have seen in the past.

It seems to us that our national decision to cut taxes must be considered in the light of three factors: the influence on policy and program of a widely accepted economic theory; our past record of fiscal restraint; and the prospective costs resulting from enactment of our backlog of unfinished legislative business.

The "prosperity through deficits" theory.—First, we call the attention of the committee to a most interesting letter written by Seymour E. Harris, Littauer professor of political economy, Harvard University, to the editor of Washington Post & Times Herald and which appeared in that newspaper on October 9. Among other things, Professor Harris asserts "The economics surely point to a larger tax cut and to a greater rise in spending."[1]

We do not agree at all with Professor Harris's philosophy but, unquestionably, he has given expression to a point of view that is now accepted by many economists, some of whom no doubt are not without influence in administration circles. We call attention to this theory only to emphasize that the economic rationalization of H.R. 8363, as interpreted and expounded by the House of Representatives and the President, expressly rejects this doctrine. Such rejection is, we think, indispensable to genuine expenditure control.

The trend of Government spending.—Second, we have only to examine the growth of Government spending over the past few years in order to emphasize the difficulty of restraining our national inclination to spend now and pay later. The record appears as follows:

Administrative budget expenditures by function, 1954–64[1]

[In billions of dollars]

Year	Amount	Year	Amount	Year	Amount
1954	67.5	1958	71.4	1962	87.8
1955	64.4	1959	80.3	1963	92.6
1956	66.2	1960	76.5	1964 (estimate)	[2] 98.8
1957	68.9	1961	81.5		

[1] The Budget of the U.S. Government, for the fiscal year ending June 30, 1963, p. 42, and the Bureau of the Budget. (These figures do not, of course, include the very considerable collections into, and disbursements from, Government trust fund accounts.)

[2] The Bureau of the Budget now estimates $97.8 billion. See testimony of Mr. Kermit Gordon, Director, Bureau of the Budget, in these hearings.

Thus, in 11 years Federal administrative budget expenditures have increased by some 46 percent or an average of $2.8 billion annually.

In the last 3 fiscal years the average increase has been $5.7 billion annually—the actual increases were $6.3 billion in fiscal year 1962, $4.8 billion in 1963, and, upon the basis of original budget estimates, $6.2 billion for fiscal year 1964. If increases were to continue at the rate established in the past 3 years, our administrative budget for fiscal year 1965 would amount to $104.5 billion, for 1966 $110.2 billion, and for fiscal year 1967 $115.9 billion.

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[1] Testimony to the same effect has been offered in these hearings by Mr. Leon H. Keyserling, former Chairman of the Council of Economic Advisers, and by Mr. Edward D. Hollander, chairman of the executive committee, Americans for Democratic Action.

This projection of current increases in Federal spending becomes especially significant when we consider the present growth trend of our economy and the increases in Federal revenue that may reasonably be expected at the proposed rates. Our present secular growth trend is approximately 5 percent annually, representing in absolute terms an increase of about $30 billion per year. At tax rates proposed in H.R. 8363, this increase in gross national product would yield some $5 billion to $6 billion in additional revenues or an amount barely sufficient to cover those increases in Federal expenditures which we have projected above. Meanwhile, the existing deficit in our budget—as enlarged by the tax cut here proposed—would presumably remain as a gap between income and outgo. Moreover, the theory that revenues will shortly increase as a result of the tax cut necessarily assumes reasonable luck in our economic future. Any serious turndown in the economy would be likely to enlarge the total deficit still more, since it would reduce substantially the yield of tax revenues and at the same time probably call forth countercyclical Government spending.

Proposed new spending programs.—We have still to consider the potentialities of spending programs already proposed. A most illuminating colloquy occurred in the course of these hearings between Senator Williams and Secretary Dillon on the subject of Mr. Blatnik's proposal for an increase of $900 million in our current spending on public works (H.R. 7351). The fact that this proposal was advanced by a Member of the Congress rather than the administration underlines the duality of responsibility for restraints on Federal spending.

As for those new programs "sponsored and supported by the Kennedy administration in this year of 1963" they amount to "at least $7,441,570,000," according to Congressman Brown of Ohio in his statement at the outset of House debate on the tax bill (see p. 16980 and following, Congressional Record for Sept. 24). Congressman Brown's astonishing total of over $7.4 billion, "in addition to or above the total of other costs of operating the Federal Government," includes the cost of carrying certain of the programs noted above into the future. A lesser beginning figure but even more startling long-term total is given in the observations of Congressman Smith of Virginia during the debate (see pp. 17132–17133, Congressional Record for Sept. 25). According to Congressman Smith, major new Federal expenditure programs proposed by the executive department for inception in the current fiscal year call for 1964 appropriation requests of slightly more than $3 billion, but would require over the next 5 years more than $17 billion in total appropriations. Recognizing the difficulty of achieving precision in "costing out" continuing legislative programs, the remarks of Congressman Brown and Congressman Smith remind us that these proposals, individually and collectively, represent in the aggregate an immense upward force against any lid that may be imposed upon spending.

Considered against this background it seems fair to ask if something more than a recital of good intentions is necessary for effective control of Federal expenditures.

We think something more is needed.

Effective expenditure control.—Obviously, the responsibility for expenditure control is shared equally by the President and the Congress. In a larger sense the responsibility rests with all of us.

The level of Government expenditures is only partially—and indirectly—under congressional control. Control of the appropriation of public funds is wholly and directly under its control. If the Congress agrees that some device more efficient than pious hope is essential for the control of Federal expenditures, then we suggest that it consider a double-barreled approach to such control.

First of all, the executive department and agencies of Government possessed unexpended balances of appropriations amounting to more than $87 billion as of the beginning of the fiscal year 1964, and those same departments and agencies requested new obligational authority of $107.9 billion in the current fiscal year.[2] Within this total of unexpended balances there is an item of $21.3 billion for foreign aid and $30.8 billion for the military functions of the Department of Defense.[3] The distinguished chairman of this committee, who is also chairman of the Joint Committee on Reduction of Non-Essential Federal Expenditures, has said, "Some of these balances could and should be rescinded. The firmness of obligations shown against many of them cannot be taken for

[2] Statement by Senator Harry F. Byrd, Democrat, of Virginia, Friday, Mar. 29, 1963.
[3] Ibid.

granted. This is particularly true in accounts like those for foreign aid funds appropriated to the President." Obviously, so long as the sum of appropriated but unexpended funds represents such a formidable total, direct control of the expenditure level by the Congress becomes difficult if not impossible.

In the process of appropriating public funds, however, the Congress possesses direct control. Although a step in that direction has already been taken in the form of section 1 in H.R. 8363, we think more should and must be done if Congress is to carry out its full responsibility in this regard. We do not favor the so-called Byrnes amendment which some feel would have constituted an abdication of legislative responsibility by transferring to the President sole authority and responsibility with respect both to spending limitations and the tax cut itself, and would have rendered the proposed tax cut wholly uncertain at either of the scheduled stages. Nevertheless, we agree with the point of view which gave rise to this proposal. Further, it does seem to us that the declaration of the sense of Congress, now appearing as section 1 of H.R. 8363, might be substantially strengthened by an assertion of intent that future annual appropriations are not to exceed the sum appropriated in fiscal year 1963 until Federal revenues have equaled the amount collected in that fiscal year. This is obviously no more than a suggestion and we have no doubt that legislative draftsmen in the Congress can devise some suitable formula. Above all, we believe that any such declaration of the sense of Congress must be particularized—it must be tied to some fixed standard such as that suggested above.

Contingency tax planning

It may be that an international emergency will arise or that the planned economic impact of the tax cut proposal will not be fully realized. If, in spite of some increases in revenue and strict control of governmental expenditures, Federal income is still not sufficient in taxes to meet the needs of our Government, future increases in revenue may be needed. In that eventuality it seems to us that Congress might properly consider at least a partial restructuring of our tax system by resort to new revenue sources and with a corresponding reduction in our overwhelming reliance on the income tax. We are convinced that the question of restructuring must be considered at some time in the future; the possibility to which we call attention here suggests that it might be given some advance consideration.

Moreover, to the extent that the present bill attempts to reduce the discrimination against high bracket personal income and to lessen the reliance for revenue on the corporate income tax, there is an element of restructuring in H.R. 8363. We would urge that the Congress consider an appropriate expression of its wish that, if new tax revenues must be sought in the future, the tax rate reforms here accomplished not be nullified by automatic reenactment of the present rate structure.

The corporate tax rate

The Ways and Means Committee's report on H.R. 8363 emphasizes the significance of corporate rate reduction as an incentive for business investment. We certainly endorse corporate rate reduction. As a matter of fact, we think it should be lowered to at least 47 percent, the figure originally suggested by the President. The proposal for acceleration of corporate payments makes it impossible for the full impact of the rate reduction to be felt by many companies for some years in the future.

Since the pertinent provisions of H.R. 8363 would defer the full effect of a tax reduction—in terms of cash flow—for corporations with a taxable income of $100,000 or more until 1971, we suggest a further corporate rate reduction to at least 47 percent is particularly important under the circumstances. Since the whole purpose of the tax cut is to stimulate the economy, this would have the advantage of conferring at least a small immediate benefit on corporations during the long transitional period which would otherwise elapse before they can realize any cash flow benefit from the proposed tax cut. An elaboration of the cash flow problems created by the acceleration proposal appear below.

It seems to us important to reemphasize the advantages to the economy of a corporate rate reduction. Unlike tax relief for consumers, which increases their disposable income without affecting the appeal of the object of expenditure, a reduction of the corporate rate has a dual effect: it increases the supply of funds and at the same time enhances the attractiveness of investment projects available for their use. By lowering the investment threshold, it enlarges the volume of eligible projects.

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This point is discussed in an institute publication, "Effect of the Corporate Income Tax on Investment" (March 1959), from which we should like to quote briefly:

"The process of capital investment may be described as the incurment of capital charges in order to obtain an operating advantage, that is to say, a favorable change in the relation of revenue to operating costs. The corporate income tax falls on the earnings of equity investment. This means that to justify such investment a project must promise to yield a pretax return that will leave an attractive aftertax return when the tax is paid. Stated otherwise, it must promise not only an attractive aftertax return but the tax as well.

"The present corporate levy of 52 percent on taxable income is equivalent to a rate of 108 percent on the aftertax return required to justify investment. If that return is 10 percent; for example, the tax is 10.8 percent of investment, the combined rate being therefore 20.8 percent. What the tax does, in effect, is to raise the required pretax return to this rate. This alters the 'terms of trade' between capital charges and operating advantage to the detriment of the former.

"The increase in the required pretax return automatically excludes a whole range of investment projects that would be eligible in the absence of the tax, or at a lower tax rate. It limits eligibility, in other words, to projects of great urgency. The result is the deferment of both new business ventures and investment in the improvement of existing operations until their expected pretax return rises to the higher requirement.

"The main effect of such a high corporate investment threshold is to hold an umbrella over existing productive facilities. For it defers the introduction of new capacity competitive therewith. Old facilities must become more decrepit and inefficient before they are replaceable. Their service lives are extended. The economy drags along in consequence with a productive mechanism of higher average age, and with more accumulated deterioration and obsolescence, than would obtain in the absence of the tax."

Distribution of personal income tax reductions.—Before proceeding to a consideration of certain of the specific provisions of H.R. 8363, we think it not amiss to comment briefly on the distribution of personal income tax cuts proposed in this bill. Although not quite so bad as the President's original proposal, the House bill still provides by far the greater share of tax relief to lower income taxpayers. The result is to increase—indirectly— the steep progressivity of the existing personal income tax structure. For example, it has been calculated as confirmed by the report of the Ways and Means Committee that under H.R. 8363 taxpayers in the $50,000-per-year-and-up-bracket will receive less than one-third of the relative tax relief afforded taxpayers in the lowest bracket.

Since this action cannot be justified in terms of the revenue produced from the taxation of upper bracket incomes, it must presumably be rationalized on other grounds of public policy. One may infer that the further distortions in the personal income tax structure envisioned by this proposal rest finally upon some hazy moral base. Without attempting to argue this rationalization, it clearly is bad economics to enlarge the existing discrimination against the most productive and energetic members of society. We urge therefore that the distribution of personal income tax reductions be restudied and we do not believe that corrective action should involve unacceptable legislative delays.

COMMENTS ON SPECIFIC PROVISIONS OF H.R. 8363

Having considered the general thrust of this proposal we turn now to specific comments on those provisions of the bill of particular interest to capital goods and allied industrial equipment producers.

Acceleration of corporate tax payments (*sec. 122*)

The bill would amend sections 6074 and 6154 of the Internal Revenue Code to change the currently prescribed schedule for payment of income tax by corporations. At the present time, corporate tax liability in excess of $100,000 for calendar year corporations must be paid in accordance with the following schedule:

(1) 25 percent by September 15;
(2) 25 by December 15;
(2) 25 percent by December 15;
(3) 25 percent by March 15 of the following year; and
(4) the remaining 25 percent by June 15 of the following year.

Similar requirements are imposed for non-calendar-year corporations.

Under the bill as passed by the House this schedule would be changed gradually over a period of 7 years to a system under which for calendar year corporations, the first installment of 25 percent would be due on April 15 of the current taxable year, and the remaining installments would be due on June 15, September 15, and December 15 of that year.

This provision entails a number of problems. For one thing, it will drastically delay the full investment incentive impact of the scheduled rate reduction to 48 percent for the average corporation. That this is the case is graphically shown in table 2 to exhibit 2 submitted to the Committee by Secretary Dillon in his appearance on October 15. This table illustrates that the taxpayments by a corporation will remain close to 52 percent of taxable income until 1071.

The proposed "acceleration" appears to be justified principally on the ground that if individuals must pay their income tax liability currently (through withholding and quarterly estimates), there is no reason for corporations not being compelled to do the same. It seems to us that this reasoning is incomplete. Most corporations have established their tax accounting on an accrual basis. Thus, they record income prior to its receipt. Consequently cash is not necessarily available to pay tax on income as that income is "earned." The problem thus presented is of great importance for smaller corporations whose cash flow position is such that they will be required to borrow funds to pay current tax liabilities. In many cases, because of the size of the corporation and the industry in which it is operating, borrowing may be possible only on the most unfavorable terms.

In capital goods industries which are particularly susceptible to severe cyclical swings in sales, it seems undesirable to require firm estimates of current income as early as April 15 of the taxable year. If Congress decides that some acceleration is necessary, it would seem desirable to require the first quarterly payment no earlier than June 15. Of even greater importance, it would be much better to delay the due date for the final quarterly payment to January 15 of the following year, thus avoiding the problems implicit in requiring the final quarterly payment prior to the yearend closing of corporate books.

We think it would be desirable to liberalize the present penalties which apply to underestimation of tax liability by corporations. For example, the 6-percent interest penalty should not apply if the estimate amounts to 60 percent of the actual tax liability shown on the final return. The current requirement of 70 percent in this regard seems too high. Finally, it would be helpful if the 6-percent interest penalty were accorded tax-deductible status. We are not suggesting that no penalty attach in cases of underestimation—rather, we think that the penalty provisions should be so drafted that they will not work a special hardship on those corporations whose underestimation is due largely to factors beyond their control.

Employee stock options (sec. 214)

Under section 421 of the Internal Revenue Code, no Federal income tax is imposed on what are termed "restricted" employee stock options until such time as the optioned stock is sold. If the option price was at least 95 percent of the market price of the stock at the time of grant, then the entire amount of gain on the sale of the stock is treated as a capital gain. Where the option price is between 85 and 95 percent of the market price, this difference is normally taxed as ordinary income at the time the stock is sold. Any additional gain is taxed at capital gains rates.

The administration originally proposed that the restricted stock option provisions of the code be repealed. The House rejected this recommendation, deciding instead that additional limitations be added to these provisions. Under the House bill, all stock options granted to any executives after June 11, 1963, must meet the following special requirements pertaining to what is termed "qualified stock options:"

1. The period during which the optioned stock must be held has been increased from 6 months to 3 years.
2. The maximum period during which the option may be outstanding has been reduced from 10 to 5 years.
3. Options must generally be issued at 100 percent of the market price rather than 85 percent.
4. In general, new options may not be exercised where old options previously issued remain unexercised.

5. The stock option plan must be approved by the stockholders within 12 months before or after the plan is adopted.

6. Stock options are not to be available to employees who hold more than 5 percent of the voting power or value of all classes of stock of the employer corporation or its parent or subsidiary.

In addition to these provisions concerning qualified stock options, restricted stock option treatment would be available for employee stock purchase plans providing that the plan does not discriminate among employees and that it has been approved by the stockholders.

As we stated to this committee during its 1961 hearings on Senator Gore's bill to repeal the "restricted" stock option provisions and to the Ways and Means Committee in its hearings on the current administration tax recommendations last spring, we are opposed to such proposals. We think that it has been clearly demonstrated during the hearings on this subject—and the Ways and Means Committee specifically so found—that stock options for key executives benefit the economy because they provide a specific incentive for such executives to acquire a proprietary interest in the corporation for which they work.

The great majority of business executives are not men of accumulated wealth. Although most would like to acquire a proprietary interest in the corporations which employ them, generally they lack the capital necessary to purchase more than a nominal amount of the corporation's stock. The problem therefore has been to provide these executives with a means by which they might acquire such a proprietary interest, and the restricted stock option has proven to be suited for this purpose. Moreover, there is testimony to the effect that the provision in the law has been particularly helpful to small companies.

We concede that some parts of the existing provisions may have been susceptible of abuse, and we concede that the Ways and Means Committee proposals generally appear well adapted to preclude the continuance of such abuses. The new limitations on pricing, on the exercise of new options when old options are still in existence, and the 3-year holding period requirement for optioned stock may well be desirable changes. The provision for stockholder approval, though it may be desirable, seems a matter more appropriately included in Federal statutes concerning securities regulations. Decreasing the maximum period of time in which an option may be exercised from 10 to 5 years is undesirable in our view. We think it unnecessary to preclude abuse situations, and that it may tend to induce corporate executives to "overstrain" themselves financially in some cases to take advantage of stock options. We urge that the present period of 10 years be retained.

Finally, we urge a change in the proposed effective date of June 11, 1963, for full application of the new restrictions. This date is significant, as we understand it, only because it is the date on which the House Ways and Means Committee took certain tentative action with regard to stock options during the period it was considering the administration's current tax recommendations. We suggest that the pertinent date on which any new restrictions might be put into effect should be the general effective date of most other sections of the bill—January 1, 1964. As a minimum, this effective date should be no earlier than the date on which the House approved the bill—September 25, 1963.

Amendments to the investment credit (sec. 202)

The Revenue Act of 1962 added a series of new provisions to the Internal Revenue Code which allow a credit against tax liability of 7 percent of the amount of investment in machinery and equipment. The credit may be used to offset tax liability in full up to $25,000 and up to one-quarter of tax liability in excess of this amount. The equipment must have an estimated useful life of at least 8 years to be eligible for the full credit, with a scaledown of two-thirds of the credit available for equipment having a useful life of at least 6 years and one-third for equipment having a useful life of at least 4 years.

The investment credit, together with the new depreciation guidelines, has already demonstrated its worth in the encouragement of new cost-cutting and job-creating capital investment. According to a study of the Department of Commerce[4] the combination of the investment credit and revised depreciation allowances has had the effect of reducing corporate taxation, and increasing corporate cash flow, by some $2.3 billion in 1962. It is also significant that quarterly plant and equipment expenditure studies of the U.S. Department of

[4] Survey of Current Business, July 1963, U.S. Department of Commerce.

Commerce-Securities and Exchange Commission reveal a strong upsurge in capital expenditures during the past year, rising from an estimated $36.4 billion at seasonally adjusted annual rates in the first half of 1962 to a seasonally adjusted annual rate of $40 billion in the third quarter of 1963, with an anticipated further increase to a seasonally adjusted annual rate of $41 billion in the fourth quarter of this year. It would, of course, be improper to ascribe all credit for this increase in capital expenditure to the benefits generated by the investment credit and the depreciation reform; nevertheless, the enhanced cash flow of $2.3 billion a year resulting from these two actions has obviously played a substantial role in encouraging and sustaining this trend. Moreover, it should be underlined that this is job-creating investment.

In proposing the tax cut now embodied in H.R. 8363, the administration has properly taken credit for its action in proposing the investment credit and in accomplishing the reform of depreciation through publication of the depreciation guidelines in July 1962 and urges they be considered in evaluating tax relief to corporations under the present bill. It is pointed out that two-thirds of the income taxes collected by the U.S. Government are paid by individuals and about one-third by corporations.[5] Consistent with this division of collections it is pointed out that corporate tax reductions proposed in the bill now before the committee plus the reductions already accomplished by the investment credit and the depreciation guidelines, will total about $4.5 billion as compared to the $9 billion reduction in individual income taxes which this bill would accomplish. Thus, preservation of the investment credit seems linked inextricably to the administration's proposal for an overall tax cut. If now, as reportedly proposed, the investment credit were to be repealed, then the structure of equity between individual and corporate taxpayers which has been advanced in the administration's rationalization of this proposal would be destroyed and, presumably, some compensating benefit in the form of a further corporate rate reduction would have to be considered. A dollar equivalence could be achieved only by a further—and immediate—rate reduction of at least three points. It is estimated that the investment credit will produce a tax saving of $1.2 billion in calendar year 1963. Given the present trend of capital expenditures it seems clear that the tax saving in calendar year 1964 cannot be less than $1.5 billion. Thus, in purely arithmetical terms a tax reduction of not less than three percentage points would be required to provide an equivalent tax saving.

In another sense, however, no real equivalence is possible in terms of the tax cut proposal's broader objectives of stimulating the economy, reducing unemployment, and enhancing the competitive position of the United States in world markets. Because the investment credit is concentrated upon the crucial area of capital investment, a dollar of tax saved by this route provides a much more substantial incentive to new investment than would a dollar of tax saved through the general rate reduction approach.

The basis-adjustment amendment.—Unfortunately, the investment credit provisions of the Revenue Act of 1962 were amended in the latter stages of legislative consideration to require that the depreciable basis of property be reduced by the amount of credit for which it is eligible. Before the adoption of the investment credit the institute published the pamphlet "Incentives to Capital Investment—Two Approaches Compared,[6]" in which we concluded that the 8-percent investment credit (the amount suggested by the Administration) was of such benefit as to require a 40-percent initial writeoff of depreciation to match the credit in overall terms.

After the investment credit had been adopted by the Congress with the basis reduction amendment added, the institute published the pamphlet "New Investment Incentives—The Investment Credit and the New Depreciation System,[7]" in which it reported on the benefits of the investment credit as finally enacted.

In addition to the reduction of the beneficial effect of the investment credit by more than one-third during the period of its existence, the reduction-in-basis amendment has created very serious problems of corporate accounting, in the ratemaking processes of regulated industries, and in the costing of defense contracts.

There is an additional special reason for repeal of the basis reduction amendment at this juncture. By now, as indicated in MAPI "Capital Goods Review

[5] Statement of the Secretary of the Treasury on H.R. 8363 before the Senate Finance Committee on Oct. 15, 1963, p. 14.
[6] Machinery and Allied Products Institute, November 1961.
[7] Machinery and Allied Products Institute, October 1962.

No. 54, Accelerated Depreciation—A Wasting Benefit," the benefits of the depreciation reform enacted in 1954—in terms of that reform's contribution to business investment funds—are now beginning to decline rapidly. Similarly, the new depreciation guidelines can be expected to yield declining relative benefits from here on out. The substantial addition to capital investment funds resulting from repeal of this amendment would do much to take up the slack.

The Ways and Means Committee acted favorably upon the recommendation for repeal of the basis-adjustment requirement and the House bill so provides. We of course completely support the action of the House in this regard. We only suggest that, in order to avoid certain technical problems, the repeal of the requirement be made completely retroactive; i.e., to property installations after December 31, 1961, the general date on which the investment credit was first available. As a minimum, it would be desirable to permit the repeal to take effect in taxable years beginning after January 1, 1963.

Broadening of credit eligibility.—The investment credit provisions of the code state that buildings and their structural components are not eligible for the credit. The reports of this committee and of the Ways and Means Committee indicate that the term "structural components" of a building is meant to include such items as central air-conditioning and heating systems, plumbing, and electrical wiring and lighting fixtures, relating to the operation and maintenance of the building. Proposed regulations on the investment credit issued by the Treasury include escalators and elevators within the term "structural components" and thus make such assets ineligible for the credit.

The House bill would change this rule with respect to new elevators and escalators installed after June 30, 1963, and modernization of existing elevators after that date. This action is taken on the ground that elevators and escalators "are closely akin to assets accessory to the operation of a business which presently are available for the investment credit"—such as machinery, printing presses, transportation or office equipment, refrigerators, individual air-conditioning units, etc.

We support this action by the Ways and Means Committee. However, we think that, for these same general reasons, credit eligibility should be extended to central air-conditioning equipment as well as individual air-conditioning units, at least when such equipment is used for industrial purposes.

Treatment of investment credit by Federal regulatory agencies.—We endorse the provision of the House bill which would state that it is the intent of Congress that the taxpayer not be required, in the case of "public utility property" or other situations subject to Federal regulatory agencies, to "flow through" the benefits of the credit to his customers. This seems to be an entirely sound position in the light of the purpose of the credit to provide an incentive for the modernization and growth of private industry. We earnestly suggest that this same principle be applied when the Federal Government is the customer in question, so that the Defense Department and the Renegotiation Board may not in effect require a "flow through" even though Congress decides to repeal the basis-adjustment requirement to the credit.

Employee group-term life insurance (sec. 203)

The administration originally proposed that the cost of employee group-term life insurance provided by employers be taxed as income to the employees, to the extent that such coverage exceeded $5,000. The institute and other witnesses before the House Ways and Means Committee opposed this provision on the ground that it would, among other things, discourage the continued use of insurance, greatly increase the complexity of employer-administration of such insurance, and work considerable hardship for older employees because of the sharp rise in premiums on such insurance in relation to age. The Ways and Means Committee modified the original proposal to provide an exclusion of $30,000. Thus, under the House bill, the cost of purchasing such insurance as exceeds $30,000 would be computed as income to the employee.

In our view, the House provision is clearly superior to the original Treasury recommendation. However, we must confess that we see no reason for this provision in the first place. The revenue consequences are comparatively negligible—the Ways and Means Committee reports that enactment of the provision will increase tax revenues by only $5 million a year. Moreover, the provision does not deal with what are really abuse situations—at least, the so-called "jumbo" insurance coverage to which Secretary Dillon referred. In our view, the Treasury should not be concerned about such insurance so long as there is

no differentiation among employees as to the amount of insurance coverage except that based upon level of earnings and length of service.

If, nevertheless, the Congress decides to adopt this type of provision, we suggest that there be an exclusion from taxability so long as the insurance benefits are based upon some reasonable multiple—for example, 2½ times—of an annual salary, with perhaps a maximum dollar limitation of $200,000.

The cost of such insurance increases not only as the coverage increases but also as the age of the insured increases. This means that there will be a considerable amount of paperwork connected with computing the annual cost, taxable to the employee, on any insurance coverage above the exclusion. Secondly, and of much greater importance, the fact that the premium costs rise rapidly as the employee reaches his middle and late forties will result in imposing a very substantial tax burden on older employees within a given company. It seems to us that this result is directly contradictory to what normally is the Government's policy of encouraging employers to provide greater financial security for their employees.

Finally, we think that the difficulty in administering the proposed requirement would be compounded by subjecting the payments to tax withholding.

Repeal of the dividend credit (sec. 201)

Under the existing provisions of the code, individuals are allowed to exclude from taxable income the first $50 of dividend income. In addition, with respect to dividend income in excess of that amount, a credit of 4 percent of that amount is allowed against tax. The President recommended repeal of both the $50 exclusion and the 4-percent credit in his 1963 tax message to Congress. However, the House bill modified the Presidential proposal—the credit would be reduced to 2 percent in 1964 and completely eliminated the following year, but the dividend exclusion would be increased to $100.

Although the House provision is, of course, preferable to the original Presidential recommendation in this area, we oppose, in principle, the elimination of the 4-percent dividend credit. One of the reasons for first providing the credit in 1954 was that it might tend to encourage equity as opposed to debt financing on the part of American corporations. The Treasury complains that this result has not come about in the intervening period of time, but it seems to us that the principal reason for this is that the credit, though helpful, is of such a limited nature that it can hardly be blamed for failing to be a decisive factor in encouraging a notable upswing in equity financing.

More important, we think, is the fact that the credit does, even though it is limited to only 4 percent, relieve some of the effects of double taxation of corporate income. The allegation has been made by the Treasury that the credit is preferential to upper income groups. We fail to understand this reasoning. In the first place, the credit provides a uniform percentage tax relief of 4 percent of dividends received for all taxpayers. Obviously, on a given amount of dividends, the percentage by which the tax liability of lower income groups will be cut exceeds the percentage of the reduction in tax liability for upper income groups. The Treasury, as we understand it, does not dispute this point, but it contends that the percentage relief provided by the credit for upper income taxpayers from the special burden of double taxation is much greater than the similar relief for lower income taxpayers. This is true only because the special burden of double taxation on a given amount of corporate income with respect to lower income taxpayers is much greater than the similar double tax burden for higher income taxpayers. This follows because any distribution of corporate earnings directly to taxpayers would be taxed at the rate applicable to the top bracket in which the particular taxpayer happens to fall. Accordingly, the fact that such earnings are subject in addition to the corporate tax does not create as much of an extra burden of double taxation for high-bracket as it does for low-bracket taxpayers. In this sense, any uniform percentage reduction in tax liability attributable to a given amount of dividends will provide greater proportionate relief for the upper income groups. But this misses the basic point. If the credit is inadequate to achieve the desired relief from the double taxation of corporate income, the remedy would obviously seem to be to modify or increase the credit, rather than to simply repeal it and ignore the problem. For present or future consideration we repeat the recommendation that we made in connection with congressional consideration of the Internal Revenue Code of 1954. A dividend credit of 10 percent will, in our judgment, go far toward dealing adequately with the double taxation problem.

Capital gains and losses (sec. 219)

The administration recommended considerable changes in the present treatment of capital gains and losses. With respect to individuals, it would have decreased the amount of capital gains includible in gross income from 50 to 30 percent, lowered the maximum tax rate from 25 to 19.5 percent, and from 25 to 22 percent in the case of corporations. The holding period would have been increased from 6 months to 1 year. An indefinite capital loss carryforward provision would have been provided for individuals. Finally, there would have been a change in the tax treatment of certain transactions which are currently taxed as capital gains—e.g., ordinary income treatment would have been required in the case of lump-sum distributions from pension or profit trusts, sale of patents, etc.

The Ways and Means Committee modified these recommendations to a considerable extent. While there would be no change in the current treatment of corporate capital gains, individuals would be required to include only 40 percent of net long-term capital gains in ordinary income subject to a maximum rate of 21 percent. This treatment would be afforded only when the capital assets in question have been held for more than 2 years, the gains in such cases to be referred to as "class A capital gains." In the case of gain from assets held for more than 6 months but not more than 2 years, existing capital gains tax treatment—the 50-percent inclusion factor and the 25-percent maximum rate—would be continued, gains in this situation to be referred to as "class B capital gains." Moreover, gain from the special types of transaction, such as lump-sum distributions from pensions and profit trusts and gain on the sale of patents which would have been treated as ordinary income under the administration recommendations) would also be considered "class B capital gains" and would continue to receive the current tax treatment. Capital losses for individuals would be treated as at present but the loss carryforward would become an indefinite one.

In general, we approve the modifications in the treatment of capital gains and losses that would be made under the House bill, and we oppose Secretary Dillon's recommendation that this provision of H.R. 8363 not be enacted. We have the further suggestion in this area that the capital loss carryforward which would be made indefinite for individuals should also be made indefinite for corporations. The same basic consideration—encouraging greater risk taking—applies in both instances, and the revenue losses entailed in either instance are relatively minor.

Sick pay exclusion (sec. 205)

The Internal Revenue Code presently provides an exclusion from income of up to $100 a week for payments made by an employer to his employee to continue the latter's wage payments when he is absent from work because of sickness or injury. In the case of absence from work because of injury, the exclusion is available immediately; when the absence is due because of sickness, however, the exclusion is available only after the first 7 days of absence unless the employee was hospitalized for at least 1 day during this period.

The administration proposed a repeal of this "sick pay" exclusion. The Ways and Means Committee rejected this proposal but would impose, as a substitute, more stringent limitations on the availability of the sick pay exclusion. In general, under the House bill, the sick pay exclusion will no longer be available during the first 30 days of absence regardless of whether personal injury or sickness is the cause of the absence.

We endorse this provision in the House bill. We agree that the sick pay exclusion, as presently worded, is susceptible of some abuse, and that it did in some instances have the unfortunate effect of encouraging absenteeism and malingering. It seems to us that the new limitations imposed by the House bill should be sufficient to deal with these existing abuses.

Employee moving expenses (sec. 212)

Under present law, certain moving expenses incurred by an existing employee, if reimbursed by his employer, may be excluded from the employee's taxable income. Generally, the Internal Revenue Service has ruled that the exclusion applies to: (1) Transportation expenses for moving the employee and his family; (2) transportation and related costs for moving the personal and household effects of the employee and his family; and (3) expenses incurred for meals

and lodging for the employee and his family while they are en route to their new location.

The House bill has approved an administration recommendation that a new deduction for such moving expenses be provided in the case of employees who receive no reimbursements from their employers and new employees whose reimbursements are considered taxable income. The new deduction would be available only if the taxpayer's new place of work is at least 20 miles farther from his former residence than was his former place of work. In addition, he may be required to include the amount of any such deduction in his taxable income for the following year if, during the 12-month period following the individual's arrival at the new place of work, he does not remain a full-time employee in that general location for at least 39 weeks.

In general, we approve of this recommendation concerning moving expenses, with a major reservation. The "Technical Explanation" from the Ways and Means Committee report indicates that the term "moving expenses" in this connection is not to include a good many necessary expenses related to moving. For example, it would not include (1) the cost of meals and lodging of the employee and his family after they arrive at a new location, if they are in a temporary lodging looking for a permanent residence; (2) the expense of house hunting at the new location; and (3) the expense of selling a house at the old location—including any loss on the sale, brokerage fees, etc.—or the expense of breaking a lease at the old location. We urge that the bill be amended to include these items within the concept of "moving expenses." In addition, appropriate explanatory language should be included in the report of the Finance Committee.

Multiple surtax exemptions and consolidated returns (*secs. 222 and 223*)

The House bill, accepting in modified form an administration proposal, provides for the repeal of the present 2-percent additional tax for the filing of a consolidated return by a group of affiliated corporations. At the same time, the bill would limit to a single $25,000 surtax exemption the multiple exemptions currently available to the members of an affiliated corporate group.

We support the removal of the additional tax on the filing of consolidated returns. However, we have noted that the effective dates of these two provisions, which apparently are designed to complement one another, differ. The repeal of the 2-percent additional tax would apply to taxable years beginning after December 31, 1963, while the proposed limitation on surtax exemptions would apply to taxable years ending after December 31, 1963. We can see no logical reason for this difference in effective dates, and we urge that it be eliminated.

In addition, we think that the policy of encouraging the filing of consolidated returns—indicated by the proposed repeal of the additional 2-percent tax—should be furthered by a repeal of the existing tax on intercorporate dividend payments which results from the fact that the applicable credit is limited to only 85 percent.

With respect to the proposed limitation on surtax exemptions, the House bill provides that the members of an affiliated group may elect to claim multiple surtax exemptions limited, in the aggregate, to $25,000. However, once such an election is terminated it may not be renewed until the expiration of 5 years. We can see no reason for such a limitation on the renewal of the election, and we urge that it be deleted.

Travel and entertainment expenses

Senator Long of Louisiana, one of the members of the Finance Committee, joined by a number of other Senators including Senators Carlson, Curtis, McCarthy, and Ribicoff, has introduced S. 2068, which would amend section 274 of the Internal Revenue Code to change the general requirements as to travel and entertainment expenses added last year under the Revenue Act of 1962. Under section 274 as it now stands, travel and entertainment expenses for business purposes, in order to be tax deductible, must meet not only the longstanding "ordinary and necessary" test but also new tests under which it would have to be shown that such expenses were either "directly related to" or "associated with" the active conduct of a trade or business. In addition, all such expenses must be documented in considerable detail with respect to amount, time, place, business purpose, and business relationship of persons entertained. S. 2068

would delete the "directly related" and "associated with" tests and substitute certain new requirements—the entertainment expenses would:

1. Have to be "reasonably designed to further the taxpayer's trade or business;" and
2. "Not primarily for the purpose of satisfying the personal, family and living expenses of the taxpayer or his representative or the recipient of the entertainment, amusement, and recreation."

This same general test would be applicable to both entertainment activities and entertainment facilities. Finally, the substantiation requirements under section 274 of the code would be deleted in favor of permitting the Internal Revenue Service greater flexibility to permit the requirement to be satisfied in the case of an employee by suitable accounting to his employer.

We believe that there are a considerable number of difficulties with respect to the present application of the requirements imposed by section 274. We are particularly concerned with the problems created by the "primary use" test as applied to the deductibility of club dues and with what appear to be overly narrow limitations on the deductibility of goodwill entertaining for business purposes. We are also troubled by what we consider to be the overly narrow requirements of revenue ruling 63-13 which sets out new requirements for per diem and mileage allowances under the general policies of section 274 and the regulations thereunder.

We think that S. 2068 might be desirable because it would liberalize the existing documentation requirements of section 274. To the extent that the bill would also make it easier to deduct the cost of good will entertaining and club dues for business purposes, we commend it. We disapprove of the existing "directly related" and "associated with" tests added by last year's legislation because we think the original "ordinary and necessary" test was sufficient to determine tax deductibility. That being the case, we are not favorably disposed to adding the new substitute tests that would be provided by S. 2068. In any event, we think it would be desirable for the Congress to consider S. 2068 at an early date—but we think it would be better at the present time to separate this problem from the current consideration of the proposed Revenue Act of 1963.

Current U.S. taxation of the earnings of foreign subsidiaries

In 1961 the administration recommended generally that the income of foreign subsidiaries of American corporations be subject to full U.S. taxation prior to the distribution of such earnings to the American corporations in question, except where the subsidiary is located in a "less developed" country. After prolonged consideration of this recommendation, the Congress decided on the adoption of the new subpart F of the code relating to what are termed "controlled foreign corporations." In general, under these provisions, current U.S. taxation is imposed upon what is termed "foreign personal holding company income," "foreign base company sales income," and "foreign base company services income" of controlled foreign corporations. These terms encompass sales income and services income related to transactions, for the most part, involving related parties. Exceptions to this special taxation on foreign base company income are provided when there are "minimum distributions" by the controlled foreign corporation to its American parent corporation, or when that income qualifies as "export trade corporation income."

We do not approve of the provisions of the new subpart F—candidly, we think that in many respects they are undesirable. Moreover, since most of the final income tax regulations on these new provisions have yet to be published by the Treasury, it is difficult to determine at this time the full implication of these complex new provisions. However, we do feel sure of one thing—the provisions of subpart F are preferable to the direct taxation of foreign subsidiary earnings originally espoused by the administration and currently proposed by Senator Gore, a member of this committee. We urge the Finance Committee to postpone further consideration of this complicated subject until such time as the Congress can give the problem of taxation of foreign subsidiary earnings the complete and undivided attention that it really deserves.

The depreciation guidelines and the reserve-ratio test

As in the case of the investment credit, the institute acknowledges the commendation due the Treasury Department for its administrative reform of tax depreciation embodied in the new "guideline class" depreciation system pro-

mulgated by Revenue procedure 62-21. However, included in this system is the reserve-ratio test which is represented as an "objective test" for determining whether or not a taxpayer qualifies for the lower guideline lives authorized in Revenue procedure 62-21. As indicated previously, the administration has included the benefits of this depreciation reform and the investment credit in its evaluation of proper corporate rate reduction. Without agreeing with the administration's position on corporate rates, we suggest that the claimed benefits of the depreciation guidelines can only be fully established by abolition of the reserve-ratio test. The MAPI study, "The Reserve-Ratio Test of Tax Depreciation Lives,"[8] analyzes the application of this "objective test" and concludes that the test is unsuitable in so many cases that an attempt to apply it across the board—as contemplated by the new revenue procedure—can only compound the confusion it was designed to cure.

It is our conclusion that for taxpayers to realize the full benefit of the new depreciation guidelines—and for the Nation to realize its full benefit in the modernization of productive plants—the guideline lives should be made available as of right and taxpayers should be permitted to negotiate shorter lives with the revenue agent where they can be justified by "all facts and circumstances." If the Treasury insists that legislation is necessary to accomplish this objective, then we recommend that appropriate action be taken by the Congress.

In this connection we earnestly urge that there be a liberalization of the depreciation treatment accorded real property. The discrimination with respect to such property—ineligibility for the investment credit and a refusal to shorten the old bulletin F useful lives in the new depreciation guideline—seems particularly inappropriate in view of the provision in the current bill which would impose ordinary income treatment to some extent on the gain realized on the sale of real property.

This concludes our statement on the proposed Revenue Act of 1963 (H.R. 8363). We desire again to express our appreciation for this opportunity of offering the institute's views on this most important legislation.

[From Capital Goods Review, Washington, D.C., March 1963]

FISCAL POLICY AND ECONOMIC EXPANSION: A CRITIQUE OF THE ECONOMICS OF THE ADMINISTRATION'S 1963-65 TAX PROGRAM

In response to an invitation from the Joint Economic Committee of Congress to comment on the President's Economic Report of January 1963, the Institute submitted a statement (on February 13) that we believe will be of interest to readers of this Review. Accordingly, it is reproduced below.—George Terborgh, editor.

Since the central issue in the 1963 Economic Report of the President and the annual Report of the Council of Economic Advisers is the administration's tax program, and since it promises to be a principal preoccupation of the Congress at this session, we have chosen to limit our observations to this issue. We want particularly to explore some of the basic economic assumptions underlying the program.

I. OVERSIMPLIFICATION IN OFFICIAL PRESENTATIONS

We should like to begin with a few comments on the oversimplification of the issues in official presentations.

Federal tax reduction at this time involves a deliberate increase in an already substantial deficit. Since this runs counter to traditional concepts of fiscal probity, and strikes many people as dangerous and irresponsible, it is obvious that the administration confronts a major "selling" effort. Obviously also, the time for this effort is short if action is to be had at this session of Congress.

Under the circumstances, it is understandable that in its effort to expound "sophisticated" doctrines on matters beyond the knowledge of the layman, the administration should present its thesis in white and black. In the Economic Report, as in other state papers submitted to Congress recently—the state of the Union message, the special message on tax reduction and reform, etc.—the impression is created that there is more certainty that in fact exists both as to the diagnosis of our economic ills and as to remedies. Disputed and controversial propositions appear with the aura of established truth.

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[8] Machinery and Allied Products Institute, February 1963.

Reason for recent slackness

One oversimplification has to do with the reasons for the unsatisfactory performance of the economy since 1957. The administration attributes this primarily to the repressive effect of heavy Federal taxes. This is one theory, but there are others. Indeed there is a whole list of factors given varying weight and emphasis by different economists. Some have to do with developments prior to the period of slackness, others to events occurring within it.

One of the antecedent developments was the exhaustion by 1957 of the special stimuli to demand carried over from World War II and the great depression. Another was the overexuberance of the 1955–57 capital goods boom, which left a good many industries with excess capacity. Among the events within the period, there was the setback to the 1958–59 recovery by a 4-month steel strike and a highly restrictive monetary and credit policy. During the recovery now underway, we have had the steel price episode, a stock market shakeout, a sluggish growth of the money supply, a profit squeeze, etc. Individual analysts will expand the list to suit their taste. The point is that there are plenty of explanations around other than the weight of the Federal tax load.

We should be the last to minimize the burden of Federal taxes on the economy, which is certainly onerous, not only because of its magnitude, but because of its distribution. We have a tax structure that bears heavily on enterprise, risk-taking, and productive investment. It exerts a continuous drag on economic progress. It does not follow, however, that this is the principal reason for the failure of the 1958–59 recovery to reach completion, or for the sluggishness of the current recovery. We may point out that the Federal tax structure and rates in both of these recoveries were practically the same as in the recovery of 1954–55, which was an exceptionally vigorous one. Something else must have changed in the meantime.

Adverse swings in budget position

The administration makes much of the drag on the current recovery and the preceding one from adverse shifts in the Federal budget position. The wide swings from deficit to surplus as the economy expands are deemed too repressive. They are said to choke off recovery before completion.

This theory must reckon with the rather disconcerting fact that adverse budget swings have been relatively smaller in the two most recent recoveries than in earlier ones that carried through to completion. If we take the total swing (decrease of deficit plus increase of surplus) during each of the postwar recoveries as a percentage of the increase in the gross national product over the interval, we get the picture in the following table:[1]

Adverse budget swing as percentage of gross national product growth

[From quarterly figures]

Recovery	During the 12-month period of greatest swing[1] (A)	During the 18-month period of greatest swing[2] (B)
1949–50	58	39
1954–55	47	48
1958–59	26	34
1961–62	9	10

[1] 1949–III to 1950–III; 1954–I to 1955–I; 1958–II to 1959–II; 1961–I to 1962–I.
[2] 1949–III to 1951–I; 1953–IV to 1955–II; 1958–III to 1960–I; 1961–I to 1962–III.

Certainly the adverse budget swing is a dubious explanation for the sluggishness of the present recovery. It has been by far the smallest of the lot; indeed during 1962, when the recovery slowed up, there was no adverse swing at all.

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[1] The swing is measured in terms of the so-called national-accounts budget, now favored by the administration in discussions of this subject.

Surplus at the end of the swing

If we turn from the total swing to the size of the Federal surplus attained at the top of the swing, we also get nowhere. The current recovery is the only one in the postwar period that has not developed a surplus. The budget position has remained in deficit, and promises to do so for some time.

Peak surplus as percent of gross national product [1]

Recovery:	*Quarterly figures*
1949–50	6.4
1954–55	1.6
1958–59	1.6
1961–62	— [2] .1

[1] 1951–I, 1956–I, 1962–II.
[2] Minimum deficit.

If neither the total adverse swing in the budget position nor the surplus reached at the end of it appear to have much explanatory value in the present situation, it is obvious that other diagnoses are in order.

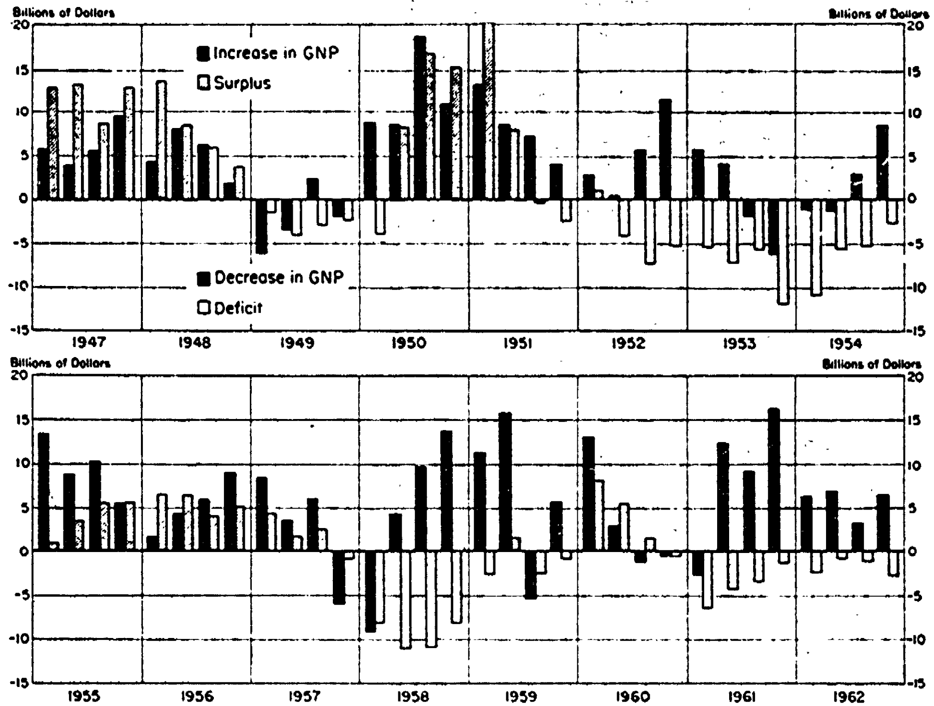
We recite these facts, not to advance a position of our own, but to emphasize the oversimplification of the official presentation. We suggest that it deserves the critical scrutiny of the committee before the proposed remedy is adopted.

II. POSTWAR SURPLUSES AND DEFICITS IN RELATION TO ECONOMIC TRENDS

There is danger that the administration's educational campaign will lead to a naive, even mystical, exaggeration of the potency of Federal deficits as an economic stimulant. History does not warrant such enthusiasm. We need only cite the fact that in the thirties the Federal Government ran deficits for 10 years in a row, at an average rate exceeding 3 percent of the gross national product, and that the economy finished the period still depressed. (A comparable deficit today would be $17 billion a year.) To take a more recent example, the economy has run slack since 1957 notwithstanding an accumulated deficit of $20 billion over the interval. Whatever may be said of deficits (and we do not prejudge the question at this point), there is clearly no magic in them.

This conclusion is confirmed by postwar history. Chart I which follows compares the change in the gross national product from the preceding quarter with the position of the Federal budget in the current quarter.

Change in the Gross National Product From the Preceding Quarter, Compared With the Position of the Federal Budget in the Current Quarter
(seasonally adjusted annual rates)



Source: Department of Commerce. The budget position is reported on the national-accounts basis.

Analysis

If Federal deficits are stimulative of the economy, and surpluses repressive, we might expect to find expansion predominant during deficit periods and contraction predominantly during periods of surplus. A glance at the chart fails to show any general pattern of this character. The relation between the budget position and economic trends has been highly variable and irregular. There have been extended periods (a year or more) with rising GNP and budget surpluses,[2] others with rising GNP and deficits.[3] There have been periods with falling GNP and deficits,[4] others (a short one) with falling GNP and surpluses.[5] Of 51 quarters with a rising GNP, more than half (28) were associated with a Federal surplus, 23 with a deficit, while of 13 quarters with declining GNP, nearly all (12) were associated with a deficit.

It may be objected that there is a lag between the budget position and the response of the economy, hence that we should "lead" the former by a reasonable period. If we lead it by 6 months, the picture is not greatly altered. Of 51 quarters with rising GNP, 24 show budget surpluses in the second quarter preceding, 27 deficits. Of 13 with falling GNP, 7 show surpluses, 6 deficits.

For those preferring a more formal analysis, the coefficient of correlation between the budget position in the current quarter and the GNP change from the preceding quarter is +0.390. In other words, there is a slight positive correlation between surpluses and rising GNP (or deficits and declining GNP). When we lead the budget position by 6 months, the correlation is −0.04. This has no statistical significance.

Possible explanations

The absence of any significant correlation for the postwar period between the Federal budget position and economic trends raises the interesting question of why the alleged effect of the budget position has failed to register. There may be two reasons: (1) Its impact may be submerged by other factors; (2) it may not have the impact alleged.

If we were dealing with simple one-way causation—if economic movements were controlled exclusively by the Federal budget position—we would expect by conventional theory to find expansion associated with deficits and contraction with surpluses. But the causation is not one way. The budget position is itself influenced by the movement and level of economic activity. What we have is a complex interaction in which the influence of the budget may be submerged by more powerful forces, hence may not be separately identifiable.

It must be recognized that even sizable surpluses or deficits are small in relation to the GNP ($10 billion is less than 2 percent, for example), and that even if their influence is in the theoretical direction it can be submerged for extended periods of time by countertrends in the economy. It can be argued for this reason that the absence of the expected statistical correlation for the postwar period is due to the smothering of the budget impact by such countertrends.

We regard this contention as exceedingly dubious. In our opinion, the key to the mystery lies elsewhere. The budget position has not had the impact attributed to it by the administration. With your indulgence, we should like to develop the point briefly.

III. THEORY OF FISCAL POLICY

It is sometimes assumed that Federal deficits are always and inherently stimulative to the economy and that surpluses are on the contrary always and inherently repressive. This is a gross oversimplification.

If we rightly understand the position of the administration, it rests on the assumption that an increase in the Federal deficit through tax reduction will yield a net addition to private spending. At first glance, this seems to follow inevitably from the fact that the beneficiaries of the reduction will have more after tax income to spend. But there is another side of the shield. Unless the added deficit is "monetized," that is to say, unless it is financed by the creation of new money, it must be financed from private savings.

If it is so financed, it places the Treasury in competition with all other users of capital—corporations, unincorporated businesses, State and local governments,

[2] 1947–48, 1950–II to 1951–II, and 1955–I to 1957–III.
[3] 1952–III to 1954–II, 1958–II to 1959–J, and 1961–II to 1962–IV.
[4] 1949, and 1953–III to 1954–II.
[5] Only 2 quarters in this case, 1960–III and IV.

home mortgage borrowers, etc.—for these savings. This competition cuts down the amount of funds available to these users. If the added Federal deficit is substantial, the drain on the capital market is reflected in higher bond yields, higher mortgage loan rates, and lower credit availability than would otherwise obtain. Marginal credit, and marginal users of credit, are squeezed out in favor of the Treasury. Thus the increase in spending by the beneficiaries of the tax reduction may be partially or wholly offset by the decrease in private (and State and local) investment financed through the capital market.

Variable effects

Whether the offset is partial or complete depends on circumstances. During economic recessions, when the private demand for funds is declining and the capital market is sloppy, it is possible for the Treasury to increase its absorption of savings without a concurrent reduction of comparable amount in non-Federal investment. If this increased absorption stimulates the economy, it is even possible that there may be no net reduction at all. But when the Treasury absorbs savings in more normal markets, the offsetting curtailment of non-Federal investment is both more prompt and more complete. The stimulative effect is correspondingly diminished.

Here, certainly, is one reason for the failure of Federal deficits of the postwar period to show the stimulative magic assumed by the official theory. The Treasury has run deficits, not just during recessions, but more than half of the time (35 quarters out of 64).[6] Since they have been financed largely out of savings, they have exerted a drag on private (and State and local) investment that has gone far to offset their stimulus.

Present situation

At the present time, the economy is not in recession, but has been expanding continuously for 2 years. It is, by various estimates, within 5 or 6 percent of its current potential and it may be closer than that. The capital market is in equilibrium. There is no hoard or pool of idle funds that the Treasury can absorb without determent to other borrowers. Under these conditions, it is by no means certain that an added Federal deficit financed from savings would be significantly stimulative. In all probability, it would be substantially, if not largely, offset by the displacement of non-Federal investment.

Obviously, such displacement is precisely what the economy does not need. Thanks in part to a tax structure weighted against saving and investment, we already have a high-consumption, low-investment economy. For the decade of the fifties, total fixed investment in the United States was a smaller percentage of GNP than in 8 of 12 Western industrial countries. In terms of investment in productive equipment, we were at the bottom of a list of 10 such countries. Not surprisingly, our economic growth rate over the decade was second from the bottom.[7]

IV. FINANCING DEFICITS

These observations are not intended to exclude the possibility of an increase in the Federal deficit through tax reduction, but they do raise the question of how such an increase (if there is one) should be financed.

The administration has been rather vague on this question, in part, no doubt, because it involves Federal Reserve policy over which it has no direct control. In its 1963 report, the Council of Economic Adivsers conveys the impression that it would welcome a considerable degree of monetization,[8] but recent statements of the Chairman of the Federal Reserve Board suggest extreme reluctance to do more than the unavoidable minimum.[9] The whole question is very much up in the air.

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[6] National accounts basis.
[7] "Capital Investment and Economic Progress in Leading Industrial Countries, 1950–60," Capital Goods Review No. 48 (January 1962).
[8] Pp. 53–55.
[9] William McChesney Martin, statement to the Joint Economic Committee, Feb. 1, 1963.

The inflation angle

There is a widespread belief that a deficit financed from savings is less inflationary than one financed by an increase of bank credit (one that is monetized). If this is so, it is only because it is less effective. It takes more of it to produce a given result. But if it is carried too far (assuming it is in fact expansionary), it becomes as inflationary as a monetized deficit carried too far. The main difference is in the appropriate dosage.

The notion that a monetized deficit is necessarily and inherently inflationary apart from circumstances and the extent of its use is a popular fallacy. Provided it does not expand the Nation's money supply beyond its legitimate requirements, it can be expansionary without being inflationary. Moreover, as we have just noted, it can achieve a given expansion with a fraction of the deficiteering required by the other approach.

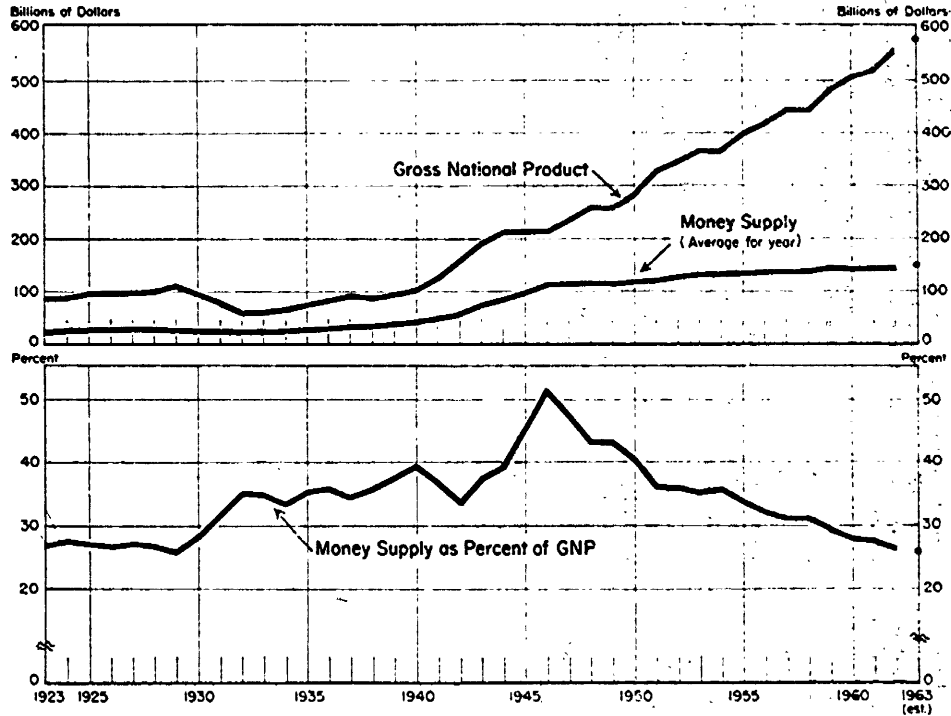
The real question at present is whether the money supply can properly be enlarged by further monetization of the Federal deficit. We should like to address this question for a moment.

Position of the money supply

The Federal Reserve System has followed for years an extremely restrictive monetary policy.[10] Over the decade 1952–62, for example, the money supply (demand deposits and currency) has been permitted to grow at an average rate just over 1.5 percent a year (compounded). This compares with an average annual growth of 4.8 percent in the gross national product. It has been possible to have this GNP growth because of constantly rising money turnover rates, starting from the abnormally low level obtaining at the end of the war. This process of acceleration cannot go on forever. The ratio of money supply to GNP has already worked its way down to a very low level by historical standards, as can be seen from chart 2.

[10] We use this term to denote money-supply policy, as distinguished from credit policy. These are not the same, and do not always move in harmony.

Gross National Product, Money Supply, and Ratio of Money Supply to GNP



Sources: Department of Commerce and Federal Reserve System.

While no one cay say with assurance what the turnover potential of the money supply is these days (so many changes having occurred since earlier experience with current rates), we strongly suspect that the economy has for some time encountered resistance to further acceleration. This suspicion is strengthened by its behavior over the past 5 years. It has suffered less from specific maladjustments than from a kind of general debility. It has lacked energy. Not once in this interval has it achieved a level of aggregate demand sufficient for full prosperity. These symptoms are precisely what we would expect from an inadequate money supply. Here, in our opinion, is a more plausible explanation of the sluggishness of the system than an insufficient Federal deficit.

Monetary growth requirements

While we repeat that no one (including the Federal Reserve Board) can say for sure how much additional acceleration of money turnover is in the cards, it is interesting to see how much expansion of the money supply would be required if the rate were to level off where it now is. To get the GNP up to the $600 billion a year level said to be its current potential would require an addition of $10 billion. If the GNP were to grow thereafter only at the average rate of the fifties (4.8 percent annually in current dollars), it would require a yearly increase in the money supply of $7 billion. This is more than it has grown over the past 4 years.

Even if turnover acceleration continues some time longer at a reduced rate, there will still be a need for more rapid monetary growth than we have been having. We believe that a properly controlled monetization of the Federal deficit is both desirable and safe.

V. OUTLINE OF POLICY

What we have had over the past few years is a fiscal policy at least intended to stimulate the economy, and a monetary policy calculated to restrain it.

Until recently, it was possible to attribute this restrictive policy to the constraints imposed by our gold and balance-of-payments position. But it is now clear, at least so far as the Chairman of the Federal Reserve Board is concerned, that it is justified on other grounds as well. Witness the following statement:

"My present feeling is that the domestic liquidity of our banks is now so high that still further monetary stimulus would do little if any good—and might do harm—even if we did not have to consider our payments situation at all. This means that if any additional Government action is needed in the financial field in order to give fresh expansive impulse to the economy, it would probably have to come from the fiscal side." [11]

If this is the final position of our monetary authorities, it is of course bootless to suggest even a modest monetization of the deficit. We are going to assume, however, that their cooperation would be forthcoming if Congress gave a strong lead, and our policy recommendations are pitched accordingly.

General approach

Since monetary policy has made very little contribution to economic expansion in recent years, the stimulative efforts of the Federal Government have been concentrated almost entirely on fiscal policy. The result has been a bad balance between the two—monetary policy underworked, fiscal policy overworked. It follows that the basic approach to our present problem should be the restoration of monetary policy to its proper place. Primary emphasis should be placed on monetary expansion. The object should be the monetization of enough of the Federal deficit to build the money supply at the rate desired.

It is no means certain that this will require an addition to the deficit already in prospect with the existing tax structure (some $8 or $9 billion for fiscal 1964). Conceivably it may be practicable, with the cooperation of the Federal Reserve System and the Treasury debt managers, to achieve the desired rate of monetary expansion without further enlarging this deficit. If, however, this is not considered practicable because of the restraints imposed by our balance-

[11] William McChesney Martin, "Monetary Policy and International Payments," an address to the American Economic Association and the American Finance Association, Pittsburgh, Dec. 28, 1962. That at least one member of the Board takes some exception to this view is indicated by the recent testimony of George W. Mitchell before the Joint Economic Committee (Feb. 1, 1963).

of-payments position, any enlargement of the deficit should be held to the minimum required for monetary purposes. This should be a fairly modest amount.

Priorities in tax reduction

Assuming an increase in the deficit is needed for monetary expansion, the question arises as to priorities in tax reduction. We believe first priority should be given to two long-overdue reforms, a reduction in the corporate rate and a scale-down of high-bracket personal rates. These reforms would not only eliminate two of the more indefensible survivals from wartime taxation; they would be a more potent economic stimulus, dollar for dollar, than tax relief primarily for the benefit of consumption.

Unlike tax relief for consumers, which increases their disposable income without affecting the appeal of the objects of expenditure, a reduction of the corporate rate has a dual effect: it increases the supply of funds and at the same time enhances the attractiveness of investment projects available for their use. By lowering the investment threshold, it enlarges the volume of eligible projects.

This point is discussed in an institute publication, Effect of the Corporate Income Tax on Investment (March 1959), from which we should like to quote briefly:

"The process of capital investment may be described as the incurment of capital charges in order to obtain an operating advantage; that is to say, a favorable change in the relation of revenue to operating costs. The corporate income tax falls on the earnings of equity investment. This means that to justify such investment a project must promise to yield a pretax return that will leave an attractive aftertax return when the tax is paid. Stated otherwise, it must promise not only an attractive aftertax return but the tax as well.

"The present corporate levy of 52 percent on taxable income is equivalent to a rate of 108 percent on the aftertax return required to justify investment. If that return is 10 percent, for example, the tax is 10.8 percent of investment, the combined rate being, therefore, 20.8 percent. What the tax does, in effect, is to raise the required pretax return to this rate. This alters the 'terms of trade' between capital charges and operating advantage to the detriment of the former.

"The increase in the required pretax return automatically excludes a whole range of investment projects that would be eligible in the absence of the tax, or at a lower tax rate. It limits eligibility, in other words, to projects of great urgency. The result is the deferment of both new business ventures and investments in the improvement of existing operations until their expected pretax return rises to the higher requirement.

"The main effect of such a high corporate investment threshold is to hold an umbrella over existing productive facilities. For it defers the introduction of new capacity competitive therewith. Old facilities must become more decrepit and inefficient before they are replaceable. Their service lives are extended. The economy drags in consequence with a productive mechanism of higher average age, and with more accumulated deterioration and obsolescence, than would obtain in the absence of the tax."

A reduction of the corporate rate by 5 points, from 52 to 47 percent, which we recommend as an interim objective, would make eligible for investment a whole range or tier of projects now excluded. Our calculations indicate many billions of dollars worth. Both from a long-range standpoint, and from the standpoint of near-term economic stimulation, this reform deserves top priority.

As for the scaledown of the high-bracket rates on personal income, little need be said. Those rates are generally recognized as indefensible. Such a scaledown, say to a top of 65 percent, would cost relatively little in revenue and would be strongly stimulative. Here, as with corporate rate reduction, the effect is twofold: the supply of disposable funds is enlarged, and the attractiveness of investment projects is simultaneously enhanced.

If these top-priority tax reductions fail to provide a sufficient increase in the Federal deficit for the purpose of monetary expansion, other reductions will of course be in order. As to these (in the event they are needed), we reserve our recommendations for the fiscal committees of Congress.

Conclusion

We should like to make another point in closing. We have urged that corporate and top-bracket rate reduction be given priority if it is found necessary to enlarge the Federal deficit to achieve an appropriate rate of monetary expansion.

Actually, we go further. We believe that these two reforms are so urgent, and so long overdue, that they should be enacted even if an enlargement of the deficit is not deemed necessary. In that event, the loss of revenue (around $3 billion a year) should be compensated either by a reduction of Federal expenditures, increases in other levies, or from new sources of revenue—such, for example, as a broadened excise tax system. The elimination of these wartime relics should not be longer delayed.

Finally, we should like to say a word on the importance of controlling the expenditure side of the Federal budget. No effort to relieve the economy of repressive taxation can get far if the budget continues to expand at its recent rate. This can only compound our fiscal difficulties over the long run. Restraint on outgo is absolutely basic.

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

Senator Douglas?

Senator DOUGLAS. No questions.

The CHAIRMAN. Senator Bennett?

Senator BENNETT. I appreciate the strong and forthright statement with respect to expenditure control, and I have no further questions.

The CHAIRMAN. Senator Dirksen?

Senator DIRKSEN. Mr. Stewart, tell me how broad gaged is the Allied Machinery Institute in terms of members and in terms of the country?

Mr. STEWART. Geographically, capital goods which, as you know, are the goods which produce other goods, are primarily concentrated as far as production is concerned in certain sections of the country.

Although, generally speaking, we represent and work with companies and associations across the country, there are concentration points like Chicago, New York, Detroit, and so on. Capital goods production has not yet blossomed in a heavy way out on the west coast.

As far as industries are concerned we work with all of the capital goods industries. Our work, which is heavily research, in economic and tax areas and so on, brings us in touch with many companies some of which are not formally affiliated with the institute.

We were originally set up as a federation of associations so that through them we see a very substantial number of individual companies.

Senator DIRKSEN. What does the institute do either by way of work in the communities where the members are located or by way of advertising as an institute to urge people generally to be restrained in their demand on the Government.

When we speak about expenditure appropriation so much of it, as you know, is generated back home, and perhaps this is a good place to ventilate an example. I received a letter, and I won't identify it further than that, from the president of a large corporation just scolding up and down over the freehanded way in which Congress is appropriating money.

A day or two later, I received a letter from the vice president of the same company really scolding for dear life over the action we had taken in reducing rather substantially some items in a public works bill when I was on the Appropriations Committee.

I put the president's letter in an envelope without comment and sent it to the vice president, and I put the vice president's letter without comment and sent it to the president. That happened some years ago. I haven't heard from either since that time. [Laughter.]

Senator BENNETT. Will the Senator yield?

Maybe there are both a new vice president and a new president?

Senator DIRKSEN. There probably are by now, but I keep thinking about expenditure control, and appropriations control, and I am searching and seeking diligently for some very specific things that will make our job a little easier.

For when you measure it against the demand that comes from back home, it becomes quite a different story.

Have you any suggestions for the committee?

Mr. STEWART. Well, first of all, as my statement indicates, I am in complete agreement with the proposition that it is not fair for the Congress to look solely to the Executive and it is not fair for the Executive to look solely to the Congress for expenditure control. Indeed as our statement says we feel that the matter of expenditure restraint traces to, as a matter of responsibility, all of us as individual citizens.

Through the facilities of the institute, although we are not and have not been an organization engaged in a popular appeal type program, we attempt to bring home the very point that you have made. I think it is extremely well taken. I think that the business community has a very grave responsibility not to talk out of both sides of its mouth on this subject and at every opportunity that I have, I tell this not only to the people that I know in local communities, but I also tell it to the business community. I think that you put your finger on a central point with respect to discharge of responsibility by business, and by individual citizens, and I couldn't be in more agreement with you, sir.

We will attempt to do more.

Senator DIRKSEN. Well, you know that Mr. Neilan of the U.S. Chamber of Commerce has been reproaching the Congress for a type of fiscal irresponsibility. But something more, he speaks also of fiscal immorality. But it is rather interesting to look at your desk of mail in the morning and find some letters from affiliate chambers telling what they want out of the Treasury for some projects back home.

Mr. STEWART. In connection with the point you are making, I was obliged to make a little talk in the Boston area not long ago and I was addressing the subject of business responsibility and business representation. At that time, I recalled publication by the legislative staff service of the Congress of a booklet some years ago on subsidies, direct and indirect. I think that if one, as a citizen or a businessman or a member of the labor group in this country, were to read that report he would be convinced that what you say is 100 percent correct.

Senator DIRKSEN. Have you any language to suggest by way of amendment to section 1, and I quite agree with you that that section ought to be particularized; but have you any language to suggest?

Mr. STEWART. We did not bring language to you. We made a suggestion of an approach. We will give the matter some attention and if we develop something which we think would be useful, bring it to the attention of the committee.

Senator DIRKSEN. Now, with respect to your other suggestions, have you prepared language on those?

Mr. STEWART. No. Some of them I don't believe require specific language, but I will ask the Medical Assistance Division staff to re-

examine our statement, and where we can make specific language suggestions if the committee would like to have them we will be pleased to present them.

Senator DIRKSEN. I would be delighted, however, if you would send up some language on section 1. I would like to see what it is. In fact, I would like to suggest a little language myself at the right time, but I would like to see the fruits of your language as well.

Mr. STEWART. We will endeavor to do something along those lines.

(The draft was not complete at time of printing of this record. It will be subsequently submitted directly to Senator Dirksen by Mr. Stewart.)

Senator DIRKSEN. That is all.

The CHAIRMAN. Mr. Stewart, I would like to have any comment you would further make in reference to unexpended balances, which makes much more difficult the balancing of the budget.

You stated accurately that $87 billion of unexpended balances as of July 1 existed. I think you said that the administration is now asking for $107 billion more, isn't that correct?

Mr. STEWART. Yes.

The CHAIRMAN. It would seem to me in order to get any assurance whatever that there can be a reduction of expenditures that these unexpended balances should have the fullest consideration and that some of them could and should be rescinded. Some of those balances, a good many of them, a good part of them, are not obligated.

Mr. STEWART. That is correct, sir.

The CHAIRMAN. Do you have any other thoughts?

Mr. STEWART. Not beyond the statement and to confirm our feeling that this is an area for very careful study and perhaps some means can be worked out whereby, unless there is clear and demonstrable proof that those unexpended balances are necessary and are in the process of being committed, that whatever appropriate action is necessary to release them might be taken.

Our comments in this area, I should emphasize, Senator Dirksen and other members of the committee, are not intended to be captious or to imply any lack of sincerity at all. It is merely our feeling that the bill reaches the committee with an agreement on principle, that expenditures should accompany tax reduction and I read statement after statement after statement which agrees with that principle. But when you get down to cases, there is not a well-disciplined means by which the executive department and the Congress can implement the principle agreed upon.

I don't know whether we are wise enough and experienced enough to provide the words to carry out that objective, but it is our feeling that some work should be done on the subject and we will try our hand at it.

The CHAIRMAN. Thank you very much.

Senator Douglas?

Senator DOUGLAS. No questions.

The CHAIRMAN. Thank you very much, sir.

Mr. STEWART. It is a privilege to be with the committee.

The CHAIRMAN. The next witness is Mr. Chester M. Edelmann of the American Retail Federation.

Take a seat, Mr. Edelmann and proceed, please.

STATEMENT OF CHESTER M. EDELMANN, ON BEHALF OF THE AMERICAN RETAIL FEDERATION

Mr. EDELMANN. Mr. Chairman and gentlemen of the committee, my name is Chester M. Edelmann. I am tax counsel of the McCrory Corp. with offices in New York City. My appearance here is on behalf of the American Retail Federation with offices at 1616 H Street NW., Washington, D.C. I am chairman of the federation's committee on taxation and fiscal policy. My association with tax problems of retailing extends over a period of nearly 40 years.

The American Retail Federation is a federation of 31 national retail associations and 43 statewide associations of retailers. The function of ARF is to provide leadership and coordination for its affiliates in Federal affairs and national legislation as they affect retailing. The tax committee of the federation has studied in detail the President's original tax proposals as well as the provisions of the House-passed tax bill. I appeared before the Ways and Means Committee of the House to present testimony on behalf of the federation on the President's tax proposals. The statement I am making here today is in line with federation policy. Each of our affiliated organizations has been advised of the points which I will cover in this statement and has had an opportunity to give us the benefit of their views.

At this point I should like to present a few facts to indicate the size and importance of the retail industry in the American economy. From the standpoint of numbers of firms in operation, the retail industry is larger than any other industry group in the Nation. There are approximately 2 million retail businesses in the United States which represents about 45 percent of all types of business. Total retail sales last year amounted to $234.5 billion, and next to Government the retail industry is the largest employer in the country, employing approximately 8½ million persons.

We agree with the overall economic objective of the President's original tax proposals and with the general purpose of this bill, H.R. 8363, as summarized in the Ways and Means Committee report.

Present economic conditions and our short- and long-range economic goals indicate that large-scale and immediate tax reductions are a necessity. The wartime nature of our tax structure is long overdue for revision. We believe the private sector of our free enterprise economy should be given a greater opportunity to generate the higher rate of growth which our economy requires today. It can and will do this through tax reductions which, if granted, should be effective no later than January 1, 1964.

We recognize that the subject of tax revision is a highly complicated matter and cannot be dealt with hastily nor in a cursory manner. The Treasury Department spent a great deal of time in developing its tax program and the Ways and Means Committee has given intensive and extensive consideration to the President's tax proposals. Considering the complexity of tax problems and the diversity of opinions as to what is needed in the way of revisions in the tax structure, the members of the Ways and Means Committee deserve the highest commendation for the end result of their work. No one could expect the perfect tax bill or that it would please everyone.

We also recognize the need and desire of the members of the Senate Finance Committee to give thorough consideration to the House-passed tax bill and to the views of those who wish to be heard on the bill.

In my statement before the Ways and Means Committee, I emphasized strongly the need for economy in Government and the exercise of restraint so far as Government expenditures are concerned. We believe the current debate over fiscal responsibility has had a salutary effect by focusing so much attention on a basic national problem. It has indicated that there is widespread concern in all sectors of our economy and Government over the level of Government spending. Though there are differences of opinion as to how expenditures are to be brought into line, we feel confident that a solution to the problem will be found. Great as the problem is, we do not think it should deter us from granting tax relief at this time.

We certainly hope and believe that there will be no diminution in the attention being directed toward the problems of Government spending and in eventually balancing the budget. The responsibility rests with both the President and the Congress. Chairman Mills, when he introduced the tax bill in the House, made an eloquent and reassuring statement of his views on "fiscal responsibility" and the road which he believes the Government should follow to lead us toward a larger, more prosperous economy. We subscribe to those views.

As to the specifics of the bill, in the interest of the time of the members of this committee, my statement will be brief and will cover only those proposals in the tax bill which are of major interest to the retail industry.

The granting of tax reductions for both individuals and corporations as proposed in this bill represents a good start toward providing much needed tax relief. However, if reductions are granted, this should not be considered the ultimate goal in reducing our tax burden. As our economy advances as a result of this first step in tax reduction, and as our budget position improves, the Congress should again consider providing even further tax relief.

So far as the rate structure for individuals is concerned, we are disturbed by one thing, and it is this: Whenever rates are increased, they are always increased more for the middle and high income brackets, and when they are decreased, they are decreased more for the lower income groups. It would surely seem that changes of this kind are creating rate distortions and causing greater imbalance in the burden of taxation.

According to our policy, we believe that proportionality should be maintained in the granting of rate reductions. As we view it, the rate structure in the present bill would make the tax structure more progressive because it grants the highest reduction to the lowest bracket (38.3 percent), with further reductions on a descending scale through the middle and upper brackets to a reduction of 12.6 percent for incomes above $50,000. This seems inconsistent with the general objective of removing the deterrents to incentive, initiative, savings and risk taking.

It seems to us that some adjustment in the proposed rates for the middle and upper brackets is called for and it could be done with little

revenue loss, if any. It is well known that the bulk of our revenue comes from the tax rates at the lower end of the scale. Whatever revenue losses are involved in such an adjustment for the middle and upper brackets could be easily recouped by a relatively small compensating adjustment of the rate at the bottom bracket.

Incidentally, I may point out that the bracket which the American Retail Federation recommended started at 15 percent, as against 14 percent recommended by the President.

As to current payment of corporate tax liabilities, for concerns whose liability exceeds $100,000, we do not oppose this proposal, but we do urge that if it is adopted, that present safeguards now in the law be retained, specifically the use of the annualization method and the 70-percent rule—so that no one pays taxes on income before it is earned. I point out the necessity for these safeguards because of the peculiar nature of retail operations. In general, most retailers earn their entire year's profits in the last quarter of the year, often referred to as the Christmas quarter. In some cases, profits may be earned in the third quarter, and only few retailers operate at a profit in the first half of the year.

Though this bill provides tax relief through rate reductions to taxpayers, it provides no tax relief to millions of our citizens with very low income who do not earn enough to be required to file income tax returns, or who file returns but pay no taxes.

Do you gentlemen realize that there are 49 million persons in this country who would not benefit even if the entire Federal income tax were repealed.

The fact is that there are 13 million individuals who file returns but whose incomes are smaller than their deductions and exemptions, so that they do not pay any taxes. These persons, together with their dependents account for 36 million of our citizens.

In addition there is a substantial number of persons, especially our senior citizens, whose incomes are lower than their personal exemptions, and who are not required to file returns. This group, together with their dependents, account for the remaining 13 million.

There is only one way that tax relief can be granted to these 49 million, and that is by repeal of the discriminatory wartime excise taxes that were imposed over 21 years ago on retail sales of toilet preparations, jewelry, handbags, luggage, furs, as well as on manufacture's taxes consumer-end products.

President Kennedy, in his tax message, stated:

> Our economy is checkreined today by a warborn tax system at a time when it is far more in need of the spur than the bit.

Chairman Mills of the Ways and Means Committee asked:

> Is it not about time that we got rid of wartime rates which have so long ago outlived their purpose?

If one of the purposes of the revenue bill is to correct the warborn tax system, then surely the elimination of these discriminatory wartime excise taxes should also be considered.

In 1954, Congress took the first step along these lines by reducing the retail rate from 20 to 10 percent. We now ask that it take the final step by removing the remaining 10 percent.

For a number of years, the Treasury Department has been sympathetic to the repeal of these taxes, but would not recommend such action to Congress because of the revenue loss involved. Surely, if the Treasury Department can recommend a revenue loss of $11 billion at this time through rate reductions, then its only objection to the repeal of these discriminatory wartime excise taxes does not really exist.

When these wartime excise taxes were imposed by the Congress in 1941, the objectives which Congress stated as reasons for such imposition were (1) to create emergency revenue, (2) to conserve manpower, and (3) to restrict the use of critical materials. The conditions which originally warranted these objectives no longer exist. In fact, so far as manpower and use of materials is concerned, our objectives are just the opposite of what they were then. Today we certainly do not need to conserve manpower. President Kennedy said in his message that—

> The most urgent task facing our Nation at home today is to end the terrific waste of unemployment and unused resources * * *

The strongest reason for the enactment of wartime excise taxes was that they were admittedly repressive and would put a brake on the business affected. They were intentionally diversionary and punitive in order to meet wartime necessities. Since they continue to repress and divert in peacetime, they are discriminatory and unfair. Consumer spending, which we must increase to sustain high-level employment, is decreased by these taxes. More people and more businesses are subjected to the repeated bite of these taxes than any other, without exception. Only complete repeal can be effective. Mere reduction in rates would be a serious mistake—the irritant would remain; the moral commitment would be unfulfilled; the discrimination and unfairness would continue.

It is a matter of record that if the Korean war hadn't happened when it did Congress would have fulfilled its moral obligation in 1950 by repealing the wartime excise taxes. On July 19, 1950, Robert L. Doughton, then chairman of the Committee on Ways and Means, wrote:

> It appeared that the decision could not easily have been other than to suspend consideration of the bill until we know more about the foreign situation * * *. I realize the heavy burden of some of the present excise taxes and also I was exceedingly anxious to do everything consistently possible to lighten this burden, but now that we are faced with a condition and not an opinion which will doubtless require considerable additional revenue, it will probably be some time before any present taxes can be reduced or repealed * * *.

In a letter dated July 20, 1950, the late Walter F. George, then chairman of the Senate Committee on Finance, wrote:

> I greatly appreciate your offer of service and understanding of the situation which prompted the committee to lay aside *temporarily* the tax revision bill." [Italic added.]

Repeal of all wartime excise taxes would place approximately $1 billion of disposable income immediately in the hands of consumers. This would produce an increase in gross national product of about $2.5 billion. The revenue feedback from the increase in GNP would be approximately $750 million, leaving a net revenue loss of only $250 million.

As to structural changes, the dividend credit and exclusion under the bill, the bill would reduce the 4-percent dividend credit to 2 percent for 1964 and repeal it entirely for subsequent years.

The $50 dividend exclusion is increased to $100 or $200 for married couples. A longstanding policy of the federation supports elimination of double taxation. For these reasons we support proposals to increase the dividends exclusion and I have suggested this be done in my testimony before the House Ways and Means Committee.

We recommend retention of the present dividend credit as a partial measure for relief against double taxation.

When this provision was enacted by Congress in 1954 it was recognized that it was only a partial step toward the elimination of double taxation of dividend income and that other measures would have to be taken to provide a full remedy. When it passed the Revenue Act of 1962, Congress again reaffirmed the need for this partial relief when it rejected the President's 1961 recommendation for repeal. Up to the present time, this method of partially dealing with the problem has gained wide acceptance both in and out of Congress.

The Secretary of Treasury has advanced certain arguments in favor of the repeal of the dividend credit. The report of the Ways and Means Committee subscribes to some of these arguments. We do not. The reasons advanced in support of this repeal do not, in our opinion, come to grips with the problem of double taxation.

The proposal for repeal of the credit is tied to a reduction in both individual and corporate rates, claiming that what is lost in one will be regained in the other. This is no answer to the question of double taxation. Full double taxation is reinstated by the repeal of the dividend credit, regardless of what the tax rates may be.

Despite arguments to the contrary, we are convinced that repeal of the dividend credit will impose an unwarranted hardship on those taxpayers who are wholly or largely dependent on dividend income, particularly older, retired persons. We also believe that the repeal takes away an important incentive that assists in the creation of equity capital.

We support the provision of the bill which would repeal the requirement that the basis of property eligible for the investment credit be reduced by the amount of the investment credit. We agree with the reasons advanced by the ways and Means Committee in its report.

We particularly support the provision of the bill that qualifies escalators and elevators as assets eligible for the investment credit. The federation presented testimony before this committee last year at its hearings on the Investment Credit Act of 1962. At that time, we urged that the definition of "other tangible property" be broadened to include retailing. We pointed out that retailers purchase and utilize certain items of built-in tangible property, other than personal, which are most definitely an integral part of the retailing process which should share the same eligibility as some specific items mentioned in the House committee report.

Among the items we mentioned were show windows—both the actual glass window front and the wall at the rear—store front signs, refrigerated, and low-temperature installations used to keep meat and other perishables, escalators, and facilities used in parking lots such as fences and outdoor lighting.

The bill limits the employee exclusion for premiums on group term insurance furnished through the employer to premiums paid for the first $30,000 of coverage. Though this represents some improvement over the President's original proposal, we oppose this provision in principle.

It is claimed that there are widespread abuses of this exclusion privilege; that certain high-level executives obtain large amounts of insurance coverage, while lower salaried employees receive limited amounts. We do not know the nature and extent of these abuses, but we believe that our State insurance laws can and should be adequate to eliminate them. Many State laws provide a maximum limit for group coverage.

We believe that employers' group plans should be fair and equitable with respect to all employees and that the amount of coverage should be proportional to the salary received or any other factor where proportionality can be maintained, such as length of service. Where such equality and proportionality exist, there should not even be a dollar limit on the amount that may be carried for the benefit of the employee tax free to him.

We support the provision of the bill that would repeal the 2 percent penalty tax which must presently be paid by corporations for the privilege of filing consolidated returns.

We believe the repeal of the 2 percent penalty is long overdue and faces up to the reality of present-day economic situations. However, we do not agree with the Secretary of the Treasury when he urges that this repeal should be contingent upon the adoption of the proposals concerning multiple surtax exemptions for commonly controlled corporations. Each of these proposals should be considered on its own merits.

For corporations where there is common control to the extent of 80 percent or more, the corporations involved generally are limited to one $25,000 surtax exemption for the group or alternatively required to pay a special penalty tax of 6 percent on the first $25,000 of their income.

Our organization is opposed to this provision of the tax bill. When enacted, our present law was designed to encourage, not inhibit, incentives for expansion and growth. Recognizing that there might be opportunities for tax avoidance, Congress established certain safeguards in the law. Those safeguards have been and still are effective.

Your honorable committee dealt with this problem in 1951 in considering H.R. 4473, which contained a provision that sought to reduce to one the number of surtax exemptions which could be claimed by a group of related corporations. (I respectfully refer you to the report of the Committee on Finance of the U.S. Senate dated Sept. 18 (legislative day, Sept. 13), 1951, and the section titled "Surtax Exemptions and Minimum Excess Profits Tax Credits of Related Corporations.")

The committee eliminated entirely this provision of the House bill. It pointed out that in certain cases, "failure to extend the full surtax exemption * * * to each corporation could affect seriously its competitive position with respect to other corporations of similar size carrying on the same type of business." Because the provisions of the bill would apply to corporations without regard to when they

were formed, the committee felt it would work a particular hardship on those related corporations which were organized in the past for legitimate business reasons, and I may point out that a great many of these corporations had been formed long before the subject of multiple surtax exemption had been dreamed of.

It further noted that the denial of the full surtax exemption can result "in a very substantial increase in tax liabilities, especially in the case of small corporations."

We believe the reasons which prompted the Senate Finance Committee in 1951 to reject a limitation to the multiple surtax exemption are equally valid today.

However, in 1951, the Congress did enact legislation to prevent splitups of existing corporations. This provision was reenacted in the Internal Revenue Code of 1954 as section 1551. Because legislation to prevent splitups is now on the books, we cannot understand why the Ways and Means Committee, in its report on H.R. 8363 said:

> * * * this substantial tax reduction should not provide added inducement to existing medium and large corporations to split up into multiple corporations.

At the time section 1551 was introduced into the law, Congress made it perfectly clear that it did not intend to "prohibit or discourage expansion of an existing business accompanied by the formation of new corporations * * *." In contrast to the intent of Congress at that time, the Ways and Means Committee now says, in its report on H.R. 8363—

> your committee does not intend to encourage the formation of these multiple corporations and therefore proposes to apply higher tax rates to corporations which are members of an affiliated group of corporations.

In our view, the existing statute is achieving its purpose; it has contributed to economic expansion and is effective in preventing splitups. The condition and reasons which warranted enactment of our present law are even more applicable today than they were when the law was first enacted.

The Congress, the Ways and Means Committee, and the Treasury Department recognize that there are good and valid business reasons for the establishment of separate corporate entities, aside from tax considerations. In other words, use of the multiple corporation structure is recognized as a legitimate means for expansion. But, the effect of what is done by this provision of the bill seems to belie this admitted recognition. The whole purpose of our tax program is to remove the shackles to incentives for expansion and growth. Yet, in this one area, we are told in effect "If you have expanded by this means in the past, or plan to do so in the future, you must pay a penalty if you wish to use the multiple surtax exemption."

We consider it a rather severe penalty, particularly for those who in good faith were encouraged to expand by use of the multiple corporate structure under the terms of the present law. Plans and commitments made by existing corporations, based on the provisions of our present tax laws, and the intent of Congress, will now be seriously disrupted.

The Ways and Means Committee report states:

> * * * there are legitimate business reasons for the use of separate corporations and, therefore, the separate corporations should generally be recognized as separate taxpayers, retaining the use of multiple surtax exemptions. How-

ever, your committee does not intend to encourage the formation of these multiple corporations and therefore proposes to apply a higher tax rate to corporations which are members of an affiliated group of corporations.

(The committee has thus recognized that some benefit is justified. However, the 6-percent penalty tax, added to the intercorporate dividend tax, results in a total tax of over 11 percent which individual corporations, or those filing a consolidated return, do not have to pay. We believe the benefits, if any, are very slim.)

The action of the Ways and Means Committee is not consistent with its declared intention since the proposed 6-percent penalty applies not only to newly formed corporations but also to existing corporations which have enjoyed the benefit of the multiple surtax exemption in accordance with Congress expressed approval.

The Treasury Department and the Ways and Means Committee make it appear that the benefits of the multiple surtax exemption inure mostly to the larger corporations. We have not seen any Treasury statistics indicating this nor are we aware of anything that would lead to this conclusion.

Our own information is to the contrary. We believe that the greatest benefits of the multiple surtax exemption inure to the smaller groups of affiliated corporations, especially those consisting of from two to five units. This conclusion is supported by the Treasury's own statistics.

Mr. Dillon estimated that under the Treasury proposal of only one surtax exemption for an affiliated group the revenue would be increased by $120 million. Only about $12 million or 10 percent would be derived from the large group, leaving 90 percent to be gathered from the small- and medium-sized groups.

Our computations also show that, under the House bill, of the $35 million that the Treasury expects in increased revenue, only $3.5 million, or 10 percent, would come from so-called large affiliated group taxpayers and 90 percent would come from the small- and medium-sized groups.

The Ways and Means Committee claims that by limiting the benefits of the tax rate reductions in the case of groups of multiple corporations, it has been able to grant a substantial tax reducation to small business in reducing the normal rate, without granting the same benefits to medium and large enterprises using the multiple corporate form of organization. This may be true, but it overlooks the fact that there are small enterprises using the multiple corporate form of organizations who will be penalized along with the medium and large enterprises. We think it would be advisable for the Treasury to supply figures showing just how many small multiple corporate enterprises would be affected by the provisions of this bill.

In conclusion, subject to the foregoing comments, we support H.R. 8363 as a first step in the direction of much needed revision in our rate structure.

We believe that the dramatic reductions granted by the bill will immediately spur our economy to greater heights because of more disposable income and greater incentive to reduce costs and expand existing business. These forces will soon result in substantially increased revenues.

We also believe that the dramatic size of the reductions will be the most useful deterrent against injudicious spending programs.

We realize that H.R. 8363 is not the solution for all our economic and social problems, but it is an important beginning, and more importantly it is a step in the right direction.

Thank you, gentlemen.

Senator DOUGLAS (presiding). Thank you very much.

Senator Bennett?

Senator Dirksen?

Thank you very much, Mr. Edelmann.

We will recess until 10 o'clock tomorrow.

(By direction of the chairman, the following is made a part of the record:)

MASSACHUSETTS MUTUAL LIFE INSURANCE CO.,
San Jose, Calif., October 24, 1963.

Re H.R. 8363.

Hon. HARRY F. BYRD,
U.S. Senator,
Senate Office Building, Washington, D.C.

DEAR SENATOR BYRD: When a man borrows from his life insurance policy he is not "paying interest for the use of his own money." It is not his own money, but a reserve set up on a scientific basis to meet all claims for that particular type of policy. It is like a business owner who would pledge his property as collateral for a loan at the bank. In neither case is he "selling out." Any restrictions on the right to use a life insurance policy as collateral on a loan will make it a second-rate security.

If H.R. 8363 becomes law the severe repercussions of this discrimination against the insurance industry and against the millions of Americans who have planned for their family security through life insurance will be most damaging to the American way of life and concept of private property ownership of life insurance. Life insurance is certainly a key aspect of the American system of private enterprise and the tax proposals are so flagrantly aimed to kill this way of life.

For what reason is it necessary to bind up and to control personal and business life insurance programs to the extent that they cannot be borrowed against, pledged as collateral and, in general, restricted to the extent that it cannot be used in the same manner as other property and investments?

Surely there can be nothing more noble than for a nation to encourage its individuals to provide for their own. If this most excellent vehicle is to be so limited and restricted relative to its borrowing power—if the split-dollar programs of closely held businesses are so restricted in the development of retirement benefits for loyal and devoted employees—if in any way the ability of private citizens to provide for themselves with insurance is impaired, the damaging effects will be most sad indeed.

For the citizens of this Nation not to speak up in protest, facing an obvious attempt to absorb small businesses by large statelike enterprises and to force state insurance and state welfare, would be most disgraceful and shocking.

The unfair proposals of taxation directed at insurance would greatly shake the basic foundations of this Nation and what it stands for, if such becomes law. It is hoped that these tax proposals with respect to insurance be soundly defeated.

Respectfully,

PAUL L. HULME.

WEST VIRGINIA NURSES ASSOCIATION, INC.
Charleston, W. Va., October 29, 1963.

Hon. HARRY BYRD,
Chairman, Senate Finance Committee,
Senate Office Building, Washington, D.C.

DEAR SENATOR BYRD: On behalf of the West Virginia Nurses Association, I would like to urge your favorable consideration of the child care deductions as included in H.R. 8363, and also the amendments recently offered by Senator Maurine Neuberger to provide for more liberal deductions.

Our professional nursing association supported the American Nurses' Asso-

ciation position in 1953 when they presented testimony in favor of changing the Internal Revenue Code that first allowed for child care deduction. Since most of our professional nurses are female, this tax relief served as incentive in bringing inactive nurses back into active employment in West Virginia where there was and remains a serious shortage.

Today, almost 60 percent of our professional nurses in West Virginia are married, and another 11 percent are widowed, divorced, or separated. With an average yearly salary of general duty staff nurses in this State of only $3,600, few of them can afford adequate child care which is further complicated by the present limitations on deductions.

Out of approximately 900 professional nurses who maintain an active license to practice nursing in this State but are not currently doing so, about 90 percent of these are married and another 2½ percent are widowed, divorced, or separated. With our extreme shortage of professional nurses in West Virginia, we certainly could use these prepared people. Many of them have indicated an interest to return to active nursing but find the cost of child care prohibitive.

We feel that if H.R. 8363 becomes law providing for liberalizations for deductions for dependents, more of our professional nurses would feel it was financially feasible to return to nursing. Along with the $900 or $1,000 deduction allowed for two or more dependents of widows, widowers, and single women, we would like to see included the same deductions for married women with children or other dependents when they have to provide all of their support. Far too many women are left to provide the living for their families without any financial assistance from the husband.

The West Virginia Nurses Association requests that you consider favorably the proposed revisions for liberalizing deductions when expenses are incurred for the care of children and dependents unable to care for themselves.

Sincerely yours,

JULIANN RITTER, R.N.,
Executive Director.

NORWICH MILLS, INC.,
Norwich, N.Y., October 29, 1963.

Senator HARRY F. BYRD,
Chairman, Senate Finance Committee,
Senate Office Building, Washington, D.C.

DEAR SIR: We would appreciate your making a part of the committee record our opposition to inclusion in the tax bill H.R. 8363, the portion regarding taxation of cost of group term life insurance.

We believe that this procedure is not worth in tax income what it will require in recordkeeping and calculation by employers who are to be involved. The idea is not conducive to employers being able to use this benefit as a part of employee benefit programs. It would certainly, in some instances, limit life coverage.

We do believe in the necessity to attempt to furnish income to the Government on an equitable basis when it is possible to do so. This is not equitable and to repeat, not worth it.

Very truly yours,

D. E. SKINNER, *Treasurer.*

PROVIDENT MUTUAL LIFE INSURANCE CO. OF PHILADELPHIA,
Philadelphia, Pa., October 30, 1963.

Revenue bill of 1963 H.R. 8363.

Hon. HARRY F. BYRD,
Chairman, Senate Finance Committee,
Washington, D.C.

DEAR SENATOR BYRD: I should like to express my opposition to section 213 of the revenue bill of 1963 as passed by the House of Representatives, wherein the owners of life insurance policies would be deprived, under certain circumstances, of claiming income tax deductions on account of interest paid on life insurance policy loans.

It seems to me that this provision would result in harassment to thousands of people who need to make loans on the security of their life insurance policies for legitimate purposes, because whenever such a loan was necessary within the first 4 years after the policy was purchased, it would cast a burden on the policyowner to explain and defend the purpose of the loan. It also seems to me that this provision would present quite a formidable problem for the Internal Revenue

Department in auditing returns where policy loan interest was involved. The question of the legitimacy of the loan would depend not only upon objective tests but quite a number of subjective tests that could lead to a multiplicity of arguments.

We believe that for the average person it is desirable, and good for the economy, that he carry proper amounts of permanent life insurance having loan and cash surrender values. Even in the eyes of a person who has no intention of making a systematic practice of paying premiums through loans, this provision of the law would tend to discourage the sale of such insurance.

In other words, it seems to me that if section 213 were enacted in its present form, the cure would be worse than the disease.

Sincerely,

T. A. BRADSHAW.

NEBRASKA STATE LEGISLATIVE COMMITTEE,
BROTHERHOOD OF RAILWAY & STEAMSHIP CLERKS,
FREIGHT HANDLERS, EXPRESS & STATION EMPLOYEES,
Omaha, Nebr., October 28, 1963.

Hon. HARRY F. BYRD,
Senate Office Building,
Washington, D.C.

DEAR SENATOR: It is my understanding that the House Ways and Means Committee, after months of deliberation, reported out the tax bill by a vote of 17 to 8.

This bill known as H.R. 8363 in our opinion is not perfect nor what we think it ought to be, but it does represent at least a minimum of what must be enacted now and for the following reasons:

(1) Taxes are extremely burdensome and some relief is long overdue. These excessive taxes have already seriously retarded the proper development of our economy and have therefore unnecessarily prolonged unemployment of millions.

(2) Reducation of income taxes, resulting in smaller revenues to the Government might well pressure elimination of waste and fat in many departments including even military defense and much more quickly than the clamor of doubletalking politicians for dramatic but meaningless budget cuts. If in their opinion such cuts were advisable then the taxpayer has the right to ask: "Why have they not been acted upon by the Congress?"

(3) We respect the integrity of men like Javits and Douglas who have the welfare of their constitutencies at heart and who are not illogically articulating for reelection at any cost.

(4) Economists of any competence at all, overwhelmingly agree that a tax reduction is beneficial and most urgently needed now.

The 4,500 railway clerks who I represent in Nebraska are soberly convinced that an income tax is in the best national interest and that it will not adversely affect national military defense. Under these circumstances what justification can there be in representative government for some Congressmen to arbitrarily and without good reason to ignore the mandate of the people?

This tax cut bill, if enacted, would provide almost $11 billion in new purchasing power and new funds for business investment, which will, within a reasonable period put millions of unemployed Americans back to work.

If we are truly sincere in our objective to reduce unemployment in other than Government projects then let's act without further delay.

I would appreciate a reply.

Sincerely yours,

ANTON F. MUNCH.

U.S. SENATE,
COMMITTEE ON PUBLIC WORKS,
October 31, 1963.

Hon. HARRY FLOOD BYRD,
Chairman, Senate Finance Committee,
New Senate Office Building,
Washington, D.C.

DEAR SENATOR BYRD: It has been called to my attention that a number of taxpayers have suffered considerable personal loss as a result of confiscation of their property by the Castro regime since 1961.

The Commissioner of Internal Revenue in reviewing rule 62-197 has held that the loss of Cuban property if confiscated or seized is deductible if it is a business asset, but it is not deductible if it is a nonbusiness asset.

Congressman Boggs earlier this year introduced H.R. 855, copy attached, which declared this confiscated property to be a casualty loss. I would like to suggest at this time that the Senate Finance Committee give some consideration to incorporating the provisions of this bill in H.R. 8363.

Very truly yours,

JAMES B. PEARSON,
U.S. Senator.

ARKANSAS STATE NURSES' ASSOCIATION,
Little Rock, Ark., October 28, 1963.

Hon. HARRY F. BYRD,
Chairman, Senate Finance Committee,
U.S. Senate, Washington, D.C.

DEAR MR. BYRD: The Arkansas State Nurses Association urges your favorable consideration to the amendment which Senator Maurine Neuberger had introduced to H.R. 8363 that would provide more liberal deductions when expenses are incurred for the care of children and dependents unable to care for themselves.

The shortage of professional nurses is acute throughout our country and salaries for nurses have not increased at a rapid rate. Even more important than the viewpoint of the national economy and the public interest is the effect that this tax relief can have in bringing inactive nurses back into the profession to help alleviate the shortage. If expenses for children or other dependents who are unable to care for themselves is necessary to produce income it should be deducted.

The present law permits only a token deduction although the responsible person is often faced with extraordinary expenses.

We sincerely request that you consider favorably the proposed provisions for liberalizing deductions when expenses are incurred for the care of children and dependents unable to care for themselves.

Truly yours,

(S) Hilda Scott,
Miss HILDA SCOTT, R.N.,
Executive Director, ASNA.

MICHIGAN STATE NURSES ASSOCIATION,
Lansing, Mich.

Hon. HARRY BYRD,
Chairman, Senate Finance Committee,
U.S. Senate, Washington, D.C.

DEAR MR. BYRD: During the past few years we in the nursing profession have become acutely aware of some of the problems of working women. We are particularly aware of the difficulties of getting professional nurses to return to the field of employment because of the economic situation—low salaries and increasing costs of care of dependents.

We urge your committee to favorably consider those recommendations in the President's special message on tax reduction and reform that would permit working women a more liberal deduction for expenses incurred for the care of children and of other dependents who are unable to care for themselves.

Michigan, as well as other States, has a serious shortage of professional nurses. Economically, it is not feasible for inactive nurses to return to employment because a great portion of their income would be consumed in expenses for child care. We believe tax relief for deductions for child care would enable many nurses to return to their profession.

The President in his tax message recommended raising the amount that could be deducted to $1,000 if there were three or more children to be cared for. A working mother would be paying essentially the same amount for the care of one or two children. We believe the deduction of $1,000 should be permitted regardless of the number of children in the home who are 12 years of age or under.

The Michigan Nurses Association requests your favorable consideration of the proposed revisions for liberalizing deductions for expenses incurred for care of children and dependents unable to care for themselves. Will you also include this letter in the record of the hearings?

We look forward to hearing from you.

Sincerely yours,

ELEANOR M. TROMP, R.N.,
Executive Secretary.

KELLEY, INMAN & FLYNN,
ATTORNEYS AND COUNSELORS AT LAW,
Denver, Colo., October 22, 1963.

Hon. PETER H. DOMINICK,
U.S. Senator,
Senate Office Building, Washington, D.C.

DEAR SENATOR DOMINICK: I believe that section 207 of the revenue bill of 1963 (H.R. 8363) presently under consideration will be disadvantageous to Colorado and many of its municipalities. The thrust of this section is to disallow as itemized deductions amounts paid to the State of Colorado and/or its local governments for gasoline taxes, alcoholic beverage taxes, tobacco taxes, and auto and drivers licenses. Further, it is my personal opinion that because of the wording of the bill, there is doubt whether the Colorado imposed motor vehicle ownership tax will continue to be deductible. I have this doubt because of the limitation of the deduction to "State and local personal property taxes" and the peculiar history of the Colorado motor vehicle tax as being a tax in lieu of a tax on personal property.

I consider the consensus of the Colorado delegation to be that, generally speaking, it is wise to let the State and local government solve a problem if it can be efficiently solved at that level. Differences of opinion exist as to when the State and local government can solve the particular problem efficiently. My point is that if the State and local government is to solve a given problem, finances must be available for them. I consider the former law of allowing the deductibility of the aforementioned taxes as one which creates an indirect grant-in-aid to the local governments to solve their individual problems. An indirect grant-in-aid, I may add, which does not require the necessity of sending funds to Washington and through intervening bureaus and agencies redirecting those funds back to the State and local governments. If Section 207 is passed, Congress will have removed a portion of these sources of local revenue. This is so because of the economic and political realities of the situation. Local administrations can more successfully defend local revenue exactions if the people know that these exactions will reduce their Federal income tax liability and if the people will not be forced to pay a Federal income tax on the very money they are paying to the State and local governments.

In order to illustrate the potential harm to Colorado and its municipalities, let us examine the effect of denying the deduction for tobacco taxes.

A. *Colorado level.*—Presently, Colorado imposes no cigarette tax even though each and every State touching its border does. The tax per package of cigarettes as of November 1, 1962, was Kansas, 4 cents; Nebraska, 4 cents; New Mexico, 8 cents; Oklahoma, 7 cents; Utah, 4 cents; Wyoming, 4 cents. Dr. Reuben Zubrow in his 1959 analysis of Colorado finances estimated that Colorado would receive approximately $9 million if it charged 4 cents per package of cigarettes. Governor Love's 100-man commission studying State and local problems has frequently discussed the cigarette tax as a source of revenue and as an alternative to increasing sales or property taxes. A great deal of the sting attached to imposing such a tax at the State level would be minimized if this exaction were deductible for Federal purposes.

B. *Municipal level.*—As of 1958, the following 33 municipalities imposed a cigarette tax in addition to Denver, Pueblo, and Colorado Springs—Aurora, Boulder, Englewood, Grand Junction, Trinidad, Alamosa, Durango, Cortez, Delta, Gunnison, Los Animas, Montrose, Akron, Brush, Glenwood Springs, Holyoke, Julesburg, Limon, Meeker, Pagosa Springs, Paonia, Rifle, Saguache, Steamboat Springs, Telluride, Aspen, Bayfield, Castle Rock, Naturita, New Castle, Nucla, Rico, and Walden.

It is the informal position of the local district director's office that the Internal Revenue Service will not allow the present Denver cigarette tax as a deduction because the tax is imposed not on the consumer but instead on the distributor. Denver could amend its ordinance to provide that the tax is a tax on the consumer and that the distributor is only collecting the tax for the convenience of the consumer and the city and at the same time increase its tax 2 cents a package thereby realizing approximately $1 million in additional revenues, with relatively little public hostility. The public hostility would be at a minimum if Denverites would be able to deduct the 4 cents per package whereas they can deduct no portion of the 2-cent tax.

Not only are future State and local taxing programs jeopardized but the effect of existing long-term revenue programs is also changed. The bill would preclude

deduction of that portion of Denver area real estate taxes attributable to the Moffat Tunnel improvement.

I am taking the liberty of sending a similar letter to all members of Colorado's Washington delegation. It is my belief that section 207 will make it even more difficult for State and local governments to realize necessary revenues to accomplish their problems. I sincerely request that you will use your efforts and influence to strike section 207 from the revenue bill of 1963.

Yours very truly,

MELVIN A. COFFEE.

NATIONAL BANK OF DETROIT,
Detroit, Mich., October 30, 1963.

Hon. HARRY F. BYRD,
Chairman, Senate Finance Committee,
Senate Office Building, Washington, D.C.

DEAR MR. CHAIRMAN: My purpose in writing you is to bring to your attention an area of confusion caused by certain changes in H.R. 8363, the Revenue Act of 1963, dealing with the deductibility of State taxes.

Specifically, the tax involved is the Michigan intangibles tax and the point of clarification desired is whether, under H.R. 8363, this tax will continue as a deduction for Federal income tax purposes.

Such a clarification is of interest not only to financial institutions and other business concerns with obligations for State taxes on intangible property, but also affects over 84,000 individual taxpayers who paid this tax last year in Michigan. In addition, if we assume that the situation in Michigan is representative of other States imposing a similar tax, then the question of clarifying the continued deductibility of this kind of State tax becomes compelling.

I have set down below a brief summary of the Michigan intangibles tax law and the possible effect of H.R. 8363. A suggested recommendation is also included for your consideration.

DESCRIPTION OF MICHIGAN INTANGIBLES TAX

The Michigan intangible personal property tax is a specific tax on the privilege of ownership of stocks, bonds, notes, money, and other intangibles. The tax varies depending upon certain conditions. Income-producing intangibles are taxed at a rate different from nonincome-producing intangibles.

The tax is based on either the income or the value of the particular intangible. Corporate stock or other evidence of corporate ownership having no par or face value is declared to have a face or par value of $1 per share or per unit of other evidence of corporate ownership.

Under a special provision in the Michigan Intangibles Tax Act, National Bank of Detroit and other banks in Michigan elected to pay the tax with respect to money on deposit with it and the tax on bank shares without recovering such tax from depositors and shareholders.

PROVISIONS OF H.R. 8363 AFFECTING DEDUCTIBILITY OF MICHIGAN INTANGIBLES TAX

Section 207 of H.R. 8363 provides, in part, as follows: "* * * the following taxes shall be allowed as a deduction for the taxable year within which paid or accrued:

"1. State and local, and foreign, real property taxes.

"2. State and local personal property taxes.

"3. State and local, and foreign, income, war profits, and excess profits taxes.

"4. State and local general sales taxes.

In addition, there shall be allowed as a deduction State and local, and foreign, taxes not described in the preceding sentence which are paid or accrued within the taxable year in carrying on a trade or business or an activity described in section 212 (relating to expenses for production of income).

"(*b*) DEFINITIONS AND SPECIAL RULES.—For purposes of this section—

"(1) PERSONAL PROPERTY TAXES.—the term 'personal property tax' means an ad valorem tax which is imposed on an annual basis in respect of personal property * * *."

DISCUSSION OF PROBLEM WITH RESPECT TO MICHIGAN INTANGIBLES TAX

The Michigan intangible personal property tax does not fall squarely within the definition of any one of the specifically deductible taxes enumerated in the provision in H.R. 8363. It clearly is not a real property tax or sales tax. It bears some of the characteristics of an income tax, but the Michigan courts have held that it is not an income tax. While it is a personal property tax, it does not appear to qualify as an ad valorem tax.

Therefore, if the Michigan intangibles tax is to be a deductible tax under the provisions of H.R. 8363, it must be classified as a tax paid or accrued in carrying on a trade or business or an activity described in section 212 (relating to expenses for production of income).

RECOMMENDATION TO COMMITTEE

While it is believed that the Michigan intangibles tax is of the type which should be deductible under the present provisions of H.R. 8363, in order that there will be no doubt as to its deductibility, it is recommended that the definition of personal property taxes be amended to read as follows:

"(1) PERSONAL PROPERTY TAXES.—The term "personal property tax" means a tax which is imposed on an annual basis in respect of tangible or intangible personal property."

We believe that this amendment would make it clear that a tax on intangible personal property such as that levied by the State of Michigan is deductible as a personal property tax.

Sincerely yours,

HENRY T. BODMAN, *President.*

FOREMOST DAIRIES, INC.,
San Francisco, Calif., October 31, 1963.

Re H.R. 8363.

Hon. HARRY F. BYRD,
Chairman, Senate Finance Committee,
U.S. Senate, Washington, D.C.

SIR: It is respectfully requested that this letter be included in the records of the Senate Finance Committee on hearings of the tax bill.

As insurance manager of a large corporation, I have serious misgivings about the House version of this bill as it relates to group term life insurance.

No one can take exception to the principle of group life insurance. Since the 1920's, it has been a growing and valued practice of progressive employers. Whether provided wholly at the employer's cost, or partly by employee contribution, it has enabled millions of persons to give their families better insurance protection than they otherwise could afford. Nor has it injured the life insurance business; on the contrary, many observers believe that group insurance has increased the average citizen's awareness of the value of insurance and has encouraged the purchase of added private insurance.

Almost without exception, group plans provide individual insurance in amounts related to earnings or position, on a nondiscriminatory basis. To interject an arbitrary limit, like $30,000, beyond which the value is taxed, would be very unfair and discriminatory.

There can be no sound economic reason for doing so. The tax gain would be insignificant as compared to the disruption of established plans, the dislocation of the insurance programs of the affected individuals and the greatly increased workload of the employers.

I strongly recommend that the Senate Finance Committee remove this undesirable and unfair provision from the bill.

Yours respectfully,

R. W. APHUGH,
Manager, Employee Benefits and Insurance.

THE PHOENIX INSURANCE CO.,
Hartford, Conn., October 31, 1963.

Hon. HARRY F. BYRD,
Chairman, Senate Finance Committee,
U.S. Senate, Washington, D.C.

DEAR SENATOR BYRD: Undoubtedly you have been deluged with communications representing every conceivable point of view on the many controversial features of the pending tax legislation. These observations on the proposed changes affecting group life insurance are forwarded to you not in the thought that they are new or different, but that we have no better forum through which to register our protests than through the chairman of your very important committee. Our company is not in the life insurance business, but we do have a group life plan for our own employees.

While the taxation of group life insurance premiums may not be a new concept so far as the experts are concerned, certainly it is to most of the many thousands of individuals covered by such insurance. It is to be doubted that the proposals are generally known to, or their significance understood by, these people, and the imposition of such a tax could scarcely fail to result in misunderstanding, impaired employer-employee relations, and ultimately protests in a volume which, as of this time, one can only imagine. Thousands of people have relied and are relying on these programs in their own financial planning, entered into in good faith and without any consideration of the tax factor. Undoubtedly many of these programs will be upset by the imposition of taxes on premiums.

We wonder if the amount of revenue that may be raised, should this proposal become effective, is significant enough to compensate for the problems that would be created.

You are so well conversant with the arguments pro and con on this matter that we are assured the subject has had and will continue to have the thoughtful consideration of yourself and your committee, but perhaps you would be aided in your consideration by knowing how others feel about it.

Sincerely yours,

J. D. TAYLOR, *President.*

THE TOOL STEEL GEAR & PINION CO.,
Cincinnati, Ohio, November 1, 1963.

Hon. HARRY F. BYRD,
Senate Office Building,
Washington, D.C.

DEAR SENATOR BYRD: As chairman of the Senate Finance Committee you have, no doubt, received many letters of protest regarding the proposal that an employee would be required to include as taxable income the cost of his group term life insurance over $30,000. We understand that this proposal is incorporated in the new tax bill H.R. 8363.

As a company we protest strongly against this measure. For over 40 years group term life insurance on a favorable tax basis has been a factor in the establishment and maintenance of employee benefit programs. To change the rule now would have a disrupting effect upon many long-established plans.

From an employer standpoint we think that the administration of this measure would, at best, be difficult. It would certainly be costly and time consuming. Further, we feel that this measure would produce little revenue for the Government. It would certainly not produce enough revenue to justify all the difficulties it would cause for the employer.

To our way of thinking the employer has already more than enough Government records to keep. We businessmen wonder when and where it will all stop. We certainly hope that the Senate Finance Committee will not add to the load by approving the aforementioned feature of the new tax bill.

We thank you for any consideration you give this letter. We request that this letter be made a part of the Senate Finance Committee's records.

Sincerely,

SANFORD M. BROOKS, *President.*

FAULTLESS CASTER CORP.,
Evansville, Ind., November 1, 1963.

HON. HARRY F. BYRD,
Chairman, Senate Finance Committee,
Washington, D.C.

DEAR SIR: We wish to offer a number of comments relative to one provision of H.R. 8363, the provision taxing employees on the cost of group term life insurance in excess of $30,000.

We are opposed to this provision of this bill for the following reasons:

1. We believe the number of persons who would be subject to this provision would be a relatively small group.
2. This type of coverage is normally the least expensive type available.
3. The accounting required to determine the taxable amounts would be greatly disproportionate to the number of people involved and to the taxes generated.
4. The total amount of tax collectible under this provision would be comparatively small.
5. It would be difficult, perhaps even impossible, to justify the additional checking by the Internal Revenue Service, and the additional governmental records required.
6. This provision would serve as a deterrent to our economic advancement in that life insurance is perhaps the best vehicle for the average citizens to provide an estate. The effect would be twofold, (1) a possible limitation on investment capital and, (2) a ceiling on family protection.
7. Imposition of such provision would be discriminatory against those persons who presently enjoy this insurance protection.

Thank you for your consideration in this matter.

Yours very truly,

WALTER W. NOELTING,
Executive Vice President and Treasurer.

THE ATLANTIC NATIONAL BANK OF JACKSONVILLE,
Jacksonville, Fla., November 1, 1963.

Hon. HARRY F. BYRD,
Chairman, Finance Committee,
U.S. Senate, Washington, D.C.

DEAR SENATOR BYRD: This is to register our sincere opposition to the group term life section of H.R. 8363, under which employees must include in their taxable income the cost of group life insurance over $30,000.

It seems to us that such a provision would impose a substantial and complicated burden of accounting both on the employer and the employees affected, without any commensurate increase in tax revenue.

For example, there is often a refund of premium on group insurance depending on experience; but this refund often is not paid until August, or later, in the year after the premium is paid, which would be after the employees have paid their income taxes.

We hope this complicating provision in H.R. 8363 will not be enacted.

Sincerely yours,

EDWARD W. LANE, Jr., *President.*

STANDARD OIL COMPANY OF CALIFORNIA,
San Francisco, Calif., October 31, 1963.

Hon. HARRY F. BYRD,
Chairman, Senate Committee on Finance,
New Senate Office Building, Washington, D.C.

DEAR SENATOR BYRD: The following statement is in opposition to the adoption of section 203 of H.R. 8363, the revenue bill of 1963. I respectfully ask that it be made a part of the record of the hearings on H.R. 8363.

Summary: No clear showing has been made by the proponents of section 203 of H.R. 8363 in support of a change in existing law which has been in effect since 1920. Present law has encouraged the growth of group insurance through the private enterprise system throughout industry with the result that today the beneficiaries of 39 million employees are protected by group insurance, the

total of which represents approximately one-third of all life insurance in effect today.

It is recommended that section 203 be deleted. The testimony before the Ways and Means Committee was concerned with the Treasury Department's proposal to tax premiums on insurance in excess of $5,000. Accordingly, no testimony was offered on the committee's solution as set forth in section 203 of the bill.

It is submitted that the proposal would produce inequities. It would harm industrial relations programs and dull employee incentive—and it does these things while producing no revenue of significance.

Let us consider the impact of this proposal on our program. In this case the company has two plans:

The first is a system of company-paid group insurance for all employees which was first started in 1914. Under this program, dependent only on length of service with the company, employees receive coverage at the end of 6 months of service equal to 3 months of earnings. This is increased until the attainment of 10 years of service at which time an employee is entitled to insurance coverage equal to 2 full years' pay at the company's expense.

The second plan is a contributory group life insurance plan which may be taken out voluntarily by employees to the extent of approximately 1 year's pay. Premiums are $7.20 per year per $1,000. Each year employees have received a rebate through waiving of premiums for about 2 months. So the net cost to the employees has been about $6 per year per $1,000.

Both of these plans, it should be noted, are available to the highest paid and the lowest paid in the company on a nondiscriminatory basis, being related solely to compensation and years of service.

The Treasury proposed certain tax reforms to eliminate inequities and achieve more revenue. Revenue would have been achieved had the Ways and Means Committee decided to go along with the recommendation to tax as income to employees the cost of such insurance in excess of $5,000 per year. Raising the exception to $30,000 reduces the revenue effect to such an insignificant number that it can be dismissed as a reason for making the change.

Accordingly, the present proposal should be examined in terms of equity and its effect on the industrial relations program and on employee incentive.

Equity: Our company has more than 4,000 employees whose pay is in excess of $10,000 per year. Included are members of such unions as Masters, Mates & Pilots, Petroleum Workers' Union, etc. These employees have in excess of $30,000 of insurance and are affected by the bill. A computer tape has been run on these employees assuming the bill, including the proposed 1965 tax rates, had been in effect in 1962.

More than 1,500 employees in the middle-management area would receive income tax credits under the bill—this means that these employees will in effect be paying less per $1,000 coverage than the lower paid employees they supervise. About 1,900 employees would pay more tax. About 700 younger employees would not be affected.

This comes about because section 203 upsets the practice of decades in charging a level premium for all age brackets and severely penalizes the older employee. On the basis of public policy Congress consistently has used the tax laws to encourage provision for families of deceased employees (joint returns for 2 years, head of household return, etc.), provision for retirement (social security, section 401 annuity plans), and aid to older citizens (extra exemption over 65, more generous medical deductions, etc.). This departure from past practice would impair longstanding family security arrangements.

Industrial relations program: The company will have the additional expense (deductible for tax purposes) of computing in payroll offices the positive and negative changes in income to employees under this proposal of withholding taxes, of reprinting its booklets for employee use (in this instance the cost of booklet and postage was in excess of $10,000), of amending its free life insurance plan so employees may have an option not to take the full amount because of the change in tax status, and of trying to explain to these affected employees why insurance of $30,000 or less receives different treatment than insurance over $30,000. It will have to answer why the young middle-management employee receives a tax discount on his insurance not available to the lower paid older employees under his supervision.

So, in essence, the House proposal would be disturbing and damaging to the morale of many thousands of employees.

Employee incentive: One objective of the Treasury's proposals was to increase incentive. Under the change in H.R. 8363 many of the employees in our company are to be told in effect that if this proposal becomes law each merit raise, each promotion, each effort to do a better job and have the company grow and provide better jobs will result in a new tax penalty on the added insurance resulting from their good work. It is particularly significant that the process of aging will result in additional taxable income without additional income with which to pay that tax.

If, in spite of the foregoing arguments, Congress believes some legislation in this area is desirable, it is recommended that—

(1) The present law should be retained with the added requirement that group insurance plans covering employees be nondiscriminatory.

(2) If any limitation on such plans is made it should be in terms of multiples of annual compensation rather than on the basis of an arbitrary $30,000 ceiling.

(3) If under the solution to be adopted by Congress an employee is to be taxed on the premiums paid by an employer on his behalf, it should be based on the average cost basis regardless of age.

The latter, we believe, is the most important. It is most desirable to have any legislation involving the taxation of premiums on group life insurance based on the longstanding practice in group insurance plans of charging a level premium rate to all employees regardless of age. This has the virtue of maintaining the practice employees have been using for years, of avoiding the complicated bookkeeping under the H.R. 8363 proposal, and of eliminating from tax impact any group insurance plan to which the employer makes no contribution.

In addition, the adoption of a level premium concept regardless of age of the employees will eliminate the complex tax credit feature of H.R. 8363. Under this bill an employee may receive a tax credit because he is young even though he is in a higher tax bracket than the lower paid but older employees. This feature represents regressive taxation, and is undesirable in any tax measure, let alone one which is designed to give relief to taxpayers.

Respectfully submitted.

H. L. SEVERANCE, *Secretary*.

LAW OFFICES, ROSS, HARDIES & O'KEEFE,
Chicago, Ill., October 31, 1963.

Hon. HARRY F. BYRD,
Chairman, Senate Finance Committee,
U.S. Senate, Washington, D.C.

DEAR SENATOR BYRD: I am forwarding herewith five copies of a statement submitted in behalf of the Chicago Association of Commerce & Industry relative to H.R. 8363. We urge the prompt enactment of H.R. 8363.

It will be appreciated if this letter and the statement may be made a part of the record.

Very truly yours,

WALKER WINTER.

STATEMENT BY WALKER WINTER, CHAIRMAN, FEDERAL REVENUE AND EXPENDITURES COMMITTEE, CHICAGO ASSOCIATION OF COMMERCE & INDUSTRY

The Chicago Association of Commerce & Industry welcomes this opportunity to present its views with respect to the revenue bill of 1963, H.R. 8363, now being considered by the Senate Finance Committee.

The membership of the Chicago Association of Commerce & Industry consists of approximately 6,000 business and professional organizations with active participation by some 10,000 individuals from such organizations in the Chicago metropolitan area.

The recommendations of the association with respect to H.R. 8363 were prepared by the association's Federal revenue and expenditures committee consisting of 60 members and have been approved by the association's 60-member board of directors. The viewpoints presented broadly represent, therefore, those engaged in business in the Chicago metropolitan area.

FISCAL RESPONSIBILITY

The association supports H.R. 8363 with the modifications hereinafter suggested and urges its enactment without delay. It fully recognizes the dangers and ill effects of deficit financing by Government and urges both the President and the Congress to make every effort to reduce spending so as to preclude deficit financing except in cases of extreme emergency.

The association is fully aware of the views of many that a reduction in tax rates should not be considered until there has been a substantial reduction in Federal expenditures. We are in sympathy with these views. Nevertheless, in our judgment the retention of the present oppressive rate structure carries with it a greater danger of a substantial budget imbalance for the future than does a reduction in those rates. Business modernization and the expansion of industrial plant can proceed at an accelerated pace if present tax rates are reduced. We believe that the shortest route to a balanced budget is through the enactment of the tax bill this year.

Stated from a different point of view, we believe the alternative to the prompt enactment of H.R. 8363 while business confidence is high, is a new surge in Federal spending programs. Once such programs are undertaken it would, indeed, be many years before rate reduction could again be considered.

RECOMMENDATIONS WITH RESPECT TO H.R. 8363 PROVISIONS

Many of the provisions in H.R. 8363 do not have major application to association members. Our comments, therefore, are limited to the sections in which our members do have a particular interest.

Reduction of income tax rates and related amendments

It is the position of the association that the rate reductions in H.R. 8363 have not been fairly allocated to the various income groups. Specifically, we believe that more of the reduction should have been allocated to the middle-income brackets and less to the lower brackets. It has been our position consistently that the reductions in the middle and upper brackets should be at least proportional to the reductions in the lower brackets in order to provide investment incentives.

In this same connection, we do not believe there is justification for removing many taxpayers from the tax rolls entirely through the enactment of a minimum standard reduction. This may be politically advantageous. It does not, however, encourage citizenship responsibility.

With respect to corporate reductions, we believe the acceleration of the installment payments of estimated income tax is unfortunate since the effect is to delay for many years the cash benefit of any tax reduction for corporations of substantial size. This will defeat one of the announced objectives of the legislation; namely, the expansion in the corporate sector.

Should this provision become law, however, a procedure should at least be available to permit a quick refund to a corporate taxpayer which has substantially overpaid its tax.

In the event rate reductions for corporations now provided for in the bill should be reduced, a new schedule for the payment of estimated taxes will clearly have to be worked out or many corporations will be in a cash deficit position.

STRUCTURAL CHANGES—DIVIDENDS RECEIVED BY INDIVIDUALS

We oppose most strenuously the elimination of the credit for dividends received by individuals. The credit now allowed, though small in percentage, has in part reduced the prior complete double taxation of corporate earnings. We believe the dividends received credit should be continued at its present rate and increased in the future.

INVESTMENT CREDIT AND ADJUSTMENT TO BASIS

We opposed the investment credit initially because we thought it provided a subsidy to one segment of business. Congress, however, in its wisdom, enacted the investment credit but most unfortunately in a way which has made recordkeeping by taxpayers most difficult. In order to simplify the application of the credit we support the elimination of the requirement that the investment credit be subtracted from a taxpayer's basis for depreciation. We also expressly support the provisions of section 202(e) of the bill relating to the treatment of the investment credit by Federal regulatory agencies.

GROUP TERM LIFE INSURANCE

We believe the $30,000 group term life insurance limitation inserted in the bill by the Ways and Means Committee is unrealistic in the light of general business practices with respect to group term insurance. It should be modified. We suggest the $30,000 limitation be increased to permit group term life insurance coverage of twice the employee's salary with a maximum ceiling of $100,000. Employees making less than $15,000 per year would, of course, continue to be governed by the $30,000 limitation.

CHARITABLE CONTRIBUTIONS AND GIFTS

We support the increase to 30 percent of charitable contributions as provided for in section 209 of the bill. We also support the other provisions of section 209.

MOVING EXPENSES

We support the provisions in the bill relating to the deductibility of moving expenses of new employees. We urge further that the committee explore the possibility of codifying the rules with respect to the deductibility of moving expenses of present employees.

STOCK OPTION PROVISIONS

The changes contemplated in section 214 concerning employee stock option and purchase plans are overlabored and technical and should be simplified.

CAPITAL GAINS AND LOSSES

We support the enactment of section 219 of the bill relating to the taxation of capital gains and losses although we deplore the complexity which is added to the code by this section. Also, we seriously question that the proposed change will unlock substantial capital investments which are now frozen.

We are unalterably opposed to the recommendation of the administration that capital assets acquired at death retain the basis of the decedent in the hands of the heir, legatee, or devisee.

INCOME AVERAGING

We favor the provisions in the bill relating to the averaging of income. We urge their enactment.

CONSOLIDATED RETURNS

We support the elimination by section 222 of the bill of the 2-percent tax on corporations filing consolidated returns.

STATEMENT BY PALMER W. HANCOCK, VICE PRESIDENT AND TREASURER, OWENS-ILLINOIS GLASS CO., IN REFERENCE TO SECTION 212 OF H.R. 8363: MOVING EXPENSES

Owens-Illinois Glass Co., in behalf of its employees, requests that H.R. 8363 be revised to permit exclusion from employees' taxable income of employer reimbursements of certain household moving expenses incurred in transferring employment location as requested by the employer.

Current provisions in H.R. 8363 limit exclusion from taxable income, of the employee who moves his place of residence, to the transportation expenses of the employee and his family, and the cost of moving his household goods and personal belongings. Accordingly, the Internal Revenue Service considers as taxable income to the employee reimbursement of any other expenses incurred by the employee in connection with the moving of his household.

Among the other expenses an employee may incur under these circumstances is a possible loss on the sale of his home in the location from which he is being transferred by his employer. Frequently, the property to be sold must be marketed too quickly to permit the employee to realize full value from it. Or, perhaps it must be placed on the market at a time when residential prices are temporarily depressed because of excess of supply over demand in the community. If, under any circumstances, the employee must assume a loss in the disposal of his home, he is doing so at the request of his employer and the conditions that make the sale at loss necessary are not of his own devising. If employer re-

imbursement of the amount of the employee's loss on the sale of his home under such circumstances is not excluded from the employee's taxable income, it represents a tax liability of the employee incurred in a situation he did not create and over which he has little control.

We respectfully suggest that the exclusion from the employee's taxable income of employer reimbursement of any loss the employee incurs in disposal of his home under these conditions is fully justified. And, we request the Senate Finance Committee to give favorable consideration to the addition of a statement to section 212 of H.R. 8363 specifically requiring that this kind of employer reimbursement be excluded from the employee's taxable income.

There is another expense related to an employee's movement of his household for which we believe employer reimbursement should not be considered taxable income to the employee. This is the actual living expenses for the employee and his family in their new location for a reasonable period of time while he is in the process of acquiring a new home or permanent residence in the new location.

Arrangements for disposal of a home in one location and the acquisition of a home in another seldom can be scheduled with such precision that they can be handled simultaneously by the employee. In almost every case, there is a period during which the employee must house his family temporarily in a motel or hotel while completing acquisition of his permanent residence in the new location. Here again, the expense incurred by the employee results from circumstances he did not devise and for which he has had little or no opportunity to minimize the expense involved.

Specific recognition in H.R. 8363 as nontaxable income to the employee of temporary living expenses for the employee and his family that are reimbursed by the employer is, we believe, justified.

I would like to add a word about the employees most frequently involved in job location transfers. The large majority of transferred employees in our company are young men with young families. They are usually young men of some promise in our business and their job location transfers are frequently arranged to widen their experience in their specific fields, to help them "grow" in terms of their future value to our business. Only rarely is the transferred employee one with an income sufficient to permit him to absorb some family moving expenses without undue personal financial loss. For the most part, our transferred employees have relatively modest annual incomes, and increased tax liability resulting from reimbursement of moving expenses could mean a financial penalty for them when they can least afford it.

Employees with children established in school and with numerous community ties, frequently encounter family resistance to moving to another location. This is especially true when it is realized that the family may incur some financial loss in connection with the move. These circumstances represent an obstacle to the employer in broadening the experience of young men of promise. They represent a deterrent to "labor mobility," of which the President spoke in his message to the Congress recommending that newly hired employees receive the same exclusion from taxable income for reimbursed moving expenses that is available to inservice employees.

In summary, we believe that recognition of employer reimbursements for loss on the sale of a home and for family living expenses at the new location for a reasonable period of time as excludable income for income tax purposes is called for out of—

(*a*) The necessity of fair treatment of transferred employees by the employer,

(*b*) The need of the employer to overcome family resistance to employee transfers, and

(*c*) The desire to promote and facilitate "labor mobility" and thus insure one condition that can contribute to higher employment levels throughout the country.

ROHM & HAAS CO.,
Philadelphia, Pa., October 31, 1963.

HON. HARRY F. BYRD,
Chairman of the Senate Finance Committee,
Old Senate Office Building, Washington, D.C.

DEAR SENATOR BYRD: I am writing to bring to your attention one aspect of the income tax bill that was passed by the House of Representatives which is of particular concern to us as an employer and to our employees as well. Our concern is with the provision that will require employees to pay income tax

on group term life insurance premiums paid by the employer for insurance in excess of $30,000. It has been said by some that this will close a loophole which has favored top, highly paid executives. This is hardly the case in our company, for the proposed legislation will subject our foremen as well as those in higher levels of supervision to the tax on insurance premiums. In fact, if inflation and wage levels continue to increase in the next 15 years as they have in the past 15 years, our hourly wage personnel will become subject to the tax.

The Rohm & Haas Co., as you may know, manufactures chemicals, plastics, and related products. We have manufacturing facilities and branch offices in various locations. The total personnel complement of the company exceeds 9,000 persons.

For many years we have had noncontributory life insurance benefits for all of our employees. We have taken pride in our ability to provide adequate coverage to our people at no cost to them. The amount of insurance is geared to the employee's earnings. Under our plan, the employee's insurance coverage passes the $30,000 mark at an income level of approximately $10,500 per year. It can hardly be said, therefore, that the proposed legislation will affect only a few highly paid executives. In fact, about 10 percent of the total number of employees in our Louisville plant would be affected immediately.

It appears probable that in years to come the tax would affect hourly wage earners as well as supervisory personnel. This is likely for two reasons. The first is the continuing increase in wage rates, which in about 15 years may bring the hourly wages of our more highly skilled jobs to a level where the corresponding insurance coverage will reach the $30,000 mark. Secondly, we cannot overlook the probability that, once this source of income has been subjected to tax, the exemption may be lowered from $30,000 to a lower figure. In the administration's original recommendation, President Kennedy proposed an exemption of only $5,000. The average employee in our Louisville plant has approximately $16,000 of insurance coverage paid entirely by the company. Our lowest hourly base wage rate yields an insurance coverage of $11,000, so that even these employees would be subject to the tax under the President's original proposal.

In reviewing insurance tables which the Internal Revenue Service has prepared and may use as a basis for administering the proposed tax, we are struck by the rate at which the tax burden on employees would increase as they approach the normal 65-year retirement age. By way of illustration, the following tabulation shows the approximate taxable premium for our employees at the $11,000 and $15,000 annual salary levels at various ages:

Premium subject to tax under Rohm & Haas insurance plan ($30,000 insurance exemption)

Salary	Age 45	Age 60	Age 63
$11,000	$25	$175	$495
$15,000	120	520	915

In view of the close relationship between the Kentucky State income tax structure and the Federal tax structure, we cannot help feeling that this might become an additional State tax as well as a Federal tax, increasing still further the already heavy tax burden of our employees in Kentucky.

The computation of each employee's additional taxable income for insurance premiums paid by the employer will place a heavy administrative burden on the employer, since this figure will have to be calculated individually for each employee, according to his insurance coverage and age. The resulting increased corporate expense is tax-deductible at corporate rates and will offset, in a large measure, the revenue collected from individuals.

We cannot help but look upon the proposal to tax group term life insurance—whatever the limit—as a breach of faith toward employees who are covered by group term life insurance plans. For at least 43 years the tax rule has been that premiums paid by employers under such policies are not taxable income to the employees. To change such a long, historical practice will without doubt create ill will on the part of employees and employers alike. It is not inconceivable that the proposed legislation could put an end to many group term life insurance programs.

We sincerely hope that the Senate Finance Committee will reject the change in the existing law with respect to taxation of employer-paid group term life insurance premiums.

Respectfully yours,

E. T. SAUER, *Plant Manager.*

OHIO STATE NURSES ASSOCIATION,
Columbus, Ohio, October 30, 1963.

Hon. HARRY F. BYRD,
Chairman, Senate Finance Committee,
U.S. Senate, Washington, D.C.

DEAR SENATOR BYRD: The Ohio State Nurses Association urges your favorable consideration of those recommendations in the President's special message on tax reduction and reform that would permit working women a more liberal deduction for expenses incurred for the care of children and of other dependents who are unable to care for themselves.

For those nurses who must work to raise the family standard of living or to make an urgently needed contribution to the health and welfare of the citizens of Ohio, the present deductions allowed for child care are quite inadequate. Many nurses do not seek employment because of the unfavorable disproportion between the cost of child care and prevailing salaries. At this time of critical nurse shortage, a more realistic deduction for child care would encourage many inactive nurses to return to the profession.

Another problem of great importance is the cost of providing for dependents unable to care for themselves. This group of individuals includes elderly ill persons and physically and mentally handicapped children. The present law permits only token deductions in these cases of extraordinary expense. Therefore. we also support the President's proposed tax relief for these expenses.

The Ohio State Nurses Association requests favorable action on these vital matters.

Sincerely,

DOROTHY A. CORNELIUS, R.N.,
Executive Director.

OREGON NURSES ASSOCIATION, INC.,
Portland, Oreg., October 30, 1963.

Hon. HARRY F. BYRD,
Chairman, Senate Finance Committee,
Washington, D.C.

DEAR SENATOR BYRD: The Oregon Nurses Association urges your favorable consideration of Senator Maurine Neuberger's proposed amendment to H.R. 8363 that would permit workingwomen a more liberal deduction for expenses incurred in the care of children and of other dependents who are unable to care for themselves.

Of the 5,843 nurses actively employed in Oregon during the past year, 4,117 are married. Of this number 44 percent are in the 19-to-40 age group. Of the 1,601 nonpracticing nurses, 1,426 are married. Of this latter number 51 percent are in the 19-to-40 age group. Approximately one-third of all practicing nurses accept employment on a part-time basis only.

In common with all States, Oregon has a critical shortage of professional nurses. Our primary source of qualified nursing personnel may be found in the ranks of the nonpracticing or partially practicing nurses. Many have stated that they would return to practice if it were economically feasible for them to do so.

There are others who are the sole support of their families and who must employ individuals to care for dependents who are unable to care for themselves. These find the present limitations on deductions for child care entirely inadequate. The cost of competent, responsible household help consumes much of their income.

Adequate numbers of qualified nurses are essential to the maintenance of the health of the citizens of our country. We hope, therefore, that you and the members of your committee will give serious consideration to providing the much-needed relief.

Sincerely,

BERTHA G. BYRNE
Mrs. Bertha G. Byrne,
Executive Secretary.

WASHINGTON STATE NURSES ASSOCIATION, INC.,
Seattle, Wash., October 30, 1963.

Hon. HARRY F. BYRD,
Chairman, Senate Finance Committee,
U.S. Senate, Washington, D.C.

DEAR SENATOR BYRD: The Washington State Nurses Association, a constituent of the American Nurses' Association, urges your favorable consideration of the amendment to H.R. 8363 proposed by Senator Maurine Neuberger to provide more liberal deductions when expenses are incurred for the care of children and dependents unable to care for themselves.

As a representative for some 4,000 registered nurses in the State of Washington, we feel that such liberalizing deductions are particularly important to the nursing profession because of the prevailing low salaries paid to nurses. Furthermore, this relief is desperately needed if we are to recruit married mothers back into the profession. There is at present, as you know, a serious shortage of nurses working, not only in our State but throughout the Nation.

This summer in Seattle, for example, 8 leading hospitals were short 132 budgeted positions for registered nurses.

We would like to quote a real-life example of a married nurse who finally left her profession because her take-home pay did not make it worthwhile for her to continue.

The general duty nurse received, from a salary of $410 a month, a net take-home pay of $326, which averaged out to $14.80 per day. She had two preschool children for whom she had to hire a nurse-housekeeper—$10 per day. Living in the suburb, it was necessary for her to own a car for transportation to the hospital—$1.70 minimum per day for maintenance and costs; laundry on uniforms, 30 cents a day; lunch, 60 cents a day. She found herself with a total of $2.20 per day profit, unless it happened that that day she got a run in her white stockings, bought whitener for her nurses' shoes, or decided to have an extra cup of coffee.

Perhaps this simple example will give you some of the reasons why we feel many married nurses are not continuing to work, although they are badly needed. And most nurses, educated for a profession they chose, would like to work within that profession if they could afford to do so.

We have chosen, for example, a general duty nurse. Yet we know the same arguments prevail in another area where professional nurses are so badly needed—in the field of nurse education.

Because we feel these liberalizing deductions will help to keep registered nurses working within the profession and will also help to recruit married nurses back into the profession, we ask you to give special consideration to the amendments to H.R. 8363.

Sincerely yours,

MRS. GERALDINE FLETCHER, R.N.,
Executive Director.

DAYTON AREA CHAMBER OF COMMERCE,
Dayton, Ohio, October 31, 1963.

Hon. HARRY FLOOD BYRD,
Chairman, Finance Committee,
U.S. Senate, Washington, D.C.

DEAR SENATOR BYRD: Recently the Board of Directors of the Dayton Area Chamber of Commerce at Dayton, Ohio, adopted a resolution urging Congress—

(i) To defer consideration of any more technical changes in the Internal Revenue Code pending further study by the Congress of needed basic tax reforms;

(ii) To enact the tax rate reductions now contained in the revenue bill of 1963 (H.R. 8363) as passed by the House of Representatives; and

(iii) If additional provisions are to be included in the bill, to not only increase the dividend exclusion but also the dividend credit (rather than repeal the dividend credit as presently provided in the bill) to the end that relief from double taxation of corporate earnings be extended, not contracted, and the furnishing of risk capital to corporate enterprise be made more attractive, rather than less attractive.

A copy of this resolution is enclosed with a request that it be read at a meeting of the Senate Finance Committee and be spread upon the record of the proceedings of the committee relating to the consideration of this bill.

In closing, I would like to emphasize that the Dayton Area Chamber of Commerce in no way disagrees with, or supports those who disagree with, the proposition that the reduction of Federal expenditures and balancing the budget is equally as important as tax relief. It is felt, however, that (i) reduction of the excessive and confiscatory rates of income taxation is important in and of itself and will give the economy a needed and welcome spur by helping to restore the incentive to business enterprises, thereby producing more jobs and more capital investments; (ii) although the rates contained in the present bill are not low enough, at least they are a step in the right direction; (iii) although a reduction in Federal expenditures is extremely important and continued assurances from Members of the Congress and the Executive for limiting expenditures should constantly be sought, it is doubtful that a workable commitment to this end can be incorporated into law, and even if possible, it would be unwise because an automatic or discretionary trigger making tax rates higher or lower would be too "iffy" and uncertain a basis upon which sound business decisions could be made.

If you or the members of the committee desire any additional information or expressions of opinion on this subject, I would appreciate your letting us know.

With best wishes.

Sincerely,

JULIAN DE BRUYN KOPS,
Chairman, National Affairs Committee.

POSITION OF THE DAYTON AREA CHAMBER OF COMMERCE RELATIVE TO FEDERAL INCOME TAX BILL (H.R. 8363)

The National Affairs Committee of the Dayton Area Chamber of Commerce acting upon the report and recommendation of the tax revision and spending control subcommittee with respect to the 1963 Federal income tax bill (H.R. 8363), passed the following resolutions on the above date:

"*Be is resolved,* That the Board of Directors of the Dayton Area Chamber of Commerce urges Congress—

"(1) To defer consideration of major technical changes in the Internal Revenue Code until it can and does enact a program of basic reform in the income tax structure;

"(2) To enact the rate reductions as contained in the revenue bill of 1963 (H.R. 8363) as passed by the House of Representatives; and,

"(3) If provisions other than rates are to remain in the bill, to remove the provision in H.R. 8363, eliminating the 4-percent dividend credit. This provision would be a most unfortunate repeal of the principle that relief from double taxation is necessary if equity capital is to continue to be available to corporate enterprise. The increase in the dividend exclusion to $100, of course, is a step in the right direction, but to remove the dividend credit is most discriminatory and unfair. If anything, the exclusion and the credit should be increased so as to eliminate as much as possible the unfair double taxation of income from corporate activity.

"*Be it further resolved,* That copies of this resolution be sent to the chairmen of the Senate Finance Committee and the House of Representatives Committee on Ways and Means, all members of these commitees, and the Senators and Representatives from Ohio."

Adopted by the Board of Directors, Dayton Area Chamber of Commerce.
DAYTON, OHIO, *October 15, 1963.*

(Whereupon, at 12:10 p.m., the committee recessed, to reconvene at 10 a.m., Tuesday, October 29, 1963.)

REVENUE ACT OF 1963

TUESDAY, OCTOBER 29, 1963

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 (presiding), Smathers, Douglas, Talmadge, Hartke, Ribicoff, Bennett, Morton, and Dirksen.

Also present: Elizabeth B. Springer, chief clerk.

The CHAIRMAN. The committee will come to order.

The Chair offers for the record a statement from Eugene P. Foley, Administrator of the Small Business Administration.

(The statement referred to follows:)

STATEMENT OF EUGENE P. FOLEY, ADMINISTRATOR, SMALL BUSINESS ADMINISTRATION

INTRODUCTION

The Small Business Administration welcomes this opportunity to present its views to this committee on H.R. 8363.

The Small Business Administration is the Federal agency which Congress has specifically directed to "aid, counsel, assist, and protect the interests of small business * * *." Accordingly, it strongly urges, on behalf of the small business community, the adoption of this tax bill.

The most urgent task confronting this session of the Congress is to revise our income tax system to reduce taxes and to increase tax equity, a revision that is long overdue. By no single action can this Congress contribute more to expand consumer demand, reduce unemployment, improve investment opportunities, increase productivity, and prolong the higher rate of growth and vigor essential to the achievement of our national goals.

Our Federal income tax system is one of the most pervasive and important influences affecting our economic life. As presently constituted, it leaves salary and wage earners too small a proportion of their earnings as take home pay, thereby unduly restricting consumer purchasing power. It takes too large a bite out of the incomes of the farmers, small businessmen, and other self-employed enterprisers, thereby destroying the seedbeds and weakening the very foundations of our private enterprise system. It penalizes the efficiency and profitability of corporate endeavor, both large and small. It reduces savings and the availability of capital, especially to small businesses and new enterprises. It drives investments under protective cover and away from their most productive uses in the economy. In brief, our present income tax structure restricts economic activity and weakens our incentives to work and save. The purpose of H.R. 8363 is to lighten this tax drain and to relieve our economy of other restrictive influences of the tax system.

THE POSITION OF THE SMALL BUSINESS ADMINISTRATION

The Small Business Administration is gratified that many of the provisions of this tax bill are designed to give particular encouragement to small business. The Small Business Administration does not take the attitude that the interests of small business in matters of taxation differ in kind from those of large busi-

ness or that such interests are necessarily inconsistent or incompatible with the interests of large business organizations. Rather, it takes the position that there is definitely a difference in degree, though there may not be a difference in kind, in the relative impact of taxes on large and small businesses. Accordingly, it congratulates the House for recognizing this difference in degree and for the solicitude generally that it has shown for the interests of the small business community. The Small Business Administration, however, does not wish to appear as a special advocate pleading for differential tax measures favoring small business that would not also be in the best interest of the total economy.

The Small Business Administration strongly supports this tax bill. While some of the provisions have special significance for small business, the effects on small business of most of the provisions would be in the shadow of the broader economic and fiscal consequences that the proposed tax reforms would have on the economy generally. Small business would reap its share of these general benefits.

SMALL BUSINESS AND ECONOMIC EXPANSION INDUCED BY TAX REDUCTIONS

By far the greatest benefits that small business would derive from the adoption of this tax bill would flow indirectly from participating in the general expansion in the economy that would be induced by lowered taxes. Most small businesses would immediately feel the thrust of the quickening of economic activity that would flow from the substantial, broad-scale tax reductions that would become effective early in 1964.

The stimulating effect on the economy of the personal income tax reductions would be immediate. These tax reductions would average about 20 percent of the current tax liabilities of most taxpayers, two-thirds of which would become effective in 1964. Historical spending practices of the people indicate that from 92 to 94 percent of these tax savings would be reflected in increased consumer purchases. The remaining 6 to 8 percent would probably flow into increased private savings and investments.

Small businesses would be among the first to feel the thrust of the increased consumer demand. A very substantial proportion of small businesses would be affected immediately, as small businesses are heavily concentrated in the trade and service industries. Throughout the South, the Central, and the Western portions of the country the increased purchasing power of the farmers and their households would be reflected in increased sales by general merchandise stores, hardware stores, home equipment suppliers, farm machinery and equipment dealers, and other small businesses. Similarly, small scale trade and service industries in the industrial and commercial centers of the mid-Atlantic, North Central, and other States would immediately feel the impact of the increased after-tax take home pay of salary and wage earners.

Small businesses engaged in manufacturing, construction, and various other activities would surely feel the impact of the general economic expansion that would be induced by lower taxes. They would benefit from the increased demand of wholesalers and retailers to replenish their inventories depleted by higher personal consumption expenditures.

REDUCTION IN DIRECT TAX COSTS OF SMALL BUSINESSES

The second most important benefit that small businesses would derive from the adoption of this tax bill would be the direct tax relief that they would be afforded. The owners of a high percentage of the 4 million sole proprietorships and partnerships, excluding the agricultural, forestry and fishery, and personal service enterprises, would experience personal income tax reductions of over $500 million in 1964 and an additional $250 million or more in 1965.

Over one-half million small corporations with annual net profits of less than $100,000 would have their income taxes reduced by over $450 million in 1964. These comprise over 95 percent of the Nation's taxpaying corporations. Collectively, the 4.5 million enterprises comprising the small business community constitute more than 95 percent of all American business firms and account for about 40 percent of total business volume. Quite obviously, they, and the 30 million people for whom they provide gainful employment, have a stake in the adoption of this tax bill.

TAX REDUCTIONS AND SMALL BUSINESS ENTERPRISE FINANCING

The proposed reductions in the direct income tax costs of the 4.5 million small business enterprises would increase their after-tax incomes by almost $1 billion in 1964 and by almost $1.25 billion in 1965 and subsequent years. In large part, these increased after-tax earnings of small corporations and of the owners of sole proprietorship and partnership enterprises would be available to them for strengthening their basic financial positions, for modernizing their plants, equipment, and other physical facilities, and for continued growth and expansion generally.

The strengthened financial position and increased after-tax profitability of these small buisnesses would, in turn, make them better credit risks and more attractive and profitable places for the investment of equity capital, both by their present owners and by other investors. Finally, but not least, the increased after-tax earnings potential of these small businesses would increase incentives for their owners to plough back into these businesses the additional funds which they would have at their disposal.

Reduced income tax rates would make investments in business enterprise relatively more attractive as contrasted with alternative investments in tax exempt State and local securities, real estate shelters, and other tax avoidance channels.

Briefly, the increased profitability and strengthened financial position of small businesses would attract some of the additional supply of available capital into new investments in smal business enterprises. Also, the increased profit prospects of small businesses would improve their borrowing power. Thus, this tax bill would contribute materially toward relieving small businesses of their perennial financing problem, a problem which provided one of the principal motivating forces in Congress for establishing the Small Business Administration and for enacting the Small Business Investment Act.

REVERSAL OF CORPORATE NORMAL AND SURTAX RATES

Appreciable tax relief would be afforded all corporations, large and small, but the relief afforded small corporations would be relatively greater and much more immediate than the relief afforded the larger corporations.

The reversal of the corporate normal and surtax rates would cut the tax on corporations with taxable income not in excess of $25,000 by 26.7 percent. The average effective rate paid by other small corporations, those with annual profits in excess of $25,000, would be reduced from 26.7 percent down to around 12.4 percent for corporations with annual profits of $100,000. These reductions compare with reductions ranging from 7.7 to 8.7 percent in the average effective rates that would be paid by the large corporations.

The Small Business Administration concurs in the following views expressed by the House Ways and Means Committee:

"* * * It is important to provide a greater rate reduction for small businesses because of their importance in maintaining competitive prices in our economy, and also because of the greater difficulty small businesses have in finding outside funds to finance their expansion. As a result, they have traditionally found it necessary to expand largely out of income remaining after tax."

These tax differentials favoring small corporations are needed to strengthen their competitive position. The differentials would increase their relative ability to retain internally generated funds to meet capital requirements, for debt amortization, and for growth and expansion.

REPEAL OF THE PENALTY TAX ON FILING CONSOLIDATED RETURN AND IMPOSITION OF PENALTY TAX ON MULTIUNIT CORPORATIONS

The solicitude of the House for safeguarding the differential tax advantage proposed for the smaller corporations is evidenced by the precautions taken to restrict large corporations from taking advantage of the differential that would result from reversing the corporate normal and surtax rates. First, the bill would repeal the 2-percent additional tax on filing consolidated returns. Second, it would impose an additional 6-percent tax, or a combined rate of 28 percent (22 percent normal plus 6 percent additional) on the first $25,000 of net profits of each unit of a multiunit corporation that elects to take multiple surtax exemptions. These two measures would limit any new tax advantage that large corporations might have for continuing or for electing to be taxed as multiunit corporate structures.

DIVIDEND CREDITS AND EXCLUSIONS

The bill would repeal the present dividend credit provision and increase the dividend exclusion from $50 to $100 (from $100 to $200 for married persons who file jointly). Doubling the dividend exclusion would benefit primarily the small investors and, in particular, the shareholders of most small, family held corporations. On the other hand, repealing the dividend credit would remove the current tax premium on dividend income in excess of the dividend exclusion level as contrasted with income from other types of investments, a premium which currently goes mostly to large investors. Whether the removal of this premium would affect appreciably the availability of equity capital to small corporate enterprises is speculative.

CAPITAL LOSSES

Individuals would be allowed an unlimited carryover, instead of the present 5-year limitation, of capital losses up to $1,000 annually. This provision would enhance appreciably the attractiveness of investments in new enterprises, particularly in small, risky ventures. It would also help the smaller investors who may not have the portfolio diversity to make it feasible for them to match capital gains and losses in only a 5-year period.

GAINS ON DEPRECIABLE PROPERTY

The difference in the treatment of capital gains realized on the sale of depreciable real property, that would be provided under the provisions of this bill, would result in increased taxation of gains realized by most types of business enterprises, both large and small, from the sale of all kinds of depreciable real property used in their business operations where the properties are sold within from 21 months to 10 years after their acquisition. While this change would perhaps impose an additional tax on some small business enterprises, it may be necessary to make this change in order for the Internal Revenue Service effectively to curtail current abuse by some taxpayers of using real estate shelters as a tax avoidance device.

INCOME AVERAGING

The limited income averaging provisions of the present law would be repealed and a broad 5-year averaging provision would be provided. This change would benefit all persons, with few exceptions, who receive, in a single year, unusually large amounts of income as compared to their average income for the preceding years. This change would lower the average tax burden on the proprietors of many small business enterprises whose profits fluctuate widely from year to year. It would be particularly helpful to the proprietors of small businesses that are heavily influenced by cyclical factors or sudden changes in business activity.

INVESTMENT TAX CREDIT

The depreciable base of property eligible for the investment tax credit would not, as at present, be reduced by the amount of the credit. This would enable taxpayers to increase somewhat their deductions for depreciation. The present requirement that the depreciation base be reduced by an amount equivalent to the credit complicates compliance and reduces the value of the credit.

The compliance problem, under the present investment credit provision, is particularly difficult for small business. Deduction of the credit for depreciation purposes requires taxpayers to keep two sets of depreciation accounts, one for tax compliance purposes and one for their own purposes of determining profits and managing the businesses. This is not a serious problem for large corporations that have specialized accounting staffs, but it materially complicates the accounting of small businesses.

The applicability of the investment tax credit would be broadened to include escalators and elevators. Also, the present credit provisions would be amended to insure that the distributors of leased property would receive treatment comparable to that of the manufacturers. These revisions would be particularly helpful to certain small businesses and would insure more equitable application of the investment tax credit.

SICK PAY EXCLUSIONS

The $100 per week sick pay exclusion that is currently available after a 7-day waiting period (unless the employee is hospitalized or injured, in which case

it is available immediately) confers unwarranted tax benefits, particularly on employees who have sustained only minor injuries. This provision is unjustifiable in its present form, as it encourages malingering by putting a tax premium on idleness and absenteeism. The present tax bill would correct this situation by extending the 7-day waiting period to 30 days and would make the exclusion available only for the time extending beyond the 30-day waiting period. This waiting period would also apply whether or not the employee is hospitalized or injured. Malingering and absenteeism by employees of small enterprises that have only a few employees can seriously handicap their operations. The tax premium on such conduct by employees should be removed.

OTHER TAX REFORMS

Numerous reforms would be provided with respect to the taxation of employee group term life insurance, restricted stock options, depletion allowances on oil and gas properties, and so forth. These revisions are extremely technical and complex. Furthermore, they would have limited application to small businesses. While these provisions could possibly affect adversely a few small businesses, the number that would be affected in this way would be relatively small. Generally, exception are made to take care of small business situations. Accordingly the Small Business Administration takes the position that these reforms are perhaps needed to curb present abuses of the income tax laws.

CONCLUSION

The most urgent task confronting this session of Congress is to revise our income tax system to reduce taxes and to increase tax equity. Revision of our income tax system is crucial and long overdue. In no other way can this session of the Congress contribute so much to the solution of our current economic problems.

Small business can prosper best in a rapidly growing economy. The principal objective of this tax bill is to lighten the debilitating drain of taxes on our economic life and thereby expand effective consumer demand, improve investment opportunities and incentives, increase productivity, and step up our rate of economic growth and expansion. The greatest benefit that small business would derive from the adoption of this tax bill would come from participating in the revitalized economy. Increased income and profits from expanded business and the many other advantages that small businesses would realize from operating in the improved business environment would surely exceed the direct benefits they would realize from tax savings.

The second most important benefit that small businesses would derive from the adoption of this tax bill would be the direct tax relief that would be afforded. This would be substantial. Appreciable relief would be afforded all businesses, large and small, but the relief afforded sole proprietors, partnerships, and small corporations would be relatively much greater and more immediate than the relief that the larger businesses would obtain. The relief to small corporations, in particular, that would result from the reversal of the corporate normal and surtax rates would be relatively much greater and more immediate than the relief that would be realized by the larger corporations.

In large part, the increased aftertax earnings of small businesses would be available for strengthening their financial position, for modernizing their plant and facilities, or for growth and expansion. In either event, they would be strengthened as a competitive force in our economy. Furthermore, inadequate financing is one of the most pervasive problems of small business. The substantial tax reductions that small businesses would derive under the provisions of this tax bill would mitigate appreciably this financing problem, as the increased aftertax profitability of small businesses would make them better credit risks and more profitable places for the investment of equity capital.

This tax bill contains many structural provisions that would result in increased equity in the taxation of small business. Small business would also benefit in a variety of other ways from these structural reforms. Some of these reforms are general in character; others are designed especially for the benefit of small businesses. With rare exceptions, small business would benefit generally from all of these reforms.

Those of us who are particularly interested in the welfare of small businesses urge the adoption of this bill.

The CHAIRMAN. The first witness is Mr. W. P. Gullander, president of the National Association of Manufacturers.

Take a seat and proceed, sir.

STATEMENT OF W. P. GULLANDER, PRESIDENT, NATIONAL ASSOCIATION OF MANUFACTURERS

Mr. GULLANDER. Thank you, Senator Byrd, and Senator Bennett. We are grateful for the opportunity to appear before this committee and express our views. Before reading my statement, however, I would like to express to you gentlemen a thought that I got the day before yesterday when I am happy to say I attended church with my wife, and Dr. Charles L. Copenhaven, who is our new minister at the Reformed Church in Bronxville, made a small statement in one sentence which immediately made me think of the problem you gentlemen are faced with, and I want to read that six- or seven-word sentence.

He said, "My God, instill in us the excitement of growth," and I think the problem that faces you gentlemen in this tax reform is one of the need for all of us to have a realization of the excitement of growth, the growth of our economy.

Now my statement.

My name is W. P. Gullander. I am president of the National Association of Manufacturers.

Our association believes there should be significant improvements in H.R. 8363 to permit this major tax reduction legislation to serve more effectively the objectives of economic growth and job creation and sound Government finance. In this testimony, I will place great emphasis on reform of the personal tax rate structure, and also deal briefly with the corporate rates and the dividend credit. We will subsequently submit in these hearings statements in regard to various structural reforms contained in the pending bill.

The relation of tax reduction to fiscal responsibility is of the greatest importance. In the past, businessmen generally have supported tax reduction only within the framework of a balanced budget. It is, therefore, in order for me to explain why we now favor some form of tax reduction in the fact of the existing large Federal deficit. The lag in economic growth and job creation over the past 6 years has required a new look at the relation of tax rates to economic progress, and of economic progress to Government finance. We believe that excessive tax rates have been and continue to be a serious impediment to the achievement of a growth rate which will assure job opportunities for all who are willing and able to work. We also believe the cause of fiscal integrity will not be served by the continuation of such tax rates.

The welfare of the entire American people is dependent upon the dynamic performance of our private enterprise system.

When for any reason the system does not perform up to par, many of our citizens suffer and our national strength is impaired. Under these circumstances, pressures for Federal spending grow and the tendency to look for centralized solutions to economic and social problems is increased. This results inevitably in reduction of the effectiveness of the private enterprise system and of the self-reliance of our State and local governments.

These pressures develop to some degree even during a temporary economic slowdown. They become much more pronounced when full recovery is not achieved quickly.

In advocating reduction in Federal income tax rates, we are not asking for Government action to stimulate the economy. We believe the leaders of Government have the responsibility to remove and avoid Government created roadblocks that hamper the effectiveness of the private enterprise system. Excessive income tax rates constitute such a roadblock to the detriment of our entire national economy.

In urging relief from tax rates which limit the Nation's economic progress, we do not in any sense downgrade the importance of fiscal responsibility. Instead, we give the greatest emphasis to its importance. Regardless of tax reduction, we believe that the level of Federal spending is too high, that the upward trend in spending on many separate programs and in the total for all programs is avoidable, and that both the executive and legislative branches of the Federal Government have an obligation to the American public to reverse this trend. The power to control or limit Federal expenditures rests with the House and the Senate just as much as the power to reduce tax rates.

Fiscal responsibility also requires attention to how revenues are raised. In our opinion, uneconomic tax rates are a form of fiscal irresponsibility.

TAX RATE ROADBLOCKS

We find widespread agreement that present tax rates place a severe restraint on the growth of the American economy. Starting over a year ago, administration spokesmen led by the President have repeatedly referred to the tax-rate drags on economic progress and job creation. In his testimony before this committee on October 15, Secretary Dillon used such words as "harsh tax rates," "our repressive tax structure" and, at another point, "our repressive tax rates" and the "stifling burden of excess taxes." This is what business has been saying for years.

The tax rates which impose such a stifling burden on economic progress and job creation are those applied to personal income and to corporate income.

This association has long advocated a major reform of Federal income tax rates which would be accomplished over a period of years. This approach would provide the maximum release of incentives and capital for economic growth with minimum effect on the Federal tax receipts in any one year.

While such complete reform seems unattainable at this time, a major objective should be to mitigate, to the greatest degree possible within the framework of H.R. 8363, the tax rate barriers to capital formation, economic growth and job creation.

Administration spokesmen have repeatedly emphasized this objective. In a recent speech before the Business Council, Secretary Dillon said H.R. 8363 will loosen the "repressive grip of high tax rates upon investment incentives." The bill as now drafted would be a help, but substantially more can be done without major effect on the tax reduction total.

The principal reason for tax rate reduction at this time is not that business has not been good this year. It is not that there are any conclusive signs that we are faced with a new economic slowdown

in the period immediately ahead. Instead, the reason is a long-term one—the fact that the periods of economic recovery since the recession of 1957 have never carried us back to the growth trend which would provide enough new jobs for all Americans seeking and needing work. The problem is compounded by the rapid buildup in our labor force which will accelerate through the remainder of this decade.

We believe that H.R. 8363, if modified as we are here recommending, will make a solid contribution toward permitting better long-term performance by the private economy as measured in growth and new job opportunities.

PERSONAL TAX RATES

The personal tax problem centers in the steeply graduated rates. Tax discussions often center on what should be the bottom and top rates, neglecting the steep climb of rates through the 22 brackets in between. The top rate is but the culmination of the buildup in rates below that level.

For years steep graduation has been advocated as a means for redistributing the wealth. However, the income tax applies to income—not wealth. The buildup in rates prevents the accumulation of wealth out of current income and thus reduces the amount of capital available for growth and job creation.

Wealth—which is simply accumulated capital—is not inimical to the public welfare, but instead serves it. The communities and States which have the greatest accumulations of wealth enjoy the highest average wages, the highest living standards, the best public services. Progress in these areas of general public concern will come most rapidly in communities and States which add most rapidly to their existing capital accumulations. These facts are recognized everywhere, but especially by the governments in our Southern States which so aggressively seek new capital and new industries to enable their citizens to catch up to the average living standards of other sections of the Nation and, for this, we salute them. Whatever limits the accumulation of new capital out of current income, operates as a drag on this catchup process; and is a special disservice to the unemployed and the underemployed wherever they may live.

Steeply graduated rates of income tax are a contradiction of the principle of incentive which is a vital part of our system of compensation. Hard work, long hours, special contribution, and achievement are essential to great progress and therefore are rewarded in compensation, but unfortunately penalized severely by the countermovement of tax rates.

H.R. 8363 tends to treat the taxpayer in the middle brackets as the forgotten man. He is the man who starts in the low bracket and by industry and great effort advances in economic contribution and leadership and, hence, in income. These men are the current and potential risk takers—the venturers who will risk what they own to proper. They are the job creators. In the Nation's self-interest, the middle brackets should be made to attract every man possible from his position in the lower brackets. If this is the land of opportunity for everyone, we need a tax rate structure that does not discourage people from making the most of that opportunity. Our rate recommendations concentrate on this need.

H.R. 8363 splits the existing first bracket of $2,000 into four new brackets of $500 each with rates of 14, 15, 16, and 17 percent, respectively.

We propose a substitution of a three-way split of the first bracket for the four-way split contained in the bill, specifically: two brackets of $500 each, and then one bracket of $1,000. Reducing rates in these brackets from the present 20 percent to 15, 16, and 17 percent, rather than the range of 14 to 17 percent as provided in H.R. 8363, would provide a revenue saving of approximately $1 billion, as compared with the H.R. 8363 schedule, for use in reducing the steepness of graduation.

Thus, there would be 1 percentage point difference between each of the first three brackets. We then propose an orderly pattern for the rest of the schedule—an increase of a consistent 2 percentage points between each of the next 16 brackets and 3 percentage points between the remaining 7 brackets.

Gentlemen, attached to this document are a schedule and a table at the back. If you will take the table and follow with me, I would like to explain it in detail so that you get a full understanding of what rate changes we propose in H.R. 8363.

We have, on the right-hand column, the income tax brackets from the bottom to the top. Then we have three basic columns. On the extreme left we have the present tax bill, the rates in the present tax bill.

In the center we have the rate provided by H.R. 8363 and the one on the right are the proposed rates.

If you will take a look first at the one on the left, the present rate, you will observe that we show 20 percent with a bracket. This bracket is the first four tax brackets.

Senator DOUGLAS. Mr. Gullander, you speak of this as the present rate; you mean the proposed rate?

Mr. GULLANDER. No, here is the present rate now in the bill.

Senator DOUGLAS. Yes, the extreme right.

Mr. GULLANDER. Yes.

Senator DOUGLAS. First on the left is the proposed one?

Mr. GULLANDER. I am sorry, because I am facing the wrong way, I have them reversed to the right.

Senator DOUGLAS. Yes.

Mr. GULLANDER. Thank you, Senator.

Here this shows 20 percent from zero to $2,000 which as you well know is the current rate for the first bracket.

In the center which is the H.R. 8363, this shows a breakup into four brackets.

We show here in the first column which is on your left three brackets, the first zero to $500 at 15 percent, next $500 to a $1,000 at 16 percent and then $1,000 to $2,000, our third bracket, at 17 percent.

You will observe alongside of these rates there is another column called rate buildup. This indicates the number of percentage points between each of the steps. And in our proposal you will notice as I say, there is one percentage point difference between the first three brackets.

Then we go to a level increase of 2 percentage points until you get up to the $60,000 to $70,000 thousand bracket.

Then we jump to 3 percentage points for the rest of the way.

If you will observe the column on your extreme right under the present tax law you will notice there is an uneven and illogical change between each of the brackets.

You go from two to four to five to four, to three to four and finally to three, two, and one, one, if you will look at the one in the center which is H.R. 8363 you have to agree the same pattern.

There is not a logical pattern to it. What is the net effect to this? You will notice here under the subtotal on your righthand side, the present law, a subtotal of 36 and then a total at the bottom of 71.

This 36 is sum total of the percentage points difference between the brackets up to the level of $20,000 to $22,000.

The 71, of course, is the sum total of all the brackets because you go from 20 to 91, a difference of 71. The thing I want to point out here is the relationship of the buildup to the level of $20,000, $22,000 is 36 of the 71 points and this as you see, gentlemen, is 50 percent of the climb up to the point of $20,000—$22,000.

Under H.R. 8363 you will notice the subtotal is 34 and the total is 56.

The relationship here is 60 percent. This means that 60 percent of the graduation occurs by the time you get to a level of $20,000 to $22,000 so that H.R. 8363 has in effect steepened the rate of graduation.

Under our proposal you will observe that 22 are the total points up to $20,000 to $22,000 out of a total of 55, or 40 percent.

This then demonstrates that in our proposal we have lessened the rate of graduation in contrast to the present bill.

As you will see from this table the net effect of our proposal is to improve the tax position of the middle brackets where incentive to invest and employ—use venture capital and create jobs—will be enhanced.

This obviously has the effect of providing somewhat less tax reduction than H.R. 8363 for people with smaller taxable income. However, in no instance would the tax savings be reduced by more than $15. For a taxable income of $500 it would be only $5. I submit that a growing prosperous economy will provide far more benefit for people with smaller taxable incomes than additional annual tax savings of $5 to $15.

The attached chart, which you also have in the back of the statement, shows pictorially the data shown on the table. It brings out vividly the critical problem of the steep climb of rates in the middle brackets. It shows that its climb would still be quite severe under the revised schedule which I have proposed to you.

The tax reduction from adopting our proposal would be $9.8 billion compared with $9.5 billion under H.R. 8363 but would represent at least a strong beginning in promoting the capital formation we need for greater growth.

CORPORATE TAX RATES

The tax rates imposed on corporate income not only stifle capital formation but also discourage expansion of present facilities and launching of new venture. The present combined top rate of corporate tax, 52 percent, is 14 percentage points higher than the 38-percent rate in effect between World War II and the Korean war. For 9

years, the tax law has contained the annual promise of termination of the final 5 percentage point increase of the Korean period, and it is time that this promise was fulfilled.

STRUCTURAL REFORM IN H.R. 8363

I urge that the structural reforms in H.R. 8363 be reviewed in regard to their merits and demerits and not be considered as a trade for reducing tax rates which should not have been imposed in the first instance. I do not believe that people with higher incomes, any more than people with lower incomes, should be expected, as the price of rate reform and reduction, to give up any tax provision which has an equitable or other reasonable basis for its existence.

Our association's taxation committee is preparing and will submit in these hearings statements in regard to a number of structural changes in H.R. 8363. At this stage, I would like to confine our views on these reforms to brief comments on the proposed repeal of the dividend credit.

DIVIDEND CREDIT

The administration has requested repeal of the 4-percent dividend credit. The bill before you, in section 201, would repeal the credit but increase the exclusion from $50 to $100. Our strong recommendation is that the credit and present exclusion be retained. This would be accomplished simply by eliminating section 201 from the bill.

The present dividend credit is a token recognition of the existence of double taxation in our tax structure and as such gives a small measure of relief from this burden. The change proposed in H.R. 8363 would have the effect of reducing the amount of after-tax income available for capital investment and would thus be contrary to the basic purpose of H.R. 8363, that of encouraging a more rapid rate of economic growth. This change of course would be a disadvantage to shareholders but, equally important, it could be a serious blow to those people who will be denied employment because of the curtailment of funds available for capital to provide such employment.

CONCLUSION

During the course of discussion on tax reduction this year, a consensus has developed to the effect that we should seek greater growth and job creation through expansion of the private economy rather than expansion of Government. This is a most heartening development. I have no doubt you will lend your endorsement to the consensus. I believe, however, we must recognize that the consensus becomes fuzzy in regard to the nature of the tax reduction which will induce the greatest expansion of the private economy over the long pull.

Concentration of tax reduction dollars at the lowest income level may provide an immediate stimulus to the economy and, thus, put a number of people to work in the very short range. Also, such a short-term stimulus may generate some economic activity which will carry through to later years. However, whatever the continuing effects of demand-type tax reductions, they must be negligible over the long run

as compared with the revitalizing effect of substantial relief from tax rates which directly and adversely affect incentives and limit capital for growth.

If the economy should respond temporarily to the fact of tax reduction, per se, and then settle back into a new period of inadequate growth, the voice of the vocal minority who believe that Government growth should have priority over private economic growth would become more audible. None of us wants this to happen. The danger of its happening will be minimized if H.R. 8363 is revised as we have proposed.

There is one thing we know for certain. If we could get back to and sustain in this decade an average growth rate which would provide jobs for those who need work and want to work, we would both greatly strengthen the base for Federal revenues and provide a continuing platform from which to fight the Federal spending battle every step of the way.

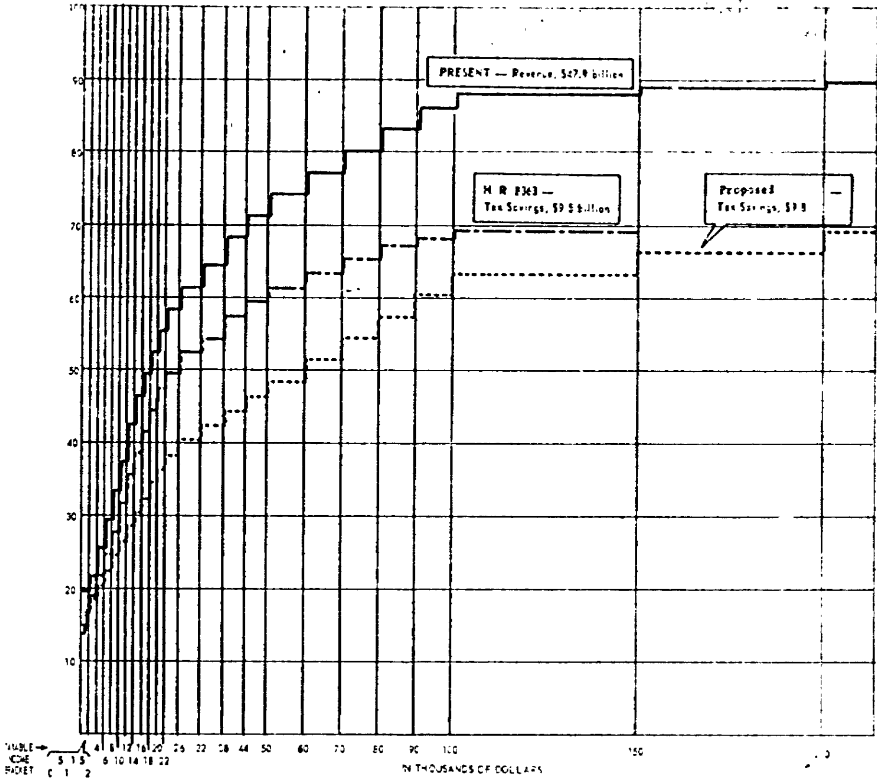
Thank you, gentlemen.

(The attachments referred to follow:)

Individual income tax—Proposed rate structure compared with present and H.R. 9363 rates

Taxable income bracket (thousands)	Proposed (tax savings, $9.8 billion)		H.R. 8363 (tax savings, $9.5 billion)		Present law (revenue yield, $47.9 billion)	
	Rates, A-1	Rate buildup,[1] A-2	Rates, B-1	Rate buildup,[1] B-2	Rates, C-1	Rate buildup,[1] C-2
	Percent		*Percent*			
0 to $0.5	15	-----------	14	-----------	20	-----------
$0.5 to $1.0	16	1	15	1		
$1.0 to $1.5	17	1	16	1		
$1.5 to $2.0			17	1		
$2 to $4	19	2	19	2	22	2
$4 to $6	21	2	22	3	26	4
$6 to $8	23	2	25	3	30	4
$8 to $10	25	2	28	3	34	4
$10 to $12	27	2	32	4	38	4
$12 to $14	29	2	36	4	43	5
$14 to $16	31	2	39	3	47	4
$16 to $18	33	2	42	3	50	3
$18 to $20	35	2	45	3	53	3
$20 to $22	37	2	48	3	56	3
Subtotal	-----------	22	-----------	34	-----------	36
$22 to $26	39	2	50	2	59	3
$26 to $32	41	2	53	3	62	3
$32 to $38	43	2	55	2	65	3
$38 to $44	45	2	58	3	69	4
$44 to $50	47	2	60	2	72	3
$50 to $60	49	2	62	2	75	3
$60 to $70	52	3	64	2	78	3
$70 to $80	55	3	66	2	81	3
$80 to $90	58	3	68	2	84	3
$90 to $100	61	3	69	1	87	3
$100 to $150	64	3	70	1	89	2
$150 to $200	67	3	-----------	-----------	90	1
$200 and over	70	3	-----------	-----------	91	1
Total	-----------	55	-----------	56	-----------	71

[1] Percentage points between brackets.



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

Senator Douglas?

Senator DOUGLAS. Mr. Gullander, may I ask you some questions on the recommended schedules which you have in your table?

Mr. GULLANDER. Yes, sir.

Senator DOUGLAS. Is this correct, that on the first $2,000 of taxable income your schedules are 1 percentage point for each bracket higher than they would be under H.R. 8363?

Mr. GULLANDER. No, Senator.

In the bracket from zero to $500 it would be 1 percentage point higher. In the bracket from $500 to $1,000 it would be 1 percentage point higher. In the bracket $1,500 to $2,000 it would be the same.

Senator DOUGLAS. Yes.

On the first three brackets you would collect approximately—you would collect $1 billion more in taxes than under H.R. 8363?

Mr. GULLANDER. From all taxpayers, yes.

Senator DOUGLAS. I understand. But on that bracket?

Mr. GULLANDER. Yes, but not more than $15 more from any one.

Senator DOUGLAS. But there are a good many families in that group so the total collection would be large.

Mr. GULLANDER. Yes, they are almost all in that group, as a matter of fact.

Senator DOUGLAS. Yes.

Now, you have equality then for the group from $1,500 to $2,000 of taxable income, and equality with those from $2,000 to $4,000 of taxable income?

Mr. GULLANDER. This is correct.

Senator DOUGLAS. And the total tax reductions are $300 million more than in H.R. 8363?

Mr. GULLANDER. This is correct.

Senator DOUGLAS. So the full billion three hundred million would be given to those with taxable incomes in excess of $4,000?

Mr. GULLANDER. The billion three, this is correct, Senator. This is correct.

Senator DOUGLAS. And since we take the standard family as a man, wife, and two children, this would be the total tax reductions given to families with incomes of over $6,400, roughly, that is assuming this to be the standard family, $2,400 exemption plus $4,000 of taxable income, isn't that right?

I am just trying to follow the mathematics of this through.

Mr. GULLANDER. Yes.

Senator DOUGLAS. Now then, at the $6,000 to $8,000 and at the $4,000 to $6,000 level, and we are speaking of taxable income all the time, your rate is 1 percent lower——

Mr. GULLANDER. This is correct.

Senator DOUGLAS (continuing). Than H.R. 8363.

At the $8,000 to $10,000 group it is 2 percentage points lower.

Mr. GULLANDER. Yes.

Senator DOUGLAS. Then at the $10,000 to $12,000 group it is 5 percentage points lower, that is 27 percent rather than 32 percent.

Mr. GULLANDER. Right.

Senator DOUGLAS. At the $12,000 to $14,000 group of taxable income it is 7 percentage point lower.

At $14,000 to $16,000, 8 percentage points lower.

$16,000 to $18,000, 9 percentage points lower.

$18,000 to $20,000, 10 percentage points lower.

$20,000 to $22,000, 11 percentage points lower, and this is true apparently in the $22,000 to $26,000 group.

$26,000 to $32,000 group it is 12 percentage points lower.

Twelve percentage points lower at $32,000 to $38,000; 13 percentage points lower from $38,000 to $44,000, and that goes through the $50,000 to $60,000 group.

Then the difference diminishes slightly——

Mr. GULLANDER. That is correct.

Senator DOUGLAS. From then on, but it is still 8 percentage points lower from the $90,000 to $100,000 group, and you do not reach the maximum of 70 percent until you reach the $200,000 mark, whereas under H.R. 8363 you reach the maximum of 70 percent at the $100,000 mark.

Mr. GULLANDER. This is correct.

Senator DOUGLAS. Well now, what this means, in effect, I think, and I would like to see the distribution by income classes, but what this means in effect is that you have diminished the tax reductions of those

under $1,500 of taxable income, and have thrown that billion dollars, plus the $300 million more, to the groups with taxable incomes above $4,000 and especially to the groups over $10,000 and possibly you may find that if we could get this split up by income groups, especially to the groups over $20,000.

Now, of course, this raises a very serious question as to equity and justice, and on this point perhaps our ideas differ and I shall not argue this at length at this time, because your time and the time of the committee is limited, except to say that I do not think—I will just register my own opinion—I do not think this is good public policy.

Mr. GULLANDER. Senator, you have hit the very meat of the problem.

Senator DOUGLAS. Pardon?

Mr. GULLANDER. I say, you have hit the very meat of the problem and I would like to talk about that specifically if I may.

Senator DOUGLAS. Certainly.

Mr. GULLANDER. As we have indicated by the chart and as the table indicates what we are trying to do is to change the steepness of the graduation, the only way to do this is where there has been abuse in the past, high rates.

Let me get a bit philosophical.

This Nation, Russia, Germany, France, any country must have capital to grow and prosper. It must have increasing amounts of capital.

How does Russia get its capital? It gets its capital by restricting the consumer goods which the people can consume and devoting that energy toward building capital goods, and the state controls this and the state owns the capital.

In our philosophy of government in this country, fortunately, in my opinion, we believe that capital ought to be owned by the people, and not by the state.

Now, that means that the country as a whole still must have greater and greater amounts of capital in order to expand, to absorb the growing working population, to be competitive in our world and to have enough capital dollars behind each man who is willing and able to work.

If we need this capital we must facilitate the people who generate capital, to so generate capital, and it is the man who has the capacity to earn an income above subsistence levels or above normal choices as far as consumption is concerned who generates this capital and accumulates it. We must in our country encourage those people who have the capacity to generate this capital not for the benefit of themselves but for the benefit of the entire Nation because the most important thing about capital is not that it pays dividends to those whose names appear on the stock certificate or whatever it may be that represents ownership, but the man in the plant in being, and the people who are working there, that add to our national wealth.

If we are going to have more capital formation in this country we have got to make it possible for those members of our society who generate that capital to generate more.

One other point. You will not find any man in this country, certainly in this room, who is more dedicated to the proposition that any man at the very bottom of the tax ladder or below where he doesn't even pay any taxes should be encouraged to become one of those men who can accumulate capital; and to do this we have to have induce-

ments for him to work harder, to use his ingenuity, to grow, to reward him for extra effort and get up in the middle brackets where he has more than just a subsistence level where he can generate capital.

So, it is two things. One, we must provide a system whereby greater capital can be developed and, second, we have got to encourage more people to become people to develop this capital and that is what our objective is.

Senator DOUGLAS. I hadn't intended to enter into a discussion at this point but since you have made this point I think I should make some comments.

I just found out yesterday that the minimum relief budget for a single man in Chicago was approximately $1,200 a year, or $24 a week, roughly. Now, with only a $600 exemption, he would be taxed on $600, if he had an income.

He is taxed on an amount necessary to bring him up to the minimum level of subsistence, and that is a subsistence level and it is not a liberal scale, I can assure you, Mr. Gullander, and the Bureau of Labor Statistics has computed minimum living standards, that is standards slightly above physical subsistence, but not lavish standards in any respect, for families of four, in various cities of the country and I shall ask permission, Mr. Chairman, to put those into the record.

The CHAIRMAN. Without objection.

(The information referred to follows:)

Estimated annual cost of goods and services [1] providing a modest but adequate standard of living for families of differing size, type, and age, 20 large cities and suburbs, autumn 1959

City	Single person under 35 years [2]	Husband and wife, under 35 years		Husband and wife, 35 to 55 years, with—			Husband and wife, retired, 65 years and over [4]	Single person, retired, 65 years and over [5]
		Without children [2]	With 1 child under 6 years [2]	1 child between 6 and 16 years [2]	2 children, oldest between 6 and 16 years [3]	3 children, oldest between 6 and 16 years [4]		
California:								
Los Angeles	$2,236	$3,355	$[illegible],387	$4,633	$5,325	$6,390	$3,111	$1,835
San Francisco	2,243	3,365	3,899	4,647	5,341	6,409	3,223	1,902
District of Columbia: Washington	2,184	3,275	3,795	4,523	5,199	6,239	3,047	1,798
Georgia: Atlanta	2,033	3,049	3,533	4,211	4,840	5,808	2,720	1,605
Illinois: Chicago	2,355	3,532	4,093	4,878	5,607	6,728	3,366	1,986
Maryland: Baltimore	2,037	3,056	3,540	4,220	4,850	5,820	2,840	1,676
Massachusetts: Boston	2,240	3,360	3,894	4,641	5,334	6,401	3,304	1,949
Michigan: Detroit	2,184	3,277	3,797	4,525	5,201	6,241	3,096	1,827
Minnesota: Minneapolis	2,169	3,254	3,770	4,494	5,165	6,198	3,135	1,850
Missouri:								
Kansas City	2,138	3,207	3,716	4,428	5,090	6,108	3,034	1,790
St. Louis	2,214	3,321	3,848	4,586	5,271	6,325	3,099	1,828
New York: New York	2,120	3,180	3,685	4,392	5,048	6,058	3,044	1,796
Ohio:								
Cincinnati	2,168	3,253	3,769	4,492	5,163	6,196	2,925	1,726
Cleveland	2,228	3,342	3,873	4,615	5,305	6,366	3,244	1,914
Oregon: Portland	2,176	3,265	3,783	4,508	5,182	6,218	3,049	1,799
Pennsylvania:								
Philadelphia	2,087	3,131	3,628	4,324	4,970	5,964	2,909	1,716
Pittsburgh	2,211	3,316	3,843	4,580	5,264	6,317	3,102	1,830
Scranton	2,030	3,045	3,529	4,206	4,834	5,801	2,681	1,582
Texas: Houston	1,941	2,912	3,374	4,021	4,622	5,546	2,641	1,558
Washington: Seattle	2,353	3,529	4,089	4,874	5,602	6,722	3,252	1,919

[1] Excludes personal taxes, social security deductions, etc., which vary by family size and cannot be estimated by an equivalent income scale.

[2] Estimates are based on the application of equivalent income scales to the costs of goods and services in the "City Worker's Family Budget" (see footnote 3). For a description of the scales, see "Estimating Equivalent Incomes or Budget Costs by Family Types," reprint No. 2357, from the Monthly Labor Review, November 1960.

[3] Estimates from "The Interim City Worker's Family Budget," reprint No. 2346, from the Monthly Labor Review, August 1960.

[4] Estimates from "The BLS Interim Budget for a Retired Couple," reprint No. 2354, from the Monthly Labor Review, November 1960.

[5] Estimates are based on the application of equivalent income scales (see source cited in footnote 2) to the costs of goods and services in the "Budget for a Retired Couple" (see footnote 4).

Source: U.S. Department of Labor, Bureau of Labor Statistics, Office of Prices and Living Conditions, Washington, D.C., Sept. 16, 1963.

Median family incomes, budget costs for a city worker's family of 4 (CWFB), and gross average weekly earnings in 1959,[1] for geographical areas, by State

Income, budget costs, and weekly earnings in 1959 [1]	Geographical area						
	The State	Urban	Rural nonfarm	Rural farm	Selected standard metropolitan statistical areas		
Alabama:							
Census median family income:							
All families	$3,937.00	$4,853	$3,177	$2,008			
4-person families	4,893.00	5,664	4,085	2,737			
CWFB total annual costs							
BLS gross average weekly earnings in manufacturing	74.21						
Alaska:							
Census median family income:							
All families	7,326.00	8,424	6,485	7,991			
4-person families	7,335.00	8,281	6,663				
CWFB total annual costs							
BLS gross average weekly earnings in manufacturing	(2)						
Arizona:							
Census median family income:							
All families	5,568.00	5,872	4,586	3,384			
4-person families	6,167.00	6,442	5,203	4,019			
CWFB total annual costs							
BLS gross average weekly earnings in manufacturing	98.09						
Arkansas:							
Census median family income:							
All families	3,184.00	4,287	2,696	2,075			
4-person families	4,170.00	5,205	3,620	2,711			
CWFB total annual costs							
BLS gross average weekly earnings in manufacturing	62.02						
California:							
Census median family income:					*Los Angeles*	*San Francisco*	
All families	6,726.00	6,880	5,718	5,161	$7,078.00	$7,110.00	
4-person families	7,457.00	7,638	6,371	5,628	7,930.00	7,765.00	
CWFB total annual costs					6,285.00	6,304.00	
BLS gross average weekly earnings in manufacturing	101.71				101.66	105.59	
Colorado:							
Census median family income:							
All families	5,780.00	6,187	4,860	4,075			
4-person families	6,306.00	6,681	5,485	4,292			
CWFB total annual costs							
BLS gross average weekly earnings in manufacturing	95.71						

CWFB total annual costs							
BLS gross average weekly earnings in manufacturing	95.71						
Connecticut:							
Census median family income:							
All families	6,887.00	6,834	7,193	5,572			
4-person families	7,297.00	7,255	7,488	6,134			
CWFB total annual costs							
BLS gross average weekly earnings in manufacturing	93.11						
Delaware:							
Census median family income:							
All families	6,197.00	6,765	5,295	4,248			
4-person families	6,777.00	7,372	5,829	4,745			
CWFB total annual costs							
BLS gross average weekly earnings in manufacturing	89.82						
District of Columbia:					*Washington*		
Census median family income:							
All families	5,993.00				7,640.00		
4-person families	6,398.00				8,224.00		
CWFB total annual costs					6,147.00		
BLS gross average weekly earnings in manufacturing					95.36		
Florida:							
Census median family income:							
All families	4,722.00	4,956	4,119	3,371			
4-person families	5,654.00	5,925	4,897	4,120			
CWFB total annual costs							
BLS gross average weekly earnings in manufacturing	73.51						
Georgia:					*Atlanta*		
Census median family income:							
All families	4,208.00	4,930	3,659	2,314	5,758.00		
4-person families	5,123.00	5,784	4,508	2,966	6,482.00		
CWFB total annual costs					5,642.00		
BLS gross average weekly earnings in manufacturing	64.88				80.20		
Hawaii:							
Census median family income:							
All families	6,366.00	6,769	5,011	5,329			
4-person families	6,587.00	6,965	5,306	5,058			
CWFB total annual costs							
BLS gross average weekly earnings in manufacturing	(2)						
Idaho:							
Census median family income:							
All families	5,259.00	5,804	5,018	4,293			
4-person families	5,726.00	6,314	5,402	4,546			
CWFB total annual costs							
BLS gross average weekly earnings in manufacturing	90.01						
Illinois:					*Chicago*		
Census median family income:							
All families	6,566.00	6,935	5,479	3,815	7,404.00		
4-person families	7,165.00	7,600	6,020	4,241	8,006.00		
CWFB total annual costs					6,567.00		
BLS gross average weekly earnings in manufacturing	96.66				98.12		

See footnotes at end of table.

Median family incomes, budget costs for a city worker's family of 4 (CWFB), and gross average weekly earnings in 1959,[1] *for geographical areas, by State*—Continued

Income, budget costs, and weekly earnings in 1959 [1]	Geographical area						
	The State	Urban	Rural nonfarm	Rural farm	Selected standard metropolitan statistical areas		
Indiana:							
Census median family income:							
All families	$5,798.00	$6,117	$5,577	$4,317			
4-person families	6,362.00	6,664	6,002	5,105			
CWFB total annual costs							
BLS gross average weekly earnings in manufacturing	100.35						
Iowa:							
Census median family income:							
All families	5,069.00	5,955	4,626	3,352			
4-person families	5,648.00	6,492	5,391	3,501			
CWFB total annual costs							
BLS gross average weekly earnings in manufacturing	93.22						
Kansas:							
Census median family income:							
All families	5,295.00	5,856	4,756	3,681			
4-person families	5,863.00	6,414	5,385	3,944			
CWFB total annual costs							
BLS gross average weekly earnings in manufacturing	93.72						
Kentucky:							
Census median family income:							
All families	4,051.00	5,285	3,285	2,467			
4-person families	4,802.00	5,850	4,063	2,948			
CWFB total annual costs							
BLS gross average weekly earnings in manufacturing	83.02						
Louisiana:							
Census median family income:							
All families	4,272.00	4,915	3,330	2,146			
4-person families	5,173.00	5,639	4,358	2,823			
CWFB total annual costs							
BLS gross average weekly earnings in manufacturing	85.08						
Maine:							
Census median family income:							
All families	4,873.00	5,327	4,466	3,569			
4-person families	5,209.00	5,689	4,835	3,938			
CWFB total annual costs							
BLS gross average weekly earnings in manufacturing	69.19						

Maryland:							
Census median family income:					*Baltimore*		
All families	6,309.00	6,657	5,434	4,253	$6,199.00		
4-person families	6,883.00	7,268	5,977	4,844	6,739.00		
CWFB total annual costs					5,718.00		
BLS gross average weekly earnings in manufacturing	88.32				92.89		
Massachusetts:							
Census median family income:					*Boston*		
All families	6,272.00	6,264	6,346	5,364	6,687.00		
4-person families	6,713.00	6,726	6,671	6,132	7,193.00		
CWFB total annual costs					6,317.00		
BLS gross average weekly earnings in manufacturing	80.93				85.81		
Michigan:							
Census median family income:					*Detroit*		
All families	6,256.00	6,590	5,615	4,561	6,825.00		
4-person families	6,785.00	7,138	6,003	5,259	7,449.00		
CWFB total annual costs					6,072.00		
BLS gross average weekly earnings in manufacturing	108.71				118.24		
Minnesota:							
Census median family income:					*Minneapolis*		
All families	5,573.00	6,468	4,626	3,099	6,840.00		
4-person families	6,084.00	6,881	5,237	3,313	7,305.00		
CWFB total annual costs					6,181.00		
BLS gross average weekly earnings in manufacturing	92.02				95.21		
Mississippi:							
Census median family income:							
All families	2,884.00	4,173	2,622	1,653			
4-person families	3,973.00	5,185	3,628	2,125			
CWFB total annual costs							
BLS gross average weekly earnings in manufacturing	60.64						
Missouri:							
Census median family income:					*Kansas City*	*St. Louis*	
All families	5,127.00	5,882	3,923	2,782	6,317.00	$6,275.00	
4-person families	5,822.00	6,473	4,853	3,399	6,810.00	6,781.00	
CWFB total annual costs					5,964.00	6,266.00	
BLS gross average weekly earnings in manufacturing	85.11				95.06	95.08	
Montana:							
Census median family income:							
All families	5,403.00	5,918	5,050	4,289			
4-person families	5,848.00	6,405	5,521	4,480			
CWFB total annual costs							
BLS gross average weekly earnings in manufacturing	94.17						
Nebraska:							
Census median family income:							
All families	4,862.00	5,828	4,184	3,243			
4-person families	5,419.00	6,319	4,952	3,311			
CWFB total annual costs							
BLS gross average weekly earnings in manufacturing	[3] 84.80						

See footnotes at end of table.

Median family incomes, budget costs for a city worker's family of 4 (CWFB), and gross average weekly earnings in 1959,[1] for geographical areas, by State—Continued

Income, budget costs, and weekly earnings in 1959 [1]	Geographical area						
	The State	Urban	Rural nonfarm	Rural farm	Selected standard metropolitan statistical areas		
Nevada:							
Census median family income:							
All families	$6,736.00	$7,200	$5,825	$4,857			
4-person families	7,322.00	7,895	6,164	4,819			
CWFB total annual costs							
BLS gross average weekly earnings in manufacturing	107.68						
New Hampshire:							
Census median family income:							
All families	5,636.00	5,817	5,426	4,625			
4-person families	6,012.00	6,243	5,770	4,843			
CWFB total annual costs							
BLS gross average weekly earnings in manufacturing	69.26						
New Jersey:							
Census median family income:							
All families	6,786.00	6,869	6,177	4,794			
4-person families	7,323.00	7,432	6,652	5,135			
CWFB total annual costs							
BLS gross average weekly earnings in manufacturing	92.45						
New Mexico:							
Census median family income:							
All families	5,371.00	6,003	3,929	3,780			
4-person families	6,002.00	6,535	4,655	4,371			
CWFB total annual costs							
BLS gross average weekly earnings in manufacturing	82.43						
New York:					*New York*		
Census median family income:							
All families	6,371.00	6,474	5,924	4,504	$6,548.00		
4-person families	6,893.00	6,988	6,415	5,029	7,094.00		
CWFB total annual costs					5,970.00		
BLS gross average weekly earnings in manufacturing	87.71				[3] 83.04		
North Carolina:							
Census median family income:							
All families	3,956.00	4,843	3,828	2,247			
4-person families	4,709.00	5,571	4,466	2,840			
CWFB total annual costs							
BLS gross average weekly earnings in manufacturing	61.20						

North Dakota:							
Census median family income:							
All families	4,530.00	5,841	4,250	3,432			
4-person families	4,955.00	6,133	4,839	3,487			
CWFB total annual costs							
BLS gross average weekly earnings in manufacturing	81.65						
Ohio:							
Census median family income:					*Cincinnati*	*Cleveland*	
All families	6,171.00	6,442	5,700	4,210	6,318.00	$6,962.00	
4-person families	6,655.00	6,897	6,108	4,932	6,903.00	7,530.00	
CWFB total annual costs					6,100.00	6,199.00	
BLS gross average weekly earnings in manufacturing	102.82				95.67	106.84	
Oklahoma:							
Census median family income:							
All families	4,620.00	5,303	3,467	3,361			
4-person families	5,471.00	5,964	4,495	3,947			
CWFB total annual costs							
BLS gross average weekly earnings in manufacturing	85.70						
Oregon:							
Census median family income:					*Portland*		
All families	5,892.00	6,286	5,434	4,824	6,340.00		
4-person families	6,510.00	6,880	5,930	5,413	6,943.00		
CWFB total annual costs					6,222.00		
BLS gross average weekly earnings in manufacturing	96.36				95.11		
Pennsylvania:							
Census median family income:					*Philadelphia*	*Pittsburgh*	*Scranton*
All families	5,719.00	5,932	5,274	4,294	6,433.00	5,954.00	
4-person families	6,151.00	6,421	5,639	4,634	6,935.00	6,296.00	
CWFB total annual costs					5,898.00	6,199.00	$56,93
BLS gross average weekly earnings in manufacturing	88.70				92.00	110.12	65.36
Rhode Island:							
Census median family income:							
All families	5,589.00	5,596	5,571	4,574			
4-person families	5,990.00	6,028	5,807				
CWFB total annual costs							
BLS gross average weekly earnings in manufacturing	72.98						
South Carolina:							
Census median family income:							
All families	3,821.00	4,582	3,648	1,982			
4-person families	4,739.00	5,373	4,500	2,844			
CWFB total annual costs							
BLS gross average weekly earnings in manufacturing	61.61						
South Dakota:							
Census median family income:							
All families	4,251.00	5,545	3,931	2,860			
4-person families	4,786.00	5,928	4,693	2,834			
CWFB total annual costs							
BLS gross average weekly earnings in manufacturing	90.32						

See footnotes at end of table.

Median family incomes, budget costs for a city worker's family of 4 (CWFB), and gross average weekly earnings in 1959,[1] for geographical areas, by State—Continued

Income, budget costs, and weekly earnings in 1959 [1]	Geographical area						
	The State	Urban	Rural nonfarm	Rural farm	Selected standard metropolitan statistical areas		
Tennessee:							
Census median family income:							
All families	$3,949.00	$4,[illegible]	$3,477	$2,222			
4-person families	4,798.00	5,[illegible]47	4,224	2,841			
CWFB total annual costs							
BLS gross average weekly earnings in manufacturing	71.46						
Texas:							
Census median family income:					*Houston*		
All families	4,884.00	5,[illegible]31	3,751	3,014	$6,040.00		
4-person families	5,7[illegible].00	6,076	4,751	3,8[illegible]	6,717.00		
CWFB total annual costs					5,370.00		
BLS gross average weekly earnings in manufacturing	89.02				103.07		
Utah:							
Census median family income:							
All families	5,899.00	6,165	5,250	[illegible],764			
4-person families	6,223.00	6,469	5,506	5,129			
CWFB total annual costs							
BLS gross average weekly earnings in manufacturing	93.60						
Vermont:							
Census median family income:							
All families	4,890.00	5,464	4,73[illegible]	3,531			
4-person families	5,319.00	5,851	5,[illegible]00	3,833			
CWFB total annual costs							
BLS gross average weekly earnings in manufacturing	74.76						
Virginia:							
Census median family income:							
All families	4,964.00	5,920	4,091	2,776			
4-person families	5,660.00	6,562	4,695	3,440			
CWFB total annual costs							
BLS gross average weekly earnings in manufacturing	69.02						
Washington:							
Census median family income:					*Seattle*		
All families	6,225.00	6,577	5,606	5,029	6,896.00		
4-person families	6,805.00	7,190	6,144	5,516	7,569.00		
CWFB total annual costs					6,562.00		
BLS gross average weekly earnings in manufacturing	98.81				97.52		

West Virginia:							
Census median family income:							
All families	4,572.00	5,623	3,982	2,841			
4-person families	5,255.00	6,202	4,650	3,567			
CWFB total annual costs							
BLS gross average weekly earnings in manufacturing	92.43						
Wisconsin:							
Census median family income:							
All families	5,926.00	6,535	5,169	3,821			
4-person families	6,422.00	6,920	5,699	4,169			
CWFB total annual costs							
BLS gross average weekly earnings in manufacturing	94.55						
Wyoming:							
Census median family income:							
All families	5,877.00	6,332	5,607	4,340			
4-person families	6,329.00	6,809	5,969	4,566			
CWFB total annual costs							
BLS gross average weekly earnings in manufacturing	94.22						

[1] For sources see: Median (before tax) income in 1959 for all and 4-person families: U.S. Department of Commerce, Bureau of the Census. "U.S. Census of Population: 1960: Detailed Characteristics." Final report PC(1)-D, table 141 in each State report.
Budget costs in 1959 for a 4-person city worker's family: U.S. Department of Labor, Bureau of Labor Statistics, "The Interim City Worker's Family Budget," Monthly Labor Review, August 1960, pp. 785-808. (NOTE.—Budget cost estimates are directly comparable only with income of families of the budget type (4-person) in the geographical areas in which the budget was priced.)

Gross annual average weekly earnings in 1959 of production workers in manufacturing: U.S. Department of Labor, Bureau of Labor Statistics, "Employment and Earnings," annual supplement, vol. 8, No. 12, June 1962.

[2] Not available.

[3] Not strictly comparable with later years.

[4] Subarea of New York- northeastern New Jersey.

Senator DOUGLAS. But I can say they range from roughly $4,100 a year, as I remember it, to up around $4,700 a year, depending upon the city.

Now, these are minimums. These families already are taxed under the present law, and they would be taxed under H.R. 8363, though not as much.

I personally do not believe we should levy taxes upon people who are below the minimum level of subsistence.

You speak of giving them an encouragement to accumulate capital. Their problem is not the chance of accumulating capital, their problem is to get enough to eat, to send their kids to school, and to meet the ordinary physical demands of existence and it is a very rigid scale, too.

Now, what you do is to take away some of the decreases which 8363 would give.

Mr. GULLANDER. On your illustration $3 a year.

Senator DOUGLAS. And that is only $5, you say that is only $5?

Mr. GULLANDER. It is only three in your illustration.

Senator DOUGLAS. On the first $500 to a single man. But that $5 may be medicine that he needs and it would be for a family, if he is up in the $1,500 taxable bracket which would roughly be a $4,000 family, it would mean a $1,500 tax deduction that he would lose as compared with H.R. 8363.

Mr. GULLANDER. It would mean $10.

Senator DOUGLAS. The person whose concern is the accumulation of capital for his company and I am not blaming you at all, $15 a family may seem to be relatively small but it is very important to many families. That $15 is crucial. It may mean medicine for a sick child, it may mean books for the child, a lot of things, and in the aggregate it amounts to a lot of money.

Mr. GULLANDER. Senator, may I say I would much rather provide a man with a better job and an opportunity to grow than I would be to giving him $15. Because this is really making a better man of him, making him self-supporting and making him able to increase his income more than $15.

Senator DOUGLAS. But these fellows who are down in the $24-a-week bracket from $24 up to $80 or even $85 a week, their problem is to get by. Their problem is to get by, and they are fighting a pretty hard battle to get by. Everyone tends to be concerned with the problems which they face, and I don't blame you for stressing the idea of giving stimulus to these people with incomes over $10,000 or $20,000 or $50,000 or $100,000 a year.

I am not blaming you at all, I am not picturing you as hardhearted in any sense.

Mr. GULLANDER. Thank you, sir.

Senator DOUGLAS. I simply say because of necessity this is where your attention has been concentrated and we are supposed to represent the people of the United States as a whole, and half the people of the United States roughly have incomes of less than $5,000 a year, that is for a family of four, family units, and probably somewhere between 20 and 25 percent have incomes less than $4,000, and yet they are taxed now and they would continue to be taxed, though to a lesser degree under 8363. We are really disagreeing over a billion dollars as to

whether it is to go to this group down at the bottom or whether it is to go to the group up at the top.

That is the issue and we could debate this for a long time.

Mr. GULLANDER. I would love to.

Senator DOUGLAS. It has been debated in this country for 150 years, ever since the time of Andrew Jackson, and I suppose it will be debated for some time to come. I simply indicate that the issue is there, and then cease.

Mr. GULLANDER. May I make one more comment on that?

Senator DOUGLAS. Certainly. You invite the danger of retaliation.

Mr. GULLANDER. Fine, I enjoy it. [Laughter.]

Let me say first, again, that I have far greater sympathy and understanding for these people and more concern for them than I do for the members of the NAM who are competent people to look after themselves.

They don't need my help to look after themselves.

Senator DOUGLAS. You are doing a pretty good job in taking care of them.

Mr. GULLANDER. Thank you, sir.

Further, let me say I have also a very keen understanding of these people's plight because, Senator, I have been through that plight myself. This is not any academic thing to me. This is complete and absolute understanding, and the greatest thing that happened to me was that this country gave me an opportunity to improve myself.

Senator DOUGLAS. Do you know what Edgar Lee Masters said in his Spoon River Anthology: "Beware of the man who rises to power on one suspender."

Mr. GULLANDER. I don't wear suspenders and I as yet have no power.

Senator DOUGLAS. I am through.

The CHAIRMAN. Senator Bennett?

Senator Smathers?

Senator SMATHERS. No questions.

The CHAIRMAN. Senator Ribicoff?

Senator RIBICOFF. One comment, Mr. Gullander.

Let's say we go along with your thinking on the last paragraph on page 6, we recognize that the middle brackets are not getting a sufficient break in the tax bill.

Would you supply the committee with your suggestions for closing up of loopholes to bring in enough income to do what you want to do for the middle income brackets without touching the people in the lower income brackets that Senator Douglas talks about?

Mr. GULLANDER. Let me answer that very specifically and bluntly, no, sir.

Senator RIBICOFF. You won't do that?

Mr. GULLANDER. Let me say this, I said advocate, I don't say submit. Our problem here is, let me reread it:

> I urge the structural reforms in H.R. 8363 be reviewed and with regard to their merits and demerits and not be considered as a trade for reducing tax rates which should not have been imposed in the first instance.

I think, let me say this, a proper tax law, if there is such a thing, is one which gives recognition to specific problems.

This the Congress has done over the years. Whether it was done

well or poorly is a matter of individual judgment, but in each case there were reasons why what you call loopholes and which we say may be exceptions to the normal law were made for specific reasons.

I think it is the responsibility of the Congress to examine into those reasons.

In any case where those reasons are still valid they must be valid in the interests of the entire economy and not for some selfish individual and we shoull leave them alone and not change it merely to raise revenues for this purpose.

Let me make another point: When we say this will be a billion dollars less than H.R. 8363, to a degree, because this tax structure is a creation of man, it is conceivable that out of the House would have come a bill to you gentlemen that would have had the bottom rate of 15 and not 14 percent and it would have had billion dollars less in there, then the question is, it looks like we are trying to take a billion dollars away from some people.

All we are saying is we ought to give them relief which happens to be a billion dollars less than a formula which come out of the House.

The House might well have brought in a formula very similar to ours. So this is not a question of taking a billion dollars away. It is a question of giving them somewhat less relief.

Actually of the total relief under our proposal, the amount that goes to people with incomes of $12,000 or less is 91.5 percent of the total reduction. I beg your pardon, 83 percent of the total reduction.

Senator DOUGLAS. What was that?

Mr. GULLANDER. Under H.R. 8363, of the——

Senator DOUGLAS. 63.

Mr. GULLANDER. H.R. 8363, the reduction for people making, in the $12,000 or less tax bracket, 91 percent goes to them. Under our proposal 83 percent still goes to them.

Senator RIBICOFF. But the point I make is this: I supported the chairman in his desire, in his understanding, that this was a very important measure and it had to be gone into very thoroughly. I disagreed with the Senator from Illinois who wanted to close these hearings early to get a bill out early.

Therefore, if this committee is engaged in looking at this measure thoroughly with a sense of fairness and a sense of equity, and since this bill will probably close for many years to come any substantial tax changes or tax reforms then there is a responsibility on the shoulders of the chairman and the committee to study this in all its implications.

Now, what I say to you is, I agree with you that this bill doesn't do right by the people in the middle-income groups, but I do agree with Senator Douglas, and I don't want to take care of the people of the middle income brackets at the expense of the people in the lower income brackets.

You make the argument that these people in the middle income brackets are important for the growth of American society, and I agree with that conclusion. But where do you pick up sufficient income by closing loopholes or making reforms that affect people who may not need all the relief the present tax bill provides in order to do what you would like to do for the people in the middle income brackets?

Since you come here to testify and you represent a large segment of American society, I am curious to receive your recommendations as to what structural changes you would prefer or you would like to see in order to make possible a change in the tax structure to take care of the middle income groups.

Mr. GULLANDER. Senator, I would not like to see any change made for that purpose.

Senator RIBICOFF. Let me ask this, would you be for closing the oil depletion allowances?

Mr. GULLANDER. That is a subject that is highly technical and I would say this, I would say over the years, the reason why that has existed is to encourage the development of the oil resources of this country.

Without that tax provision we would not have today the oil resources we have and I do not think it is in the economic interests of the Nation as a whole, not people who own oil company stock, I don't happen to own any incidentally, but for the Nation as a whole we won't have the power those oil resources give us, and if you close this you are changing the whole economic structure as relates to finding of fuel.

Senator RIBICOFF. Let's say you had to make a choice: you could either close up the oil depletion loophole or take care of the middle income brackets. Which is more important to American society, to close the oil loophole depletion or take care of these people?

Mr. GULLANDER. That is a good question, Senator. Let me beg the question by saying this, I don't think this is the problem we are really faced with because we don't really have to take that route in order to accomplish this.

I would say this, it is more important for the economy as a whole and, therefore, for the low income end, that we do what is right with respect to the exceptions to the law if the tax law provides things that are for the economic good of the entire country.

It is to the overall good that we benefit those in the middle and upper brackets, it is because this is where capital formation occurs, and this is more than anything else what will help the working man.

I wish we had so much capital, we had so much labor opportunities, that labor was as scarce in this country as in Europe. We have pockets of unemployment in this country. You had pockets of unemployment in Europe. What happened? They moved from southern Italy all the way to Germany because there was a vacuum there for, demand for, labor. There was enough activity and growth that you needed these people, and this is what this country needs, economic growth in the economic sphere.

Senator HARTKE. Will the Senator yield?

Do you contend the workers' status in Europe is comparable in any way whatsoever to the status of working people in the United States?

Mr. GULLANDER. I am talking about the relative level of unemployment.

Senator HARTKE. I understand that.

But the point is if their wages were at the rates we had in the United States, do you think there would be that high rate of employment and there would not be pockets of unemployment?

Mr. GULLANDER. There would be tremendous pockets of unemployment.

Senator HARTKE. That is right.

Mr. GULLANDER. My point is it is the demand for labor that creates the solution.

Senator HARTKE. But there is no point to believe that our people retrogress to the working standards of the people in Europe in order to achieve full employment.

Mr. GULLANDER. I don't propose that.

Senator HARTKE. Is it fair to talk about full employment in Western Europe as compared to the United States when there is this wide differentiation which probably creates this wide gap?

Mr. GULLANDER. It is fair when you use it as an illustration of what happens to the labor force when you have demand for labor regardless of what causes the demand for labor and I say we can have this high demand for labor in this country if we have a rapid rate of growth.

Senator HARTKE. I thank the Senator.

Senator DOUGLAS. There is one further question I would like to ask.

I hadn't realized you had made a distribution of reduction in taxes by income classes but you have at least done so, at least partially.

Did I understand you to say that 93 percent of the dollar reductions under H.R. 8363 went to those with incomes less than $12,000 a year?

Mr. GULLANDER. Those who fall in the tax brackets below $12,000, I distinguished that, yes; 9.15 percent.

Senator DOUGLAS. And 83 percent under your——

Mr. GULLANDER. Would fall into that group, that is correct.

Senator DOUGLAS. So that under the administration plan 7 percent went to the group above?

Mr. GULLANDER. 8½ percent.

Senator DOUGLAS. I thought it was 93, I beg your pardon. Eight and a half percent and under your plan 17 percent.

Mr. GULLANDER. This is correct.

Senator DOUGLAS. So that roughly you have doubled the amount of the tax savings going to people in this group?

Mr. GULLANDER. That is the only way you can change the curve of graduation.

Senator DOUGLAS. I understand.

I am just trying to get the factual basis.

Mr. GULLANDER. This is correct.

Senator DOUGLAS. Do you have an estimate as to the relative proportions returned or saved for groups over $20,000 or the taxable brackets over $20,000, under H.R. 8363 and under your bill?

Mr. GULLANDER. Let me read you six figures which I think will give you this.

Senator DOUGLAS. Yes.

Mr. GULLANDER. We have in this fashion, in the bracket from 12 to 22, you will recall we talked of 12 and below, from the bracket 12 to 22, H.R. 8363 is 4.5 percent; in our proposal it is 9.3.

In the bracket 22 to 50, H.R. 8363 is 2.4 and our proposal is 5.3.

In $50,000 and over it is 1.6 compared to 2.2.

If I remember correctly when you get to the very top there is no difference. I believe this is correct.

Senator DOUGLAS. Yes.

I am glad to have those figures for the record.

Thank you.

Mr. GULLANDER. Thank you.

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

The next witness is Mr. Arthur T. Roth, Bankers Committee for Tax Equality.

Take a seat, sir, and proceed.

STATEMENT OF ARTHUR T. ROTH, COCHAIRMAN, BANKERS COMMITTEE FOR TAX EQUALITY

Mr. ROTH. My name is Arthur T. Roth. I am chairman of the board of the Franklin National Bank, Franklin Square, Long Island, N.Y.

I might say that we think of our bank as a country bank. We call ourselves a country bank even though we have total resources of over a billion dollars but it wasn't too many years ago when our resources were just a half million dollars.

I appear before you as cochairman of the Bankers Committee for Tax Equality. May I say, Senator, that the thesis of my testimony today has to do with tax equality as the name of our committee indicates. I am going to speak on the subject of the inequity between the tax treatment afforded commercial banks and their competitors the savings and loan associations and savings banks. When this basic injustice is corrected, it will add some $250 million to our tax rolls as income and maybe it will help to correct the situation the NAM spokesmen referred to a few minutes ago—the overtaxation of the middle-income group. This may make it possible to reduce their tax rates somewhat.

I also have a reference in my testimony to inequities that exist between commercial banks themselves. Certain banks are allowed great tax-free bad-debt reserves and others get practically none. Those that are allowed the very small tax-free reserves for bad debts are the many thousands of small banks in the United States. Some 90 percent of the banks, are thus treated unfairly compared to the large banks that have a high tax-free reserve for bad debts.

The views I express here today are those of the 5,500 members of the Bankers Committee for Tax Equality.

Our testimony today deals both with the balance between revenues and expenditures in this tax bill and with the competitive situation in the savings industry. We hope our views will be helpful to your committee in its consideration of the facts leading up to the many decisions you will be called upon to make during the next several weeks.

In many ways, the very special relationship of a commercial bank to his customers gives him a better opportunity to evaluate the opinions of both individuals and business concerns as to taxes and other financial matters than is generally afforded to economists, lawyers, and industrialists.

Whether in a large or small city, the banker's advice is sought constantly by thousands of borrowers desirous of making use of the bank's credit facilities and depositors seeking financial counseling.

In our free society, the commercial banker has the opportunity of analyzing the heartbeat of our economic system.

When the President's tax proposals were announced, the Bankers Committee for Tax Equality was anxious to obtain an accurate cross-section opinion of commercial bankers from all over the United States both in regard to proposed tax reductions and in regard to possible reforms in our corporate and individual income tax structure.

Accordingly, our committee's staff, with the aid of a competent professional polling organization, prepared a questionnaire which was sent early in February 1963, to the presidents of all the 13,771 commercial banks in the United States.

Mr. Chairman, I am submitting a copy of this questionnaire and the results of the poll should you desire to place it in the record at this point.

The CHAIRMAN. Without objection.

(The information referred to follows:)

Tax reduction survey

	Percent	Number of banks
1. Under what conditions would you favor a reduction in Federal income taxes? (Check 1 answer only.)		
(a) No strings attached, we need a tax reduction at once	6	285
(b) Tax reduction now only if a substantial part of the loss in revenues is made up by tax reform included in the same legislation	5	235
(c) Tax reduction now only if a substantial part of the loss in revenues is made up by tax reforms included in the same legislation and if there is a significant reduction in Government spending	45	2,137
(d) Tax reduction now only if there is a substantial reduction in Government spending; I do not favor tax reforms at this time	36	1,699
(e) I do not favor tax reduction at this time under any circumstances	5	220
No answer	3	123
2. If you favored a reduction in Federal income taxes, in question 1 above, do you believe the best interests of our economy will be served by:		
(a) Using the larger portion of the tax reduction to lower the corporate income tax rates?	15	691
(b) Using the larger portion of the tax reduction to lower the income tax rates on individuals?	15	693
(c) Following the President's recommendation, which would result in approximately 20 percent of the tax reduction going to corporations and 80 percent of the tax reduction going to individuals?	50	2,390
Other comments	5	225
No answer	15	700
3. Do you favor retaining the $50 dividend exclusion and the 4-percent dividend-received credit, as it is now in the tax law, even though this retention may result in sacrificing some new tax cuts?		
(a) I favor retaining these features	79	3,705
(b) I favor eliminating these features	17	785
No answer	4	209
4. Should the tax reform bill include provisions for taxation of savings and loan associations and mutual savings banks on the same basis as commercial banks?		
95 percent, 4,480, yes; 2 percent, 76, no; 1 percent, 63, no opinion; 2 percent, 80, no answer.		
Total questionnaires mailed		13,771
Total replies received to Mar. 5, 1963	34	4,699

Mr. ROTH. Some 4,699 (34 percent) of the questionnaires were returned by March 5, 1963, and tabulated. We are informed by the polling organization, Central Surveys, Inc., that this response is much greater than is usually experienced from pollings by mail using questionnaires of this degree of complexity.

They also told us that the number returned constituted an adequate sampling and predicted that the percentages would remain virtually unchanged if all 13,771 replied.

An analysis made by Central Surveys, Inc., based on the 4,699 responses, states:

There is very little support by American bankers for an immediate "no strings attached" Federal income tax reduction. As shown by the answers to question 1, only 6 percent favor this, but about as many (5 percent) oppose a reduction now "under any circumstances." A majority, 81 percent, favor a tax reduction only if accompanied by a reduction in Government spending. This 81 percent includes 45 percent who want both tax reforms and reduced Government spending, and 36 percent who want reduced Government spending but oppose tax reforms at this time. Another 5 percent believe the loss in revenue should be offset by tax reform but do not refer to a reduction in spending.

The analysis continues:

There is a big margin in favor of giving most of the tax cut to individuals rather than corporations. Exactly 50 percent of the bankers follow the President's recommendation of approximately 20 percent of the tax reduction going to corporations and 80 percent to individuals, and another 15 percent say that "the larger portion of the tax reduction should be used to lower the income tax rate on individuals." Only 15 percent prefer to use the larger portion of any tax reduction to reduce corporation income tax rates.

Retention of the $50 dividend exclusion and the 4 percent dividend-received credit is favored by most (79 percent) bankers. Only 17 percent would eliminate these features from the present tax regulations.

Nearly all (95 percent) would tax savings and loan associations and mutual savings banks on the same basis as commercial banks. Only 2 percent object to such a provision.

I might say here again if these so-called mutual thrift institutions were taxed on the same basis as commercial banks, it would add $250 million annually to the tax revenues or Treasury. We realize, of course, that this survey was made about 7 months ago and it is possible that events in the meantime may have changed the opinions of some bankers.

We do not believe, however, that a survey made today would differ substantially. The considered opinion of a banker based on a cold appraisal of the economic facts is not subject to much change. The facts have not changed, as this committee is well aware.

To me, the survey indicates that bankers are in accord with President Kennedy's promise that an immediate and substantial reduction of Federal tax rates on individual and corporate incomes would both increase employment and production and lead to an overall growth of our domestic economy.

Their replies indicate they believe a substantial part of this reduction should go to individuals to increase their consumption potential and a lesser part to corporations as an incentive to capital investment.

The bankers' conclusion that there should be no tax reduction unless there is a "significant reduction in Government expenditures" reflects their fear of the dangers inherent in uncontrolled deficit financing.

I have discussed this point with many of them and believe that they are trying to tell us that there must be positive indications of a return to a balanced budget. This policy change is necessary for the establishment of a sound dollar both at home and abroad.

While our members view a tax cut as necessary to stimulate our economy, the bankers agree it must not be of such magnitude as to threaten possible inflation nor, on the other hand, should it be so small as to be ineffective.

As you gentlemen well appreciate, the bill before you calls for a loss of revenues of $11.7 billion resulting from reductions in corporate and individual tax rates.

It provides for a net recovery of $600 million from other structural changes and reforms. We feel, therefore, that the additional $250 million which could be secured from fully taxing mutual savings banks and savings and loan associations is no insignificant amount, particularly when compared to the $600 million the House recovered.

Looked at from another viewpoint, this $250 million in additional revenue would make possible another one-half of 1 percent reduction in the corporate rate or it might be used to make an important contribution toward reducing the tax rate of the middle-income bracket as suggested by Mr. Gullander, president of NAM, this morning.

As bankers, we support the principle, so ably enunciated in the Presidential tax message, that the "revision of our Federal tax system on an equitable basis is crucial" to the "growth and vigor of our national economy."

We agree that high Federal income taxes constitute an "unrealistic drag" on "private purchasing power, initiative, and incentive."

The measure before you tends to alleviate effects of the high tax burden and to correct some of the injustices that presently exist in our tax structure. For this reason, we believe that the bill should be passed. Nevertheless, its passage would still leave many inequitable situations which affect adversely major segments of our economy.

One such situation concerns the partial freedom from taxes still enjoyed by mutual savings banks and savings and loan associations. This unfair advantage permits them to pay higher returns for the savings dollar than can be paid by fully taxed commercial banks.

This attraction for the savings dollar has increased their loanable funds to the point that they now seek new investment outlets outside their specialized field of home financing.

Should they be allowed to expand their functions into new fields, the tax base will be further eroded at the expense of commercial banks and the Federal Treasury. Surely, correction of this inequitable situation falls within the scope of the President's tax message which proposes:

> Broadening of the base of the individual and corporate income taxes, to remove unwarranted special privileges, correct defects in the tax law, and provide more equal treatment of taxpayers—thereby permitting a larger reduction in tax rates than would otherwise be possible and making possible my proposals to alleviate hardships and inequities.

Mr. Chairman, your committee has long been the champion of tax equity. In 1951, it was the Senate Finance Committee, under the chairmanship of Senator George, which first proposed to tax these so-called mutual financial institutions on the same basis as commercial banks. The committee approved provisions to subject their income to the same corporate tax rates as commercial banks and to permit them to make the same tax-free additions to bad-debt loss reserves.

Unfortunately, the bill was amended on the floor of the Senate and in the conference committee to provide a special loss reserve.

In House Report No. 1447, 87th Congress, 2d session, 1962, the House had this to say about these previous efforts:

> In 1951, however, Congress repealed the exemption of these mutual savings institutions, and subjected them to the regular corporate income tax. At the

same time, however, these institutions were allowed a special deduction for additions to bad-debt reserves which proved to be so large that they have remained virtually tax exempt since 1951.

As you will remember, the 1951 legislation provided that a mutual savings bank or a savings and loan association, although subject to regular corporate rates on taxable income, could make an addition to a reserve for bad debts each year so long as—

(1) The amount set aside did not exceed the income return for that year, and

(2) The amount was not in excess of that necessary to bring its total reserves and surplus up to 12 percent of its deposits or withdrawable accounts at the close of the year.

During the decade that followed, from 1952 to 1961, the assets of these mutual savings banks and savings and loan associations grew from $41 to $125 billion.

During the same 10 years, they paid Federal income taxes of less than $70 million, while they retained $5,500 million tax-free as additions to reserves, surplus, and undivided profits. This represents the payment of slightly over 1 percent in Federal income taxes.

Taking note of this situation, the President, in his tax message of April 20, 1961, called attention to the existing inequity in the following words:

> Some of the most important types of private savings and lending institutions in the country are accorded tax deductible reserve provisions which substantially reduce or eliminate their Federal tax liability.

He further states:

> These provisions should be reviewed with the aim of insuring nondiscriminatory treatment.

Implementing the President's tax message, the Treasury submitted its recommendations for taxation of mutual savings banks and savings and loan associations to the Ways and Means Committee.

On August 8, 1961, the Treasury suggested that these institutions—

> be allowed to retain earnings tax free only in accordance with a bad-debt reserve formula comparable to the formula applied to commercial banks; that is, their bad-debt reserve ceiling would be limited to three times their average annual loss experience over the worst consecutive 20-year period since 1927.

The Treasury estimated that this would produce an average bad-debt reserve ceiling of between 2 to 3 percent of uninsured loans which would be comparable to the average ceiling of 2.4 percent applicable to commercial banks.

In its tentative decision to tax these mutual financial institutions in a more effective manner, the Ways and Means Committee followed substantially the Treasury suggestions. The committee release of January 30, 1962, stated:

> The committee tentatively decided on a system for taxing mutual savings banks and savings and loan assocations. When the new provisions become fully effective (1966), such organizations would be allowed a loss deduction, in lieu of the present bad-debt reserve, equal to 3½ percent of the net increase in all loans made during the year. Where such an organization can show, based upon its past experience a need for a higher rate, under appropriate formulas to be developed by the Treasury Department, such higher rates could be used.

A 3-year transition period was provided during which the so-called mutual thrift institutions would have paid less than the full rate of taxation.

During the first year, they would have paid a tax equal to 50 percent of the regular tax; during the second year, 66⅔ percent; during the third year, 83⅓ percent; and in the fourth year they would have paid full tax. New associations would have been permitted to build reserves up to the 3½-percent levels.

In subsequent deliberations on the Revenue Act of 1962, the Ways and Means Committee, departing from its tentative decision, introduced the concept of a transfer of tax-free income to a bad-debt reserve equal to 60 percent of taxable income annually with no limitations on the amount to be accumulated.

In so doing, the House committee followed a most unorthodox tax theory permitting the establishment of unlimited reserves bearing no relation to experience or reality. In attempting to justify its action, the Ways and Means Committee, stated, in its report (H. Rept. No. 1447):

> Your committee's bill does not impose any overall ceiling on the amount which may be accumulated by a mutual savings institution with respect to its reserve for losses on qualifying real property loans. However, your committee intends, from time to time, to review the status of this reserve to be sure that the balances maintained in these reserves remain reasonable in light of the overall requirements of the mutual savings institutions.

After we called this matter to the Senate Finance Committee's attention in our presentation of April 11, 1962, your committee responded by inserting a provision in the Revenue Act of 1962, which limited these loss reserves on qualified real property loans to 6 percent of these loans. In explanation, the committee stated (see S. Rept. No. 1881, 87th Cong., 2d sess. p. 41), that this amount:

> * * * in your committee's estimation should provide an adequate protection against losses. Therefore, the deduction of any amount in excess of this is believed inappropriate.

While this limitation would be effective in subjecting nongrowing institutions to full payment of Federal income tax, in the judgment of bankers and others it would be wholly ineffective in limiting tax-free transfers to loss reserves on the part of fast-growing institutions.

Such rapid growth may be anticipated since most housing experts expect homebuilding to continue at its present high rate. Some authorities anticipate even greater growth in the last half of this decade.

When the representatives of the savings and loan industry appeared before the Senate Finance Committee last year in an effort to preserve their special tax privileges, they complained that passage of the Revenue Act of 1962 would force many of them out of business.

They testified that increased taxation would prevent them from servicing the home construction business of America, and would result in the need for tremendous governmental aid to the housing industry.

In testifying before the Senate Finance Committee, Henry A. Bubb, legislative committee chairman, U.S. Savings & Loan League, said that during the 1950's their assets grew on an average of about 15 percent a year. He continued:

> Were this Congress to adopt a law for savings and loan associations remotely resembling that recommended by the commercial banks, the need for various types of governmental aid to housing would reach unprecedented levels * * *.
>
> Our mission in life is to assist American families in all walks of life to buy homes. We earnestly hope that the congressional decision on the tax law will not place any insurmountable obstacle to our performing this job.

The next witness before your committee was Oscar R. Kreutz, legislative chairman, National League of Insured Savings Associations, who echoed the sentiments of Mr. Bubb, saying:

The impact of the House proposals will be severe and immediate upon all institutions * * *. All associations, beginning in 1963, under the provisions of the House bill, would face substantial increases in costs. Their ability to pay a competitive return on savings would be correspondingly reduced, which in turn would markedly reduce the flow of savings into the home mortgage lending field * * *.

Gentlemen, all of these dire predictions concerning the consequences of passing the 1962 Revenue Act have proved to be false, completely false.

The assets of the savings and loan associations recently passed the $100 billion mark. They are continuing to grow at an ever-increasing rate. In the first half of this year alone, savings and loan associations obtained $6 billion in new savings.

According to the Wall Street Journal of October 18, 1963, the U.S. Savings & Loan League reported an increase of $915 million in the net savings in the Nation's savings and loan associations for the month of September. The league also stated:

* * * The gain for the third quarter was about the same as for the like 1962 quarter, in contrast to increases of 19 percent in the first quarter and 51 percent in the second quarter * * *.

Savings and loan associations nationally added more than $2 billion to their mortgage portfolios in September, boosting the total for the quarter to $6.0 billion, up 23 percent from the year-earlier quarter, the league said. The associations also had on their books on September 30 some $3 billion in commitments to make future mortgages, up 25 percent from the year-earlier figure and "pointing to a continued high lending volume over the balance of the year," the trade group said.

It would almost seem as if they have been too successful for their own good. Instead of their dividend rates being reduced, 1963 has seen a continuing rise in the dividend returns paid by mutual savings banks and savings and loan associations despite the fact that the provisions of the 1962 Revenue Act took effect January 1, this year.

As you gentlemen well know, the widely heralded shortage of funds to finance home mortgages has not materialized. Actually, there is a surplus of such funds, so much so that with the continued increase in savings placed with these institutions they actively are seeking new sources of investment and additional banking powers.

Just this month, the House Banking and Currency Committee held hearings on H.R. 8245, which, among other things, would permit Federal chartered savings and loan associations to invest in State and municipal bonds and to make loans on household furnishings and equipment, to provide funds to finance college education, and to make loans on mobile homes. They don't know what to do with all that money.

At the same time the savings and loan associations are seeking authority to accept for deposit public funds of the United States, funds, of private pension and profit-sharing plans, and funds of small business investment companies.

Representatives of mutual savings banks have also appeared before the same committee, testifying on H.R. 258, asking for the establishment of a national system of Federal mutual savings banks.

We believe these actions of the mutuals seeking new outlets for the investment of their surplus funds and new powers refute the major arguments they themselves have advanced for tax favoritism over their competitors, the commercial banks.

Equal taxation can be accomplished by removing the present provisions in the Revenue Act which permit the so-called mutual thrift institutions to divert either—

(1) Sixty percent of their annual income to the tax-free loss reserve, or

(2) An amount necessary to increase the loss reserve to 3 percent of qualified property loans at the close of the year.

Elimination of these provisions would permit the Treasury Department to apply the same administrative rulings for the determination of bad-debt allowances that now apply to commercial banks.

As I pointed out earlier in my testimony, your committee originally made this recommendation in 1951. (See S. Rept. 781, 82d Cong. 1st sess., pp. 25 to 28.) At that time the Senate Finance Committee summed up its action as follows:

At the present time, mutual savings banks are in active competition with commercial banks and life insurance companies for the public savings, and they compete with many types of taxable institutions in the security and real estate markets. As a result your committee believes that the continuance of the tax-free treatment now accorded mutual savings banks would be discriminatory. So long as they are exempt from income tax, mutual savings banks enjoy the advantage of being able to finance their growth out of earnings without incurring the tax liabilities paid by ordinary corporations when they undertake to expand through the use of their own reserves. The tax treatment provided by your committee would place mutual savings banks on a parity with their competitors.

In regard to savings and loan associations the committee in 1951 said:

The grounds on which your committee's bill taxes savings and loan associations on their retained earnings, after making a reasonable allowance for additions to reserves for bad debts, are the same as those on which mutual savings banks are taxed under the bill. Moreover, since savings and loan associations are no longer self-contained cooperative institutions as they were when originally organized there is relatively little difference between their operations and those of other financial institutions which accept deposits and make real estate loans.

In 1961, the Treasury advanced the same suggestion.

For a short period of time the House Ways and Means Committee also proposed to grant the so-called mutual financial institutions a loss reserve of only 3.5 percent of loans.

Mr. Chairman, I have taken the valuable time of your committee to review this legislative history in order to establish one extremely important fact.

At one time or another, your committee, the House Committee on Ways and Means, the Treasury, and the President have recognized the loss of revenue and the injustice inherent in a double standard of taxation applied to commercial banks and their competitors. Since everyone concerned agrees that something should be done, I respectfully submit, gentlemen, that this tax bill is a good place to do it.

Not only would such action constitute an elementary step for tax reform and eliminate a glaring inequity, but based on estimates furnished last year by the joint staff to your committee, it would produce approximately $250 million a year in new revenue.

Certainly this tax reform meets all the criteria imposed by the President. It constitutes "removal of certain inequities and hardships in our present tax structure."

This reform would certainly "remove unwarranted special privileges, correct defects in the tax law and provide more equal treatment of taxpayers."

By bringing in $250 million of additional revenue it might even permit "a larger reduction in tax rates than would otherwise be possible," as the President suggested.

Mr. Chairman, the change necessary to effect this reform and secure for the Treasury a quarter of a billion dollars in revenue is a simple change. All that is necessary is for the committee to eliminate section 593 of the Internal Revenue Code of 1954 (as amended) which provides the special formula for determining the amounts of income which mutual savings banks and savings and loan associations can add to bad-debt loss reserves on a tax-free basis.

The elimination of this section would make these institutions subject to section 166(c) which grants the Secretary of the Treasury discretionary powers to prescribe bad-debt loss reserve treatment. The Secretary has already indicated his willingness to apply the same rules to mutual savings banks and savings and loan associations as now apply to commercial banks.

Mr. Chairman, I have now made the major point which the Bankers Committee for Tax Equality wished me to present to your committee. While I am here, however, I believe you might be interested in our group's reaction to the application of the bad-debt formula presently used for commercial banks.

The present formula for bad-debt reserves is unworkable and unjust to the point of being almost ridiculous as it applies to commercial banks.

Replacing this present formula with a uniform loss reserve offers another opportunity for your committee to eliminate another inequity in our tax structure.

What is this present formula that I complain about?

Under section 166(a), any business can charge off actual losses arising from bad debts. Section 166(c) provides an alternate formula by which, at the discretion of the Secretary of the Treasury, an organization may deduct amounts which represent a reasonable addition to a reserve for bad debts.

Many commercial banks still prefer to use the specific chargeoff method of accounting, while others have shifted to the reserve method in line with mimeograph No. 6209, issued December 8, 1947 (C.B. 1947-2, p. 26). This administrative ruling provided that, in the case of commercial banks, the maximum which can be deducted from taxable income, in any one year, shall be an amount equal to the average annual loss for the most recent 20-year period (moving average).

This amount cannot bring the total balance to more than three times such average annual loss. This ruling was modified in 1954 by a supplemental mimeograph 54-55 (C.B. 1954-1, 60), to permit the use of any consecutive 20-year period after 1927, to determine the average annual factor. The ruling follows:

A bank, in computing a reasonable addition to its reserve for bad debts, may use an average experience factor based on any 20 consecutive years of experience

after 1927, in lieu of a moving average experience factor determined on a basis of 20 years including the taxable year.

This ruling froze the depression experience into the formula but it still failed to recognize that efficient banks needed such reserves as well as the inefficient who experienced the worst losses in the early depression years.

The need today is uniformity in the establishment of loss reserves. There can be no assurance that those banks who suffered in the late 1920's and early 1930's will be the ones who require assistance in any recession ahead. The law of averages tends to rule out this possibility.

In talking to bankers throughout the country, I find them almost unanimous in their opinion that a uniform method in the establishment of reserves should be substituted for the present ridiculous formula which attempts to measure future losses by the experience of individual institutions during the great depression.

An actual example of the extremes produced by this formula is recorded in the 95th Annual Report of the Comptroller of the Currency for 1957. Referring to a study which had just been conducted of "Reserve for Bad-Debt Losses on Loans," Comptroller Ray M. Gidney stated, and I quote:

The reserve for bad-debt study revealed substantial inequities between commercial banks having very high loan loss experience factors and those having small factors. Simply to show the spread between the high and low loan loss factors, a bank in Illinois is permitted under the present formula to establish reserves for bad debts equal to 24 percent of its eligible loans. On the low side, a bank in Pennsylvania having eligible loans of $1,400,000 has a loan loss factor of only 0.002 percent entitling it to a present reserve ceiling of only $84.

In other words, the bank in Illinois is permitted to set up a tax-free reserve of 24 cents out of every dollar while the bank in Pennsylvania is permitted only six one-thousandths of a cent out of every dollar for the same reserve.

On $1 million in eligible loans one bank is permitted a reserve of $240,000 while another would be limited to only $60.

One bank has a tax-free advantage 4,000 times greater than the other. It would not surprise me at all to discover that the loans in the bank with the $60 loss reserve actually contain the greater risk. Unjust? Yes, it is also ridiculous and obviously unwarranted. It is just plain stupid.

Here are some of the reasons why a uniform rate for bad-debt reserves, should be established, rather than using a rate based on an individual bank's historical experiences of the 1930's.

1. Many banks with a high degree of risk loans have a smaller loss ratio than others with a low degree of risk loans.

2. The formula is largely based on the experience of the depression years of 1930 to 1936 which is no longer applicable because—

A. Banks are better supervised.

B. Depressions should not again be as severe.

C. The Federal Reserve has broader lending powers to aid banks than in 1930–36.

D. We have FDIC insurance.

E. Lending practices of banks are much improved.

F. The 1930–36 lending experience of a bank is no indication of its future prospect for losses. Management, types of loans, economic conditions all have changed.

Consider especially the effect of the present formula on small banks. They need more protection because of their location in single industry areas of little or no diversification. They grant more loans to small businesses where there is the greatest risk. They cannot afford to pay adequate salaries for high-skilled credit officers.

It may surprise you to learn that nearly 50 percent of all commercial banks—mostly small banks—set up no tax-free bad-debt reserves under the present Treasury formula.

Why? The formula is too complicated. Detailed records dating back 30-odd years are not readily available, especially in the small banks.

Furthermore, the formula may produce a rate unworthy of the effort.

The American Banker of May 27, 1963, effectively summarizes the objections of the members of the bankers committee to the formula presently applied to commercial banks, and I quote what appeared in the American Banker:

> These ratios are based on a period in the past and often bear small resemblance to a bank's loss experience in the current period. Obviously there are inequities in the formula, as the Comptroller's advisory committee suggested last summer, not only between banks, but with respect to other financial institutions.

In seeking tax justice, we respectfully suggest that—

1. All financial institutions should be subject to the same rules in the establishment of bad-debt loss reserves that now apply to commercial banks.
2. That consideration be given to altering the present Treasury regulations to relate such reserves to risk assets instead of to actual experience during a bygone period in our economic history.

Congress can either delegate the responsibility for changing the formula to the Treasury setting forth the guideline to be followed, as it has done in the past, or Congress can change the formula by law.

This concludes my testimony speaking for the Bankers Committee for Tax Equality. I personally, have some thoughts on a formula that I believe would meet with the favor of the Treasury as well as a goodly number of bankers.

I must say, however, this is my own view and does not represent the position of the members of the bankers committee. The committee has not yet taken an official stand on such a formula. We are considering submitting these views as well as the views of others to our membership for a vote of approval.

In the meantime, gentlemen, I now propose a reform which will cost my own institution, Franklin National Bank, $4 million in additional taxes, in the interest of tax equality.

Franklin National Bank has an unfair advantage over the average commercial bank. We are permitted a tax-free reserve for bad debts which is 25 percent higher than the average commercial bank. This reserve formula is based on the experience of cur bank in the thirties when we were a half-million-dollar bank, and today we are a billion-dollar bank.

How can you do those things? We don't need this kind of a reserve. And more important, the average bad-debt reserve which applies to all banks, is in my opinion also too high.

Therefore, I propose that this be corrected and as I said, it will cost us $4 million in additional taxes to our own institution, if it is corrected. My proposal is we do away with the present ridiculous formula for bad-debt reserves and replace it with one that is sound, just, and equitable to all.

What is the revised formula which I propose here today? A reserve of—

A. Four percent on the first $5 million of eligible loans, and

B. Two percent on eligible loans over $5 million.

What effect will this proposed formula have on revenue to the Treasury? The revised formula should produce a slight increase in revenue to the Treasury.

Here is an estimate of the rates which would be available to various size banks under the proposed formula, as of December 31, 1961.

(The table follows:)

Deposits	Number of banks	Reserve for bad debt formula
Less than $1,000,000	1,181	4 percent.
$1,000,000 to $2,000,000	2,481	Do.
$2,000,000 to $3,000,000	1,928	Do.
$3,000,000 to $5,000,000	2,454	Do.
$5,000,000 to $10,000,000	2,533	Do.
$10,000,000 to $25,000,000	1,702	4 to 3 percent.
$25,000,000 to $50,000,000	520	3 to 2.5 percent.
$50,000,000 to $100,000,000	232	2.5 to 2.2 percent.
$100,000,000 to $500,000,000	247	2.2 to 2 percent.
$500,000,000 to $1,000,000,000	39	2 percent.
More than $1,000,000,000	23	Do.

NOTE.—Estimated eligible loans for all banks range from 40 to 60 percent of deposits.

Here I have tabulated the deposits of these banks, and the number of banks in each category and the reserve for bad-debt formula that would apply to these banks. You will see that the 4-percent reserve would apply to all banks with deposits of less than $10 million.

For banks with deposits of between $10 and $25 million, the formula would be somewhere between 4 and 3 percent. Here we have covered 92 percent of all the banks in the country and given them a better reserve than they have today by far. We have provided a tax-free, bad-debt reserve for most of these small banks that find it impossible to get the figures together to set up a reserve, under the present system. As I testified previously, this is some 40-odd percent of the small banks of the country. They will now enjoy an opportunity to have a tax-free reserve for bad debts which they don't have today.

Of course, the tax losses resulting from what we are giving to these small banks is offset by reducing the percentage of tax-free reserves for the larger banks, like our own. We have over 3-percent reserves and we would be reduced to 2 percent under this plan.

The bigger banks don't need it as much as the small banks.

Mr. ROTH. Thank you, Mr. Chairman and members of the Senate Finance Committee for the opportunity to appear here today.

The CHAIRMAN. Thank you.

Senator DOUGLAS. Mr. Roth, I don't know that I agree with you in all your proposals on taxation of mutual building and loan associations and mutual savings banks because of the element of mutuality which these organizations still have, and which could be, in my

opinion, and should be, further developed, but I do want to pay tribute to you for two things that I know about:

First, you with your associates, including my friend, Mr. Tark of Chicago, and Mr. Stoddard of Michigan, were the only bankers in the country, so far as I know, last year to endorse and advocate the imposition of withholding the basic individual income tax on dividends and interest just as this is withheld on wages and salaries, and I want to say you set a great example of public spirit in doing this.

You were of tremendous help not only by your example, but in the concrete suggestions you offered showing that the administrative difficulties would be very slight.

Now, unfortunately, we lost that battle and it will be some years or some time before we can return to it but I want to tell you how grateful I personally am for this.

Mr. ROTH. Thank you, Senator.

Since you bring it up, I might say I don't think we really lost the battle. I think we gained a great deal from it. I still firmly believe and many bankers now recognize the fact that this system of reporting that we have today is far more costly than withholding would have been. Of course, withholding would have brought in a great more revenue to the Treasury, too.

On the other hand, if this question of withholding had not come up and if we had not discussed it fully, as we did, I don't think we would have account numbers today as we do in the reporting system. To the extent that the Congress was enabled to put through this numbering system so today we have all these people reporting, their numbers to the Treasury we have benefited. It has surprised me. I think we are going to get more in taxes than I anticipated because of the reporting. It may be far more than I anticipated.

Some day we may have withholding. When we do we will have gained by securing this necessary information for Internal Revenue. Withholding may have been delayed for a few years but a lot of good may have come out of all of the discussion.

Senator DOUGLAS. In other words, that was a sacrifice fly which brought the run in from third base. [Laughter.]

Mr. ROTH. Yes, all right, I will agree to that.

Senator DOUGLAS. Well now, let me say there is a second reason why I admire you, and that is the fact you started with a very small bank on Long Island, what used to be known as Long Island City.

Mr. ROTH. No, it was the Franklin Square National Bank in Franklin Square.

Senator DOUGLAS. You say your assets are now over a billion dollars?

Mr. ROTH. Over a billion dollars.

Senator DOUGLAS. How much over?

Mr. ROTH. A billion one fifty million dollars.

Senator DOUGLAS. Among the banks of the country what is your relative size?

Mr. ROTH. 25th in size.

Senator DOUGLAS. 25th.

I noticed you have also been successful in fighting off, largely successful in fighting off, the efforts of the gigantic New York banks to move onto Long Island, and to largely take over the business in that area, isn't that true?

Mr. ROTH. To a large extent we have. The years we fought them we grew in size and now we are of the size where we can effectively compete with them. Maybe if we had given in years ago they might have taken us over, but there is no chance of that today.

Senator DOUGLAS. I want to congratulate you because I happen to believe in a broad distribution of economic power, and while I have nothing against the gigantic New York banks, I don't think it is a healthy thing to have a relatively small number of huge institutions dominate the lending and the investment field in the country.

I want to say that I take a great deal of pride in seeing you successfully carry out what some of us believe the essence of the American system is, namely, ethical and competitive capitalism rather than monopolistic capitalism.

Mr. ROTH. Thank you, Senator.

Senator DOUGLAS. Have you made an estimate as to how mush added revenue the changes which we made last year in the taxation of savings—building and loan associations and mutual savings banks would bring to the Treasury?

Mr. ROTH. I am afraid the Treasury is going to collect considerably less than we hoped they would collect under the changes made last year. These institutions have found ways of avoiding the payment of taxes. Their very growth has been one way of avoiding it. As you can see from my testimony, the formula applied to these so-called mutual thrift institutions is based upon size and the amount of their loans. Of course, many have grown so fast that when you apply the 60 percent of income formula whereby they are allowed to set up a tax-free reserve based on their ever increasing loans, there is very little on which they have to pay a Federal income tax.

I don't recall exactly what the figures were. I thought it was in the neighborhood of $200 million we expected to be able to collect this year in the form of taxes through the bill that was enacted last year. I would say if we collected half that amount we would be fortunate.

Senator DOUGLAS. I wondered if the staff could get figures from the Treasury as to what their estimates are on the added revenue.

The CHAIRMAN. Obtain that for the record.

(The figures referred to follow:)

TREASURY DEPARTMENT,
ASSISTANT SECRETARY,
Washington, October 31, 1963.

Mr. COLIN F. STAM,
Joint Committee on Internal Revenue Taxation,
House Office Building, Washington, D.C.

DEAR MR. STAM: I understand that you were asked to obtain a revised Treasury estimate of the increase in tax imposed on mutual banks and savings and loan associations under the Revenue Act of 1962.

The original estimate, a revenue gain (gross) of $200 million, was based on incomes estimated for calendar year 1963. The later data now available do not indicate a need to revise that estimate.

Sincerely,

STANLEY S. SURREY.

Mr. ROTH. When we continue to enact these compromise legislative provisions dealing with the taxation of savings and loan associations instead of something that is straightforward and which subjects them to full Federal taxes we continue tax inequities. The Treasury should

be permitted to set up a proper loan loss ratio that would be applied to both savings banks and savings and loans and commercial banks, equally.

Senator DOUGLAS. Yes.

But shouldn't there be a higher rate of bad debts on real estate loans than on ordinary commercial banking, ordinary loans?

Isn't that a more risky business?

Mr. ROTH. Under ordinary circumstances, with carefully made loans, I would say no. With the way some of the lending is being handled in California and other areas of the country including your State of Illinois I would say there is more risk, but unnecessarily so. With the little authority that is given to the Federal Home Loan Bank Board to properly supervise these institutions, I would say, yes. We are starting at the wrong point when we say give them a higher reserve to compensate for poorly made loans. I say, see that they are properly supervised first, the same as commercial banks are supervised.

The Federal Home Loan Bank Board has little or no authority over the savings and loan associations to get them to adhere to good banking practices.

That is your trouble, not the loss reserves.

Senator DOUGLAS. May I say that, of course, you are aware, are you not, that part of the trouble in Illinois, and there is trouble there, has come because of a law which was passed, I believe, in the early 1950's under the aegis of a gentleman by the name of Orville Hodge, which permitted the conversion of mutuals into stock, profitmaking stock, companies.

Mr. ROTH. That is right.

Senator DOUGLAS. And that the difficulties have occurred almost entirely among these institutions, isn't that true?

Mr. ROTH. That is true and that is what your difficulty is in the State of California where Mr. McMurray has so much trouble. He can't control the institutions in that State, and the ones he can't control in the State of California are the stock savings and loan associations.

Senator DOUGLAS. Well, I would simply like for the record to point out that this occurred some years back when one of the most powerful political figures in the State was Mr. Orville Hodge, who later went to the penitentiary for embezzling approximately $2½ million to the State.

He returned a million and a half of it and this was then said to be an adequate return.

Mr. ROTH. I would like to repeat, yes, I say they may appear to need higher reserves in many areas than the commercial banks because of high-risk lending they are doing today. But the kind of lending they are doing today is the fault of lack of supervision, and the lack of supervision is apparently because Congress has not given the Home Loan Bank Board the kind of authority it needs in order to supervise these institutions properly.

Senator DOUGLAS. Thank you very much.

The CHAIRMAN. Senator Bennett?

Senator BENNETT. No questions.

The CHAIRMAN. Senator Morton?

Senator MORTON. No questions.

The CHAIRMAN. Thank you.

The next witness is Mr. Carroll F. Lewis, the Manufacturers Association of the City of Bridgeport, Conn.

STATEMENT OF CARROLL F. LEWIS, HONORARY CHAIRMAN, COMMITTEE ON TAXATION, THE MANUFACTURERS ASSOCIATION OF THE CITY OF BRIDGEPORT, CONN., INC.

Mr. LEWIS. Good morning, Senators.

My name is Carroll F. Lewis. For the past 29 years I have been actively engaged in Federal, State, and local taxation for a national corporation.

Until retiring recently I was the tax accountant for a large manufacturing concern located in the Greater Bridgeport area. I appear as honorary chairman of the Committee on Taxation of the Manufacturers Association of the City of Bridgeport, Conn., Inc.

This association's committee on taxation is comprised of 17 tax executives of small, medium, and large member manufacturers. It has been active on matters of Federal, State, and local taxation since 1950.

The Manufacturers Association of Bridgeport has a membership of some 100 manufacturers in the Greater Bridgeport labor market area.

We desire to present briefly our observations on the Revenue Act of 1963 (H.R. 8363) as passed by the House of Representatives and its practical effect upon manufacturers, manufacturing executives and other employees.

Also we will review the general economic impact of the measure particularly with respect to the creation of job opportunities which would provide increased employment by manufacturers.

Industry has long been throttled by high wartime and postwar tax rates which choke off any real opportunity to expand productive facilities and provide employment opportunities for those presently unemployed and for our exploding youth population which is just beginning to flood into the labor market.

The Bridgeport Manufacturers Association and its committee on taxation have long espoused the need for tax rate reform on a sound economic and fiscal basis.

Major changes in our tax system are made at infrequent intervals. It is imperative that a constructive tax rate reform program be adopted now to restore the healthful growth of our national economy.

It is equally important that in making urgently needed reforms in the individual and corporate segments of our Federal tax structure that we do not embrace new principles which might prove harmful to individuals or to our national financial stability in the future.

The bill now before you which its sponsors predict will stimulate economic activity by manufacturers and other private enterprises falls far short of accomplishing this purpose.

Instead, it would provide millions of individual taxpayers with relatively small tax savings which would aggregate some $2.5 billion the first year and some $7 billion in subsequent years, which is poured into the economic stream as consumer purchases is counted upon to accelerate business activity.

It actually does not provide needed corporate tax relief which will free funds immediately for jobmaking direct investment.

Corporation cash will be syphoned off by the "speedup" starting in 1964 and full relief will not be attained until 7 long years have passed in 1971.

Because of the "speedup," many corporations, due to lack of adequate working capital, will have to continue to borrow money to meet the taxpayment schedule.

Certainly the "speedup" of corporate payments would encourage continued Federal deficit spending as it largely offsets any further deficit which would result from immediate tax relief for corporations.

Specifically, review of the House bill would lead to the observation that the manufacturing economy of the Greater Bridgeport area would experience no immediate nor early stimulation due to the following:

1. There would be insufficient corporate savings to stimulate any substantial purchase by manufacturers of machine tools and other production machinery and equipment.

2. The cash position of manufacturers would not be improved appreciably due to the acceleration of corporation tax payments in excess of $100,000 per year during the transition period.

3. Any cash increase resulting from tax reduction would hardly augment the working capital, alter the cash flow, reduce borrowing to pay taxes, or increase dividend payments of a single accelerated corporation despite the aggregate tax reduction forecast.

4. One great incongruity in the House bill merits most serious consideration. Those men of industry and commerce who bear the executive and administrative responsibility for the success of American enterprise are indeed the forgotten men in tax rate reforms proposed by the House. They are largely the taxpayers in the middle brackets where taxes are not "graduated" but leap from bracket to bracket.

5. Historically, the Federal Government as a matter of official policy has declared group insurance and other employee benefits not to be wages. The House bill's provisions to tax group life insurance premiums on employer paid life insurance exceeding $30,000 and all employer paid accident and sickness wage continuation payments during the first 30 days of illness—and thereafter all over $100 per week—as "income" would buy this new precedent subject to taxation all so-called fringe benefits as wages, that is, as ordinary income.

6. In the Revenue Code of 1954 some relief from double taxation of domestic dividends was allowed individual taxpayers. The House bill would revert in part to the prior practice and defeat in some measure the principle of eliminating all forms of double taxation.

7. Another basic principle, which has safeguarded individual taxpayers, is being attacked in the House bill which would whittle away at lawful deductions which have been valid virtually since the adoption of the Federal income tax.

8. The principle of balanced budgets inscribed on the tablets of fiscal responsibility have apparently been destroyed and Federal deficit spending has become the "Golden Calf" which all America is supposed to worship.

Under the proposed tax reductions some 467,500 corporations earning $25,000 or less could have a maximum tax saving of $2,000—actu-

ally the average would be only $500 according to House committee table 9—which would provide little in the way of either cash, or for new or even used equipment.

Some 80,000 corporations earning from $25,000 to $100,000 would have a maximum saving of $3,500 the first year and $5,000 in succeeding years.

Table 9 also indicates that some 54,000 corporations having taxable incomes from $25,000 to $50,000 would have an average reduction of $2,300 and those from $50,000 to $100,000 would average $3,800.

Corporation having taxable incomes of $100,00 to $1 million would experience an average reduction of $1,800 in 1965 as shown in the extension of table 9 in exhibit A. Exhibit A is attached and as is indicated here it is taken from the House committee report.

Since it is estimated that it takes an investment in plant and equipment of $18,000 to create one new job these reductions might not increase employment substantially.

While both the investment credit and depreciation rate reform adopted last year in effect increased cash available for investment, tax relief for all of the Nation's "speedup" corporations would not free funds substantially for the next 7 years.

Although the "speedup" is more than covered by tax reduction, the remainder available for corporate investment is relatively small when compared to modernization and expansion presently needed to create any number of new jobs.

The dearth of new cash under the House bill is dramatically illustrated in exhibit B which affords comparison of "net additional cash available to corporations" having taxable income of $25,000, $200,000, $300,000, $1 million, $5 million, and $10 million.

I might add here that the figures for the $10 million are taken directly from that report.

Percentagewise or dollarwise, the year-to-year reductions available to corporations after the "speedup" would hardly stimulate company-by-company plant modernization or expansion or new equipment purchases of any major significance.

This fact is of immediate concern to Bridgeport area manufacturers, many of whom make machine tools, machinery, and components.

Although proposed corporate tax reductions which purport to stimulate job-creating capital goods purchases are of prime interest, the proposed reductions in individual income taxes of employees are also of great concern to employers.

Presumably the Revenue Act of 1963 would provide significant tax reductions for employees at all income levels but analysis hardly supports this premise.

Interesting observations can be drawn from the table contained in the Ways and Means Committee report pertaining to married taxpayers with two dependents (exhibit C).

I refer you to that as a matter of interest and the average weekly savings extended out there seem relatively small.

Neither annual tax savings nor proportionate average weekly savings by individual taxpayers earning from $3,000 to $20,000 annually would provide means for their initiating major purchase or investment undertakings which would stimulate substantially increased employment, or economic growth.

The family breadwinner earning an adjusted gross income of $5,000 would find the tax reduction would put only $1.63 more in his weekly paycheck. After offsetting last year's increased cost of living it might provide a pack or two of cigarettes.

A higher bracket wage earner or the salaried man who had achieved an executive, administrative, or professional "exempt" status with a salary of $7,500 a year would receive a tax reduction of $3.23 per week which might improve his family's food, help out on the dime store purchases, or aid in contributing to the church collection plate.

Those earning from $10,000 to $20,000 per year might budget some savings deposits, pay on existing debts, or make monthly payments on some item of consumer household capital equipment.

Actually, typical taxpayers with a family of four earning from $5,000 to $15,000 per year and having a taxable income of $1,000 to $12,000 would take from 8 to 60 months to pay for a $300 washing machine from their tax savings, that is illustrated on exhibit D.

But the crux of the situation is found in the income tax middle brackets in which the executives and administrators who direct American enterprise find their disproportionate tax burden.

They are expected to direct the actual operations, develop new products, find the customers, build and tool the plants, provide jobs for millions of workers, invest their personal savings as risk capital, and contribute generously to charitable causes and educational institutions.

Certainly they are entitled to an even break when tax rate cuts are distributed.

However, those who shoulder their own responsibility find that, under the House schedule, they would be penalized an additional 2 or 3 percent for each $2,000 of taxable income they may earn from $2,000 to $22,000.

It might be observed that this is not a major sector of the voting population, but proper financial incentives would encourage efforts toward the creation of employment opportunities for the mass of voters.

Incidentally, it might also be noted that a substantial number of executive and administrative personnel in the Federal Government fall into these same middle brackets.

It is important that adjustments in the tax rate be wholly equitable if they are to be made at all. Even though some increase in the deficit may be incurred, it would be about the surest way to guarantee future economic advancement.

Apparently, tax bracket inequities do not suffice as penalties for economic leadership—executives and administrators of American enterprise must also suffer "reforms."

We would like to emphasize the observations upon important basic principles which were presented to the House Ways and Means Committee.

For the past 30 years the sociological, political, and group organizational emphasis has been upon the necessity of the employer or the State providing complete security to every employee and his dependents against all misfortunes which would befall them on or off the job—during employment, unemployment, or retirement—in health, accident, sickness, or death.

Year by year, the employer has been called upon to provide a lengthening list of benefits providing employee security often referred to unappreciatively as fringe benefits.

During periods of war or emergency, in order to bypass wage stabilization regulations, the Federal Government officially determined that benefits provided to employees on a group basis are not wages.

The President proposed a new principle—diametrically opposed to those established in the past—that certain benefits providing some security with respect to sickness and death are subject to taxation.

This introduces a most disturbing complication which forebodes the ultimate taxation of all employees for all employer-provided benefit programs—both with respect to premium costs and benefits derived—as actual wages, that is as ordinary income.

The Ways and Means Committee included among the "reforms" taxation of premiums on employer-provided life insurance in excess of $30,000.

This, in effect, would establish this one category of "fringe" benefits—group life insurance premiums—as wages subject to taxation. This reversal of established principle should not be permitted under any circumstances as it would threaten the whole concept of tax exemption of employer-provided employee benefits.

Employers have generally accepted a formula of "two times annual earnings" as an appropriate amount of group life insurance for those bearing the burdens and risks of executive, administrative and professional responsibilities.

Every employee earning over $15,000 whose employer followed this formula in providing group life insurance coverage would be penalized for his initiative.

Every employee whose employer provided coverage in excess of "two times salary" would be penalized even more severely by this "reform."

Such "reform" penalty would increase the tax burden of those in the middle brackets who bear the responsibility of America's economic success. The older employee suffers an increasing inequity with passing years as this "reform" ignores the "group" concept of such insurance in which the insured enjoys a level premium regardless of age.

Instead of releasing individual talents to undertake any risks to accomplish an individual's maximum contribution to economic advancement this tax on group life coverage over $30,000 would serve as a threat to his security with resulting avoidance of the threatened dangers of ulcers, heart attacks, travel hazards, long hours, lack of normal rest, and so forth, thus inhibiting the exercise of natural talents.

Both in principle and practical effect this provision of the House bill could cost the Nation many times the paltry $5 million which the Appropriations Committee might cut out of the $100 billion budget in any one of many places without any appreciable or noticeable effect on the Nation's welfare.

Provision of off-the-job sickness and accident benefits, in the form of accident and health insurance, for employees by employers is mandatory in five States; that is, New York, New Jersey, Pennsylvania, California, and Rhode Island.

Though not mandatory in Connecticut, it is provided in one form or another by the majority of Bridgeport area manufacturers as one of the "fringe" benefits.

Some companies have generously provided their own salary or wage continuation plans which give unearned payments to employees who are absent, due to accident or sickness, equal to all or some portion of their normal earnings.

Some plans supplement tax-free accident and health (sickness) insurance payments which frequently approximate unemployment benefits.

Many employers are so sincerely concerned for their employees' well-being that they voluntarily provide benefit payments designed to replace some portion of a wage earners take-home pay when he is flat on his back and unable to engage in his normal income-producing activity.

Presently the tax law generally excludes all employer-paid sickness and accident benefit payments in amounts up to $100.

Taxation of such income during the first 30 days, as proposed in the House bill, would further reverse the principle properly enunciated in the Revenue Code of 1954 that such fringe benefits are not wages, and positively identify them as ordinary income subject to taxation.

Actually, this might force employers to purchase commercial insurance rather than "self insure" and make direct payments to employees.

As long as the employer pays the benefits directly, he can be sure that the employee who wants to keep his job or get ahead will not malinger. If the employee should malinger, the employer can discontinue payments and control the incident case.

However, if payments are provided through nontaxable insurance benefits, it is possible for an employee to malinger as long as the insurance company adjuster does not pursue the case or the employee's own personal physician will not provide specific information on the exact nature of the illness or the condition of the employee's health.

It often takes longer than 30 days for the physician to complete the insurance company's accident and sickness report forms provided to the employee which leaves the employee without benefit of cash income for well over 30 days.

Likewise, representatives of insurance carriers may not check into an employee's condition until after 30 days have elapsed.

From a practical standpoint there is no valid reason for altering the existing equitable exclusion of accident and sickness benefits which humanely afford some measure of security to employed persons suffering off-the-job personal injury or illness.

For years prior to the adoption of the Revenue Code of 1954 there had been a growing concern among taxpayers about the existing double taxation of dividends.

To offset in part the effects of double taxation, individual taxpayers were granted a $50 exclusion and a 4 percent credit of the remaining dividends not to exceed 4 percent of the taxable income.

It would seem that any claim that reduction in the corporate rate affords individual taxpayers relief from double taxation equal to the present 4 percent dividend credit results from specious reasoning.

Reduction of the corporation rate by 4 percentage points leaves total corporate taxable income taxed at 48 percent at its source.

Any tax or dividends received by individual taxpayers from these previously taxed corporate earnings constitute a second tax resulting in double taxation.

Just because the corporate rate has been reduced *x* percentage points doesn't mean that dividends from these same earnings have been relieved of double taxation. Such relief at the source could only result if the corporate tax were abolished or possibly if taxable earning were computed after deducting dividends.

It would be unfortunate indeed if the principle of providing relief from double taxation to the individual taxpayer be diminished by such revenue-raising structural changes.

Certain State and local taxes have been deductible for Federal income tax purposes historically due to the natural regard in which one taxing entity should hold another.

It seems unfortunate that, as the price of tax reduction, proposed reforms would break through this long-established principle.

Undoubtedly it would afford taxpayers taking itemized deductions with a simpler form of tax computation and at the same time simplify Federal auditing procedures.

However, at the first sign of prospective reduction in tax revenues, the Internal Revenue Service might ipso facto determine that it was also impossible to estimate accurately sales taxes resulting from consumer purchases.

Manufacturers in the Greater Bridgeport area are deeply concerned about future growth of the Nation's productive capacity and production levels which will create new job opportunities.

We are still firmly convinced that a tax reduction program geared to anticipated economic growth, together with prudent reduction of Federal expenditures, which would stimulate capital formation and investment in modern industrial expansion, is essential to our national growth and progress.

The Revenue Code of 1963, presently before your committee, does not fulfill this need but recognition of the principle of tax reduction as essential to capital formation and economic growth is implicit in the bill passed by the House.

Continued Federal deficit spending has consumed a disproportionate amount of the gross national product in recent years as illustrated by the following comparison; these figures being taken by the way from Department of Commerce figures, and you will note that the gross national product and disposal has increased 1.8 times while Federal Government expenditures have increased 2½ times.

In 1950, gross national product, $284.6 billion; Federal Government expenditures, $41.027 billion; disposable personal income, $207.7 billion; corporate profits after taxes, $22.8 billion.

In 1961, gross national product, $518.7 billion, Federal Government expenditures, $102.123 billion; disposable personal income, $363.6 billion; and corporate profits after taxes, $22.7 billion.

Times, gross national product, 1.8; Federal Government expenditures, 2.5; disposal personal income, 1.8; and corporate profits after taxes, 1.

Obviously, although disposal personal income apparently kept pace with the gross national product, Federal deficit expenditures left corporations (and stockholders) little more to devote to capital investment.

If Federal expenditures had been kept in line with the gross national product, 1961 expenditures would have been only $74 billion and $28 billion would have been available for capital growth.

If the end result of this income tax revision is primarily an increase in purchases of consumer goods, it might create a shortage, which in turn would inflate prices.

When coupled with continued inflationary Federal deficit spending, such inflation could spark an inflationary spiral which might harm rather than strengthen our national economy.

In addition some of the reforms might work against our national economic progress.

For 30 years the advocates of free consumer spending, corporate economic regulation and Federal deficit spending have proclaimed these means to be the only true path to economic growth.

As tempered by the House Ways and Means Committee and passed by the House, it may be well to adopt the Revenue Act of 1963 with such judicious modifications as may be dictated by the wisdom of your committee.

Only then will it be possible to judge the validity of the proponents' philosophy. We can then hopefully look forward to another opportunity to return to Federal fiscal responsibility and sound economic growth.

Before I read the last paragraph, may I suggest again to you, gentlemen, that you look carefully at these exhibits because I think they give some very interesting answers.

We are deeply appreciative of this opportunity to place before your committee these observations of our Committee on Taxation of the Manufacturers Association of Bridgeport on behalf of manufacturers of the Greater Bridgeport area.

Thank you.

(The attachments referred to follow:)

EXHIBIT A

Estimated cash available to corporations in 1965—Recapitulation of figure data table 9—H. Rept. 749

Taxable net income	Number of taxable corporations	Computed tax liability, present rates, in millions	Amount of reduction, in millions	Average tax reduction per taxpayer	Average cash available in 1965 from tax reduction [1]
$0 to $25,000	467,500	$874	$233	$500	$500
$25,000 to $50,000	51,000	636	126	2,300	2,300
$50,000 to $100,000	25,000	759	94	3,800	3,800
$100,000 to $1,000,000	25,500	3,427	299	11,700	1,800
$1,000,000 and over	4,000	18,664	1,438	359,500	61,000
Total	576,000	24,360	2,190		

[1] Using 1965 percent taken from table 10—House Rept. 749 on Revenue Act of 1963 (H.R. 8363). It should be noted that the average cash available in the 2 highest brackets above will not change materially until 1969.

EXHIBIT B

Net additional cash available to corporations[1]

Calendar year	Taxable income											
	$25,000	Percent[2]	$200,000	Percent	$300,000	Percent	$1,000,000	Percent	$5,000,000	Percent	$10,000,000	Percent
1963												
1964	$2,000	8	$5,500	2.75	$2,168	0.72	$2,168	0.21	$2,168	0.04	$2,168	0.02
1965	2,000	8	9,000	4.50	7,957	2.65	12,297	1.23	37,532	.75	68,098	.68
1966	2,000	8	9,000	4.50	10,188	3.40	12,988	1.30	29,063	.58	48,988	.49
1967	2,000	8	9,000	4.50	10,187	3.40	12,987	1.30	29,062	.58	48,987	.49
1968	2,000	8	9,000	4.50	10,188	3.40	12,987	1.30	29,063	.58	48,987	.49
1969	2,000	8	9,000	4.50	11,312	3.77	24,192	2.42	97,837	1.96	189,793	1.90
1970	2,000	8	9,000	4.50	11,313	3.77	24,192	2.42	97,838	1.96	189,793	1.90
1971	2,000	8	9,000	4.50	13,000	4.33	41,000	4.10	201,000	4.02	401,000	4.01

[1] Computed on same basis as table 10 in the House Rept. 749.

[2] Percent of taxable income.

EXHIBIT C

Married taxpayer with 2 dependents (salary or wages only)

Salary or wages [1]	Exemptions itemized deductions	Taxable income	Tax		Annual tax savings	Average weekly savings
			Existing law	H.R. 8363		
$3,000	$3,150					
$5,000	3,500	$1,500	$300	$215	$85	$1.63
$7,500	3,900	3,600	720	552	168	3.23
$10,000	4,200	5,800	1,196	962	234	4.50
$15,000	4,950	10,050	2,213	1,831	382	7.35
$20,000	5,700	14,300	3,410	2,835	575	11.06

[1] 78 percent of all taxpayers fall within the brackets listed.

EXHIBIT D

Tax-savings timetable for average taxpayer to purchase $300 washing machine (married couple with 2 children) filing jointly

Taxable income [1]	Annual savings [1]	Average monthly savings	Months required to purchase $300 washing machine
$1,000	$60	$5.00	60.0
$2,000	110	9.17	32.7
$3,000	150	12.50	24.0
$4,000	180	15.00	20.0
$8,000	300	25.00	12.0
$12,000	460	38.33	7.8

[1] Above figure data in first 2 columns taken from table 7-A of House Rept. 749.

The CHAIRMAN. Thank you, Mr. Lewis.

Any questions?

Senator DOUGLAS. Just one question, and that relates to the question of the deductibility of premiums on retirement pensions.

Would you remove any limit on the amount of premiums which could be tax free or would you apply the ratio of twice annual earnings?

Mr. LEWIS. I think I would apply the ratio of twice annual earnings.

Senator DOUGLAS. Of course, there are some very high salaries in American industry. Take some people getting as much as $500,000 a year. Applying the twice the ratio you suggest that would mean you could deduct premiums on a million dollars of insurance, isn't that right?

Mr. LEWIS. That is right.

Senator DOUGLAS. Don't you think a person with an income of $500,000 a year salary can on the whole provide for his own retirement?

Mr. LEWIS. He should be able to.

Senator DOUGLAS. That is all.

Mr. LEWIS. May I make one comment, though?

Senator DOUGLAS. Surely.

Mr. LEWIS. On this insurance proposition, the company that I worked for gave me quite a sizable amount of money that diminishes

until I become 75 years of age but the pension was rather small so it takes quite a sizable hunk out of my money, the tax on it. That is just the individual looking at it.

But on the whole, I think some limitation could be put on the higher but I think twice annual earnings would be a good formula.

Senator BENNETT. No questions, Mr. Chairman.

The CHAIRMAN. The next witness is Mr. Edwin J. Rosenbaum.

STATEMENT OF EDWIN J. ROSENBAUM, ECONOMIST, NEW YORK, N.Y.

Mr. ROSENBAUM. Thank you, Mr. Chairman, my name is Edwin J. Rosenbaum, and I am an economist residing at the Hotel Park Chambers, 68 West 58th Street, New York.

1. After imposition of State government taxes, the Federal Government for 1962 exacts a tax on corporate earnings amounting to $26 billion.

2. The vital factor in corporation taxes lies in the economic fact that unless corporations can pass on to the consumers the full tax and reap a reasonable profit; that is, inflate the selling price, the corporation taxes are capitalized and absorbed in a lower selling price of the investor's stock, a lower income and a lower liquidated buying power of the investor.

3. Personal income taxes are not capitalized.

4. When buyers' resistance in domestic markets and lower competitive prices in domestic and export markets effectively block the passing of wage increases and high taxes, industry depression, unemployment, stagnation, or final bankruptcy result. To develop dynamic business, full employment, and balanced prosperity, corporation taxes must be reduced to a maximum of 36 percent.

5. High stock market averages are a misleading index of rounded national prosperity. Railroads, steels, coppers, store stocks, airlines, textiles, and many other fundamental businesses are depressed by unrealistic, uneconomic, and unconscionable taxation. Variety stores and supermarkets show four-fifths of 1 percent down to losses on their gross business. The Federal Government now mulcts investors of 52 percent of these pitiable earnings and personal income taxes are superimposed on the dividends.

6. An immediate 10 percent or $5,200 million reduction in corporation taxes, capitalized at 10 percent would generate $52 billion to potential or actual spending power.

7. Wall Street's yardstick is 15 times earnings or a 6⅔ percent capitalization. On this basis, a $5,200 million corporation tax reduction could generate $78 billion of potential or actual spending power.

8. The initial reduction of 10 percent in corporation taxes must be followed by successive annual reductions of approximately 2 percent a year for 3 years so that corporation taxes are reduced to a maximum of 36 percent. The Federal Government will reap income taxes and profit taxes on most of $39 billion of generated spending power, one-half the Wall Street norm of 15 times earnings. Taxes will be garnered over the ensuing 3 years from $23.4 billion more of the further generated spending power.

9. Whether New York Central stock sells at 247 as it did in 1929, or at 22 now, it still has virtually the same number of shares and stock-

holders. The price now is 9 percent of its 1929 price, but due to dollar depreciation, the liquidated buying power is just 4½ percent of its 1929 value. This example applies more or less to other major businesses which I first mentioned. Thus, our national income presents a vast imbalance in corporations' income, a vast imbalance in buying power of investors in American industry.

10. Not all of this $8 billion will be passed on to the stockholders. In prosperous corporations the potentially increased earnings will create lower prices for the corporations' products, resulting in savings for the consumer and strengthening corporations' competitive position in export markets. For borderline corporations, increased earnings will be capitalized and possibly paid to stockholders. In any event, they will generate buying power. A capitalized potential or actual buying power of $80 to $120 billion will be engendered, a healthy economic climate created, and capital investment encouraged.

11. Seventy percent, 80 percent, and 91 percent of income taxes block the flow of investment capital. Cuba and some South American governments expropriate American investments. High-bracket taxes constitute expropriation by our Federal Government.

12. Economic facts disprove the necessity for tax reduction in the lower brackets as demanded by labor leaders, estimated by them at 7½ cents per hour. Such reduction would aggravate the vast imbalance in buying power. American wage scales are 2½ times British scales. They then ascend greatly in comparison with wages in all other prosperous nations. Automobile and refrigerator buying requires no stimulant. For labor to get full employment, buying power must be generated in other sectors of our economy.

13. The entire 1962 tax for incomes up to $6,000 is $35.633 billion. Consumer credit used primarily by lower income tax brackets amounted to $63.45 billion on December 31, 1962. According to banking information two-thirds of this credit will be paid off during 1963, and be replaced by new consumer credit of $42.3 billion plus an approximate increase of $6.35 billion of new consumer credit buying, or a total of $48.65 billion. This amounts to $3.34 billion more than the entire Federal income tax collection for 1962.

14. According to Federal Reserve reports, 1,400,000 homes were built in 1962 and home mortgages increased a net of $16 billion. But 4 percent of $152 billion in home mortgages outstanding December 31, 1961, were amortized; so the actual volume of new mortgages was $22 billion, two-thirds of which or $14.67 billion was utilized by people in lower income tax brackets. Add this $14.67 billion to the $48.65 billion consumer credit and we get a total of $63.32 billion or 7.3 times the proposed personal income tax reduction.

15. The new consumer credit created during 1963 is $3.34 billion more than the entire income tax collections for 1962. Including home buying it is $18 billion more than the entire 1962 income tax collection.

16. In 1962 savings alone increased $31.8 billion over 1961.

17. For employed labor there is ample buying power. For labor to get full employment, buying power must be generated in other sectors of our economy. Here, the proposed tax bill fails.

18. According to National Association of Manufacturers' table of percentage increases covering the period of 1947–50 to 1960–61, con-

sumer incomes after taxes increased 88 percent; consumer expenditures 85 percent.

19. Government expenditures increased 166 percent.

20. Business investment in new plants and equipment increased 70 percent.

21. Business profits increased just 19 percent.

22. Thus as business invested 70 percent more to get ahead, due to mounting wages the profit margin fell behind.

23. The proposed corporation tax reduction to 48 percent or $2 billion is overwhelmed by the $900 million payroll tax increases; $1.4 billion State and local tax increase and tightened business taxes of $600 million. (These figures are cited by U.S. News & World Report.)

24. Projecting the 1962 corporation tax of $26 billion into 1960 as an example, the Government would demand in addition the final, crushing $12 billion tax payments accelerated on an average of 11½ months. This blow could and would prove a major disaster for a vast number of corporations now using these liquid funds in their business.

25. A major bank informs me that up to 80 percent of corporations use these funds for payment of bills, discounts, and deferred payments. This liquid capital, providing discounts, 2 percent 10 days up to 8 percent 10 days with 60 days dating, 4 up to 15 times a year in some instances, provides the lifeblood of their business. For them, tax acceleration blocks the aorta with resultant unemployment and lower tax collections.

26. The vaunted, constructive effect of the proposed corporation tax reduction is just a mirage.

27. In England, corporations are allowed 130 percent of the cost of new plants and machinery as a basis for accelerated depreciation; 55 percent may be deducted the first year. Thus 61.5 percent of new investment costs is almost immediately recaptured for corporate use. The English also allow corporations variable tax reductions on their exports.

28. It has been stated that our exports are increasing a negligible 2 percent in 1963. The English, though barred from the Common Market, increased their exports 25 percent.

29. The Herald Tribune, on either July 24 or 25, 1963, showed our exports in 1962 lost 2,410,000 tons against 1961 and our imports increased 3,200,000; a total loss in our trade balance of 5,610,000 tons.

30. Our adverse balance of payments has been running over a $5 billion rate, 66⅔ percent greater than last year; and nothing adequate is done to remedy it.

31. Inflationary increased corporation taxes cited above plus tax acceleration adversely affect our exports, our balance of payment. How long can this endure? How long before dollar devaluation, euphemism for national bankruptcy?

32. About 4 months ago, Secretary of the Treasury, the Honorable Douglas Dillon, stated that at present rate dollar devaluation would occur within 1 year to 2 years at most. At best, the Treasury Department's borrowing from Europe effects a temporary palliative, merely plunging our Nation deeper into the quicksand of adverse payments.

33. I have read that a trillion dollars of indebtedness is outstanding. Are creditors, bondholders, mortgage owners, bank depositors, fiduciary funds to lose 10 percent to a possible 50 percent of their buying power, $100 billion to a possible $500 billion of their savings by an eventual 10 percent to a possible 50 percent dollar devaluation? Once before futile devaluation was imposed on our people.

34. The profit motive for venture capital to invest in some of the 50,000 new patents granted last year must be developed. The need to increase buying power and employment in marginal and nearly 380,000 nonprofitable American corporations in 1962 and modernization of obsolete plants constitute the vital challenge to income and corporation tax reduction. (These figures were cited by Mr. Roger Blough of the United States Steel Corp.)

35. The English tax dividends just once, 38¾ generally paid by the corporations. There is no double taxation on dividends.

36. A reduction of high personal income taxes to a final 42-percent level will spur venture capital, and reduction of corporation taxes to a final 36-percent maximum will galvanize corporation capital and overcome industrial stagnation in vast sectors of our economy with an immediate impact on employment.

37. The tax reduction for prosperous corporations results in lower price tax; that is, increased buying power for the consumer. From the mine, farm, sea, and forest, 52 percent corporation taxes are now escalated three, four, or five times to the finished retail product. A reduction of 16 percentage points in each of the three, four, or five processes results in greatly reduced retail prices. At all levels of processing it strengthens our competitive position in world markets.

38. The escalated reduction of 16 percentage points imposed on practically every item of daily living would develop as great savings for those in the lower tax brackets as the proposed 30-percent tax reduction; for the very low tax brackets this would save much more. For social security recipients and other aged living on fixed incomes in depreciated dollars, the corporation tax reduction would prove a godsend.

39. We have approximately 17½ million people aged 65 and over. A 30-percent income tax reduction in the lower brackets with resultant increased inflation will further impoverish these people and the young living on fixed incomes.

40. Government retrenchment, constructive tax reduction, statesmanship will strengthen the dollar and strengthen our competitive position in world markets. The $40 to $60 billion trip to the moon has been characterized by eminent scientists as virtual boondoggling. This Roman circus is a huge tax drain on personal and corporate incomes which are capitalized.

41. Politicians have created a Washington bureaucracy paying three times as many employees as actually needed. No nation can afford such government disorganization.

42. Even today stockholders and workers are paying the costs of the brutal steel strike with its enormous ramifications and its impact on our economy. There is no end in sight, about 5 years ago United States Steel sold at 105.

43. Labor better beware exacting a "pound of flesh" at the bargaining table and beware the collectivist state with labor existing on low-

ered wages and government doles. In the late 1920's, labor extorted too high wages, wages far above their intrinsic value. Labor is now repeating that performance on a grand scale.

44. Labor has gone too far.

45. In England, Keynes' theories have been completely discredited and repudiated. Our Government considers Keynes the economic messiah, and appoints, personally discredited and rejected in Europe, Mr. Walter Heller, a Keynes high priest, as Chairman of the President's Council of Economic Advisers.

46. Mr. Gardner Ackley and Mr. John P. Lewis of the President's Council of Economic Advisers, creating a Keynes socialist, collectivist state, would direct and fix wages, hours, production costs, selling prices, quantity, and profits. Mr. Lewis states that tariff cuts would create "greater exposure of American industry to foreign competition." This hardly stimulates venture capital or employment.

47. After the steel industry's absorption of five wage increases, with all due respect, the denunciation of miniscule steel price increases, the sinister acceleration of corporation taxpayments in the tax bill, and the avowed economic principles of Mr. Ackley and Mr. Lewis constitute megaton blasts against free enterprise.

48. According to latest annual reports, a Keynes—collectivist—socialist—welfare operation, the six British nationalized industries reported losses equivalent to $343,372,400. Project this into six major American industries, many times the size of the British. British wage scales are 40 percent of ours.

49. Twin English imports, Keynes and the collectivist state, twin festers, have proved inferior to free enterprise, which made our great country.

50. The Chase Manhattan Bank's "Business in Brief" No. 52, seasonally adjusted graph shows Federal Government spending at a rate of $114 billion, and pointing upward. I submit that the unsound taxation of higher bracket incomes and of corporations block balanced prosperity and full employment. This tax bill creating greater deficits hardly offers a pretense of a cure.

With your kind permission I submit addenda which pertains to our huge foreign aid consequence taxes and balance of payments.

On Sundays I often turn on the radio to a Bible class. All members of this august committee are familiar with the following lesson. The teacher asks, "How many lepers did Jesus cure and how many went afterward to thank him?"

The answer, "He cured 10, and 1 went afterward to thank him."

Our natural allies will remain our allies, but those we are trying to buy, here the Bible speaks.

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

The committee will adjourn until 10 o'clock tomorrow morning.

(Whereupon, at 12:30 p.m., the committee recessed, to reconvene at 10 a.m., Wednesday, October 30, 1963.)

REVENUE ACT OF 1963

WEDNESDAY, OCTOBER 30, 1963

U.S. SENATE,
COMMITTEE ON FINANCES,
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, Douglas, Gore, Talmadge, Ribicoff, Williams, Carlson, Bennett, and Dirksen.

Also present: Elizabeth B. Springer, chief clerk.

The CHAIRMAN. The committee will come to order.

The first witness is Mr. Andrew B. Young of the American Bar Association.

Please proceed.

STATEMENT OF ANDREW B. YOUNG, ON BEHALF OF THE AMERICAN BAR ASSOCIATION

Mr. YOUNG. Mr. Chairman and members of the committee, my name is Andrew B. Young. I appreciate this opportunity to appeal before you to present this statement on behalf of the American Bar Association, of which association's section of taxation it is my privilege to be chairman. The American Bar Association is an organization of 114,000 lawyers, and the section of taxation numbers upward of 9,000 American Bar Association members who have a common interest in the law of taxation.

The American Bar Association has, for many years, inquired into means of more fairly imposing and collecting taxes for the support of Federal, State, and local government. In tax matters it frequently acts on the advice of and through its section of taxation. For several years the section of taxation has been studying substantive tax reform. In May of this year the board of governors of the Association directed the section of taxation to continue its study of the Federal tax structure and this direction was affirmed by the house of delegates in Chicago in August of this year. We were given the instructions in the form of approval by the house of delegates of recommendations of the section of taxation which read as follows:

Whereas the council of the section of taxation believes that the present Federal income tax structure does not provide for an equitable distribution of the tax burden and for a sufficiently broad tax base; and

Whereas the council of the section of taxation believes that the present Federal income tax structure stifles incentives for work and investment and is not conducive to economic growth and stability; and

Whereas various published data indicate that national personal income in the United States is in excess of $450 billion, but because of an accumulation of exceptions and special provisions caused by the impact of excessively high income tax rates, something less than one-half of this amount is subject to income tax under present rules; and

Whereas the council of the section of taxation believes that the Federal income tax structure is unnecessarily complex and should undergo substantial revision in order to—

(1) Broaden the tax base,
(2) Reduce the income tax rates,
(3) Simplify the technical provisions,
(4) Simplify administration, and
(5) Ease the burden of compliance,

Now, therefore, be it resolved, That the council of the section of taxation recommends that the board of governors of the American Bar Association approve—

(1) The continuance of inquiry and research by appropriate committees of the section of taxation leading to the objectives of establishing a fair and equitable tax system, broadening the tax base, and providing incentives for work and investment,

(2) The consideration of specific measures designed to achieve the objectives in paragraph (1) which will have the effect of—

(*a*) Insuring that every person, able to do so, pay in taxes his fair share of the cost of government;

(*b*) Including in gross income items not now included and curtailing special benefits and personal nonbusiness deductions;

(*c*) Establishing with respect to individual incomes a graduated rate structure with a maximum rate of approximately 40 percent;

(*d*) Establishing with respect to corporate incomes a rate structure which would tax corporate incomes not in excess of the maximum rate on individual incomes;

(*e*) Ameliorating or eliminating the double taxation of corporate income; and

(*f*) Modifying the estate and gift tax structure in the interest of simplification, greater fairness and equity, and consistency with the income tax.

I will refer to these instructions as the first ABA resolution.

The bar, genuinely interested in a sound and effective Federal revenue system, has seen mounting evidence that substantial tax revision is long overdue. The tax base has been steadily narrowed by special benefits; increases in tax rates that occurred in response to national emergencies have been frozen as expenditures continue to increase; steady growth of the body of statutory tax law (overlaid with a mounting structure of rule, regulation, and court decision) has resulted in a complexity that staggers the imagination; an overburdened Internal Revenue Service is struggling against a mountain of paper (more than a hundred million returns were filed last fiscal year). Because of increasing complexity of regulation and problems of interpretation, 51 million individual taxpayers and another 2 million partnerships and corporations are confronted with a problem of compliance that strains the fabric of the voluntary compliance system that is so essential to the success of our system.

While our section has not yet reached specific conclusions as to what it shall recommend to the house of delegates, the first ABA resolution under which we are operating should not be taken as a suggestion that tax reform be indefinitely postponed. A large number of highly competent lawyers in the section have been busy for months on this project and expect to develop a tentative statement of position before the end of January. I have made a commitment to the section of taxation that this inquiry and research will be brought to a conclusion by the time of its annual convention in New York next August.

Against the background of this study the American Bar Association adopted at the same time as the first ABA resolution a second resolution which contains its views on the national administration's proposals. The section of taxation has been directed to urge these views before the proper committees of the Congress. I will refer to this resolution as the second ABA resolution.

The American Bar Association has evaluated the scheme of revenue revision which, in broad outline, was before it in May of this year and which is, with many changes in form but not in broad perspective, embodied in H.R. 8363. It has reached a decision which is set forth in the first two numbered paragraphs of the second ABA resolution as follows:

> *Be it resolved,* That the American Bar Association after careful study recommends to the Congress:
>
> 1. That the national administration's proposals for structural revision of the Internal Revenue Code would not accomplish the type of basic reform required, but are piecemeal in nature and add greater complexity; and
> 2. That the Congress should defer consideration of major structural changes until it can enact a program of basic reform in the income tax structure.

We would be the first to acknowledge the need from time to time to make technical changes in the Internal Revenue Code (as has been done on many occasions in the past) to eliminate unintended benefits or to correct unforeseen hardships that have developed in the administration or interpretation of the code. This is an inevitable process and is not to be discarded because the side effect is further proliferation of sections, subsections, paragraphs, and subparagraphs, as this is a fair price for the adversary system of tax law administration that is part of our fiscal life. The proposed legislation has provisions of this type (in the case of section 216 involving as much as 30 pages of statutory verbiage—the very complexity of which could raise justifiable question). However, without evaluating the merits of specific proposals about which serious questions have been raised by others, we would have no objection to the process of closing loopholes and relieving unforeseen hardship, so long as it does not deter us in achieving our ultimate objective of basic substantive tax reform—and so long as it is not an excuse for going only a small part of the way toward a generally agreed upon objective.

Let us anticipate the old observation that "half a loaf is better than none." This is not quite true, as every change in the boundary between tax advantage and tax disadvantage creates a new alinement of taxpayers who justifiably adjust their affairs to a new set of ground rules and are justifiably concerned about a fresh and second assault on newly prepared positions. It is our considered judgment that a step-by-step approach endangers the attainment of the real and ultimate objective. Moreover, the policy of "little by little" lacks the inherent candor that the taxpayer is entitled to expect from the tax collector.

We believe that the pending legislation falls considerably short of the reasonable objectives that the American Bar Association has established as part of a program of establishing a fair and equitable tax system and of broadening the tax base. Referring back to the first ABA resolution, H.R. 8363 goes only a grudging way toward "including in gross income items not included and curtailing special benefits

and personal nonbusiness deductions." Far from coming to grips with the problem of ameliorating or eliminating the double taxation of corporation income—which is basic in restoring tax neutrality as between incorporated and unincorporated business competitors—the proposed legislation is an unmistakable step in the opposite direction. So far as the simplification of technical provisions is concerned, the most casual perusal of H.R. 8363 will reveal 34 pages of statutory language in section 214 to accomplish a result that is described as not having any appreciable revenue effect (H. Rept. 749, p. 71). Section 219 devotes 39 pages of legislative language to provisions which will have to be understood and applied by upward of 2 million taxpayers with incomes of less than $10,000 a year. (See joint committee print, 87th Cong., 1st sess., "Federal Revenue Facts and Figures," p. 235).

I believe it unnecessary to go into the small print to demonstrate the validity of the first two paragraphs of the second ABA resolution. Let us now consider the third paragraph of that resolution which provides as follows:

Be it resolved, That the American Bar Association after careful study recommends to the Congress:

* * * * * * *

3. That, if rate reductions are enacted in 1963—

(*a*) The Congress should enact at this time a measure which will have the effect of reducing the present rates on individual incomes by the same proportion in each bracket, except that, in the interest of achieving fairness and equity and of encouraging work and stimulating investment, the rates in the upper brackets after such reduction should be further modified so that no rate will be higher than 65 percent, and

(*b*) The Congress, to the extent that any reductions in rates on corporate incomes are deemed appropriate in addition to the adjustments in individual rates referred to in subparagraph (*a*) above, should enact at this time reductions in corporate income tax rates which apply proportionately to large and small corporations alike; and, in this connection, if the Congress should enact provisions for the further acceleration of corporate tax payments, it should not thereby largely remove the immediate cash benefits accruing to a corporation from rate reduction.

This recognizes the obvious right of the Congress to determine the fiscal program of the Nation while at the same time deferring the ultimate decision as to the ideal structure of the revenue system. This ultimate decision should, in the words of the first ABA resolution, insure that "every person able to do so pay in taxes his fair share of the cost of government." We think any rate changes now in prospect should be interim, with attention paid primarily to the health of the economy; and, in our view, ultimate rates must be reevaluated in the light of the ultimate changes in structure and tax base.

Tested against this judgment, which is expressed in the third paragraph of the second ABA resolution, H.R. 8363 is deficient in certain respects that are evident from the most superficial analysis.

(*a*) The individual rates are not reduced the same proportion. The taxes in the brackets between $2,000 and $90,000 are all reduced to a lesser degree than the overall tax reduction of 20 percent (see staff description of H.R. 8363 prepared for the Committee on Finance at pp. 2, 3).

(*b*) The maximum rate is appreciably below the recommended maximum 65 percent set forth in the second ABA resolution.

(*c*) The corporate rate reduction, instead of being "applied proportionately to large and small corporations alike," is being applied in

favor of the small corporation and here again (contrary to the direction toward simplification) in section 223 are to be found another 31 pages of statutory text to make sure that the objectives will be obtained.

(*d*) On the question of whether the benefits of rate reductions are "largely" removed by changes in the current tax payment program, although we are informed that all corporations will receive some net benefit, we find that some will receive less than one-twentieth of 1-percent reduction in cash payments in 1964 and an average annual reduction of less than 1 percent for the period 1964 through 1968 (if the estimated payments are based on 75 percent of tax liability).

I think the committee will be interested to know that a great many of our section members—as individuals giving advice on their own responsibility—are making technical comments as to specific sections of H.R. 8363. Their technical comments are being forwarded to the joint committee staff and to the staff of your own committee in a sincere effort to be helpful to you and them in your performance of the legislative function.

The American Bar Association feels strongly its repsonsibility to assist in the establishment of a Federal tax structure that will provide an equitable distribution of the tax burden and an incentive to work and investment conducive to economic growth and stability. Regardless of the decision your committee may make on matters covered by the American Bar Association resolution, you may continue to rely on the American Bar Association and its section of taxation to make their members available to you in the public service in our common aim of a fairer and more effective Internal Revenue Code.

The CHAIRMAN. Thank you very much, Mr. Young, for a very interesting statement.

As I understand it from your statement:

> We think any rate changes now in prospect should be interim with attention paid primarily to the health of the economy; and in our view ultimate rates must be reevaluated in light of the ultimate changes in structure and tax base—

That means I assume, if this tax is enacted at all it ought to be on a temporary basis.

Mr. YOUNG. I don't think that there is any question about that, Senator.

Certainly none who have considered this matter think that this bill is the achievement of what might be called the ultimate objective of substantive tax reform. The fairness of any process of broadening the base has to be evaluated in determining whether the rates that are placed upon taxpayers are fair, so of necessity you will be faced, I think, with a difficult decision if and when you take the next step of determining whether some of these benefits that you are now extending to some taxpayers will not have to be taken away from them.

I would think that would be a painful process.

The CHAIRMAN. I assume you have in mind that if this bill should be enacted in a form which does not meet changing requirements of the tax system it would postpone the all-inclusive legislation which you think is necessary for a better distribution; is that one of your fears?

Mr. YOUNG. That is the correct standard.

The CHAIRMAN. Isn't it your fear that if this bill is enacted as it now is, it will postpone better readjustments of the taxes and closing of the loopholes and so forth?

Mr. YOUNG. I think it will not only postpone it, Senator, I think to substantial extent it may make it impossible.

What happens, as indicated in my statement, when you make new alinements of the line between tax advantage and tax disadvantage is that you establish a new frontier or battle line which will be defended actively when there is a new assault made on the base itself and at that time I think you will find you will have very little rate adjustments left to extend as an incentive to adjust that base or readjust that base.

The CHAIRMAN. You mentioned the fact that attention be paid primarily to the health of the economy. What do you think is the health of the economy now with respect to justifying a tax reduction of this kind?

Mr. YOUNG. Well, you will note that the bar association very carefully avoided taking any position as to whether or not your committee, in the exercise of your sound judgment, should make any rate reduction in that direction.

Any views I would have obviously would have to be my own, my personal viws.

The CHAIRMAN. If you made it temporary what length of time would you suggest?

Mr. YOUNG. I would consider it temporary so long as they existed up to the time when you were making a real honest-to-goodness reevaluation of the entire problem.

The CHAIRMAN. I gather from your statement that there should be an interim.

Mr. YOUNG. Yes, sir.

The CHAIRMAN. One year, two years, or what?

Mr. YOUNG. Well, sir, I would certainly hope that the Congress could address itself to the full course of revenue revision within that period of time at which time you would adopt what I would hope would be permanent revision.

The CHAIRMAN. You would prefer a reconsideration of the whole tax bill that is now before us rather than the passage of the bill in its present form?

Mr. YOUNG. Yes, sir; that is a correct interpretation.

The CHAIRMAN. Senator Gore?

Senator GORE. You made a very interesting statement. Those who have in the past been the strongest advocates of the use of taxation as a means of affecting our national economy have been, as I seem to recall, and are, of the opinion that we should reduce taxes and have deficit financing when in a recessionary condition, and then when we have periods of prosperity taxes should be increased and something paid on the national debt.

Do you seem to recall this kind of theory as having been advocated for a number of years?

Mr. YOUNG. Well, I think it would be safe to say, Senator Gore, that there is no theory that is available to the exercise of your imagination that hasn't been suggested. I must say that I have never been conscious of any strong surge, if you will, toward a system that would adjust rates under those circumstances.

I have understood that there have been many occasions where a rate was set which was calculated to create a surplusage in good times to be applied against the debt with the expectation perhaps if the economy turned down you might of necessity have an insufficiency of income to meet the costs of Government.

I have heard that statement very frequently, sir.

I would find it extremely difficult, however, to fairly adjust rates every year, if you will, depending upon your evaluation of the immediate prospect of the economy.

I can see as a minimum that would be a rather contentious arrangement.

Senator GORE. Which is by way of saying, is it not, that the application of the Keynesian theories would be impossible in our system of society, economy, and government.

Mr. YOUNG. That is correct, sir. The Keynes supporters have never been able to find unanimous acceptance of their views.

Senator GORE. Well, I seem to recall that a recommendation was made last year that, in pursuance of this economic theory, the Congress should delegate to the President the power to lower or raise tax rates.

Do you recall that?

Mr. YOUNG. I remember that somebody made that suggestion. That is a suggestion, however, that you cannot associate with me, Senator Gore. [Laughter.]

Senator GORE. I am trying really to refresh my own memory.

Mr. Chairman, would you mind if I asked Mr. Stam if such a recommendation was made that the Congress delegate—would you respond to that, Mr. Stam?

The CHAIRMAN. Mr. Stam?

Mr. STAM. Pardon me, did you say delegate the power to make the——

Senator GORE. It seemed to me that someone suggested to the Congress that it delegate to the Chief Executive the power to raise and lower taxes depending upon economic conditions.

Mr. STAM. That was recommended, I think, in one of the budget messages by the President, just last year.

Senator GORE. When was this?

Mr. STAM. Last year, I think.

Senator GORE. Was it last year?

Well, Mrs. Springer has evidently remembered it and has gone to get the message. So you see this is not really an abstract matter I am trying to interrogate you on. It has been the subject of recommendations to the Congress by the President of the United States.

I noticed in the paper the last day or two that General Motors' profits are at an alltime high. Isn't that situation true of a large percentage of our corporations, or are you acquainted with those statistics?

Mr. YOUNG. Well, sir, all I can tell you about that is what I read in the U.S. News & World Report coming down on the plane. I think on the third quarter figures, you would be justified in that statement.

Senator GORE. I would like to read this for your information, and for the information of the committee.

This is dated May 8, 1962:

I transmit herewith for the consideration of the Congress a draft and a technical explanation of a bill which would give to the President, subject to Congres-

sional disapproval, standby discretionary authority to reduce personal income rates when economic circumstances require such action. The bill implements one of the three proposals advanced by my economic report for bolstering the Government's ability to pursue effectively the objectives of the Employment Act of 1946.

I will not read the whole message, but I thought you might find this interesting.

Mr. YOUNG. Well, Senator Gore, as one citizen to another, and as an individual who was raised and educated under somewhat different than current theories of economics, I think I would view the suggestion with some degree of alarm.

Senator GORE. Do you have children?

Mr. YOUNG. Yes, sir.

Senator GORE. Do you know of any provision in the tax code that is more unrealistic than the exemption of $600 for a dependent child?

Mr. YOUNG. Possibly.

The additional $600 exemption that is given to a man, for example, by reason of the age of his wife.

Senator GORE. You be careful what you are saying; the wife may be more expensive than the child. [Laughter.]

I concede in some cases that is true.

You were speaking of an extra deduction based on age.

Well, the point I am trying to raise with you is do you think that the personal exemption of taxpayer and dependent, the theory of which is to permit a level of subsistence for a family before the Federal Government lays a tax upon the income of that family unit, is sufficient?

Mr. YOUNG. Again, you are addressing that to me as an individual I hope, Senator.

Senator GORE. Well, yes, as a citizen.

Mr. YOUNG. All right, let me say this: If you were to——

Senator GORE. I hope you understand I am not trying to embarrass you in any way.

Mr. YOUNG. No, sir.

Senator GORE. I am trying to make the point as best I can that one of the inequities in the law is the low exemption given to a taxpayer for a dependent.

The allowance for a married couple in 1940 was $2,000.

If $2,000 was on the verge of poverty in 1940, and this was an adequate exemption, then now when the cost of living is more than twice as much, it seems to me that $1,200 is wholly inadequate.

Mr. YOUNG. Well, Senator, with all due deference to what you say, I would like to sort of plead confession and avoidance on this.

In the first place, the confession part of it is that I would agree that the standard of minimum subsistence today is appreciably higher than it was at that particular time.

The other thing I would like to raise is whether one is justified in suggesting that certain people, let's say people of very moderate means—I can remember when I made a good bit less than that—should be excused from any contribution to his Government.

I think that is a very serious question.

In other words, I am urging on you somewhat out of context the philosophy of the widow's mite, if you please, and I again, as an individual, get increasingly concerned about the circumstance that

there becomes an imbalance between the number of our citizens who pay taxes and those who do not.

I just raise the question as to whether perhaps that is good political science. I personally obviously don't think so. Many people disagree with me.

Senator GORE. I once entertained the view that if we made Federal income taxpayers of the mass of the people, that would cause them to be less demanding of the Government and of our society.

That hasn't worked out. If a man pays $6 in taxes, he may very well demand $6,000 in benefits. He may be more demanding instead of less.

Mr. YOUNG. Well, Senator, I guess the difference between you and me, I still believe in Santa Claus?

Senator GORE. In Santa Claus?

Mr. YOUNG. Yes, sir.

Senator GORE. Well——

Mr. YOUNG. And I do not regard the U.S. Government as Santa Claus.

Senator GORE. That is not a difference between you and me. I am not going to let you put me in that position. [Laughter.]

Mr. YOUNG. No, Senator, I think that I continue to aspire, I continue to hope, although I have become somewhat cynical, as I guess all of us do as we get older, but I still aspire to think that perhaps there is no point in giving up. I guess that makes me a perennial optimist regardless of the facts of life.

Senator GORE. There is no difference between you and me in that. I found your testimony very interesting.

Thank you, Mr. Chairman.

The CHAIRMAN. Senator Williams?

Senator WILLIAMS. No questions.

The CHAIRMAN. Senator Talmadge?

Senator TALMADGE. Mr. Young, I take it from your testimony that you would defer all structural changes at this time and wait for a more comprehensive bill, is that what you mean?

Mr. YOUNG. That is correct, sir.

Senator TALMADGE. What would you add by way of structural changes, for instance, that have not been included in this bill?

Mr. YOUNG. Well, I can only at this point address myself back to the mandate under which the tax section has been asked to operate, which in the first instance was a direction toward the broadening of the base.

That, of course, involves, Senator, an evaluation of gross income and the evaluation of deductions.

In the element of gross income, I think you get into concepts, just to take a very narrow part of it, if you will, of what have been described as the fringe benefits.

This bill attacks some and it very carefully does not touch others. When we get on the deduction side, if you will, we will find moves toward reduction of, or elimination of, nonpersonal deductions, some of them, but not all of them.

Without suggesting that the solution is an easy one, I would suggest to you that the bill perpetuates the discrimination between the owner of a residence and the renter of a residence.

The solution to that problem is a difficult one. I don't think that is necessarily an excuse for not addressing yourselves to it. I mention these by example, I am not trying to be encylopedic, Senator.

Senator TALMADGE. You referred a moment ago to reading the U.S. News & World Report.

Did you see their so-called simplified tax plan they published several months ago?

Mr. YOUNG. Yes, I looked that one over, sir. That was a fairly sharp cut into the concept of the present revenue act.

The fact that it was a sharp cut, however, I don't think necessarily was an indication that it was wrong.

I still was not able, and the bar association has not attempted, to evaluate whether the size of the reduction of revenue was in the national interest. The conclusion, of the magazine, of course, was that it was.

The bar association has no opinion on that.

I have no competence to express a judgment on it.

Senator TALMADGE. Thank you, Mr. Young.

I have no further questions, Mr. Chairman.

The CHAIRMAN. Senator Carlson?

Senator CARLSON. Mr. Young, I appreciate very much your testimony here this morning. If I understand it correctly, you are using an expression I was thinking of, that we should make haste slowly in dealing with this tax legislation.

On the opening day of this hearing our distinguished chairman made a statement about this tax bill that I think it is well to remind ourselves of. He stated, and I quote:

> This is a major tax bill. It covers 304 pages. It contains 234 proposals to amend the complex tax code and it would add 7 new provisions. It would involve every individual and corporate taxpayer in the country. It should not be considered lightly. It cannot be considered hurriedly.

It seems to me your testimony this morning advises this committee to at least stop, look, and listen at a major revision in our tax structure.

Mr. YOUNG. I think that is correct. I wish I had the grasp of the English language that your chairman had when he made that statement. I think it is an excellent statement.

Senator CARLSON. I notice in your statement that you mention, and I am going to quote here:

> A large number of highly competent lawyers in the section—

I think having reference to a group in the American Bar Association—

> have been busy for months on this project and expect to develop a tentative statement of position before the end of January.

Do I understand from that that we, as a committee, could expect additional information from your group by that date?

Mr. YOUNG. I think that that is a tentative statement which would be tested against the other members of that group.

In other words, we have no intention of airing our differences publicly at that early date. I have made a commitment to our section that we will conclude our inquiry and research by the time the program for our annual meeting goes out, somewhere around the first of July.

Senator CARLSON. I am sure that every member of this committee

realizes the complexities that are in any new tax legislation and we would like very much to have some simplification.

I was interested in your comment in regard to section 216 which, of course, deals with personal holding companies.

Mr. YOUNG. Right.

Senator CARLSON. You state that it has 30 pages of statutory verbiage, the very complexity of which could raise justifiable questions.

I am glad you mentioned that because many people who are pressing for early action without any consideration or without any chance for this bill to me seemed to fail to realize the many problems that we are going to face.

Then you get down to section, let's see, I believe it is section 214, that deals, as I understand it, with employee stock options and purchase agreements.

There you state that this section, I believe, has 34 pages, and you also mention section 219 which, I think, deals with capital gains which has 39 pages.

This is information, I think our taxpayers should have because there is a great pressure—we act hastily without giving due study and consideration, and I will say for the credit of this committee, and I served on it for a number of years as well as the House Ways and Means Committee, that we do take our time in writing tax legislation and I hope we will do so this time.

I think it is essential we do and if you have some suggestions for simplification we will be greatly indebted to the American Bar Association if you will give them to us.

Mr. YOUNG. Without underestimating the task we have taken on, I sincerely feel we will get that for you.

Senator CARLSON. Thank you very much.

The CHAIRMAN. Senator Dirksen?

Senator DIRKSEN. Mr. Young, are you sure somebody in the tax section of the bar association didn't draft 216?

That applies to 2 million taxpayers under $10,000 of income. That looks like as fruitful a place for tax lawyers as I can think of.

Mr. YOUNG. Well, the difficulty, Senator Dirksen, to get back to the horrible problem of earning a living is that over 90 percent of those taxpayers who will be affected by that section earn under $10,000 a year. I seriously doubt as to whether we will be justified in charging a commensurate fee of those worthy citizens when they have to make up their tax returns.

Senator DIRKSEN. Don't you think we would be justified in view of your statement here, as to the abstruse nature of the tax bill, that we ought to write in an extra section to set up a school for taxpayers and then we ought to provide for training instruction on tax law so one can go to school at night and find out what to do with his tax returns?

Mr. YOUNG. Well, I hope it doesn't get that bad, Senator. I think that we are setting up an increasingly difficult problem of compliance. It is very easy to say, "Well, this law isn't complicated; the complicated provisions only apply to a few taxpayers."

But that isn't true. The complicating provisions in some cases apply to a great many taxpayers, and I think it is unfortunate——

Senator TALMADGE. Will the Senator yield at that point?

Senator DIRKSEN. Two million aren't a few, I must say, with incomes under $10,000 in this day and age.

Yes, I yield.

Senator TALMADGE. Someone has referred to this tax bill as a bill for the relief of tax lawyers and certified public accountants.

Do you share that view?

Mr. YOUNG. I have no opinion about the accountants, Senator. Insofar as the lawyers are concerned I have already indicated that this is just going to make us do do more work for less pay because frankly our clients are, I doubt, able to pay for the amount of time it will take to make up the return.

Senator TALMADGE. I thank the Senator for yielding.

Senator DIRKSEN. Mr. Young, I am glad to have a sound unequivocal endorsement of a concurrent resolution I introduced on May 14. I presume that has come to your attention.

Mr. YOUNG. It has just come to my attention.

Senator DIRKSEN. It is too much pressure that we have the first report on this study report by January 13, 1964. I think, however, that since there is some likelihood there won't be a tax bill by that time, that perhaps I had better defer that date a little; don't you think?

Mr. YOUNG. No; I would rather you wouldn't defer the date, Senator. Quite frankly, the need to do something basic and proper is sufficiently pressing that I don't think we can indulge ourselves and indulge your constituents and our clients in too much more time under the existing structure.

I would hope that you would keep the pressure of time on addressing yourself to this difficult problem.

Senator DIRKSEN. I have only one more observation to make.

You mentioned the widow's mite, I suggest you go back and look that up again, and examine it and then send me a little note on it, because as I remember that story that's exactly all she had.

She had nothing else.

Mr. YOUNG. All right, sir, I will take it back. She should have only given a half her mite, 50 percent of it. [Laughter.]

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

Senator GORE. Mr. Chairman, I have something else.

The CHAIRMAN. Senator Gore.

Senator GORE. I have read further this message to which I earlier referred, the Presidential message of May 8, 1962, and I find that these were referred to as temporary reductions.

Let me read:

> Enactment of the proposed legislation would provide the basic legislative determination to use a temporary reduction in individual income tax rates when economic circumstances require such action.

So, there has been an interesting genesis of the philosophy involved in the pending bill.

Last year there was this request for authority by the Chief Executive to lower taxes temporarily when economic circumstances required.

Now, we have a bill permanently reducing the level of governmental income and, as you have said earlier, you seemed to recall that instead of being in a recession, corporation profits, dividends, cash flows; all seem to be at an alltime high.

Yet instead of a temporary reduction we are asked for a permanent reduction. Would you care to rationalize those points of view for us or would you plead confession and avoidance—not confession but avoidance?

Mr. YOUNG. It would be better if I would plead nolo, Senator.

Senator GORE. Nolo contendere?

Mr. YOUNG. Yes.

Senator GORE. All right.

The CHAIRMAN. Senator Ribicoff?

Senator RIBICOFF. No questions, Mr. Chairman.

The CHAIRMAN. Thank you very much, Mr. Young. You have made a very interesting presentation.

Mr. YOUNG. Mr. Chairman, in closing, I would like to have included as a part of the record the resolution and the attached report which I have described in my testimony as the ABA second resolution.

The CHAIRMAN. Without objection so ordered.

(The resolution and report referred to follows:)

RESOLUTION ADOPTED BY THE HOUSE OF DELEGATES, AUGUST 1963, AND REPORT OF THE SECTION OF TAXATION

Be it resolved, That the American Bar Association after careful study recommends to the Congress:

(1) That the national administration's proposals for structural revision of the Internal Revenue Code would not accomplish the type of basic reform required, but are piecemeal in nature and add greater complexity; and

(2) That the Congress should defer consideration of major structural changes until it can enact a program of basic reform in the income tax structure; and

(3) That, if rate reductions are enacted in 1963—

(*a*) The Congress should enact, at this time, a measure which will have the effect of reducing the present rates on individual incomes by the same proportion in each bracket, except that, in the interest of achieving fairness and equity and of encouraging work and stimulating investment, the rates in the upper brackets after such reduction should be further modified so that no rate will be higher than 65 percent; and

(*b*) The Congress, to the extent that any reductions in rates on corporate incomes are deemed appropriate in addition to the adjustments in individual rates referred to in subparagraph (*a*) above, should enact, at this time, reductions in corporate income tax rates which apply proportionately to large and small corporations alike; and, in this connection, if the Congress should enact provisions for the further acceleration of corporate tax payments, it should not thereby largely remove the immediate cash benefits accruing to a corporation from rate reduction; and be it further

Resolved, That the section of taxation is directed to urge the foregoing recommendations upon the proper committees of Congress.

REPORT OF THE SECTION OF TAXATION

The national administration's proposals for "structural revision" of the Internal Revenue Code do not accomplish the type of basic reform required to provide for a more equitable distribution of the tax burden, to promote incentives for work and investment, and to simplify the provisions of the code for the benefit of taxpayers and the Government alike. The administration's proposals would, for the most part, merely serve to complicate the tax system without accomplishing the underlying objectives of improving the system.

A detailed analysis of the administration's proposals for so-called tax reform discloses that the recommendations do not, in any sense, constitute basic reform but on the whole add even greater complexity to an already overburdened code. The history of the development of the Internal Revenue Code demonstrates that the piecemeal approach, such as reflected in the administration's proposals, inevitably produces exception upon exception and piles complexity upon confu-

sion. In this sense, it is a move in the wrong direction. Only a basic redrafting of the entire code, accompanied by a substantial reduction in rates, can clear out the barnacles which have attached themselves to the Federal income tax laws over the past five decades. Therefore if the Congress acts on the proposals in this session it should defer consideration of major structural changes until a basic tax reform program can be enacted.

The American Bar Association has taken no position on the question as to whether or not it is desirable as a stimulus to the economy to have an immediate reduction in tax rates. It is believed, however, that if there is to be an immediate reduction in rates, such reduction in rates should be proportionately across the board, except that in no event should rates in the top brackets be higher than 65 percent. If the range of progressive individual income tax rates is ever to be made reasonable and realistic so as to remove the very high rates, which so many now agree stifle incentives, the graduation in rates must be narrowed so that the disparity between the lowest rate and the highest rate is not nearly so great as at present. A step in this direction would be to cut off the top brackets at 65 percent. Reducing rates proportionately across the board, except as noted above, would tend to maintain the status quo with respect to rates until the broad tax reform program can be enacted.

The application of this recommendation with respect to possible reductions in taxes may be illustrated by the following examples. If the reduction were on the order of 10 percent, the revenue effect would be a loss of $4.7 billion, assuming the tax base remains the same; if the progression to the top brackets were cut off at 65 percent, the additional revenue loss would be $112 million. If the reduction were limited to a 12.5 percent overall reduction in present rates, the revenue loss of such reduction applied to the present base would be $5.9 billion, plus an additional loss of $88 million attributable to cutting off the revised top rates at 65 percent.

The administration's proposals for corporate rate revision (including reversal of surtax) and for accelerated payments for certain corporations would, if enacted, produce the net result of an immediate tax outlay for large corporations and a tax decrease for small corporations. It is believed that whatever total reductions in taxes are not absorbed in individual rates should go proportionately to large and small corporations alike. It would seem that the general objective of providing an economic stimulus to the economy by a tax cut would be fostered by providing an immediate cut to corporations who are large employers and purchasers of machinery and equipment as well as small corporations. The increased cash for improvement and expansion, resulting from reduced taxes of corporations, should not be offset by cash demands to put corporations on a pay-as-you-go basis.

Respectfully submitted.

RANDOLPH W. THROWER,
Chairman, Section of Taxation.

The CHAIRMAN. The next witness is Mr. Bernard H. Little, of the Ohio Manufacturers Association. Please proceed.

STATEMENT OF BERNARD H. LITTLE, SECRETARY-TREASURER OF THE OHIO BRASS CO., ON BEHALF OF THE OHIO MANUFACTURERS ASSOCIATION

Mr. LITTLE. Thank you, Mr. Chairman and members of the committee.

My name is Bernard H. Little. I am secretary-treasurer of the Ohio Brass Co., Mansfield, Ohio. I appear here in behalf of my company and the Ohio Manufacturers Association, located in Columbus.

Let me say first that I commend this committee for its determination to give due and deliberate consideration to the content of H.R. 8363 before final action is taken thereon. Tax reduction in the magnitude of $11 billion provides a rare opportunity to serve the public welfare. It is of great importance that the bill, when enacted, reflect fully the wisdom and judgment of this committee.

My testimony will deal with the effect of the bill in the corporate community, and its significance for the individual, and then touch on the fiscal implications of reducing taxes when the budget is in the red.

In regard to the corporation, I believe it is a truism that only when the corporate community as a whole is substantially in the black do we have much opportunity of keeping the Federal budget out of the red.

The bill—among other things—would reduce over 2 years the combined top corporate rate from 52 to 48 percent, accelerate corporate payments, and permit use of the investment tax credit without reducing the basis for depreciation.

CORPORATE RATE REDUCTION

In the period of rapid business expansion between World War II and the Korean war, the top corporate rate was 38 percent. During the Korean war it was increased to 52 percent. When the last 5 percentage points were imposed, the law provided for termination to become effective January 1, 1954. Every year since, this termination has been postponed 1 year.

I doubt if anyone would disagree that, if the commitment for termination in 1954 had been kept, there would have been greater economic expansion and more jobs would have opened up both in manufacturing and distributive businesses since then. It does seem unfortunate that at this late hour, when the problem of too much unemployment has become chronic, we are talking about reducing the corporate rate only 4 percentage points. Instead, we should be getting back to the 38-percent rate which existed before the Korean war.

ACCELERATION IN CORPORATE TAX PAYMENTS

Moreover H.R. 8363 would dilute the relief from the 4-percentage-point reduction through the further acceleration of corporation tax payments. It would clutter the record to discuss the time relationships between the rate reductions and the achievement in 1970 of the final step in acceleration; hence, I will treat the two as if they were happening simultaneously.

In his testimony on October 15, Secretary Dillon stated:

> Many of the larger companies that will be subject to the full effect of accelerated payments conventionally fund their tax liabilities by investment in Treasury tax notes and other short-term securities. In general, then, the accelerated payments would not disturb their net working capital. Current payments would liquidate accrued income taxes payable and therefore reduce short-term liabilities by an equivalent amount.

The first sentence is correct, but the rest of the paragraph is misleading. From the standpoint of financial statement presentation, net working capital is not disturbed by acceleration. However, the productivity or yield from the liquidated assets has been lost. There is no offset for this loss by reducing the accrued liability for taxes.

My calculation is that the loss of interest on the liquidated assets, computed at 4 percent, would eliminate about 25 percent of the economic value of the rate reductions.

If H.R. 8363 carried a much more substantial reduction in the corporate rate, I do not believe many corporations would object to the acceleration. It seems unfair, however, to tie such action to minimum

rate reduction; and a mistake to do so in view of the importance of corporations in our national effort to achieve greater growth and make more jobs available.

INVESTMENT TAX CREDIT

In the case of the investment tax credit, the bill would repeal the provision requiring a downward adjustment of the basis of property eligible for depreciation to the extent that the credit applies. We support this repeal and hope it remains in the bill. Aside from the release of current funds, repeal would eliminate the accounting inconsistencies now involved in recording the credit. As was brought out during the congressional consideration of the administration's original recommendation for the credit, it is in basic form a means of rate reduction and not a form of depreciation. The elimination of the depreciation provision will enable the credit to serve fully its intended purpose.

THE 4-PERCENT DIVIDEND CREDIT

Turning to the individaul, we would first like to record our most vigorous opposition to repeal of the 4-percent dividend credit. The credit is but a modst recognition of the inequity of double taxation on corporate income paid out in dividends. It should remain in the law.

In his testimony, Secretary Dillon stated that repeal of the credit "is necessary to justify the rates adopted for middle and upper income brackets."

Why?

Would such rates be considered too low, except that nearly the full inequity of double taxation is reimposed for most stockholders? Elsewhere in his testimony, Secrtary Dillon describes existing tax rates in such words as would seem to justify reductions far greater than the 15 to 20 percent provided in the bill.

The movement to reform the structure of the tax law has been promoted and widely acclaimed as basically designed to achieve greater equity among taxpayers. I am aware that the Secretary's testimony contained tables which seemed to indicate that the credit provides greater relief to high income taxpayers than to those in the lower brackets.

I would question the import of these tables because it seems to me that the credit, 4 percent of dividend income, has the same value to a stockholder in the lower brackets as it has for a stockholder in the higher brackets. Regardless, nowhere do I find in the Secretary's testimony any statement to the effect that elimination of the credit would result in equitable treatment, as regard any stockholders, except those whose holdings are so small that increase in the exclusion is a fully offsetting factor.

I urge upon you the view that the burden of proof seems to have been misplaced in this controversy over the credit. At best, the credit stops far short of relieving the double tax burden for even the highest income taxpayers.

Let's not make the stockholder the first major "goat" of structural reform. The men and women who save in large or small amounts and provide the equity capital for American business are the source of the driving force of the American free enterprise system. Without

their capital, there would be no place for the savings of others who are looking for fixed income to assure their security.

We can't have an open economic society based on debt alone and without private ownership of the means of production. When we have more people with more venture capital, we will have the base for greater growth and more new good jobs. Without that base, all other actions combined will prove futile in the long run.

THE CASUALTY LOSS DEDUCTION

Another provision of the House bill which is unfair to the individual is section 208. This section seems to have been adopted more with an eye to what might be called practicality than to equity. It would limit the deduction for personal casualty and theft losses to amounts in excess of $100 per loss. Secretary Dillon, in his testimony, justifies the limitation as being similar to that for the medical expense deduction and completely avoids the principle involved.

This principle is that a person's existing assets are acquired out of income after tax, and hence when such assets are destroyed he should be allowed to replace them from income before tax. This is a quite different concept from that underlying the medical deduction.

The effect of the limitation is to discriminate against the taxpayer who has a series of relatively small losses, as compared with a taxpayer whose total loss is no greater, but confined to a single instance.

The report of the House Ways and Means Committee supported the limitation by reference to the $100 deduction clause in casualty insurance policies. It did not take note that the limitation made may well have the effect of influencing a downward trend in the level of deductibility in private policies, thus increasing the cost of coverage. There is a more appropriate frame of reference from the insurance field; namely, major medical coverage. These policies are written so as to protect the insured, regardless of whether this qualifying medical expense in a given year is a result of one illness or an accumulation of illnesses.

On principle, section 208 should be eliminated from the bill. If it should be retained, equity would require that the limitation be cumulative as regards all losses and not apply to single losses.

PERSONAL TAX RATES

Section 221 of H.R. 8363 would permit tax averaging for persons with widely fluctuating incomes. Under the bill, rates for all taxpayers above the lowest level would be reduced 15 to 20 percent.

Averaging, in effect, would take income out of a year in which it is earned and tax it in a year in which it was not earned. This will be a great help to artists, athletes, and others who may enjoy only a few years of high earnings, or of persons in many other endeavors whose incomes tend to fluctuate rather widely.

Even in the business world there are sharp rises and falls in position and earnings. I do not mean to indicate lack of sympathy wherever and whenever earning fluctuate widely between tax years, for reasons beyond the control of the taxpayer.

However we cannot avoid two facts: First, that averaging will establish a tax shelter of special benefit to people who may be dis-

inclined to work hard year after year; and second, that our major concern must be the achievements and contributions of people who feel a driving necessity throughout their lives to use all of their talents to the limit of their capacity, year in and year out.

All of the pressures for the averaging device have come from the severe graduation of the personal tax. If this graduation did not penalize people who could not take advantage of averaging, there would be no problem as regards people with the widely fluctuating income. The averaging device, therefore, avoids the real problem. Whether or not this committee approves averaging, the rate through the middle to the high brackets should be reduced much more than would be done by the bill before you. I concur with preceding witnesses with respect to the inequity and the adverse economic consequences of excessive graduation, especially through the middle brackets. My point is that the emphasis should be placed on moderation of this graduation to the utmost limits within the general magnitude of the tax reduction provided in H.R. 8363, as the only means by which the country can reap the full benefit of the efforts of people whose energies pace the economic advance of the Nation.

CONCLUSION

In conclusion, tax reduction is good, in and of itself, because it lets people spend more of their money and government spend less. Even though tax reduction is initiated in a period when the budget is in the red, it establishes priority for greater reliance on the private economy and less reliance on government spending. The key objective of tax reduction at this time, however, should be to establish an economic climate which will generate more income for all people, put people to work who are now unemployed and provide jobs for new workers as they come in the labor force, and thus advance the overall national well-being. If this objective is achieved, it will of itself protect against excessive Federal spending in the years ahead. It also will greatly strengthen the Federal revenue base.

I subscribe to the view that the passage of tax reduction legislation should be accomplished by contemporary evidence that Federal expenditures are being brought under control. On the other hand, I express the hope that the question of current fiscal responsibility not be allowed to overshadow the importance of shaping the tax bill so that it will contribute the most to long-term economic growth.

Moreover, I urge that there be no hesitancy in making significant increases in the total of tax reduction afforded in H.R. 8363, if this is necessary to get agreement on moderating rate graduation, and to avoid inequities in the tax law.

The CHAIRMAN. Thank you very much.

Senator Douglas?

Senator DOUGLAS. I have only one question.

In your conclusion, you state as follows:

> Tax reduction is good in and of itself because it lets people spend more of their money and the Government spend less.

If this were true the best thing of all would be to have Government spending nothing and the people spend all, and you would have no taxes, isn't that true?

Mr. LITTLE. Well, there is an equation there.

In my opinion, the productivity of the country and the control of the spending is better in the hands of the people rather than the Government excessively.

Senator DOUGLAS. Then you agree with the conclusion which I drew from your statement; namely, that if it is good to have the Government spend less and the people spend more, the best thing of all is for the Government to spend nothing and for individual people to spend everything.

Mr. LITTLE. No, I don't——

Senator DOUGLAS. You don't agree to that?

Mr. LITTLE. That is not what I intended in this statement.

Senator DOUGLAS. I am glad to hear that.

Mr. LITTLE. Obviously, the Government must maintain and provide certain services for the benefit of all the people.

Senator DOUGLAS. I am glad to see that.

Mr. LITTLE. It is the extent to which they spend it.

The CHAIRMAN. Senator Carlson.

Senator CARLSON. Mr. Little, as a representative of a great group of manufacturing industries in your State, do you really believe that a reduction in taxes will give us an economic expansion that will put a larger percentage of our unemployed people to work?

Mr. LITTLE. I believe that it will provide the basis for doing this. We have areas of unemployment in Ohio even though we are one of the most productive States and one of the most heavily populated States, and I feel with additional resources with which to expand our productive capacity we would be able to create additional jobs.

Senator CARLSON. Of course, that is our hope, those of us who are working on this piece of legislation, that it will create an economy that will furnish employment.

But some of us are greatly concerned that even with a tax reduction it will not solve our unemployment problem and that is the reason I ask you this question because you do represent a great group of industry on whom we will have to depend to furnish jobs.

After all jobs are furnished either through private industry or through public works and I sincerely hope we may maintain the private economy and private enterprise system and furnish these jobs.

Mr. LITTLE. I know in the experience of the company with which I am directly associated, that the retention of some of the tax dollars on a pro forma basis over the last 5 or 6 years would have permitted us to make some expansion that we have been unable to accomplish.

Senator CARLSON. Thank you very much.

Mr. LITTLE. They may have been limited.

The CHAIRMAN. Senator Gore?

Senator GORE. Do you endorse that theory or the nostrum that the way to balance the budget is to reduce taxes?

Mr. LITTLE. In substance, I do.

Senator GORE. If an $11 billion tax reduction is good, why don't we make it 15?

Mr. LITTLE. If it is necessary to accomplish a sharper reduction in the rates, I would be in favor of making it a larger—maybe not 15, but 11 or 12 or whatever would be required in order to reduce this steep progression of rates in the middle-income group, and also to give corporations a lower tax rate, a lower tax base on which to operate.

Senator GORE. Well, I was not asking you this question in relation to the equities involved but merely addressing my question to the theory of reducing taxes in order to bring in more revenue ultimately.

What period of time do you think would be required, since you endorse this theory, to produce a larger revenue?

Mr. LITTLE. My answer obviously must be very nebulous, because most of the economists in the country and people who have far greater ability than I have never been able to predict what this period would be.

It would have to be considered with the economy subsequently at the time, and the domestic situation of the economy. You couldn't say an $11 billion tax reduction in 5 years would be recouped in additional revenues on a smaller base.

I mean I couldn't make that prediction. I don't know of anyone who could.

But I know that the retention of tax dollars is inherent in the expansion of investment capital and economic growth.

Senator GORE. Well, you know, we have had a period of time in which to have a fair test, it seems to me, of this theory.

We had a big tax reduction in 1954.

Do you think that 9 or 10 years is sufficient time to test out this theory?

Mr. LITTLE. Well, first of all——

Senator GORE. This multiplier has been operating all the time and you would think that this would have balanced our budget by now.

Mr. LITTLE. I don't recall that the corporate tax rates have been reduced. We may have effected some so-called reforms which in some cases were offset by——

Senator GORE. Mr. Chairman, could I ask Mr. Stam to indicate the order of magnitude of tax reduction in 1954?

The CHAIRMAN. Mr. Stam?

Mr. STAM. One of the great things they did in 1954 was the excess profits tax was terminated. That was a big obstacle to corporations.

And then, of course, there were some reductions in individual taxes.

The CHAIRMAN. What was the total of the excess profits tax?

Mr. STAM. The total of the excess profits tax reduction was $7.2 billion.

Senator BENNETT. The bulk of the reduction in 1954, except for the excess profits tax reduction, was in individual and, as I remember it, it was a 10-percent across-the-board reduction.

The lowest rate was reduced from 22 to 20, and the others were correspondingly reduced.

Senator GORE. Thank you, Mr. Stam, and Senator Bennett.

Well, with a $7 billion tax reduction in 1954, which would not vary too greatly as a percentage of our gross national product from an $11 billion cut now, one would think, it seems to me, that if this theory is ever going to work out, that a 10-year period would be a fair trial period.

Would you agree with that?

Mr. LITTLE. You are asking me if I agree from 1954 to 1964—I don't.

Senator GORE. You think we need a longer period?

Mr. LITTLE. No; I think we are talking about two different eras, in one in which we had a war tax and we had an unstable internal

tional situation, and the Korean war and taking off an excess profits tax, I never considered an excess profits tax as a standard corporate tax anyway; it is only an emergency tax.

Senator GORE. Nevertheless, when you remove this tax from corporations you give more money, you leave more money, in the hands of corporations to spend, to invest, to retain, to distribute in dividends.

We are talking about wartime rates now; 52-percent rates are wartime rates.

The lowering of the personal exemption to $600 is a wartime measure.

Mr. LITTLE. I wouldn't dispute that the elimination of excess profits tax would stimulate corporate productivity to some extent but I think that intervening changes in the atmosphere under which corporations operate today have diluted or offset a great deal of that impact.

Senator GORE. Well, I will not proceed further with this. Obviously, a dollar in the spending stream, whether it comes from the use of savings by individuals, is derived from reduction in taxes or comes from a governmental program of vocational training, area redevelopment, from whatever source, does have a stimulative effect.

Mr. LITTLE. Well, it would depend on how and where the streams were going and how many tributaries and diversions the stream has en route.

Senator GORE. Thank you, Mr. Chairman.

The CHAIRMAN. Senator Dirksen?

Senator DIRKSEN. Mr. Little, how large is Ohio Brass in terms of people?

Mr. LITTLE. We employ about 3,000 people, and our consolidated net sales are $50 or $51 million annually.

Senator DIRKSEN. I notice where you discuss averaging you say, first, averaging would establish a tax shelter of special benefit to people who may be disinclined to work hard year after year.

You don't attach any sinister attribute to that; do you?

Mr. LITTLE. None whatsoever; merely as a graphic example of the strangling effect of our excessive individual rates.

If our individual rates were reasonable, and the progression wasn't so steep, the people who earn excessive or large amounts in any one year wouldn't need this averaging of income.

Senator DIRKSEN. Well, of course, I was thinking of it in terms of individuals. A professional man, for instance, will work hard for 6 months of the year.

Mr. LITTLE. Right.

Senator DIRKSEN. And then when he sees what Uncle Sam takes decides it is just as well to move over and let somebody else render that service.

In fact, I know several who do exactly that.

Mr. LITTLE. I can't quarrel with that. My principal analogy and the example I am trying to make there is, clearly set forth, is the fact that the crippling rates necessitate averaging of income, and the present code sections 1301 to 1305 provide some relief for averaging anyway.

Senator DIRKSEN. Yes. I want to compliment you on your pointed and candid statement.

Mr. LITTLE. Thank you.

Senator DIRKSEN. You call a spade a spade in your statement.

Mr. LITTLE. Well, that is why I came.

Senator DIRKSEN. Yes, sir.

Mr. LITTLE. Thank you.

The CHAIRMAN. Senator Ribicoff?

Senator RIBICOFF. No questions.

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

The next witness is Mr. W. T. Hyde, Jr., of F. S. Smithers & Co. Mr. Hyde, please come around and proceed.

STATEMENT OF W. T. HYDE, JR., F. S. SMITHERS & CO.

Mr. HYDE. Mr. Chairman and members of the committee, my name is W. T. Hyde, Jr.

I do not represent anyone or any organization. I merely am appearing as an individual and I greatly appreciate the privilege of submitting my views to the committee.

Senator RIBICOFF. Mr. Chairman, would you be good enough to tell us who F. S. Smithers & Co. is?

Mr. HYDE. F. S. Smithers & Co. is an investment bankinghouse in New York. I am a partner of that firm. I have a prepared statement but in the interests of time, and with your permission, Mr. Chairman, I will not read it. I will briefly comment on it.

The CHAIRMAN. Thank you very much.

Mr. HYDE. The proposed——

The CHAIRMAN. It will be inserted in the record.

Mr. HYDE. The proposed tax bill has been called a tax reduction but I don't think it can be considered that.

There can be no tax reduction by this committee because it is the Appropriations Committee that decides what the Government will spend, and this committee merely says how the money is to be raised.

It must be raised by taxes either today or tomorrow or by inflation which is the worse tax of all.

I consider this bill as an attempt to remove some of the restrictive influences taxes have on the economy. I don't think, however, that this bill fulfills that objective.

It provides only nominal relief of about $50 a year to 36 million people who filed personal income tax returns in 1960.

That is about half of the people who filed returns in that year. It is equal to only 2 percent of their average income, which was $2,450.

This bill would give no relief at all to 13 million people who filed returns but had no taxable income.

It would give no relief to the 4 million unemployed.

All people, wealthy or poor, do pay corporate income taxes. I believe that the corporate income tax is the most serious deterrent we have on the economy today. It is a hidden tax. It is as much a cost of business as wages or materials or anything else, and it has to be paid by the consumer.

The stockholder does not pay it.

The corporate income tax probably will be over $25 billion this year, which is almost $400 per worker. It would be about 6 percent of disposable personal income, and about 3 percent of corporate revenues.

It is definitely a brake on the economic machine. It is an insidious cost of business because it cannot be reduced by management through greater efficiencies.

It impairs the corporations' ability to reduce costs by putting in machinery or expanding for greater efficiencies. A corporation is entitled to expect return of at least 10 percent on its investment, but when the Government takes half of the earnings it must earn 20 percent, because the Government does not put up any of the capital.

If the corporation income tax were eliminated, prices could be reduced by over $20 billion. It would enable individuals to buy more units of services and goods with the same money they have today.

It would halt and reverse inflation. Inflation appears to be gaining. Basic material prices have been increasing in the past few months. Elimination of the corporate income tax would improve our position in foreign trade.

It would help solve our gold problem. It would encourage business to expand, to lower costs further, and to produce more and new goods.

I doubt whether we could in one stroke eliminate the corporate income tax but I do think that we could take an initial step which would not reduce Government revenues, but would attain part of the many benefits that elimination of the corporate income taxes would bring.

As I mentioned, it would lower prices and halt inflation. It would encourage industry expansion. It would reduce unemployment because more goods would be produced, more services would be purchased, and, again, it would benefit our foreign trade position.

I would like to make a specific proposal. The corporate income tax of 52 percent is made up of two different taxes, the normal tax of 30 percent and the surtax of 22 percent.

I would suggest a credit against the surtax of 20 percent of corporate earnings, after paying the normal tax, plus dividends paid out.

The net effect of this would be to reduce corporate income taxes by about $11 billion.

I believe that under our competitive conditions it is safe to assume that at least $8 billion would be used to reduce prices.

The balance would enable corporations who are now in the red or not earning an adequate return, to increase their earnings to what might be considered normal.

The $8 billion reduction in prices would be the same, or I should say have the same effect on the economy, as $8 billion increase in purchasing power.

It would not, however, cause inflation such as a reduction of personal income taxes and deficit financing.

The turnover of money is about three times in a year, so that this $8 billion reduction in prices would have the same effect as an increase in purchasing power of about $25 billion.

Corporations today amazingly are spending about $39 billion on expansion. It is proof that a certain amount of this must go on to keep corporations in competitive business.

Undoubtedly the provisions for rapid depreciation and investment credit have been helpful, but these treat only the symptoms and not the disease.

I believe that a reduction in the effective corporate income tax from 52 to 30 percent would increase the amount of expansion. I think it

is safe to say that corporations would spend an additional $10 billion on expansion.

After allowing for depreciation accruals, this would equal only 2¾ percent of corporate assets which is a moderate rate of growth.

The economic effect of the spending of this additional $10 billion would again be multiplied by the turnover of money, and would, therefore, stimulate the economy by $30 billion.

So, together with the reduction in prices, the total stimulation to the economy should be around $55 billion a year.

I have prepared a table in my statement you might like to refer to which shows the effects on the tax receipts of the Government.

The first column which is headed "Current" indicates what might be expected in the way of corporate income taxes under present law, with $50 billion of corporate income subject to both normal and surtaxes.

As you can see the 30-percent normal tax takes $15 billion, and the 22-percent surtax would take $11 billion, or a total of $26 billion.

In the second column, which is adjusting the same figures to the suggestions I have made, would first reduce the corporate income to $42 billion. Normal tax on that at 30 percent would be $12,600 million, leaving $29,400 million subject to the surtax.

A surtax credit of 20 percent would amount to $5,900 million, leaving $23.5 billion subject to surtaxes.

I would assume that in almost all cases this amount would be distributed as dividends and, therefore, provide an additional credit against earnings subject to the surtax, so, there would be no surtax.

Now, below in the summary of this, I have shown where the revenues of the Government would be increased or decreased from this.

The normal corporate tax would be reduced by $2.4 billion, and the surtax would be reduced by $11 billion, or a total of $13.4 billion.

Below, I have shown the effect of a 20-percent effective tax rate on the additional $55 billion of personal income which I believe would be caused by this type of tax reduction.

That would amount to about $11 billion.

Using an effective 30-percent tax rate on the increase in the dividends the corporations would pay, would add another $2.2 billion or a total of $13,200 million of additional taxes that would be obtained from individuals who would have additional earnings with which to pay them.

There are a few technical facts I think I would like to point out. I will read them. To assure the payment of the additional dividends, I would suggest an increase in the corporate surtax rate to 50 percent. Together with the normal 30-percent tax, and allowing for the surtax credit, this would make a total maximum tax rate of 58.3 percent for a corporation which paid no dividends.

However, to eliminate a hardship on those corporations which, because of indenture or other restrictions, are unable to pay cash dividends, it would be advisable to permit stock dividends to be deductible from earnings subject to surtaxes in an amount equal to their fair market value, and such stock dividends should be made taxable as ordinary income to their recipients at the same fair market value.

I had the privilege in 1942 of appearing before this committee at which time a new provision was adopted by Congress which permitted

public utility companies to deduct preferred dividends from earnings subject to surtaxes.

It was recognized at that time, with war shortages, an extension of this to all dividends would have been highly inflationary. That condition does not exist now. There is ample capacity to meet the increased demands which would result from such a change in the tax or an extension of this provision to all dividends, and I believe it would have a deflationary effect today.

Last year General Motors, whose earnings were at a record level, paid one and a half billion dollars in income taxes which was equal to about $290 for each car and truck it produced.

If it had paid only the normal tax of 30 percent, its taxes would have been $600 million less, but it still would have been equal to $115 per car, and I believe that would be passed on in lower prices to the purchaser of the car.

Major electric utilities of the country paid $1.3 billion in taxes, income taxes, last year. About 40 percent of this or over $500 million, represented surtaxes.

The Bell Telephone system had a similar situation. There is no question that a great deal of this reduction in corporate taxes would be passed on to the individual in lower prices for their products and, after all, it is the individual who pays the tax, not the corporation.

I sincerely hope you will give consideration to this thought. I want to thank you for the privilege of presenting it to you.

(The prepared statement of Mr. Hyde follows:)

STATEMENT ON CORPORATE INCOME TAXES BY W. TRUSLOW HYDE, JR.

The proposed revision in income taxes has been called a tax reduction. Actually, there can be no tax reduction unless and until there is a reduction in Government expenditures. These expenditures must be paid for either through present or future taxation or through inflation, which, over a period of time, erodes the value of the currency and is a tax on the Nation's savings which falls most heavily on those least able to bear it. A shifting of the tax burden, however, is a necessity which is long overdue.

If the House-approved tax bill fails to stimulate the economy sufficiently to offset the resulting loss of revenues, taxes will have to be increased in future years. However, changes could be made in the corporate tax structure which would not only avoid a loss of revenues to the Treasury but would stimulate business activity and reverse the inflationary pressures. The result would be a decline in unemployment, an increase in the purchasing power of current income, and a strengthening of our competitive position in world markets which should go far toward solving the gold crisis.

In 1960, which is the latest year for which detailed figures are available, there were 61 million individual income tax returns filed with the Internal Revenue Department. Of these, 42 million, or 69 percent had adjusted gross income of less than $6,000 with an average of $2,900. Income taxes paid by these 42 million individuals amounted to $9.6 billion or 7.9 percent of their combined adjusted gross income and averaged $229 per taxpayer. If the tax rates proposed in the House-approved bill had been in effect in 1960, the savings to these 42 million taxpayers would have averaged only $70. As the minority of the Ways and Means Committee stated, this is only cigarette money. Furthermore, 13 million of the returns showed no taxable income and these individuals plus the 4 million unemployed would receive no direct benefits at all from the proposed reduction in tax rates. On the other hand, over 60 percent of the proposed $8.75 billion reduction in personal income taxes under the House-approved bill would go to only 30 percent of those filing income tax returns and would average $290 for these individuals with larger incomes.

At the present time, personal savings are running at a record annual rate of almost $30 billion or 7.4 percent of disposable personal income while, at the same time, installment debt of over $50 billion is at a new high both in absolute terms and in relation to disposable personal income. These conflicting trends

would seem to indicate that the higher income taxpayers are increasing their savings while the lower income taxpayers are feeling a squeeze between income and expenditures and have been going more deeply into debt. It would appear doubtful whether the proposed tax reduction will materially stimulate the purchases of the higher income taxpayers who are not spending a normal portion of thir present disposable income, while the lower income taxpayers might well use a large part of their tax savings to reduce their mounting debt. If, as seems probable, the tax savings are used in these ways, the extent to which the proposed tax reduction will stimulate business activity will be minimized and make it extremely doubtful whether the Treasury will be able to recover the loss of revenue which would result from the House-approved tax bill.

Corporate income taxes, on the other hand, are an indirect hidden tax paid by everybody with no consideration of the principle of "ability to pay." Corporate income taxes, which amounted to $22 billion in 1960, are a cost of business as much as wages and are paid by the consumers and not the stockholders. The present 52-percent corporate income tax rate is shackling American industry, keeping it from going ahead, keeping it from offering more and better job opportunities, and putting it at a disadvantage in worlld competition. If there were no corporate income tax, prices could be reduced by over $20 billion or $300 per worker without reducing wages or personal income. This would be equal to approximately 5½ percent of disposable personal income and would benefit those with low incomes as well as those with high incomes. It would help stop the forward momentum of inflation, would improve our competitive position in relation to imports and exports, and would enable our own people to buy more units of goods and services for the same amount of income.

The corporate income tax is also a serious deterrent to corporate expansion. Since it is related to earnings and not volume it is the most insidious cost of business with which corporations have to contend. In many cases it precludes corporations from making investments which would improve their efficiencies and enable them to reduce prices and to expand in order to produce more and new products to satisfy the insatiable wants of the people. To justify an investment in plant and machinery a corporation certainly should be able to anticipate a profit of at least 10 percent on its capital. With the Treasurys' hand outstretched in demanding half of every dollar of profit without contributing any part of the capital, the corporation's own capital must carry a double burden and earn 20 percent before taxes in order to have 10 percent left over for its stockholders. The wonder is that, with this load to carry, corporations will invest $39 billion in new facilities this year, as few investments can be expected to earn 20 percent either through increased efficiencies or greater sales. Special tax provisions, such as the investment credit, rapid depreciation, and proposals for export credits are all attempts to overcome the onerous effects of an uneconomic tax. However, they merely treat the symptoms while the disease is allowed to remain.

If it were possible to eliminate the corporate income tax, there is little question that corporate investment would increase substantially over current levels. It is difficult to estimate just how much corporations might spend on new plant and equipment if relieved of the burden of corporate taxation, but the low level of current expenditures is indicated by the fact that new capital over and above depreciation accruals being invested in new facilities is only about 3¾ percent of depreciable assets and 1¼ percent of total corporate assets. If new investment over and above depreciation accruals were 2¼ percent of total corporate assets, expenditures for this purpose would increase $14 billion annually. Such an increase in corporate expenditures could be expected to be multiplied three times in its effect on the economy and increase personal income by $42 billion a year.

As much as I would like to, I am not suggesting complete elimination of corporate income taxes at this time. They are too imbedded in our tax structure to permit their immediate elimination without undue repercussions on the economy. As an initial step to reduce the restrictive effect of corporate income taxes on business activity, however, I respectfully suggest that the Congress change the current method of computing corporate income taxes. Under the present method, taxable corporate income is subject to both the normal tax of 30 percent and the surtax of 22 percent. To relieve corporations of some of this excessive tax I would suggest that the present corporate taxable income be subject to only the normal corporate tax of 30 percent and that 80 percent of the balance of corporate taxable income, less dividends paid, be subject to the corporate surtax. On the basis of current corporate income of approximately $50 billion, the practical effect of such a change would be to reduce corporate income taxes by

$11 billion which could be used either to reduce prices or increase dividend payments. With the competitive forces in our free economy which have kept price increases far below wage increases, and with corporate earnings at a record high, 75 percent or $8 billion of this tax relief could be expected to be reflected in lower prices and the balance would permit an increase in the earnings of depressed industries.

As indicated by the ratio of business receipts of somewhat over $900 billion in 1960 and personal expenditures of approximately $830 billion the annual turnover of money in this country is approximately three times. A reduction of $8 billion in prices therefore would have the same effect on the economy as an equal increase in purchasing power which could be expected to increase personal spending by close to $25 billion. In addition, a reduction in the effective corporate income tax from 52 to 30 percent would undoubtedly stimulate corporate expenditures for expansion by at least $10 billion a year. This would bring corporate expansion to around $50 billion which, after depreciation accruals, would be equal to only about 2¾ percent of corporate assets which would still be a modest rate of growth. The economic effect of these additional expenditures would also be multiplied about three times by the normal turnover of money and should stimulate the economy by about $30 billion. The total effect of an $8 billion reduction in prices and a $10 billion increase in corporate expenditures therefore should stimulate the economy and increase personal income by $55 billion. Applying an effective income tax rate of 20 percent to this additional personal income would produce additional income tax revenues of $11 billion a year. The Treasury would also recover additional taxes on the larger amount of dividends which corporations might be expected to pay if relieved of the present 22-percent surtax. Under these conditions it is reasonable to expect that corporate dividends would be increased by $7.5 billion which, at an effective incremental tax rate of 30 percent, would produce additional tax revenues to the Treasury of $2.2 billion. Total tax revenues from additional personal income plus additional dividend payments therefore would aggregate $13.2 billion which, as shown in the following table, would fall only $200 million short of making up the loss of $11 billion in corporate surtaxes and a decline of $2.4 billion in normal corporate income taxes.

[In billions of dollars]

	Current	Proposed	Increase (+) or decrease (−)
Taxable corporate income	50.0	42.0	
30-percent normal tax	15.0	12.6	
Total	35.0	29.4	
Surtax credit (20 percent)		5.9	
Total		23.5	
Dividend credit		23.5	
Subject to surtax	50.0	Nil	
22-percent surtax	11.0	Nil	
Summary:			
Taxable corporate income	50.0	42.0	(8.0)
Corporate normal tax	15.0	12.6	[1] (2.4)
Corporate surtax	11.0		[1] (11.0)
Net corporate income	24.0	29.4	5.4
Dividends	16.0	23.5	7.5
Retained corporate earnings	8.0	5.9	(2.1)

[1] The loss of revenues to the Treasury of $13,400,000,000 would be largely made up by additional individual income taxes as follows:

	Billions
20-percent effective tax rate on $55,000,000,000 additional personal income	$11.0
30-percent effective tax rate on $7,500,000,000 additional dividends	2.2
Total additional individual income tax	13.2

To assure the payment of the additional dividends, I would suggest an increase in the corporate surtax rate to 50 percent. Together with the 30-percent normal tax and, allowing for the 20-percent surtax credit, this would make a total maximum tax rate of 58.3 percent for a corporation which pays no

dividend. However to eliminate a hardship on those corporations which, because of indenture or other restrictions, are unable to pay cash dividends it would be advisable to permit stock dividends to be deducted from earnings subject to surtaxes in an amount equal to their fair market value, and such stock dividends should be made taxable as ordinary income to their recipients at the same fair market value.

This is neither a new nor a radical departure from our present system of corporate taxation. In fact, it is an extension of a provision I had the privilege of suggesting and which the Congress adopted in 1942 when it permitted preferred dividends of public utilities to be deducted from earnings subject to surtaxes. At that time it was recognized that elimination of double taxation through an extension of this principle to all dividends would be equitable; but, when wartime restrictions limited the availability of goods and services, the adoption of such a policy to all dividends would have been inflationary. With our present adequate capacity the inflationary threat has been removed and an extension of this tax policy would now result in lower rather than higher prices. Last year, for instance, General Motors, whose earnings were at a record level, paid $1.5 billion in income taxes which were equal to approximately $290 on each of the 5,239,000 cars and trucks it sold. If it had paid only the normal corporate income tax of 30 percent the $600 million income tax savings would have been equal to $115 per car most of which would undoubtedly have been passed on to the purcahsers leaving them with that much additional purchasing power with which to buy other goods or services. Similarly, the major electric utility companies in the country paid Federal income taxes of $1.3 billion last year of which about 40 percent or over $500 million represented surtaxes. If these surtaxes were effectively eliminated, the bulk of the savings would be passed on through lower rates. Even those industries whose earnings are at at disappointing level because competitive conditions have made it impossible to pass on the full increases in operating costs would find that those competitive conditions would necessitate reducing prices to reflect a substantial portion of any tax reduction. In addition, economies made possible by increased efficiencies resulting from larger corporate expenditures for modernization would also tend to reduce prices and reverse the inflationary trend.

I am hopeful that this proposal for tax reform would be only an initial step toward recognizing all dividends as a cost of operation under a capitalistic system and permitting their deduction from taxable corporate income. This would release the brakes which are now retarding our economy and would permit it to absorb the current unemployed and create jobs for the increasing numbers which will be entering the labor force over the next decade.

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

Senator Douglas?

Senator DOUGLAS. Mr. Hyde, in your statement, you state as follows:

Corporate income taxes which amounted to $22 billion in 1960 are a cost of business as much as wages and are paid by the consumers and not the stockholders.

Mr. HYDE. Yes, Senator.

Senator DOUGLAS. You make this as an unqualified statement and I assume you mean therefore that the taxes are passed on in the form of higher prices?

Mr. HYDE. That is true, Senator, I believe.

Senator DOUGLAS. Therefore you reason in the concluding sentence of this second paragraph that if the corporate taxes are removed or reduced this would enable prices to be reduced and therefore greater quantity to be demanded.

Mr. HYDE. That is correct, sir.

Senator DOUGLAS. But I notice your second paragraph, the one just below that, the second sentence again:

Since it"—

The corporate income tax—

is related to earnings and not volume it is the most insidious cost of business with which corporations have to contend. In many cases it precludes corpora-

tions from making investments which would improve their efficiencies and enable them to reduce prices and to expand in order to produce more and new products to satisfy the insatiable wants of the people. To justify an investment in plant and machinery a corporation certainly should be able to anticipate a profit of at least 10 percent on its capital. With the Treasury's hand outstretched in demanding half of every dollar of profit without contributing any part of the capital, the coporations' own capital must carry a double burden and earn 20 percent before taxes in order to have 10 percent left over for its stockholders.

This second paragraph seems to imply that the corporate income diminishes the—it is not passed on to the consumer but diminishes the—profit after taxes belonging to the tax holders and, therefore, it comes to the stockholders.

That is, in one paragraph you argue it is passed on to the consumers in the form of high prices and in the other paragraph you argue that it comes out of the owner's, stockowners, in the form of lower earnings and lower dividends presumably also.

Now, both cannot be true in absolute terms.

Mr. HYDE. Well, I believe they can, Senator. The returns——

Senator DOUGLAS. They can be partially true, that is the first paragraph could be partially true and the second paragraph could be partially true, but I don't see that both can be true in their absolute forms in which they are stated.

Mr. HYDE. If a corporation is going to earn 10 percent on its capital but give half of its earnings away, then it has to contend with that additional cost and it is passed on.

Senator DOUGLAS. All right.

Now, what you are saying is that the corporate tax is passed on to the consumer and, therefore, it is not double taxation to the stockholder, if it is passed on to the consumer. It is not a double tax to the owners of the corporation?

Mr. HYDE. No, sir; it would not be.

Senator DOUGLAS. Now, that is a very interesting statement, because the attack on the corporate income tax which has been made by the last set of witnesses, over the last week really, has been that the corporate tax is double taxation.

The argument for the dividend credit, for example, is being based, as you heard the representative of the American Bar Association this morning say, on the ground that corporate income taxes are double taxation to stockholders and the dividend credit is just a partial attempt to compensate for that.

This seems to be the sole defense which is advanced for the retention of the dividend credit.

Now, what you are saying is that it is not double taxation at all because the tax is really passed on to the consumers, and I compliment you for your integrity in making that reply.

Mr. HYDE. Thank you, sir. I believe that any cost accountant takes into consideration the income tax which must be paid by any corporation.

Senator DOUGLAS. That is very significant testimony. You are an investment banker?

Mr. HYDE. Yes, sir.

Senator DOUGLAS. You have been in the investment banking business for a number of years?

Mr. HYDE. Yes, sir.

Senator DOUGLAS. You have assisted in the flotation of bond issues and stock issues of corporations?

Mr. HYDE. Yes, sir.

Senator DOUGLAS. You have consulted with corporation executives as to what their expected earnings will be?

Mr. HYDE. Yes, sir.

Senator DOUGLAS. In these conferences you have heard them say we will have to fix a price at a given point because of the corporate tax.

Mr. HYDE. Senator——

Senator DOUGLAS. I am not involving you in the Sherman Antitrust Act here but I mean in the conversations you have heard these gentlemen speak of the corporate income tax as a cost, as a business cost?

Mr. HYDE. Yes, sir; it is, and I think that this is brought out in any hearings before a public utility commission having to do with rates.

Senator DOUGLAS. Yes.

Mr. HYDE. The tax impact on the increase or decrease is always taken into consideration.

Senator DOUGLAS. And in manufacturing concerns, too, do you have this experience with manufacturing concerns?

You see the situation with the public utility or private utility tends to be a monopoly.

Mr. HYDE. Yes, sir.

Senator DOUGLAS. Have you floated issues for manufacturing concerns or large retail establishments?

Mr. HYDE. Yes, sir; we have.

Senator DOUGLAS. And it is the same line of reasoning followed by corporation executives in these cases?

Mr. HYDE. I am not in the management of any of those corporations.

Senator DOUGLAS. I know. But you take part in the discussion of the terms under which bond and stock issues are——

Mr. HYDE. I don't personally, Senator, but I do know that the tax impact is an important one with all corporate earnings.

Senator DOUGLAS. May I say, Mr. Chairman, I think this expert witness has given very strong testimony in favor of the elimination of the dividend credit, and also given very strong testimony to rebut the contention that the investment credit should be given to private utilities.

Thank you very much.

The CHAIRMAN. Senator Bennett?

Senator BENNETT. I think part of the morass in which you now find yourself grows out of the phrase the Senator from Illinois used, "passed on to the consumer," which carries with it the inference that the price is raised after the tax has been adjusted.

Let's put ourselves in one or two situations, sir.

Here is a corporation that makes no profit. Does it have a profit to pass on to the consumer?

Mr. HYDE. No, sir.

Senator BENNETT. Does it pay any tax which is passed on to the consumer?

Mr. HYDE. No, sir.

Senator BENNETT. And, therefore, it has not retained earning and it has no income out of which to pay dividends?

Mr. HYDE. That is correct.

Senator BENNETT. All right.

Here is another corporation that, let's say, makes a profit of $100,000 and for round figures pays $50,000 of that in taxes.

Does that determine in advance that it is going to make a price scale which will yield it $100,000 of income?

Isn't profit always the residue?

Mr. HYDE. Senator, I am not in the manufacturing business. I can't honestly answer it from experience.

Senator BENNETT. OK. Your experience—you are experienced in reading statements?

Mr. HYDE. Yes, sir.

Senator BENNETT. Where does the profit show up on the statement? It is always on the last line, isn't it?

Mr. HYDE. The income.

Senator BENNETT. The income is listed.

Mr. HYDE. The income, and then the income tax and then the profit.

Senator BENNETT. Wait a minute, wait a minute. The income is listed, then the costs of doing business, the expenses, the other things are deducted to arrive at what may be called a profit.

Mr. HYDE. Yes, sir.

Senator BENNETT. Then, if that corporation owes an income tax that is further deducted from the profit before taxes on arriving at profit after taxes.

Mr. HYDE. That is correct.

Senator BENNETT. But profit is the residue. It cannot be planned for.

Mr. HYDE. I think that most corporations plan to operate profitably.

Senator BENNETT. Sure. They don't plan to operate at a loss.

Mr. HYDE. But——

Senator BENNETT. But they can't predict exactly what their profit is going to be, because they can't anticipate a year in advance the total amount of payroll they must meet. Certainly they can't anticipate their sales. They can make a general estimate based on previous years' experience, plus a hope that they are going to do better. But they can't anticipate their sales.

So, in effect their prices are not set with the anticipation that a certain amount of that price is going to be income tax.

Profit is a residue—the income tax is a factor of that residue. And while it is true, and I think, I agree with you except for the way you accept the words that the Senator from Illinois fed you, while it is true that—there can be no income tax unless there has first been a profit, and therefore the profit comes as a result of the price.

I don't think we can say in advance that the manager of this business planned to pay an income tax of a certain size.

Therefore, he developed a price pattern or structure of a certain type which would yield him the amount of money he was going to pay as income tax.

Mr. HYDE. Senator, I wish that you would ask that of the cost accountants or the budget departments of some manufacturing corporations, and I am sure you would get a better answer than I could give you.

Senator BENNETT. Well, that is fine. I have been manger of a small corporation. I know how you look each month at your figures to see whether you did as well or not quite so well as you expected.

I know you keep an eye on your gross profit rate, which you never can completely predict.

So, when you admitted to Senator Douglas that the cost of the income tax was calculated in advance, as a part of the price, then you opened the door to another interesting assumption, which the Senator made, which was that since the consumer has paid in advance an amount necessary to produce that profit, that avoided double taxation on the stockholder.

Mr. HYDE. I believe, Senator, that the corporation, when they decided to expand or put in new machinery at a certain cost, takes into consideration the fact that half of the profits from that investment will have to go to taxes and, therefore, price their goods to allow for it, and have a return on the investment they are making.

Senator BENNETT. I think the manager takes into consideration either the increase or decrease in his costs which results from his decision to put new machinery in, but I don't think that he is planning that on the basis of the income tax he is going to pay.

But I can't understand your reasoning or Senator Douglas' which says that because the customer is going to pay a certain price for the product, which in the end as a residue is going to result in a certain income tax due, that that, therefore, avoids double taxation on the stockholders.

Will you tell me what the relationship is between the price for the product paid by the consumer and double taxation on the stockholders?

Mr. HYDE. Senator, I feel that the double taxation should be eliminated through a credit or elimination of the corporate income tax so that every stockholder who receives his dividends pays a tax on the basis of his own tax bracket.

Senator BENNETT. Well, now, if I may come back and interpret what you are trying to say to me, as I understand it, are you saying that if the corporation pays a tax on its profit that the stockholder should get a credit for that tax so that he will not pay that tax when he receives a dividend?

Mr. HYDE. That, I believe, is the way it is done in England. I would much prefer to have the corporation get a credit for the dividend it pays out.

Senator BENNETT. It is six of one and a half dozen of the other.

Mr. HYDE. Except that in the case of crediting it to the corporation the dividend then becomes taxable to the recipient in his own bracket.

Senator BENNETT. Yes, there is that difference.

But are you still prepared to assure the Senator from Illinois that you believe that because you believe corporate income taxes are "passed on to the consumer" in terms of price, higher price, because the tax has eventually to be paid that that, therefore, eliminates double taxation on the stockholder?

That is, as I understand it, the interpretation put on your statement by my friend from Illinois.

Mr. HYDE. I think that is what Senator Douglas was intimating.

I believe that with reduced corporate income taxes, prices would be reduced.

Senator BENNETT. So do I.

Mr. HYDE. And that is what I feel is the primary necessity to unshackle business from this tax.

Senator BENNETT. I agree with you completely. But what relation has that to double taxation of stockholders?

Mr. HYDE. Well, I can see the point of Senator Douglas, and I can see your point. [Laughter.]

Senator BENNETT. Well, you are like the man who can look out into the sky and see two stars very far apart. I have no further questions.

Senator DOUGLAS. Mr. Chairman, may I congratulate the witness on his honesty, and integrity, and his answers and his refusal to be led down the garden path by my good friend from Utah.

Senator BENNETT. In other words, the leading down the garden path is your department. [Laughter.]

Senator DOUGLAS. No, you made the effort. But the witness in his integrity declines to be seduced. [Laughter.]

The CHAIRMAN. Senator Gore?

Senator GORE. Well, I found your statement, that if corporation taxes were reduced prices would be reduced, to be interesting.

Now, a big tax reduction was given in 1954. Have you noticed any reduction in prices?

Mr. HYDE. There was quite a decline, I think, I don't have the figures but I think there was quite a decline in prices starting around 1956, I think it was, or 1955. I think there was—another point, Senator Gore, in 1954, I think, as was brought out earlier, it was the excess profits tax that was reduced, and that, in theory anyway, took away all excess profits.

Senator GORE. Let's come to the reduced tax liability of last year as a result of investment credit and accelerated depreciation.

Can you cite any instances of corporations reducing prices as a result of that?

Mr. HYDE. Senator Gore, those are not tax reductions. Those are tax deferrals. The corporation still has to pay the tax, but it is deferred until a later time.

Senator GORE. Well, it very materially affects the cash flow, and I think the economists wouldn't entirely agree with you.

A tax deferred is a tax reduced, not in full but certainly partially.

Mr. HYDE. Of course, there is a big argument at the moment by various accountant firms as to the treatment of these deferrals you mentioned, whether they should be allowed to flow through to earnings or whether they should be reserved, or just what the treatment should be.

Some say 48 percent of the—of it should be reserved and others the whole thing.

Senator GORE. Thank you, Mr. Chairman.

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

Mr. HYDE. Thank you, sir.

The CHAIRMAN. The committee will adjourn until 10 o'clock tomorrow morning.

(By direction of the chairman, the following is made a part of the record:)

HOUSE OF REPRESENTATIVES,
Washington, D.C., October 21, 1963.

Hon. HARRY FLOOD BYRD,
Chairman, Finance Committee,
U.S. Senate, Washington, D.C.

DEAR CHAIRMAN BYRD: Upon the request of Mr. Robert J. Burton, 217 Quincy Avenue, Long Beach, Calif., I am bringing to your attention his inquiry about retirements income credit on schedule B, form 1040, 1962, part VIII.

This schedule permits taxpayers under 65 (husband or wife or both), receiving a public retirement pension, to make an entry in line 1(a) of this section, whereas, if husband or wife or both, receiving a private retirement system pension and are under 65, they can make no entry on line 1(a) or 1(b), thus they lose one-half or all of the retirement income credit.

Information was obtained for Mr. Burton from the Internal Revenue Service which stated that "when considering the enactment of the Internal Revenue Code of 1954, the Committee on Finance submitted Report No. 1622 to the Senate (Report No. 1622, 83d Cong., 2d sess., June 18, 1954, to accompany H.R. 8300)." IRS referred in particular to the following portion of that report:

"In many cases, public retirement systems provide for the retirement of covered employees before the age of 65. The House bill, by limiting the retirement income credit to individuals 65 years of age or over, would exclude such persons although the purpose of the provision is to afford relief to individuals depending for their livelihood on their pensions or similar retirement payments. Your committee's bill extends the retirement income credit provided by the House bill to pensions, annuities, or similar payments received from public retirement systems by individuals less than 65 years of age."

Mr. Burton feels that it is unfair to make the distinction between retired persons receiving payments from public retirement systems and individuals who are receiving annuity payments from private retirement systems. He asked that I express to you his desire to see this benefit extended to all retired persons under 65 years of age, regardless of the source of their annuities.

Thank you for your courtesy.

Sincerely yours,

CRAIG HOSMER,
Member of Congress.

COLORADO SPRINGS, COLO., *October 10, 1963.*

Senator PETER DOMINICK,
Senate Office Building,
Washington, D.C.

DEAR SENATOR DOMINICK: While the tax laws are being revised I would like to bring up one point that might be worthy of consideration. It comes to my mind because at the present time I have a client where this point is involved. The point I'm talking about is insurance premiums on the life of corporation officers in order for the corporation to obtain a bank loan, beneficiary being the bank. It would seem logical that this would be an expense of the corporation in order to secure the loan. If they did not consent to taking out insurance and paying premiums they would be unable to get the loan. To get around the point that might be raised—that insurance proceeds are nontaxable, hence the premiums should be nondeductible, I would propose in certain cases, like above, that premiums be deducted as expense, such as interest and other loan expenses, and if the person insured died that the proceeds would be taxable to the extent of insurance premiums paid. It seems only logical that we have here an ordinary business expense that is not deductible. I would appreciate your comment on above suggestion.

Yours truly,

EDGAR P. GREGORY,
Certified Public Accountant.

PHOENIX MUTUAL LIFE INSURANCE CO.,
San Francisco, Calif., October 14, 1963.

Hon. HARRY F. BYRD,
U.S. Senator,
Washington, D.C.

DEAR SENATOR BYRD: As you study H.R. 8363, I am taking the liberty of calling your attention to section 213. Also, enclosed is the 1962 Life Insurance Fact Book.[1]

My understanding is that the House wants the tax cut to bolster the economy. This could be one helpful solution. However, it doesn't seem logical on the other hand to permit the passage of any legislation which would slow down economic growth and thereby cause the Treasury to lose more than it could gain.

The best educated guesses in the insurance industry are that section 213 becoming law would decrease the amount of life insurance sold in the United States by as much as 20 percent. The 1963 Life Insurance Fact Book indicates that slightly over $61 billion of ordinary life insurance was sold by all life companies in 1962. This means that about $12 billion less ordinary life would be sold, assuming that the 1962 production remained level.

House Ways and Means expects the Treasury to realize a savings of only $10 million. Have they submitted an estimate to you as to how our national economy, the country at large, the life insurance companies, the agents, or the revenues of either the United States or the States would be affected? The premium dollars on $12 billion flow into every segment of our economy. They mean men and machines at work and much more than $10 million savings to the Treasury.

The right of substantial individuals and business enterprises to purchase ordinary life insurance on a systematic borrowing basis and to deduct the interest on the accumulated loan means that estates and businesses can continue long after the insureds have died. These citizens and businessmen currently have a method of being able to own the amounts of insurance necessary to guarantee permanent security to their families and employees within their ability to pay the premiums.

I am confident that you and the other members of your distinguished committee will consider the above after you obtain the facts, which can be made available at your direction, and display your usual wisdom in arriving at a proper decision for the best interest of all our people and which at the same time will not be discriminatory toward one of the most democratic institutions ever established in our great country.

Very respectfully,

HOWARD E. TAYLOR.

SUBMITTED BY MORRIS E. BURTON, PRESIDENT, FRANKFORT JUNIOR CHAMBER OF COMMERCE, FRANKFORT, KY.—REVENUE BILL OF 1963 (H.R. 8363)—RESOLUTION

Whereas the Frankfort Junior Chamber of Commerce is ever mindful of Federal legislative enactment which affects the economic and social lives of the people of this great Nation; and

Whereas there is currently pending in the Congress of the United States H.R. 8363 proposing the reduction and reform of income taxes; and

Whereas the Frankfort Junior Chamber of Commerce believes it is the desire of the citizens of the United States to have fair and equal application of our tax laws; and

Whereas the trend in Government is toward automation, the use of identifying taxpayers by number rather than by name, and the elimination of personal contact in our self-assessing tax system; and

Whereas the Frankfort Junior Chamber of Commerge believes it is the sacred duty of the Congress of the United States and the Internal Revenue Service to give special consideration to the individual taxpayer as to possible increase in cost and/or efforts to comply with such laws and regulations where such increases in cost and/or efforts outweigh the benefits to the Government; and

Whereas the Frankfort Junior Chamber of Commerce has revised and studied

[1] 1962 Life Insurance Fact Book made part of committee files.

in detail the provisions of the revenue bill of 1963 (H.R. 8363), now before the Congress of the United States, with the above stated objectives in mind: Now, therefore, be it

Resolved, That the Frankfort Junior Chamber of Commerce on this 3d day of October 1963 has adopted the following positions and recommendations with regard to this proposed legislation:

Tax cuts: We endorse the proposed size of the tax cut ($11 billion) but we are firmly opposed to the policy of deficit spending on the part of the Federal Government and recommend strong measures to curtail and control what appears to be an accepted fiscal policy.

Individual tax rate cuts: We approve of the rate cuts in the top and bottom brackets but, in our opinion, the middle income brackets should receive a greater than proportionate cut since they are the ones most affected by reform proposals.

Corporation tax rate cuts: We endorse the proposed cut in corporate tax rates.

Capital gains: We would not separate capital gains into classes as proposed. We believe all capital assets should be treated alike as to holding period, tax rate, etc. We favor reduction in rates on long-term gains to 21 percent and increasing holding period to 2 years.

Capital losses: We believe that capital losses should be allowed to be carried forward indefinitely (until exhausted) as proposed.

Dividends received credit and exclusion: We would repeal the 4 percent dividends received credit but would increase exclusion beyond that which is proposed. Suggested exclusion: $300 ($600 for a married couple if each has dividend income of $300).

Investment tax credit: We support the proposal to no longer reduce depreciable basis by the amount of the credit. We believe it will be an aid to business. It will also nullify the mandatory provision of the credit, since under present law, depreciable basis is reduced by the amount of the credit, whether it is claimed or not.

Group term life insurance: We endorse the provision to tax employees for premiums paid by employer on insurance in excess of $30,000. However, we would suggest relieving the employer of the additional bookkeeping required in reporting such taxable income on W–2 forms.

Reimbursed medical expenses: We believe the proposed change is reasonable, but will be difficult to administer.

Sick pay exclusion: We are firmly oppsoed to any changes in present sick pay exclusion provisions. We believe the proposed changes would largely defeat the purpose for which this law was originally enacted.

Standard deduction: We support the proposed changes in the standard deduction.

Itemized deductions: We are opposed to limiting deduction for taxes. We believe all taxes which are presently deductible should remain deductible.

Casualty loss deduction: We are opposed to a limitation on deduction for casualty losses. We believe casualty losses should remain fully deductible.

Income averaging: We endorse the proposal to allow actors, authors, farmers, and others with fluctuating incomes to average them over a 5-year period. We believe this has been much needed and will prove helpful for those involved.

Stock options: We endorse the proposed changes in stock option provisions with one exception—the holding period should be changed to 2 years instead of 3, as proposed. This would be consistent with recommended change in holding period for long-term capital gains.

Recapture of depreciation on real estate: We support the proposed change since it will bring all depreciable assets under a uniform law.

Sale of personal residence by person over 65: We are opposed to this provision since it would further complicate and add to the number of laws for which there is little need.

Charitable contributions: We endorse the proposed changes with regard to charitable contributions.

Loans to carry insurance: We are opposed to denying deduction for interest on a debt to buy or carry life insurance. We believe all interest should remain deductible. Also, the proposed change would be difficult to administer.

Moving expenses: We believe proposed changes will further complicate the present law with regard to moving expenses. In our opinion, both old and new employees should have to include as income any reimbursements which are in

excess of moving expenses. At the same time, both old and new employees should be allowed to deduct job-connected moving expenses which are not reimbursed.

Medical expense deductions: We endorse the proposal to remove the 1-percent floor on deduction for medicine and drug costs for taxpayers over 65, or for dependent parents over 65.

Child care expenses: We support the proposed increase in deduction up to $900 for child care expenses. We believe this is a reasonable and desirable change.

Consolidated returns—Repeal of 2-percent tax: We endorse the proposal to repeal the present 2-percent additional tax charged for filing a consolidated return.

Corporate current taxpayments: We support the proposal to put corporate estimated tax payments on a current basis, over a period of 7 years.

THE ROCKY FORD NATIONAL BANK,
Rocky Ford, Colo., October 21, 1963.

Hon. HARRY F. BYRD,
New Senate Office Building,
Washington, D.C.

DEAR SIR: I am writing you in regard to the proposal to change the ordinary income requirements for purposes of determining whether a corporation is subject to the personal holding company penalty tax. Currently section 542 of the Internal Revenue Code provides that personal holding company income (interest, dividends, rent, royalties, etc.) must be less than 80 percent of total gross income in order to avoid the penalty tax. The proposed change in the code would limit personal holding company income to 60 percent of total gross income to avoid the penalty tax.

You may know that the personal holding company is used quite frequently to purchase controlling interest in small banks. This is a particularly useful tax device in the purchase of heavily overcapitalized banks, such as the Rocky Ford National Bank. As a practical matter it is the only way that banks can change ownership and still remain independent country banks. The alternative is to sell to a big company or a group of already wealthy investors who are able to pay cash without requiring dividends to be paid out of the bank.

You are familiar with section 332 of the Internal Revenue Code which provides a vehicle for purchase of a company in which a substantial debt is incurred with no income tax consequences. The normal practice is to form a corporation which in turn contracts for the stock of the existing operating company. The operating company then becomes a subsidiary of the new corporation. The subsidiary is then liquidated tax-free into its parent, if at least 80 percent of the stock is owned by the parent corporation. The income-producing operation is then in the same taxpayer unit with the debt obligation. No dividend is required to service the debt since the company merely pays its own obligations out of funds provided by net profits after income tax.

The above-described procedures under section 332 are not available in the acquisition of a bank. The banking charter cannot be transferred from one corporation to another which would be necessary in the liquidation of a subsidiary into a parent corporation. The net result of the various sections in the code work to the extreme disadvantage of the purchaser of a bank while the purchaser of any other type business has a specific provision to facilitate acquisition at no immediate tax cost. The purchaser of a bank must, as a practical matter, attempt to use a holding company and at the same time acquire another business in the holding company to provide the ordinary income necessary to avoid the personal holding company penalty tax when dividends are paid out to service the debt.

As you can appreciate, this is a significant factor in attempting to maintain local individual ownership of the country banks. On the other hand, I can appreciate and understand the motives of the Treasury Department. They are attempting to minimize the possibilities of wealthy, high tax bracket individuals from "incorporating their pocketbook" by putting a substantial portfolio of marketable stocks in a corporation along with some nominal business and, in effect, get their dividends nearly tax free.

I believe very strongly there should be preserved the only remaining possibility for acquisition of a bank on somewhat the equivalent net tax effect as acquisition

of any other business. If Congress believes a need exists to change the ratio of ordinary income to total gross income, then I believe there should be an exception in regard to dividends received from a subsidiary owned at least 80 percent by the holding company. A provision along these lines would allow the legitimate acquisition of a bank in accordance with the laws presently existing. Congress has recognized through section 332 that it is not proper to levy an income tax on the mere purchase of a business. My request is entirely consistent with section 332 and the sections providing for consolidated returns.

Recognizing that section 332 cannot be used since bank charters cannot be transferred, I am asking your support in at least maintaining a "status quo" on the personal holding company sections in the Internal Revenue Code as it would affect the acquisition of substantially all the stock of a company which cannot for other reasons be liquidated into the parent corporation. I would be happy to answer any questions you may have concerning this matter and will appreciate your support for this position.

Yours very truly,

H. LEE STURGEON,
Executive Vice President.

LAW OFFICE OF WILLIAM D. LOUCKS, JR.,
New York, N.Y., October 22, 1963.

Hon. HARRY F. BYRD,
Chairman, Senate Finance Committee,
Senate Office Building, Washington, D.C.

DEAR SENATOR BYRD: On Feburary 19, 1963, I submitted comments to the chief counsel, Commitee on Ways and Means, with respect to President Kennedy's tax program, as officially explained by Secretary Dillon at his first appearance on February 6, 1963, before that committee.

I shall limit this letter to criticisms of those provisions of H.R. 8363, as reported out by the Ways and Means Committee on or about September 13, 1963, which I feel are still unfair to the taxpayer.

Aside from being a taxpayer myself, I am an attorney admitted to practice in the State of New York and before the U.S. Supreme Court, certain Federal courts, and all the courts of New York State. I also hold a current enrollment card entitling me to practice before the Internal Revenue Service.

I do not consider myself a tax attorney as such, however. My practice is general, but, of necessity, I do much income-tax work for individual clients. These clients range from persons with virtually no "after-tax" income, upward to taxpayers with substantial separate or joint incomes.

Many of these people are middle-aged or elderly and are highly dependent on dividends and tax-free social security for their income. Few of them have incurred substantial capital gains during recent years. Many of these taxpayers are widows or widowers. Hardly any of them own any municipal bonds. I would guess that the average tax rate bracket for these taxpayers has been something like 40 percent on their top income during the last few years.

The comments which follow are limited to the aspects of H.R. 8363 which I consider inequitable to these people, myself included.

When the tax bill was originally proposed, the administration spoke in terms of giving middle- and upper-bracket taxpayers some relief. This bill does little to help them. Recently, Senator Long of your committee has proposed a so-called optional method of taxation which would apparently go so far as to tax fully tax exempt income on municipal bonds. I oppose this on constitutional grounds, and because there is very little left in our world today which the U.S. Government does not tax.

My specific objections to H.R. 8363 are these:

1. *The dividends received credit should be restored.*—I again challenge the statement which Mr. Dillon made last February before the House Ways and Means Committee to the effect that the dividends received credit was primarily designed to reduce the impact of high tax rates. The truth is that it was created partially to overcome the effect of pre-1954 double taxation of dividends. It is a most favorable privilege, particularly to retired persons on fixed incomes. You will not find many top-bracket taxpayers interested in the dividends or the dividend credit, however. Its chief appeal is to the middle-bracket person who was supposed to be helped by H.R. 8363. Wealthy persons have long since invested in municipal bonds, oil and gas wells, and other wholly or partially tax-exempt (but legitimate) means of accumulating income after taxes.

I strongly urge that your committee amend H.R. 8363 to restore the full dividends received credit provisions which are now authorized by the code.

2. *The entire concept of capital gains taxation should be simplified, and relief much greater than that in H.R. 8363 should be granted.*—Of course, capital gains should not be taxed at all. They are not true income; they are additions to principal, a fact long recognized by many foreign jurisdictions.

If you are going to tax them at all, the President's recommendation to reduce the 50-percent-includible portion, on long-term gains, to 30 percent (changed by H.R. 8363 to 40 percent) represents progress. But what is so magic about a "long-term" gain, and why further complicate taxpayers' lives by dividing capital gains into three categories instead of the present two classes?

Again we have the case of our Government imposing an economic philosophy on us through tax laws. Gains realized after 2 years are no "cleaner" than gains realized after 6 months; nor, for that matter, are 6-month gains "cleaner" than anything achieved in less than 6 months.

The answer is, of course, "revenue." The spenders need it—more and more of it.

But what the Treasury doesn't seem to realize is that every time it imposes a new holding period, it "locks in" a large group of taxpayers who might otherwise sell, thereby reducing revenue.

The original proposal made by President Kennedy was much better than the solution in H.R. 8363. Your committee should go back to it, with only one change: it should retain 6 months, rather than 1 year, as the cutoff point for dividing short-term from long-term gains.

3. *The proposed capital gains tax at death must not be imposed.*—The vacillations of Secretary Dillon and the administration on this whole subject have been remarkable.

The latest evidence of the uncertainty of the administration about what it wants took place when the Secretary testified before your committee on October 15.

He said that the capital gains tax rate cut on property held more than 2 years (H.R. 8363) is unacceptable unless you restore the "tougher rules for inherited property." (The President had just finished praising the bill in a nationwide broadcast.) The Wall Street Journal quotes Secretary Dillon as saying "without closing the escape hatch by which our wealthy taxpayers can avoid all tax on substantial amounts of capital gains, there is no justification for a reduction in rates of primary benefit to such taxpayers."

I have marked my copy of the Secretary's comments with the words "by dying." There is actually no way that Mr. Dillon's wealthy taxpayer can avoid this taxation so long as he lives. What Mr. Dillon proposes is to force the dead man's wife and children to pay these paper gain profits after his death without giving any allowance for the same taxpayer's paper losses.

Frankly, I do not know how men as wealthy as President Kennedy and Secretary Dillon have the gall to propose this sort of taxation. Perhaps if one has as much money as these two gentlemen have, it does not hurt. I can assure you it will hurt my family, my clients, and many thousands of people who have some capital on paper but who are not millionaires. It is wholly unfair. Nowhere have I found any discussion on the "paper losses" problem. There are many unfortunate individuals in this country who have made poor investments and who now have one or more pieces of wallpaper to show for them. In many cases, they have been unable even to deduct these poor investments as capital losses on their income tax returns because of the strict rule that an investment loss must be taken in the year in which it becomes worthless. If the unfortunate investor does not find out about the worthlessness of his investment until 3 years after it becomes worthless, he is forever foreclosed from claiming the capital loss.

It seems to me that the Government could stop thinking in terms of raising revenue long enough to try to put itself in the position of the taxpayer who, it is now proposed, should be taxed on unrealized paper profits on his death, without being allowed any deduction for similar unrealized (but very realistic) paper losses on his death.

I repeat the following statements which I made in my February 19 letter to the Committee on Ways and Means, because I believe them relevant to this problem of attempting to tax unrealized gains at death (of course, they are already subject to murderously heavy State and Federal estate taxes):

"I am an estate planner by profession. The man who wrote the paragraph in Mr. Dillon's presentation implying that older persons remain immobile in their

investments because they expect their heirs to receive a stepped-up basis for their own assets after their death, simply has not had any experience in dealing with older people.

"Most of them do not even know or understand that their assets will be revalued at death. They are very much aware of capital gains taxes and, if they are immobile, it is almost always because of the heavy burden of this tax on stocks bought years ago. A real cut in capital gains rates, without any increase in the holding period, should cure this.

"But will your committee please give a most careful consideration to another, often more urgent reason why older people remain locked in their security position? Many of them have either bought the securities or acquired them by gift or inheritance many years ago, with no idea of their true cost.

"If these people, in their lifetime, cannot establish true cost, how can their executors do so after their death, and how will the administration ascertain such cost from their honest but ignorant fiduciaries?

"This proposal to tax accrued capital gains at death should be wholly rejected: It does not merit serious consideration by your committee because it is wholly unfair both to those whose securities are worth less at death than what they paid for them, and to the many thousands of other persons whose cost records are missing or incomplete. Now comes the U.S. Government 30 or 40 years later and suggests that, of course, every taxpayer should have accurate cost figures available for his or her executor's use.

"The burden of this proposal on every executor, if enacted, should be enough to take banks and many other reputable fiduciaries out of that business completely.

"Incidentally, for those of you gentlemen who are attorneys, who have prepared estate tax returns, and who are seriously interested in tax simplification, I suggest that you reread in its entirety this section entitled 'Equal Treatment of Gains Accrued on Capital Assets at Time of Transfer by Gift or by Death', and visualize the problems in preparing the final Federal income tax return of a decedent, to say nothing of preparing a form 706."

Finally, although the matter is not before you at the moment, I urge your committee to introduce legislation to broaden the present Federal estate tax exemption of $60,000.

Today, a businessman with total assets of $130,000, including a car and a house worth $40,000, and last debts and administration expenses of, let us say $10,000, will leave an adjusted gross—but certainly not a liquid—estate of $120,000. If his will gives all his assets to a surviving widow, there will be no Federal estate tax, although there will be a State inheritance or estate tax in most cases.

Suppose the widow is really able to realize $40,000 net from the sale of the house, and suppose she is able to turn all the remaining $80.000 into liquid assets available to reinvest. This will leave her with exactly 120,000 U.S. dollars (1963 vintage).

Conservatively invested, the most she could expect to realize on this capital would be $4,800 a year maximum before income taxes. Would you gentlemen consider your wives well provided for on the above statement of facts?

I urge you to consider raising the exemption at least to $150,000, so that a man or woman could accumulate as much as $300,000 before Uncle Sam decides that it is good social policy to take it away from the surviving beneficiaries in the family.

Very truly yours,

WILLIAM D. LOUCKS, JR.

HOUSTON, TEX., *October 22, 1963.*

Hon. HARRY F. BYRD,
Chairman, Committee on Finance,
U.S. Senate, Washington, D.C.

DEAR SENATOR BYRD: These comments relate to H.R. 8363, the Revenue Bill of 1963 now under consideration by the committee. There is a section of this bill which would treat a company whose shareholders had entered onto an option to sell the stock of the company to another company or individual as if the latter company or individual were the owner. For example, if company A has an option to acquire the stock of company B, then the 6-percent surtax penalty can be applied to the income of company B.

The economic burden of this penalty may fall upon the shareholders of company B if the option contains a variable formula dependent upon book value

or profits, and it definitely will fall upon the shareholders of company B should the option not be exercised.

This seems to be a harsh provision, in any event, but most particularly so when applied to options entered into at a time when current proposals could not have been foreseen.

There are many situations in which good business judgment, entirely unrelated to taxes, results in the acquisition of an option to acquire the stock of another company so as to give the option holder time to arrange financing or, more often, time to evaluate the operations of the company to be acquired over a period of time.

Since the House committee reports do not indicate exactly why the option provision in section 1563(e)(1) was included, I shall not try to suggest a method for distinguishing between those options which might be used to thwart the purpose of the penalty surtax provisions of the bill as compared to those options which would not have such a purpose or effect, although I believe that your experts can develop language along this line.

If nothing else, however, I would suggest that a cutoff date be established so that options entered into prior to the cutoff date would not be taken into account for the purpose of determining constructive ownership of a company. Since this provision was not explicitly referred to earlier, it seems to me that the cutoff date should be the date that the new legislation was reported to the House by the Ways and Means Committee.

Respectfully yours,

GORDON S. MOORE.

GYRODYNE CO. OF AMERICA, INC.,
St. James, Long Island, N.Y., October 22, 1963.

Hon. HARRY F. BYRD,
Chairman, Senate Finance Committee,
Senate Office Building, Washington, D.C.

DEAR SIR: We earnestly request your committee to reject the proposals to tax group term life insurance coverage provided employees by their employer as part of a general benefit program.

This bill seems aimed at limiting group term life insurance benefits for employees. It will also impose excessive administrative and recordkeeping burdens on employers.

In addition, the foundation of many employee benefit programs has been the favorable tax basis of group term life insurence. To change the rule now would have a disrupting effect upon many long-established plans.

In our opinion these proposals are based upon poor tax-raising theory in that the items giving rise to taxable income do not provide the cash out of which the tax can be paid.

We respectfully request your committee record show our comments to those sections of the new tax bill (H.R. 8363) dealing with group term life insurance.

Very truly yours,

STANLEY RUFFETT, *Assistant Treasurer.*

THE REUBEN H. DONNELLEY CORP.,
New York, N.Y., October 21, 1963.

Hon. HARRY F. BYRD,
Chairman, Senate Finance Committee,
U.S. Senate, Washington, D.C.

DEAR SIR: I have written your committee before with respect to the tax bill relating to group term life insurance but am tempted to write again and request that my comments be made a part of the committee record because the recent changes in the bill do not resolve some of the serious difficulties in this area.

In recent years, the trend of group life insurance plans has been toward increasing the amount of insurance available to employees. Whereas plans originally provided for one-time earnings, most plans now provide for two-times earnings and up. Thus, under many company plans, middle-income employees often have group life insurance in excess of the $30,000 amount mentioned in the bill. It seems to me that the trend toward greater amounts of life insurance for employees is to be encouraged and has great social worth.

The older the employee, the greater is the benefit of the group concept, whether it is medical insurance or life insurance that is involved. Many plans are heavily employee contributory plans as is the case in the group life insurance plan of this company. However, the cost of insurance for an older employee is substantially higher than the average group rate so that his realized income in accordance with this legislation rises with his age even though in his earlier years of employment there would have been no realized income.

It is very difficult for me to find any sound basis upon which the older employee should be penalized for carrying as much insurance as his company plan will provide him. There is obviously very little revenue to be derived from this source and it will only be derived at a substantial administrative cost to employers and group insurance plans generally.

Sincerely,

E. GARRETT BEWKES, Jr.,
Secretary and General Counsel.

BOSTON INSURANCE CO.,
Boston, Mass., October 22, 1963.

Re Federal income tax legislation—Inclusion of group term life insurance.

Hon. HARRY FLOOD BYRD,
Senate Office Building,
Washington, D.C.

DEAR SIR: This company wishes to be recorded as opposed to the inclusion of any group life insurance premiums paid by the company, in the income of its employees for the purpose of assessment of income taxes. We urge you, as chairman of the Senate Finance Committee, to use your influence against such legislation which is essentially another attempt to misuse the income tax law for purposes of social legislation.

The anticipated tax revenue to be received by reason of this proposed change in the income tax laws is relatively very small and is certainly not sufficient even to justify the additional expense caused to all companies carrying group insurance. Such expense will rise because of the necessity for keeping additional records and making payroll reductions based on insurance premiums paid. The actual expense of recordkeeping for all companies might very well exceed the amount of the tax to be received by the Government. Consequently it is an uneconomic method of seeking to procure additional revenue.

Furthermore, as presently set forth, the additional income tax would be levied against individuals already in a somewhat higher tax bracket, whereas one of the important reasons for the new tax law is to give these very individuals some relief from the disproportionate and unfair burden of the tax assessed against them. This would seem to be an example of giving something with one hand and taking it away with the other. The entire principle of enforcing social legislation through the tax law is wrong and should be avoided.

Although this company is engaged in the insurance business, it does not write the type of insurance involved here and our interest is the same as any other employer's purchasing group life insurance for its employees.

We urge you to use your best influence to delete this objectional provision from the income tax law.

Sincerely yours,

C. S. HART, *President.*

NORTH TARRYTOWN, N.Y., *October 22, 1963.*

Re revenue bill of 1963 (H.R. 8363), bill section 213; Insurance loans.

Hon. HARRY F. BYRD,
Chairman, Committee on Finance,
U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: I am in general agreement with the objectives of H.R. 8363. However, I am writing in opposition to one of its provisions. Bill section 213 is, in my opinion, an absurdly unjust discrimination against the taxpayer who has a reasonably good income but no capital. The chief effect of the section would be to keep such a taxpayer from providing, through insurance, the estate he has not yet been able to provide through savings.

Section 213 is intended to reduce the attraction of life insurance and annuity contracts which contemplate the systematic direct or indirect borrowing of part or all of the increases in cash value for premium payments. That object is to be accomplished by not permitting the deduction of interest on loans incurred

for the payment of premiums. The deduction would not be denied, however, if premiums due in 4 of the first 7 contract years are paid without borrowing.

I have before me a table of payments due under a $100,000 "minimum deposit" life insurance contract, showing interest in the first 4 years (at full borrowing) to be: First year, nil; second year, $72; third year, $215; fourth year, $359. In these years, the deductibility of interest is not of as much consequence as it becomes later. A man who, without borrowing, pays his premiums in full for 4 years, is then free under bill section 213 to borrow the full accumulated value in the fifth year and thereafter to deduct interest amounting to: 5th year, $480; 10th year, $1,080; 15th year, $1,668, until even after tax benefits the interest burden becomes so great that he is no longer getting cheap term insurance through an ordinary life plan. At that point, without further obligation to anyone, he can simply let his policy lapse.

Disregarding anticipated dividend accumulations, the annual premium on the policy before me is $3,735, or about $15,000 for 4 years. The merits of section 213 can be analyzed in terms of that policy by considering the positions of the following taxpayers:

A. 70-percent top tax rate. Has around $1 million in inherited assets but wants insurance to help with estate tax cash. Can meet premiums aggregating $15,000 over 4 years from after-tax income.

B. 70-percent top tax rate. Buys securities on margin, invests in real estate subject to mortgages, in short leads a complicated financial life. No IRS agent could show a definite connection between one of B's loans and the payment of insurance premiums.

C. 40-percent top tax rate. Good salary, no savings. Able to pay full premiums for 4 years from aftertax income.

D. Any top tax rate. Borrows (not by policy loans) to pay part of first four annual premiums, but does not claim the relatively unimportant interest deductions. In fifth year, borrows on policy and begins claiming deductions, confident that he has left no clues.

E. 30-percent top tax rate. Has common stock investments of about $15,000. Current expenses too great to permit full premium payments from income, but can increase family protection by taking full $100,000 policy, selling stock (reluctantly, and subject to capital gains tax) to make up full premiums without borrowing. Hopes that excess cash available in fifth policy year can be reinvested in a favorable market. Wonders why the Congress thought it desirable to make him sell instead of borrowing.

F. 30-percent top tax rate. No capital, not enough spare income after taxes to pay full premiums on $100,000 policy for 4 years without borrowing. Reluctantly takes $50,000 policy instead.

Section 213 would have serious effects upon F's family if he should die before providing for them in other ways. It might have serious effects upon E. To A, B, C, and D, it might prove annoying, but it would not present serious problems.

I am a buyer, not a seller, of insurance, and I have no intention of buying more than I have. I took out my "minimum deposit" policy long before the August 6 effective date, which I assume will not be changed, for the application of bill section 213. I have no personal reason, except the beliefs stated above, for urging that section 213 be stricken from the bill.

Respectfully yours,

EDWIN H. TODD.

STATE OF ILLINOIS, HOUSE OF REPRESENTATIVES,
Jacksonville, Ill., October 22, 1963.

Re H.R. 8363.

Hon. THRUSTON B. MORTON,
U.S. Senator,
Senate Office Building, Washington, D.C.

DEAR SENATOR MORTON: The Senate Committee on Finance now has pending before it the President's tax bill, H.R. 8363, which was only recently passed by the House of Representatives. There are many provisions in that bill which relate to the eligibility of transactions for capital gains treatment. I understand that the entire area of capital gains was extensively reviewed by the House Ways and Means Committee when it considered H.R. 8363.

The purpose of this letter to you is to express the hope that you may be able to support a capital gains amendment to the above bill. I understand that the Ways and Means Committee overlooked the subject matter of this amendment. The amendment which I am referring to is contained in S. 2154, intro-

duced by Senator Russell Long, who stated that the purpose of the amendment is to accord equity to small mutual insurance companies and life insurance companies, so that they may be taxed on gains from bonds purchased at less than par value in the same manner as other taxpayers are taxed.

All other taxpayers are taxed at capital gains rates on market profits realized from purchasing bonds at less than face value when the bond is sold or redeemed.

Small mutual insurance companies and life insurance companies, however, are not entitled to treat their bond discount profits as capital gains because the present Internal Revenue Code provisions require them to accrue a pro rata portion of the discount each year instead. Other taxpayers are not required to accrue their bond discount in this manner.

Senator Long's bill would eliminate this discrimination against small mutual insurance companies and life insurance companies, by removing the required accrual of bond discount by these companies for years after 1962, thereby according them the same capital gains treatment on the sale or redemption of bonds purchased at a discount as is given all other taxpayers.

I will appreciate it very much if you could refer my letter to Senator Byrd, chairman of the Finance Committee, and have it included in the hearings on H.R. 8363 so that the committee may consider this matter when it reviews the bill. Senator Long's explantory statement appears on pages 16451–16452 of the September 18, 1963, Congressional Record, and I believe clearly describes the present discrimination in the law, showing that other taxpayers are not required to accrue their bond discount as are the small mutual and life insurance companies.

I will greatly appreciate any support you might be able to give to this position.

Sincerely yours,

HARRIS ROWE.

THE COLUMBIA GAS SYSTEM, INC.
New York, N.Y., October 23, 1963.

HON. HARRY F. BYRD,
Chairman, Senate Finance Committee,
U.S. Senate, Washington, D.C.

DEAR SENATOR BYRD: The companies of the Columbia Gas System, with over 12,000 employees, supply gas directly and indirectly to 3,500,000 consumers in the Appalachian area and the eastern part of the United States. As you may know, two of the companies, Virginia Gas Distribution Corp. and Atlantic Seaboard Corp., serve customers in Virginia.

We have followed with keen interest and deep concern the Treasury tax proposals, the hearings before the House Ways and Means Committee, and the 1963 tax bill passed by the House of Representatives. Because of this concern we have analyzed the proposed legislation and developed a statement of position. The statement sets out our views both as to tax reduction at a time of excessive governmental spending and deficit financing and on certain proposed structural changes in the tax code of particular interest to our companies and their employees.

We enclose four copies of this statement of position and ask that it be included in the record of the Senate Finance Committee on the tax bill in lieu of a personal appearance before the committee. We would like to draw particular attention to our belief that Federal spending must be controlled and that until there is concrete evidence of such control there should be no tax reduction. This view stems from a strong belief that the continuation of deficit financing by our Government will have serious adverse effects upon the Nation's economy. We have witnessed in the last 24 years the severe loss in the value of the dollar.

Such loss involves important moral as well as economic considerations which both business leaders and Congress have an obligation to consider. Inflation is a confiscator of savings; it results in cruel treatment to those with fixed incomes; it weakens our position in world trade and foreign affairs. While we believe a reduction in taxes is necessary and desirable, we are unable to support tax reduction without a meaningful limitation on Federal spending or deficits.

In addition we would like to call your attention to the sections in the position statement on repeal of the dividend credit and taxation of employer contributions to group term life insurance.

Very truly yours,

JOHN PARTRIDGE, *President.*

STATEMENT OF POSITION

This bill is the product of the House Ways and Means Committee's deliberation on the administration's 1963 tax program and contains many modifications of the original administration program. The major features of the committee's draft bill are:

Reduction of individual tax rates by an average of 20 percent with a new range from 14 percent at the bottom bracket to 70 percent at the top bracket, and a reduction in the corporate tax rate from 52 percent to 48 percent. Approximately two-thirds of the income tax reduction and one-half of the corporate income tax reduction would be effective commencing January 1, 1964, with the balance of the proposed reductions becoming effective January 1, 1965.

Capital gains tax rates would be reduced on the sales of assets held by the taxpayer for a period of at least 2 years. Under the proposal, 40 percent of the gain on such sales would be taxed at ordinary income tax rates or the entire gain would be taxed at 21 percent; the present rates would still apply, however, to sales of assets held under 2 years and to gains from patent sales, iron ore and coal royalties, breeding livestock, timber cutting, unharvested crops, and lump-sum payments from certain pension and profit-sharing plans.

Numerous structural changes in the Internal Revenue Code which would affect taxable income would bring the average reduction in indivdual's taxes to about 18.7 percent. However, the effect of the proposed structural changes would be to yield relatively greater tax reductions to persons with low taxable incomes than to those with high taxable incomes with the difference estimated to range from a high of 38.6 percent reduction in taxes in the taxable income class 0 to $3,000 to a low of 13.1 percent in the taxable income class of $50,000 and over.

Structural changes of particular interest to Columbia Gas System, its stockholders and employees are: repeal of the 4-percent tax credit currently allowed stockholders against their dividend income, a speedup in the payment of estimated quarterly tax payments by corporations over a 7-year transition period, the treatment of employers' contributions to group term life insurance plans as taxable income to employees and changes in the sick pay exclusion and moving expense deductions. The bill also contains a provision stating how Federal regulatory agencies should treat the investment credit in rate cases and would repeal the present provision of the law requiring that the depreciable tax basis of a new asset be reduced by the amount of the investment tax credit.

POSITION OF COMPANY

1. A reduction in income tax rates, although desirable and necessary for continued economic growth, should be made only in connection with the control of Government expenditures to eliminate Federal deficits and their inflationary effects.

2. The proposed structural changes in the internal revenue code, publicized as "reforms" would not simplify and reform but would further complicate an overly complex and lengthy tax code. As a group the proposed structural changes should be rejected and a comprehensive program of structural revision should be evolved by Congress based upon a consistent and acceptable economic philosophy. With regard to the structural changes of particular interest to the company, its stockholders and employees, the company opposes—

(i) Repeal of the dividend credit;

(ii) Acceleration of corporate quarterly tax payments;

(iii) Taxation of the employee for employer contributions to group term life insurance plans;

(iv) Limitation of the sick pay exclusion;

(v) Establishment of a minimum standard deduction.

The company supports—

(i) Deductions of moving expenses for new and existing employees of a firm who are not reimbursed for such expenses.

(ii) Investment tax credit provisions removing the requirement that the depreciation basis of a new asset must be reduced by the amount of the tax credit taken, and specifying that Federal regulatory agencies may not require utilities who claim the investment tax credit to pass along all of the tax savings to customers in the form of lower rates.

REASON FOR COMPANY'S POSITION

Reduction in tax rates

When business is good the Federal budget should be balanced. Tax rates should be set to balance the budget or yield a modest surplus in the expansion phase of the business cycle. This will tend to stabilize economic activity by restraining demand and the inflationary factors associated with high employment and full use of productive capacity. To set tax rates at a level which would produce sizable Federal deficits during the expansion phase would not only increase the burden of Government debt, it would create economic instability by accentuating the boom characteristics of the phase and adding the inflationary factors of an artificially increased demand and money supply to the situation of high employment and capacity production with its potential for cost push inflation. Furthermore, tax rates which yield substantial deficits in the expansion phase of the cycle would create much larger deficits in the contraction phase of the cycle. Not only would we be faced with perpetual deficits and an ever-increasing burden of national debt, but also with an artificially created boom and bust business cycle. Therefore, if a tax reduction is to be enacted now, it should be accompanied by a reduction in or a limitation on Federal expenditures.

Repeal of dividend credit

Corporate profits paid out in dividends are taxed twice, first by the corporate income tax and second by the individual income tax paid by the shareholder on the dividends. The present credit against tax of 4 percent of dividend income gives only small relief from this unfair double taxation and should be increased, not eliminated as proposed by the bill. The company believes that the existing dividend credit has contributed substantially toward interest in equity investment and the ability to sell new issues of common stock. This ability is vital to the company's growth; since 1954 when the dividend credit provision was enacted the Columbia Gas System has raised $131 million in additional capital by the issuance of common stock. The expansion of the system during this period would not have been possible without the ability to sell stock on favorable terms. The proposal to increase the exclusion from taxable income of $50 of dividend income a year to $100 of dividend income a year is not a satisfactory substitution for the dividend credit and will not offset the effects of the loss of the credit on the marketing of equity securities.

Acceleration of corporations estimated quarterly tax payment schedule

At present corporations with income tax liabilities in excess of $100,000 a year pay approximately half of their estimated tax in the year of tax liability with the balance being payable in the following year after the tax is computed and known. Under the proposal by a speedup in estimated quarterly payments, nearly all of the tax liability will be paid in the year in which it is accrued and prior to a determination of the tax actually due for the year. The transition to the new system would take 7 years. During this period the acceleration of tax payments will impose a cash drain on corporations which will nearly offset the effects of the proposed reduction in corporate rates. This proposal does not make sense. The primary purpose of reducing taxes is to stimulate economic growth. A reduction in corporate tax rates, more than in any other area, can be expected to result in greater investment in productive facilities and consequent economic growth. Furthermore, the plan would require estimating tax liability and paying one-fourth of the amount in April of the year of accrual. The income of many businesses is subject to sizable fluctuations arising from such factors as weather, strikes, unusual market conditions and an estimate so early in the year may be completely inaccurate. If a corporation pays quarterly payments on the basis of a large overestimate, it may be put in a critical cash position when business drop off.

Taxation of employees for employer contributions to group term life insurance plans

This proposal would alter the long-standing tax treatment for group term life insurance by taxing employee participants of the plan on employer contributions. The amount of the employer's contribution to the plan which would be treated as taxable income of a particular employee would be measured by the cost of group term insurance at the age level of the employee with a standard table of cost at different age levels being provided for tax purposes. This table shows the cost of such insurance increasing greatly with age and would place a substantial additional tax burden on older employees. The adoption of a new

concept of taxing employee benefits by imputing compensation in a tax year when there is no receipt of actual cash benefits will endanger the development and even the continuance of these desirable employee insurance plans. In setting up these plans, both employer and employee provide for the security of employees and their families. This should be encouraged not discouraged by Congress. Many individuals have made their life insurance plans in reliance upon the established congressional policy and will be saddled with unforeseen and extremely high income tax expenses in the latter years of their lives, if the proposal is adopted. The administration proposed to exclude the first $5,000 of term insurance from taxation; the Ways and Means Committee raised this to $30,000, but once the principle of taxing employees for employer's contributions is established, it is logical to expect the reduction or removal of the exclusion in the next or following sessions of Congress.

Limitation of the sick pay exclusion

The company recognizes that employees on sick leave generally incur expenses which are not and cannot be completely covered by medical insurance plans. The present exclusion of sick pay from taxable income affords some relief to the sick or injured employee. The company therefore opposes the proposal to limit the applicability of this section to employees who have been absent from work more than 30 days.

The minimum standard deduction

The standard deduction as it now exists principally benefits low-income taxpayers. The tax benefit of the deduction is granted without regard to any actual expenditures of the taxpayer for contributions to church, educational, or charitable organizations, for interest costs in purchasing a home, or for the burdens of State and local taxation which the taxpayer may bear. The present standard deduction is computed as a percentage of income, 10 percent with a maximum amount of $1,000. In the event that the taxpayer expends funds for deductible items in excess of 10 percent of income, he is, of course, free to and in nearly all cases will utilize itemized deductions. To the extent that his expenditures for these items are less than 10 percent of income, he will, of course, accept the free tax benefit given by the standard deduction. The upper limitation of $1,000 means that this potential unearned tax benefit is available principally to the lower income taxpayer. The scales are already tipped in his favor. The philosophy behind the granting of deductions is to encourage certain types of expenditures and to recognize that certain other expenditures are required to allow the taxpayer to be gainfully employed, such as payment of union and professional dues, expenditures for tools and for State and local taxes. The utilization of standard and minimum standard deductions is not reasonably related to the underlying concept of allowable deductions.

The new proposal would allow each taxpayer a minimum standard deduction of $300 with an additional allowance of $100 for each dependent, including his spouse, regardless of income or actual deductible expenses. The administration attempted to justify this on the basis that it would provide additional relief for low-income taxpayers; however, the proposed rate reductions would give them greater proportional relief than other income groups. Furthermore, the establishment of the proposed minimum standard deduction would reduce the number of taxpayers by 1.5 million persons. This is bad policy because it would decrease the country's tax base when nearly all agree that true and meaningful tax reform will require increasing the tax base, and even more important, the voter who pays no taxes will have no incentive to restrict governmental intervention in society—to the contrary, his selfish interest will be to approve and vote for representatives who will offer him more and more benefits to be paid by someone else.

The assumption by more citizens of some financial responsibility for governmental expenditures would be a healthy thing for all concerned. It would seem that a better proposal would be to reduce standard deductions and personal exemptions and establish a very low or nominal tax rate for small incomes.

Deductions of moving expenses for new employees and existing employees who are not reimbursed for such expenses

At present employees are allowed, within certain limits, to exclude reimbursed moving expenses from taxable income when moving for the convenience of his existing employer; however, moving expenses are not allowed as an exclusion from income if they are paid by a new employer, nor is the employee who moves and pays his own expenses permitted to deduct such expenses. The provision

would equalize treatment among employees and encourage the mobility of the labor force, an important factor in the relief of surplus labor in distressed areas. Furthermore, it is in line with the policy of allowing deductions for expenses necessarily incurred in order to allow the taxpayer to be gainfully employed, such as payment of union and professional dues and expenditures for tools and special work clothes.

Investment tax provisions

Although Congress passed the investment tax credit law for the purpose of encouraging taxpayers to invest in new plant, certain Federal regulatory agencies have indicated that they might require regulated companies to pass along all of the benefits of the investment credit to their customers. This would remove the tax incentive to construct new plant and thwart the intent of Congress. As a result the Ways and Means Committee added a provision designed to insure that the benefits of the investment tax credit are not to be completely taken away from the taxpayer by Federal regulatory agencies.

After the House of Representatives passed the 7-percent investment tax credit bill the Senate added an amendment which required taxpayers to reduce the depreciation basis of a new asset by the amount of tax credit taken. The effect of this amendment, which would be repealed by the Ways and Means Committee bill, was to reduce the effective credit from 7 percent to less than 4 percent; also serious difficulties were encountered in establishing appropriate accounting treatment for the acquisition of assets subject to the credit. There seems to be general agreement that Senate amendment to the law should be repealed.

SUMMARY

During the post-World War II years high levels of economic activity have been enjoyed by our economy. During this time the Federal Government has spent more than its revenues in almost every year. Currently, the Nation's economy is functioning at a high level of activity. Despite this the Federal Government will run at a very substantial deficit. Tax reduction can only aggravate such deficit.

We must recognize that continued Federal deficits will ultimately stimulate inflation, may cause a possible devaluation of our dollar and will undoubtedly aggravate an already pressing problem; namely, the balance-of-payment situation. In the long run such results are most detrimental to all citizens. Inflation is a confiscator of wealth; it penalizes the saver; it results in cruel treatment to those on fixed incomes; it destroys our prestige in world affairs. Consequently, the company is unable to support tax reduction until such time as there is evidence of real progress in holding the line on Federal spending and the elimination of Federal deficits.

LODDING ENGINEERING CORP.,
Auburn, Mass., October 18, 1963.

Representative HAROLD D. DONOHUE,
House Office Building, Washington, D.C.

DEAR CONGRESSMAN DONOHUE: I was very pleased that you were able to meet with me and other members of the Worcester Chamber of Commerce Congressional Action Committee last week.

In talking with various people when we were down there, I got the impression that there was not too much interest in the President's tax bill. I want to assure you that we, here, are very much interested in the passage of this bill pretty much in the form recommended by the House.

I would appreciate your presenting our views to the Senate Finance Committee.

With best regards.

Very truly yours,

ISRAEL WEISMAN, *Treasurer.*

FEDERATED INSURANCE,
Richmond, Va., October 25, 1963.

Re new tax bill H.R. 8363, group term life section.

Hon. HARRY F. BYRD,
Chairman, Senate Finance Committee,
Senate Office Building, Washington, D.C.:

The group term life section of H.R. 8363 has some very objectionable features which should be considered quite carefully. The bill appears to limit group

term life insurance by taxing the employee if the group term life insurance is in excess of $30,000. It is doubtful that there will be much increase in tax income from this source.

For years and years, group term life has had a favorable tax basis. If we are to change the rules now, it would definitely have an adverse affect upon many plans that have been in existence for a long time. Then too, the computing of withholding of each employee's additional tax income would be a costly and time-consuming procedure for the employer. Finally, and this is most important, the cost under the bill rises sharply with age, not withstanding the fact that the common practice is to determine an average group life premium rate for all covered employees regardless of age.

It is difficult to see where there are any advantages in the provisions of this group life term section to offset the very serious disadvantages to both employer and employee. Inflation and the resulting wage and salary increases are making it necessary for employers to increase the employee benefit program—including the increasing of life insurance benefits. The terms of this section of the bill would seem to have a tendency to eliminate increases in life insurance benefits in many instances and certainly would not seem to be desirable.

EARL WAGNER.

HARTFORD FIRE INSURANCE CO. GROUP,
Hartford, Conn., October 23, 1963.

Hon. HARRY F. BYRD,
Chairman, Senate Finance Committee,
Senate Office Building, Washington, D.C.

DEAR SENATOR BYRD: We hope that the Senate Finance Committee will not approve these provisions of H.R. 8363 which would tax employees on the "cost" of group term life insurance in excess of $30,000.

The $30,000 exemption may at first appear to be a reasonable basis for compromising a controversial question, but we consider it to be no more than an expedient. We do not believe that principle should yield to expediency.

The report of the Committee on Ways and Means itself suggests the very reasons why we must voice our objections. That report observes that it is desirable to encourage employers to provide life insurance for their employees and that such a basic amount of insurance does much to keep family units together when the breadwinner dies prematurely. This is tantamonnt to observing that employers should be encouraged to provide insurance up to an arbitrarily specified amount. We cannot agree; not when so many taxpayers who would be affected are middle income wage earners who find it difficult enough to provide for their families without being discouraged from doing so by the imposition of further income tax liabilities.

Whether it be called a fringe benefit comparable to other benefits of employment which are not taxed, a proper subject of collective bargaining, or a voluntary private assumption of financial burdens which would otherwise require public assistance, the employer-financed group term life insurance program has for decades been an important factor in our economy and has enjoyed favorable tax consideration. The proposal would, despite the $30,000 exemption, subject employers to additional costly internal accounting procedures and reporting requirements, which costs they would deduct for tax purposes, and would impose new tax liabilities on those very individuals who need the lower cost insurance which these programs permit. It is wholly irrelevant whether this family protection is acquired without tax liability. The need for family security is paramount; all which can be generated by assisting employers and restraint on the part of government.

We question whether the revenues under the proposal would justify the cost entailed, whether the proposal could be effectively administered, and whether it might not destroy the very stabilizing incentives which the House committee report extols. In brief, we are deeply concerned over the possibility, if not the probability, that this additional drive for revenues would do a great deal of harm without producing correlative benefits.

We hope that these brief comments in opposition will be made a part of the committee's record.

Sincerely,

HALE ANDERSON, Jr.,
Assistant General Counsel.

RICHFIELD OIL CORP.,
Los Angeles, Calif., October 23, 1963.

HON. HARRY FLOOD BYRD,
Senate Office Building,
Washington, D.C.

MY DEAR SENATOR BYRD: The Revenue Act of 1963, now under consideration before the full Senate Finance Committee, contains provisions in section 203 which would seriously disrupt group term life insurance programs established under a law in existence since 1920 and which now cover approximately 89 million employees.

The theory of this tax "reform" is that it would eliminate inequities and produce more revenue. Actually, our analysis of the section has convinced us that it will create, rather than eliminate, inequities, and add obvious administrative costs to Government and industry which will substantially reduce, or completely eliminate, the anticipated $5 million annual revenue increase. Furthermore, enactment of this section would be highly detrimental to long-established industrial relations programs designed to stimulate rather than to stifle employee incentive.

These group term life insurance policies are the result of carefully developed programs which emphasize the importance of an employee's career with his company. The benefits from the employer's support are spread over the entire period of the employee's participation in the plan.

Under existing law, it has been the prevailing practice for many years for employees to contribute to group insurance premium payments at a uniform rate at all ages so that an unduly heavy burden is not placed upon the employee in his later years. Section 203 would ignore completely this equitable principle upon which such programs are based. It would change, for tax purposes, this longstanding practice by applying a schedule based on the attained age of each individual participant which would result in tax credits for the younger and tax liabilities for the older. Thus, every group term life insurance plan would, in effect, be an individual plan for tax purposes and a uniform premium group plan for contribution purposes. It is apparent that these contradictory positions are indefensible and confusing.

Section 203 would thereby change longstanding congressional public policy which has favored the enactment of tax laws advantageous to older citizens. In countless thousands of instances, younger employees receiving income tax credits under the proposed new law would, in effect, be paying less per $1,000 of insurance coverage than would the lower paid employees they supervise. This inequity is nonexistent under present law where nondiscriminatory programs are available to the highest paid and to the lowest, and where these policies are related only to compensation.

For each and all of the above reasons, I respectfully urge you to oppose enactment of this measure and to support retention of the present law with respect to group term life insurance plans which are nondiscriminatory in character.

Sincerely,

CHAS. S. JONES.

ERIE-LACKAWANNA SYSTEM BOARD OF ADJUSTMENT,
BROTHERHOOD OF RAILWAY & STEAMSHIP CLERKS,
Cleveland, Ohio, October 24, 1963.

HON. HARRY F. BYRD,
Senate Finance Commitee, Senate Office Building,
Washington, D.C.

DEAR SENATOR: It is my understanding that after many months of deliberation, the Ways and Means Committee reported out tax bill H.R. 8363 which would amend the Internal Revenue Code of 1954 to reduce individual and corporate income taxes; make certain structural changes with respect to income tax, etc.

While H.R. 8363, as introduced, is not perfect, the increase in standard deduction for small taxpayers who do not itemize deductions for contributions to church, charity, interest payments, etc., is very desirable, and I am in sympathy with the provision for full deductibility of expenses for medicines and drugs for persons over age 65 as compared to the present 1 percent of income, regardless of age.

While I have not yet reached the golden age and do not find myself in the category of the small taxpayer taking the standard deduction, I nevertheless feel that a majority of our working masses will receive the beneficial effects of this bill and in the judgment of economists employed by some of our largest financial institutions, will provide in the neighborhood of $11 billion in new purchasing power and new funds for business investment which should put millions of unemployed American workers back to work and prevent a possible recession in 1965.

May I therefore urge you to support H.R. 8363 as reported by the House Ways and Means Committee? Thank you.

Sincerely,

H. L. BECK.

GARLOCK, INC.,
Palmyra, N.Y., October 25, 1963.

Senator HARRY F. BYRD,
Chairman, Senate Finance Committee,
Washington, D.C.

DEAR SENATOR BYRD: The purpose of this letter is to register a formal protest with the Senate Finance Committee against the proposed tax treatment of group term life insurance as outlined in H.R. 8363.

The favorable tax basis of group term life insurance has been a big factor in the establishment and maintenance of our well-rounded employee benefit program. To change the tax rule now would have a disrupting effect upon our program.

There seems to be little reason for the proposed change since relatively little tax income will result. It will, however, succeed in causing a revision in many group life insurance plans and for all intents and purposes place an upper limit on employees group life insurance amounts.

The cost and complexity of computing and withholding each employee's additional income would likely preclude the continuance of our present insurance plan.

Such a tax would be a departure from the longstanding concept of group term life insurance. Heretofore the common practice has been to determine an average group life premium rate for all covered employees regardless of age. Because ours is a contributory plan, the additional tax burden would only be felt by our older employees.

In behalf of my company, I request that the above comments be made a part of the committee's record.

Sincerely,

A. J. MCMULLEN, *President.*

THE FIRST NATIONAL BANK OF KANSAS CITY,
TRUST DEPARTMENT,
October 25, 1963.

Hon. HARRY F. BYRD,
Senate Office Building,
Washington, D.C.

DEAR SENATOR BYRD: I hope you won't mind receiving the views of just an ordinary taxpayer concerning the proposed income tax legislation.

I am sure we would all like to have lower taxes, but in my opinion a balanced budget is much more important at this time than tax reduction. It seems to me, furthermore, that our economy is quite well adjusted to the present level of corporate and personal income taxes, and that leaving them at their present rates would not cause the recession or depression that has been so widely predicted by various prominent Washington figures.

If the Congress really wants to improve the tax situation, it should get to work and simplify the tax laws, a task which is long overdue. This may not be popular with lawyers and accountants who are the principal beneficiaries of the present complicated tax structure, but simplification has to be accomplished sooner or later. Why not now?

Respectfully yours,

ALFRED L. BENJAMIN.

UNITED STATES COUNCIL
OF THE INTERNATIONAL CHAMBER OF COMMERCE, INC.,
New York, N.Y., October 25, 1963.

Re statement for record of hearings of Senate Committee on Finance on H.R. 8363.
Hon. HARRY F. BYRD,
Chairman, Committee on Finance,
U.S. Senate.

DEAR SENATOR BYRD: This statement is submitted on behalf of the Committee on Taxation of the United States Council of the International Chamber of Commerce. You are respectfully requested to include it in the record of the hearings of the Committee on Finance on H.R. 8363, the revenue bill of 1963. This statement contains comments on two amendments intended to be offered to the bill by Senator Gore. One amendment would incorporate in the bill the so-called interest equalization tax that has been recommended by the President and is pending before the Committee on Ways and Means in the House of Representatives. The other amendment would drastically revise and extend the taxation of income of controlled foreign corporations that was first instituted in the Revenue Act of 1962.

INTEREST EQUALIZATION TAX AMENDMENT

We suggest to the Committee on Finance that it defer consideration of the proposed interest equalization tax until the Committee on Ways and Means has acted on it.

If the Committee on Finance decides to consider the proposed tax, we urge that it consider the effect of the proposed tax on our international trade and investments and on our relations with the other nations of the free world. The tax as proposed would handicap U.S. business operations abroad so that the longrun result would be to reduce the sale of U.S. goods and services in foreign markets and reduce the flow of dividend and interest receipts on foreign investments—thus worsening our balance-of-payments position.

One bright spot in the U.S. balance-of-payments position today is the surplus in our balance of trade. Care must be taken that a tax on purchases of foreign securities does not reduce directly or indirectly American goods and services sold abroad or reduce incentives to investments that yield earnings available for repatriation. Enactment of a U.S. tax on purchases of foreign securities could well add to the already difficult circumstances surrounding the upcoming GATT negotiations.

The Committee on Taxation of the U.S. Council recommends that Congress not enact the so-called interest equalization tax. The proposed tax is wrong in principle. It would mean the imposition of an arbitrary governmental control on the free flow of international investments—contrary to a principle upon which the United States historically has based its economic development.

CONTROLLED FOREIGN CORPORATION AMENDMENT

Senator Gore's amendment would repeal the statutory provisions enacted in 1962 with respect to taxation of U.S. shareholders on income of controlled foreign corporations and substitute even harsher tax treatment of U.S. shareholders.

The principal changes proposed by the amendment are—

(1) A pro rata share of all undistributed earnings and profits of the year would be included in the income of a U.S. shareholder of a controlled foreign corporation, in comparison with the inclusion, under present law, of certain types of income described as foreign base company income.

(2) The definition of controlled foreign corporations would be extended to include corporations in which a majority of the stock is owned by U.S. shareholders, even though no one of these shareholders has a substantial interest, and, with respect to corporations organized abroad in the future, the definition would include foreign corporations in which any U.S. shareholder owns as much as 10 percent of the stock.

(3) The exemption for income of foreign corporations that distribute a specified minimum percentage of their earnings and profits, based upon the foreign income taxes to which they are subjected, would be eliminated.

(4) The exemption of income earned by export trade corporations and reinvested in export trade businesses would be eliminated. While the export trade corporation exemption has proved to be of extremely limited effect, Senator Gore's amendment would eliminate the small benefit that has resulted from it.

There is one provision of merit in the proposed amendment. It would permit a foreign corporation to elect to be taxed in substantially the same manner that a U.S. corporation is taxed. This provision is too restrictive, however, in that it would deny percentage depletion deductions to foreign corporations electing to be treated as domestic corporations.

The Committee on Taxation of the U.S. Council recommends strongly that the Committee on Finance reject Senator Gore's proposed changes in the tax treatment of controlled foreign corporations.

American businesses abroad are seriously concerned by the restrictions imposed on their operations by the Revenue Act of 1962. If the Committee on Finance considers the tax treatment of income earned by foreign corporations that are owned in whole or in part by U.S. shareholders, it should ease the present tax restrictions on doing business abroad, not make them more difficult.

Respectfully submitted.

ELLSWORTH C. ALVORD,
Chairman, Committee on Taxation.

THE CONNECTICUT MUTUAL LIFE INSURANCE CO.,
Newport News, Va., October 25, 1963.

Hon. HARRY F. BYRD,
Washington, D.C.

DEAR SENATOR BYRD: There is a provision in the pending tax bill that is wholly inequitable; namely, the restriction of exempting interest on loans made on an insurance policy to pay premiums on that policy. The cash and loan values on a policy belong to the policyholder and if he wishes to use the money to pay the premiums on the policy or any other, that is his choice. Then it follows that the interest he pays to borrow on his own policy to pay his premiums should be just as inviolable as that interest paid to buy real estate or Rolls Royce.

Each time he pays his premium the cash value of this contract increases; therefore, he is borrowing to buy an asset. When you take into consideration the tremendous appreciation of that contract when he dies, you can see that this is good business economy. Life insurance is the basic structure of our economy.

Also, it is time or past time that a single person living alone get some relief on his or her taxes. When one person—or four—is living in a house or apartment it still has to be kept up. I wonder if you realize how many widows or single women live alone and have no household exemptions and no marital deductions? In many cases you will find they are helping an aged parent or a niece to go away to school. This group needs relief.

You are doing what you can to keep the spending within reason and we all appreciate it very much but I do believe if I did not have such high taxes that I could buy a new automobile more often. (My present one is a 1958 vintage.) That should help the economy. Look at the people who might have to pay increased taxes if I bought a car. I might even take a nice trip—on an American ship or in this country, of course.

With kindest regards to you.

Yours sincerely,

STELLA FORD STEPHENS.

HAWAII STATE CHAMBER OF COMMERCE,
Honolulu, Hawaii, October 24, 1963.

Hon. HARRY F. BYRD,
Chairman, Senate Finance Committee,
Senate Office Building, Washington, D.C.

DEAR SENATOR BYRD: May we take this opportunity to present our views with regard to H.R. 8363—the Revenue Act of 1963.

The reaction of the Hawaii State Chamber of Commerce to the proposal can succinctly be expressed by agreeing that a tax cut is fine—it is long overdue and

we would like it—but, what will we do with the cut if the country's fiscal policies bring on an inflation that makes the tax-cut money saved worthless?

We do not believe the tax-cut measure is acceptable unless firm assurances or provisions are made which will require a reduction in Federal expenditures providing for a balanced budget. Also, we would like to see some planning done which would permit orderly reduction of the Federal debt.

The declarations made by the President, and the language of section 1 of the bill are encouraging, for there is an apparent recognition that Federal spending must be restrained. On the other hand, these statements appear to have no force of law and, therefore, we respectfully suggest that no tax bill be reported out until the President has submitted his budget for fiscal 1965.

Thank you kindly for accepting this statement in lieu of a personal appearance.

Very truly yours,

CLIFFORD H. BOWMAN, *President.*

(Whereupon, at 12:05 p.m., the committee recessed, to reconvene at 10 a.m., Thursday, October 31, 1963.)

REVENUE ACT OF 1963

THURSDAY, OCTOBER 31, 1963

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, Douglas, Gore, Williams, Carlson and Curtis.

Also present: Elizabeth B. Springer, chief clerk.

The CHAIRMAN. The committee will come to order.

The first witness is Mr. Ward Ashman of the National Conference of Public Employee Retirement Systems.

Please proceed, Mr. Ashman.

STATEMENT OF WARD ASHMAN, PRESIDENT, NATIONAL CONFERENCE ON PUBLIC EMPLOYEE RETIREMENT SYSTEMS; ACCOMPANIED BY DR. MADALINE KINTER REMMLEIN, LEGISLATIVE COUNSEL

Mr. ASHMAN. Good morning, Mr. Chairman and members of this distinguished committee. I would like to ask your permission to have Dr. Madaline K. Remmlein, our legislative counsel, come and sit here at the table with me.

Senator DOUGLAS. It is a wise man who comes assisted by an able woman.

Mr. ASHMAN. Thank you.

The CHAIRMAN. Proceed, sir.

Mr. ASHMAN. My name is Ward Ashman. I am the executive secretary and administrator of the School Employees Retirement System of Ohio, and my offices are in Columbus, Ohio. Our retirement system covers approximately 60,000 employees of the public schools in Ohio other than teachers. I have held my position for the past 17 years. I am appearing here today as president of the National Conference on Public Employee Retirement Systems.

Membership in the conference is composed of 188 State and local organizations of public employees in 35 States. Membership is also maintained by two national organizations.

Organizations belonging to the conference are of two kinds: Public retirement systems and associations of public employees not themselves operating a retirement system, but belonging to one. These organizations have individual members already retired, but most

are predominantly composed of active employees looking forward to retirement in the future.

The individuals who are represented by the member organizations are policemen, firemen, State employees, teachers and other school employees, other local employees, county employees, sheriffs, and some Federal employees. The total number of individuals represented by membership in the conference is approximately 2 million.

The objectives of the conference are to safeguard and promote the rights and benefits of the present and future members of public employee retirement, pension, or annuity and benefit systems; and to achieve equitable taxation of retirement income for public employees now retired or to be retired in the future. The conference was organized in 1942 to coordinate the efforts of various public employee groups for the achievement of these objectives.

Because of the interest of the conference in the Federal income tax as it applied to retired persons, it is concerned with pertinent provissions of the current bill (H.R. 8363). There are a number of provisions in the House-passed bill which will lighten the tax burden on our members, many of whom must live on extremely low retirement income.

The proposed tax rates will be of some benefit to most of our people. The proposed minimum standard deduction will be of special advantage to those who are in the low income tax brackets and have few deductions. Removing the 1-percent floor on deductible medicines and drugs will also be of help to those who must spend large amounts for medicines as most elderly people do. Limited exclusion of gains on the sale of a home by those age 65 and over is a proposal which the conference has endorsed for several years.

Although reduction of the dividend income credit and its repeal for years subsequent to 1964 may harm some retired people, the increase in the excludable amount of income derived from investments may prove an offset since most public employees do not have large investments.

Reduction from 20 to 15 percent of eligible retirement income subject to the retirement income credit is understandable in principle in view of the rate changes, and it is our opinion that, in the overall, few public employees would be harmed by this proposal.

In general, then, may we say that we have no objection to H.R. 8363 as it passed the House. However, we would like to have the Senate add three features which are of vital concern to our members.

First: The retirement income credit is applicable to a maximum base of $1,524. This figure was arrived at by amendment in 1962 (Public Law 87-876). The purpose of that legislation was to make the retirement income tax credit more nearly equal to the nontaxable social security benefits. It is our contention that inequity still exists.

A married man receives a social security benefit and his wife, if eligible, receives a benefit equal to half her husband's primary benefit. Both are tax free. A married man without a social security benefit may take a credit of a percent of his eligible retirement income up to the maximum social security primary benefit. However, no provision is made for retirement income credit on behalf of this man's wife unless she is eligible for the credit on her own income, although the husband must support her. To make the tax treatment of the married couple without social security benefits more nearly equal to that of

the married couple receiving social security benefits, the law should permit a retirement income credit on behalf of the wife on a base equal to one-half the amount of the husband's income subject to the credit.

For example, two married couples, each with $5,000 gross income, file joint returns. All are over age 65.

Couple 1 receives $1,524 as the husband's primary social security benefit and half as much, $762, is paid as the wife's benefit. Thus, $2,286 of the gross income of this couple is tax free. On the balance of $2,714, couple 1 would pay $8 tax under current law and no tax at all under H.R. 8363.

Couple 2, also with $5,000 gross income, does not receive any social security benefits, but they are entitled to the maximum retirement income credit. Their tax after application of the credit would be $111 under current law and $82 under H.R. 8363.

This, we think, is grossly unjust. Language which will eliminate the present inequity is appended as exhibit A. We urge the committee to consider this proposal.

Second: Under current law, the recipient of a retirement benefit is forced to use part III–A or part III–B of schedule B in reporting pension income. Thus, with regard to employee benefits, a retirant who can recover his own contributions (or cost) within 3 years must report his benefits as tax-free income until the total of his contributions have been recovered; thereafter, the total benefits are taxable. On the other hand, one who cannot recover his contributions within 3 years must use the exclusion ratio under which a portion of his benefit is nontaxable each year, beginning with the year of retirement, that portion remaining the same for life.

On the surface, this statutory provision would appear to benefit newly retired persons because most can recover their own contributions within 3 years during which their pension income is nontaxable. As a matter of fact, however, it has been proved that the exclusion ratio is more beneficial to those who live out their life expectancy. Exhibit B of the appendix to this statement illustrates that, on the same income, one person's taxes may be many times as high as another's. H.R. 8363 does not correct this inequity either by a structural change or by its lower rates. As a result, some retired taxpayers now and in the future will have left after taxes much more than others receiving the same income, though their living costs may be comparable. The conference believes that each retired person should be entitled to choose either part III–A or part III–B. Language to effect this option is attached as exhibit C. It consists of a bill (H.R. 848) introduced by Congressman Boggs of Louisiana, on January 9, 1963.

Third: Section 403(b) of the current law permits certain organizations to purchase annuity contracts for their employees. Originally, the eligible organizations were those tax exempt under section 501(c)(3) of the Internal Revenue Code. The Internal Revenue Service ruled that public school systems were not qualified to use this provision since they are not tax exempt under section 501(c)(3). Therefore, Congress in 1961 amended the law so as to include public school employees.

The conference feels that if the so-called tax-sheltered annuity is available to one particular group of public employees, it should be made available to all. Firemen, policemen, State, city, county, and

other local employees, as well as Federal employees, should be treated the same as public school employees in this regard. Therefore, we are asking the Senate to amend section 403(b) to this effect. Exhibit D suggests language which would accomplish this purpose.

Also, the suggested language in exhibit D would clarify a point which is now ambiguous for all such employees, including school employees. Section 101(b) of the Internal Revenue Code is concerned with death benefits of certain employees. It provides for an exclusion of $5,000 in death benefits paid on account of an employee under an annuity purchased by an employer which is referred to in section 503(b) (1), (2), or (3). When section 403(b) was amended in 1961 to include public school employees, section 101(b) was not amended to coincide. Therefore, school employees are uncertain as to the application of the death benefit exclusion payable under the annuities authorized by the 1961 amendment.

The conference takes the position that these annuities should be available to all public employees, and that the death benefit exclusion should also be made available to all public employees for whom these annuities are purchased.

The National Conference on Public Employee Retirement Systems thanks the committee for this opportunity to present its views and will be happy to answer any questions which committee members may wish to raise at this time or later during consideration of needed amendments to the House-passed bill. We particularly urge the committee to consider the above three points so as to eliminate discrimination existing under current law.

(The exhibits previously referred to follow:)

Exhibit A

A BILL To amend section 37(d) of the Internal Revenue Code of 1954 so as to equalize the application of the retirement income credit of married couples with the tax treatment of Social Security benefits received by a married couple

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That section 37(d) (relating to the limitation on retirement income qualifying as the base for application of the retirement income credit) is amended by inserting between the words "income" and "shall" the phrase "for each individual entitled to credit on retirement income".

Sec. 2. That paragraph "(2)" is renumbered "(3)".

Sec. 3. That a new paragraph is inserted at the end of paragraph (1) to read as follows:

(2) The amount of retirement income for a married couple filing a joint return shall not exceed $1,524 for the husband and $762 for the spouse who is not eligible for credit on account of her own income.

Exhibit B

Two male taxpayers each receive $3,800 as a retirement benefit. Both are over age 65 and entitled to two personal exemptions. Both use the standard deduction instead of itemizing their deductions on page 2 of the tax form. Because of differences in the retirement systems to which they have belonged, one paid $200 more in contributions than the other. Taxpayer 1, whose cost was $11,300 must use part III–B of schedule B because he can recover his cost within 3 years. Taxpayer 2, whose cost was $11,500, must use part III–A because he cannot recover his cost within 3 years.

Taxpayer 1 pays no tax for the first 3 years. Thereafter his tax annually would be $453 less the credit of $304.80 under current law. The life expectancy of a man age 65 is 15 years. Over the 12 years during which taxpayer 1 would be paying taxes, he would pay $1,776. Under H.R. 8363, taxpayer 1 would use

$400 as his standard deduction, making his tax $348 less $228 credit. Over the 12 years, he would pay an aggregate of $1,040.

This example is not for the purpose of comparing taxes taxpayer 1 would pay under current law with those he would pay under H.R. 8363. It is intended to compare taxpayer 1 with taxpayer 2.

Taxpayer 2 finds that his expected return is $57,000 which gives him an exclusion ratio of 20.2 percent, making $768 of his $3,800 retirement benefit nontaxable. On the balance of $3,032, his tax under current law would be $305 which would be wiped out by the tax credit of $304.80. Under H.R. 8363, taxpayer 2 would use $400 as his standard deduction, making his tax $214.80, which would be wiped out by the credit at the new rate.

Taxpayer 1 would pay $1,040 in taxes, whereas taxpayer 2 would pay no taxes, although both receive the same retirement income.

EXHIBIT C

H.R. 848

IN THE HOUSE OF REPRESENTATIVES

JANUARY 9, 1963

Mr. BOGGS introduced the following bill; which was referred to the Committee on Ways and Means

A BILL To amend section 72 of the Internal Revenue Code of 1954 to permit retired employees to elect use of either subsection (b) or subsection (d) to report income from employees' annuities

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That section 72 of the Internal Revenue Code of 1954 (relating to the taxation of annuity income) is amended as follows: The last sentence of subsection (b) is amended to read "This subsection shall not apply to any amount for which an eligible individual elects to have subsection (d) (relating to certain employee annuities) apply."

SEC. 2. Subsection (d)(1) is amended by substituting the following language at the end of paragraph (B): "then such an employee may elect to exclude from gross income all amounts received as an annuity under the contract until there has been so excluded (under this paragraph and prior income tax laws) an amount equal to the consideration for the contract contributed by the employee. Such an election shall be irrevocable and after the total consideration contributed by an employee (who has elected to use subsection (d) in lieu of subsection (b) has been so excluded, all amounts so received under the contract shall be included in gross income."

EXHIBIT D

A BILL To amend section 403(b) of the Internal Revenue Code of 1954 as extended in 1961 to public schools, so as to grant the same privilege to the States and all political subdivisions thereof, and to clarify application of section 101(b) of the Internal Revenue Code

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That section (b) (relating to the Taxability of Beneficiary under Annuity Purchased by Section 501(c)(3) Organizations or Public School System) is amended to substitute for the words "or Public School" the words "or any State or political subdivision thereof" in the title of subsection (b);

SEC. 2. That clause (ii) of section 403(b) is amended to omit the words "an educational institution (as defined in section 151(e)(4), by an" so as to read "(ii) for an employee (other than an employee described in clause (i), who performs services for an employer which is a State, a political subdivision of a State, or an agency or instrumentality of any one or more of the foregoing; * * *".

SEC. 3. That subparagraph (iii) of section 101(b) is amended to omit the words "which is an organization referred to in section 503(b) (1), (2), (3) and which is exempt from tax under section 501(a)" and to substitute the words "referred to in section 403(b)."

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

Senator Douglas.

Senator DOUGLAS. Mr. Chairman, I recognize that the problems of the taxation and exemption of the person over the age of 65 are complicated. I am going to ask that the staff prepare a memorandum on the subject which could be inserted in the record.

The CHAIRMAN. Without objection, that will be done.

(The document referred to follows:)

STAFF MEMORANDUM

Senator Douglas requested information as to the maximum level of income a person over age 65 would have and still be free of all income tax.

Under present law, a single person age 65 or over can have an income of $3,499.99 without having any income tax to pay while a married couple may have an income of $7,000 without having any income tax to pay. This assumes that the single person and married couple are eligible for the maximum retirement income credit, that all of their income is dividend income, and that both husband and wife in the latter case are eligible for the dividend exclusion. The computation is as follows:

	Single person	Married couple
Gross income	$3,499.99	$7,000.00
Exclusion of $50 or $100 of dividend income	50.00	100.00
Adjusted gross income	3,449.99	6,900.00
Less standard deduction	(1)	690.00
Subtotal		6,210.00
Less exemptions	(1)	2,400.00
Taxable income	(1)	3,810.00
Tentative tax	377.00	762.00
Dividend credit, 4 percent (maximum 4 percent of taxable income)	76.20	152.40
Subtotal	300.80	609.60
Maximum retirement income credit or credits (1524 × 20 percent)	[2] 300.80	609.60
Final tax	00.00	00.00

[1] Uses optional tax table.

[2] Because the tax is the same for $50 income brackets for those using the optional tax table, it is impossible to arrive at an income level which precisely uses up the maximum retirement income credit. However, the retirement income credit allowed never may exceed the tax before the credit.

Under the House version of H.R. 8363, a single person age 65 or over can have an income of $3,249.99 without any income tax to pay while a married couple may have an income of $6,247.05 without having any income tax to pay. The assumptions are the same as those made above for the examples under present law. The computation is as follows:

	Single person	Married couple
Gross income	$3,249.99	$6,247.05
Exclusion of $100 or $200 of dividend income	100.00	200.00
Adjusted gross income	3,149.99	6,047.05
Less standard deduction	(1)	604.71
Subtotal		5,442.34
Less exemptions	(1)	2,400.00
Taxable income	(1)	3,042.34
Tentative tax	229.00	457.20
Maximum retirement income credit or credits (1,524 × 15 percent)	228.60	457.20
Final tax	[2] 00.40	00.00

[1] Uses optional tax table.

[2] The Internal Revenue Service permits taxpayers to ignore any tax of less than $1.

Senator DOUGLAS. I would like to address one or two simple questions to the witness. Is it not true that the provision for the reporting of split income was double the exemption which a married couple over the age of 65 will receive? I made some computations and I think that a single person, and even under existing law, gets an exemption of $2,800, and that a married couple can therefore get an exemption of $5,600 a year. I do not think this includes the divident credit which is unlimited under present law, of 4 percent, rather, or $50, and under the proposed bill will be a minimum of $100 per person or $200 for the couple to be the equivalent of making tax free the dividends on approximately $5,000 worth of stockownership. These facts are approximately true, and I do not guarantee they are precisely true—does not this mean that the aged couples or retired public employees are not in such a bad position as you state?

Mr. ASHMAN. Mr. Chairman, I wonder if I might refer Senator Douglas' question to our counsel, Dr. Remmlein, please.

Dr. REMMLEIN. Senator, I am not sure that I followed all the details. I could not quite hear you all the time. It seems to me that you started out by talking about the splitting of the income.

Senator DOUGLAS. What I was saying was that split income permitted a couple over the age of 65 to have tax free twice the income permitted to a single individual.

Dr. REMMLEIN. Yes, sir.

Senator DOUGLAS. And that, therefore, the rough computations which I have made seem to indicate that a single person over the age of 65 claiming the various exemptions can get up to $2,800, and therefore, the aged couple could get up to $5,600. What I say is, is that substantially correct?

Dr. REMMLEIN. Does it not depend on the source of the income to an extent?

Senator DOUGLAS. Each can get retirement income.

Dr. REMMLEIN. Only if the wife is entitled on her own, outside of the community property States.

Senator DOUGLAS. Yes.

Dr. REMMLEIN. And there we have the trouble that they do not allow the splitting unless the retirement income was earned in the State. For example, a married couple who retires from a noncommunity property State and moves into a community property State is not entitled to split.

Senator DOUGLAS. Is it not true that each can get a double exemption?

Dr. REMMLEIN. Each can get a double exemption, as everyone else. You mean the personal exemption of $600 each?

Senator DOUGLAS. I understand. What I am simply trying to bring out is this: are not people over the age of 65 quite well protected now by the provisions of the existing tax laws, and so forth?

Dr. REMMLEIN. I say in response that they do have some advantages that have been put into the law because of their age and the reduced income they have after they are aged 65. That is not the point of our testimony.

Our testimony is that there are some discriminations among those over 65, not all of those 65 being treated the same.

Senator DOUGLAS. Well now, on the social security business, is it not true that people over the age of 65 can get an exemption of $1,200 on earned income outside of social security?

Dr. REMMLEIN. Yes, sir.

Senator DOUGLAS. And is it not true that they get an exemption of approximately one-half of income between $1,200 and $1,700?

Dr. REMMLEIN. For earned income, yes.

Senator DOUGLAS. Yes. I have the memory that over $1,700; am I correct on that?

Dr. REMMLEIN. No, I do not think that is right.

Senator DOUGLAS. Mr. Woodworth, is that right?

Mr. WOODWORTH. Over age 72 there is no cutback for earned income.

Senator DOUGLAS. So that it is a complete deduction?

Mr. WOODWORTH. They can get a deduction of the full $1,524 multiplied by the lowest bracket tax rate, 20 percent, without any reduction for earned income if they are age 72 or over. If they are over age 72 and they receive earned income between $1,200 and $1,700 their credit income on which the credit is based is reduced by one-half for that income. If the earned income is over $1,700, the amount on which the credit is based is reduced one dollar for each dollar of the excess over $1,700.

Senator DOUGLAS. Reduced dollar for dollar.

Mr. WOODWORTH. Yes.

Senator DOUGLAS. We will make that modification.

Dr. REMMLEIN. There are two different things here though. You are talking about social security work limitations, and the work limitations on the retired income credit.

Senator DOUGLAS. More and more women are working, and this is true of married women. I do not know the percentages, but we can put it in the record from the census of occupations, so that more and more women are becoming eligible for social security, even though married, and to the degree that they are employed after 65 and have what is termed "earned income," they can receive the same deductions as their husbands; isn't that true?

(The following was later received for the record:)

Information obtained from the Social Security Administration indicate that there are 35.4 million living female workers who are in an insured status. This is 52.2 percent of the female population over age 14. The comparable data for men are 53.8 million living male workers who are in an insured status. They represent 83.3 percent of the male population over age 14.

These data were taken from the Quarterly Summary of Earnings, Employment, and Benefit Data, January 1963, table 6, published by the Social Security Administration.

Dr. REMMLEIN. Well, there are two different things. The social security, eligibility for social security, and working limitations which might reduce the social security benefits, that is one thing. The other thing is the retirement income credit and the work limitations under it.

Now there are, of course, many working married women. If they are entitled to either the social security payments on their own or entitled to a retirement income credit on their own they get it. But if they are not eligible for social security on their own earnings, the wife gets half as much as the husband, just because she is the wife——

Senator DOUGLAS. What you are proposing, I take it, is that income from the pension systems which you mention, outside of social security, will be tax exempt; isn't that what you are proposing?

Dr. REMMLEIN. That is not the proposal, sir. The proposal is that the retirement income credit base allow half as much for the wife as is allowed for the man. If his base is the maximum of $1,524, then he should have the $762, I guess it is, half as much as that, for his wife whom he is supporting, when she does not have any retirement income that is eligible for the retirement income credit on her own.

Senator DOUGLAS. Are you proposing to make some of this income tax exempt?

Dr. REMMLEIN. No, that is not in this statement, except indirectly through the credit.

Senator DOUGLAS. Wouldn't that make it largely tax exempt? What is the purpose of the credit if it is not to diminish the amount?

Dr. REMMLEIN. That is the purpose of it.

Senator DOUGLAS. Well then, I think what I said was correct.

You will remember H.R. 10 of last year?

Dr. REMMLEIN. Yes, sir; I do.

Senator DOUGLAS. Which the Senator from Tennessee and I were the only two Members of the Senate to vote against, which provided that the self-employed would have contributions to the system made tax exempt, but some of the benefits received from the system at the end would be taxable, as I remember it?

Dr. REMMLEIN. Yes, sir.

Senator DOUGLAS. We pointed out this was a subsidy in various forms amounting to free interest, nontaxable interest earnings, during the period of accumulation, and also provided that since the incomes after 65 tended to be lower than incomes during the active period and the exemptions and credits greater, it provided for lower rates of taxation. But this was defended and passed on the ground that, after all, it was the income at the end which was to be taxable.

Now, you come along and suggest that part of the income under this system of pensions for State and local government employees will be nontaxable, and you do this in the name of uniformity. But don't you have a great difference now between State and local employees and the self-employed? I am inclined to think that if your proposal goes through we will soon have a measure exempting self-employed persons from taxation of the pensions when received after the age of 65.

You see, you get a salient into the tax system excepting a certain type of income from taxation for a limited class, and then everybody else wants it for themselves. The result is that the loophole becomes a rivulet, then becomes a stream, and becomes a mighty torrent, and then is swept away completely.

People do just as you do. They say, "This is a fine thing, the bill is a fine thing, insofar as it helps us, but we would like more, we would like more or we will take the features of the bill which benefit us, but we demand the rejection of those features of the bill which either do not help us or which injure us."

Here we are trying to write a tax bill not merely for special interest groups, and you are a perfectly legitimate group, but for the best interests of the country as a whole.

Dr. REMMLEIN. Well, Senator Douglas, in my opinion there is no distinction whatever between the taxation of the retired public employees and the self-employed under H.R. 10. If the employee has not contributed to his pension fund and gets a free pension from the

State or local government it is fully taxable, subject to the credit, just as the self-employed will be taxed on his benefits subject to a credit.

When the public employee contributes he recovers his costs, because he has already paid taxes on the full salary before the deduction, before the contribution to the retirement system is made. So he recovers his costs, and then it is fully taxable subject to the credit, so there is no distinction in my mind between the public employee and the self-employed under H.R. 10 in treatment. Both are taxable on the benefits, after they have recovered the costs in the case of public employees because they have already paid taxes at a higher rate during their active years, and they both are entitled to the credit.

Senator DOUGLAS. Under H.R. 10 they do not pay taxes now on their contributions to the fund up to a given limit. They do not pay taxes.

Dr. REMMLEIN. They pay the tax on the benefits.

Senator DOUGLAS. Contributions on their behalf.

Dr. REMMLEIN. They pay the tax on the benefits. So also, for example, the State of Delaware, which also has a free pension system. They pay pensions to the State and local employees there to which the employees do not contribute. The minute they retire then they pay taxes on the benefits. They do not pay taxes on the amount that the State puts into that fund on their behalf before they are retired.

This is exactly the same as the self-employed under H.R. 10, and the self-employed under H.R. 10 are entitled to take their retirement income credit after they pay their tax, the same as public employees.

The retirement income credit applies to all retired people who meet certain qualifications, not just public employees.

Mr. ASHMAN. Mr. Chairman, I wonder if I might make one comment on what I think we would like to bring out very clearly about the so-called inequity on the allowances received by public employees and those received under social security.

Under social security the amounts received are nontaxable. Now, in some States public employees are not covered by social security.

Senator DOUGLAS. Contributions by the government.

Mr. ASHMAN. I am talking about the allowances they received, the nontaxable.

Senator DOUGLAS. But the amounts contributed by individuals have already been taxed under the individual income.

Mr. ASHMAN. And that also applies to public employees.

Senator DOUGLAS. Yes.

Mr. ASHMAN. Now, in the State of Ohio there is not a public employee covered by social security. We happen to have the staff systems which cover that.

Senator DOUGLAS. Let me say this: you are eligible to come in if you want to come in, isn't that true?

Mr. ASHMAN. That is exactly right, but I want to point out——

Senator DOUGLAS. The policy we have followed, subject to correction by the chairman and the Senator from Kansas, who know much more about this than I do, the policy we have followed is that any group that wants to come in can come in.

Mr. ASHMAN. We agree we do not want to come in. But I would like to make the point about the retirement allowances that are paid to these people. The social security allowance that is paid to a retired person is fully excluded. In our own retirement systems our people pay up to 7 percent of their salaries.

When they receive an allowance they do not have this exclusion of only a partion of this money that is nontaxable, and it is used as a base for a retirement income credit.

So in the case of a public employee, the most he can benefit from this amount that, if you want to call it excluded, is excluded, at the lowest rate. In the case of social security the allowances that are received get the benefit of the top dollar rate.

Senator DOUGLAS. Those are limited. What is the highest amount that is paid?

Mr. ASHMAN. Let us take the case of an executive, let us take the case of someone who is in the very high income bracket and has a lot of income. The $1,524 or the $2,228 that is excluded from taxes gives him the benefit of the top tax income bracket, does it not? In the case of the public employee, he gets a top limit of a low rate against only $1,524. This makes a whale of a difference in the treatment of those two classes of people.

Senator DOUGLAS. Well, Mr. Chairman, I am afraid I will have to simply ask that the staff prepare this memorandum on the relative tax liability of Federal employees, State and local employees, not members of the social security system with those who are social security employees.

The CHAIRMAN. That will be done.

STAFF MEMORANDUM

The principal differences between the tax treatment of Federal, State, and local government employees who are not covered by social security with those who are, can be summarized as follows:

1. With respect to Government pension income, there is no minimum age limitation. The individual may receive a retirement income credit with respect to Government pension income regardless of his age. However, the pension income eligible for the credit is reduced dollar for dollar, for any earned income in excess of $900 if the Government retiree is under age 62. On the other hand, except in the case of those totally disabled, old-age and survivor insurance-benefits are not available to those under 62.

2. The maximum income upon which the retirement income credit is based is $1,524 in the case of the retirement income credit available in the case of retired Government employees. The maximum primary old-age and survivors insurance benefit also is $1,524.

3. For a husband to receive a retirement income credit and for the wife to receive a second credit, both must have had 10 years of prior earnings experience. On the other hand, in the case of old-age and survivors insurance if a husband is eligible for a primary insurance benefit, the wife may be eligible for a benefit payment of one-half the size of the husband's, whether or not she has had any prior earnings experience.

4. In the case of the retirement income credit both the husband and the wife who have had prior earnings experience are eligible for a full retirement income credit. In the case of old-age and survivors insurance benefits, however, generally the husband receives a full primary benefit and the wife the equivalent of a half primary benefit. The only exception to this is where the wife's own primary benefit exceeds the "half" primary benefit she is eligible for as a spouse.

Senator GORE. No questions.

The CHAIRMAN. Senator Carlson.

Senator CARLSON. Just one question. I was interested in one statement you have on page 3. You state:

Reduction from 20 to 15 percent of eligible retirement income subject to the retirement income credit is understandable in principle in view of the rate changes, and it is our opinion that, in the overall, few public employees would be harmed by this proposal.

I do not quite get that because as I understand the present law, these people who are eligible for this retirement, which is $1,524, are entitled to an income credit of $304.80.

Mr. ASHMAN. It is on the basis of 20 percent of the $1,524.

Senator CARLSON. That is correct. Under the pending bill, H.R. 8363, the maximum retirement income credit would be $228. Would not that have a substantial effect on the retirees?

Mr. ASHMAN. Senator Carlson, were were intending—we tried to be entirely factual—we have no quarrel with the 15 percent, but you will find that, in working out the application under the rates of H.R. 8363, on the first $2,000 that rate for the entire amount will be just a little over 15 percent, it is about 15½ percent the way we figure, and that is the reason we made the statement that way. We have no quarrel with the effect at all of these rates under H.R. 8363 in this particular application.

Senator CARLSON. You would not object if we retained the existing law on 20 percent?

Mr. ASHMAN. Well, I do not know whether to answer you as president of the conference or individually. Primarily I would say that I think all people, regardless of category, should be treated the same across the board.

Senator CARLSON. That is all, Mr. Chairman.

The CHAIRMAN. Senator Gore?

Thank you very much, Mr. Ashman.

Mr. ASHMAN. Thank you, sir, for the opportunity of appearing before you.

The CHAIRMAN. The next witness is Mr. Carl C. Bare of the National Fraternal Order of Police.

Mr. Bare, you take a seat, sir, and proceed.

STATEMENT OF CARL C. BARE, CHAIRMAN, LEGISLATIVE COMMITTEE, NATIONAL FRATERNAL ORDER OF POLICE

Mr. BARE. Mr. Chairman and members of the committee, my name is Carl C. Bare. I am a deputy inspector of police in the city of Cleveland, Ohio, and chairman of the National Legislative Committee of the Fraternal Order of Police. Our organization represents local, county, and State policemen from all parts of the country and a large number of retired policemen and their dependents.

We are vitally interested in the bill now being considered by this committee. While we agree generally with the provisions of H.R. 8363, we feel that it should be improved in certain areas.

Our members, who are principally in the lower income brackets, are happy to see the proposed rate reductions, which will reduce their tax burden somewhat and increase their buying power. Other provisions of the bill will be of help to some. Because policemen are generally recognized to be underpaid, any savings that can be made will be greatly appreciated by them.

We feel that some additions should be made as it applies to retired persons. Three proposals for amendments have been made by the National Conference on Public Employee Retirement Systems with which we are affiliated. We concur with these recommendations and would like to further emphasize them as they apply to our members.

Proposal 1: To provide a retirement income credit for the wife of a retiree is of special interest to us. Many of our retired members would be affected by this provision. Since most policemen are family men, their wives have not been employed and, therefore, have not qualified on their own for social security or any other retirement benefit.

I might interject here, there is another thing that keeps them from getting the benefit on their own of $1,524 retirement income credit, and that is, at retirement they must have been employed during 10 years of their lives. Most of these women may have worked a few years before they married the policemen, but since they have been married to them, they have not been employed and cannot meet the qualification that they have been earning $600 a year for the 10 years. So under no circumstances can they qualify for the retirement income credit under the present law and under the provisions that are still left in H.R. 8363. They must be supported entirely by the retirement income of their husbands.

As pointed out in the example by Mr. Ashman, this family would pay a tax considerably higher than that paid by the same family if retired under social security. This is very unfair.

It is further shown that couple 2 in the example would receive a tax reduction from $111 under current law to $82 per year under H.R. 8363. Giving these people $2.42 per month would do very little to stabilize the economy.

The proposed amendment would not completely eliminate the favored treatment received by social security recipients because this income is not declared for tax purposes and, therefore, applies to the top bracket of the taxpayer rather than the lower rate which applies to other retirement income. This income must also be considered in figuring allowable medical deductions, thereby reducing them. It would be much more equitable to exclude from gross income an amount equal to the credit base.

Policemen have been pioneers in establishing local retirement systems to provide for themselves and their families when they are no longer able to perform their duties. We do not feel that they should be penalized, nor that it is the desire of Congress, to penalize them for having the foresight to make these provisions. We, therefore, strongly urge this committee to include this proposed amendment.

Proposal 2: To permit the recipient of a retirement benefit to use part III–A or part III–B of schedule B in reporting pension income is also important to us. Since policemen, due to the nature of their duties, must retire at an earlier age than most people, their pensions must be higher than average to meet their needs. Contributions are in most cases recoverable within 3 years and they, therefore, must use part III–B. Exhibit B of the National Conference on Public Employee Retirement Systems points out that these persons would pay considerably more in taxes in most cases than those who can use part III–A. This proposal is very important to our members, who will be retiring in the future, and we urge its adoption.

Proposal 3: To extend the so-called tax-sheltered annuity provisions to all public employees should be included in the bill. We feel that all such persons should be treated alike.

These proposed amendments would tend to equalize tax treatment for all retired people and particularly help retired public em-

ployees who are discriminated against in present law and would continue to be similarly treated in H.R. 8363. The Fraternal Order of Police sincerely thanks the committee for this opportunity to present its views. We will be happy to answer any questions or provide any further information which the committee members may desire.

Thank you.

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

Senator Douglas?

Senator DOUGLAS. No questions.

The CHAIRMAN. Senator Carlson?

Senator CARLSON. No questions.

The CHAIRMAN. Thank you very much, sir.

The next witness is Mr. Walter Bouldin of the Edison Electric Institute.

Please proceed.

STATEMENT OF WALTER BOULDIN, PRESIDENT, EDISON ELECTRIC INSTITUTE; ACCOMPANIED BY JOHN THORNBORROW, DIRECTOR, ECONOMICS AND STATISTICS, EDISON ELECTRIC INSTITUTE, AND JENNINGS T. SMITH, ATTORNEY

Mr. BOULDIN. I would like to have Mr. John Thornborrow of the Edison Electric Institute, and Mr. J. T. Smith, attorney, accompany me.

My name is Walter Bouldin. I live in Birmingham, Ala. I am president of Alabama Power Co., and this year the president of Edison Electric Institute.

I am appearing here today on behalf of the Edison Electric Institute, the trade association for the investor-owned electric utility companies which serve approximately 80 percent of the electric consumers in the United States.

The treatment in H.R. 8363 of dividends received by individuals is, we believe, a backward step. While the doubling of the $50 exclusion will be helpful, the net effect of section 201 will undoubtedly be to increase the extent to which corporate earnings are subject to double taxation. Such double taxation hampers the broadening of ownership of corporations, and impedes the investment of risk capital in our enterprise system. Risk capital is, of course, essential to industrial progress, particularly in an industry such as the electric utility industry, where rapid growth is requiring very large amounts of such risk capital. Further elimination of double taxation of corporate earnings we submit is the desirable goal, rather than increase of such double taxation.

As was pointed out by Mr. J. T. Wolfe in testimony before this committee when H.R. 10650 was under consideration, the provision for an investment credit discriminates against the electric and other segments of the regulated utility industry. As this act was finally passed by the Congress, the electric utility companies were given a 3-percent credit while other industries were given a 7-percent credit.

The purpose of the investment credit was to provide an incentive for growth of industry by reducing one of the major factors of cost, the tax cost, leaving more funds available for expansion and modernization of plant. While the sale price of electricity is usually fixed

by public authority, the costs of producing and distributing electricity are not so fixed, and are increasing like the costs of other business. The sale price of electricity like any other product is finally determined by costs. We believe the modernization and expansion of our plant and the consequent reduction in the cost of electricity is as important to our Nation's growth and development as reduction in the cost of other commodities and hence this discrimination in amount of investment credit is unjustified.

We are basically in accord, however, with the limitations placed on Federal regulatory agencies in the treatment of the investment credit contained in section 202 of H.R. 8363.

The President in his special tax message to this Congress proposed, among other things, the broadening of the base of corporate income taxes and the removal of unwarranted special privileges in order to provide more nearly equal treatment of taxpayers. This part of my statement is directed to that aim.

The electric utility industry in the United States is made up of two major segments—the investor-owned companies, which serve about 80 percent of the electric customers, and the Government owned or financed projects, which serve about 20 percent of the electric customers. Such Government projects consist of Federal, State, and municipal systems and rural electric cooperatives financed by the Federal Government through the Rural Electrification Administration.

The total tax liability of the investor-owned segment of the electric utility industry is, on the average, more than any other one industry. These taxes for the year ended December 31, 1962, were approximately $2.7 billion. Over half of the taxes paid were to the Federal Government as corporation income taxes.

The investor-owned electric utility companies incur taxes to the local, State, and Federal governments equivalent to about 24 cents out of each dollar of revenue they receive.

The Government-owned or financed power agencies are required to pay on the average only about 3¼ cents in taxes out of their revenue dollar, none of which is paid to the Federal Government in the form of income taxes.

Regulatory commissions recognize that income taxes like other taxes must be paid by the customer and allow rates for service that under the usual circumstances permit a company to earn an after-tax income sufficient to maintain a market for its securities.

The Federal Government, as of December 31, 1962, operated approximately 13 percent of all the electric utility generating capacity of the Nation. As of June 30, 1961, the Federal Government had an investment of about $5.6 billion in properties for generation and sale of electric power.

These projects are not required, under present law, to pay any Federal income tax, although Tennessee Valley Authority, as but one example, reported a net income, after all interest payments, of $56,-160,000 on its electric operations for the year ended June 30, 1962, income on which an investor-owned operation would be required to pay the 52 percent rate in corporation income taxes.

Electric energy generated at the Federal projects is sold under a so-called preference clause, which gives priority to municipal, State,

and cooperative distributors, none of which is required to pay Federal income taxes. The principal beneficiaries of this tax exemption are the preference customers among the 20 percent of the Nation's electric consumers served by municipal, State, and cooperative distributors, and industrial establishments supplied directly by the Federal projects.

In other words, some 80 percent of our people are paying taxes to the Federal Government equivalent to about 13½ percent of their electric bill, while the preference customers of Government power are exempt from this tax and are getting off scot free.

This is by no means the whole story. The great investment in Government power facilities was made from taxes paid by the general public. The benefits from those taxes are flowing primarily not to the general public but to the relatively few customers of Government power. The taxes invested in Government power were worth about 6 percent per annum to the taxpayers from whom they were taken. The Government power customer does not pay nearly that much interest on the investment he uses. Equity requires that the ordinary consumer of Government power pay in his electric bill the equivalent of what was taken from the taxpayers for his use—that is, some 6 percent per annum of the investment—and that the ordinary consumer of Government power pay for the support of his Government the equivalent of the taxes our customers pay. We do not believe that there is any justification in taxing all citizens to help pay the electric bill of a few citizens.

We submit that here is a place where the tax base can and should be broadened, removing unwarranted special privileges and providing more nearly equal treatment of taxpayers. We recommend as a base broadening step that the Federal corporation income tax be made applicable to Federal Government power agencies, in the same manner as it is applicable to investor-owned companies.

In making this recommendation we recognize that mere applicability of the corporation income tax to these Federal power agencies will not put them on a par with the utility companies in the payment of taxes. The best we can determine, if the corporation income tax were applied to these Federal power agencies as they are now operating, the tax revenue would be only some $34 million per year, because most of the Federal projects are now operating in the red. This $34 million would amount to only about seven-tenths of 1 percent of the estimated $4.7 billion invested in Federal power projects, after deducting the investment TVA allocates to serve the AEC load. This compares with about 2.86 percent of electric plant in service that is paid in Federal income taxes by the investor-owned electric utility companies. To produce a proportionate tax payment these agencies should pay an amount equal to 2.86 percent of the investment allocated to electric plant, which would amount to approximately $135 million a year.

Our recommendation is only the first step. In order for the Federal projects to pay their proportionate amount of Federal income taxes their revenue responsibility will have to be made such as to provide an adequate return on the people's investment in the projects and taxes proportionate to those paid by the investor-owned companies. Only then will these Government investments be just to the American taxpayers.

This, we know, involves changes in laws that are beyond the responsibilities of this committee. However, if provision is made in the

Internal Revenue Code for applying the corporation income tax to these Federal Government power agencies in the same manner as it is applied to investor-owned companies, an important step will have been taken toward tax equality which will produce an increase in Federal revenue.

Thank you, gentlemen.

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

Senator Gore?

Senator GORE. No questions.

The CHAIRMAN. Senator Carlson?

Senator CARLSON. Mr. Bouldin, I appreciate your statement.

I was interested—I believe I read correctly the other day that the electric industry nationwide, investor owned, is our Nation's largest industry when it comes to investment, some $40 billion, and if I remember the figures correctly, you are expanding at the rate of 7.16 percent per year compounded, which means we would double this great industry every 10 years, is that correct?

Mr. BOULDIN. That is correct, sir.

Senator CARLSON. Do I understand that you would like to have the investment credit changed from 3 to 7 percent?

Mr. BOULDIN. Of course we would, sir.

Senator CARLSON. That would, of course, be in the interest of assisting in the expansion of the industry as a whole.

Mr. BOULDIN. Yes, sir; undoubtedly.

Senator CARLSON. Well, I appreciate the great value of this industry, and I think you are rendering a great service.

That is all, Mr. Chairman.

Mr. BOULDIN. Thank you.

The CHAIRMAN. Gentlemen, I want to thank you for a very interesting statement.

Mr. BOULDIN. Thank you.

The CHAIRMAN. The next witness is Mr. Steve Stahl of the Oklahoma Public Expenditures Council and the Investors' Union of America.

Take a seat, sir.

I want to say we are very happy to have you, and I want to congratulate you on the fine work you have done for the elimination and reduction of nonessential expenditures.

Mr. STAHL. Thank you, Senator.

The CHAIRMAN. Would you proceed.

STATEMENT OF STEVE STAHL, EXECUTIVE VICE PRESIDENT, OKLAHOMA PUBLIC EXPENDITURES COUNCIL, AND PRESIDENT, INVESTORS' UNION OF AMERICA

Mr. STAHL. Thank you.

My name is Steve Stahl. I resided at 1919 Northwest 33d Street, Oklahoma City. I am the executive vice president of the Oklahoma Public Expenditures Council and president of the Investors' Union of America.

The Oklahoma Public Expenditures Council is a privately supported, statewide citizen organization interested in securing economical, efficient government at all levels. The Investors' Union of Ameri-

ca is a nationwide organization of thrifty Americans, whose savings have been invested in the purchase of the tools of production; and, whose purpose is that of preserving America's free enterprise system, solvent government and sound money and to protect the investor from unwarranted government interference, and unjustified competition in a free market economy.

Senator Byrd, I greatly appreciate the opportunity of appearing before you and your colleagues on the Senate Finance Committee to present my views with regard to H.R. 8363—the Revenue Act of 1963.

Certainly, there are few, if any, Americans who are not in favor of a reduction in Federal taxes and a thorough revision of the Federal tax structure which is bleeding the poor, soaking the rich, destroying incentive, and braking economic growth.

On the other hand, a great many Americans—in fact, a majority in my judgment—who have been categorized as Puritans by the President's chief financial adviser, are not in favor of a tax cut financed by further Federal borrowing.

Therefore, this measure, which you gentlemen are considering, is ill-advised unless it is accompanied by a reduction in Federal spending which will insure a balanced budget and permit a planned, long-range reduction of the Federal debt.

Anything less than this is the ultimate in fiscal irresponsibility and downright dangerous to the future of our great Republic and the freedom of its citizens.

Furthermore, gentlemen, I do not believe we have any moral right, whatsoever, to charge the bill for our profligacy to our children, grandchildren and great-grandchildren.

Deficit spending by the Federal Government has developed from a bad habit into a planned policy. This constant increase in the Federal debt is destroying confidence both at home and abroad and it must be stopped if we are to avoid bankruptcy.

Just how long can we continue piling debt on top of debt and remain solvent? There must be a breaking point beyond which we dare not go. Certainly in this troubled world in which we live, economic strength is as essential as military might in the defense of our Republic and the security of its citizens.

Apparently members of the House Ways and Means Committee, the architects of this legislation, are concerned about our frightening fiscal picture. Otherwise, they would not have written section 1, which "recognizes the importance of taking all reasonable means to restrain Government spending," into the bill.

The sincerity of this declaration is not questioned, but its effectiveness is subject to grave question as is the President's letter of accord.

What we need is a positive reduction in Federal spending rather than a declaration of restraint which is subject to a variety of interpretations.

When this legislation was being debated in the House, the Honorable Wilbur Mills, chairman of the House Ways and Means Committee, said:

> I believe that given the passage of this bill, the President has committed himself to a course of true economy in Government expenditures. Of course, it can hardly be expected that this will affect his views on programs already sent to us.

These new and costly programs, such as Federal aid to education, urban mass transit, area redevelopment, Youth Conservation Corps, Domestic Peace Corps and many others, if approved by Congress, will cost taxpayers or their children a conservatively estimated $7 billion annually. And it will increase Federal spending by that much.

The President, despite his televised pledge "to a course of true fiscal responsibility leading to a balanced budget," pledged for enactment of all these new programs in his recent conservation tour.

We cannot accept this action as evidence of any desire for restraint in Federal spending.

Most, if not all, of these new programs, like so many already in operation, have built-in cost escalators which are bound to increase rather than decrease Federal spending in the future.

Even the estimated deficit of $9 billion for the current fiscal year will increase interest payments on the Federal debt by at least a quarter of a billion dollars and these payments are now costing taxpayers more than a million dollars an hour.

Further, the inflationary aspects of H.R. 8363, without a corresponding cut in spending, may well serve to substantially increase the cost of defense and other essential functions of the Government.

Insofar as Congress is concerned, it is apparent that a great many Members are deeply concerned over the Federal fiscal situation which can only be described as nothing short of terrifying.

However, the truth of the matter is Congress has lost control of the Federal purse strings. The countless number of bills seeking to improve the fiscal control machinery of Congress which have been introduced in both the Senate and House since the end of World War II provide sufficient evidence of the truth of this statement.

Regrettably, most of these efforts have failed to bear fruit with the result that Congress has found itself progressively less capable of exercising the fiscal responsibility given it by the Constitution. And, this responsibility cannot be met by using the mechanics, procedure, and organization designed to meet the needs of that long dead era when Federal expenditures were less than the current interest payments on the Federal debt.

In view of these facts, gentlemen, it is apparent that the only safe and sure way of combining expenditure reduction with tax reduction is to write specific expenditure controls into the bill now under consideration.

Since the publicized purpose of this legislation is to encourage economic growth, we question the wisdom of those provisions in the bill which delay the benefits of tax reduction to corporations for a period of at least 5 years and which will increase taxation of dividends in most brackets.

It is our contention that the proposed increase in the unfair double taxation of dividends in the middle and upper income brackets will further reduce the incentive to provide the money needed for the creation of new jobs. It will, therefore, have a negative rather than a positive effect on the Nation's economy.

Further, should the Federal Government borrow the money to finance this tax reduction from the public, the primary purpose of this legislation will be defeated since taxpaying citizens will have no

additional money for consumer purchasing or investment in capital expansion. If it is financed through the Federal Reserve by increasing the money supply, creeping inflation may be spurred into galloping inflation.

This, of course, would be harmful to every American and disastrous to the thrifty, hard-working American people who have scrimped and saved in order to take care of themselves in their old age. These are the people who have lost more than half the purchasing power of their retirement dollars through inflation.

These are the people who can be "pauperized" by inflation which is certain to follow a Government program of increased spending and tax reduction. We believe these people are entitled to full consideration by this committee, as well as future generations, whose legacy may well be a bankrupt nation.

Gentlemen, as you all know, the President has repeatedly expressed concern for the plight of our senior citizens in his all-out effort to secure enactment of the King-Anderson bill to provide medical care for the aged under social security.

This interest and concern is not in evidence in the provisions of H.R. 8363. Here we refer particularly to the proposed changes in dividend credits which we contend should be increased rather than eliminated.

This proposal will actually increase rather than reduce the Federal tax burden on millions of our elderly citizens now dependent on the income from their invested savings.

This fact has been repeatedly called to our attention in the volume of mail we have received regarding this bill, as you will note in the excerpts from letters appended to this statement.

Furthermore, we believe a great majority of American workers and professional people in the middle income brackets also will be greatly disappointed. Many may find their taxes have been increased rather than reduced.

Elimination of the deductibility of certain State taxes and the present divident credit, together with an increase in social security taxes as proposed in H.R. 6688, provides no assurance of any tax relief for these hardworking, thrifty American people who constitute the backbone of our Nation.

In summation, we are in favor of a thorough revision of the present Federal tax structure and a substantial reduction in the excessively high Federal tax burden. However, this reduction should definitely be tied to a reduction in Federal spending which will provide for a balanced budget next year and not sometime in the distant future.

We would also recommend that the Senate Finance Committee delay final action on this legislation until the 1965 budget message is submitted to Congress. This delay will provide members of the committee, all other Members of Congress, and the taxpaying public, an opportunity to add up the appropriations and spending authorizations enacted this year and to analyze the spending requests for 1965.

Certainly this information is more important than hasty action on a bill which has been labeled "the most important legislation before Congress in the past 15 years."

May I also express the hope that this Congress will take the necessary action to regain control of the Federal purse strings and establish

the procedures and facilities which will enable you gentlemen and your colleagues to adopt a policy of fiscal responsibility in the management of Federal affairs which will tie together revenues, expenditures, and debt. Historically, the National Taxpayers Conference has recommended and supported legislation to accomplish this essential need.

While a reduction in Federal taxes and spending is necessary and desirable, we are convinced that the elimination of unwarranted Federal interference and unjustified Federal competition with our free enterprise system is equally essential to a sound, healthy growth in our economy.

Senator Byrd, citizen-taxpayer associations from nine States—Florida, Idaho, Illinois, Montana, New Hampshire, New Mexico, New Jersey, Oregon, and Utah—have endorsed this statement.

Senator GORE. What about Virginia?

Mr. STAHL. There is no taxpayers association in Virginia, Senator Gore, and I am reasonably sure they do not need one there. [Laughter.]

The CHAIRMAN. The position of Virginia has been well known.

Mr. STAHL. The letters from the executive officers of these organizations are attached to this statement and I respectfully request that they be included in the record.

In addition to these organizations, we have received more than a thousand letters from individuals in all sections of the Nation in support of this statement. Pertinent excerpts from a number of these letters are also attached to this statement, and I would like to file these letters with the committee for their inspection, if it is your desire.

Senator Byrd and members of the Senate Finance Committee, the opportunity to present our views on this important legislation is deeply appreciated and we are grateful for your consideration and courtesy.

The CHAIRMAN. Mr. Stahl, I congratulate you on a very fine statement and an accurate analysis of the pending bill and its effects.

Mr. STAHL. Thank you.

The CHAIRMAN. We will insert the letters from the taxpayer associations in the record.

(The documents referred to follow:)

EXCERPTS FROM LETTERS SUPPORTING STAHL'S STATEMENT

"As a housewife, I agree that taxes should be lowered, especially since my husband's taxes amount to more than I pay for groceries; but to lower them without a corresponding cut in Government spending is the height of folly because the ensuing inflation will be more devastating to my household budget than our present high taxes."—JULIA SHORT, Oklahoma City, Okla.

"I have read the draft of your statement to the Senate Finance Committee and most heartily endorse the thoughts set forth therein. I suppose to some of those who consider themselves powerful in government the endorsement of a secretary in the business world would be considered of no consequence but when I go to the polls my vote is, as yet, worth as much as the next one."—Mrs. FRANCES THARP, Tulsa, Okla.

"I have read a copy of your statement to the Senate Finance Committee on H.R. 8363. I cannot think of anything that I would care to add as you have covered the ground in a masterly way. I am getting pretty well along in years and have eating money to last me the rest of my life, but I fear for our children and grandchildren * * *. Please quote me as being unalterably opposed to any

tax cut without a commensurate cut in Federal spending."—E. T. SPRINGER, Cimarron, N. Mex.

"Being a widow, and a working one, I would like to have my taxes cut but we can no longer preserve the image of a responsible America if we do not stop this wasteful plunge ahead and return to fiscal responsibility."—HELEN L. FRESOM, Ardmore, Okla.

"As a newspaperman and small investor, I sincerely hope you will be able to convince members of the Senate Finance Committee that there are millions of Americans who would willingly forgo the temporary benefits, if any, of a tax cut for the permanent benefits of true fiscal responsibility."—KENT RUTH, Geary, Okla.

"This bill appears to be a dishonest attempt to make political hay during a presidential election year by giving the citizen the false illusion that his taxes are being reduced."—JOHN DONALDSON, New London, Ohio.

"We agree with your point of view 100 percent. We must reduce spending before we reduce taxes and those who claim the reverse is true are just plain nuts on the subject of economics."—EDWARD E. CARPP, Paw Paw, Mich.

"My wife and I are over 65. We could sure use some tax relief, but we don't want the kind the President has proposed. Cutting our meager 4-percent dividend credit is rotten to the core. Canada allows a 20-percent credit."—L. W. HOSKINS, Evanston, Ill.

"As a retiree, I am very much alarmed at the administration's irresponsible and reckless spending. We are headed down the rapids as fast as possible to fiscal destruction. I can see my life savings, accumulated for the old-age retirement, being wiped out."—GEORGE G. VANDIVER, Miami, Fla.

"I am retired physician without any pension or social security. I might appeal for myself and many others like me who will actually be hurt by the proposed tax bill, but my appeal is for the financial security of our country about which I am sincerely worried."—H. ROSS MCALLISTER, M.D., Bakersfield, Calif.

"If Congress does not regain control of the Federal purse strings and quit kiting our debts into the future, God only knows the terrible mess our children will be in. What we need is a return to good, common, horsesense."—C. V. COEY, Stockton, Calif.

"I am a retired businesswoman living on dividends and interest on stocks and bonds. I have long objected to the double tax on dividends. Under the proposed change it looks as though my income tax will be increased considerably rather than reduced. Naturally, I am not happy about that but would be glad to pay the higher tax if it would mean the Federal Government would get out of the red."—DOROTHY VORSE, Santa Barbara, Calif.

"It takes two things to get people to invest their savings in stocks: one, of course, is money, the other is confidence. President Kennedy's proposal for a tax cut recognizes the need for money, not the need for confidence."—C. N. BACIGALUPI, D.D.S., Healdsburg, Calif.

"We are retired, both 68 years of age, and we are dependent upon the income now received from the investment of lifelong savings in American industry. I checked our last year's income tax statement and I find that should the 4-percent credit on dividends be eliminated that, in our tax bracket of 26 percent, the proposed reduction in that bracket would be more than extinguished by the elimination of the 4-percent credit on dividends, with the result that we would be called upon to pay more, not less, in Federal income taxes."—RICHARD T. WHITNEY, U.S. Naval Reserve, Retired, Redart, Va.

"For my own part, I object firmly to the removal of the 4-percent dividend credit. I am one of many who have depended upon dividends from lifetime savings to be independent of any Government handout. As you well know, dividends are the remnants, in fact, of what is left after the Government has taken 52 percent from the majority of corporations which are the lifeblood of our economy." —FREDERICK M. DREW, Jr., Ansonia, Conn.

"We older people, living on the proceeds of money invested wisely over the years, can't calmly accept the fact that inflation has cut our scarce dollars into less than half their original value, and that inflation and more inflation is evidently the plan of the present administration."—RUTH R. LINN, Inglewood, Calif.

"You have prepared a splendid statement. I can think of nothing to add to it or take from it and I am sure that when you say, 'We are in favor of a thorough revision of the present Federal tax structure and a substantial reduction in the excessively high Federal tax burden; we believe this reduction should be defi-

nitely tied to a corresponding reduction in Federal spending,' you are stating the views of a vast majority of the suffering taxpayers of our Nation. I am confident that Chairman Byrd agrees with us and sincerely hope that enough members of his committee agree to give H.R. 8363 the treatment that it deserves."—R. P. JACKSON, Great Falls, Mont.

"Actually, we have heretofore been of the same opinion; namely, if the administration feels that we need a tax cut to spur the economy, then we must counterbalance this by a corresponding decrease in Federal spending. We, in our own households, would certainly never consider going further into debt by spending more when our income is being reduced. On a large scale this applies to the Government as well. It seems to us at times that the present administration spends money as though it were going out of style."—JOHN F. HARTMAN, Severna Park, Md.

"It is my hope that the present administration will someday come to grips with reality. Their dream bubble of prosperity through increasing debt must be punctured, otherwise this great Nation will be ultimately destroyed."—R. T. HOOD, Jr., M.D., Kinston, N.C.

"First let me thank you for the interest you have shown in a more economical government. As a banker I am alarmed at the fiscal irresponsibility being exhibited by our Federal Government. And this business that we aren't able to understand and appreciate the problems faced by the administration in Washington is for the birds."—CHARLES F. HEARD, Macon, Ga.

"Old fashioned as it may appear, we feel that Government like individuals cannot exist under a program of continual deficit financing. Let us hope that the rational thinking Senators on the Finance Committee will be able to overcome the naive thinking of those who believe the economic liberals who are childishly trying to destroy our country under the guise of progress."—STEWART F. ASEMUS, Ansonia, Conn.

"I agree wholeheartedly with the statement you have made regarding H.R. 8363. This continued flight from economic reality, and what appears to be a concerted effort to plunge our Nation into fiscal chaos is truly terrifying."—JOHN G. O'TOOLE, Boise, Idaho.

"If Mr. Kennedy is really sincere in this matter, why is he not willing to let the tax bill rest until after he has presented his spending program to Congress in January? I think we all know the answer. Every thinking person agrees that tax reduction without spending reduction is sheer nonsense. It should be the responsibility of Congress to gear tax reductions to spending reductions. That would be the businessman's approach. But then I suppose the businessman is still known by another name in high official circles."—JULIAN M. SMITH, Wynnewood, Pa.

"I heartily agree with the entire text of your statement. I sincerely hope that you may be able to impress this upon the minds of the Senate Finance Committee that the Americans are getting fed up to their ears in the fiscal irresponsibility of our Government."—J. NEIL ARRINGTON, Hopewell, N.J.

The CHAIRMAN. The other letters that you have presented to the committee will be filed as they would be too voluminous to put in the record.

Mr. STAHL. That is right.

The CHAIRMAN. A list of those who wrote the letters will be included in the record.

(The list referred to follows:)

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(The documents referred to will be found in the files of the committee.)

The CHAIRMAN. Now, briefly, as I understand your position, you want performance in reducing expenditures instead of promises.

Mr. STAHL. That is correct.

The CHAIRMAN. I am fully in accord with that.

We, of course, must all recognize that we have had 3 consecutive years of deficits, and now with these proposals pending, and with the approval of the administration, there will certainly be 6 or 7 consecutive years before we will have a balanced budget. So we are starting a new procedure here, and that is to plan deficits for tax reduction. The claim is made that it will balance the budget. But the validity of this claim is very doubtful.

There is no man who is more anxious for a tax reduction than I am. based on sound premises, and those premises, at this time, necessitate a reduction of expenditures. It is my belief that of the nearly $100 billion in expenditures now, many billions can be saved by the elimination of useless and wasteful expenditures, without doing any injury to the public service.

So I want to say that I am in full accord with what you have said, and I fully agree that we ought to know what the next budget is, as you have stated, and whether or not there will be a reduction of expenditures before we reduce taxes to the extent of $11 billion.

If we start reducing taxes and increasing expenditures at the same time, we may be asked to do it again. I think that is one of the most serious parts of this proposed legislation. No previous President has ever recommended tax reduction based upon a planned deficit—if we start it now, and it does not succeed, then the economists will say, "Well, we didn't reduce taxes enough," and then they will say reduce taxes more.

So I regard the proposal as utterly unsound and, so far as the chairman is concerned, he will do his best to oppose any bill that does not contemplate reasonable expenditure reductions, with the presentation by the President of a budget reducing expenditures.

We must also recognize, Mr. Stahl, as I know you do, that there are $87 billion of unexpended balances that are now available for expenditure without further action of Congress, and it is in the power and authority of the President as to whether or not to make these expenditures.

So considering the conditions as a whole, I regard this bill as a part of a momentous policy for planned deficits, which could end in fiscal disaster.

I thank you very much.

Senator Gore?

Senator GORE. I was interested in your comments as to the inadvisability of increasing the national debt in order to give tax reduction or, as you put it, borrowing the money to give tax reduction.

Mr. STAHL. That is correct.

Senator GORE. Well, now, what would you say about borrowing the money not only to give a tax cut but also borrowing the money to pay the interest on what we owe, and borrowing the money to pay the interest on what we are going to borrow in order to give the tax reduction?

Mr. STAHL. I think that would be utterly ridiculous, Senator.

Senator GORE. Isn't that what is proposed?

Mr. STAHL. That is what is proposed in the bill, yes. You are proposing——

Senator GORE. No, I am not proposing.

Mr. STAHL. Well, the bill proposes a tax reduction which, on the basis of Federal spending, would have to be financed by further borrowing. I do not think there is any question about that whatsoever.

Senator GORE. Now, as a businessman, would you think there was some practical difference in borrowing money in order to invest in an income-producing facility or borrowing money from one bank to pay your debt to another bank, and then borrowing money from a third one to pay the interest on what you already owe, and then on what you are borrowing?

Mr. STAHL. Well, in the first place, there is a vast difference between a business enterprise, borrowing money to invest in expansion which will increase the revenues to that industry, and permit payment of debt.

Now, I doubt very much if I were in debt beyond my ability to pay the one bank that I would be able to go to another bank to borrow that amount of money, plus the interest I owe, to pay the first bank.

Senator GORE. What about some of your rich uncles?

Mr. STAHL. Well, unfortunately, Senator, I do not have any rich uncles. [Laughter.]

Senator GORE. Well, go ahead with your analysis. Suppose you owed a lot of money, more than you could shoulder, and yet you continued to spend more than you took in, and you continued to borrow from Peter to pay Paul, and continued to borrow more to pay interest on the money that you borrowed. Where would you end up?

Mr. STAHL. Why, I would end up broke and, of course, in the first place, I am saying this to you, that I do not think that second and third bank you are talking about would lend me the money, and certainly they would not permit me to charge it to my children and grandchildren, I am sure of that.

Senator GORE. Well, with the present deficit are we not already borrowing the money to pay the interest on the debt we owe?

Mr. STAHL. Regrettably, yes; and that is what I would like to see halted immediately. The only way in the world you can do it is to, first of all, reduce Federal spending. Then, if we can get back to a balanced budget, with enough money left over from expenditures to pay something on the debt, then I think we will be in a sound position in this country.

Senator GORE. Well, whatever happened to that Keynesian theory that has been popular for the last few years to the effect that when the profits and income of the country are at a very high level we should pay something on our national debt, but when our economy slips into a recession then, perhaps, it is necessary to spend some money to improve community and public facilities in order to provide employment for people? Has that been forgotten?

Mr. STAHL. Apparently it has. And, may I say, sir, I have never subscribed to that theory.

Senator GORE. Do you take the position that taxes have one purpose, and one alone, the raising of revenue?

Mr. STAHL. The raising of revenue to finance the proper functions of government at Federal, State, and local levels.

Senator GORE. You do not think then that taxes should be levied for any economic, social, or political purpose other than raising the necessary revenue to meet the obligations of the Government?

Mr. STAHL. That is correct.

Senator GORE. Is that puritanical economics?

Mr. STAHL. I suppose you might classify it as that, Senator, yes.

Senator GORE. No, I am not classifying it.

Mr. STAHL. Well, I would classify it as such, yes.

Senator GORE. Do you think this viewpoint of yours prevails in the Department of the Treasury of the United States?

Mr. STAHL. I certainly do not at the present time.

Senator GORE. I gather from your statement that you think that this bill deserves careful consideration, and that the public interest requires this committee to give it careful consideration?

Mr. STAHL. I certainly do; yes, sir.

Senator GORE. Did you ask to testify on this bill?

Mr. STAHL. I did.

Senator GORE. In doing so, I suppose you were well aware of the constitutional right of the people to petition the Congress?

Mr. STAHL. That is correct.

Senator GORE. Thank you, Mr. Chairman.

Mr. STAHL. I might say to you, Senator, I have here, or we have received in our office, more than 1,000 letters from citizens from all over this country. Very few of these letters are on engraved stationery. I sent out a digest of the statement I was going to make to the members of the union and to the members of the expenditures council, and to this day we have not yet had one letter of disapproval of this

statement; and these, as I say, these letters have come in from approximately 40 States, and they are from just the plain, common, ordinary American people.

Senator GORE. Now, since in the course of this hearing I have made certain of my economic and political views known, to the criticism of some, I would like to make it plain that I do consider a planned deficit to provide a tax reduction, and a planned deficit for the purpose of developing our natural resources and making appropriate capital investments, two entirely different matters.

Please understand, and I want the record to show, that I think there are times when taxes should be used for purposes other than the raising of revenue. On that point you and I are in disagreement.

I think there are times when the Government of the United States can, and should stimulate the public sector of our economy, indeed when the public interest requires stimulation of the public sector of our economy. Right now, the pent-up need of our economy is principally in the public sector—education, schools, highways, hospitals, navigation, irrigation projects, reclamation projects in communities in your State and in others, research on cancer, health, technological improvements. These, all I have named, are in the public sector of our economy. I do not attempt here extemporaneously to provide a catalog of the pent-up needs of our society, but at least these are some.

Do you think this proposed bill would in any way stimulate research to find a cure for cancer?

Mr. STAHL. I certainly can see no evidence in this bill that it would, sir.

Senator GORE. Now, let me come back a moment to the question of investing in income-producing facilities. I think our great highway improvement program now underway will be vastly stimulative of the private sector of the economy, not only in the provision of employment opportunities in the manufacture of materials for concrete, steel, aggregate and other materials used, and construction machinery, but also in providing jobs in the actual construction, which, of course, is done by privately owned construction companies. And over and beyond that, when we improve the transportation facilities of the country we stimulate the economy of the country. Now, this is one type of public function which, in times of recession, I think we could properly undertake—we could accelerate.

During the previous administration, members of this committee will recall and, perhaps, you may recall, I supported former President Eisenhower in accelerating the highway program, in accelerating public works, hydroelectric dams for irrigation projects which increased the income of people who, in turn, pay more taxes.

So this is what I mean, these are some examples of what I mean, when I refer to making an investment in natural resource development or in appropriate capital facilities.

I think this would be one kind of a deficit. This would be a positive deficit. This would be a constructive deficit.

But to borrow money and increase the national debt merely to give tax reduction and thus increase the deficit and increase the cost of interest in carrying the public debt is an entirely different matter.

Now, although you say you think taxation should be confined to the primary purpose of raising revenue—and that, I believe, is your

view—if we are to use fiscal policy for economic and social purposes, would you think the more constructive, the more advisable course would be to plan the deficit for improving the capital facilities of our communities and the Nation, or for giving tax reduction?

Mr. STAHL. Senator, let me say this to you——

Senator GORE. I am asking you to choose between theories neither of which you endorse, I understand.

Mr. STAHL. Senator——

Senator GORE. Maybe you do in part.

Mr. STAHL. Senator, let me say this to you: There certainly is room for disagreement between the two of us or between anyone with regard to what are the proper functions of government.

My point is simply this: If you decide, Congress in its judgment decides, that any one of these programs which are mentioned in this statement or any others are necessary, well, then, in this time, in this period of prosperity, let us have the courage to raise the taxes, to levy the taxes, necessary to finance those programs rather than to charge them to our children. That is what I am complaining about.

Senator GORE. Well, now, the highway system is under construction and, as it is being completed, there will be more use of automobiles and trucks.

Mr. STAHL. That is right.

Senator GORE. And they, in turn, will use more gasoline and oil produced from the wells of Oklahoma and other States.

Do you think it would be just as sound for the Congress, instead of passing this bill, to repeal all of the user taxes on gasoline, oil, diesel fuel, all kinds of fuels and lubricants, the excise taxes on automobiles and tires—if we took all the highway user taxes off, would it not stimulate the economy? Would that not make available more money to go into the spending stream?

Mr. STAHL. I do not think so, Senator, and I have no——

Senator GORE. I have asked you several questions. Let me put them one at a time. I do not want to put you at a disadvantage nor do I want you to give me an incorrect answer. I might assume that you were answering one question when you were, in fact, giving an answer to another. I should not have asked you so many of them.

Let me begin this way: What is the Federal gasoline tax, 4 cents? If we repeal the 4-cent gasoline tax, wouldn't that give every man who drives a pickup truck, livestock truck, trailer truck, or automobile more money to spend for something else?

Mr. STAHL. Certainly it would.

Senator GORE. Would not that be just as stimulative, insofar as it goes in dollar amount—say, to $1 billion—would not that be just as stimulative of the economy as any of the reductions proposed in the pending bill?

Mr. STAHL. No. I do not think so because, first of all, I have no quarrel with the Federal highway program. I think it is necessary.

Senator GORE. Well, Mr. Stahl——

Mr. STAHL. Now, wait a minute. But you are raising the taxes to do it.

Senator GORE. What I am asking you is this: Let us assume there is a $1 billion tax reduction proposed in the pending bill. If we assume that this $1 billion in tax reduction is going to stimulate the

economy, place more money in the hands of the people to spend, and thus stimulate the economy, couldn't you say identically the same thing about taking off $1 billion of the taxes now levied on highway users?

Mr. STAHL. I do not think you could, sir; no.

My point there, Senator, is simply this: I mean if you were to eliminate the Federal tax on gasoline, tires, and so on, on which you are financing this Federal highway system, if you eliminated those taxes would you close down that program?

Senator GORE. Well, with a deficit in the trust fund, I think that might be the case. But what I am trying to ask you is a simple hypothetical question. Would a tax reduction on gasoline not put as much extra money in the taxpayers' pockets as a similar reduction in taxes on any other items?

Mr. STAHL. That is probably true, certainly.

Senator GORE. Yes.

Mr. STAHL. Any tax reduction may——

Senator GORE. But you do not think that would be sound?

Mr. STAHL. No, I do not. If you continued with your highway construction program, I do not think it would be sound.

Senator GORE. In the case of the highway program, which was overwhelmingly supported by the automobile industry—it was proposed and advocated by the heads of our big automobile companies. In fact, they advocated borrowing the money to build highways, and they favored increasing taxes to build highways, to build highways in either case. Here we build something useful to the community, whether we pay for it as we go, which I advocated, or whether we borrow money, sell bonds, to build the highways. But if we borrow money to give a tax reduction, I think we have something else entirely. We would have nothing to show for our money.

Mr. STAHL. That is right.

Senator GORE. Highways are an investment in the future of America facilitating the economic growth of America. I do not feel that the borrowing of money to reduce taxes is quite in that category.

Mr. STAHL. I am in complete agreement with you, Senator.

Senator GORE. Thank you, Mr. Chairman.

The CHAIRMAN. Senator Williams?

Senator WILLIAMS. No questions.

The CHAIRMAN. Senator Curtis?

Senator CURTIS. No questions.

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

Mr. STAHL. Thank you, Senator. I will leave these letters.

The CHAIRMAN. Thank you.

The committee will adjourn until 10 o'clock tomorrow morning.

(By direction of the chairman, the following is made a part of the record:)

D.C. RETIRED TEACHERS ASSOCIATION,
Washington, D.C., October 26, 1963.

Hon. HARRY FLOOD BYRD,
Chairman of the Finance Committee,
Senate Office Building, Washington, D.C.

DEAR SENATOR BYRD: It has been the experience of the D.C. Retired Teachers Association that the U.S. Senators have always been very sympathetic toward problems related to teachers and most generous in their considerations. With this in mind we are hopeful that your committee will agree with those provisions of

H.R. 8363, the Revenue Act of 1963, that promise relief in the payment of income taxes to the Internal Revenue Service for people aged 65 years or older.

Specifically we request the following:

(1) The retention of the extra $600 personal exemption for each taxpayer aged 65 years or over.

(2) The provision of a minimum standard deduction of $300 which is in addition to the $600 exemption provisions.

(3) The repeal of the existing "floor" on the deductibility of medicine and drugs insofar as that provision relates to persons aged 65 and over.

(4) The increase of the dividend exclusion from $50 to $100.

(5) The retention of the present retirement income credit.

(6) The exclusion from the tax base of any taxpayer aged 65 years or older, of any capital gain attributable to $20,000 of the sales price of his personal residence.

The thoughtful consideration of the Finance Committee to any provisions that will promote the welfare of retired persons, particularly those 65 years of age or older, is earnestly requested.

Yours sincerely,

MARGARET MOORE, *Legislative Chairman.*

(Whereupon, at 11:45 a.m., the committee was in recess, to reconvene at 10 a.m., Friday, November 1, 1963.)

REVENUE ACT OF 1963

FRIDAY, NOVEMBER 1, 1963

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, Douglas, Gore, Talmadge, Williams, Carlson, Bennett, and Dirksen.

Also present: Elizabeth B. Springer, chief clerk.

The CHAIRMAN. The committee will come to order.

The first witness is Mr. Howard B. Dean, of the Association of Stock Exchange Firms.

Mr. Dean, will you come forward, please, sir?

STATEMENT OF HOWARD B. DEAN, OF HARRIS, UPHAM & CO., NEW YORK, N.Y., AND GOVERNOR OF THE ASSOCIATION OF STOCK EXCHANGE FIRMS; ACCOMPANIED BY MILLARD F. WEST, JR., OF AUCHINCLOSS, PARKER & REDPATH; AND FRANCIS J. HUGHES, GENERAL COUNSEL

Mr. DEAN. Mr. Chairman and members of the committee, my name is Howard Dean.

I am a partner in Harris, Upham & Co., a stock brokerage firm having 50 offices located in 21 States. Our firm does no underwriting and its primary concern is transacting business for approximately 100,000 individual customers throughout the country.

I have asked to testify today in my capacity as a governor of the Association of Stock Exchange Firms and as chairman of its legislation committee.

Our association has 38 governors and represents a cross section of the investment business and, consequently a cross section of the American investor. By that I mean we have people on our board who also serve as governors of the New York Stock Exchange, American Stock Exchange, the regional exchanges, and various industry organizations, such as the Investment Bankers Association of America and the National Association of Securities Dealers, Inc.

Periodically, our association holds board meetings in key cities across the Nation, and at these meetings we are afforded an opportunity to exchange ideas with the financial and business leaders and individual investors of each particular area.

We have recently held board meetings in Houston, Richmond, Hartford, and Salt Lake City, and we plan to meet in Boston and

Chicago this winter and spring and probably in New Orleans later in the year.

It was, in fact, at Salt Lake City that our board decided its policy concerning the House version of the administration's tax program, and I was instructed to request an opportunity to appear before this committee to express the thoughts and comments of our membership.

I appreciate your allowing me to be here now.

With me today are Mr. Millard F. West, Jr., a partner of Auchincloss, Parker & Redpath, who is the governor of our association for the District of Columbia, and Mr. Francis J. Hughes, general counsel of the association.

At the outset let me repeat that I am a broker dealing with investors and not a tax expert; therefore, I will attempt to reflect our ideas from an investor's point of view.

Because the association staff and research facilities are limited, we prefer not to comment on all of the provisions of this omnibus tax bill. Rather, we would like to direct our comments to the capital gains and the dividend tax credit and exclusion provisions of H.R. 8363—the areas of immediate, specific concern to the investing public.

In the many Association of Stock Exchange Firms board deliberations on the tax program, the opinion of our 600 members, as reflected in our board meetings, is one of support of the primary purpose of the bill which is to lower tax rates—to reduce barriers to investment and thus stimulate economic growth.

In his 1963 tax message, President Kennedy pointed out the urgent need to solve the unemployment problem and accelerate the growth of the economy. He recognized that tax revision was essential for these goals when he said:

> * * * Our tax system still siphons out of the private economy too large a share of personal and business purchasing power and reduces the incentive for risk, investment, and effort—thereby aborting our recoveries and stifling our national growth rate.

Secretary of the Treasury Douglas Dillon, expanded on this statement at a later date when he testified:

> * * * But no job creating action that the Government may taken can be as effective as action to release the pent-up energies of our private economy by removing the restraints imposed by our repressive tax rate structure. This will restore incentives for risk taking, initiative, and extra effort—incentives that have been held in check in recent years.

I would like to assure the committee that the association and, in my opinion the securities industry and shareowners, are in complete accord with these statements. If our economy is to prosper and grow, some of the investment barriers presently inhibiting the free enterprise system must be lowered or removed entirely.

Incentives for risk taking, initiative, and extra effort undoubtedly will be encouraged by the proposed reduction in the corporate and individual tax rate structure.

With respect to the taxation of capital gains, the House Ways and Means Committee, after profound consideration, saw fit to retain the present provisions on capital gains and to set up a new capital gains category. Under this provision, only 40 percent of the gain on assets held for 2 years or more will be includible in taxable income, with an alternate maximum rate of 21 percent.

In our estimation, this decision to lower the inclusion rate from 50 percent was a sound one and quite in keeping with the administration's statements quoted above. The securities industry has long advocated a cut in the effective capital gains tax rate as a means of unlocking vast amounts of capital and increasing tax revenues.

The association fully supports this proposal and the proposal to have an indefinite carryover of unused capital losses. There is no question in our minds that these changes in the capital gains area are sound steps in the direction of encouraging the investment and mobility of capital.

Ever since the 4-percent dividend credit and $50 dividend exclusion were adopted as modest initial steps in relieving the double tax on corporate earnings distributed as dividends, the association has had a consistent and continuing interest in encouraging an increase in these relief provisions. We have testified before this committee and before the House Ways and Means Committee in the past when these provisions were instituted and whenever efforts were made to eliminate or reduce this modest relief.

The present bill proposes to increase the dividend exclusion from $50 to $100. This by itself is a most welcome recognition that double taxation does exist and should be eliminated. Unfortunately, the legislation under consideration proposes to phase out the 4-percent dividend tax credit—the other half of the original, Congress-approved package—over a period of 2 years.

After taking such positive steps with respect to capital gains and the dividend exclusion—steps that will encourage investment incentives—we are at a loss to understand why the administration takes an opposite tack with respect to the 4-percent dividend tax credit. In testimony by other witnesses, it has been indicated that an increase in exclusion will eliminate double taxation for an additional group of shareowners. Though this is true, it must be recognized that elimination of the 4-percent tax credit will increase double taxation on dividend income for a great many middle-income taxpayers.

It must also be kept in mind that in the credit-exclusion package, the tax credit of 4 percent gave the same percentage of relief to all investors.

The $50 exclusion was designed to provide additional relief to small investors—as a supplement to the basic credit. We believe that the credit also helps the smaller investor more than the larger one. Regardless of which side one takes on this issue, the fact remains that corporate earnings distributed as dividends are subject to double taxation.

It is also clear that the 4-percent tax credit and $50 exclusion provide some relief from this double taxation. It would, therefore, seem to follow that if the tax credit and exclusion were increased to a point which would completely eliminate double taxation, a good deal of money would be made available to the investing public, which money would be available to help stimulate and encourage equity investment.

I have been glancing through some of the statements that have been presented to this committee in the past few weeks and find that many witnesses, as individuals, or speaking for groups representing farmers, retail store owners, and manufacturers of various products, have commented favorably with respect to retaining the 4-percent dividend tax

credit—and even increasing it. I understand that Mr. Keith Funston was down here last Friday on behalf of the New York Stock Exchange and made a thorough presentation on this subject. The association takes the same posture with respect to the tax credit and exclusion on behalf of its members throughout the country.

It is not my intention to delve into the statistical pros and cons of this question because I feel that the subject has been quite thoroughly covered by Mr. Funston and other witnesses and that statistics and charts on these matters are available from many sources and have already been presented to you gentlemen.

In conclusion, I respectfully urge this committee to give serious consideration to the following recommendations:

1. Approval of the new capital gains category which reduces the effective capital gains rate for certain assets held in excess of 2 years;
2. Approval of the proposed capital loss carryover provision as a boon to small investors with inadequate gains to offset losses;
3. Retention of the 4-percent dividend tax credit as a step toward completely eliminating double taxation on dividends;
4. Approval of the provision increasing the dividend exclusion from $50 to $100.

Again thank you, Mr. Chairman and members of the committee, for granting us this appearance.

If you have any questions, Mr. West, Mr. Hughes, or I will do our best to answer them.

The CHAIRMAN. Thank you very much, Mr. Dean, for what I regard as a very excellent statement.

Senator Douglas.

Senator DOUGLAS. Mr. Dean, you know, of course, that the administration proposed that while on the one hand the capital gains tax would be reduced from 25 to 21 percent, and the included gains would be reduced from a maximum of 50 to a maximum of 40 percent, that on the other hand they proposed the taxation of capital gains at death, when the estate was transmitted to the heirs which at present escapes taxation. The statistical records seem to show that approximately $12 billion of capital gains is transmitted at death, upon which no capital gains tax has been paid or will be paid. The revised proposal of the administration was that in the computation of capital gains, allowance be made for the payment of inheritance taxes, so that if, let's say, the capital gains had been $200,000, and the inheritance taxes $50,000, as I understand it only the $150,000 would be taxed at capital gains rates and then only in the revised proposal of the administration, upon sale and realization.

Now, how do you feel about this? This is one of the large, what I regard as one of the largest, loopholes in our whole tax system, and the taxpayer, the small taxpayers, and the Government, the citizens, probably lose many billions of dollars a year in revenue. This escapes capital gains taxation completely.

Now, the House, as you know, rejected that feature, but put in the feature which you praise.

Now, it would help us very much if you would come out in ringing terms in favor of the original proposal.

Mr. DEAN. Well, my personal feeling on that, Senator—and, as I say, I am not an tax expert—is that perhaps part of the theory behind

the question might be linked more closely with the question of estate and gift taxes, which were perhaps designed to circumvent a complete passing on of inherited capital——

Senator DOUGLAS. But as I understand it, the revised proposal, and Mr. Woodworth can correct me if I am wrong, the revised proposal of the administration was that any inheritance tax paid would be deducted from the capital gains and then the capital gains would only be taxed when realized.

Am I right on that, Mr. Woodworth?

Mr. WOODWORTH. That would be the effect of it, yes.

Senator DOUGLAS. Yes.

Mr. DEAN. In other words, it would just pass on the base.

Senator DOUGLAS. You would not be able to avoid the payment of capital gains by inheritance as now, and we are losing each year now revenue on some $12 billion of capital gains.

Mr. DEAN. I personally would much prefer to see that whole question linked with a review of inheritance and estate and gift tax legislation, rather than with this particular tax bill. The latter's basic purpose is to give tax relief. I really don't feel qualified to go any further than that on the subject.

Senator DOUGLAS. I wish you would consider it, because it is very important.

Capital gains realized during one's lifetime are taxed, and very frequently, I think what is really income, which is properly subject to personal income taxes, is disguised as a capital gains and this is true of corporations as well as of individuals.

But even so, then on inheritance there is no taxation of capital gains, and the proposal of the administration, the revised proposal, that is, that any inheritance tax paid should be deducted from capital gains realized would seem to me to be most eminently fair.

Now this, as I say, is one of the biggest loopholes in our whole tax system. One of the troubles is that no one comes in or very few people come in to propose we close any of those loopholes but approve every measure that either creates new ones or widens those already in existence.

That is all, Mr. Chairman, so far as I am concerned.

The CHAIRMAN. Senator Williams?

Senator WILLIAMS. Mr. Dean, only one comment or perhaps the staff can clarify your earlier answer.

It is my understanding that this revised proposal of the Treasury Department was only made in the spirit of compromise and that they are still standing on their original objective, that is, full capital gains paid on unrealized income at death and the regular inheritance tax on the remainder. I would like to ask the staff if I am correct in that—that the Treasury has never retreated from their original proposal but only accepted this latter suggestion as a spirit of temporary compromise.

Mr. WOODWORTH. It is my understanding that the Treasury has not withdrawn the original proposal, but indicated to the Committee on Ways and Means its willingness to go along with the proposal Senator Douglas described.

Senator DOUGLAS. In the same spirit of compromise I would be willing to go along with it, too.

Senator WILLIAMS. Well, I have heard of people getting in trouble by compromising positions. [Laughter.]

Senator DOUGLAS. If this principle is right, there is nothing to fear. Why shouldn't capital gains be taxed?

Senator WILLIAMS. Under the law when a person leaves an estate the inheritance tax goes as high as 70 percent and the full value of that estate is taxed on these present rates, which run as high as 70 percent. It would leave in some instances 30 percent of the estate, and then if the administration's proposal were put through, as they have requested, there would first be a 25 percent tax and then a 70 percent on the remaining 75 percent. It does seem to me that the administration did make a rather far-fetched proposal.

As their proposal came down first they did not even take into consideration the extension of the $60,000 exemption, which would mean that if the small property owner, for instance, an elderly couple, 50 years ago had a $10,000 farm that is worth $50,000 today died it would still be subject to a capital gains tax on the $40,000.

I think the Treasury Department in their original proposal did make rather far-sweeping suggestions in the changing of tax rates for estates.

Senator DOUGLAS. John, if you will forgive me, I made it perfectly clear I was discussing the revised proposal. I said the revised proposal a half dozen times.

Senator WILLIAMS. I wasn't speaking of Senator Douglas' position but speaking of the Treasury Department position now.

I understand your position. But I am speaking of the Treasury Department's original proposal.

Senator DOUGLAS. Don't they have a right to change their minds, too?

Senator WILLIAMS. Oh, sure. I hope they change it some more.

That is all.

Senator DOUGLAS. That is all I have.

The CHAIRMAN. Senator Gore?

Senator GORE. No questions.

The CHAIRMAN. Senator Carlson?

Senator CARLSON. Mr. Dean, I notice you start your statement here you rather infer that your association represents a cross section of the security business, that you are speaking for the industry.

How large or how general is your association? How large is the organization?

Mr. DEAN. Perhaps I should have elaborated a little bit more in my statement.

On our board are men who serve as governors of the New York Stock Exchange, American Stock Exchange, National Association of Securities Dealers, the regional exchanges, and so on and throughout the country each governor has a district for which he is responsible. It may include part of a State or two or three or more States. Before we have our regional meetings, which are approximately quarterly, each governor will pull together the members of his particular area and they will have a lengthy discussion, at perhaps the business office of the governor or some other focal point, to discuss the important problems of the day.

At the present moment, we think this tax bill is the most important problem. Before we went to Salt Lake City, we appraised each of

our regional governors on the issues that were before us, not only the tax bill but internal problems and other questions that might affect the entire securities industry. They then had regional meetings of their own, and subsequently we all got together in Salt Lake City and decided what position we wanted to take on the various problems.

The idea is really basically a question of keeping appraised of what the people throughout the country want, from the investor point of view, rather than just the New York City or Wall Street viewpoint—to try to get a cross section of every area. As you gentlemen know, the growth of the stockholder total in this country has been tremendous, not only in numbers but regionally, including places that never heard of the stock market before; some of the people in those communities became interested.

That, I would think, would be the primary purpose of this association, and would also perhaps give you an idea of why we think we can speak for a pretty good cross section of this industry.

Senator CARLSON. I am personally familiar with your offices in Wichita, Kans., and Kansas City, and I know it gives these people an opportunity to meet and discuss some of the problems that you have been discussing this morning. I appreciate it very much.

Mr. DEAN. Thank you.

Senator CARLSON. That is all, Mr. Chairman.

The CHAIRMAN. Senator Talmadge.

Senator TALMADGE. No questions.

Senator BENNETT. No questions.

The CHAIRMAN. Senator Dirksen?

Senator DIRKSEN. Mr. Dean, what has been the experience of your association and your member companies, with respect to the advent of so many little people into the market? That has been one of the phenomena of the last 4 or 5 years.

Mr. DEAN. Well, it certainly has, Senator. It has been quite a revelation to all of us. I think the association has tried to make people more familiar with the technicalities, the mechanics, the underlying purpose of the stock market.

Certainly, when we go to these various cities, we make a tremendous effort to include all of the business leaders of the community. We have dinners, we will have two or three luncheons, we have open meetings, and we have panels in which we try to get a governor of our association to represent each segment of this business, so that the people can come in and learn just exactly what is going on.

In turn, the business leaders of the area may go back to perhaps their home company, which may have a great many shareholders, and relay the basic information we have provided.

This question of investment clubs has risen to a point where people are getting together at every opportunity—during lunch hour and so on—to discuss their investments. We have tried to disseminate much of the information that is prepared for us by the New York Stock Exchange, so that the public will know what is going on, and will understand a little bit more about the so-called mystery of the stock market.

Senator DIRKSEN. About 2 years ago, one of the local brokerage firms advertised a lecture by a stock market expert. I was curious enough, having been invited to go down and see what it was all about,

and the place was packed and, incidentally, this fellow gave a pretty good account of himself.

Has that got to be a common practice now in listening to experts around the country?

Mr. DEAN. It certainly has; I would like to defer there to Mr. West, who has had perhaps more experience than I have.

Mr. WEST. I would say particularly, Senator, perhaps in the Washington area, that it really is. This trend started 4 or 5 years ago. Today, many firms, including our firm, will have a lecture course, and we find that the response is equally as great today as it was when we started this some years ago, and that the appetite of the public is quite insatiable in trying to learn something about the stock exchange.

It also seems to me that the association, through its publications and through its manual for registered representatives, who are our salesmen, outline in great detail the responsibilities of these men. And the association performs unusually valuable service by making these men who contact the public conscious of the regulations, and of their very definite responsibilities to the public.

I think this affords the public tremendous protection against unscrupulous activities, which we certainly did see on the part of some small firms in this area in the past several years.

Senator DIRKSEN. Mr. Dean, when Mr. Funston was before the committee, I made an off-the-top-of-the-head suggestion about the possibility of a compromise—namely, to preserve the dividend credit and the exclusion, and find some appropriate cutoff place.

That, of course, does not met your contention that, in principle, the tax—any tax—on dividends, already taxed at the corporate level, constitutes double taxation; but we deal with a very practical problem here on Capitol Hill, and wondered whether you had any observations with respect to such a proposal.

Mr. DEAN. Well, we have discussed that proposal, Senator. I think it is a very interesting thought. It is something that, frankly, had never occurred to us before. I don't know what the monetary aspects of it would be, and I understand that the committee staff is going to look into its; but certainly the association would welcome anything that would provide relief or be a step forward, if you will, along these lines. And I would think, when the study is completed, why, we would certainly would want to take that up and look into it. It is very interesting.

Senator DIRKSEN. That is all, Mr. Chairman.

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

Mr. DEAN. Thank you.

The CHAIRMAN. The next witness is Mr. J. Sinclair Armstrong, of the U.S. Trust Co. of New York.

Senator DIRKSEN. Mr. Chairman, may I extend a personal greeting to Mr. Armstrong as former chief of the Securities and Exchange Commission, and, in my book, a very outstanding public servant.

Senator DOUGLAS. Mr. Chairman, may I say Mr. Armstrong was for many years a distinguished member of the Illinois bar. And he gave good service here in Washington. As in so many other cases, as his ability became known he was drafted to the East, to replete or to replace the somewhat effete and worn-out bloodstream of the east-

ern financial sections, so that he has imparted some Middle Western vitality to Wall Street and we are very glad to welcome him here.

I hope for the sake of the State he will come back to Illinois, although I am not so certain from the standpoint of my political future that I should welcome him. [Laughter.]

The CHAIRMAN. I would like to say the Chair agrees with everything that has been said at this time.

STATEMENT OF J. SINCLAIR ARMSTRONG, U.S. TRUST CO. OF NEW YORK

Mr. ARMSTRONG. Mr. Chairman and Senators, I am exceedingly grateful for the very kind observations which the two Senators from my State, if I may call it my State, have given, and also your gracious welcome.

I am exceedingly proud of my years in Illinois, and I am very grateful for the wonderful support that I had while I was in official life from the Senators from Illinois.

The CHAIRMAN. You may proceed, sir.

Mr. ARMSTRONG. Mr. Chairman and Senators, my name is J. Sinclair Armstrong. My home is at 211 East 18th Street, New York City, and I am executive vice president of the U.S. Trust Co. of New York, 45 Wall Street, New York City.

My colleagues at the Trust Co. and I very much appreciate the opportunity afforded me to express our views on H.R. 8363, the tax reduction bill now before you.

As one who in earlier official capacity frequently testified before other committees of the Senate, it gives me great pleasure to appear before the Committee on Finance.

The U.S. Trust Co. of New York, a banking institution chartered by the New York Legislature in 1953, has specialized for 110 years in trusts and investment management for individuals, members of families, and religious, educational, and charitable institutions of all kinds, and for pension and retirement funds of corporations, employee associations, and labor unions, and a number of public authorities, including the State of New York. We and our customers, as do all Americans, have a great stake in your deliberations on H.R. 8363.

In the interests of conserving your very important time this statement will be brief. I will touch upon the major points as we see them affecting the broad national interest, and then upon two substantive provisions of the bill which we suggest be changed.

Our effort will be to be as helpful to the committee as we can, but not to burden you or unduly lengthen your record, as our views, in extensive form, on many aspects of the President's original tax proposals have already been placed before the House Ways and Means Committee.

TAX REDUCTION THIS YEAR IS URGENTLY NEEDED IN THE NATIONAL INTEREST

At the outset, let me say that our chairman, Mr. Hoyt Ammidon, who testified before the House Committee, and my colleagues, Mr. Frederick N. Goodrich and Mr. Helmut Andresen, whose papers on the economic and technical aspects of the President's proposals were

submitted to the House, asked me to express to the committee their vital interest in the bill now before you, and our strong recommendation that it be favorably reported by your committee and passed by the Senate. We suggest several amendments, but with or without them, this bill should be passed.

We believe that the enactment—this year—of tax reduction is in the national interest and is urgently needed if the economy is to proceed at a pace to provide the jobs, the goods and services, and the national defense and welfare which the American people require and are capable of achieving.

STRUCTURAL CHANGES AND REFORMS IN THIS BILL ARE GENERALLY ACCEPTABLE—OTHERS CAN WAIT TILL LATER STUDY BY THE CONGRESS

There are many aspects of this bill that one or another group or interest has praised and many aspects that have been attacked. There has been criticism of the administration and the Congress for not rushing through tax reduction regardless of the need for structural changes.

Others have attacked the administration and the Congress for compromising on some of the original reform proposals, for not holding out for them at all costs.

And many have felt that tax reduction should be directly tied to the President's budget estimates to be submitted in January 1964.

Mr. Chairman, we think these arguments are all beside the point at this stage. The administration had several years to consider, in the Treasury's ivory tower, every possible kind of alleged reform, and the Treasury has sent many such proposals to the Congress.

The Ways and Means Committee, in that congressional process which we believe to be the most essential safeguard of the liberties of our people, studied them all carefully, debated, listened to official and private citizens' views, and then decided by careful voting what the provisions of the bill before the House should be, and the House resoundingly passed it.

Some people have expressed disappointment that this bill really does not simplify the tax structure, indeed in some respect its makes it even more complicated.

The failure here is to realize that each of the provisions of the tax laws represents some carefully considered decision by the Congress. These are not lightly to be swept away. And so long as rates, dictated by revenue needs, are high and steep, and in this bill they remain high and steep, the ameliorating provisions—exemptions, deductions, exclusions—all for important purposes—sickness, old age, medicine, pension, State and local taxes, contributions—must be kept in the law if the system is to have equity at all.

So we ourselves are not disheartened by this bill's failure to simplify the tax structure. And, without commenting on them specifically, we think many of the structural changes in this bill are good and in the public interest.

Nor is this by any means the last time that reforms will be before the Congress. It would be a tragedy to hold this bill up because of failure to contain some reform provisions that some group or another wanted.

THE PRESIDENT'S POSITIONS ON THE NEED FOR TAX REDUCTION AND CONTROL OF EXPENDITURES ARE SOUND

The President has expressed the view that the enactment of this bill is "urgently needed this year." We agree.

The President has also stated that tax reduction must—

> be accompanied by an even tighter rein on Federal expenditures, limiting outlays to only those expenditures that meet strict criteria of national needs.

We accept the President's position on this and take comfort from the constitutional power the Congress has over appropriations to keep future spending in line with revenue.

So we sincerely hope that your committee will report the bill favorably and that the Senate will pass it.

OUR VIEWS ON FIVE MAJOR ASPECTS OF THE BILL

Now, taking the few major points, as we see them, about tax reduction as provided by the bill now before you.

1. TAX REDUCTION FOR INDIVIDUALS IS NEEDED TO STIMULATE CONSUMPTION AND INVESTMENT IN THE PRIVATE SECTOR OF THE ECONOMY

The individual tax reduction provided by this bill will make available to the American people for consumer spending and private investment of the order of $5.64 billion in 1964 and $8.76 billion in 1965 which otherwise would be drained from the private sector of the economy.

It is estimated that over 1 million new jobs will be needed every year, especially with teenagers and young men and women coming out of school and college and ready and willing to work productively.

To provide these, the private sector of the economy must operate at closer to full capacity. The unemployment rate must be brought down below the unacceptably high rates of recent years, still running about 5.5 percent, if America is to achieve the productivity of which she is capable.

And it is only by productivity—by men, women, and our great industrial, agricultural, and scientific plant and resources operating at close to capacity—that real progress in improving our standard of living can be achieved.

2. TAX REDUCTION FOR CORPORATIONS IS NEEDED TO STIMULATE EXPANSION AND MODERNIZATION OF AMERICAN INDUSTRY

The tax reduction provided by this bill will make available to American industry for investment and reinvestment $1.4 billion in 1964 and $2.3 billion in 1965.

This, with the investment credit provided by the Revenue Act of 1962 and the new depreciation guidelines, which are two very constructive steps taken by the Congress and the Treasury, respectively, last year, will release about $4.5 billion for the expansion, modernization, improvement of our industrial capacity. This process is urgently needed if our productive capacity is to keep pace and maintain a competitive position with industry abroad.

8. PRESENT STEEPLY PROGRESSIVE TAX RATES SHOULD BE MODIFIED TO REWARD PRODUCTIVITY AND PROVIDE INCENTIVE

This bill recognizes and attempts to diminish the dragging, the braking, effect on productivity and investment of the steeply progressive tax rates.

These steeply progressive rates of income tax on individual and confiscatory rates of income tax on corporations were imposed during World War II and the Korean war.

Our argument here is not against progressive rates as such. Obviously, some progression is needed if the revenue requirements of the Government are to be met consistently with taxpayers' ability to pay. Rather our belief is that the progression should be easy so as to permit rewards for productivity and effort.

The rates should be an incentive to work and investment. They should not drag and sap the economic life of the Nation by making it simply not worth the candle for people to work hard and risk their capital.

In the truest sense, it has been by our people's hard work seeking reward and the venture of their capital seeking profit that the greatness of our country has been built.

The rates in the bill before you are not perfect. In ranging from 16 percent up to 77 percent in 1964 and 14 percent up to 70 percent in 1965 they are still steeply progressive, but they are an improvement over the present 20 percent up to 91 percent rates.

It is an improvement that under the rates in this bill a single person will not reach the 50-percent tax bracket until his taxable income rises above $20,000 in 1964 and above $22,000 in 1965.

These compare with the $16,000 figure, above which the Government becomes a single person's senior partner under present law.

Yet even with this improvement the rates proposed in this bill still retain the atmosphere of confiscation. Some depressing effect of this on consumption and investment will remain.

The individual rates first proposed by the President were less steeply progressive. But the President proposed a number of Treasury-sponsored reforms, so-called, to broaden the tax base and to recoup some of the revenue to be given up by rate reduction.

We strongly opposed these before the House committee, but, in wisely deleting these, the House attempted to recover some revenue by substituting an upward rates revision. We urge you gentlemen to accept the rates in this bill as reasonable in all the circumstances, and a drastic improvement over present incentive-stifling rates.

Before the House committee, we criticized and questioned the new treatment of the standard deduction and the extra exemption for dependents. It seems to us wrong from the economic and social point of view, and totally inconsistent with the announced objective of broadening the tax base, that 1.5 million more citizens should be granted income tax immunity and have no direct financial responsibility for the Government. It seems to us inequitable that rates, deductions, and exemptions for lower incomes should reduce present tax liability as much as 38 percent while rates in higher brackets should reduce present liability as little as 12 percent.

Yet the great virtues of tax reduction are that it will permit the worker and investor to share more in the fruits of their labor and investment and that it will induce greater productivity.

However the rates in this bill may discriminate in favor of persons with lower incomes and against those with moderate and larger incomes, they are much better all along the line than the rates in the present law.

4. CAPITAL GAINS TAXES SHOULD BE REDUCED TO STIMULATE INVESTMENT AND ENHANCE MOBILITY OF CAPITAL

The bill before you grants a small measure of relief from the debilitating capital gains tax which, by its lock-in effect, restricts capital formation and movement and is uneconomic to begin with as a direct tax on capital.

The provision before you is far better than the original proposal which would have subjected unrealized appreciation at time of gift or death to capital gains tax treatment. It was proposed that such a tax be piled on top of gift and estate taxes.

It seemed to us anomalous that such double taxation of appreciated assets should be included by the Treasury in a bill the avowed purpose of which was to reduce taxes, and the House wisely rejected it. We strongly urge this committee to follow the House line on this.

The Secretary of the Treasury suggested in his testimony that the capital gains provisions of this bill be deleted, leaving the rates where they are now. We urge you not to do this, but to accept the capital gains tax provisions in this bill which the House has approved.

5. GOVERNMENT SPENDING SHOULD BE CAREFULLY CONTROLLED

In broad effect, the tax reduction here proposed must be considered along with other measures for the economic well-being of our country. Taken alone, tax reduction will be no panacea.

(*a*) Conservative fiscal policy is needed: We urge that the Congress follow carefully the declaration by Congress expressed in section I of this bill regarding the use of revenue increases "to eliminate deficits" and "reduce the public debt" and "the importance of taking all reasonable means to restrain Government spending."

The fiscal integrity of the dollar cannot be assured if uncontrolled deficits are condoned. Confidence in the dollar at home and abroad would be destroyed, and on this confidence, which is fortunately still intact, depends our ability to weather the acute balance-of-payments squeeze.

If that is not weathered, the leadership of the United States in world affairs could be greatly damaged. Devaluation and inflation could follow.

So tax reductions, accompanied by conservative fiscal policies, could be a boon. But if tax reduction should prove to be a prelude to out-of-control spending, especially on noneconomic programs, it could be extremely dangerous.

(*b*) Conservative monetary policy is also needed: Similar considerations apply to the need for a conservative monetary policy. Certainly no one could argue, in the face of the huge expansion of private debt, by $500 billion since 1945, and the increase in Federal and local public debt, that the country has not walked on the expansionist monetary side of the street.

Yet the basic misunderstanding still prevails—the belief that easy money, easy credit, can create demand. Indeed, it would seem that there is almost a national fixation about expansionist monetary policy, credit-ease, and low interest rates.

It is not money supply alone that creates demand for goods and services. Rather it is productivity, the productivity of our industrial plant and our working people. An increase in the money supply alone, caused by easy credit and low interest rates, without an increase in the goods and services our people make, cannot increase the standard of living.

Such a money supply increase can only lead to inflation and to reduction of the dollar's real value.

Senator GORE. Mr. Chairman, may I ask a question there?

The CHAIRMAN. Senator Gore.

Senator GORE. You have just said an increase in the money supply alone, caused by easy credit and low interest rates, without an increase in the goods and services our people make cannot increase the standard of living.

You just said earlier that what we need to do is to increase productivity. Why would you conclude that without this, the standard of living is not going to be increased if consumers, whether it is by easier credit policy or whether it is by tax reduction or whether it is by stimulation of the public sector of our economy, if by whatever means people have more money to spend?

Our real problem is idle productive capacity. I don't quite understand how you get around to saying this. This is the very aim of economic stimulation by whatever method, to utilize the productive capacity of the country to provide full employment.

Would you explain yourself?

Mr. ARMSTRONG. Well, I am afraid, Senator Gore, I don't understand your questions, sir.

What I say is that if you increase money suply, if you print a lot of money and there is no increase in goods and services, that there is no increase in the standard of living because there are only the same amount of goods and services that the money can buy.

You have more dollars chasing the same goods, and so——

Senator GORE. Why do you use the term "print a lot of money?"

Mr. ARMSTRONG. I use the term "print a lot of money" because this is the classic concept we are speaking about.

Senator GORE. Is it your classic concept or just whose is it?

Mr. ARMSTRONG. I am not a classical economist. I am speaking about the classical concept of printing money such as was done at the time of the French Revolution. You have the same goods and services and an awful lot more money and it doesn't increase the standard of living of the people.

Senator GORE. So you are not talking about the printing of money here which goes on 24 hours a day?

Mr. ARMSTRONG. No, sir; of course not.

Senator GORE. You are talking about the French Revolution.

Mr. ARMSTRONG. I am talking about the concept of printing press money. They have the same thing going on in Brazil right now. They have got many, many more cruzeiros chasing the same goods and services.

Senator GORE. Will you define that term "printing press money."

Mr. ARMSTRONG. Printing press money is money that is not backed by some reserves.

Senator GORE. Do you know of any law by which such could occur in the United States?

Mr. ARMSTRONG. At the present time I do not believe that there is a law.

I believe the law that provided for the 300 million, I think, of the $2 bills, that issue was terminated, was it not?

Senator GORE. I am not sure.

Mr. ARMSTRONG. I have forgotten whether that law is still in effect. It provided for an issue of 300 million of $2 bills.

Senator GORE. So you are really not sure whether this term you are using is possible of implementation under the law today?

Mr. ARMSTRONG. I am perfectly clear that the law provides for reserves for the American currency, sir, but this has to do with the whole Federal Reserve mechanism of the Reserve System, the banking system, and the creation of deposits.

Senator GORE. Do you know of anyone who has advocated printing press money?

Mr. ARMSTRONG. Not at the present time, no; not printing press money. We are talking here, sir, about easy credit.

Senator DOUGLAS. Mr. Armstrong, I have here a $20 Federal Reserve System bill and I give that to you and ask you if that is printing press money?

Mr. ARMSTRONG. Oh, no, sir.

Senator DOUGLAS. Wait a minute.

Mr. ARMSTRONG. Because it is backed by the Federal Reserve, 25 percent gold. I believe that requirement is still the law, Senator, is it not?

Senator DOUGLAS. You see there in fine print, your eyes are probably better than mine.

Mr. ARMSTRONG. I am afraid they are not.

Senator DOUGLAS. "This note is legal tender for all debts, public and private, and is redeemable in lawful money at the U.S. Treasury or any Federal Reserve Bank."

Now, suppose you were to present this at the Federal Reserve or at the U.S. Treasury, and ask for gold, would you be able to get it?

Mr. ARMSTRONG. No, sir.

Senator DOUGLAS. Then, it is not redeemable, is it?

Mr. ARMSTRONG. No, sir, it is not redeemable in gold.

Senator DOUGLAS. Then is it printing press money?

Mr. ARMSTRONG. Sir, I believe not, because—not in the sense that the phrase has been used in this discussion.

Senator DOUGLAS. You mean it is good printing press money?

Mr. ARMSTRONG. Sir?

Senator DOUGLAS. You mean it is good printing press money? What is the distinction between good printing press money and bad printing press money?

Mr. ARMSTRONG. No, I am not making such a distinction here, Senator Douglas. What I am talking about here is the increase of credit and the enforced extension of credit through an easy monetary policy, that is what I am talking about here.

Senator DOUGLAS. I think the Senator from Tennessee is correct in saying that the term "printing press money" is very loosely used. The point is that the Federal Reserve notes of the country which amount to about $30 billion, I think, are not redeemable in gold. There is some silver there rapidly being depleted, but if any considerable amount was presented for redemption, it could not be redeemed in silver.

What happens, and I have asked Mr. Martin about this many times, I solemnly hand him a Federal Reserve note on the Bank of Richmond and he hands me a Federal Reserve note in equal denomination on the Bank of New York or I will try to give him one on the Bank of Philadelphia and he will give me one on the Bank of Richmond.

But that is pure hocus-pocus. We might as well recognize the fact that we have a managed internal currency, and the only way gold is used is in our foreign exchange. We have the gold exchange standard for foreign exchange, but the internal currency is not redeemable in gold.

Now various proposals were made, but when the Eisenhower administration came in they quickly backed away from that one.

Senator GORE. Well, I shouldn't interrupt——

Senator DOUGLAS. That is all right, because I interrupted you.

Senator GORE. I should not have asked to interrupt the statement of the Senator, Mr. Chairman, but when these prejudicial terms are used so loosely, and apparently without appropriate application, I sometimes feel the necessity of calling a halt. Every time someone advocates a monetary policy equal to the growing needs of our country, he is immediately branded as an advocate of printing press money.

As the Senator from Illinois has said, we have a managed currency. We left the gold standard many years ago. I don't complain that we have a managed currency, but the currency supply, as you well know, is only a part of the money supply.

In a very real way, you and I when we write our personal checks are putting money into circulation.

Mr. ARMSTRONG. Oh, yes, sir; the money supply includes deposits.

Senator GORE. This country moves, this whole economy moves, on credit.

Mr. ARMSTRONG. That is right.

Senator GORE. And interest rates can be artificially high or artificially low. The word "artificially" is sometimes prejudicially used to condemn interest rates that are at a reasonable level.

As a matter of fact, the interest rate structure is determined largely by the actions of the Government itself, in its relationship to the private sector of our economy. Government policy can deliberately raise interest rates, and this has been consciously done while low interest rates are the publicly announced policy of the administration.

Now, Secretary Dillon says, with the passage of this bill, long-term interest rates will rise.

Now, a Government program could just as consciously and just as determinedly and just as effectively have lower interest rates as an objective.

What I am trying to say is that the money supply and interest rates are a matter of governmental monetary policy, and I doubt if either you or I contribute to the erudition of the discussion by loosely using these prejudicial terms.

I am sorry that I interrupted your statement. I am following it with great interest.

Mr. ARMSTRONG. Senator Gore, let me assure you I have no intention to use a prejudicial term loosely or in any other way. Such is not my intention and if the words "printing press money" offend you, I apologize for it. But what I am talking about here——

Senator GORE. I am not offended.

Mr. ARMSTRONG (continuing). Is monetary policy, and the question is should the monetary policy of this country be conducted in a very expansionist, very easy money, very low interest rate way, and what I am suggesting to you, sir, is that in our opinion, for whatever it is worth, and I am not saying that it is worth any more than any private citizen who has studied this problem and come to his own conclusions, that is all it is worth, in our opinion, it is contrary to the best interests of our country to have an expansionist policy, credit ease, which contributes to a very, very expanded supply of money in the aggregate, that is to say currency, deposits and all the rest of it, at a time when there isn't the correlative production of goods, the expansion of capital facilities, the production of goods which in turn is accompanied by the creation of jobs, and the employment of the people.

Take, for example—perhaps this would put in context what we are trying to develop—we think we have a very, very high standard of living in this country, sir, and we do, compared with other countries in the world. We are fortunate and we are blessed. But take an average of all the people in this country, take an average income that they have, how much better it would be if this could be raised and increased. What would a family of four people, let's say, having $7,500 be able to do if they had more, if they had better housing, if they had better school facilities. But just to create the additional money to give them, say, $8,500 a year, without on the other side creating the schools, creating all of the medical facilities and the things of this kind, if the money comes without the production then it doesn't produce a higher standard of living.

That, sir, is the point I was trying to bring out by this discussion which may be very inadequate and if it is, I am sorry.

Senator GORE. Well, you express your views quite well and I respect your views. I take it you and I would agree that the law of supply and demand operates with respect to credit as with any other element in our economy?

Mr. ARMSTRONG. Oh, yes, sir; indeed it does.

Senator GORE. Now, if we have a growing economy, a growing national product, growing population, do you not think that it would be necessary to have an increase in the availability of credit and money supply?

Mr. ARMSTRONG. Oh, yes, absolutely.

Senator GORE. Equal to that?

Mr. ARMSTRONG. Oh, yes, absolutely.

Senator GORE. I think you and I agree. All I have ever advocated along this line is that the monetary policy be commensurate with the necessary growth of our economy. That is all I have ever advocated.

Mr. ARMSTRONG. I think we are in complete agreement on that, Senator Gore.

Senator GORE. But the present policy is not that. The present policy is to use monetary policy as a repressant, and now you advocate also

that the expenditure side of the Government be repressed, but you want to cut taxes.

These are the three principal ways in which our economy, according to an agreement which Secretary Dillon and I arrived at, can be stimulated. You advocate repressing the economy with two of the three and stimulating it with one of the three.

Now, I think that I could make a good argument that what you advocate is not an expansionary policy, not a policy which would bring about an increased rate of growth, but rather a repressive one. You could make one perhaps equally convincing to yourself, that what you advocate is expansionary. It would seem doubtful to me.

Mr. ARMSTRONG. Senator, perhaps there is a difference of opinion——

Senator GORE. Would you excuse me?

Mr. ARMSTRONG. Yes, sir; I will, of course.

Senator GORE. I have an important call.

Mr. ARMSTRONG. I would just hate to have the record seem as though I am advocating any repressive policies. I certainly am not referring to that. But there is obviously a discussion here whether it is in the private or the public sector.

Senator GORE. Will you excuse me?

Mr. ARMSTRONG. Thank you.

Senator GORE. By the time you finish your statement I will be back.

Mr. ARMSTRONG. Yes, sir.

Senator DIRKSEN. Mr. Chairman, while Senator Gore is gone Mr. Armstrong mentioned Brazil, and the undulating value of the cruzeiro. I wish you would say a little bit more about it.

Mr. ARMSTRONG. Well, Senator, I am not an expert on that or any other subject, but I understand from what I read in the papers and from what other bankers who have affairs in South America tell me, that this is a very acute and drastic and debilitating situation going on, and this is printing press money. This is just rolling off the printing presses 24 hours a day.

I have, if one may get from the generalities to the specific, I have a friend who works in one of the international departments who was down in Brazil for several years, and in the purchase of a small automobile for his family use he paid $900—the equivalent in cruzeiros of $900—and 3 months later he was transferred to the United States; he sold it for $1,200, the same dollar value but, that is to say, he sold it for an equivalent of $900—but with multiple times three—plus one-third—in cruzeiros.

In other words, the cruzeiro had depreciated by a third in 3 months in respect to this automobile. This was not a new automobile, so we don't have that dealer factor in it. Well, this is the kind of thing that just makes it impossible for any economic system to work well, Senator Dirksen.

Senator DIRKSEN. Now, Brazil is a country of 70 million. You don't have to go back to the French Revolution to see the phenomenon of printing press money.

Mr. ARMSTRONG. Yes, sir.

Senator DIRKSEN. In our own time, in a rather substantial country with lots of natural resources.

Mr. ARMSTRONG. I am in full agreement, sir.

Well, Mr. Chairman, shall I proceed with my statement?

The CHAIRMAN. Proceed, sir.

Mr. ARMSTRONG. Shall I proceed with my text?

Since 1945, this process has been going on steadily, at rates between 1½ and 2½ percent a year. I think I should interpolate by saying those figures I am using are from the so-called gross national product deflater. These are published Government figures.

This slow erosion of the purchasing power of the dollar is a drag on the economy and one of the reasons for the economy's failure to utilize manpower and plant to full capacity and achieve satisfactory growth. A conservative monetary policy is urgently needed.

WE SUGGEST TWO AMENDMENTS

1. THE DIVIDEND RECEIVED CREDIT SHOULD NOT BE REPEALED

We suggest deletion from the bill of the repeal of the dividend received credit. It is unfair and uneconomic, and a depressant to equity capital formation, that earnings are taxed first at the corporate rates and then at the individual rates before they flow through to the investor. The congressional policy established in 1954 reduced to some extent this double taxation of corporate dividends. This bill would now reduce to 2 percent for 1964 and eliminate for 1965 the 4-percent dividend received credit for individuals.

We believe this is a retrogressive step in our national tax policy. It will tend to curtail equity investment.

It is not a complete answer to argue at this point that the dividend exclusion has been raised by the bill from $50 to $100, though we applaud that, as it will give small stockholders a lift. The point is that if double taxation of corporate earnings is unfair and unsound, and we believe it is, the problem is not solved by excluding entirely a small amount of dividend income from taxation.

The dividend received credit should not be repealed. Indeed, we suggest that the committee consider whether the dividend received credit should be raised to 15 percent as was originally contemplated by the Congress in 1954, and whether other suggestions made in recent days to eliminate this double taxation should be adopted.

May I interpolate there, Mr. Chairman, to say I was referring to the suggestion of Senator Dirksen which I had read about in the newspaper and about which he inquired today.

Other suggestions certainly may be appropriately considered by the committee, in our opinion.

2. CONTRIBUTIONS BY EMPLOYERS TO GROUP TERM LIFE INSURANCE FOR EMPLOYEES SHOULD NOT BE ATTRIBUTED TO EMPLOYEES AND TAXED TO THEM AS INCOME

The proposal to attribute to employees and tax them upon premiums paid for group term life insurance purchased by their employers we believe to be entirely contrary to sound tax policy in the field of employee benefits.

For years the Congress has encouraged employers through pension, profit-sharing, and group insurance programs, to supplement, over and above social security benefits, the funds available to workers in their retirement years and to their dependents in case of their early death. Thus employer contributions to pension, profit-sharing, and group term life insurance plans have been deductible as business expense

from gross income of the employer, and the amounts of such employer payments have not been taxed when paid to such plans. Taxes have applied when distributions are made to employees and beneficiaries, as income taxes when pension and profit-sharing plan distributions are made, and as estate taxes when insurance proceeds are distributed.

The Treasury's initial proposal to tax all employer premiums, which we strongly opposed, was changed by the House committee so as to exclude employer premiums for group term life insurance up to $30,000. This is a step in the right direction, but does not go far enough. The amount is too low. If the effort is simply to prevent abuse by so-called jumbo coverage, it is much too low.

In the group policy for employees of the U.S. Trust Co. of New York, the company provides coverage of three times earnings for employees of 15 years' service or less and four times earnings for the 15-year-and-more employees. For the former, this $30,000 ceiling hits at the $10,000 salary level, for the latter at $7,500. This is hardly jumbo coverage.

If the committee retains the provision at all, we suggest a much higher exclusion amount, which the committee itself should choose. The amount of the exclusion should be low enough to prevent the jumbo coverage abuse, but high enough so as to maintain intact the congressional policy of encouraging employer provisions for workers in their old age and for their dependents in case of early death.

Another objectionable feature of this provision is that the premium rates to be applied will either be taken from Treasury tables which are weighed heavily against older employees or, if actual cost to the employer is used, that it be attributed to each employee on the basis of his age. This would inject a complex calculation for each employee under each plan and might force the use of the Treasury table.

If this provision is left in the bill at all, we urge that the bill be amended to permit the actual average premium rate for all employees under each individual plan to be used in determining the amounts to be attributed to each employee, regardless of age.

CONCLUSION—WE URGE ENACTMENT OF TAX REDUCTION THIS YEAR

In conclusion, Mr. Chairman and Senators, we urge enactment of tax reduction in 1963. The bill before you, whatever criticisms are made of it by us and others, is basically a good bill, in the national interest. Its effect will be even more advantageous if it is accompanied by sound fiscal and monetary policies.

The best thing about the bill is that it is a start on a course, to use the words of the President of the United States at a talk he delivered in New York City on December 12, 1962, "to reduce the burden on private income and the deterrents to private initiative which are imposed by our present tax system."

So we hope you will report it favorably and soon, and that the Senate will pass it.

Thank you very much.

The CHAIRMAN. Thank you.

Senator Carlson?

Senator CARLSON. No questions.

The CHAIRMAN. Senator Douglas?

Senator DOUGLAS. Mr. Armstrong, I notice you want the tax cut this year.

Mr. ARMSTRONG. Yes, sir.

Senator DOUGLAS. In view of that you say there isn't time to consider tax reform.

Mr. ARMSTRONG. I didn't mean that way, Senator Douglas. I believe that there are many, many provisions of the law which are constantly under scrutiny in the Treasury, and which may be constantly under scrutiny by this committee. My submission is that this bill be passed. This isn't to prohibit or prevent in any way our continuing to discuss reform.

Senator DOUGLAS. Here you say it would be a tragedy to hold this bill up because of failure to contain some reform of provisions that some group or another wanted. Previously you have laid stress on getting the bill passed this year, and on that note you closed your testimony.

May I say I also hope that we can pass tax reduction this year, and some of us made a motion which we thought would result in this, but we were defeated, and we accept the decision. It is now apparent, I think, that there is not going to be a tax cut this year. This committee still has, I believe, a hundred and an undetermined number, somewhere between 110, 115 witnesses yet to be heard. At the rate we are going, for a day, 5 days a week, this will take some 5 to 6 weeks more. The hearings, therefore, will not be terminated until the 10th of December. We have been warned that if the civil rights bill is then on the floor of the Senate, that this committee will not be permitted to meet while the Senate is in session, which means that during the preliminary period of sparring we cannot meet after 12 o'clock and then if we do get down, or when we get down, to round-the-clock sessions not be permitted to meet at all, so in my judgment there is no chance whatsoever of getting the tax bill this year.

I regret this, but I mean it is a fact of life. At the rate we are going it is probably unlikely if we get a tax bill well into the middle of the winter.

Now, in view of that wouldn't we have time for consideration of some tax reforms?

Mr. ARMSTRONG. Senator, I am absolutely in favor of this committee, as I was of the House committee, giving the most careful consideration to this bill and any proposal that is brought along to you by the Treasury or the public witnesses, including the two that we ourselves have made.

As I mentioned, I think I used a phrase that this congressional scrutiny is in my opinion the great preserver of the liberties of the people and nothing that I say derogates from my view that the committee should give this its most careful consideration.

But, Senator, the point is that the economy needs, in our opinion, the additional stimulation that would be provided in the private sector by the tax reduction in the individual and corporate rates and this we believe is urgently in the national interest.

Senator DOUGLAS. I agree with you on this, I agree with you on this. But the bill is going to be held up without questions—is being held up. In view of the fact we are going to have delay, shouldn't we consider

the reforms while we delay or while we consider, perhaps that is a more polite term to use, while we consider it.

The CHAIRMAN. I would like, the chairman would like, to make an answer.

I think that is a very unfair statement made by the Senator, that this bill is being held up. The House took 8 months. It heard more than 200 witnesses. Now, the Senate Finance Committee, if we followed the motion offered by the Senator from Illinois, we, would not have had the pleasure of hearing you today, because he wanted to conclude all the hearings by October 30.

Now, this committee has worked hard on this bill, we have had worthwhile witnesses, we have gotten a great deal of information we otherwise could not have gotten. We have an equal responsibility with the House. It is true that the House initiates revenue legislation, but the Senate has the same responsibility under the Constitution that the House has. Here we have been, we had this bill, we got this bill over here less than 30 days ago and I repeat that the House had 8 months to consider it. It was not sent over here until then, and I think it is very unfair for the Senator from Illinois to say that this bill is being held up.

Mr. ARMSTRONG. Well, sir, I hope that I have identified myself with your views on that subject, because nothing that I said is intended to or does indicate that this committee should give any less consideration to this bill. I believe it should be very, very carefully considered, and as I mentioned, any proposal which members of the Treasury or any other witness wants to make, and we ourselves are very grateful for the opportunity to appear before the Senate Finance Committee, to discuss the bill and how it affects us and our customers, our stockholders and our workers, we are very grateful for that opportunity.

The CHAIRMAN. Thank you, Mr. Armstrong.

Senator DIRKSEN. Mr. Chairman.

You have heard Government described as an old waterlogged scow, our Government particularly. We don't move particularly fast and it doesn't always move very far at one time but it never sinks.

Mr. ARMSTRONG. I agree.

Senator DIRKSEN. Thank you.

Mr. ARMSTRONG. Thank you, Senator Dirksen.

The CHAIRMAN. Mr. Armstrong, I would like to associate myself with you on the "conservative fiscal policy is needed," that heading. I want to see if our interpretations agree. It reads:

> The fiscal integrity of the dollar cannot be assured if uncontrolled deficits are condoned. Confidence in the dollar at home and abroad would be destroyed, and on this confidence which is fortunately still intact depends our ability to weather the acute balance-of-payments squeeze. If that is not weathered the leadership of the United States in world affairs would be greatly damaged. Devaluation and inflation would follow. So tax reduction accompanied by conservative fiscal policies could be a boon. But if tax reduction should prove to be a prelude to uncontrolled spending especially on noneconomic programs it would be extremely dangerous.

I agree with every word of that. But I want to ask you whether you think that the present Federal spending is out of control.

Mr. ARMSTRONG. I am sorry, I didn't hear it.

The CHAIRMAN. I say, is present spending by the Federal Government out of control in view of the fact that our debt has been increased in 10 years by $40 billion, and the interest has been increased by three

billion four? So do we, by this statement, think our spending is out of control, our deficit spending, or not?

Mr. ARMSTRONG. Sir, I do not think it is out of control but I think it is very much higher than it ought to be, and I am very concerned that it could go out of control, very concerned, and I think——

The CHAIRMAN. You are aware of the fact, no doubt, that we have had 3 deficit years, 1961, 1962, 1963, and we have added $15 billion to the debt. You are also aware of the fact that the administration itself, the administration, Secretary Dillon, admits to 3 more deficit years. I think it will be longer than that. Economists have put the balancing of the budget back to 1972.

It is my feeling that it is out of control. If we can't balance the budget once in 6 years, that certainly indicates that it is not the prudent spending that should accompany especially a tax cut, because inevitably the tax cut will add to the deficit, certainly even if you accept the theory that it stimulates business and, therefore, would be in the end a desirable thing to do.

So you don't think that the fact that we have added $40 billion to the public debt in 10 years, when we were at peace, you think that was not out of control, unwise expenditures?

Mr. ARMSTRONG. Sir, I do not believe it is out of control, but I think it is very serious and if it accelerates I think it would be very dangerous.

The CHAIRMAN. What would be your limit to the deficit because that is the way we measure spending that is not made up by taxes. What would be your definition that a budget is out of control?

Mr. ARMSTRONG. I think I would rather relate it to a percentage of the gross national product.

The Federal spending is a percentage of the GNP and I would have to supply a figure. I have the impression that those who argue in favor of increased Government spending find some comfort from this relationship that even though in the dollar amount it is increased and even though the debt has increased, the percentage of GNP has remained about the same.

The thing I am afraid of is that it may go on up and then I think that could be very dangerous.

The CHAIRMAN. I think your fear is justified in that respect.

Mr. ARMSTRONG. I would like to say, Senator Byrd, if I may just add a word on this, maybe it is dangerous to characterize one or another of the national problems which this country has as the most important. Perhaps everybody thinks that the one they are interested in is very important at the time. But I believe that this balance-of-payments problem is exceedingly important, and it will affect all of our citizens.

It is not just something that goes on in the financial capitals. If the rest of the world should lose confidence in the fiscal integrity of the United States, it would be a terrible tragedy. And from this point of view, I believe that the sound fiscal policy that is referred to in title I of this bill, I believe it is important and I surely hope that the President's budget estimates and the Congress action on those appropriation requests are in conformity with that policy.

The CHAIRMAN. You say there if tax reduction proved to be a prelude to out-of-control spending, especially on noneconomic programs.

What do you mean by noneconomic programs?

Mr. ARMSTRONG. I had not run down through things that might or might not be economic, but I think what I am trying to suggest there is that some Government activities are more likely to lead to the creation of real wealth, to the creation of things that are productive, things that are truly creative, and others are not, and I don't think I can pinpoint one or another program as being bad.

I think that every program that comes before a congressional appropriation committee obviously wouldn't get through if there weren't some justification for it, but I believe there are variations in this that the Appropriations Committees can sense as these appropriations requests are made to them by the executive departments.

The CHAIRMAN. You are aware of the fact that these programs are constantly increasing?

Mr. ARMSTRONG. Yes.

The CHAIRMAN. President Kennedy has made recommendations for quite a number of new programs this year.

Thank you very much.

Senator Gore?

Senator GORE. I gather from what you say that you are concerned with the size of the deficit.

Mr. ARMSTRONG. Yes.

Senator GORE. You say that in light of the fact that you are recommending a tax cut——

Mr. ARMSTRONG. Yes.

Senator GORE (continuing). Which would vastly increase that deficit. You are nodding your head, but the stenographer can't put that in the record.

Mr. ARMSTRONG. I am sorry; yes.

Senator GORE. Do you recognize the inconsistency therein?

Mr. ARMSTRONG. Certainly, but I think one has to go on, Senator Gore, and visualize what the likelihood is of a recovery of revenues by reason of the stimulation of the economy. Were it not for the expectation that the economy would be stimulated, that employment would be increased, that unemployment would be decreased, this would be unwise. I think this is perfectly clear from the official testimony that has been given. I think that the Secretary of the Treasury's initial statement on this before this committee was just excellent. I am in full accord with it.

Senator GORE. Well, he very cleverly supported a nostrum that may or may not prove to be effective.

In your testimony you marshal in support of your view the unemployment problem that we have and idle capacity that we have.

You say:

> The unemployment rate must be brought down below the unacceptably high rates of recent years if America is to achieve the productivity of which she is capable.

I would agree with that, but what evidence do you have that the enactment of the pending bill will end the unemployment that is at such a disastrous rate in the Appalachian Mountain area?

Mr. ARMSTRONG. I can't speak, Senator Gore, to the specifics of the economy of the Appalachian Mountains area in terms of the concept. I am not familiar enough with it. I have seen statistics put out by the people who talk about fuel, the use of fuel for the generation of electricity, that lead me to believe that notwithstanding the use of nuclear

energy and oil, that the usage of coal is going to be increased on out to the year 2000. I believe that this is a coal mining area, but I can't relate the Appalachian economy specifically to this, because I just don't know enough about it. I believe that employment in the coal industry has been enhanced against a declining trend because of the use of mechanization, wonderful equipment that has been used.

I know this process is helping the transportation of coal by the railroads which have been a sick industry. It seems to me this is the effect that one must look for, but I can't relate it specifically for you. I am not enough of a student of it.

Senator GORE. You used the word "specific," and I think it is a well-chosen word. You say you cannot relate this tax bill and the effect of this tax bill to this specific problem.

Mr. ARMSTRONG. To the Appalachian area, because I don't know enough about the economy of the Appalachian area to discuss it in specifics.

Senator GORE. Well, I hold in my hand an article from the Washington Post of October 27 which bears a headline: "Cut in Taxes Held No Help to Bulk of U.S. Unemployed."

Mr. ARMSTRONG. To what?

Senator GORE. B-u-l-k. Let me read you just one or two sentences:

> Is the Nation's army of unemployed doomed to continued joblessness until their schooling and skills are increased?
>
> Will a tax cut merely open up jobs for the well educated who are now in short supply?
>
> These questions have been raised with special force by Charles C. Killingsworth, a labor market specialist at Michigan State University. His thesis has drawn so much attention in the administration that Chairman Walter Heller of President Kennedy's Council of Economic Advisers has himself replied to it.
>
> In brief, Killingsworth argues that automation and the growing outlays for services like insurance or education have transformed the demand for labor. These irreversible trends, he says, increase job openings for the skilled and the schooled; job opportunities for the uneducated and unskilled are shrinking.
>
> A tax cut, Killingsworth contends, increases demand generally but doesn't affect the quality of workers. The extra demand generated by a tax cut will be spent primarily on the products and services that employ the skilled. So, the professor concludes, the administration program will make only a small dent in unemployment.
>
> Even worse, some of the tax cut's force will be dissipated, he says. This is because some of the demands it creates won't be satisfied due to a shortage of skilled workers.

I will place the whole article in the record.

(The article referred to follows:)

[From the Washington Post, Oct. 27, 1963]

CUT IN TAXES HELD NO HELP TO BULK OF U.S. UNEMPLOYED

(By Bernard D. Nossiter, staff reporter)

Is the Nation's army of unemployed doomed to continued joblessness until their schooling and skills are increased?

Will a tax cut merely open up jobs for the well educated who are now in short supply?

These questions have been raised with special force by Charles C. Killingsworth, a labor market specialist at Michigan State University. His thesis has drawn so much attention in the administration that Chairman Walter Heller of President Kennedy's Council of Economic Advisers has himself replied to it.

In brief, Killingsworth argues that automation and the growing outlays for services like insurance or education have transformed the demand for labor. These irreversible trends, he says, increase job openings for the skilled and the schooled; job opportunities for the uneducated and unskilled are shrinking.

QUALITY A FACTOR

A tax cut, Killingsworth contends, increases demand generally but doesn't affect the quality of workers. The extra demand generated by a tax cut will be spent primarily on the products and services that employ the skilled. So, the professor concludes, the administration program will make only a small dent in unemployment.

Even worse, some of the tax cut's force will be dissipated, he says. This is because some of the demand it creates won't be satisfied due to a shortage of skilled workers.

For the administration, Heller readily agrees that the unskilled and unschooled make up an outsized portion of the jobless. But the key question, Heller says, is what has caused the increase in unemployment in recent years. And here the statistical evidence indicates that unemployment is not rising more rapidly at the bottom of the skill ladder.

Between 1957 and 1962, Heller observes, the jobless rate for male college graduates doubled; the rate for those with 8 or less years of school rose only by one-half or about the same as the rise in unemployment generally.

RATE WAS SAME

Moreover, take a look at 1954 and 1962, 2 years in which unemployment was the same 5.6 percent, Heller says. If the unskilled have been losing out, the unemployment rate for the most skilled should have declined. But it didn't. In both years, the jobless rate for the highly trained professional and technical workers was the same, 1.7 percent.

On a homelier level, Heller might have pointed to Detroit. Unemployment in the Motor City's labor market was a whopping 11.1 percent in 1961; so far this year, it has averaged only 5.4 percent. The difference appears to be two strong auto years in a row. In other words, increased demand—not a change in the skills of Detroit's labor force—shrank the jobless rolls rapidly.

Yesterday, however, Killingsworth returned to the attack in a speech at Michigan State. Heller's figures, he suggested, conceal more than they reveal. Between 1957 and 1962, the number of workers counted in the labor force with 8 or less years of schooling fell sharply and their average age increased; those with college degrees rose rapidly and their average age decreased. It is logical, Killingsworth argued, to expect that unemployment for a younger, growing sector of the labor force would rise faster than the rate for an aging, shrinking group.

As for Heller's professional and technical groups, nearly a quarter have had no college training at all. So, the average jobless rate for this sector may have held constant because the less educated found it harder to get jobs while the better educated found it easier.

INVISIBLE JOBLESS

Having disposed of Heller's statistics to his own satisfaction, Killingsworth came up with some of his own. He makes elaborate calculations for the "invisible unemployed." These are the workers who don't show up in the official statistics because they are neither at work or looking for work. However, if jobs were open, they would be seeking employment.

Killingsworth estimates that there are nearly 1 million male workers in this shadow class. He lumps them in with the officially counted unemployed to calculate the changes in real unemployment. And he compares the situation in 1950 with 1962.

Here is what he finds:

Percentage change in real unemployment

[Rates, 1950–62, for males]

Years of school completed:	
1 to 4	100
5 to 7	47
8	53
9 to 11	26
12	43
13 to 15	2
16 or more	36

As Killingsworth sees it during the 1950-62 period, unemployment generally rose fastest among the least educated and actually declined among the best educated.

This puts the ball back in Heller's court. With the tax bill at stake, he can be expected to smash it back promptly.

Senator GORE. So when you say that you are unable to relate this bill specifically to the high rate of unemployment in Appalachia, you make a profound statement. Neither can the administration, neither can the advocates of this bill. And you can say the same thing about structural unemployment generally.

How is this bill going to help the man in his fifties who has lost out because of automation? You can't specifically relate it to him. I know that eventually the advocates fall back upon aggregate demand, but there again, the people who are persistently and chronically unemployed may not be reached. Indeed, most experts with whom I have talked and whose writings I have read say it will not reach them.

Yet, you and many others—please understand I am not trying to be unpleasant with you and I hope I never am with anyone before this committee—you and many others wrap around you the burden of the unemployed and give that as a reason for passing this bill, when the experts say that this cannot be specifically related. Indeed, you used that term yourself.

Now, if this does not reach the problem, the principal problem of our society, why do we take the risk with the economy? Suppose that you give this tax reduction and it doesn't solve the problem of the unemployed. Suppose this rate which you say is unacceptably high remains, will we, 2 years later, have another tax cut?

Mr. ARMSTRONG. Senator Gore, please let me be absolutely clear on this record, and with you, sir, I said I could not relate this tax cut to the specific—specifically to the economy of the Appalachian region because I am not an expert on that subject. I was quite surprised that you said the administration couldn't, because it seems to me they have economists and people who are studying this thing. Indeed, there was something about an Appalachian authority or corporation in the newspaper today.

Senator GORE. It had nothing to do with this tax cut.

Mr. ARMSTRONG. But this isn't to say I can't relate by it, by the mantle of aggregate demand or other accents on this, other emphasis on this, a tax cut to the rate of employment and the rate of unemploymen in this country.

If the opinion which I have, and many people have, and which the Secretary of the Treasury has testified to before this committee is—if their opinion is, and our opinion, that unemployment will be affected favorably and employment will be affected favorably by reason of an increase in the amount of the earnings on capital, and labor being available to the owners of capital and to the laboring people—if we are wrong on that, we are wrong; but this is our opinion from the point of view of aggregate demand, and we submit it to you for your consideration.

Now, true it is that there has been a great change in the whole industry, and I am trying to get back to that because that is what Appalachian means to me.

Senator GORE. It means more than coal.

Mr. ARMSTRONG. And you mentioned about equipment, and I mentioned equipment; modernization. But think of what has happened in other parts of the world where the coal industry has not been modernized, and the terrible depressions that have occurred—for example, in the coal industry in the United Kingdom—and I submit to you, sir, that it has been by the modernization of the coal industry that coal, as a fuel, has been able to be kept on a competitive basis with other fuels, and has maintained its usage in the economy. This is why I mentioned to you, from the point of view of energy studies, that coal is going to have a great and very important future in this country.

Senator GORE. You said this was your opinion?

Mr. ARMSTRONG. Yes, sir.

Senator GORE. And it might be proven wrong?

Mr. ARMSTRONG. Certainly.

Senator GORE. Now, suppose it is proven wrong, or in error. Suppose that the unemployment situation is not solved; suppose it does remain at an unacceptably high level. Then, unless this tax cut is reversed, we will have permanently hampered the Government in its facility and flexibility in solving—or trying to solve—the problem, in trying to achieve the goal of full employment by other means.

Would you advocate, if 2 years from now this level remained unacceptably high another $11 billion tax cut?

Mr. ARMSTRONG. Well, I can't answer that question until the time. But, sir, I think, if I may say so, and I am referring to my own testimony here, it is a very great mistake to analyze this problem only from the standpoint of structural unemployment, and only from the standpoint of the persons who do not have the skills. I mentioned in there a million younger people coming into the labor force. Is it to be that the Government is not to have a tax policy which stimulates the industry, and which stimulates private industry, so that these people in these tremendous numbers can find their way into the American stream of work?

It seems to me—I recognize the validity of everything you say about structural unemployment, and it concerns me very much, but I think there are very, very much greater problems here that the Congress is faced with; and the thing that is involved here is the debilitating effect of these tax rates today on American industry, and on American business, because there is a drag—there is a drag on business, there is a drag on people's interest and ability and willingness to work; and this is the thing that these progressive rates have done to the country, and this is the thing that makes it impossible to achieve high employment, sir.

Senator GORE. Now, with respect to stimulating the economy, you wouldn't contend that there is a shortage of investment capital now, would you?

Mr. ARMSTRONG. I would not call it a shortage of capital in the United States, but I think there is a very great shortage of capital worldwide.

Senator GORE. We are speaking of the United States.

Mr. ARMSTRONG. We are not here in a vacuum. We are here related to all the rest of the world. There is a very great and drastic capital shortage worldwide, Senator Gore.

Senator GORE. Suffice it to say that Secretary Dillon, only a short time ago, said that our times were characterized by an excess of savings. So there is no shortage of capital, apparently. Corporate profits are at an alltime high. The liquidity of corporations is at an alltime high. I could cite other things.

Therefore, it would be rather difficult to convince me that the real needs of our society are to further increase liquidity of corporations, further increase savings, further increase cash flows, further increase profits, and dividends.

This is not the element of our economy that is depressed. You and I have not been talking about that element of the economy that is really depressed.

The one-fourth of our society, of our people, who live either in abject poverty or on the fringes of poverty, the unemployed of whom you speak so appealingly, the 7 million on relief, the people who lost out on jobs through automation, because of age, because of lack of skills, it is this segment of our society that needs stimulation. And, if they could have a decent American standard of living, then the demand would be so great that businessmen would invest to build facilities to supply the products which these people would buy at a profit. Would you agree with that?

Mr. ARMSTRONG. I certainly do. I think when you are talking about the need to increase the standard of living, Senator Gore, this is the essense of the problem.

Senator GORE. All right. Now, you and I agree as to the segment of our society that is in greater need of economic improvement and greater need of stimulation. Now, let's look at our society as a whole, and see where the needs of our society as a whole are. Would you say we need more hotels or hospitals?

Mr. ARMSTRONG. I can't answer that question. I believe that the hotel industry is running at somewhat less than capacity. Private hospital facilities are strained. I suspect that there are thousands of beds in Government-owned hospitals that are not occupied.

Senator GORE. Well, you have just made an interesting statement. You said you couldn't answer the question but it seems to me you answered it very well. You said that hotels were running at less than capacity. Actually, one hotel after another is in the red, is that not true?

Mr. ARMSTRONG. As an industry, I don't believe that is true, Senator Gore, but I yield to you because you are the expert on this; I can't answer your question.

Senator GORE. At least you say that hotels are operating at something less than capacity, and yet you say that all the private hospitals are literally running over. I have seen patients out in the halls.

Mr. ARMSTRONG. Sure.

Senator GORE. I will not belabor this point, but the needs of our society, it seems to me, in the long run are such things as health, education, employment, transportation facilities, urban renewal, rapid transit. The needs of our society, the pent-up needs of our society, are largely in the public sector. This may not be a popular thing to say, but I think it is the truth. Why should we pass a bill to further enrich the private sector of our economy, where the profits and the dividends and the cash on hand are at an alltime high, and neglect

the public sector of our economy where the real needs of our society and demands of our society rest unfulfilled?

Research in cancer, health——

Mr. ARMSTRONG. Senator, I just hope you are not putting me in the position of not favoring the development and expansion in these sectors where you are saying there should be this great improvement, and I agree with that. When the chairman asked me what did I mean by uneconomic projects, I am a trustee of a hospital and I know something about this from the point of view of the privately endowed hospital that works in conjunction with universities, and with public facilities in the city of New York, and I know the tremendous need for research, and I would call research a very important economic program. I think the amounts of money that this Congress appropriates to research are vitally important, but I don't quite see how that affects this problem.

The question here, the question, I think, that is posed, is whether it is going to be more productive to the American people for the people themselves and capital to have a greater reward from their work and their investment of capital than they are now permitted under present tax law, whether that is going to be more stimulating to the economy, taken as a whole, than not permitting that, and having the thinking through Government-directed programs. That is the choice. And we, sir, I believe, just from what has been said here, would be on opposite sides of it. I think there is a balance, and it is for Congress to say what the balance is, you and your collective judgment. It is not for us as private citizens to know the answer.

But I believe, and I believe very strongly, that the people in your State, and the people in your community taken in the aggregate will be much better off, that employment will be higher and unemployment will be lower if the Congress passes this bill.

Senator GORE. Well, first, let me say that I am not attempting to put you in a disadvantageous position. You say that it is the responsibility of those who occupy a position such as I occupy to reach decisions on these things.

Mr. ARMSTRONG. Yes, sir.

Senator GORE. It may be that I have overpressed my point of view during the course of this hearing. Frankly, I am trying to reach the hearts and the minds of men like the Senator from Illinois, the Senator from Virginia, the Senator from Nevada, other Senators who listen here and I am trying to reach American people, because this is an unwise bill, in any view, which is proposed to us.

You might be interested to know that Secretary Dillon told us that this same—I wouldn't call it theory, I don't quite dignify it with that term—the same idea was suggested and considered during the administration of President Eisenhower. It was rejected.

I happen to have been the author of a bill to accelerate the construction of our highways. I dare say you would not class that as an uneconomic expenditure of money, because it facilitates the commerce of the country. And President Eisenhower signed this bill into law. This, along with many other things, provided then a stimulus, and this country came out of the recession. But here is proposed not a temporary program, not a program aimed specifically at the people who are unemployed, but a permanent program based upon

a theory which you say yourself may be proven wrong. It is a dangerous course. You stated how dangerous it would be if it didn't work. It might undermine the value of our currency. Senator Byrd reread your remarks.

Mr. Chairman, I have trespassed too long. You have been a very provocative witness and I hope a fruitful one.

Mr. ARMSTRONG. Thank you very much, Senator Gore.

Senator BENNETT. Before the Senator closes will he give me my State back, please? [Laughter.]

Senator GORE. I would indeed.

Mr. ARMSTRONG. Senator Gore, I would just like to have just one more, not the last, word but another thought about profits because you mentioned profits being at an all-time high, and I guess it is true that employment is very high, perhaps in actual numbers it is just under 70 million people, this is wonderful, but profits are running along about, after taxes, corporate taxes, around $25 billion, and between $22 and $25 billion. This is where they have been sitting for a long, long time, 10 or 12 years during which time the gross national product has gone from around 400, pretty close up to 600. We ought to pass, if we are lucky, 600 billion on an annual GNP rate in the first quarter of 1964 and hopefully we will. It certainly is not an inducement to the American people to invest, to see profits, more than 50 percent of them, drained away, and then themselves taxed at individual rates on those profits. This is no inducement, and if production in our society is primarily in the hands of enterprises that are owned by investors, I submit to you that these corporate and individual tax rates are debilitating and depressing for the national economy, even though, and despite them the economy has a fine record of achievement.

Senator GORE. With respect to incentives, with respect to stimulating the private sector or our economy, I recall to you that a large tax reduction bill was passed in 1954.

Senator Bennett was kind enough to suggest, and I think he made a valuable contribution, that that tax reduction amounted to approximately the same percentage of gross national product that an $11 billion tax cut now would. So this theory has had an opportunity to operate.

You would think that after 10 years, 9 years, this would have balanced the budget by now. It hasn't. But on top of that last year over my opposition, and over the opposition of the chairman of the committee, the Congress enacted a tax bill providing vast incentives for investment, the investment credit, and the Secretary of the Treasury sitting where you are now sitting, told us that the investment credit would be far more stimulative of investment than a general tax reduction would be. We passed that.

Then by administrative action there was a generous acceleration of depreciation.

When you add these together, approximately $5 billion of tax reduction will have gone to the so-called investment sector of our economy. Now it is proposed to cut several billion more. You say this proposed cut may be proven wrong.

Mr. ARMSTRONG. No; I say this is moving in the right direction, and should prove right and I think the actions that the Treasury took and that the Congress took last year are one of the reasons that the

economy is doing as well now as it is. And, sir, you may recall that the estimate of the future, expressed by the American people through their action in, their attitude toward, the stock market, was very negative during the first half of 1962, and then these steps took place, and I am perfectly sure, as an observer of the scene, Senator Gore, that these two actions by Congress and the Treasury are one of the reasons that this economy did not retrogress but moved forward in the last year. I think they were very constructive.

Senator GORE. Well, members of my staff have analyzed the statements and programs of many corporations, and one after another they are in a strong, fortuitous financial position, and have continued with their planned programs for investment. So I hope you will pardon me if I look with some askance upon the advisability of further increasing the availability of investment capital when it is so plentiful and is so unused; when our problem is not lack of production facilities, but idle production facilities; when the real needs of our society are for the things of health, education, community facility improvement.

Please understand I don't like deficits any more than you do, but if I must choose between a deficit to build highways, and income producing and generating facilties, saving the lives of our people and facilitating our commerce, on the one hand, and a deficit merely to give tax reduction on the other, I will choose the former. I am not sure——

Mr. ARMSTRONG. Sir, was that highway program not self-sustaining?

Senator GORE. Just a moment.

Mr. ARMSTRONG. Sorry.

Senator GORE. I am not sure that we are in an economic situation where we must choose either in any large amount. And if I may go just one step further, with appreciation for the attention of my distinguished colleagues, I cited to the Secretary of the Treasury the example of my own State, to which you referred. It happens that a large number of the counties in my State were eligible for the area redevelopment and accelerated public works program. I worked assiduously to obtain approval of projects. We secured the approval of more than 100 and many are now underway, and I am advised by the employment security officials in my State that unemployment is at the lowest rate in several years. I believe it is 3.8 percent.

Now, you would think from my description, I daresay, that vast amounts of money are being expended in Tennessee. Well, compared with this tax bill, it is really peanuts. The total cost of these projects is approximately $20 million, and yet we are talking here of $11 billion which you say cannot be specifically related to the problems of the unemployed. So I think that we do need to have programs to relieve the suffering of the unemployed, but they should be specific programs which can be directed to the betterment of these people, not in the year 2000, but now. And I do not see that this general tax cut, and I have read you an article by an eminent labor market specialist who says flatly that it will not reach this problem.

I appreciate your appearance. At least it has provoked me to express my views and draw from you your own views. Maybe this is worth while, maybe it is a waste of time.

Thank you, Mr. Chairman.

Mr. ARMSTRONG. Thank you, Mr. Chairman.

Senator BENNETT. Mr. Chairman, may I raise a question or two? I realize that it is 12:20, but so many questions have been raised by my friend from Tennessee that I think one or two of them need to be presented from the opposite point of view.

So, I would like to suggest to you this basic question: Suppose we decided to try to solve our basic problem of unemployment by a planned, determined policy of easy credit, and suppose we decided to make Federal credit available to everybody at so cheap a rate that they could be induced to go out and buy enough merchandise and services to put these people back to work. I can visualize credit at less than 1 percent and pay it back after 40 years. Would that be in the long run a sound solution for our current problem?

Mr. ARMSTRONG. No, it certainly would not, Senator Bennett.

Senator BENNETT. Wouldn't it in fact, it might, put people to work this year, it might begin to put them to work very quickly, but in the end what would happen to our—the value of our money?

Mr. ARMSTRONG. It would sink; it would become worthless; and I suggest, sir, that the very first thing that would happen in such a course of action, if it were pursued, is that there would be a terrible flight from the dollar.

Senator BENNETT. And our international problem would be greatly aggravated, almost come to a crisis in a very few weeks.

Mr. ARMSTRONG. Yes, sir, absolutely.

Senator BENNETT. I realize I am exaggerating this.

Let's look at the other thing. Supposing we go all the way on the problem——

Senator GORE. Before you leave that, you say you realize you are exaggerating. I am sure you realize, too, that you are suggesting a possibility which I have never suggested and which I would not support.

Senator BENNETT. Well, I realize that you wouldn't go all this way. You would go part way in this direction, but I can remember that during the thirties savings banks couldn't pay any interest on dividends because the going rate of Government bills was a quarter of 1 percent. That is about as far as you can go on credit. This was used to finance the war effort.

Let's now talk about using it as a device in the private sector of the economy to get people back to work. That is the point of view from which I have asked it. Let's turn the page over and look at the other alternative.

Suppose we decided that the way to solve this problem is the way that my friend suggests, represented by building roads, let's have a program of Federal expenditure which has no concern with the question of deficits.

Let's use Federal money to put these 4 million people back to work at any kind of project that is necessary. That could get people back to work quick. What would happen to our economy in the end, if that program were followed? Is that a sound long-range solution of our problem?

Mr. ARMSTRONG. No, it is not, Senator Bennett, and when it was tried in the past in the thirties it didn't work. It quite clearly didn't work. And it just is not a way that is going to solve the problem here, in my opinion.

Senator BENNETT. I understand your testimony to mean that you feel that the tax reduction route will help but these other two things must not be allowed to get out of control.

Mr. ARMSTRONG. Yes, sir, that is exactly right.

Senator BENNETT. Because if they do get out of control, though they might give us a short-term lift, a very real shot in the arm, in the end they would destroy us?

Mr. ARMSTRONG. Yes, sir. I have a different feeling about the highway program that Senator Gore mentioned because if it is what I think it is, it is self-financed by the use tax as it goes along. This, as I understand it, does not contribute one way or another to the Federal deficit.

Senator BENNETT. But one of these days, though, we are going to come to the end of the highway program unless we build a new one.

Mr. ARMSTRONG. Yes.

Senator BENNETT. And the men who are now working on highways will have to find themselves another job. So, if you are going to go the route of direct Government expenditure to create jobs, then you have got to continually expand the Government expenditures because today's jobs run out, and you have to have more jobs tomorrow. But if you go the route of private investment, this route is self-generating. The money you put there will generate more jobs for tomorrow.

Mr. ARMSTRONG. Yes, yes.

Senator BENNETT. Do you agree with that?

Mr. ARMSTRONG. Yes, sir, I certainly do.

Senator BENNETT. To my friend from Tennessee, I can't resist one other comment. One of the reasons the hotels are in trouble, and I was once a member of a managing group that ran a little country hotel, is that there are too many motels, and the motels are being built at a rate which I think is going to bring them in trouble before too long, and yet the Federal Government, with the ARA program, has been supplying Federal money to build more motels.

So, our friends who are in the hotel business are in trouble, in part, because of this concept of Government spending in a competitive area. I am sorry to keep this thing going.

Senator GORE. Will the Senator yield?

Senator BENNETT. Yes.

Senator GORE. I think that the Senator and I would agree that what we really need is a proper mix. He and I might disagree as to what was sound or unsound.

Senator BENNETT. I think that is right.

Senator GORE. But what we really need is a proper mix of the public and the private sectors of our economy. There are many things which our people need which cannot be supplied or at least our society has not found them supplied by private industry, such as the reclamation and irrigation projects in the State so ably represented by the distinguished Senator, such as the TVA in my State, such as highways, such as urban redevelopment. We have not found that private enterprise could solve these problems, and there are other problems, other functions which private enterprise can do more efficiently, and I think more properly. If I may trespass just 1 more minute, I am firmly and deeply convinced that private enterprise is the mainspring of our economy and must remain so, and I want to

keep it so. But I do not believe that we can neglect the pressing needs of our society, particularly those needs which are not answered by private enterprise. So what we need is the proper mix of monetary policy, fiscal policy, and tax policy to promote an adequate rate of growth and a solution of the human problems of our society, and the economic, educational, and health problems of our society.

Senator BENNETT. The Senator from Utah would agree, but I think when the two of us sat down to select the ingredients that went into the mix and the volume that went in we might find ourselves in disagreement.

Senator GORE. Of course, neither of us would deal in extremes.

Senator BENNETT. No.

Senator GORE. You have promoted almost an agreement here.

The CHAIRMAN. Mr. Armstrong, you have made a very frank and able witness, and the Chair thanks you.

Mr. ARMSTRONG. Thank you very much, Senator Byrd and gentlemen.

The CHAIRMAN. The next witness is Mr. Moses H. Wilbourne of the Cole Supply Co.

STATEMENT OF MOSES H. WILBOURNE, PRESIDENT AND TREASURER, COLE SUPPLY CO., TUSCALOOSA, ALA.

Mr. WILBOURNE. Thank you, sir.

Chairman Byrd and other members of the Senate Finance Committee, ladies, and gentlemen, I am Moses Wilbourne of Tuscaloosa, Ala. I am presenting this in the interest of the small businessman and the small corporation, with rather limited operations as to territory and area—of which there are many—not the very small corporations but those with possibilities of growth and development if a more favorable tax picture in the lower bracket could be made effective. If these corporations with possibilities of development could do so, then in the final analysis, they could produce more revenue.

The effect of double taxation on us small operators is almost confiscatory and leaves us very little with which to expand our operations, where and when needed.

I would like to bring into this very vividly the case of the small corporation. As you know, there is a tax differential on the first $25,000 for all corporations. This is, and has been, extremely important to the small corporation, but inadequate in order to have capital left over to meet changing conditions, the competitive situations and with the necessity of paying more on every level of operation, and of having on hand larger inventories and considerably more in accounts receivable.

When the next $25,000—$50,000 is taxed at 52 percent—it simply doesn't leave enough for a small corporation to operate on without borrowing for the purpose. The tax bite is too heavy—it will hardly permit a small corporation to function.

The multimillion-dollar nationwide corporations have enough volume and have been able to add enough to the price of their products to have enough left. Reference: Steel companies in other days. But the small corporation, in places of this size, on a limited volume, simply has a terrific struggle to have capital left.

The necessity of a new and improved tax law is so thoroughly, completely, and comprehensively covered by Rene A. Wormser in the March 18, 1963, U.S. News & World Report until little further suggestions are needed.

According to press reports, Henry Ford and approximately 25 businessmen were to meet in Washington to consider setting up machinery to suggest: "A more feasible and fair tax program to Congress."

They are the multimillion-dollar operators to whom this limited differential makes little or no difference—but to the small corporation, it is like dollars in the 1930's—big as cart wheels. Now, as then, the differential applies to $25,000 as it did in the depth of the depression and in the 1930's where the tax was much lower.

	Percent
1933–36 (flat rate on all earnings)	13¾
1936, 1937, and 1938:	
1st $2,000	8
$2,000 to $15,000	11
$15,000 to $40,000	13
Over $40,000	15
1939:	
1st $5,000	12½
$5,000 to $20,000	14
$20,000 to $25,000	16
Over $25,000	19

And what you had left, you could do three to four times as much with as you can today.

Paying personnel takes three to four times as much, and in many instances—as much as 10 times—and more.

The $25,000 differential as it now applies, as contrasted with the 1930's, can almost be compared to the horse-and-buggy days as contrasted with today.

The $25,000 on which the differential applies today—the tax is much more, and the small corporation can only do a third to a fourth or possibly a fifth as much with the residue.

So, to we who struggle with the problem—the need is obvious and the lack of consideration will be painful and pinching.

Others on the top echelon scale, I am sure, have and will present programs; however, I am crying and pleading for the small corporation, of which I am a principal stockholder in one, president, and chief executive officer.

Our paths have not been without problems that proper tax structure would help a whole lot.

My proposal is: If the tax differential could be on the first $75,000–$100,000, instead of the first $25,000, then the small corporation would have a chance to grow and be more of an asset to their community, State, and Nation, and produce more revenue.

Senator Gore, even if it were $50,000, it would give us a chance because after operating a corporation, as president and treasurer for 28 years, and with the same corporation for 35 years, I still borrow money, and I think the day is going to need to come when we are going to be able to keep some.

Another point in this is liquidity in life and in death. Since I am getting up to about 58, my point is should I die, and being a principal stockholder, where will the money come from, and I would hate for the business that I gave my life to to be absorbed by one of the giants, and the tax laws seem to favor that.

Listening to you some yesterday, Senator Byrd, I am very much opposed to the present waste in Government. I have followed it through the years through the U.S. Chamber meetings and through the various reports, and I am strongly in favor of a balanced budget and for a reduction in the Federal debt. I hope, sir, you will all work toward it.

The CHAIRMAN. I am glad to hear that.

Mr. WILBOURNE. I think the Chair knows that.

The CHAIRMAN. Many witnesses have not mentioned balancing the budget or paying off anything on the debt.

Mr. WILBOURNE. I have been waiting, sir, to see if something like that would not happen for some 10 or 15 years, and I am still waiting, and I hope to live to see the day when we have sound fiscal policy.

The plea I want to make is for tax relief and consideration for the small businessman and small corporation so that they can become a more healthy and effective part of the American economy, and so that the future of American business can be on a broader base which has for so many years of our history been the backbone and bulwark of the American system.

I am vitally concerned with whether under the present laws the small corporation can be liquid enough in life and in death. Will there be enough net income after taxes to grow and expand? We are in an expanding economy—we have to grow or die.

Competent, professional advice has said that under the tax laws as they now exist, small corporations will not have money—cash on hand and in banks—until 5 years after the company stops growing.

A higher basic differential of $75,000 to $100,000 should permit a small corporation to make reasonable progress with cash left after taxes.

A corporation needs to retain most of its money to grow on.

This is a two-pronged dilemma:

(1) The need for money after taxes for the small corporation to expand and grow.

(2) Enough liquidity to retire sufficient stock to pay death taxes when needed at the demise of one or more principal stockholders and for the corporation to subsequently be a continuing entity and a vital, effective, competitive, growing organization, and there be enough to do this without being seriously hurt from an income tax standpoint.

The income and estate taxes taken as a whole make it difficult for a small business worth $500,000 to $1 million to be kept in a family after the death of the husband or father who is usually the one who founded the business. Many people will not consider a business worth $1 million as a small business, but by one definition, a small business is one with less than 500 employees. The small businesses that I am particularly and specifically referring to are those with less than 100 employees—of which there are many—I am trying, also, to present the idea that these small corporations will be better revenue producers if permitted to grow.

Of major concern to majority stockholders in small corporations is liquidity after death.

In many instances, the owners of the majority interest in a closely held corporation are forced to be absorbed by an industry giant to be able to pay taxes and still realize anything on their investment.

Section 354 of the Internal Revenue Code considered with the definitions under section 368 of the Internal Revenue Code allows large companies to absorb smaller companies without an immediate income tax consequence. In hundreds of instances, owners of businesses worth $1/2 million to $1 million have chosen to be absorbed by industry giants because of the reorganization provisions of section 368.

This trend is, in my opinion, economically unsound. In fact, certain divisions of the Department of Justice are spending millions of dollars fighting mergers which the tax laws seem to encourage.

The bill which has come from the House Ways and Means Committee proposes a maximum tax of 21 percent on capital gains where the assets have been held more than 2 years. This seems to be a step in the right direction, and it could perhaps be implemented by a nonrecognition of gain in certain instances where the proceeds are reinvested similar to those where there are involuntary conversions of property or sale of the personal residence. This would seem to allow the sale of the closely held business to other small businessmen rather than to the larger corporations.

The corporation of which I have been president and treasurer for 28 years, and of which I have devoted 35 years of my life (40 years of active business life is about the span of most of us), has inventories, accounts receivable, and equipment 8 to 10 times what they were in 1946, but still almost no cash. In fact, the tax laws, as they affect most small corporations, make it necessary to borrow almost constantly in order to continue to operate. It is certainly "painfully apparent" that corrective measures need to be taken—that is, proper tax structure for the small and growing corporation.

Our Government has spent many millions of dollars with administrative agencies, such as the Small Business Administration. I firmly believe that a policy of lower taxes for small corporations would have made much of the lending work of the Small Business Administration unnecessary.

I have been quite active in charity work in Tuscaloosa. In the interest of United Fund Organizations, many of whom are finding it more and more difficult each year to raise their ever-increasing quotas, and in the interests of those charitable and eleemosynary institutions who are not participants in United Funds, I am making a final suggestion and request that corporations be permitted to use 15 percent of their first $50,000 of net income or 10 percent of their first $100,000 of net income as a deductible item when so contributed.

I will use an example. Tuscaloosa's United Fund a few years ago had a budget of $113,000. This year it is $325,000. Herewith 5 percent of a corporation which would have a $25,000 or $30,000 net income, that is just hardly enough. This would help those types of organizations.

You can certainly see from the contents of my letter how tremendously important this is to us, and I feel very deeply and earnestly that it is equally important to other small corporations struggling for survival in our present, extremely competitive—but nevertheless, wonderful American economy.

I feel that this letter outlines rather specifically my basic thinking and reemphasizes in several places the tremendous importance that we place on these suggestions proposing improvements and hoped-for

possibilities in our new tax law which are so urgently, and in some cases—almost desperately needed.

With a sincere thank you for your patience, cooperation, and helpfulness—not only toward us, but for what this will mean to so many small corporations, I am, cordially and sincerely yours.

My three points, sir, hurriedly, are a higher basic differential so that the small corporations across the country can grow; liquidity in life and death for a corporation that a man has given his life to so that he can go on to have enough left, and then asking for this for the United Fund and for the charities.

My study started with an article by Rene A. Wormser entitled "The Need for a New Tax Bill." I thought it was wonderful, sir, and I would like to leave a couple of copies marked, as I saw it, for the record if any of you people would have time to study it.

I have three more props. One is the name "I. Jones, proprietor," the small businessman, the importance of the small businessman in the economy of our country. I hope he can keep on staying in business.

Another one I have is, "He was everybody grown a little taller," a picture of Abe Lincoln. The small corporation needs to grow.

Another, "He wrote a song for the home of the brave," the Star Spangled Banner. I hope that the small people continue to operate small corporations in the home of the brave.

I thank you, gentlemen.

The CHAIRMAN. Thank you very much for your cooperation, sir.

The next witness is Mr. E. S. Hall, of Farmington, Conn.

Mr. Hall, I am sorry to say that we have a very limited amount of time before we must adjourn to go to the Senate floor for a vote.

Mr. HALL. I know it.

The CHAIRMAN. It will be appreciated if you will condense your statement, sir.

STATEMENT OF E. S. HALL, SECRETARY, FREEDOM, INC., FARMINGTON, CONN.

Mr. HALL. I think it will be best to put my prepared statement in the record complete as it is, and I shall use a few minutes in direct testimony without reference to it.

Senator Gore, I have been very much interested in your comments on unemployment. A tax cut or an income tax cut gives no buying power to the unemployed. It merely transfers buying power from Government, its biggest spender, to private spenders, some of whom will not spend. Therefore, the immediate effect of it is to reduce the economic growth.

Those who save, part of the buying power they get from a tax cut, by investing their savings in the economy, will improve the economy for a long-range effect, but the immediate effect of a tax cut does not do any good.

There is one point about this whole matter of deficit spending that I would like to say a word about. This is, perhaps, in reply to a book called "A Primer on Government Spending," by Heilbroner and another one. It reflects the attitude of the administration toward Government spending.

It is perfectly obvious to anybody that since the equation of exchange in economics states the number of units of money spent divided by the number of units of commodities paid for is equal to the average price of the commodities, from that equation it is perfectly obvious that the Government's duty is to increase the money in the system at the same rate that business increases the commodities to maintain prices stable.

But our Government for a great many years has been, by deficit spending, increasing the money in the system at a much faster rate than business has been increasing the gross national product. That is why it costs us 25 cents to ride a bus today instead of a nickel. That is why this slow inflationary process goes galloping on, and that is the thing that has to be stopped.

We have to find some way to set this economy of ours straight. In the course of these years that I have studied taxation I have come to the conclusion that cutting tax rates and tax reform, in general, is a waste of time. The Internal Revenue Code has gone far beyond any sane limit. It is a preposterous and subversive monstrosity, basically unsound.

It is based directly on the progressive income tax, and the progressive income tax is not an American principle. It is not a matter of the ability to pay. It was advocated by Karl Marx in the Communist manifesto to abolish capitalism, the system that has built the United States, and set up socialism, a system that cannot even feed the hungry in Russia, Red China, and Cuba.

Now, it seems to me we are not very smart in trying to operate our economy by means of a tax system which was written to abolish it. This does not seem to me to be good sense, and yet I understand perfectly well how we came to get into this situation, because the distribution of personal income has never been just in our capitalist system. Some people have not been getting all that was coming to them, and it never occurred to Congress to pass a law to provide for the just distribution of incomes.

Instead we have been wasting our time for years in passing laws to redistribute incomes, and the most complex and voluminous of all these laws is the Internal Revenue Code based on the progressive income tax.

The progressive income tax takes money from employers and gives part of it back to the employees. Wouldn't it be better to provide for the just distribution of profit in the first place?

The only way we can do that is what I have summarized on page 2 of my testimony. Now, this is a very profound document. It has been developed over the years. It was suggested originally by John Coolidge who lived 7 years in the White House, and if we can have 6 minutes more, that is all it takes, I would like to read this thing very carefully, with the understanding that you might possibly want to sign it.

Mr. Chairman, shall I go ahead with it?

The CHAIRMAN. Will that complete your statement?

Mr. HALL. That will complete my statement.

The CHAIRMAN. You may read it.

DECLARATION OF ECONOMIC FREEDOM AND INDUSTRIAL PEACE

Mr. HALL (reading):

When in the course of human events it becomes clear to honest people that the Marxist revolution is mistaken, that it leads to tyranny and serfdom, a decent respect to the opinions of mankind requires that they declare the facts which impel them to finish the American revolution, the revolution that leads to complete economic freedom, good will in industry, and peace of earth.

We hold these truths to be self-evident: That all men are created equal; that they are endowed by their Creator with certain inalienable rights; that among these are life, liberty, and economic freedom;

That economic freedom is essentially private ownership of business; that private ownership of business is acquired by investing capital; that money is capital; that life is capital at least as precious as money;

That a business is a combination of property and personnel, property alone cannot operate; that they who invest money own business property, the common capital measured by the amount of money invested; that they who invest life (while selling their services for salaries or wages) own themselves, the personnel, the human capital measured by the amount of their year's pay;

That capitalism, the private-ownership-of-business system, grew up from feudalism with a mechanical defect; namely: the master-servant relationship in business; that, when employees are hired as servants or independent contractors, their personal ownerships of themselves, the human part of the business, are not recognized; they are not taken into the business as partners, they are kept out; that, having neither the incentives nor the responsibilities of business ownership, neither hope of profit nor risk of loss, they tend to do little and demand much—shorter hours and higher wages; that, since wages are part of cost while the price of the product must cover not only the cost but the profit, their wages never can be high enough to enable them to buy their full shares of the product—the distribution of personal incomes has been unjust; that, consequently, part of the product remains unsold, inventories pile up, business slows down, unemployment rises—recession; and that, because wages alone are not enough to give them economic justice, they are always demanding "social justice";

That government, in response to their demands, either steals business property and kills capitalists, as in Cuba, for example, or makes laws to redistribute incomes, as in the United States—minimum-wage, right-to-strike, and other labor laws which, by forcing employers to pay higher-than-free-market wages, foster unemployment and wage-price inflation—laws to "soak" employers and "progressive" taxes on profits and other incomes—laws to aid employees' benefits, welfare, relief, medical care, social security, et cetera; government-ownership-of-business system, the heavenly system that requires an iron-bamboo curtain, thousands of miles of barbed wire, and the wall across Berlin, to keep its beneficiaries from escaping.

Laws long established should not be changed for light and transient reasons, but, when a long train of laws, leading invariably to the same end, evinces a design to abolish free-market capitalism, it is our right, it is our duty, to provide a law that will correct the defect in capitalism and distribute incomes justly—the Freedom Tax law, a law that will:

(1) Let employers hire employees as limited partners and withhold a flat percentage tax on all profits, salaries, and wages, the rate adjusted currently as provided hereinafter. Pay the balance of profit (or the loss) in cash dividends, or in business property ownership credited (or charged if a loss) to the partners, in amounts proportional to their respective amounts of money invested and year's pay. Comparisons made from annual reports show that, in a profitable business, whether you are a business-property owner or a personal owner, you will get a take-home raise. When employees are limited partners, they will work loyally and efficiently. No featherbedding. No strikes. Industrial peace in the United States. Minimum-wage and other labor laws will be obsolete, and can be repealed. Dividends on the business-property ownership, acquired by employees reinvesting part of their profit, will care for seniority and retirement in the natural way, better than pensions, better than social security. Every man a capitalist.

(2) Adjust the tax rate currently in response to price trends and issue redeemable currency in limited amounts corresponding to increases in the gross national product, to balance the budget, gradually retire the debt, restore and

maintain the buying power of the dollar, and reduce and stabilize prices in the natural free-market manner. The just distribution of goods and services which follows the just distribution of incomes will not be disturbed by the proportional income tax, no matter how high the rate.

The high rate needed to balance a defense or a war budget will soak up the "inflationary gap" between personal incomes from all production and available consumer goods. As inflation subsides, imports will decrease and exports will increase. Balance of payments will improve. Loss of gold will be checked. Steadily expanding economic growth will create new jobs and reduce unemployment.

(3) Let the needy change from miscellaneous relief to a system of direct aid for food, clothing, and shelter, plus payment of all their medical bills, locally administered by social workers and the clergy. No special taxes. No accounting overhead. Lowest cost to taxpayers. Medical care for all the needy. Total security.

(4) Pay Government and other nonprofit employees an incentive from and in proportion to the billions they save and return to the Treasury or other source. Save enough to cut the budget of taxes $7 billion.

(5) Provide for the general use of farm-income insurance, correlated each year by Government, to guide production in the free market. The high cost of eating will come down.

When employers recognize the personal ownerships of employees and thus remove the cause of the "class struggle," Communists and other Socialists will be left without a mission, left with no "wage slaves" to "liberate." We can set an example of strikeless prosperity in partnership capitalism, expose the folly and immorality of socialism, show Marxists they are victims of the world's worst fraud, and challenge them to abandon their mistaken attempt to socialize the world and join us in the fight for complete economic freedom and industrial peace.

We, the people of the freed nations, partners in production, our private ownerships completely recognized and justly accounted for, can outproduce and outfight all the socialized serfs on earth. Partnership capitalism, not socialism, will win the cold war. Partnership capitalism, not socialism, is the system of the future, the shining hope of wise and honest people everywhere.

We, the subscribers, in view of the fact that socialism and communism are two faces of the same international conspiracy to abolish capitalism, do solemnly publish and declare our loyalty to partnership capitalism and to the United States of America. And for the support of this declaration, with a firm reliance on the protection of divine providence, we mutually pledge to each other our lives, our fortunes, and our sacred honor.

Mr. HALL. If we can do it, it will straighten out our economy, solve the fiscal and tax problem, and win the cold war.

The CHAIRMAN. Mr. Hall, we will insert the rest of your statement in the record.

(The document referred to follows:)

STATEMENT BY E. S. HALL, SECRETARY, FREEDOM, INC., FARMINGTON, CONN., ON THE BEST KIND OF A TAX CUT

The Revenue Act of 1963 is a monument to the industry and experience of Chairman Mills and the Ways and Means Committee and staff, based on the Treasury's assumptions: (1) That the Internal Revenue Code is basically sound; (2) that it exerts a drag on our economy because the rates are too high; and (3) that all we have to do to stimulate economic growth and balance the budget (after a temporary rise in deficits) is to cut tax rates.

I agree taxes are too high, but believe the assumptions are false. It isn't the high rates; it is the progressive income tax that slows our economic growth. The progressive income tax wastes our time, warps business decisions, eats up the capital needed for expansion, invites our best producers to slow down and quit. Incentive in reverse: The more we make, the less of it we keep.

The heavy progressive or graduated income tax was advocated by Karl Marx in the Communist Manifesto to abolish capitalism, the natural free-market private-ownership-of-business system that built the United States, and establish socialism, the price-controlled-and-supported government-ownership-of-busi-

ness system which has failed to feed the hungry in Soviet Russia, Red China, and Cuba.

In capitalism, however, the distribution of personal incomes has been unjust. Instead of giving us a law that would distribute incomes justly, Congress has been trying to correct the injustice by making many laws to redistribute incomes. Of all these laws, the most complex and voluminous is our progressive income tax law, the Internal Revenue Code.

The Internal Revenue Code of 1954 with amendments to date covers 1,280 pages. The Revenue Act of 1963 has 310 pages. One thousand five hundred and ninety pages of tax law to do one simple thing which it almost never does; namely, collect enough revenue to balance the budget! By failing to collect enough revenue, it necessitates deficit spending which inflates money, causing prices and imports to rise and exports to fall. Thus it causes the demand for protection, damages our balance of payments, and reduces our gold reserves. The Internal Revenue Code is a preposterous and subversive monstrosity, basically unsound. We need the new tax law that could be developed from the freedom tax bill, H.R. 737, a law that will collect the needed revenue, distribute personal incomes justly, and give every one of us a tax cut, a real take-home raise.

Now, as in 1776, it is time for a tax revolution. It is time for a declaration far more basic than the opening declaration of the Revenue Act of 1963. It is time for a declaration of independence from the half-baked ideas of Karl Marx. It is time for the declaration of economic freedom and industrial peace.

The Declaration of 1776 was the platform on which we won the war for independence; the names of those who signed it have had an honored place in our history. Today's declaration is the platform on which we shall win the cold war; the names of those who sign it will be honored by our posterity.

The CHAIRMAN. The committee will recess until 10 o'clock Monday.

(Whereupon, at 1 p.m., the committee was recessed, to reconvene at 10 o'clock on Monday, November 4, 1963.)

REVENUE ACT OF 1963

MONDAY, NOVEMBER 4, 1963

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, Long of Louisiana, Smathers, Anderson, Douglas, Gore, Talmadge, Williams, Carlson, Curtis, Morton, and Dirksen.

Also present: Elizabeth B. Springer, chief clerk.

The CHAIRMAN. The committee will come to order.

The witnesses today are Mr. Henry Ford II, and Mr. Stuart Saunders. They represent the Business Committee for Tax Reduction in 1963.

Their prepared statement indicates that they wished to appear together, and the committee welcomes you as two of the very distinguished businessmen of this country. Both of these gentlemen are well known. Mr. Ford, of course, needs no introduction. Mr. Saunders is a distinguished citizen of the State of Virginia and is a long-time friend of mine. He was a highly sucessful president of the Norfolk & Western Railroad. He is now the chairman of the board of the Pennsylvania Railroad.

Mr. Saunders, I understand that you desire to make a presentation, and you may go ahead.

STATEMENT OF STUART T. SAUNDERS AND HENRY FORD II, COCHAIRMEN, THE BUSINESS COMMITTEE FOR TAX REDUCTION IN 1963; ACCOMPANIED BY FRAZAR B. WILDE, VICE CHAIRMAN

Mr. SAUNDERS. Mr. Chairman and gentlemen of the committee, first of all, Senator Byrd, let me acknowledge those very kind words, and on behalf of my associates we welcome this opportunity and are privileged to be here today.

My name is Stuart T. Saunders. Sitting beside me is Mr. Henry Ford II. We are cochairmen of the Business Committee for Tax Reduction in 1963. Also sitting with us on my left is Mr. Frazar Wilde, vice chairman of our business committee, and also chairman of the Connecticut General Life Insurance Co. of Hartford, Conn.

We are here to support the dual goals of this organization—prompt, across-the-board tax reduction for individuals and corporations, and restraint in Federal spending.

These objectives were set forth in a statement of principles adopted when the committee was formed last April. Briefly, we believe that the present high level of Federal income tax rates inhibits incentives,

discourages economic growth, and is partly responsible for a level of unemployment which remains too high. We, therefore, recommend a prompt tax cut of about $10 billion per year achieved through reduction of all individual rates and of the corporate tax rate.

We also believe that in order to obtain the benefits of tax reduction, strict control of Federal expenditures and appropriations by both the executive and legislative branches of Government is essential. On May 28, our executive committee called for a reduction in the 1964 budget and stated that it believes that there is no situation foreseeable which would necessarily require the 1965 and 1966 budgets to increase over that proposed for 1964.

Business support for these goals has been growing at a gratifying rate. Our original target was 300 members, but the committee now has a membership of 2,767, most of them heads of their businesses, who share a common concern for the long-term growth of the private economy.

They come from every State in the Union and represent every segment of the business community, from large manufacturing companies and financial institutions to small retail establishments.

Perhaps no member of the business committee is satisfied with all the details of all the specific provisions of H.R. 8363. Accordingly, it would be inappropriate for us to comment on specific, technical features of the bill.

However, our executive committee has concluded that this bill, on balance, reasonably serves the broad objectives of our organization. The executive committee has also approved this testimony, and has asked us to express its appreciation for this opportunity to present its views.

The members of the executive committee are—

Cochairmen:

Henry Ford II, chairman, Ford Motor Co.

Stuart T. Saunders, chairman the Pennsylvania Railroad Co.

Vice chairmen:

Sam M. Fleming, president, Third National Bank in Nashville.

Frazer B. Wilde, chairman, Connecticut General Life Insurance Co.

Frederick R. Kappel, chairman, American Telephone & Telegraph Co.

T. S. Petersen, retired president, Standard Oil Co. of California.

David Rockefeller, president, the Chase Manhattan Bank.

Gardiner Symonds, Tennessee Gas Transmission Co.

J. Harris Ward, chairman and president, Commonwealth Edison Co.

Treasurer: Robert C. Baker, chairman and president, American Security & Trust Co., here in Washington.

Finance committee chairman: William C. Stolk, chairman, American Can Co.

Secretary: Claude E. Hobbs, Jr., director of Government relations, Westinghouse Electric Corp.

We support the general principles of H.R. 8363 for one fundamental reason, because we believe in a private enterprise economy. We believe that tax reduction will reduce the role of Government spending

in our economy and expand the role of private consumption and investment. And we believe that the American people will benefit from this shift.

There has been a great deal of debate over the effects of this bill on the Federal budget. This debate has been extremely helpful in arousing public concern over the rapid rise in Federal expenditures, but we think that one basic point has often been ignored.

Whatever effect a tax cut may have on the budget for this year or next, the basic fact is this: if the rate of taxation is reduced, then ultimately the Federal Government must take, in taxes, a smaller share of the national income and leave a larger share for State and local governments and the private sector.

In connection with this last statement, let me say we mean by this, Mr. Chairman, that this bill will result in a relative decrease in the share of national income absorbed by Federal taxes, and a relative increase in the share of other segments of the economy. The major increase, of course, will be in the private sector.

But, as the Treasury Department has pointed out, passage of this bill will also result in a very substantial increase in revenues accruing to State and local governments even though there is no increase in their tax rates. The reason, of course, is that it is hoped and expected, in fact, that this bill will stimulate a sharp increase in the rate of economic growth, thus increasing the national income and the tax base.

For decades, we have marched steadily toward bigger Government and bigger Government spending. The Federal budget has absorbed an increasing portion of our gross national product. This bill, it seems to us, is a turning point. It expresses a growing national consensus that Government is not the final answer to all our problems.

It expresses a growing public awareness that high taxes slow the growth of income and employment by reducing incentives to work and to risk savings in business ventures.

We recognize, of course, that many Government expenditures are necessary or highly useful to our society, and we know that Federal taxes and expenditures must and will continue at a relatively high level. However, experience has demonstrated that the current level of expenditures and tax rates is too high to permit satisfactory long-term economic growth.

Our Federal tax structure, in its main substance and impact, was conceived during World War II as an emergency step to raise urgently needed revenue. It was designed deliberately to curb expansion of the private economy and to finance expansion of Government activity.

The depressing effects of such tax rates were not felt during the war because of the artificial expansionary pressures of the military effort. These rates did not throttle the economy during the postwar decade because of pent-up civilian demand, and because of the Korean war.

What has been demonstrated in the past 6 years is that private demand and private investment cannot grow at a satisfactory rate when high wartime tax rates are prolonged into more normal peacetime conditions. During these 6 years, investment has been subnormal, and the unemployment rate has averaged 6 percent.

The first thrust of a tax cut would be to stimulate consumer spending and therefore production of consumer goods. In our opinion, the stimulus a tax cut would give to consumer spending, while bene-

ficial, is important mainly in the short run. It will continue to have an effect in the long run, but the principal long-term impact of a tax cut on the growth of our economy will come from added investment in up-to-date plant and equipment. It is widely recognized that the inadequate performance of our economy has its roots in the generally low level of return on business investment since 1957 and the resulting low level of capital spending.

Because there has been so much talk lately about record corporate profits, we want to emphasize that corporate profits after taxes have gone down, whether measured as a percent of invested capital, of sales, or of the corporate portion of GNP. As a percent of stockholders' equity, profits of manufacturing corporations are far below the levels of 1955–57 and earlier postwar periods of prosperity. In fact, aftertax profit as a percent of stockholders' equity for the period since 1957 is below the recession level of 1953–54.

The result is plain. From 1957 to 1962, GNP went up 16 percent in constant dollars. But plant and equipment spending went down 1 percent. In the first half of this year, plant and equipment spending was only 8.8 percent of GNP—the lowest level in 17 years.

We have a chart here, to my right, showing the lag in business investment since 1957 contrasted with the growth of consumer and Government demands for goods and services.

The conclusion is obvious, we think. Something needs to be done to stimulate more business investment. What that something is, also seems obvious. Businessmen invest in plant and equipment when they have the money to invest and the expectation of an adequate return.

The proposed tax cut attacks these problems in the most direct way. A cut in tax rates on corporate and individual incomes increases the attractiveness of investment in business ventures, especially the riskier ventures that must find backing if we are to have high, natural growth rates.

Present high tax rates load the scales heavily in favor of safe investments and against the risks of bringing out a new product or trying to sell in a new market. Tax reduction will reduce this bias. It will attract investment in new businesses and new ideas and thereby spark a faster rate of economic growth.

The increased cash flow resulting from the proposed reduction in the corporate income tax will also help many businesses, especially smaller ones, to finance new investment.

By making investment more attractive, tax reduction will channel more corporate and individual funds into investment. By increasing the expected return on investments, it will induce businesses to make investments that would otherwise not be made, and it will induce American and foreign businessmen to make investments in this country that might otherwise be made abroad. By increasing the expected return on investments, it will draw more funds into business ventures of all types.

The proposed tax cut will have still another effect on investment that could turn out to be the most important of all. As you know, investment decisions are strongly influenced by businessmen's views of the long-term business outlook. One of the factors that influences their judgment of the business future is their estimate of the Government's attitude toward business in the months and years ahead.

Most of the businessmen we have talked to regard the vote on the tax-reduction bill as a test of Government confidence in the private enterprise system. If the basic principles of the bill are enacted, they will take it as a sign that our national policy is to try to achieve faster growth through private enterprise. If tax reduction is not passed, they will take it as a sign that our national policy is to achieve faster growth through massive Federal spending. Business investment decisions will certainly reflect, to some extent, this reading of the political weather.

This, of course, is not sufficient reason for enacting a tax cut. But we do want to suggest to those who may favor a tax cut for other reasons, that this is an additional consideration of some importance.

We know that many people in Congress and elsewhere are fully convinced of the benefits of a tax cut, but are nevertheless opposed to cutting taxes now because of their concern over the Federal budget deficit. As we have already made clear, the Business Committee for Tax Reduction in 1963 shares this concern and strenuously opposes increased deficits to finance increased Federal spending.

We would like to discuss some of the reasons why our committee favors the tax reduction bill in spite of our concern, and in spite of the fact, that a tax cut will add to the budget deficit in the short run. And we want to tell you why we believe that tax reduction offers the best hope of controlling spending and balancing the budget in the longer run.

Some of the opponents of this bill, and even some of its supporters have tended to view tax reduction as just another way to give the economy a new dose of deficit spending stimulation. We think this conclusion is fundamentally in error; if it were valid, we could not support this bill.

An increase in the budget deficit caused by a reduction in taxes is very different from an increase caused by bigger spending. It is different because a policy of deficit spending stimulation adds temporarily to aggregate demand but does not help to provide the added incentives and investment we need for continuing economic growth. The proposed tax cut, on the other hand, is not an artificial stimulant, not a pep pill, but a step toward restoring the incentives that induce natural and vigorous growth in the private economy.

A temporary increase in the deficit is not the purpose, but the price of the tax bill. Our committee accepts this price because a tax cut is so urgently needed to restore the vitality of private enterprise—because a tax cut is the single most important step that could be taken at this time to stimulate the growth of taxable income—because the growth of taxable income, combined with control of Federal expenditures, will, in time, cancel out the loss of revenue resulting from a tax cut and thus contribute, not only to balanced budgets, but also to budget surpluses and a reduction in the national debt.

Perhaps, most important of all, in our thinking, is the conclusion that a tax cut would exert strong pressure to achieve better control of Government spending. In fact, the debate over the tax-reduction bill has probably done more to arouse public and congressional support for expenditure control than anything else that has happened in a long time.

As you know, it has been predicted that Congress will reduce regular appropriation bills this year by about $5.4 billion. Moreover, a num-

ber of proposals for new programs costing additional billions have not been passed. We are informed that, for the first time in many years, Congress might appropriate less money in this fiscal year than in the previous fiscal year. A good way to encourage strong spending discipline again next year and the year after is to pass the tax bill.

The basic reason for concern over budget deficits is that they could create strong inflationary pressures. At present, however, demand is too low rather than too high. It is too low to take up the slack in the economy and to provide enough jobs, and some sections of the country are suffering from severe, chronic unemployment.

Inflation caused by excessive demand is not likely to occur in these circumstances because supply can readily be expanded to keep pace with demand up to the point where the economy is again operating at reasonably full capacity.

We can have the benefit of more jobs and higher production, without inflation, only if wage and fringe increases are kept within reasonable bounds and businesses exercise strong control over all their costs. We are, therefore, heartened to note that excessive wage and fringe increases have become less common and that industry has a good overall record on cost control in recent years.

As far as the long-run outlook is concerned, a tax cut contains a number of built-in mechanisms that counteract inflationary pressures.

In the first place, by increasing pressure for spending control, a tax cut will hold Government spending below what it would otherwise have been, and thereby partially offset the rise in demand resulting from lower taxes.

Second, a tax cut helps to counteract inflationary pressures by providing added incentives for investment in the new production capacity which is necessary to keep supply in step with rising demand.

And, finally, a tax cut helps to reduce inflationary pressures by stimulating capital expenditures to replace outmoded and inefficient plants and equipment, thereby raising the efficiency and productivity of industry.

For these reasons, a rise in demand created by a tax cut is less likely to lead to inflation than a rise in demand due to increased Government spending.

In this connection, we wish to emphasize, again, as we did in our statement of principles, the importance of financing the deficit in a noninflationary manner.

These considerations, together with strong indications that Congress and the administration will limit the rise in Federal spending, lead us to conclude that we can have a tax cut without inflation. We don't suppose it's a sure thing. There are some risks. But the odds seem good enough, and the benefits of a tax cut are certainly high enough, to justify the risk.

In conclusion, we want to discuss, very briefly, why we believe it is important to enact tax reduction this year. Certainly, the effective date should be January 1, 1964.

We know that the proposed tax cut is not a cure-all that will keep us from ever having a recession again.

But we do believe that a tax cut will put new strength in the economy, strength that will help to prolong the upswings in the business cycle and carry them to a higher level than has been reached for the last 6 years.

The longer we wait before cutting taxes, the closer we come to the next downturn. The sooner we act, the better our chance of prolonging our present momentum. As Mr. Ford and I outlined in our letter of October 14 to all Senators, we believe serious risks are involved in not acting this year.

If we wait too long, we may well find ourselves back where we were in 1958, and again in 1960—with business falling off, Government receipts dropping, unemployment climbing, Government expenditures rising, and the budget deficit going sky high. As you well know, these are the circumstances that make for overwhelming pressure to prime the pump with more and more Government spending.

Today, we have even more to lose from this course of events than we had in 1958 or 1960. Public opinion today seems ready to abandon the effort to achieve prosperity through Government spending. There is growing bipartisan support for curbing the growth of government and giving the private economy a better chance to show what it can do.

If we miss the opportunity to take this step now, it may be a long time before it comes again.

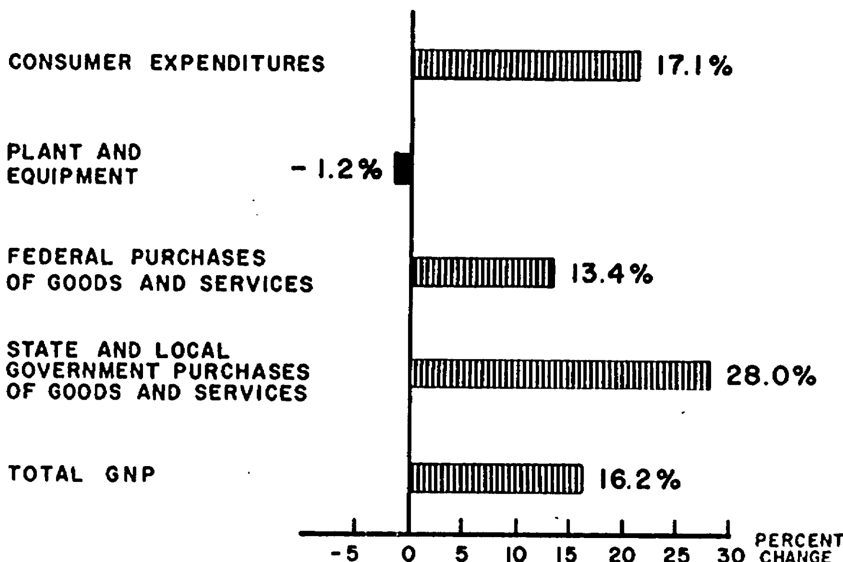
As we said earlier, this tax bill is not perfect. It is not a panacea. But it is a big step in the right direction.

On behalf of the Business Committee for Tax Reduction in 1963, we thank you, sirs, for the opportunity to testify in support of the broad goals of H.R. 8363—tax reduction and restraint in Government spending.

(The attachment referred to follows:)

PERCENT CHANGE IN REAL GNP
AND MAJOR CATEGORIES OF EXPENDITURE
FOR GOODS AND SERVICES

1957-1962



The CHAIRMAN. Thank you very much, Mr. Saunders.
Mr. Saunders, you state:

As you know, it has been predicted that Congress will reduce regular appropriations bills this year by about $5.4 billion.

Who made that prediction?
Mr. SAUNDERS. Just recently Congressman Cannon, who is chairman of the Appropriations Committee made this statement in connection with the appropriation bill just a few days ago, and I think he is, as you all know, a very well-known authority in this field. He said this:
"The table discloses that the House has cut $4,731 million from the budget request considered in the nine regular bills it has passed for fiscal 1964. Characteristically, the Senate has been reversing some of these cuts. But the early outlook for final congressional reductions on the order of $5,400 million on regular bills for 1964 remains valid."
That was the statement he made just a few days ago.
The CHAIRMAN. Are you speaking of the expenditure budget or speaking of new obligational authority?
Mr. SAUNDERS. That was the obligational budget.
The CHAIRMAN. That is a very different thing from the expenditure budget.
Mr. SAUNDERS. That is true, of course.
The CHAIRMAN. New obligational authority generally speaking, is new appropriations. They may be actually spent over several years. If they are cut now they may be supplemented later. The spending will be out of both new appropriations and appropriations enacted in prior years. As a matter of fact there were some $87 billion unexpended balances in previous appropriations before the first appropriation bill was enacted this year. The President requested $108 billion in new obligational authority this year. If these new requests were granted, he would have $195 billion available for expenditure. It is actual expenditures each year—not new obligational authority—as compared with revenue which determines the deficit or surplus.
Mr. SAUNDERS. That is correct.
The CHAIRMAN. What really counts is the expenditure budget.
Mr. SAUNDERS. However, the $87 billion, as I understand it, they are authorizations, but do not necessarily obligate them to spend. The President may or may not.
The CHAIRMAN. Well, this reference you made to reductions of $5.4 billion is not the spending budget.
Mr. SAUNDERS. No. But if, as I understand it, Senator Byrd, you make reductions now of this amount, in due course of time it is bound to have an effect on your spending budget. I mean you have got to start at some point in time. We are suffering now from an excess of expenditures that were authorized some years ago. If you will start cutting down that would certainly benefit in the long run.
The CHAIRMAN. An obligational authority can be canceled and put back, or not canceled in the future.
Mr. SAUNDERS. That is correct.
The CHAIRMAN. It is the expenditure budget which is immediately important.

Mr. SAUNDERS. I agree with that, sir.

The CHAIRMAN. That determines the deficit.

Mr. SAUNDERS. I agree with that. But if you do not start cutting at some time, and if you do not start cutting in your obligational budget, you are never going to cut the other, in my judgment.

The CHAIRMAN. But you say for this year. I think, Mr. Saunders, with all respect to you, that could be a misleading statement. It does not necessarily mean the reduction of the expenditure budget.

Mr. SAUNDERS. Well, I can accept your statement to this extent, that certainly it does not mean a cut this year in the expenditure budget. But it does seem to me that the point is perfectly valid that if you do make these reductions this year we are going to benefit from it in the long run and, necessarily so, and we welcome this reduction in the obligational budget. We think it is a very healthy step.

The CHAIRMAN. I want to differ with you on the "necessarily so" because an obligation can be authorized or decreased this year and put back the next year.

The expenditure budget is the one that counts. That determines whether or not you have a deficit as between revenue and expenditures.

Mr. SAUNDERS. But the salutary thing, Senator, is you have taken the first step, and if you didn't take that we would not be faced with this good prospect.

The CHAIRMAN. Then you say that your executive committee called for a reduction in the 1964 budget and, and I quote—

believes there is no situation foreseeable which would necessarily require the 1965 and 1966 budgets to increase over that proposed for 1964.

Mr. SAUNDERS. That is right.

The CHAIRMAN. Where did you get that information?

Mr. SAUNDERS. Well, we get it on this basis, that looking at the budget for the current year or fiscal 1964, and the level of spending that has been taking place, we see no reason why the administration and Congress, acting together, if you are sincere in wanting to exercise discipline in government spending, as to why these things cannot be held down, and we think that a tax cut would be a very strong lever in bringing that about.

The CHAIRMAN. Is that wishful thinking on your part or is it based upon some information?

Mr. SAUNDERS. I do not know that you can base anything on these other that what actually eventuates. It is not wishful thinking to this extent. We are merely expressing an opinion as to what we think Congress can do if it wants to do it.

The CHAIRMAN. Your organization has been working very closely with the executive branch of the Government?

Mr. SAUNDERS. No, sir; that is not true.

The CHAIRMAN. Well, then, the President addressed you.

Mr. SAUNDERS. Yes, he addressed us.

The CHAIRMAN. I just was wondering whether you had some information about these reductions.

Mr. SAUNDERS. As a matter of fact, I do not know whether they agree with that statement at all.

The CHAIRMAN. I recall the House made one reduction in a basic bill and the President severely criticized it. That was a reduction in foreign aid. Do you think that reduction ought to be put back or not?

Mr. SAUNDERS. I do not think it would be appropriate for me to come here to undertake to tell you or the Senate what specific things you ought to do. You are much closer to them than I am.

On the other hand, as a citizen interested in good government, and a businessman who is very much opposed to deficit spending, I am convinced that if Congress really wants to reduce expenditures they can do it, and we think that this bill will provide a greater incentive and a better atmosphere to bring it about than anything that has happened in a long time.

The CHAIRMAN. As a matter of fact, very few appropriation bills have been enacted at this session.

Mr. SAUNDERS. There have been quite a few through the House.

The CHAIRMAN. I do not know anybody who can predict what is going to happen. I have been here 30 years, and I have not been able to predict what the Congress can do in the future.

Mr. SAUNDERS. I am only giving you what Congressman Cannon said.

The CHAIRMAN. I am not trying to embarrass you at all.

Mr. SAUNDERS. You are not embarrassing me at all.

The CHAIRMAN. I just do not understand where you got the figures you have given when most of the appropriation bills have not been enacted.

Mr. SAUNDERS. Well, there are a number of appropriation bills that have passed through the House. The bills that have had House action on them so far—you have got your supplemental agricultural bill, the supplemental public works acceleration bill where, you know, there was a substantial cut of $900 million made. Then you have got the 1964 appropriations for Interior, Treasury, Labor, Agriculture, Legislative, State, Justice, Commerce, Judiciary, Defense, District of Columbia, and Independent Offices, with a total appropriation of $80 billion involved, $80,558 million involved, with a reduction of $4,734 million. They have all been acted on by the House, and several have been acted on by the Senate.

Senator WILLIAMS. Which one did you say had a $900 million reduction?

Mr. SAUNDERS. I thought it was the public works acceleration bill.

The CHAIRMAN. How many of those bills you have read off have been passed by both branches of the Congress? All of these have been passed on by both branches of the Congress?

Mr. SAUNDERS. All of these have been passed on by the House. The Senate, I think, has acted on four.

The CHAIRMAN. I would respectfully submit that you cannot predict what is going to happen with appropriation bills when they have not passed.

(The record on enactment of appropriation bills to date follows:)

Status of appropriation bills, 1st sess., 88th Cong.

Number of bill	Short title	Passed House	Received and referred in Senate	Reported in Senate	Passed Senate	Sent to conference	Conference report agreed to in— Senate	Conference report agreed to in— House	Date approved	Number of law
		1963	1963	1963	1963	1963	1963	1963	1963	
H.J. Res. 284	Agriculture supplemental, 1963	Feb. 27	Feb. 28	Feb. 28	Mar. 4	X X X	X X X	X X X	Mar. 6	88-1
H.R. 5279	Interior, 1964	Apr. 2	Apr. 3	May 22	May 28	July 10	July 18	July 17	July 26	88-79
H.R. 5366	Treasury, Post Office, 1964	Apr. 4	Apr. 8	May 3	May 8	May 15	June 4	June 4	June 13	88-39
H.R. 5517	Supplemental, 1963	Apr. 10	Apr. 11	Apr. 24	May 1	May 3	May 15	May 14	May 17	88-25
H.R. 5888	Labor, Health, Education, and Welfare, 1964	Apr. 30	May 1	Aug. 1	Aug. 7	Sept. 23	Sept. 26	Sept. 26	Oct. 11	88-135
H.R. 6754	Agriculture, 1964	June 6	June 10	Sept. 12	Sept. 30					
H.R. 6868	Legislative, 1964	June 11	June 13	June 25	June 26					
H.R. 7063	State, Justice, Commerce, 1964	June 18	June 19							
H.J. Res. 508	Continuing, 1964	June 25	June 25	June 25	June 25	X X X	X X X	X X X	June 29	88-55
H.R. 7179	Defense, 1964	June 26	June 27	Sept. 17	Sept. 24	Sept. 26	Oct. 8	Oct. 8	Oct. 17	88-149
H.R. 7431	District of Columbia, 1964	July 11	July 15							
H.J. Res. 667	Continuing, 1964	Aug. 27	Aug. 27	Aug. 27	Aug. 27	X X X	X X X	X X X	Aug. 28	88-109
H.R. 8747	Independent Offices, 1964	Oct. 10	Oct. 11							
H.J. Res. 782	Continuing, 1964	Oct. 28	Oct. 28	X X X	Oct. 28	X X X	X X X	X X X		

Source: Excerpt from Senate Calendar, Monday, Nov. 4, 1963.

The CHAIRMAN. Let me call your attention to the recent increases in expenditures. In 1961 expenditures totaled $81,500 million; in 1962 the expenditures were $87,800 million; in 1963 fiscal year, the expenditures were $92,600 million.

You are basing your support of the tax cut, as I understand it, on the theory that there will not be increases, that there will be a reduction of $5.4 billion, and then there will be no increases in the years of 1965, and 1966.

You stand for a balanced budget, do you not?

Mr. SAUNDERS. Yes, sir; certainly.

Let me correct one statement you just made, Senator Byrd. We are not basing or predicating it upon these figures being exact. We are basing it upon the expectation that this will take place, and the hope. But we think that this tax bill will enable Congress to go a long ways to bring this about. We think it will be a powerful incentive to make Congress more economy minded.

The CHAIRMAN. I would respectfully suggest that these figures you are giving are too conjectural for use in justifying a tax cut of $11 billion, you are talking about some appropriation reductions that have not yet been enacted, and you are giving assurance that the future appropriations for 1965, and 1966 will be reduced in proportion to reductions this year which have not been determined. To the contrary there has been a steady increase in the expenditures of the Federal Government, as you well know.

Mr. SAUNDERS. I do not think anyone, Senator Byrd, can give you any assurance or guarantee that Federal expenditures are going to be held in line. We are expressing the hope and belief that they will be, and we believe that this bill is the best way to effect that.

We do believe, as a matter of fact, that the history of the past 6 years or the past 15 years, you can take it any way you want to, has demonstrated if you continue to follow the policy you have been following we are going to have exactly what you are talking about, increased Government spending, larger deficits, and no balanced budget, and the people of this country have come to the conclusion that the program that you advocate will not work, and we think it is time to try something else.

We think that—we are sick and tired of deficit spending, and the program that you are advocating, the program that has been followed by this committee or this Congress for so many years, has produced nothing but deficits—11 out of 15 years we have had deficits. I think it is high time we tried something else.

Senator DOUGLAS. Mr. Chairman, I want to defend the chairman from the criticism which the witness has just given. [Laughter.]

I do not believe that the chairman entertains those ideas at all. I want the record to show that the attack by the witness upon the chairman is unjustified and untrue.

Mr. SAUNDERS. Senator Douglas, may I say this, I know no one who can defend himself better than Senator Byrd, and I know of no one who needs help more than I do. [Laughter.]

The CHAIRMAN. The Senator from Illinois seldom defends the chairman. [Laughter.] But, we remain good friends and I thank him.

I do not want to take up too much time with questioning. I do suggest that these are conjecturals that you have made about having

no increases in expenditures for the years 1965 and 1966, and also about the present year, where some have not been finally enacted. You must have seen the statement the President made about the House daring to cut the basic foreign aid bill by $400 million. He said it was fiscal irresponsibility, and severely condemned the legislative branch of the Government for making this cut.

You, of course, know that the taxpayers in the $3,000 bracket only get a $49 a year reduction?

Mr. SAUNDERS. Yes; I have seen figures.

The CHAIRMAN. In the $5,000 they get $67 reduction. The $5,000 to $10,000 get $90 reduction; the $10,000 to $20,000 get $165; the $20,000 to $50,000 get $560; the $50,000 and over get an average reduction of $2,194.

The average reduction for all taxpayers is $110.

Mr. SAUNDERS. Yes.

The CHAIRMAN. I respectfully differ with you when you think that is going to be a great stimulant to business, and solve the unemployment problem.

It has been stated by the Secretary of the Treasury that this will remedy our imbalance of payments to foreign countries and prevent the gold from going out. You say it is going to bring prosperity, and some say it will do this, that and the other.

If we have reached the point in this country where all you have to do is to reduce taxes and add to the public debt to solve our problems, the solution would be very simple——

Mr. SAUNDERS. We have not said that, Senator Byrd. In fact, we have said just the contrary.

The CHAIRMAN. Don't you think, as a businessman, when you make an expenditure—this proposal is actually an expenditure, a reduction of the revenue, of $11 billion to be charged into the debt—that you ought to have performance as to the budget rather than a promise?

Mr. SAUNDERS. Well, any businessman who makes an investment knows there is a great deal of risk in it. There are very few things in this life that are certain that I know of, and certainly investment is one of the most speculative things you have to make, and unless you have a real incentive, unless there is an element which gives you a chance to really get your money back at a decent rate of return, a good rate of return, you are not going to make it.

We look upon this tax cut here as an investment in the future. We are asking you to make an invesment of some $10 or $11 billion in the future of this country, and we believe you are going to get a handsome return on it, and that is the basis on which we make business investments. We think that is a good basis for the Government to make an investment in the future of this country.

The CHAIRMAN. Now, the expenditures start with the budget presented by the President; do they not?

Mr. SAUNDERS. That is true.

The CHAIRMAN. What great harm would be done, if this bill were not enacted until after the budget is submitted in January, and we find out whether there will be reductions in expenditures?

Mr. SAUNDERS. Well, I think that is a very plausible suggestion.

On the other hand, I think it is fraught with danger, and I think it is unnecessary. In the first place, I do not believe that the budget,

whatever budget the President sends up, should be controlling on whether this tax cut should go forward or not. I, of course, am very hopeful that the budget next year will be no higher than fiscal 1964. But even if it is $1 billion or something higher, I think the Congress of the United States has the responsibility to cut it back, and I would hope you would do it, or even cut it more than that.

Moreover, as you well know, after the first of the year you are flooded with all sorts of messages and proposals. Congress traditionally never passes or passes few, if any, bills in the early part of the year.

Being an election year, I do not know what might happen to this tax bill; and you are also going to get into a great debate, I am afraid, over the question of retroactivity, when the effective date should be. All in all we think this is a good bill. It is going to help our economy, and if it is a good bill, why postpone the day? Why don't we take action now?

If it is bad it should be turned down. If it is good it should be enacted. It should stand on its own merits.

The CHAIRMAN. You have no particular fear of increasing the deficit?

Mr. SAUNDERS. Of course I have a fear of increasing the deficit, and the very reason I am here today is because I do not like what has been happening for the past 15 years when we have had deficits 11 out of the 15 years. I think there is something wrong with the course we have been pursuing.

The CHAIRMAN. To your knowledge has any President recommended to Congress a planned deficit based on tax reduction?

Mr. SAUNDERS. I do not call this a planned deficit. I call this an investment in the future of this country, and I think it is a program to do away with deficits.

The CHAIRMAN. You say you believe that the budgets are going to be held down and not increased. How do you know that?

Mr. SAUNDERS. I do not know that. I am hopeful it will be. We think this bill will be a strong incentive to hold them down.

The CHAIRMAN. You think to postpone this tax reduction until the budget comes in would be inadvisable?

Mr. SAUNDERS. I think it is unwise; yes, sir.

The CHAIRMAN. It is only 60 days from now.

Mr. SAUNDERS. I think you run the risk, we run the risk, of getting no tax bill whatever. Business people right now have to make decisions for next year with reference to capital expenditures. If we do not know whether there will be a tax bill or not——

The CHAIRMAN. Why do you say there will be no tax bill?

Mr. SAUNDERS. I do not know. I have no assurance.

The CHAIRMAN. The bill is carried over——.

Mr. SAUNDERS. That is true.

The CHAIRMAN. Until next year, and many of those, and I am one of them, want a tax reduction. I want it badly. I pay substantial taxes.

I sit here as chairman of the Finance Committee. I am on both sides, and I want it. But I want it on a sound basis. I do not want to add it to the public debt.

Mr. SAUNDERS. That is where the question of——

The CHAIRMAN. Why would 60 days make all this difference?

Mr. SAUNDERS. I do not see what can happen in the next 60 days which would change this bill from a good bill into a bad bill or vice versa.

The CHAIRMAN. Mr. Saunders, I do not seem to be able to make myself clear to you. I say that the budget submitted by the President is a first step toward expenditures, and that we have a right, the Congress has not only the right but the responsibility, before it enacts this tax bill, to know whether the expenditures are going to be recommended at a higher, lower, or at the same rate by the President.

Mr. SAUNDERS. But, it seems to be, Senator Byrd, that regardless of what the President recommends, which I now hope that he will recommend a budget that is on the low side, but regardless of that, Congress has a responsibility also to reduce expenditures and to hold these in line, and if he does not do it, you all should do it for him. You should not hold up this bill on the basis of wait and see what, if anything, he is going to do.

The CHAIRMAN. Of course, we have a joint responsibility. But you have had enough contact with Government to know it is very difficult to cut the budgets sent in by the Chief Executive because the burden of proof then rests upon the Congress. With the President actively opposing reductions, as Mr. Kennedy is now doing in foreign aid, it is difficult, if not impossible, to cut the budget.

I won't take any more time. Senator Smathers.

Senators SMATHERS. Mr. Chairman, the only thing I would like to say at this moment is that I wish to congratulate Mr. Saunders on the statement which he has made. I find myself in almost total agreement with it.

I would like to, at this point, waive my right to ask questions and reserve it in case I want to ask some later.

Mr. SAUNDERS. May I say, Senator Williams, these other people are here to testify, too. Direct the questions to anybody you like. [Laughter.]

The CHAIRMAN. I understood Mr. Saunders was going to do the talking. I owe you an apology. You are a very distinguished American, Mr. Ford. We would be delighted to hear from you.

Mr. SAUNDERS. Thank you, sir.

Senator WILLIAMS. Does Mr. Ford wish to make a statement first?

Mr. FORD. No. I do not have any statement to make, Senator Williams.

The CHAIRMAN. Mr. Ford, do you desire to address the committee? We should be pleased to have you.

Mr. FORD. Senator Byrd, Mr. Saunders read the statement on behalf of the executive committee of the businessmen's committee.

The CHAIRMAN. We would be very happy, sir, to have you make a statement.

Mr. FORD. Well, whatever I will make, I will make off the cuff, Senator. I was just going to say there is just one point of clarification I would like to make on expenditures.

From the very beginning the committee felt that it was very difficult for the committee itself to tie the control of Federal expenditures with the need for a tax cut. We felt that the growth of the economy of the United States had not been taking place at a quick enough

rate, that there was substantial structural unemployment in this country, and that even though the tax cut recommended would increase the Federal deficit over a short period of years, this tax cut was justified in order to contribute to a faster growth of the economy and to help reduce the unemployment problem which presently exists in the United States.

Now, I agree with what Mr. Saunders has said, sir, and I know it is your philosophy that Federal expenditures must be controlled.

On the other hand, I think that you would agree that it is very difficult for this businessman's committee to, in any way, have any effect on the control of expenditures, either those submitted by the administrative branch of the Government or the discussions which would take place in the Congress after they have been submitted by the administrative branch.

So, therefore, we felt that we should disassociate ourselves in our interest in seeing this general tax cut take place from specifics on controls of expenditures.

We are not for high Federal expenditures. But we did not feel that we could take a positive position in this area. Our job was to do all we could to promote a tax cut, both corporate and for individuals in 1963.

Senator GORE. Mr. Chairman, would you let me make an observation? These two gentlemen have now expressed sharp disagreement. Maybe they should resolve their own difference before speaking in a unified way for their organization.

Mr. FORD. Ours is a very loose organization, Senator Gore.

Senator GORE. It must be.

Mr. FORD. We not only speak as a part of this group but also——

Mr. SAUNDERS. In what respect, may I inquire?

Senator GORE. It must be very loose because the chairman and vice chairman have disagreed with each other.

Mr. SAUNDERS. We have not. Would you be specific, sir?

Senator GORE. I just asked the chairman to yield. I will be glad to come back to this when it is my term to ask questions.

Mr. SAUNDERS. Thank you very much.

The CHAIRMAN. I wanted to make it very clear to Mr. Ford that the chairman has no idea of any plan to link together tax reduction and expenditures. But before he can vote for this bill the chairman thinks it would be proper to have some statement, as positive as possible, that the executive branch of the Government intends to hold down expenditures instead of urging upon the Congress the highest peacetime budget ever submitted.

Pardon me.

Mr. FORD. Senator, as Mr. Saunders has already testified to the Finance Committee, our committee very strongly feels that there should be control of Federal expenditures, and I cannot disagree with your statement, but I do feel that business generally in the United States has felt that this tax bill would be effective on January 1, 1964, and I think that to some extent this has already been discounted.

Certain businesses are looking forward to the reduction in corporate tax in the hope that they can expend more funds for capital expenditures, and I feel that although the economy is very strong at the

moment, the psychological situation can change very quickly, and I do not know how many individuals in this country have looked forward to personal tax cuts and planned their own personal budgets in the hope that they would get a tax cut by January 1.

I can well understand your feeling that it would be best to see the Federal budget for fiscal 1965 before voting on this tax cut. I think that is a very realistic approach to the problem.

Frankly, I think the control of Federal expenditures, although it is something we all want, is going to be a hard goal to achieve, and I do not know how you go about it, because I have not spent much time here in Washington, and I have never been in Government, but I know this is a problem, and I would hope that some way could be accomplished, but I do not know how.

The CHAIRMAN. Thank you, sir.

Senator Williams.

Senator WILLIAMS. Gentlemen, as I understand it, you look upon this tax reduction as a long-awaited dividend to the American taxpayers, who are, in reality, the stockholders of America. Would that be a fair definition of what you said?

Mr. SAUNDERS. I think that is one way to put it, yes.

Senator WILLIAMS. That is the way I look at it.

Now, both of you are presidents of two of America's greatest corporations. As presidents of those corporations would you recommend a dividend to your stockholders if you had a deficit comparable to what we have on the national level, and considering that in the past 30 years you had only lived within your income or produced a surplus in 6 years? If your company had such a record as that would you recommend this dividend to your stockholders?

Mr. SAUNDERS. Well, I think—if you want to call it a dividend, I do not call it a dividend.

Senator WILLIAMS. You just agreed with me that it is a dividend.

Mr. SAUNDERS. It is only matter of semantics. Actually I said it was an investment, and I regard it as such, and when you talk about something being a dividend, you are talking about something that belongs to the people in the first place. If you would pursue your policy, you are entitled to all the money in this country, the Government is, and whatever we give the taxpayers is a dividend—that is not my philosophy of government.

Senator WILLIAMS. Just get it straight, and don't refer to this as my policy. This is your policy as well we are discussing. We both agreed in the beginning——

Mr. SAUNDERS. Yes, but I think we used——

Senator WILLIAMS (continuing). This could be termed a "dividend." If you want to disassociate yourself from your earlier statement, all right.

Mr. SAUNDERS. What I am talking about is this, let me put it in these words.

Senator WILLIAMS. That is what I want you to do, put it in your own words, and not try to state my position. Just use your own words.

Mr. SAUNDERS. Let me express my views then. A business corporation has a project before it. Maybe it is losing money, maybe it has

a substantial deficit, but here is an investment they can make costing, say, $1 million. They get a 25-percent return on that investment. That is good business, and business people do that day in and day out, borrow money even when they are losing money to make more money in the future, to get new markets, create more wealth, and that is exactly what is being proposed in this tax bill.

Senator WILLIAMS. On that line of reasoning, why not increase this tax reduction a little bit, and maybe we can make a payment on our national debt?

Mr. SAUNDERS. Of course, you can make anything absurd, Senator. You can say that 1 spoon of sugar is good, then 10 are even better. But there has got to be some balance.

We think that this bill represents a constructive step. We do not think it goes far enough, certainly not. As a matter of fact, I think our tax rates will still be too high even after the step that you are taking here. But you cannot go all the way at one time. It has to be done gradually.

Senator WILLIAMS. As you have pointed out before, cutting the expenditures is very hard to achieve. I have as yet to hear any witness before our committee, nor have I talked with any citizen back home, who is not in full agreement that Government expenditures should be reduced. We are all in agreement.

But when we start to reduce them we always find that each one objects to a reduction in his particular project.

Now, the House cut foreign aid, and you have just bragged about the fact that the House made these reductions in their appropriations bills. The President denounced that reduction and is asking the Senate to restore it.

Would you support the House reduction on foreign aid or do you think the Senate, as the President said, should restore part of it? We have to be specific if we are going to answer those questions. What would be your personal position?

Mr. SAUNDERS. As I said, in response to a similar question from Senator Byrd, I think it would be presumptuous on my part to come before this group and to undertake to tell you what expenditures you ought to cut or what ones you should not cut. I think that is primarily your function.

We are certainly willing to offer our views and to give you the benefit of them. Whether it should be foreign aid or whether it should be ARA or whether it should be mass transit or what, that, it seems to me, is for the Congress to decide.

I have no hesitation in saying that the level of spending is far too high. But as to what the specifics and what the merits or lack of merits of any particular project may be I cannot say that to you. If I did I would be saying it without adequate information. If I spent my full time here I think I would be in a position to offer a judgment on it, but I am not in my present position.

Senator WILLIAMS. You have made some rather definite suggestions here this morning so far, but our great difficulty has been that no one will take the responsibility of saying "This particular project should be cut." Do you not have an opinion on this point?

Mr. SAUNDERS. I think that is the responsibility of Congress, if I may say so, sir. It is the responsibility of the administration and the

responsibility of the Congress. It is not my responsibility as a citizen to tell you what you ought to do in any particular field.

Senator WILLIAMS. Then you feel that you would be willing to support any decision we make in connection with this tax bill because it is our responsibility and not yours?

Mr. SAUNDERS. All we are asking you to do is to act. I think you will reach the right decision. I have no doubt about it.

Senator WILLIAMS. Now, to be specific on this particular bill—one section of this bill repeals the 4-percent dividend credit. As I understand it, you support the bill with that provision in it?

Mr. SAUNDERS. As I stated earlier, Senator Williams, there are a lot of features about that bill we do not like. Our committee, as such, has taken no position on any of the particular items in the bill, and we do not expect to.

Speaking individually, in my own position as an individual citizen, I do not like the elimination of the 4-percent credit. But I am so much in favor of a tax cut, and I think that the benefits will be so great that I am willing to accept things in this bill that will cost me money personally but which I think will benefit the country in the long run and which, I think, are worthwhile.

Senator WILLIAMS. What I am trying to get clear. Would you support the bill with the repeal of the dividend credit?

Mr. SAUNDERS. Yes, sir.

Senator WILLIAMS. Is that your position, too, Mr. Ford?

Mr. FORD. Yes, sir.

Senator WILLIAMS. The administration has suggested that either we should delete from this bill that section which would reduce the capital gains tax or we should include in the bill a new section which would tax at capital gains rates all of the unrealized income upon the death of the individual.

Do you embrace that administration suggestion in that respect?

Mr. SAUNDERS. No, sir. Again our committee, as I may say, has taken no position on any of these matters as such. We are taking a position simply on the overall bill.

We think the bill, taken on balance, is a good bill. We do not support the administration's view with reference to capital gains.

Senator WILLIAMS. If the administration's position were approved, suppose we leave the capital gains provision in the bill and suppose there was included in the bill also the additional section which would tax at capital gains rates all unrealized income on the death of the individual, would you still support the bill with that provision in it?

Mr. SAUNDERS. Our committee, as I said, takes no position on that. But, as an individual I would. Mr. Ford might not. We have made it clear in our statement of principles that as to individual items that each member of our committee has a right to have his own views. There has to be no conformity of view at all.

Senator WILLIAMS. I appreciate that, and I am just asking about yourself and your position.

Mr. Ford, would you state what your position would be, assuming that the committee added to this bill a new section, which would tax at capital gains rates all unrealized income at death.

Mr. FORD. I am against the Treasury's proposal as an individual, Senator.

Senator WILLIAMS. I might say I do not agree with it either, I want that clear, but the administration is making that recommendation. But if the administration's approval and recommendation were adopted in this bill, would you still support the bill with that provision in it?

Mr. FORD. That is a very difficult question for me to answer because I do not know that I am qualified to answer it.

I think you have got to take into consideration lots of different topics that I do not know that I am qualified to take into consideration. I have not personally gone through all of the aspects of the House-passed bill. There may be others in there that I would object to strenuously, as well, and I have not looked at. My position as a member of this committee or as an individual, is not that am I for the bill with or without particular amendments which have been made by the House.

So I have not considered the bill on that basis. My support of the bill, as I have already stated, Senator, is based on the consideration that I think will increase the economic growth in this country at a faster rate, and also help to reduce unemployment, and it is an investment in the future for this country.

I have not considered whether I would be for the bill, frankly, with or without this amendment or other amendments as suggested by the House.

Senator WILLIAMS. Well, you do embrace the bill as it was passed by the House?

Mr. FORD. In general, yes, sir. I would accept the whole bill as passed by the House.

Senator WILLIAMS. You would have to be familiar with it to do that. I am sure you have not endorsed it without knowing what is in it.

Mr. FORD. No, sir; I do not know the details that are in the bill. I have not read the bill.

Mr. SAUNDERS. Let me say this, Senator. Our position is simply this: We are familiar, without going into the details of individual proposals, we are satisfied that overall, and considering everything that is in the bill, this is a good bill on balance, and we are in favor of it.

Senator WILLIAMS. Well, I happen to be one who thinks this new proposal of the Treasury's to put a tax of capital gains rate on all unrealized income at death is a rather far-fetched and dangerous suggestion; but it has been made, and I was trying to get your opinion.

If the administration is successful in persuading this committee or the Congress to include that provision and that is the one change for which they are asking, would you still support the bill?

Now, Mr. Saunders has said that he would, and I would like to know what your position would be because some of us are going to be confronted with that choice. I do not agree with it, but other members of the committee may——

Mr. FORD. I do not agree with the proposal of the Treasury either, sir.

Senator WILLIAMS. Would you still say it would be a good bill, worthy of passing, even though it embraced that suggestion? Or do you think that would be the turning point that would lose your support?

Mr. FORD. I think you have got to look at the bill as it comes down to the final drafting, and see what other things are put in or taken out, and I do not know how the bill is going to end up, sir, in your committee, and I think it would be rather impossible for me to make such a decision.

Senator WILLIAMS. It would for me. But I am making the assumption that no other change is made in the bill, only the addition of the Treasury's recommendation to tax at capital gains rate unrealized income at death; just assume all other factors in the bill were left the same.

Mr. FORD. Well, I do not know what study would show about how this affects people, so I am just not qualified to answer that question, Senator.

Senator WILLIAMS. One other question. After this bill has been disposed of, prior to next June we are going to be confronted with the problem of extending certain excise taxes.

Many of these excise taxes were also Korean war taxes.

Would you say that the enactment of this bill would lay aside any possible consideration of eliminating these excise taxes and that they would have to be extended, or do you think they, too should be dropped next July.

Mr. SAUNDERS. I think that matter should be carefully considered by the Congress and, of course, will be.

However, I do not think, by and large, what action you take here in any way forecloses your decision of what action you may decide to take later on with regard to other taxes.

Certainly there are many features of this—this will not end all need for consideration of our tax structure—there are many things by way of reform and things of that sort that Congress will want to consider.

But our position is that the great benefits that will come from this bill should not be delayed for the long period of time that consideration of these matters will entail.

Senator WILLIAMS. I was not suggesting that the bill be delayed for consideration of that proposal, but quite a few people are asking us while we are considering reducing many of the wartime taxes why we don't recognize these excise taxes for what they are, wartime taxes, and repeal those also. Of course, you run into several billion dollars additional.

Mr. SAUNDERS. Basically, my feeling is we have too much reliance on the income tax as a source for operating our Government, and I think the great feature, the salutary feature, of this bill which is fundamental, is that it is a step away from heavy reliance on income tax. We have got to come to other types of taxes, a broader tax base, and this is a healthy step in moving away from that principle.

Senator WILLIAMS. I will not delay the committee because there are others who wish to ask questions. I will ask you just this question: Are you satisfied with the stock option provision of the bill as passed by the House?

Mr. SAUNDERS. No, sir.

Senator WILLIAMS. But you embrace the bill with it?

Mr. SAUNDERS. Yes, sir.

Senator WILLIAMS. Is that your position, too, Mr. Ford?

Mr. FORD. I would think there might be a couple of areas, Senator, that your Finance Committee might consider. First, the capital gains section, where you now have three types of capital gains, as I understand it.

You have the present capital-gains situation after holding for 6 months, in which you pay 25 percent. You have the new proposal in the House bill in which you are going to pay 21 percent after holding for 2 years, and in the stock option provisions of the bill there is a third proposal for capital gains which is the 21-percent rate after a 3-year holding period after exercise.

This is again not a subject that the Business Committee has discussed in any way or has taken a position on. This is a personal feeling, and I happen to have testified on this section before the House Ways and Means Committee. My personal feeling is that simplification of this capital-gains section, as it is proposed in the stock-option revisions, might be considered by your committee.

I would think, possibly, that this 3-year holding period might be reduced to 2, as for other properties held by individuals which are not parts of a stock-option plan.

There is another section in the stock-option proposals made by the House that I would also think might be considered by your committee, and that is that they have proposed that options must be exercised in sequence, and that you must take up the first option completely, 100 percent, before it is possible for you to take up a second option which may have been granted to the same individual, even though, in accordance with the plan, a part of the second option might be exercisable before this individual, in accordance with the plan, might have the right to exercise, completely, his first option.

I do not have a suggestion at the moment as to how this might be corrected. I think that there are several ways in which it can be done, and, if you would like, we can get together with some other companies which are interested in this area, and make you a written proposal on this. We have not talked outside Ford Motor Co. on this at all, and because it might be beneficial to Ford, and it might be not beneficial to a lot of other people, I would hesitate to make a proposal as to how to correct it, but I think this sequential proposal which has now been presented by the House that a man must take up his first option before he can start to take up the second one, even though he might be able to, in accordance with the plan, take up a part of the second option, I think this creates a hardship on the individual. One never knows what the price of the option may be, and I think it is not a very fair proposal.

Senator WILLIAMS. Of course, we appreciate your suggestions and they will be taken into consideration.

But I get back to my original question. In the event that the committee fails to make any changes in that section, and leaves it as it is, would you still not change your endorsement of the bill?

Mr. FORD. Change my what, sir?

Senator WILLIAMS. Your endorsement of the bill. You would still endorse the bill, even though there were no changes made in this particular provision?

Mr. FORD. I always have hopes, Senator, that some of these things may get corrected.

Senator WILLIAMS. I appreciate that.

Mr. FORD. My hope may be unfounded.

On the other hand, I would, as an individual now, because we have not discussed these changes in our committee, we have only discussed the general tax reductions—I think I would; yes, sir.

Senator WILLIAMS. I just noticed that you say that plant and equipment spending went down 1 percent after 1957. Is it not true that, in 1957, Congress repealed the so-called 5-year amortization which would mean, more or less, a cutoff. Do you think that that change in the tax structure may have accounted for some of the reduction in the subsequent years?

Mr. SAUNDERS. That is possible.

Senator WILLIAMS. Would you agree with that point?

Mr. SAUNDERS. I really do not know, but I think that is probably right.

The CHAIRMAN. Senator Anderson?

Senator ANDERSON. Mr. Saunders, you were questioned quite a bit about your statement about a prediction of $5.4 billion. As a matter of fact, in your text, you do not say anything about the expenditure budget, do you? As I read what you say, you say it has been predicted that Congress will reduce regular appropriation bills, this year, by about $5.4 billion.

Mr. SAUNDERS. Yes, sir.

Senator ANDERSON. You quoted Clarence Cannon to that effect, did you not?

Mr. SAUNDERS. Yes, sir.

Senator ANDERSON. Therefore, there was such a prediction made, wasn't there?

Mr. SAUNDERS. That is my understanding.

Senator ANDERSON. Yes, I think so, too.

In recent years, the Federal budget has persistently shown deficits, has it not?

Mr. SAUNDERS. That is correct.

Senator ANDERSON. Secretary Dillon has indicated the basic reason for this condition has been the failure of the economy to produce sufficient revenues, because, under our present tax system, it has not operated at a rate at which it is capable to produce sufficient revenues. Do you agree with that?

Mr. SAUNDERS. Yes, I do. And, as I said earlier, Senator, we think that this bill marks a turning point in our economic history. It is a shift away from reliance upon Government spending as a factor in our economy, and to a greater emphasis upon private enterprise. We think this is a breath of fresh air.

Senator ANDERSON. Is the tax cut, proposed in H.R. 8363, a necessary condition, along with expenditure restraint, to lead us out of persistent deficits and to a balanced budget?

Mr. SAUNDERS. We feel very definitely so. This, of course, is a matter of judgment, and your very distinguished chairman disagrees with my philosophy, my point of view.

Senator ANDERSON. But you are the witness.

Mr. SAUNDERS. I respectfully suggest to the committee that the policy which we have been following for these many years, since World War II, a tax structure that was built out of two things: the depres-

sions of the thirties and the war years, World War II, which has not been basically changed except for minor changes in 1954, that this type of taxation or this tax structure is holding back the growth of the country.

Unless some change is made, we are going to have these persistent deficits, and we are never going to correct the situation with which we are faced now. It is a matter of choice of approach, and we respectfully suggest to you that the Congress should give this a fair trial.

Senator ANDERSON. Under this tax cut, with its emphasis on increased demand and investment incentive, would you expect the economy eventually to move upward so that the revenues under the tax system at a higher level of economic activity will exceed our present revenues?

Mr. SAUNDERS. Very definitely so. We believe if you make a reduction of the magnitude of $10 to $11 billion now, with the multiplying effect of $30 to $40 billion of new money in our economy, plus restraint, rigid restraint, on the Federal expenditures, that the inevitable result is bound to be that you are going to have more money available in our economy, less unemployment, a higher rate of growth, more money available for tax purposes, and that the result is going to be not only, we hope, a balanced budget, but surpluses and something to pay on the national debt.

Senator ANDERSON. If that is so then you would agree that we would have a better chance of balancing our budget under this tax bill, with moderate rates of tax, than under the present system of rates?

Mr. SAUNDERS. That is the burden of what we are saying today. There is no assurance that anything is going to work, and nobody can tell this committee it can be done, but we think it is an experiment worth trying, and we think it is an investment. Of course, there is some risk involved, but we think this is an investment having every prospect of showing a handsome return, and we hope very much that the Congress will see fit to make it.

Mr. WILDE. May I interject to say——

Mr. SAUNDERS. Mr. Wilde.

Senator ANDERSON. I beg your pardon.

Mr. WILDE. I wanted to add, Senator, that the only concrete experience that the country had, which was the period after the First World War when we tried this device of cutting taxes, it worked very well, so we have specific evidence of it. Cutting taxes stimulates the economy, produces more revenue in a very relatively short time, and it did then.

Senator ANDERSON. I do feel, however, you are in a somewhat different period so far as deficits are concerned.

Mr. WILDE. This is probably true. But fundamental things exist in economics, and there are some fundamentals that tend to repeat themselves.

Mr. SAUNDERS. England has gone through this experience, too, with a reduction in taxes, and has stimulated its economy very substantially, reduced their employment rate to around 2 percent.

Senator ANDERSON. Do you believe the real problem in reducing tax rates when the budget is in deficit is the problem of inflation?

Mr. SAUNDERS. I did not get that question.

Senator ANDERSON. Do you think that the only real problem in reducing tax rates when the budget is in deficit is the possibility of inflation?

Mr. SAUNDERS. That is one of the problems. But we do not think that there is any real risk of inflation involved in this tax cut. If we did we would have a very different view about it.

With the tremendous amount of surplus capacity that you have in this country, the high rate of unemployment; until this gap is closed substantially, I do not think there is any great risk of inflation.

Senator ANDERSON. This program has been called a planned deficit. Do you regard this bill as deliberately creating a deficit or do you regard the consequent deficit under this bill as a transitional deficit which would disappear when we achieve a balanced budget?

Mr. SAUNDERS. I think I said, and I reemphasize, that, of course, this is going to produce a short-run deficit, there is no way to escape that. But we think that this bill will substantially increase the gross national product of this country; that it will make much more money available for governmental purposes, and that if you have control of expenditures, you are not going to have—we will get out of this deficit spending much quicker; and we are hopeful—I do not think it is wishful thinking, we are hopeful—that within a reasonable period of time we can get back into surpluses or balanced budgets.

Senator ANDERSON. Your committee on tax reduction sent out Report No. 18, dated October 11, 1963, which, I thought, was very good reading. I am not going to cite all of the comments you made, but you tried to illustrate why you thought it was important that the tax bill be enacted this year, and I want to ask you whether you still think these reasons are valid. One of them was that "the delay and doubts created by failure to enact the bill this year could entail serious economic risks." "As businessmen," the report said:

> we are convinced that prospects for continuing and increasing the recent pace of economic growth will be greatly strengthened by enactment of the tax bill now.

Do you still believe that?

Mr. SAUNDERS. Very definitely.

Senator ANDERSON. The report said:

> There are indications that the economy is now approaching a critical juncture—at the very time the Senate is determining whether or not to enact a tax reduction bill this year. Experience since 1957 shows that the present high tax rates, business investment and private spending are not vigorous enough to sustain prolonged economic upswings that would bring the economy up to a satisfactory level of operations.

Do you still believe that?

Mr. SAUNDERS. Of course, at the present time the boom seems to be pretty strong. But I think we have got to look at this very carefully. We are now in the 33d month of this so-called period of good times. Capital investment, as I mentioned in my statement, is at the present time at the lowest point it has been in 17 years, relatively. All of these factors suggest that while I do not think that you are going to have any recession in the near future, and I do not profess to be an economist or anything of that sort or forecaster, I do not believe there is anything like that in the immediate offing.

On the other hand, I think there has been considerable anticipation of the benefits of this tax measure, and that if there is no tax bill

or if it is delayed unduly, that you may see some downturn or dampening because of the failure of things to materialize which people have been expecting generally.

Senator ANDERSON. In the other points, the report said:

> One factor in the economy deserves special mention. We are approaching the end-of-the-year period when many business firms must make final decisions on their capital spending programs for 1964.

That is still a valid point, is it not?

Mr. SAUNDERS. Yes, sir; very definitely.

Senator ANDERSON. Then you quote from the expressions in the October letter of the First National City Bank of New York stating that:

You continue:

> Nation's Business observed that "failure by Congress to pass sound tax legislation could easily lead to a moderate decline in business activity early in 1964."
>
> In a poll of the National Association of Business Economists, the average forecast among all respondents indicated that tax reduction alone would make a $12 billion difference in the annual gross national product rate by the fourth quarter of 1964.

Were those important statements, in your view?

Mr. SAUNDERS. Very definitely, and I think that this should be taken into account in that regard. I am confident in saying this to this committee: Business support for this measure, tax reduction, and tax reduction in 1963 is widespread in this country. Businessmen that I see every day, and Mr. Ford and our committee of some 2,700, feel very strongly that this tax reduction bill is vital to our economy, and it ought to be acted upon now.

I think the Congress—of course, you have your own sources of communication and information—but the businessmen of this country, among them there is a widespread consensus. You see it in the U.S. Chamber of Commerce. There has been a complete reversal almost of their thinking in this field, and the education that has taken place in businessmen's thinking in this field has been much greater than I think a lot of people realize.

Senator ANDERSON. I just want to say that I have been home for a week, and that is always helpful. I found that tax reduction was probably more in the minds of business people than any one subject, and they seem to be in favor of it.

Mr. Ford, may I just ask you two or three short questions? In the speech that you made some time ago—I don't suppose you people think we ever read these, but we do—on July 8, 1963, at the Arkansas State Chamber of Commerce, you said:

> Despite our high tax rates we are still unable to balance the budget. To some extent we are unable to do so because high tax rates discourage the extra work and the new investment necessary to achieve more rapid expansion of taxable income.

Do you still subscribe to that?

Mr. FORD. Yes, sir. I think, Senator Anderson, that one of the things that this tax bill will achieve is more investment in risk enterprises and the development of products that do not already exist which, I think, will expand the economy.

Senator ANDERSON. I am not a witness, but the building and loan associations, savings and loan associations, are just growing tremen-

dously fast, because they can get a safe 4.6, 4.8, or 4.5 return, and they have lost the desire to go out and risk their dollars in competitive business which is necessary to keep this economy going.

In that same speech you said:

> The best hope of balancing the Federal budget, it seems to me, is a combination of two policies:
>
> A tax cut to stimulate the growth of taxable income, and a strenuous effort to control the rise in expenditures.

Do you still subscribe to that? I take it you do from what you said a moment ago.

Mr. FORD. Yes.

Senator ANDERSON. And then the last one I read to you is your statement that:

> We will have so little time after a tax cut to get the budget back in balance before inflation threatens again. At any event, the risk of continuing to allow taxes to act as a drag on the performance of the whole economy is a far greater risk than inflation today. There is no safe, riskless way out of the corner we are in, but I believe that a prompt substantial general tax cut offers us by a great margin the best odds we can get.

Do you still subscribe to that statement?

Mr. FORD. Yes, sir.

Senator ANDERSON. Thank you.

The CHAIRMAN. Senator Carlson?

Senator CARLSON. Mr. Saunders, as one member of this committee who thinks taxes are too high, both corporate and personal, I certainly concur in many of the statements you make.

One thing that concerns me as a member of this committee is what assurance have we that this tax reduction would reduce unemployment in this country? That really concerns me. How are we going to get back into the pockets of what I would say are really serious unemployment situations?

Mr. SAUNDERS. Well, I think that's one thing which Mr. Ford has just alluded to, if you increase the incentive, particularly for risk capital, you are going to find a lot of new products produced; you are going to find a lot of new markets.

Another thing, in order to keep our manufacturers' products competitive in foreign markets, and also in markets here with products from abroad, if we do not keep our tax rates in line with what they are in the rest of the world, and on top of that with a much higher labor structure, labor rates per day, than most other countries have, unless we give business in this country a reasonable break on their taxes, providing more incentive, we are never going to correct this problem.

On the other hand, if we do, I think we are making a direct attack on this problem of unemployment.

Another factor you have got to consider is that all sorts of inducements are being offered. For instance, Canada now, is offering to American manufacturers who produce products in Canada, giving them a special refund in taxes if they will export, produce a certain amount of goods.

American industry cannot compete in these markets unless we get a better break, both in our tax rates and in our depreciation rates than we have been getting up to this time.

But if we do, I think you will see substantial progress made in reducing unemployment.

Senator CARLSON. This committee, in the last session of Congress I trust did assist some in the investment credit, and the accelerated depreciation, which should have been helpful.

Mr. SAUNDERS. That is correct. It was very helpful, but not enough, but a step in the right direction, a very helpful step.

Senator CARLSON. I assume it is your chart that I have been studying?

Mr. SAUNDERS. That is correct.

Senator CARLSON. Based on the 5-year period, 1957–62, I notice that the consumer expenditures were up 17.1 percent.

Now, did your committee make any projection as to how that might look in 1963–68 or a 5-year period?

Mr. SAUNDERS. No, sir.

Senator CARLSON. You do not know how much you can expect tax reduction to increase consumer expenditures?

Mr. WILDE. May I butt in on that? Senator, history shows that the consumer will spend between 92 and 94 cents of every dollar he gets, and in the paper this morning it showed that the expenditures of consumers had gone up $4 billion in the last period there. If there is anything guaranteed in economics, that phenomenon is guaranteed.

Senator CARLSON. In other words, assuming that we do, and I am certain there will be some increase in the consumer expenditures, there is no question but that because it is a natural tendency—I have noticed that many of our commodities are increasing in price, and that could have some tendency toward inflation. That would also enter into this, would it not?

Mr. SAUNDERS. There has not been any very substantial increase in prices recently, sir.

Senator CARLSON. Of course, some of the items that are used in industry, and some of the consumer items, I notice, are gradually climbing. We will not get into that discussion, but I think you will agree with me there have been increases.

Mr. SAUNDERS. There have been increases, but relatively small compared with what we have seen in years past, and also relatively small in view of wage increases.

Senator CARLSON. Of course, inflation starts on a rather small basis at a time, does it not?

Mr. SAUNDERS. That is correct.

Senator CARLSON. I notice that in plant and equipment, that was down 1.2 percent.

Is it not true that during this period preceding this period there was an overexpansion of industry, and this was a kind of leveling out process, and that right at the present time there is a considerable increase in the expenditure for plant and equipment?

Mr. SAUNDERS. Pardon me, sir.

The facts will bear this statement out, sir. In 1955 we had $37 billion of capital expenditures, that is for plant and equipment, nonresidential construction; 1958, $41 billion; 1960, $47 billion; 1961, $45 billion. In 1963 it runs at the rate of $50 billion.

But on a percentage basis it is pretty constant. It runs from 8.8 up to 9.5 percent of gross national product. There may have been some overproduction or overspending in the period that you are talking about, but I do not think it was significant enough to account for the 8.8 or low point we have reached now.

Senator CARLSON. Is it not a fact that for 1963, and based on statements I have read, and I have no figures before me, that the expenditures for plant and equipment should be much higher in 1963 and 1964? I mean business is planning it that way, is it not?

Mr. SAUNDERS. I think that is true, sir; and I think your investment credit and new depreciation guidelines will be helpful. It has not shown it yet, but it will.

Senator CARLSON. The third point there, Federal purchases of goods and services, is up 13.4 percent, and if we vote to keep it down, and fail to vote substantial sums for that, wouldn't that be decreased?

Mr. SAUNDERS. Yes.

Senator CARLSON. That item would go down. I am speaking of the gross national product. That is the basis of the tax bill.

Mr. SAUNDERS. That is right.

Senator CARLSON. Then you have the State and local government purchases of goods and services, which went up 28 percent during the 5-year period. Isn't it reasonable to assume that practically every State, municipal, and local government is going to increase its taxes from now on out for a period of time?

Mr. SAUNDERS. No, sir; I do not. If you continue your high, or if the economy continues on its present level or plateau, or if we have a downturn, I think your State government expenditures are going to continue to go up. But if you pass this tax bill and even if they maintain their present rates of State and local taxation, do not increase them, you are going to find there is substantially more money available for the States for State and local purposes than there is now.

For instance, a study made by the Treasury Department shows that in the State of Virginia you will have $40 million more available to your State and local governments on the present tax levels, assuming that you have a growth in your economy, which we think this tax bill will produce.

So you are going to have a great deal more money available to the State and local governments if this tax bill is passed even at their present rates, and there is going to be less need for increasing State and local taxes. But I do not say there is not going to be some increase, but the reason will be less.

Senator CARLSON. Having served as a Governor of a State, I can appreciate some of the pressures you get, and I can speak for the State of Kansas which is confronted, I know, with the next budget of the legislature in January which must, I think have some increase in taxes. Of course, this tax bill, even if it were adopted by January 1, would not have the effect of getting business and industry increased.

Mr. SAUNDERS. That is correct.

Senator CARLSON. I think that is true of most States. My thought was that if you are going to reduce Federal taxes and increase State taxes, how much is it going to help the economy?

Mr. SAUNDERS. It would not help it a great deal if that is what happens. But I do not think that is what is going to happen, or at least I hope not. We are hopeful all of this will not be consumed by any means by increased State and local taxes.

What I am trying to say is that you are going to increase the gross national product; you are going to make more money available to the States at their present rates, and the occasion for the increased State and local taxes is going to be far less.

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Senator CARLSON. I can asssure you, Mr. Saunders, as one member of this committee, we will work out something that will do all of the things you have said. We will have to work it out. I appreciate your suggestions.

Mr. SAUNDERS. I appreciate that statement, Senator. But, of course, we have no assurance either. We think it is an experiment well worth trying.

Senator CARLSON. That is all, Mr. Chairman.

The CHAIRMAN. Senator Douglas?

Senator DOUGLAS. Mr. Saunders, if you had your way would you cut Federal expenditures by the amount of the tax reduction?

Mr. SAUNDERS. No, sir. If I had my way I would have to know a lot more about it than I know now to say what I would do.

Senator DOUGLAS. I mean, you have been making an argument that you favor this bill because you think the tax cut would put increased pressure to reduce expenditures.

What I am trying to get at is this: is it your purpose to prevent the annual deficit from increasing? If you cut expenditures by the amount that you reduce taxes, you do not increase the deficit. If you do not do so, you increase the deficit. What I wanted to get at was your position in this matter.

Mr. SAUNDERS. Senator Douglas, what I tried to say was this: I have not suggested, although I would hope it might be possible, to make a reduction in Government expenditures. I have not suggested that the Government expenses be reduced, or at least by any certain amount.

What we have been suggesting is rigid control of expenditures. In other words, I think if you can hold the line on Government expenditures, and if you can increase your economy substantially, that this matter of deficits will take care of itself. In other words, it does not necessarily call for a reduction.

Senator DOUGLAS. You see, when the tax bill was originally proposed, the argument of the administration, with which I happen personally to agree, was that this would result in an increase in the total money demand for goods; that this would result in people being put back to work who, with more money in their pockets would buy more and put still others to work, and there would be a multiplied effect. But this was really based on the assumption of a Federal deficit. We might just as well face that fact.

Now, I thought I detected signs of this argument in Mr. Ford's statement. But in your statement I thought you were arguing that we should have a cut in expenditures equal to or closely equal to, a reduction in taxes, and I must say that some of the recent statements of the Secretary of the Treasury have been to this effect, although he started out on the other foot.

This is a very important question, and I wondered if what you were going to say is that you do not favor a reduction in expenditures equal to the reduction in taxes or that you do.

Mr. SAUNDERS. I have said that we—I have not suggested any reduction. I would hope that you could have one, but I have said and, as I say in my statement, we would hope that the budget for 1965 and 1966 fiscal years would be at the same level relatively as 1964.

Senator DOUGLAS. Then you say the pressure should not be increased. If taxes are reduced, then this means an increased deficit.

Mr. SAUNDERS. No, sir; it does not.
Senator DOUGLAS. Well, immediately.
Mr. SAUNDERS. Well, perhaps immediately; yes.
Senator DOUGLAS. Immediately.
Mr. SAUNDERS. Yes; for the short run.
Senator DOUGLAS. How do you think it would not lead to an ultimate deficit?
Mr. SAUNDERS. I think that you are going to stimulate your economy by some $30 to $40 billion a year.
Senator DOUGLAS. May I stop you right there?
Mr. SAUNDERS. Certainly.
Senator DOUGLAS. Then you believe in the so-called multiplier?.
Mr. SAUNDERS. Certainly I do.
Senator DOUGLAS. Well, now, I thought your paper was an argument, an eloquent argument, against all this, and now you turn out to be one who believes in governmental deficits as a means of stimulating total demand, putting people back to work who, with more money in their pockets, will buy more and, Mr. Saunders, this happens to be something I believe in, too, and I want to congratulate you. But your original testimony was in precisely the opposite direction. [Laughter.]
Mr. SAUNDERS. Let me make myself clear. [Laughter.]
I said that this is an investment that we are advocating here. You called it a deficit, a shortrun deficit.
Senator DOUGLAS. Yes.
Mr. SAUNDERS. You can call it that if you want to. That is what it is.
But, on the other hand, it is an investment, and you can term that any way you like, but that means that you are going to produce a bigger economy, we hope, and more wealth.
Senator DOUGLAS. I find my thoughts moving right along with yours, and I had some economists connected with the Joint Economic Committee who estimated there was a combined multiplier and accelerator effect of approximately four. A tax cut of $10 billion would ultimately stimulate the economy by amout $40 billion; that this would reemploy some two to two and a quarter million people. With the Federal Government getting back about one-fifth of the increase in the total gross national product, this would increase by $8 billion, at lower rates, and then the Federal loss would only be $2 billion from a $10 billion cut, after time had worked these things out. And there would be, as you have properly said, an increase from State and local revenue. Those figures you quoted from Virginia were figures I happened to work out, too, may I say.
But don't you think that this argument is inconsistent with the argument that is now being advanced, "Well, we should cut taxes, it is true, but cut Federal expenditures by the same amount."
Mr. SAUNDERS. We have not made any such suggestion as that.
Senator DOUGLAS. I know, but that is being made.
Mr. SAUNDERS. I am sure it has been made.
Senator DOUGLAS. Then you repudiate that argument?
Mr. SAUNDERS. I do not repudiate anything. [Laughter.]
Senator DOUGLAS. Well, you either must be for it or against it.
Mr. SAUNDERS. Let me say what I am for. I say I am for rigid

control of Federal expenditures. I am in favor of a balanced budget. I am in favor of rigid control of expenditures. I am in favor of this tax bill because we think it will promote the——

Senator DOUGLAS. You mean ultimately.

Mr. SAUNDERS. Yes, sir; not too ultimately, we think——

Senator DOUGLAS. But in the short run, of course, there will be a deficit. You are willing to endure the short-run deficit because you think in the long run it will result in an increased gross national product, and in increased revenues.

Mr. SAUNDERS. I do not think anybody can say, can give you an exact timetable or schedule.

Senator DOUGLAS. Yes.

Mr. SAUNDERS. All we are suggesting to you is that we think that this is a risk that is worth taking, an experiment worth trying.

Senator DOUGLAS. Well, I find myself in agreement with you now.

Mr. SAUNDERS. Yes.

Senator DOUGLAS. I am very glad that we have clarified this because the first part of your testimony was entirely in the way of cutting expenditures and this, as a matter of fact, is the tack which the Secretary of the Treasury is taking at the moment. He started off on an expansionist bid. Now he is moving on a restrictionist bid.

Well, now, let me ask you this, Mr. Saunders. Ever since 1957 we have had high unemployment and a high degree of unused capital equipment.

Mr. SAUNDERS. Yes.

Senator DOUGLAS. If you take part-time unemployment, which is time lost, as well as complete unemployment, the average has probably been a little over 7 percent; it is 6.7 percent at the moment. The degree of unused capital equipment is probably at least 15 percent. How do you think this has happened? Why has there been a failure to put people to work with idle equipment turning out goods which the economy needs?

Mr. SAUNDERS. I think you have got a high degree of obsolescence, in the first place, in your plant and equipment in this country.

Senator DOUGLAS. All right.

Mr. SAUNDERS. And you need substantial capital investment to modernize our plants.

You talk about 100-percent steel capacity in this country, I mean operating, when we used to speak in those terms. A lot of those mills are 30 to 40 years old, and when you speak of that as surplus capacity, it really is not. It is not competitive with Japanese steel mills or with German steel mills.

Senator DOUGLAS. You do not think there is surplus capacity?

Mr. SAUNDERS. I think there is some surplus capacity, and I think it is greatly exaggerated. There is a great deal of obsolescence.

Senator DOUGLAS. It may be, but you think there is some?

Mr. SAUNDERS. Yes. I would not say how much; I really do not know.

Senator DOUGLAS. I thought you said there was tremendous surplus capacity.

Mr. SAUNDERS. I said in terms of obsolescence, yes.

Senator DOUGLAS. Well, I am still not quite clear as to why you think this high volume of unemployment has continued.

Mr. SAUNDERS. Well, as I say, I think that our rate of growth is too slow. As you well know, better than I do, sir, that a 3-percent growth in our gross national product only enables us to stand still. I mean, it barely takes care of the new people coming into your work force, and your increased productivity there.

Senator DOUGLAS. Why hasn't our gross national product increased more rapidly?

Mr. SAUNDERS. One of the reasons is the excessively high tax rates we have in this country, both corporate and individual.

Senator DOUGLAS. You mean profits have not been high enough?

Mr. SAUNDERS. That is correct.

Senator DOUGLAS. You know this is very puzzling. The Department of Commerce has been improving its collection figures, and on page 7 of the Economic Indicators, I have had some computations made, and I find that corporate profits after taxes, plus capital consumption allowances, which is the allowance for depreciation, have been running from 1958 to 1962, $41 to $55 billion a year.

And if you subtract from this dividends paid out to stockholders, and investments in corporate plant and equipment, you get this very interesting result, namely, that you have an excess of $32.7 billion since 1958 through 1962, not distributed in dividends, not invested in corporate plant and equipment, but really floating investment funds, which are put into Government bonds, generally short-time Government bonds, and into real estate and the rest.

But it raises the question as to why these sums which have been available have not been invested in business.

Mr. SAUNDERS. Because of your low rate of return.

Senator DOUGLAS. Pardon?

Mr. SAUNDERS. The low rate of return on your investment or prospect of it.

Senator DOUGLAS. Now, we get to a fundamental point. Do you think the rate of return would be higher if we could stimulate consumer demand?

Mr. SAUNDERS. That would help, of course.

Senator DOUGLAS. That is what some of us feel.

Mr. SAUNDERS. I do not think that is the only thing, but it is some of it.

Senator DOUGLAS. I know.

Mr. SAUNDERS. It has got to be a two-pronged affair, and I think this bill represents a fair balance between the two.

Senator DOUGLAS. I have only one more question. I would like to address it to Mr. Ford, and although it is not connected with this subject, Mr. Ford, I want to congratulate you for the fine work you did when you took over the management of the Ford Co. in getting rid of Harry Bennett, which was one of the most courageous decisions that I know a business has made.

Mr. FORD. Thank you, Senator.

Senator DOUGLAS. I want to congratulate you on that most sincerely. I want to congratulate you on the interest which you and your family have taken in education, and other features which, I think, deserve great praise.

Mr. FORD. Thank you.

Senator DOUGLAS. But this is the question I want to ask you. I got hold of some Treasury figures which the Secretary of the Treasury

confirmed as being accurate, which showed that in the year 1959 there were five people in the country who had adjusted gross incomes of over $5 million, and this did not include any interest they might get on tax-exempt bonds, it did not include writeoffs which they had made for oil drilling and developmental costs, did not include at least half of capital gains, but even so they had adjusted gross incomes of $5 million, and they did not pay a single cent in Federal income taxes.

There were 15 people with adjusted gross incomes of over $1 million, who did not pay a single cent in taxes; and 20 with adjusted gross incomes of over $500,000 who did not pay a single cent in taxes.

Now, very frankly these figures shocked me, and I think they shock most Americans as they come to know them. Don't you think we should do something to rectify that situation?

Mr. FORD. Well, I do not know anything about these situations, Senator. It is the first I have ever heard of them. I do not know how this works or how it is possible.

Senator DOUGLAS. I will send the figures to you, and I would appreciate it if at some time you would think about this matter and help us.

But don't you think this indicates something that the Congress should look into?

Mr. FORD. It seems very strange and not possible, but I am sure it is possible if they gave you the figures.

Senator DOUGLAS. The Secretary of the Treasury has assured me they are correct, and that is in the record, as a matter of fact, the tables are in the record. I will give you the page citations or to any associates that you may have.

But don't you think this is something that Congress and the country should pay attention to?

Mr. FORD. I am sure there are a lot of loopholes in the tax laws that ought to have something done about them.

Senator DOUGLAS. Loophole is a very modest term to attach. You see, a man with $5,200 of taxable income, let us say, a wage earner who gets $100 a week, will pay and have withheld from his pay approximately $460 in income taxes. He pays more taxes than these men who have a thousand times his income.

Now, the unfairness of this situation, I think, if continued, is going to destroy peoples' faith in Government and in the democratic system.

Mr. FORD. I do not think this is public knowledge, general public knowledge, put it that way. So I do not know how these people figure their income taxes.

On the other hand, I think there has been a tendency in government to be interested in socialization, if you want to put it that way, in not allowing the fellow who is able to produce more than his neighbor, let us say, to reap the benefits of that. I think it would be very detrimental to the economy of this country if the Congress saw fit not to allow rewards for effort.

Senator DOUGLAS. Well, but you would not——

Mr. FORD. I think with a leveling kind of thing you can do great harm to the economy of this country.

Senator DOUGLAS. Yes. But I am sure, Mr. Ford, you would not say that it is proper for people with incomes over $5 million to pay no taxes.

Mr. FORD. I never heard of it before. I know nothing about it.

Senator DOUGLAS. These are the facts. I checked very carefully. I am sure you would not say that.

Mr. FORD. I would find it very strange, but I know nothing about it.

Senator DOUGLAS. As a matter of fact, subject to correction, as I remember the other tables which the Secretary of the Treasury put into the record, people with incomes of over $5 million, all people with incomes of over $5 million, paid an effective average tax rate of only about 25 percent, which would be the rate on a $20,000 to $40,000 man. So that the 91-percent rate which people hold up as a hobgoblin is effective in only a relatively small number of cases.

Senator ANDERSON. Are you talking gross or net income?

Senator DOUGLAS. I was saying adjusted gross income, which does not include interest on tax-exempt bonds, does not include fast write-offs on drilling and developmental costs, and does not include half of capital gains which is excluded. As a matter of fact, here they are in the record, these figures are now officially a part of the record, beginning on page 278 and continuing on pages 279 and 280, and the table that I quoted, Mr. Ford, is on page 280. Do you see that first table, "Number of Returns by Effective Tax Rates Based on Adjusted Gross Income by Income Classes; All Returns With Adjusted Gross Income of $500,000 or More, 1959," and then notice that the first column, zero taxes, 5 with incomes over $5 million; no taxes, 2 with from $2 to $5 million; no taxes, 8 from $1 to $2 million; no taxes, or 15 over $1 million, no taxes; 5 from $500,000 to $1 million, no taxes; or a total of 20 of over $500,000, no taxes.

Mr. FORD. They are pretty lucky to be able to work it out that way, are they not?

Senator DOUGLAS. Well, you say they are lucky, Mr. Ford. I do not say there is anything illegal in this, but certainly this seems to me to be something that should be looked into.

Senator CURTIS. Would the distinguished Senator permit me to ask him just a brief question?

Senator DOUGLAS. Surely.

Senator CURTIS. Are these cases covered under the category of taxpayers giving more than 90 percent of their income to charitable causes?

Senator DOUGLAS. I am not certain. I think that is one factor. I am not certain that this is the only factor. It is one factor.

Senator CURTIS. It is conceivable that one can, meeting certain conditions over a long period of years, give away his income.

Senator DOUGLAS. I think that is one factor.

Well, I simply say that there is a big question of justice in our system of taxation, Mr. Ford, that I think we should pay attention to it as well as stimulation. The Senator from Tennessee and I have been misunderstood in this matter. We do not want to have consideration of equity and justice ruled out in dealing with these tax matters. I complimented you most sincerely in the beginning of my statement. I have a very high opinion of you personally. I wish you would put your public spirit to work, which is real, in making the tax system more just as well as more stimulating.

Mr. FORD. Thank you.

The CHAIRMAN. Are you through?

Senator DOUGLAS. That is all.

The CHAIRMAN. Senator Curtis?

Senator CURTIS. Thank you, Mr. Chairman.

I apologize to you distinguished gentlemen for being a bit late here, but I have read your statement.

I think over a period of years that the number of speeches I have made condemning the high tax rates would constitute a fair-sized filibuster, so that part of your thesis I thoroughly agree with.

I do find myself quite disturbed over the expenditure side of the books, and I want to ask you about some of that.

Have you made a study on your own of the budget of the United States, both the current budget and its projected budget, for the short range and the long range?

Mr. SAUNDERS. We have made no exhaustive study; no.

Senator CURTIS. Have you had any interviews with the Bureau of the Budget?

Mr. SAUNDERS. No; no, sir.

Senator CURTIS. Have you had any interviews with the chief budgetary officer in the principal departments of Government, such as Defense, Agriculture, elsewhere?

Mr. SAUNDERS. No, sir.

Senator CURTIS. Now, you would recognize the fact, would you not, that expenditure control is something that is a bit long range in its effect?

Mr. SAUNDERS. By and large; yes.

Senator CURTIS. Yes.

I think that it is possible for a very liberal Congress to convene, enact all manner of new programs to put the Federal Government into new fields, to respond to the wishes of countless pressure groups, and put their program in; that 2-year Congress to wind up its work and adjourn, and what they have done is scarcely noticed among the expenditures.

A great many programs start out with probably no expenditures the year they are voted, a nibble the second and third years; many programs hit their peak in 5 or 7 years, some of them longer than that.

I think it is also possible on the appropriations side for a similar thing to happen. Now, before something is appropriated, the program must be authorized. Before the Appropriations Committee is called upon to appropriate money for, say, general Federal aid to education, the Congress will have had to pass a bill authorizing it.

Likewise, in a single fiscal year appropriations might be held down, and still have no impact on the overall growth of Government, or no impact on the total spent because we end the fiscal year the 1st of July sometimes with unexpended balances. There are always great sums in the pipeline.

If a department wishes they can speed up spending the last couple of months before a fiscal year is over or they can drag their feet; they can just quit ordering; they can take 2 or 3 days longer in deciding to negotiate a contract, and the ultimate bills coming in under that contract will be in another fiscal year.

So I tell you, quite frankly, I am not at all impressed. I am not at all impressed by the alleged current reduction in appropriations. I

am glad they are reduced rather than increased, but it does not go to the basic thing of built-in increases, of the cost of expanding the Federal Government or the delayed effect of authorizations and appropriations.

Has anyone for this Businessmen's Committee for Tax Reduction in 1963 made an exhaustive study of the budget?

Mr. SAUNDERS. No, sir.

Senator CURTIS. Upon what——

Mr. SAUNDERS. Let me say that we have had studies made, but I would not call them exhaustive.

Senator CURTIS. Yes. I notice through your statement here, and the people who receive your literature, write me and they say that to reduce the taxes will be a wholesome force on the Congress to reduce expenditures. Can you cite me an instance of that?

Mr. SAUNDERS. We think that this current or the things which you have just referred to, the reductions that are taking place, are not fortuitous; that they do not just happen. They are a reflection, in good part—I do not say wholly but in good measure—of the pressure that is being put upon the Congress, the widespread public debate over public expenditures. Not in recent years, never to my knowledge, has this issue received the emphasis it is receiving now.

I think it is the most wholesome development that has occurred in a long time, and we think this debate over the tax measure has been very wholesome.

Senator CURTIS. I think it has been very wholesome. I tried to state, I did not intend to make a speech, but merely to make a statement as a background for my questions. I want to state that I did not regard the lowering of the appropriation bills for 1 year as significant at all. It does not measure the expansion of government; it does not measure built-in increases. It does not measure obligations that come along.

For instance, and I am speaking theoretically right now, but it has actually happened, the Commodity Credit Corporation is authorized to make loans on commodities to raise the price. They reloan their money. But as they create a deficit, because they have had to sell farm products for less than they take in, as they create a deficit periodically Congress has to appropriate money to reimburse the Commodity Credit Corporation.

Now, for a particular Congress to pass over the obligation of restoring the funds of the Commodity Credit Corporation does not lessen the expenditures of the U.S. Government.

Now, my question is, Can you cite any governmental program that has been turned down or curtailed because of lack of revenue?

Mr. SAUNDERS. Because of lack of what?

Senator CURTIS. Revenue.

Mr. SAUNDERS. No, I cannot cite any; no, sir. But that does not prove—my inability to cite does not make it a fact, because my ignorance in that field is rather large.

Senator CURTIS. Yes. I agree that there are a great many Members in the House and the Senate who say, "No" to programs that they are in favor of, and they feel that are good, because there is no money in the Treasury.

But I think it is also safe to say that that group has never been in the majority. This is my 25th year here in Congress. I have

never known a proposed Government program or an expansion of the Federal Government turned down because there was not any money in the Treasury.

Mr. SAUNDERS. I do think this is significant, Senator Curtis, that the gentleman on the Ways and Means Committee, Mr. Curtis, who is one of the stanchest advocates in opposition to Government spending, and a very able member of the Ways and Means Committee in a letter that he wrote to his constituents within the past month, made the statement that we may have lost the battle but won the war. He said—this is what he said to his constituents—that it was remarkable the change in thinking that exists in Congress here with reference to Government spending, and he thought it was largely attributable to this tax reduction debate.

Senator CURTIS. I think that debate is good.

Mr. SAUNDERS. I do not think he would have made that statement if he did not think it was true.

Senator CURTIS. I think the debate has been very wholesome, but I can think of no Government program that has been advocated and turned down because it had to be paid for by deficit financing.

Now, you said you had had no conferences with the Bureau of the Budget on this. Have you had any conferences with the President on the question of any details in his plans for controlling expenditures?

Mr. SAUNDERS. We have had only one—I do not know whether you would call it a conference—we saw the President, I think it was July or August, at which time we urged him very strongly, our group, to make every effort to control expenditures and to reduce them. I guess it was in terms of controlling expenditures. We told him as flatly as we knew how, that we thought this was vital to the success of this program and, as we have stated in our statement of principles, we think that unless there is rigid control of expenditures that the beneficial effects of a tax reduction program will be largely negated.

Senator CURTIS. Yes. Well, now, I do not think it would be ethical for me to ask anyone to quote the President so I will not ask you whether or not he picked out any specific programs that he had on the agenda that he was pushing through Congress that were going to be set aside if he could get this tax bill through.

Has your committee given any consideration to the statement by the present Director of the Bureau of the Budget who says that a balanced budget would be bad on the economy, increase unemployment, and would raise taxes?

Mr. SAUNDERS. You are speaking of Mr. Kermit Gordon's statement?

Senator CURTIS. Yes.

Mr. SAUNDERS. We do not agree with him.

Senator CURTIS. But he is the Director of the Budget.

Mr. SAUNDERS. That is correct, but that does not make us change our opinion.

Senator CURTIS. I do not agree with him either.

His predecessor, Mr. David Bell, sat where you are sitting now, and informed the chairman of this committee that in fiscal 1962 they planned a budget deliberately as an antirecession measure, and that is on the public record. Have you given any thought to that?

Mr. SAUNDERS. I think, Senator Curtis, it is certainly true that statements such as you have cited have been made, and I do not agree with them.

I think though that this is true, that there has been some change, I do not know how strong, and we will have to wait and see what happens, but certainly as of this time there is considerable evidence that the administration is showing a greater desire to control expenditures than they have heretofore. I would wish they would manifest more.

Senator CURTIS. Would you give me some examples?

Mr. SAUNDERS. Well, there are a lot of bills that are not being pushed through Congress that I think would have gone through if this tax bill had not been——

Senator CURTIS. What ones?

Mr. SAUNDERS. I do not know that I can cite you any. The cutback of the acceleration in the public works program of some $900 million; the mass transit bill.

Senator CURTIS. Has the administration withdrawn their support of the mass transit bill?

Mr. SAUNDERS. They might as well have.

Senator CURTIS. But have they?

Mr. SAUNDERS. I do not know, but it is getting nowhere.

Senator CURTIS. But have they withdrawn it?

Mr. SAUNDERS. No, it is locked up in the Rules Committee.

Senator CURTIS. My question is this: the Congress has a responsibility——

Mr. SAUNDERS. They are not pushing it.

Senator CURTIS. And I think they should face it. But I understood you to say that there is evidence that the administration is controlling expenditures more than ever. What I want to know are some specifics. What appropriation bill has been criticized or even vetoed because it was too high? What of the dozens and dozens of requests for new programs that have been withdrawn from the Congress?

Mr. SAUNDERS. Let me say this, first, Senator: I am not here to defend the administration or to blow their horn. This is a nonpartisan group. As a matter of fact, it is heavily nondemocratic, I would say. [Laughter.]

We have no brief for what you are trying to imply. We believe in balanced budgets and free enterprise, as much as you do. In fact, if I may say so respectfully, I am afraid we believe more so, because we think that this bill will promote free enterprise in this country as nothing else which has been advocated in a long, long time.

I do not want to associate myself or say that the administration is responsible for this or that. We are saying that we think overall—who is responsible for it I do not know, whether it is the administration or the Republican Party or both of them, and I think both are, to a good measure—but I think there is developing an atmosphere, at least I hope there is—it is too early to say, perhaps—but an atmosphere of real Government control of expenditures.

Senator CURTIS. I won't quarrel with you, but I won't yield and acquiesce in your statement that you are more for private enterprise than I am. I have consistently voted against the expansion of the Federal Government.

Mr. SAUNDERS. You will never find us criticizing you for that.

Senator CURTIS. I cast the lone vote in the Senate against a Federal program of mental health, which certainly holds the heartstrings, if any program will, but I am against the expansion of the Federal Government.

Now, I am not suggesting that your committee is carrying the torch for the administration. I am basing it upon your statement here that a tax reduction will be a pressure for reducing expenditures.

Mr. SAUNDERS. We sincerely believe that.

Senator CURTIS. But you cannot give me any instances of the Government, of the administration, withdrawing requests for added Government, either incidentally or as a quid pro quo for this tax bill, can you?

Mr. SAUNDERS. I cannot. I do not know that they have withdrawn their support or anything of that sort. All I am saying to you is, citing what is a fact, that these bills are not being passed. Who is responsible for that I do not know.

Senator CURTIS. It is a matter of public record. The administration has declared for them, asked the Congress to pass them, urged committee chairmen to hold meetings on them, and the fact that they have run into snags is perhaps the problem of a lot of people. What I am trying to say is that I am having such a hard time reconciling the cutting of taxes and actually increasing expenditures, increasing the scope of the Federal Government, putting the Government into more things.

I wish with all my heart that I could accept your statement here that a reduction of revenue would hold down the spending. I am open to some citations on that.

I asked you about David Bell and Mr. Gordon.

Dr. Seymour Harris, financial adviser to the Treasury, is another individual who believes in planned or managed deficits. He stated, in substance, that the reason that deficit financing had not spurred our economy was because the deficits were not large enough. Do you agree with that?

Mr. SAUNDERS. I do not see how you can ask a question like that. Certainly I do not, and everything we have said here today is contrary to that. You have heard what I said, sir. It is absolutely contrary to any suggestion of that sort.

Senator CURTIS. No, it is very pertinent to your statement.

Mr. SAUNDERS. Well, it cannot be.

Senator CURTIS. Because your statement says that this will be a restraint against spending.

Mr. SAUNDERS. That is correct.

Senator CURTIS. Now, this man is still in Government.

Mr. SAUNDERS. We are not—I do not even know Mr. Seymour Harris. We have nothing to do with who is in the Government or who is not. What we are trying to do to you is to express a conviction in which we believe sincerely and in which the business people of this country believe.

Senator CURTIS. I believe wholeheartedly with you on the fact that these rates are too high, and I cannot find much fault, if any, on the way that reduction is distributed to the various segments of our economy. I can pull out of my files dozens of speeches where I proclaimed your theme.

But now another high-placed adviser to the administration who has, I think, a diplomatic post now, Mr. John Galbraith, stated that the ancient concept of a balanced budget must be deliberately and publicly rejected. You do not agree with that?

Mr. SAUNDERS. Certainly not.

Senator CURTIS. Well now, I am not citing to you what college students say in a debating society. I am reciting to you the official pronouncements of another branch of the Government, and I would be the happiest person on earth if you could come up with some concrete evidence that increased spending and a failure to expand the Federal Government has ever been retarded because there was not money in the Treasury.

Mr. SAUNDERS. Senator, we certainly agree with you, we are in favor of a balanced budget just as much as you are.

Senator CURTIS. I know that.

Mr. SAUNDERS. And we are in favor of reducing taxes.

We do not think the two things should be tied together, and if you are going to tie them together you are not going to do anything. We think you ought to reduce taxes, and we think you ought to control expenditures. I think the Congress of the United States and the Senate are big enough to do both of those jobs, and you should not do it together. You ought not to do it together. It is no distinction in principle; to us it is a matter of approach.

Senator CURTIS. Have you sent any literature to the businessmen in my State pointing out the new Federal programs being advocated, and urging them to oppose them?

Mr. SAUNDERS. That is not our function. This organization is not an overall organization trying to remake the country.

We were organized for one single purpose or two really. Our primary purpose is to get a tax reduction. Now, we think that is of primary importance to the economy of this country.

We also, like you, want expenditures reduced, but that is not our primary function here. We will support you in the reduction of expenditures, certainly we will. But here we are saying the two are not interdependent, and they should not be tied together. If you tie them together you are not going to do anything.

Senator CURTIS. All right.

Now, with the exception of wartime expansion, has our great expansion of the size and scope of the Federal Government been carried on a cash basis or by deficit financing?

Mr. SAUNDERS. I suppose largely by deficits because we have had so many of them.

Senator CURTIS. Yes.

Mr. SAUNDERS. That is the thing we do not like. We think you are going to continue to have them if you continue to pursue the policy that you are advocating. You are never going to correct that situation as long as you are going to insist on balancing the budget before you reduce taxes.

Senator CURTIS. Well, wouldn't you go as far as saying that we ought to at least hold the line on expenditures?

Mr. SAUNDERS. We did say so, sir. The trouble is people do not listen to us. They say, when we asked for a reduction of taxes, "Of course, you mean that." We say in the same breath that we want

to hold the line on expenditures, but nobody hears that. We say that to you now, we want you to hold the line on expenditures, and we expect it to be done.

Senator CURTIS. By whom?

Mr. SAUNDERS. By you, the Congress of the United States and by the administration—a joint responsibility.

Senator CURTIS. Do you think it will be done?

Mr. SAUNDERS. That is up to you all.

Senator CURTIS. Well, that is pretty general in your answer.

Mr. SAUNDERS. Well, it may be general, but how can I be more specific?

Senator CURTIS. By the same token there has always been a militant minority in both bodies.

Mr. SAUNDERS. I say thank God for militant minorities.

Senator CURTIS. These minorities have voted against increased expenditures, but they never win.

Mr. SAUNDERS. I think you win more than you think. It is just like Justice Holmes once said. He said:

> You go fishing some days and you don't think you have got many fish. But you look in your creel and you have got more fish than you think you have.

I think you are doing a lot more good than you get credit for or at least you are willing to admit.

Senator CURTIS. Currently we are talking about a reduction in foreign aid. A reduction from what? It is a reduction under the amount that is being pressurized by the administration that asks for this tax reduction.

Mr. SAUNDERS. Well, suppose you had not done what you did, it might be twice as much as it is. You have made a lot of progress.

Senator CURTIS. But, Mr. Saunders, I asked you if you had discussed this with the President and urged a reduction. Don't you think it would be effective if you would be as militant and produced detailed studies and the specifics on the expenditures as you have been on the tax reduction?

Mr. SAUNDERS. I think you are exaggerating what we have done on the tax reduction, in the first place. We only expressed our views, and this is the first body we have ever appeared before. We were invited here.

We, of course, have been active to a certain degree, but we have in every publication we put out, we always join control of expenditures or restraint of expenditures with tax reduction. We emphasize both of them. I do not know of any—of course, as I said, we are not out to try to change the world or anything like that. We are simply stating what we believe to be a basic philosophy which will benefit this country.

Senator CURTIS. I come from a State that I think has an income which is below the average, but there are none of these education bills that have been passed this year that I have supported.

We do not have the money. I do not want our schools run from the Federal Government.

The administration forced down our throats a depressed areas bill. I did not hear any of these people complaining about it. It was quite ridiculous.

We woke up one morning and read our papers in Nebraska that 12 counties had been declared depressed areas. One of them was Dawson County, Nebr.

It is a very rich county in the Platte Valley; has a number of thriving cities, and it has had more industrial growth than any other place, highly irrigated.

If you would take the whole county and include streets and highways and cemeteries and recreation parks and everything, and divide it by the farm income it was over $80 an acre last year. But the administration classified it as a "depressed area."

About a week later the Department of Agriculture published a list of the most prosperous agricultural counties in the United States, and of the 2,000 counties, Dawson County, Nebr., was 54th from the top. It was among the very highest.

I am not challenging the sincerity of your desire for control of Government expenditures, and I think that if they are not controlled and they are not cut back and a reversal of doing everything from Washington, that we are gone.

But I do seriously question the statement repeated in the publications and in your statement today that a tax reduction bill will hold down expenditures, because, it is not borne out by history. It is not giving the individual citizen who receives this message an accurate picture, as I see it.

I want to say, as I said in the beginning, I exclude from that any isolated and periodic cuts for 1 year in appropriations. You have to ascertain the question of whether or not the Federal Government is growing, you have to take into account the built-in increases, you have to take into account the pressure, not from the people back home.

The people I represent do not want these programs. They are advocated in Washington and forced on them.

My people are poor people, and I hate to have them told that to reduce taxes will reduce expenditures, because the facts are that in the thirties, well-intentioned efforts to relieve the depression set in motion a lot of programs that are costing us billions of dollars now, and it was all done on deficit financing.

The many programs being advocated today not only are planned on deficit financing but I cited three or four of the top budgetary people to the effect that they are opposed to a balanced budget.

So my quarrel is not at all challenging your sincerity in reduction of Government expenditures. I know that is genuine. It narrows down to one thing: telling the people that a reduction in taxes will mean a reduction in expenditures when it cannot be borne out.

I have just one more thing here. I have taken too much of your time. I have here what appears to be a statement of principles of the Businessmen's Committee for Tax Reduction in 1963. No. 4, and I quote:

> At the same time, we urge in the strongest possible terms economies in and prudent control of Federal expenditures. Failure on the part of the Congress and administration to establish and adhere to rigid expenditure discipline could well negate the good emanating from tax reduction.

Do you agree with that?

Mr. SAUNDERS. Certainly.

Senator CURTIS. So if we reduce taxes and increase expenditures we could destroy the good effect that tax reduction might bring.

Mr. SAUNDERS. That is correct. We are counting on you to keep them down.

Senator CURTIS. That is contrary to the theme pronounced by the distinguished Senator from Illinois that he wanted the pump primed both by releasing more tax money and also by deficit financing.

Mr. SAUNDERS. We do not advocate that. We do not advocate that.

Senator CURTIS. Didn't you so understand his questioning?

Mr. SAUNDERS. I think that speaks for itself. I did not get that point, but maybe he did. That was not my understanding.

Senator CURTIS. Yes.

Later on, in that same page, it says:

> Specifically, we advocate (a) a substantial reduction in all individual tax rates from the present range of 20 to 91 percent and (b) a reduction in the rate of corporation income taxes to at least 47 percent.

I wish you would have added a (c) there, and specifically advocated a reduction of not less than 5 percent in expenditures. I do not want to overstate it, but I must again point out that expenditures can be controlled in a particular fiscal year.

They can spend a lot of money if they want to push it out, or they can drag their feet the last few months. So the only way you can measure spending is by its impact over the years.

I commend you, gentlemen, for your defense of private enterprise. I commend you for your diligence in urging tax reduction. I commend you for your position here against excessive spending. I think you would have to be a mighty force for private enterprise if you would have been equally as militant with the budget officers in the various departments of Government, Mr. David Bell, Mr. Gordon, Mr. Galbraith, Dr. Seymour Harris, as well as the White House themselves, where this spending originates. It does not originate with the people.

I thank you, Mr. Chairman.

The CHAIRMAN. Senator Morton?

Senator MORTON. Mr. Chairman, I am going to try to arrange it so that these gentlemen can get to lunch in a minute.

I disagree, to some extent, with my good friend and colleague, Senator Curtis, in that I think there is some evidence in this Congress of lower expenditures by virtue of the bill under consideration.

We passed the so-called ARA or the increased authorization for this accelerated public works program. The House rejected it by a very close vote. It was to be brought up on the House side again, and I think—I cannot prove this, but in talking to my friends on the Ways and Means Committee—that there was a quid pro quo, and that the administration agreed not to push that extra $500 million, or whatever it was, this year.

Senator CURTIS. This year.

Senator MORTON. If they could get the tax bill. Maybe they won't push it next year. If it is dead, it is dead without an administration push; at least we know that. So I think there is some evidence, not as much as I would like to see.

I think, Mr. Chairman, that the ground has been pretty well covered, and I have no further questions.

The CHAIRMAN. Thank you, Senator Morton.
The committee will recess until 2:30, and the Chair will have to ask the witnesses to return at that time.
(Whereupon, at 12:35 p.m., the committee was recessed, to reconvene at 2:30 p.m. on the same day.)

AFTERNOON SESSION

The CHAIRMAN. The committee will come to order.
The Chair recognizes Senator Gore.

STATEMENT OF STUART T. SAUNDERS, HENRY FORD II, AND FRAZAR B. WILDE—Resumed

Senator GORE. Mr. Chairman, I wish to direct my questions to Mr. Ford, who, I have understood through the press, took the lead in organizing this group.

Please understand that all of us have an appreciation for the efforts of any citizen to contribute to the national welfare as he understands it, and also to promote his own welfare as all of us have a right, and in some respects a responsibility, to do.

So my questions shall be directed, I hope, courteously and in that framework.

I am very interested in the organization of this group of which you are cochairman. I gather from press accounts that you took the lead in this. Would you be so kind as to relate to the committee the genesis of this organization?

Mr. FORD. Senator, the genesis of the organization came about through two meetings at which there were five or six people, which took place in the Treasury Department, at the request of Secretary Dillon and Under Secretary Fowler. We were asked whether we would like to participate—the group that was there—to participate in the formation of a committee which would be made up of a lay group, of the general public, if you will, housing people and so forth, agriculture, and business people, and whether we would consider supporting the measures which had been proposed in the President's tax message.

Senator GORE. Would you mind relating the names of the people who were present, other than yourself, Secretary Dillon, and Under Secretary Fowler?

Mr. FOWLER. Well, I will make an effort. I am not sure that I can remember them all.

Mr. Saunders was there; Mr. Wilde was there. I do not remember whether each of them was there on both occasions. Mark Crisap, former head of Westinghouse, who is deceased, was there; Jim Oates was there, an insurance executive; Sam Fleming, the president of the Third National Bank of Nashville was there. There were certain other Treasury people whose names I do not, at the moment, recall, and whom I do not know personally.

Senator GORE. Who invited you to come to the meeting?

Mr. FORD. I believe Secretary Dillon, as I recall it.

Senator GORE. By long-distance telephone?

Mr. FORD. Yes, sir.

Senator GORE. So this group really originated with the Treasury?

Mr. FORD. Well, I would say the germ of the idea came from the Treasury. However, during the discussions which ensued at these meetings, there was quite a difference of opinion as to whether the business community, at least as represented by those who were present at those meetings, could support the reforms as presented. And further, from their standpoint, whether a committee made up of such a broad group could ever really get down to brass tacks and agree on anything.

So we proposed—we considered amongst ourselves the setting up of a businessman's committee for tax reduction in 1963. So from that time on, we have completely disassociated ourselves from the Treasury, and we have acted on our own. We have, naturally, from time to time, discussed problems, but we have not considered ourselves to be an arm of the Treasury or any other part of the administration.

Senator GORE. Was there any discussion, at the time, of the propriety of the Secretary of the Treasury organizing a lobbying group?

Mr. FORD. I did not know there was any impropriety, myself.

Senator GORE. I am not saying there was or was not. I am asking you if that subject was discussed.

Mr. FORD. That subject was not discussed as far as I can remember, sir.

Senator GORE. Was any suggestion made to you and others with respect to the possibility of registering under the Lobbying Act?

Mr. FORD. When the committee was finally formed, we got together after the meetings at the Treasury, separately, on our own, and put together a list of about 50 business people that we asked to a luncheon here in Washington, at which time we——

Senator GORE. Well, the question I asked you, if I may redirect it, was whether or not at this meeting with the Secretary of the Treasury, Douglas Dillon, and Under Secretary Henry Fowler, there was any suggestion or any mention of the possibility of the lobbying group finding it necessary to register under the Lobbying Act.

Mr. FORD. There was no agreement that we were going to do anything, Senator.

Senator GORE. I am not asking you if there was any agreement. I am asking you if this subject was in any way mentioned.

Mr. FORD. Not to the best of my recollection; no, sir.

Senator GORE. Now, what was the date of this meeting?

Mr. FORD. Oh, I do not remember. Sometime in February or March—I am not sure.

Senator GORE. Now, after this meeting, you say another meeting was called of about 50 businessmen. Who called this meeting?

Mr. FORD. The group that got together after the meeting in the Treasury Department and others. We formed an executive committee and we issued invitations to some 50-odd business people.

Senator GORE. Where did this second meeting occur?

Mr. FORD. At the F Street Club, at luncheon.

Senator GORE. What date was set for this second meeting?

Mr. FORD. April 25, 1963.

Senator GORE. Now, were you and Mr. Saunders elected cochairmen or were you appointed by the Secretary of the Treasury, or what?

Mr. FORD. The group that got together, after disassociating ourselves from the Treasury Department—there were six or seven of us—

agreed among ourselves how we would form this executive committee, and it was just worked out amongst ourselves.

Senator GORE. So this group of six or seven were called together, as you related, by the Secretary of the Treasury and his assistant, and, to use your words, the "germ of the idea" was that of the Secretary of the Treasury. So in conformance therewith, this group met apart from the Treasury Department, at which time you decided among yourselves what official capacity you would have in the organization ultimately to be evolved?

Mr. FORD. Mr. Saunders does not agree with my recollection.

Mr. SAUNDERS. May I say a word?

Senator GORE. Yes, indeed.

Mr. SAUNDERS. What actually happened was this. The group of 5 or 6 Mr. Ford refers to, we issued invitations to some 50 or 60 business people to come to the F Street Club.

Senator GORE. Was this the same day?

Mr. SAUNDERS. No; this was subsequent to that. That meeting was held April 25. I would say this meeting was held early in April.

Senator GORE. Who sent the invitations?

Mr. SAUNDERS. The group of five. The letter was signed by all the people present at that meeting—Mr. Fleming, Mr. Ford, Mr. Wilde——

Senator GORE. Do you have in your files, Mr. Ford, or either of you, the names of this select group of 50?

Mr. SAUNDERS. We would be glad to furnish them.

Mr. FORD. Yes, we have them.

Senator GORE. Would you furnish that to us?

Mr. SAUNDERS. Certainly; be glad to.

(The material referred to follows:)

INVITEE LIST—ORGANIZATION MEETING, THE BUSINESS COMMITTEE FOR TAX REDUCTION IN 1963, WASHINGTON, D.C., APRIL 25, 1963

J. Paul Austin, president, Coca Cola Co.
Robert C. Baker, chairman and president, American Security & Trust Co.
Harry Hood Bassett, president, The First National Bank of Miami.
S. D. Bechtel, chairman, Bechtel Corp.
Elliott V. Bell, chairman, executive committee, McGraw-Hill Publishing Co., Inc.
John E. Bierwirth, chairman and director, National Distillers & Chemical Corp.
James B. Black, chairman, Pacific Gas & Electric Co.
Joseph Block, president, Inland Steel Co.
Roger E. Blough, chairman, United States Steel Corp.
Harold E. Boeschenstein, president, Owens-Corning Fiberglas Corp.
Harlee Branch, Jr., president, Southern Co.
W. Lyons Brown, chairman of the board, Brown-Foreman Distillery Co.
Goodwin Chase, president, First National Bank of Tacoma.
John T. Connor, president, Merck & Co., Inc.
Donald C. Cook, president, American Electric Power Co.
Milton Cummings, Brown Engineering Co.
Frederic G. Donner, chairman of the board, General Motors Corp.
Dr. Elmer W. Engstrom, president, RCA.
R. Gwin Follis, chairman, Standard Oil of California.
Gen. James H. Gavin, president, Arthur D. Little, Inc.
Harold S. Geneen, president, International Telephone & Telegraph Corp.
Preston Hotchkis, president, Fred H. Bixby Ranch Co.
Amory Houghton, Jr., president, Corning Glass Works.
W. Maxey Jarman, chairman, Genesco, Inc.
Edgar Kaiser, president and director, Kaiser Industries.
Frederick Kappel, chairman, American Telephone & Telegraph Co.
Fred Lazarus, Jr., chairman, Federated Department Stores, Inc.

Lawernce Litchfield, Jr., president and director, Alcoa.
Homer J. Livingston, chairman, First National Bank of Chicago.
John L. Loeb, partner, Loeb, Rhodes & Co.
Robert Marsh, chairman of the board, First & Merchants Bank.
John A. Mayer, president, Melon National Bank & Trust Co.
Thomas B. McCabe, chairman of the board, Scott Paper Co.
William A. McDonnell, chairman, St. Louis-San Francisco Railway.
W. P. McMullen, Jr., chairman of the board, Deposit Guaranty Bank of Jackson.
Joseph Irwin Miller, chairman, Cummins Engine Co., Inc.
Don G. Mitchell, 3 West 57th Street, New York.
Charles G. Mortimer, chairman, General Foods Corp.
Charles Myers, president, Burlington Industries.
Thomas S. Nichols, chairman of the board, Olin Mathieson Chemical Co.
James F. Oates, Jr., president, The Equitable Life Assurance Society.
W. A. Patterson, president, United Air Lines.
Herbert V. Prochnow, president, The First National Bank of Chicago.
M. J. Rathbone, chairman of the board, Standard Oil Co. (New Jersey).
Philip D. Reed, 375 Park Avenue, New York, N.Y.
Richard S. Reynolds, Jr., president, Reynolds Metals Co.
David Rockefeller, president, Chase Manhattan Bank.
R. E. Salvati, president, Island Creek Coal Co.
John A. Sibley, chairman, executive committee, trust co. of Georgia.
Philip Sporn, president, American Electric Power, Inc.
Allan Sproul, Kentfield, Calif.
Frank Stanton, president, Columbia Broadcasting System, Inc.
William C. Stolk, chairman, American Can Co.
Charles H. Sommer, president, Monsanto Chemical Co.
J. Cameron Thomson, chairman, Northwest Bancorporation (retired).
J. Harris Ward, president, Commonwealth Edison Co.
Thomas J. Watson, Jr., president, International Business Machines Corp.
Charles Welman, chairman, First Charter Financial Corp.
Sidney J. Weinberg, partner, Goldman, Sachs & Co.
W. K. Whiteford, chairman of the board, Gulf Oil Co. of California.
A. L. M. Wiggins, Huntsville, Ala.

Mr. SAUNDERS. Let me finish what I was going to say, sir.

Senator GORE. Yes, indeed.

Mr. SAUNDERS. No officers were named at this time. The group of five invited this group. They responded. We had this meeting.

At the meeting of the 35 or 36 people, they authorized the executive committee to select certain officers of this group. Subsequent to that time, the executive committee named Mr. Ford and myself as cochairmen of this group. That is the way we came into office. We did not seek office.

Senator GORE. This is an example, I suppose, of the office seeking the man. The Secretary of the Treasury sought you out to——

Mr. SAUNDERS. The Secretary of the Treasury had nothing to do with the selection of Mr. Ford and me as cochairman of this committee.

Senator GORE. But Mr. Ford has testified that it was Secretary Dillon who called him to the first meeting. Who called you?

Mr. SAUNDERS. Under Secretary Fowler called me and asked us to come. And consider that, as Mr. Ford has explained to you, what he called us for did not take place at all. He was talking about a citizens' committee for tax reduction. We did not go along with that idea and decided to go along on a wholly different approach, a business committee. As you know, a labor committee was formed for tax reform subsequently, with which we have no connection whatever.

Senator GORE. Well, Mr. Ford, how did you go about soliciting members? You said in your testimony this morning that member-

ship has reached more than 2,000 now. How did you go about soliciting for members?

Mr. FORD. We expanded the executive—the committee was somewhat expanded at the time of this luncheon with the five original people plus others added on a regional basis. Each of us undertook in our own regions to try to interest as many business people as we possibly could.

Senator GORE. How many did you personally contact?

Mr. FORD. Oh, I do not know, sir.

Senator GORE. Do you have some estimate?

Mr. FORD. Ten or twenty.

Senator GORE. Was this done by personal visits or by long distance?

Mr. FORD. By phone. And also by mail.

Senator GORE. Who paid for the calls?

Mr. FORD. I guess the calls were probably paid for by Ford Motor Co.

Senator GORE. Congressman Byrnes referred to the meeting in Washington as the "Millionaires' March on Washington." Did you pay your personal expenses there or did Ford Motor Co. pay for that?

Mr. FORD. You mean the luncheon itself?

Senator GORE. The traveling expenses and the luncheon—the expenses of the trip.

Mr. FORD. Ford Motor Co. paid for them.

Senator GORE. Ford Motor?

Mr. FORD. Yes, sir.

Senator GORE. What size budget does this organization have?

Mr. FORD. We do not have any budget. We collected approximately $160,000. It is registered as a lobbying organization. Mr. Huston, the executive director, is also a registered lobbyist. I think we have spent to date around $130,000 or $127,000.

Senator GORE. Do you have the source of your contributions? Is that a matter of record?

Mr. FORD. Yes, sir.

Senator GORE. Will you supply it to the record at this point?

Mr. FORD. Yes, sir.

Mr. SAUNDERS. We cannot supply it right now. We will supply it.

Senator GORE. I understand.

(The following was later received for the record:)

Contributions to the Business Committee for Tax Reduction in 1963 [1]

Connecticut General Life Insurance Co	$1,000
Adams, Cates Co., Atlanta, Ga	1,000
Westinghouse Electric Corp	1,000
Norfolk & Western Railway	1,000
Ford Motor Co	1,000
Burlington Industries, Greensboro, N.C	1,000
Brown-Forman Distillers Corp., Louisville	1,000
American Security & Trust Co	1,000
Third National Bank of Nashville	1,000
Milton K. Cummings (Brown Engineering Co., Huntsville, Ala.)	1,000
William F. Oates, Jr. (Equitable Life Assurance Co.)	250
Frank Sulzberger	250
General Motors Corp	1,000
County Trust Co. of White Plains, N.Y	1,000

[1] Beginning May 10, 1963, through Nov. 4, 1963.

Contributions to the Business Committee for Tax Reduction in 1963[1]—Con.

Corning Glass Works	$1,000
Robert H. Levi, the Hecht Co., Baltimore, Md	200
J. Richardson Dilworth, 30 Rockefeller Plaza, New York	100
W. Arthur Grotz, Western Maryland Railway Co	100
Sidney J. Weinberg, Goldman, Sachs & Co	500
George F. Smith, Johnson & Johnson	250
Donald C. Cook, American Electric Power Co., Inc	500
John E. Bierwirth, National Distillers & Chemical Corp	500
J. W. Reavis, Jones, Day, Cockley & Reavis	500
Alfred W. Jones, Sea Island Co., Georgia	100
E. S. Marsh, the Atchison, Topeka & Santa Fe	1,000
Archer-Daniels-Midland Co	500
Philip D. Reed	200
Shenandoah Life Insurance Co	50
The First Pennsylvania Banking & Trust Co	500
Frederick R. Kappel	500
Wachovia Bank & Trust Co	100
Duke Power Co	500
W. P. Pat McMullan, Deposit Guaranty Bank & Trust Co., Mississippi	500
Texaco, Inc	1,000
Carl M. Loeb, Rhoades & Co	1,000
Inland Steel Co	500
Aetna Insurance Co	250
The Lane Co., Inc	100
A. D. Barney	100
Bankers Life of Nebraska	200
North Carolina National Bank, Charlotte	200
Bankers Trust Co., New York, N.Y	250
General Foods Corp	1,000
Continental Illinois National Bank & Trust Co. of Chicago	1,000
Federated Department Stores, Inc., Cincinnati	1,000
William S. Street, Seattle, Wash	100
Chicago & North Western Railway Co	500
The Youngstown Sheet & Tube Co	500
The Phoenix of Hartford Insurance Co.'s	200
Turner Construction Co	200
Gaylord Donnelley, Chicago, Ill	200
Leonard Spacek, Chicago, Ill	300
Cabot Corp	100
J. L. Barr, 5402 Windsor Lane, Shawnee Mission, Kans	50
Guaranty Bank & Trust Co., Worcester, Mass	100
Geo. F. Brown & Sons, Inc., Chicago, Ill	100
The Connecticut Bank & Trust Co	250
W. M. Jarman	250
Eaton Manufacturing Co., Cleveland, Ohio	500
Thompson Ramo Wooldridge, Inc	1,000
First National City Bank, New York	1,000
Radio Corp. of America	1,000
Commonwealth Edison Co	1,000
L. G. Atkins, Charlotte, N.C	400
Broadway-Hale Stores, Inc., California	200
Guyan Machinery Co., Logan, W. Va	100
Farrel Corp	100
J. Wilson Newman	100
James W. Young	100
Tennessee Gas Transmission Co	1,000
Irving Trust Co	1,000
CIT Financial Corp	1,000
New England Mutual Life Insurance Co	500
Scudder, Stevens & Clark, New York	500
Island Creek Coal Co., Huntington, W. Va	200
Commerce Trust Co., Kansas City, Mo	200
R. L. Ireland III, Brown Bros., Harriman & Co	1,000
G. A. Ransom, special No. 3 (Union Carbide Corp.)	1,000
Sheraton Corp. of America	100
Stupp Bros. Bridge & Iron Co., St. Louis, Mo	100

[1] Beginning May 10, 1963, through Nov. 4, 1963.

Contributions to the Business Committee for Tax Reduction in 1963[1]*—Con.*

Manufacturers Hanover Trust Co	$1,000
The May Department Stores Co., St. Louis, Mo	500
Ideal Cement Co., Denver, Colo	500
E. F. Hutton & Co	500
Universal Oil Products Co	200
Carolina Power & Light Co	100
Norfleet Turner, Memphis, Tenn	100
Wabash Railroad Co., St. Louis	1,000
The Pure Oil Co	500
The Carpenter Steel Co	250
The Sherwin-Williams Co	250
Reynolds Metals Co	1,000
Johnson & Johnson, New Brunswick, N.J	1,000
The National Brewing Co	500
Libbey-Owens-Ford Glass Co	200
Lone Star Cement Corp	500
Jack M. Miller, Kansas City, Mo	50
Elliott V. Bell, New York, N.Y	250
Associated Spring Corp	1,000
Frisco-St. Louis-San Francisco Railway Co	500
Meredith Publishing Co	250
Fred C. Foy, Koppers Co., Inc	250
Marvin Bower, McKinsey & Co., Inc	100
Stanley M. Cooper, New Britain, Conn	100
Phoenix Mutual Life Insurance Co	250
Morenz Neuhoff, Jr	500
National Savings & Trust Co	100
The First National Bank of Miami	100
The Akron Standard Mold Co	200
Aetna Life Insurance	300
Pitney-Bowes, Inc	250
Whirlpool Corp	1,000
First National Bank of San Diego	100
William H. Chisholm	100
Merck & Co., Inc	500
J. C. Penny Co	1,000
Midland-Ross Corp	300
Gerard Trust Corn Excahnge Bank	300
Bank of America	1,000
Tom K. Smith	50
Rupert C. Thompson, Jr	100
Corn Products Co	500
Georgia Railroad Bank & Trust Co	100
Soo Line Railroad Co	200
Central Standard Life Insurance Co	200
Texas Telephone & Telegraph Co	500
George Olmsted, Jr	100
Trammel Crow	1,000
David Rockefeller	1,000
Joseph E. Seagram & Sons, Inc	1,000
Gilbert W. Humphrey	500
The Hartford Electric Light Co	200
Grand Union	200
S. D. Lunt & Co	100
Charles W. Hoyt	50
Swift & Co	1,000
General Telephone & Electronics Corp	500
Armstrong Paint & Varnish Works, Inc	100
Pope & Talbot, Inc	100
David Packard	250
First National Bank of Portland, Maine	100
Aluminum Co. of America	750
New York Telephone Co	250
Nashua Corp	100
R. F. Whittle	25
International Business Machines	1,000

[1] Beginning May 10, 1963, through Nov. 4, 1963.

Contributions to the Business Committee for Tax Reduction in 1963[1]—Con.

Monsanto Chemical Co	$1,000
FMC Corp	500
American Hardware Corp	500
American Export Lines	50
T. S. Petersen	200
B. F. Goodrich Co	1,000
National Gypsum Co	500
New Jersey Bell Telephone Co	250
Foote Mineral Co	100
Holly Sugar Corp	100
G. Albert Lawton	25
United States Trust Co	250
National Rubber Machinery Co	250
Walter D. Fuller	100
Clarence E. Elderkin	100
State Capital Life Insurance Co	50
First National Bank in St. Louis	250
Lewis W. MacNaughton	250
American Potash & Chemical Corp	200
Fairfield County Trust Co	100
Estabrook & Co	100
Akron, Canton & Youngstown Railroad Co	100
Millers National Insurance Co	50
Consolidated Edison Co. of New York	1,000
S. F. Wollmar	250
William H. Moore	200
The Bauer Bros. Co	100
Home Federal Savings & Loan Association of Des Moines	100
Baltimore Gas & Electric Co	500
American Agricultural Chemical Co	100
Bibb Manufacturing Co	100
John Nuveen & Co	200
Milton Bank & Safe Deposit Co	25
Central Maine Power Co	100
Acacia Mutual Life Insurance Co	250
Pennsylvania Power & Light Co	250
Bell Telephone Co. of Pennsylvania	250
Sahara Coal Co., Inc	100
Republic Supply Co. of California	100
United Life & Accident Insurance Co	100
Douglas B. Whiting	25
Leonard Dreyfuss	50
J. Howard Marshall II	100
Lawson Milk Co	100
American National Bank & Trust Co. of Chicago	100
Arnold Machinery Co., Inc	100
Republic National Life Insurance Co	100
G. D. Searle & Co	250
Citizens & Southern National Bank	250
Pacific Telephone	250
Washington National Insurance Co	400
De Coppet & Doremus	300
American-Standard	500
National Biscuit Co	1,000
International Harvester Co	500
Percy L. Douglas	200
Hartford Steam Boiler Inspection & Insurance Co	100
First Wisconsin National Bank of Milwaukee	100
First National Bank of Atlanta	500
American Sugar Co	250
Trenton Trust Co	100
James Bruce	100
Southwestern Life Insurance Co	100
Security National Bank (Sioux City)	50
Goodyear Tire & Rubber Co	1,000
Heinemann Electric Co	250
Newburger & Co	150

[1] Beginning May 10, 1963, through Nov. 4, 1963.

Contributions to the Business Committee for Tax Reduction in 1963[1]*—Con.*

Contributor	Amount
Minneapolis-Moline, Inc	$100
Western Kentucky Gas Co	100
Theo. H. Davies & Co., Ltd	100
Harland Knight	50
James G. Fox, Jr	50
Connecticut Light & Power Co	200
Kern County Land Co	500
Harlem Savings Bank	100
P. H. Glatfelter Co	100
Smith, Barney & Co	100
The Sperry & Hutchinson Co	500
Dresser Industries, Inc	750
United States Steel Corp	1,000
Shepherd, Murtha & Merritt	250
Harrisburg Steel Co	250
Pittsburgh-Des Moines Steel Co	50
Maust Coal & Coke Corp	500
North American Reassurance Co	25
Gulf Mobile & Ohio RR. Co	100
William Carter Co	100
Black & Decker	200
Firestone Tire & Rubber Co	1,000
American Life Insurance Co. of New York	25
Davidson Rubber Co	200
Indiana National Bank	100
Newton F. Korhumel	100
August Belmont	150
American Snuff Co	200
Roos-Atkins	100
Bullock's Inc	200
Steel Parts Corp	100
D-A Lubricant Co., Inc	100
Cunningham Kiewit Co	100
Congdon & Carpenter Co	50
Bristol-Myers Co	1,000
H. Daroff & Sons	100
Republic Foil, Inc	100
Bethlehem Steel Co	1,000
Taylor & Co	500
Illinois Tool Works	100
Pennsylvania Industrial Chemical Corp	100
American Metal Climax, Inc	250
Moore, Leonard & Lynch	50
Florida Steel Corp	100
Standard Brands, Inc	500
Western Gear Corp	100
Peet Packing Co	100
Dickerson, Inc	150
Seth Horne Development Corp	100
McLouth Steel Corp	500
Slab Fork Coal Co	250
Korshoj Construction Co., Inc	100
Northern Illinois Gas Co	250
Kenneth M. Owen	25
Whitehead & Kales Co	100
Pease Woodwork Co	100
Fruit Growers Express Co	100
Concrete Pipe & Products Co., Inc	50
C. H. Masland & Sons	100
Mick-or-Mack Stores Co., Inc	100
Hatfield Electric Co	100
Bankers Health & Life Insurance Co	100
Berglund Motor Co	25
Egger Steel Co	100
Manufacturers National Bank of Detroit	500
Mueller Brass Co	100
Oglebay Norton Co	100

[1] Beginning May 10, 1963, through Nov. 4, 1963.

Contributions to the Business Committee for Tax Reduction in 1963 [1]*—Con.*

Roberts Toledo Rubber Co	$30
J. Large, Western Power & Gas, Chicago, Ill	100
Scott Paper Co	250
Wallace & Tiernan, Inc	100
Massachusetts Mutual Life Insurance Co	500
Associated Dry Goods Corp	250
Cleveland-Cliffs Iron Co	500
Harvey Aluminum	200
McDevitt & Street Co	50
Georgia-Pacific Corp	500
The Mennel Milling Co	50
The First National Bank of St. Paul	100
Newbery Electric Corp	100
Hickey-Freeman Co	100
Fred H. Slate Co	100
Garrett, Miller & Co	50
First National Bank of Rochester, Minn	50
Merritt-Chapman & Scott Corp	750
Bohn Aluminum & Brass Corp	250
Southern California Edison Co	250
Robertshaw Controls Co	200
Allison Steel Manufacturing Co	100
Carolina Steel Corp	100
Gates Rubber Co	250
W. O. Hickok Manufacturing Co	25
Cincinnati Steel Products Co	25
Virginia National Bank (Norfolk)	500
Republic National Bank of Dallas	25
R. W. Purcell	100
Hill Richards & Co	100
American Steamship Co	150
Interstate Motor Lines, Inc	200
Bemis Bros. Bag Co	100
I. Magnin & Co	100
Fredrickson & Watson Construction Co	200
Socony Mobil Oil Co., Inc	1,000
Tejon Ranch Co	125
A. L. Garber Co	200
Estate of Leander J. McCormick	100
State National Bank of El Paso	200
Burroughs Corp	1,000
Charleston National Bank	150
John M. Franklin	100
Louisiana Land & Exploration Co	200
Blyth & Co., Inc	500
Virginia Electric & Power Co	250
Southern Materials Co	100
Norfolk Shipbuilding & Drydock Corp	200
Wean Engineering Co., Inc	500
Title Insurance and Trust Co	250
Jessop Steel Co	100
Munsingwear, Inc	500
Central National Bank	100
Federal-Mogul-Bower Bearings, Inc	250
Shwayder Bros., Inc	100
Mr. W. T. Kelly, Jr	100
Thilmany Pulp & Paper Co	100
New York Life Insurance Co	500
Sotco (Southern Textile Machinery Co., Inc.)	50
The Sexauer Co	50
The Flintkote Co	100
Cott Beverage Corp	50
The Diversey Corp	100
The Budd Co	500
Maui Electric Co., Ltd	50
East Tennessee Packing Co	50

[1] Beginning May 10, 1963, through Nov. 4, 1963.

Contributions to the Business Committee for Tax Reduction in 1963[1]*—Con.*

Hawaiian Telephone Co	$150
Union Bank (Los Angeles, Calif.)	250
Gilbane Building Co	25
National Starch & Chemical Corp	250
Mechanical Mold & Machine Co	50
Pacific Mutual Life Insurance Co	500
Mr. B. S. Gilmer	250
Con-Gas Service Corp	250
Mr. George Wingfield, Jr	50
Olin Mathieson Chemical Corp	500
Levi Strauss & Co	500
Jewel Tea Co., Inc	250
Bliss & Laughlin, Inc	250
Mr. S. C. Amren	20
Douglas Aircraft Co	500
Carrier Corp	500
Air Reduction Co., Inc	250
The Dumore Co	100
Business Men's Assurance Co. of America	100
Copper Range Co	50
Green Giant Co	100
Maui Pineapple Co., Ltd	100
Utah Power & Light Co	200
Vanadium-Alloys Steel Co	200
The Borden Co	500
First National Bank in Little Rock	100
Hartford National Bank & Trust Co	250
Associates Investment Co	1,000
International Milling Co	500
Champion Papers, Inc	200
Life & Casualty Insurance Co. of Tennessee	150
Inter-County Telephone & Telegraph Co. (Fort Myers, Fla.)	100
Castle Rubber Co	100
Mr. John Sherwin	100
Hurst Printing Co., Inc	25
Mr. Morton S. Cressy, Jr	50
Dewar, Robertson & Pancoast	100
Nager Electric Co., Inc	100
National Steel Corp	500
Union Bag-Camp Paper Corp	250
Mr. Charles Keller, Jr	150
Mr. R. B. Evans	25
Worcester Pressed Steel Co	100
Mr. Strauder G. Nelson	500
Dillingham Corp	100
Providence Journal Co	100
Donahue Sales Corp	100
J. I. Kislak, Inc	50
Mr. Robert W. Galvin	200
Folger, Nolan, Fleming & Co., Inc	100
Kershaw Manufacturing Co., Inc	50
The Nestle Co., Inc	500
Mr. Franklin E. Sheidler	20
Mr. George Jackson	100
The AP Parts Corp	100
Mr. J. D. Anderson	25
Senco Products, Inc	50
The Wurzburg Co	100
Bankers Life Co	300
Mueller Co	100
Mr. Elmer T. Stevens	100
Olympia Brewing Co	100
Mr. R. F. Windfohr	100
The Electric Furnace Co	100
General Public Utilities Corp	500
Shands & Baker, Inc	100

[1] Beginning May 10, 1963, through Nov. 4, 1963.

Contributions to the Business Committee for Tax Reduction in 1963[1]*—Con.*

Mr. John F. Forbes	$50
Triangle Conduit & Cable Co., Inc	100
E. E. Black, Ltd	100
Vogue Rattan Manufacturing Co	75
Coldwell, Banker & Co	250
Mr. Everett P. Hadley	250
New England Telephone & Telegraph Co	250
Mr. Nicholas H. Noyes (Eli Lilly Co.)	100
Denver Clearing House Association	500
Morrison-Knudsen Co	500
Cummins Engine Co	250
Kelsey-Hayes Co	250
Trust Co. of Georgia (Atlanta)	250
Transport Management Co	100
National Bank of Washington (Tacoma)	100
California & Hawaiian Sugar Refining Corp	100
Pacific Gas and Electric Co	1,000
Texas Instruments, Inc	500
Summit Trust Co	100
U.S. National Bank of Omaha	100
Cino Chemical Co	25
Waverly Mills, Inc	100
A. Y. McDonald Manufacturing Co	50
Crucible Steel Co. of America	50
Dixie Mercerizing Co	100
W. T. Grant Co	100
The Food Marts	100
Montana Power Co	200
General American Transportation Corp	200
Chicago, Rock Island & Pacific RR. Co	500
Consumers Power Co	500
Valley National Bank	200
Marsh & McLennan	100
Silco Cut Price Stores, Inc	150
Braislin, Porter & Wheelock, Inc	100
Bank of Hawaii	100
Mr. P. W. Pitzer, Jr	50
Mr. W. L. Stewart	50
Robertson Sign Co	50
Cramer-Krasselt Co	40
Milton Roy Co	25
C. Ed Flandro, Inc	20
Norris-Thermador Corp	250
The Merchants National Bank of Mobile	250
Macco Corp	250
Porter Sesnon	25
Central Missouri Trust Co	100
Oilgas Royalty Corp	25
Lawrence Warehouse Co	100
Celanese Corp. of America	500
A. O. Smith Corp	200
Coast Manufacturing & Supply Co	50
R. V. Dorweiler Co	50
Interstate Finance Co	100
Minneapolis-Honeywell Regulator Co	250
International Telephone & Telegraph Corp	500
Hilbish Motor Co	25
Maxwell M. Upson	100
First American Title Insurance & Trust Co	200
Republic Aviation Corp	500
Rochester Gas & Electric Corp	500
Mr. Walter H. Sammis	100
B. C. Ziegler & Co	100
United Air Lines	200
Wellman Engineering Co	25
J. M. Tusing	100
Hill & Knowlton, Inc	100

[1] Beginning May 10, 1963, through Nov. 4, 1963.

Contributions to the Business Committee for Tax Reduction in 1963[1]—Con.

Concord Motors, Inc	$25
The National Cash Register Co	500
Corcoran, Foley, Youngman & Rowe	100
Franklin Finance Co	25
Capital Co	200
Arthur Rubloff	150
Tidewater Oil Co	500
Mr. Philip H. Watts	50
Eagle Pencil Co	250
First National Bank of Nevada	100
Sayles Finishing Plants	100
Knappen Milling Co	100
Eastern Coal Corp	1,000
Equitable of Iowa	250
The Union Oil Mill, Inc	100
Pyle National Co	50
Beneficial Management Corp. (to be credited to Beneficial Finance Co.)	500
Allegheny Power System, Inc	100
The Pillsbury Co	250
Joseph Horne Co	100
Southern Railway System	500
Kerr-McGee Oil Industries, Inc	500
British Motor Car Distributors, Ltd	200
The Potomac Edison Co	100
Carondelet Realty Corp	50
Smith Motor Co., Inc	25
Clary Corp	50
American National Bank	50
Marlin-Rockwell Corp	100
John Tarrant	100
Brown-Rogers-Dixson Corp	50
The E. Kahn's Sons Co	100
Dunn & McCarthy, Inc	100
Island Federal Savings & Loan	50
The Hilliard Corp	100
Neville Chemical Co	50
Bakersfield Savings & Loan Association	100
J. L. McCaffrey	100
Rubbermaid, Inc	200
Edward Russell Taylor	100
Shaker Savings Association	50
Security Mutual Life Insurance Co	50
SPO, Inc	25
Marine Midland Corp	1,000
Richards-Wilcox Manufacturing Co	200
Clyde Williams	25
Detroit and Northern Savings & Loan Association	100
ACF Industries, Inc	200
J. V. Norman, Jr	10
Rogers Construction Co	100
First-City National Bank of Binghampton, N.Y	50
Kempton Dunn	100
American Brake Shoe Co	500
Xerox Corp	500
Blumenthal Print Works	250
The American Saw & Tool Co	250
The Title Guarantee Co	200
Riverland Hardwood Co	100
Caterpillar Tractor Co	500
T. W. Samuels Distillery	150
United Fruit Co	100
Hickey-Mitchell Co	150
National Home Life Assurance Co	100
Copolymer Rubber & Chemical Corp	100
Iowa-Illinois Gas & Electric Co	100
Curtis Kinard Oil Co	100

[1] Beginning May 10, 1963, through Nov. 4, 1963.

Contributions to the Business Committee for Tax Reduction in 1963[1]—Con.

Pittsburgh Forgings Co	$100
James Pair Personnel Service	25
Electrical Products Consolidated	100
Spencer Chemical Co	100
Lytton Savings & Loan Association	50
Beverly Hills Federal Savings & Loan Association	50
J. Aron & Co., Inc	100
Hesston Manufacturing Co., Inc	100
A. F. Jacobson	100
Ohio River Co	50
Wheeling Steel Corp	500
City Loan & Savings Co	100
Globe Corp	100
Consolidated Foods Corp	250
H. J. Heinz Co	200
Koontz Wagner Electric Co., Inc	50
Morgan Guaranty Trust Co. of New York	1,000
Julius Wile Sons & Co., Inc	100
Peter B. Ruffin	500
Ling-Temco-Vought, Inc	100
The Ohio Citizens Trust Co	250
Colonial Stores, Inc	100
Brooks, Harvey & Co	50
Harris Pipe Mills	50
JOFA, Inc	25
First Federal Savings & Loan Association of New York	100
The First Pyramid Life Insurance Co. of America	100
Clinton H. Brown	100
National Gas & Oil Corp	50
The Toledo Edison Co	200
Associated Merchandising Corp	100
The Interstate Amiesite Corp	10
The Snyder-Bently Co	15
Charles L. Hutson, Jr	100
The Atlantic Refining Co	250
Neptune Meter Co	100
Parts, Inc	100
Redwing Carries, Inc	150
Clarence J. Robinson	100
Corry Jamestown Corp	25
Hoosier Engineering Co	25
Detroit Ball Bearing Co	500
Ira H. Hardin Co	50
HumKo	50
Malone & Hyde	50
Cooper Tire & Rubber Foundation	200
Old Ben Coal Corp	100
Stangler Bros	25
Hoover Co	500
Seattle-First National Bank	200
Florida Soap Corp	100
Mr. W. M. Day	200
Seessel's	25
Choctaw, Inc	25
KTBS, Inc	5
Geo. H. McFadden & Bros., Inc	100
Martin Oil Co., Inc	100
Ring, Mahoney & Arner	50
Lifetime Distributors, Inc	50
Reynolds, Smith & Hills	50
The Columbian Peanut Co	100
Larus & Bros., Co., Inc	100
J. W. Greer Co	25
Automatic Retailers of America, Inc	200
Industrial Finance & Thrift Corp	100
Cook & Co., Inc	50
Arthur Fulmer	25

[1] Beginning May 10, 1963, through Nov. 4, 1963.

Contributions to the Business Committee for Tax Reduction in 1963[1]—Con.

The Columbia Manufacturing Co., Inc	$100
Chrysler Corp	1,000
National Burial Insurance Co	50
Arthur F. Greer	5
Morton Salt Co	500
D. H. Overmyer Warehouse Co	25
Howard E. Green	50
Harry L. Dillin	10

[1] Beginning May 10, 1963, through Nov. 4, 1963.

Senator GORE. Mr. Saunders, did the Pennsylvania Railroad pay your expenses?

Mr. SAUNDERS. No, sir; I was not with the Pennsylvania at that time.

Senator GORE. That would be a bit unfair, would it not? Did Norfolk & Western?

Mr. SAUNDERS. Yes; they did. That is my recollection. Let me say a couple of things to fill in what Mr. Ford said, if I may, sir.

Senator GORE. Yes, sir.

Mr. SAUNDERS. We started out and our original objective was to have 300 members, 250 or 300 members. But actually, after we got this thing started, it grew like Topsy. As Mr. Wilde, here, who is chairman of the membership committee knows, this thing has been wholly voluntary. We have never really done what you might call make any great solicitation for members or anything of that sort.

Senator GORE. Does either of you know whether the corporations represented or the individuals who met here in this meeting in Washington, at which the President spoke, paid the expenses of those who attended? Do you know what the general pattern was?

Mr. SAUNDERS. I do not, no.

Senator GORE. You have answered only with respect to yourselves?

Mr. SAUNDERS. That is correct.

Senator GORE. Now, if either of you can tell me from your records the membership of this committee, I would be very pleased to know it. What was the membership on April 1?

Mr. SAUNDERS. We would be glad to supply it. I just do not know. We didn't have any on April 1. It was not formed until April 25.

Senator GORE. What was it on June 1?

Mr. SAUNDERS. I cannot give you those figures, but they have been going up. It has been going up gradually, although rather rapidly at first.

We shall be glad to supply them.

Senator GORE. All right. What was it on August 1?

Mr. SAUNDERS. I do not know, but it was in the neighborhood, I would say, of around 1,800 to 2,000 at that date.

(The following was later received for the record:)

The Business Committee for Tax Reduction in 1963

On April 1, membership was none.
On June 1, membership was 435.
On August 1, membership was 1,948.

Senator GORE. Well, during August, I note that four new members were acquired in Tennessee and two of them were employees of Ford Motor Co. or associated with it. I am happy that you have employees in Tennessee.

Mr. FORD. So are we. We are happy to have them in our glass plant there.

Senator GORE. It is a very fine industry. When was the subject of tax reform first discussed? Were the reforms which the Treasury had recommended discussed at the meeting with Secretary Dillon?

Mr. FORD. Yes. We discussed the general situation. I would say the business people who were at this meeting were not terribly enthusiastic about the reforms that had been suggested and felt that they could not go along with them and, therefore, they could not support the bill as it was presented.

Senator GORE. So you decided you could not support the bill if it contained the reforms that had been recommended?

Mr. FORD. That was our general contention to the Secretary.

Senator GORE. Was this a decision of the group which met separately?

Mr. FORD. Nothing was organized while we were in there talking with the Secretary.

Senator GORE. When you met at the F Street Club, were tax reforms discussed?

Mr. FORD. We had a statement of principles which——

Mr. WILDE. May I add something, Senator?

Senator GORE. Yes, sir.

Mr. WILDE. I have a very distinct recollection of that meeting. One of the controversial subjects before this tentative group was the reforms in this sense, that we thought they were so complex and so hard to evaluate and there were so many of them that, as a matter of policy, we should decide to form this committee on the basis that our interest would be confined to the two major income tax structures: the personal and the business. And the reason for it was purely pragmatic, that we did not think we had time to study all the various individual, secondary issues I call them, and we would get into a terrible hassle trying to evaluate them.

So we were not against them per se because they were reforms, but we just thought it was not practical, that we would stick to the two main issues. This was the decision upon which this group of about 35 decided to make this organization active.

Senator GORE. And those two main issues were?

Mr. WILDE. Personal and business corporate tax reform.

Senator GORE. You mean reform and economy?

Mr. WILDE. This is semantics and I do not understand the language well enough to know. But to me they were both designed to make the economy more effective by reducing this high incidence of direct taxation. I think that is reform.

Senator GORE. I was not trying to draw any fine point, but were the two things you agreed upon reduction in taxes for individuals and corporations?

Mr. WILDE. This is right, sir.

Senator GORE. Now, I understood from your statement of principles, from the letter signed by the cochairmen of this committee, dated October 11, and also from your joint statement this morning, that the two-pronged approach was for tax reduction and expenditure reduction.

Mr. WILDE. We did not have any debate on it, because everybody was agreed. We debated quite a bit——

Mr. SAUNDERS. It was not expenditure reduction, it was control of expenditures.

Mr. WILDE. Control of expenditures, not reduction.

Mr. SAUNDERS. Control of expenditures, not reduction.

Senator GORE. Well, I understood you in response to questions by Senator Byrd this morning to favor reduction in expenditures.

Mr. SAUNDERS. I think you misunderstood us, Senator, or at least if we said that, we did not express ourselves as clearly as we should have. We are, of course, not opposed to reduction in expenditures if they can be achieved. But our statement of principles and all the statements that have been made are based upon a rigid control of expenditures. They may not be the same thing under certain circumstances.

Senator GORE. So you are really not saying to this committee that you favor reducing expenditures.

Mr. SAUNDERS. We are saying to you that we are in favor of a rigid control of expenditures.

Senator GORE. Well, the law controls expenditures.

Mr. SAUNDERS. Who makes the law?

Senator GORE. I beg your pardon?

Mr. SAUNDERS. You make the laws.

Senator GORE. Well, public money can only be expended in conformance with law. The laws control it. I do not wish to get into, as you say, semantics here, but these are not difficult words. I understood you to favor reducing expenditures, but now you are unwilling to say you do. Maybe I misunderstood you. If I did, I am sorry.

Mr. SAUNDERS. Could I read you what I said?

Senator GORE. I remember what you read, but I thought you said to Senator Byrd that you hoped that the budget would be cut and that the expenditures would be reduced. Now, maybe it is not important whether you did or did not, but that was my clear understanding. Now you may say what your view is if you like.

Mr. SAUNDERS. Basically, we are saying we want rigid control of expenditures. We said we did not think the budget for 1965 or 1966 should be above the level of 1964. Of course, if expenditures can be reduced, we would like that very much. But we have not said that. Certainly, any prudent control of expenditures or any reduction that is possible without other harm to the economy or to this country, we are in favor of.

Senator GORE. Now, you are opposed to deficit financing, are you not?

Mr. SAUNDERS. Basically, yes.

Senator GORE. What do you mean, basically? Are you opposed to it or not?

Mr. SAUNDERS. Certainly we are opposed.

Senator GORE. But you are in favor of deficit financing if it is necessary to get a tax cut?

Mr. SAUNDERS. We are in favor of it if you want to call it deficit financing. I called it investment this morning, and I think it is a matter of terminology. We are in favor of a shortrun deficit in order to produce a balanced budget. We think that this course will do that.

Senator GORE. Well, I shall not get into a discussion with you at this time as to whether it does.

Mr. SAUNDERS. That is a matter of judgment, I suppose.

Senator GORE. Well, it is also a matter of experience. Congress reduced taxes by more than $7 billion in 1954 and it has not balanced

the budget yet. Now, I do not know whether you mean the short-run——

Mr. SAUNDERS. There were 2 years subsequent to that, immediately after, when the budget was balanced. The only 2 years, in fact, consecutively that we have had in many years in which the budget was balanced was following the tax reduction in 1954.

Senator GORE. Is that what you mean by shortrun?

Mr. SAUNDERS. No, we do not mean shortrun. We think, to put it the other way, shortrun deficits, yes.

Senator GORE. But you are giving an example now——

Mr. SAUNDERS. But we are talking about long-term surpluses or balanced budgets. We are not talking about short runs.

Senator GORE. Would you mind giving me just some inkling of what you mean by short term and long term?

Mr. SAUNDERS. It is all relative, but we would hope if you have rigid control of expenditure and if the economy responds as we hope and expect it will to this tax cut, in a matter of 2 years or somewhere in that range, we will be able to approach a balanced budget. It might happen quicker, may be a little longer. No one can say.

Senator GORE. Mr. Chairman, am I correct in recalling that the Secretary of the Treasury forecast deficits through the next 3 years?

Senator BYRD. I think that is correct.

Mr. SAUNDERS. That is correct, I read his testimony.

Senator GORE. Then you do not agree with the Secretary of the Treasury?

Mr. SAUNDERS. I do not disagree with him. I say if it is possible, that if the economy responds as we hope it will, this thing may come about quicker than the Secretary suggests. It may not. But by virtue of suggesting that it may, it does not mean I disagree with him.

Senator GORE. Mr. Ford, in your letter to me of October 11, you used the term which is very dear to the heart of the people who work for the Ford Motor Co., very dear to the heart of working people everywhere. It is a term that they understand, "take-home pay." I read from your letter:

> And regardless of the decision on retroactivity, the effective date of increased take-home pay for the more than 60 million Americans subject to income tax payroll deductions certainly would be delayed—

and so on.

Do you know what the increase in take-home pay would be for—well, let's take a simple example. Take a single taxpayer working for me or for you, I am not trying to find a Ford employee directly, please understand. Take a single taxpayer with taxable income of $4,000 a year. Do you know how much his increase in take-home pay would be per week?

Mr. FORD. No, sir.

Senator GORE. It would be less than $3 per week. Do you know what the increase in take-home pay, income after taxes, would be for a single corporation executive, with a taxable income of $300,000 a year?

Mr. FORD. No, sir.

Senator GORE. Do you have any idea?

Mr. FORD. No, sir. I have not figured it out.

Senator GORE. Well, I have a table prepared by experts and it will be more than $1,000 per week. Now, since you had not bothered—

since you had not figured it out, I give you this information, not as prepared by me but as prepared by the technical experts of this committee. Do you think it fair to give a tax reduction of less than $3 a week to one man and more than $1,000 a week to another?

Mr. FORD. Well, sir, I had no knowledge of how they in the House arrived at the amounts and the spread of the amounts. Nor have we in the committee undertaken any position in this. I think that if a man has worked his way up in an organization to the point where his salaries and emoluments are in a certain area, why, the reduction which will be applied to him, naturally, will be a greater figure than that of the fellow who has a lower base pay.

Senator GORE. In terms of social justice, or on any terms, do you support that kind of bill?

Mr. FORD. I have no criticism of this bill in this respect; no, sir.

Senator GORE. And you did not know that the increase in take-home pay provided by this bill would bring about a distorted result like that?

Mr. FORD. I question the word "distorted," sir.

Senator GORE. I will accept your objection to the word. I will change it to "disparity" of tax benefit.

Mr. FORD. There is a disparity, there is no question about this. But I would like to say, Senator, if I may, that I think the total effects of the bill, which will be $11 billion, are of a cumulative nature and that this will be spent all across the spectrum in the consumer purchasing areas, from the lowest to the highest income individual, who reaps the rewards of the reductions if they are passed, and I think this will create a stimulus to the economy which will cause greater economic growth in the future than we have been able, apparently, to get in the past through other means.

I further think that the corporate reduction will allow corporations to, as was said this morning, expend funds for capital facilities and also allow them to expend funds that they might not necessarily expend in research and development, which will provide new products and allow them to get into different areas of business that they might, under the present bill, not do.

Now, the figures which are before me, in the hearings before your committee here, show the distribution of this. I have read this. I do not know—I would not know how to do it any better, sir.

Senator GORE. Well, I hope this committee can find a way to do it better, if we are to have a tax reduction. Maybe I can suggest a way to do it better.

Do you know what the personal exemption from taxation or income is for a man and wife?

Mr. FORD. You mean the $1,200 exemption? Is that what you are talking about? Or the $600 exemption?

Senator GORE. $600.

Mr. FORD. Yes.

Senator GORE. As I understand the theory of the personal exemption, it is to permit a family or a taxpayer to have a subsistence level of income before the heavy hand of the U.S. Government lays a tax upon his income. Do you so understand that?

Mr. FORD. Yes, sir.

Senator GORE. Do you consider $1,200 for a man and his wife an adequate subsistence level, an adequate level of income for a subsistence level of life? Not a satisfactory American level? How would you characterize it?

Mr. FORD. This would not be his total income. This would be before the adjustments for his total income in the tax would have to be taken out. So that would not be his total income, as I understand it.

Senator GORE. I do not want to misunderstand you. Are you saying that, in your view, the income of a man and his wife should become taxed when it exceeds $1,200 a year?

Mr. FORD. No, sir. I am not saying that.

Senator GORE. What do you think the average rent for an apartment or shelter of any sort in Washington would be?

Mr. FORD. In Washington, D.C.?

Senator GORE. Or Detroit or Nashville?

Mr. FORD. I think it varies all over the lot, Senator, depending on the location.

Senator GORE. Yes. Would you give an estimate of what comfortable living quarters would rent for per month?

Mr. FORD. This is not anything that I know anything about, and I would hesitate to make a guess. As I say, it would depend on the location and whether it is furnished or unfurnished or what kind of a dwelling we are talking about. I would assume that it would vary tremendously.

Senator GORE. Well, though you disclaim any knowledge of this, those of us who represent the people, all the people—you and the $1,200 couple also—must have some knowledge of living standards and the cost of living.

Do you really think that $1,200 is a high enough exemption for a man and his wife?

Mr. FORD. Well, Senator, I do not know the answer to that question. I do not know—you see, as I understand your question—I may not understand it correctly. But a man has *x* number of dollars income and from this income you are deducting $1,200. Then he pays the tax on what is left.

Senator GORE. What is above that.

Mr. FORD. Yes; so I do not know what the individual's total income might be, so it is very hard for me to answer your question.

Senator GORE. Do you know what the personal exemption for a man and his wife was in 1940?

Mr. FORD. No, sir; I do not.

Senator GORE. It was $2,000.

Mr. FORD. Well, I am sure that the tax rate in all the brackets was different then, sir, than it is today.

Senator GORE. So is the cost of living.

Mr. FORD. Yes, sir.

Senator GORE. The cost of living is more than twice as much now as it was then. Do you know why this was changed?

Mr. FORD. Why the cost of living was changed?

Senator GORE. Why the personal exemption was lowered.

Mr. FORD. So that the Government could have more money to spend on what it felt it had to spend money on.

Senator GORE. That was one reason. Do you know what the second principal reason was?

Mr. FORD. No, sir; I do not.

Senator GORE. It was to dampen consumer demand; to siphon off the savings of the people so that inflation would not be so disastrous. These two reasons caused me to vote to lower the personal exemption for a man and his wife from $2,000 to $1,200. Now, meanwhile, the cost of living, as I have said, has more than doubled. If you had the responsibility of representing the people, would you think this $1,200 an adequate amount, or would you consider raising it?

I think I have asked you an improper question. I am asking you a hypothetical question. I am in the position of responsibility and I am the one who must decide that and I shall withdraw that question.

What I am trying to drive home to you people who are head of this powerful committee of businessmen that has brought so much pressure and publicity to bear on this bill and for this bill is that this is an unfair and an unjust bill. I am surprised that you did not know that it would represent such an increase in take-home pay for some and such a small increase in take-home pay for others.

Mr. FORD. I believe that wages have gone up substantially, too—I know they have.

Mr. SAUNDERS. They have gone up about three times what they were in 1940.

Mr. FORD. The average U.S. income, as I see it here, has increased to around $7,000. Now, there are always inequities, but it is one of the problems we all face. And there is structural unemployment that is deplorable, in West Virginia and Kentucky and I am sure probably some in your State, too. There is some in Michigan. And I wish that we could do something about this. My only feeling is that the most constructive thing that the country can do, that you can do in the Senate and in the House, is to pass this tax reduction bill.

Now, when it comes to how it is distributed, sir, I am not knowledgeable in this area and I do not know. I do not know how to answer this question.

Senator GORE. You recognize, of course, that members of this committee must reach a determination on details of this sort which have escaped you?

Mr. FORD. Absolutely.

Mr. SAUNDERS. Let me say this, sir: We think that when you are giving approximately $8.9 billion to the individuals, of which 18 percent of that $8.9 billion goes to taxpayers with incomes of less than $5,000 and 41 percent goes to the taxpayers between $5,000 and $10,000, and out of the $8 billion, something like $525 million goes to taxpayers over $50,000, that is approaching a fair distribution.

Senator GORE. Would you mind reading the first figure there?

Mr. SAUNDERS. Of the $8.9 billion, $1.6 billion, or 18 percent goes to those with incomes of less than $5,000.

(Senator GORE. How many American citizens must share that $1.8 billion?

Mr. SAUNDERS. I do not know. I can give you that figure. It is in the testimony offered by the Secretary of the Treasury at page 151. I will get it in a moment.

It is only in percentages.

Senator GORE. You know, you can play mirror games with percentages.

Mr. SAUNDERS. Under $10,000 is 22.9 million. That is what it is.

Senator GORE. I have been speaking in actual dollar increase in take-home pay for taxpayers in different categories. Now, if we must come to percentages, let me give you one. Mr. Ford, you suggested that an average family income was between $6,000 and $7,000, did you say, or did you say a little in excess of——

Mr. FORD. I said around $7,000, sir.

Senator GORE. All right; let's take the average taxpayer, since we want to deal in percentages and averages. The average taxpaying family in the country, I think, is a man, wife, and two children. That is about as near to an average family unit as we can come. And I have calculations here that show such a family of four, with a taxable income of $8,000, would get an increase in take-home pay of less than 5 percent. But if that same taxpayer happened to be in the corporate executive level, with a taxable income of $600,000 a year, he would get a 100-percent increase in after-taxes income.

What I am trying to show you gentlemen here is—I do not know whether you have been mesmerized by this mirror game of percentages or not—I hope not—you deal, in this bill, in this way: The large percentages are applied to the large amounts and the small percentages are applied to the small amounts. This is how you get this great disparity of benefits.

Now, Mr. Ford, you have mentioned structural unemployment and I shall not go further on this disparity of tax benefits under the bill—yes, I would like to go one step further, if you will pardon me. Senator Douglas referred to statistics furnished by the Treasury which show that some taxpayers with a million-dollar income per year, some with a $5 million income per year, paid no taxes at all. I have before me a table prepared by the Secretary of the Treasury, which contains about the most astounding statistical information that I have seen in many years. I asked the Secretary of the Treasury to prepare a table giving a typical taxpayer's taxes at given income levels or brackets—sort of a composite taxpayer in the $10,000 bracket or $20,000 or $100,000, and so forth. And I would like to read you what this table shows. This table is also based on the typical or composite taxpaying family—man, wife, and two children.

Now, on the typical taxpayer, with an adjusted gross income—the Treasury has not made any tables, as far as I can find, based on taxable income. They seem to prefer to use "adjusted gross," which you and I understand to be considerably different from taxable income. When this bill becomes law, if it does, this composite man, this typical taxpayer, not a millionaire, but one who has $1 million per year of adjusted gross income, will be paying taxes at a rate of less than 24 percent. Does that surprise you?

Mr. FORD. It does surprise me. I do not know the figures.

Senator GORE. The average taxpayer with an adjusted income of $100,000 a year will pay in the 29 percent range.

Mr. FORD. Would he be paying more than the person in the million-dollar bracket?

Senator GORE. Well, let me give you the exact figures. Understand, Mr. Ford, this is not my table. This is the Department of the Treasury's. I must say that I have found it astounding. I will read you the exact figures: Adjusted gross income of $100,000 would pay

$29,670; $200,000 would pay $56,675; $500,000, $138,216; $1 million, $238,037.

I would like you gentlemen to take this home. It has been an astounding table to me. Yet those of us who think that the crying need in the tax field is for tax reform to bring about some equity and fairness, then you gentlemen say you would not support a bill unless the tax reform elements were dropped out.

Mr. FORD. I do not think we said that, sir. We said we did not feel we should take a position on tax reforms because we did not agree with them.

Senator GORE. No. I recall what you said. You said you agreed you could not support a bill as long as these reforms were in it. If you think I am incorrect, we can go back and have the stenographer read what you said.

Mr. FORD. I will take your word for it.

Senator GORE. Well, now, if I may go on—please understand, I am not trying to be unpleasant with anyone. I am fighting for what I think is a principle of social justice and fairness. Here we have a tax structure so filled with loopholes and favoritism that we bring about legally the results which I read to you, and yet when Congress attempts to bring about some reform, there is the fiercest resistance by the leading and most influential citizens that we have. Now, you mentioned——

Mr. SAUNDERS. Senator, may I say that we do not agree with that statement? We certainly do not. We think it is an equitable tax bill and we would not be supporting that if we did not.

Senator GORE. Well, since you say that, I would say that under present law, this typical taxpayer with a million dollars per year income will pay in the 26 percent bracket. If this bill becomes law, the situation will be more inequitable, he will pay in the 23 or 24 percent bracket.

Mr. SAUNDERS. We do not oppose you and we are not suggesting that you should not have tax reforms. We are simply saying that the need is for getting the economy moving and for long-range development. If you want reforms, if these things you are talking about are bad, certainly they ought to be corrected. We are not opposing them.

Senator GORE. Which ones will you support?

Mr. SAUNDERS. I cannot say offhand. But we are not here opposing reforms of any sort.

Senator GORE. Will you support a tax reform to require the payment of taxes upon the profit earned upon the exercise of a restricted stock option?

Mr. SAUNDERS. Well, I think that these questions do not lend themselves to categorical answers. There are a lot of features here that ought to be considered. I think it is a matter of great concern as to what is the proper method of taxing stock options. I do not say what any particular pat formula should be or vice versa. It is a matter that ought to be thoroughly considered.

Senator GORE. Well, your cochairman has written extensively on the subject and he writes with a facile pen. I have read, Mr. Ford, many things you have written and said. The best I can make of it, Dean Griswold appears to be the leading opponent of restricted stock

options—at least, he writes well on the subject. And so far as I can tell, you are the leading advocate of restricted stock options. At least you speak strongly in support of them.

Mr. FORD. I do, sir.

Senator GORE. I notice in your article in the Harvard Business Review you refer to restricted stock options—well, let me read from it:

> At the same time, we also developed a group of exceptionally able younger men who contributed materially to the company's growth and who were not being rewarded commensurately with their contribution.

(The entire article by Mr. Ford will be found in the hearings for Nov. 25, 1963, which appears in pt. 4.)

Then you proceed to say that you permitted them to purchase restricted stock options. Do you recall that?

Mr. FORD. That is correct, yes, sir.

Senator GORE. So you considered this as a reward to them for their contributions to the company?

Mr. FORD. I think stock options have done as much as anything to provide management of corporations in this country with incentives. And I certainly believe and I think that all of us believe that human beings need incentives to do a job. I do not participate in the stock option plan at Ford Motor Co. or in any other stock option plan. So I hope I am speaking quite objectively in this case.

I think that what has happened with the stock option law has benefited the growth of—the growth of the United States has benefited by the fact that a stock option law was put into effect. You can always say that these people have possibly earned more than was suspected they would when the option law was introduced. Nobody knows what is going to happen to the stock market. So this is a case which is always in effect. The market can go down as well as up, but in my opinion, the fact that there has been a stock option law has contributed immensely to the economic growth of this country.

Senator GORE. I do not here intend to raise the question of whether a restricted stock option has proved itself, whether an option is an incentive, whether it is proper, whether it has contributed to the economy. For the time being, just let me agree with your statement in that regard.

The question I raise is this: You reward—excuse me—I do not mean to be personal about this. Not only your company but many companies reward, as you put it in your article, your officials for their contributions by giving them the right to purchase stock at less than its market value.

Mr. FORD. We do not give them that right, sir. We grant them an option, but we do not know whether it is going to be more or less than the market.

Senator GORE. You and I know what you do. You grant them the opportunity of purchasing the stock within a given time, at a given amount, and it may turn out that this reward, when he exercises his option, is, say, $100,000 or $1 million.

Mr. FORD. It may be nothing.

Senator GORE. It may be nothing. It may be nothing. But if it is a reward, then it is income and the reform I advocate is that whenever that option is exercised, whether that official makes $1,000 or $100,000 or $1 million or $5 million, he has then realized his reward just as if he had drawn a salary and therefore, he should pay taxes on that. But the law does not so provide.

Mr. FORD. Well, I am happy the law does not so provide.

Senator GORE. So you oppose that tax reform, I take it, from what you have said and from what you have written. You would oppose taxation of income realized as the result of the privilege of buying stock at less than market value?

Mr. FORD. If I follow what you said correctly, you said that an individual should pay an income tax on the profit on stock between the time of the grant and the time of exercise?

Senator GORE. No. I said at the time of exercise.

Mr. FORD. At the time of exercise. Well, he has not realized the profit or loss at that time. He simply bought the stock, so you are asking him to pay a tax on something he has not realized.

But now it comes—excuse me.

Senator GORE. Do you seriously contend that if the Ford Motor Co. rewards me for my contribution to the success of that company with the privilege of buying stock for $100, which I can sell on the open market on the same day for $200, that I have not realized a profit? Do you seriously contend that?

Mr. FORD. You have an ordinary tax if you do that. You have an ordinary tax at whatever the rate is in your bracket. If you sell the day you exercise you pay ordinary income tax for it.

Senator GORE. I did not say if I sold it. I said which I could sell.

Mr. FORD. Well, may I take an example of a fellow granted an option at $20 for one share, to make it simple, and he exercises as to that one share, and the price is $40, so he has got a $20 profit, but he has not realized anything. He just got the stock certificate. He paid $20 for that which he can sell for $40.

Senator GORE. And you would change that?

Mr. FORD. Sir?

Senator GORE. You have given him a $20 equity in his stock as a reward for his service to your company, but you would not have it treated even as a capital gain.

Mr. FORD. No, sir. I do not see how that would be fair.

Senator GORE. I happen to know an instance of a man who told me that through restricted stock options he had an equity in excess of $5 million.

Mr. FORD. I am sure that has happened, but not because of this, because if you follow this through a step further, which I would like to do in my example, under present restricted stock option law which is in effect, not the new proposals, he has got to hold that stock for 6 months before he can dispose of it. So he bought a stock that was worth $20 at the time of grant and at the time of exercise worth $40, so he made a $20 paper profit.

Six months later he sells, and the stock is at 10, so he has gotten $10 actually. But you would tax him on the $20 profit, and he is broke. [Laughter.]

Senator GORE. Let us take the example——

Mr. FORD. I do not know what the guy does to pay the tax.

Senator GORE. Well, he gets the reward for his services. This is income.

Mr. FORD. I doubt if that is reward, sir.

Senator GORE. And this same gentleman, who I do not want to personalize, this same gentleman has an equity fortune which,

when I talked to him, was in excess of $5 million. I understand it is now in excess of $7 million. But he has paid no taxes whatsoever. The law does not require him to do so. Yet every person who sweeps the floor in his factory has the tax hand of the Government biting a piece of his check every week.

Mr. FORD. Senator Gore——

Senator GORE. Do you call that fair?

Mr. FORD. Absolutely, Senator. If I understand your example correctly; I may not, but you say he has $7 million. That sounds to me like he has got a $7 million paper profit. That stock may be below the option price when he sells it, he may be in the red; I do not know this.

I do not know what is going to happen to the economy of this country. When the stock market broke a year ago last May I can assure you there were a lot of people who were worried, and I know a couple of companies that, I think, made a dreadful mistake, and they repriced their options. I think that is a terrible thing to do, but they repriced them because these people were all under water.

Senator GORE. You mean you think it is terrible to reprice their options?

Mr. FORD. Absolutely.

Senator GORE. You know, of course, that is permitted under present law.

Mr. FORD. It is, sir.

Senator GORE. Would you advocate that reform?

Mr. FORD. I do, sir; I have.

Senator GORE. Good.

Mr. FORD. I have suggested, I suggested it to the House Ways and Means Committee in my testimony before the committee.

Senator GORE. Under the present law this gentleman, who, fortunately for him finds no necessity for selling the stock—indeed he indicated clearly to me he had no intention of doing so—can pass this stock on to his children without any income tax or capital gains tax ever being paid on this vast fortune.

Mr. FORD. Well, I must just say I am not opposed to passing things on to your inheritors. I think that is one of the basic things that makes this economy and makes this free enterprise system great. I would like to take an example of another kind on this business of taxing income at death, the appreciation of it at a capital gains rate before you pay an inheritance tax.

You take an able man who starts out with, we will say, a $5,000 investment, and by shrewdness and hard work and much labor and a little luck and a little help maybe he builds a business up to a fantastic amount. Let us say he builds it up to $1 million—a $1 million enterprise.

At the time of death, it seems to me, it is eminently unfair to tax him on that increase of his $5,000. I do not know why he should not leave that to his heirs. If it is taxed, he may have nothing left afterward. His heirs may not even be able to sell this equity.

This, of course, is an entirely different proposition, but the——

Senator GORE. What we are illustrating here by this exchange, it seems to me, is that the people whose income is earned in the form of

wages are the people who are really discriminated against by our tax laws.

Mr. FORD. That may be, Senator. I do not happen to think so. I do not think they are discriminated against. I think that the tax rates have been figured out by people who are a lot more intelligent than I am, and this has been promulgated over a period of years, and I would not know how to make it any better.

Senator GORE. I will ask one further question. I feel that I have, perhaps, overtrespassed upon the time of the chairman and members of the committee.

You mentioned structural unemployment a few moments ago. Before noon you discussed the need for more investment capital, yet when Mr. Saunders was asked about the danger of inflation he pointed to our enormous productive capacity.

How do you think this tax bill is going to solve the problem of structural unemployment?

Mr. FORD. I think that with the passage of the tax bill, if it should be passed, that you will see more expenditures for facilities by corporations, that we will have more consumption by the consumer because of this tax reduction, and because of this, the unemployment picture in this country is going to be materially affected, in my opinion.

Senator GORE. You think that the tax reduction in 1954, the accelerated depreciation granted by executive action, the investment credit passed last year, are not sufficient to create a reservoir of investment capital?

Mr. FORD. I do not think so, sir; and I think this new bill as proposed will provide an incentive which will be a great stimulus to the growth of our economy, and in that respect will make great inroads in the unemployment situation we find ourselves in today.

Now, I happen to serve with Mr. Saunders on the President's Labor Management Policy Committee, and this has been a subject of discussion in this committee, and I think that—I cannot quote the other members of this committee, I would be out of order if I did so—but I feel that they, in general, think the same way.

Senator GORE. Do you think the principal benefit then is to stimulate investment capital?

Mr. FORD. I think that is part of it. I think it is going to stimulate consumer spending as well.

Senator GORE. Those are the two principal stimulants, in your view?

Mr. FORD. Yes, sir. I think it will do other things, but I think those are the two principal ones.

Senator GORE. Are you aware of the fact that Secretary Dillon said in his speech to the bankers a short time ago that an excess of savings characterized our times?

Mr. FORD. Savings are high; yes, sir. But that doesn't——

Mr. SAUNDERS. That is just the point, Senator. There is no incentive to invest. The tax rates are too high.

Senator GORE. Now, therefore, you would increase the savings more in order to encourage investment in our productive facilities?

Mr. SAUNDERS. We would encourage investment. It would increase the incentives.

Senator GORE. Would this process of replacing outmoded plant and equipment mean fewer or more jobs?

Mr. SAUNDERS. In the long run I think it will mean more.

Senator GORE. Now, there again we get into the long run. We have an unemployment problem in the short run.

Mr. SAUNDERS. That is right.

Senator GORE. It is very pinching to some 4 million people.

Mr. SAUNDERS. That is right; and we have the problem of automation.

Senator GORE. Will this bill increase automation?

Mr. SAUNDERS. It may to some extent.

On the other hand, it will create new products, new markets, and you have got to face it, this country cannot stand still. We have to compete with foreign countries, and if we are on the basis of going backward or standing still, we are going bankrupt. You have got to make this economy grow, and you have to face this issue.

Senator GORE. I do not want to inquire with respect to either of the companies which you gentlemen represent. I am not inclined to do that. But, just in general, do you not know that corporations are in the most highly liquid position that they have been in, perhaps, ever?

Mr. WILDE. May I comment on that, Senator, because this is my business?

Senator GORE. First, will you answer the question, one of you?

Mr. WILDE. I know——

Senator GORE. That is true?

Mr. WILDE. It is substantially true.

Senator GORE. All right.

Mr. WILDE. But this is an across-the-board figure and does not apply to thousands of companies in this country.

You see, as an insurance company my duty is lending to these companies. There are literally thousands of companies in this country who are in very modest financial condition, and would like to get some money to either expand or go in for new products, and this is what we try to meet.

Senator GORE. So you are saying that this excess of savings, these retained earnings, this high degree of liquidity is not true of all?

Mr. WILDE. I am saying that is correct.

Senator GORE. This condition is an across-the-board condition?

Mr. WILDE. That is right, sir.

Senator GORE. Don't you realize that this tax bill is an across-the-board proposition, and instead of helping that it will bring about greater disparity?

Mr. WILDE. Well, I do not undertsand it that way, because it lifts the advantage to a smaller company by reversing the brackets so that the smaller company—which I particularly would like to see helped—gets a real boost. I have not got the figures on it, but you know what I mean by going down. Then the larger companies, and those above that bracket, are treated alike, the same percentage being applicable on a 2-year basis.

Senator GORE. Well, I am not the one who wants to stop progress, the remodeling of outmoded plants wherever they are, but I know of no shortage of productive capacity.

It seems to me that is not the problem. Now, Mr. Ford speaks of stimulating consumer demand. There I agree with him that we do

need to stimulate consumer demand, but again it seems to me we must specify what consumer demand, and where.

You mentioned structural unemployment. This is certainly in the most acute need of correction. Yet the tax benefits here go not directly to any of these people at all. It is only the "trickle down" process. It may or may not reach them.

This is the basic disagreement. I will not question you about this, but just let me say, in conclusion, since some of my colleagues are here, and I often talk for their benefit—I am not sure they appreciate it—but it seems to me that the real needs in our society, the pent-up demands, are in the public sector of our economy.

Senator Curtis said this morning that he had voted against funds for the mentally ill. That is his privilege. But it seems to me that we need to do something, our society needs to do something, to help the mentally ill.

We need to prosecute cancer research. I have referred to hotels and hospitals. The hotels are empty, the hospitals are full. Go into the hospital in any town and you find patients sitting out in the hall.

The companies you gentlemen—well, excuse me—the private sector is no' building hospitals. This is in the public sector. Do we need more vacations with pay or better education? Do we need bigger profits or more research?

Mr. Ford, you and I worked shoulder to shoulder for the highway bill. You thought investment in a public facility was a great thing then. I am not sure Mr. Saunders agreed with you entirely. [Laughter.]

Mr. SAUNDERS. I did not.

Senator GORE. Well, I felt some disagreement between you this morning.

Mr. SAUNDERS. I think that is healthy.

Senator GORE. When Senator Byrd asked you about postponing this tax bill until we could see the budget, you thought that would be quite unwise. Yet when he broached this subject to Mr. Ford, he thought it was a realistic approach. Now you are not in agreement about railroads or highways, so you are indeed a loose organization.

Thank you.

The CHAIRMAN. Senator Long?

Senator LONG. I do not know whether we can approach this bill or should approach it on the basis that the reductions that we make ought to try to follow a pattern of a certain percentage of increase in take-home pay.

If that is what we are going to do, how are we going to benefit those who are not going to pay any taxes at all under this bill? Sometimes I have been able to get my friend from Tennessee to go along with me, and sometimes not, on my amendment to increase welfare payments.

If that is what our purpose is, to increase take-home pay percentagewise, I would say that is where we could make the greatest increase, if we just take the billion, take $2 or $3 billion of this tax reduction and put that on welfare payments.

Did you understand when Senator Gore questioned you about those making more than $1 million paying taxes of less than 23 percent of adjusted gross income that that figure was arrived at by assuming that charitable contributions should be taxed prior to the deduction,

and taking into account such things as capital gains, assuming that interest on State and municipal bonds should be taxed?

Senator GORE. Would the Senator yield there?

Senator LONG. Yes.

Senator GORE. I believe adjusted—Mr. Stam can tell us—I believe the term "adjusted gross income" does not incorporate income from tax-exempt bonds, and only incorporates one-half of the capital gains; is that correct, Mr. Stam?

Mr. STAM. Yes.

Senator GORE. Thank you.

Senator LONG. I believe that 23-percent figure is arrived at by first estimating what the full amount of the gain is, and arriving at what the tax on the total would be, and then coming up with the conclusion that the capital gain which has been taxed at 25 percent, the figure would still average out higher than the 23 that the Senator made reference to.

Senator GORE. Do you have one of the tables?

Senator LONG. If that capital gain is arrived at by sale of stocks and bonds which, to a considerable degree, were financed with borrowed money, then the interest deduction against the capital gain causes the tax on the capital gain to be very small indeed, sometimes no tax at all, in effect if you look at one as against the other.

Likewise, it can be contended and, perhaps, for some purposes we should disallow a tax—disallow that deduction on charitable contributions. I believe you know one of the largest items that causes persons in high income tax brackets to appear in the type table to which the Senator made reference as paying around a 23-percent rate in the overall, is that those people find it to their advantage, either to their own desire to benefit humanity or to their tax advantage, for one reason or another, to make large charitable contributions.

I think that is one of the largest, if not the largest, items that causes a person in that income bracket to be in the table as paying a tax of 23 percent.

In other words, if a man had made, let us say $1 million, the Government would take about $60,000 out of the first $100,000; it would take $76,000 out of the next $100,000; and 90 percent out of the rest of it.

Now, suppose that man gave $700,000 of that $1 million to charity—it could be a foundation, it could be a church—and the table would show the man is paying around 23-percent taxes on the adjusted gross, I assume you did not understand that when you were queried about the table, as indicating that people making large amounts of money paid a small percentage of that in taxes. One of the principal explanations of it is that those people made very large charitable contributions.

Mr. SAUNDERS. That is correct.

Senator LONG. Those are all the questions I have, Mr. Chairman.

The CHAIRMAN. Senator Smathers?

Senator SMATHERS. I would like at this time to make a statement and ask just a few questions.

First, I want to commend my good friend, the Senator from Tennessee, for being, as always, a gentleman and restrained, though I do not always agree with him, I always recognize him to be the ultimate in being able and above all a gentleman.

Senator GORE. I want to thank you. I recognize these witnesses are gentlemen, too.

Senator SMATHERS. Let me ask just a couple of questions now.

With respect to the organization of the business committee, as I understand it, Secretary Dillon invited you to meet for the purpose of discussing the tax reduction proposal.

Mr. SAUNDERS. That is correct.

Senator SMATHERS. And invited you to meet and discuss the advisability of forming a committee which would be for tax reduction; is that correct?

Mr. SAUNDERS. That is correct.

Senator SMATHERS. Thereafter you people disassociated yourselves from the position of the Treasury and went on your own knowledge and your own judgment as to how far you would go in supporting this tax bill; is that correct?

Mr. SAUNDERS. Yes.

Senator SMATHERS. The question was raised as to whether or not this was proper. Do you know any reason or have you ever been advised by your lawyers or anybody else that this was in any fashion improper?

Mr. SAUNDERS. No, sir. On the contrary, we did ask the opinion of counsel, both our own company counsel, and other counsel. We got an opinion from a very prominent law firm as to whether there was any impropriety in what we were doing. The only thing they suggested was that our group register under the Lobbying Act. We only have two paid people, one is the executive director, and a secretary. The executive director is registered as a lobbyist, and we filed statements under the Lobbying Act.

Senator SMATHERS. You understand that under our system and under our laws, that you can make your views known with respect to not only this legislation but any other type legislation about which you have an opinion?

Mr. SAUNDERS. That is our understanding. I hope that is right.

Senator SMATHERS. Do you know whether or not, Mr. Ford, when you were interested in the highway bill, and the Senator from Tennessee was interested in the highway bill, was any question raised about the propriety of that which you were doing in behalf of the highway bill?

Mr. FORD. No, sir; no question raised.

Senator SMATHERS. You know, of course, that in some instances there had been some statements made that this administration—talking about the executive branch—has not pursued with enough vigor the policies which it has advocated.

Would you not agree that in this particular instance that the executive branch is attempting to pursue with vigor its belief in the need for a tax reduction program?

Mr. FORD. Yes, sir.

Senator SMATHERS. Do you see anything wrong with the Secretary of the Treasury calling you and asking you to assist in this program than the President of the United States getting on nationwide television and advocating a tax reduction bill?

Mr. FORD. No, sir?

Senator SMATHERS. Now, with respect to the expenditures, how you charged off your expenses of this when you came down; would it be

your judgment as businessmen that even those who oppose this bill, who came here—I do not know exactly who they are—but would you suspect that they, too, deducted their expenses against their business?

Mr. FORD. It would be my assumption.

Senator SMATHERS. I think that would be correct.

Mr. SAUNDERS. We also think, Senator, if this bill is passed it is going to be highly beneficial to the various companies we represent. It is distinctly——

Senator SMATHERS. You think it is legitimate?

Mr. SAUNDERS. There is nothing more important that we can do to promote the interests of our companies.

Senator SMATHERS. Actually the members of the AFI-CIO who, I understand, are for this bill, would you presume that the individuals who appeared in their behalf charged the expense of the the trip against the treasury of the AFL-CIO?

Mr. SAUNDERS. I would assume so; yes.

Senator SMATHERS. Now, let me ask you just a couple of questions with respect to the matter of reducing expenditures.

As I recollected your testimony, you did say that you wanted to hold the line, is that right, on expenditures?

Mr. SAUNDERS. That is correct, sir.

Senator SMATHERS. Then, in answer to the question asked you by the Senator from Delaware, I think you said that you did not, however, or maybe it was the Senator from Illinois, you did not, however, believe that we should reduce Government expenditures by the amount that the tax bill would cost.

Mr. SAUNDERS. We are not advocating that. We want to at least hold the line. If it is possible to reduce expenditures consistent with the needs of the Government, why, certainly we are in favor of that. We are in favor of economy in Government.

Senator SMATHERS. But you are also in favor of a balanced budget, and against deficit spending?

Mr. SAUNDERS. Absolutely.

Senator SMATHERS. It is your judgment, as an experienced businessman, that we are not going to get rid of these deficits and these unbalanced budgets unless we adopt a tax reduction program, and proceed along this particular line?

Mr. SAUNDERS. We have definitely come to that conclusion, and it is based in large measure on the history of the past 6 years.

Senator SMATHERS. With respect to this matter of deficit financing, and the question as to how long we will have the deficit, have you ever heard, Mr. Saunders, in your railroad business, of a railroad reducing rates for a time in order to get more business in order to put the company in the black?

Mr. SAUNDERS. Certainly; that is a standard practice and, as a matter of fect, your chainstores in this country operate on that basis entirely. They are reducing prices to get more business at a smaller unit profit; our whole mass production economy is based on that concept, by and large.

Senator SMATHERS. Is that somewhat the same philosophy that you have toward this bill, that by the reduction of taxes and the encouragement of people to spend more money—and we know they will spend more money—that thereafter the economy will be stimulated and that

there will be returned to the Treasury of the United States a greater amount of money in revenue even at the lower rates?

Mr. SAUNDERS. That is exactly our viewpoint.

Senator SMATHERS. Then with respect to certain provisions of this bill which you do not approve of, as I understand it, nevertheless your group is supporting the overall bill even though if you had your chance to write the bill you might not write it exactly like that?

Mr. SAUNDERS. We are supporting the bill in the way it has been passed by the House, even though there are features in the bill that we do not like. There are features that we think ought to be corrected, and that we hope this committee will decide to correct. Yet we are supporting the bill.

Senator SMATHERS. I have the question asked of me by a lot of my constituents as to whether this is a rich man's bill. Do you consider this to be a rich man's bill?

What is your answer to the question as to whether or not it is a rich man's bill?

Mr. SAUNDERS. We think definitely that this is not a rich man's bill; that it is a complete misnomer to characterize it as such.

We think that overall this bill is an equitable bill, that it is well balanced as between high income tax brackets and low income tax brackets; that it gives a modest reduction to corporations. The rate of percentage reductions is much higher to the lower income people than it is to the higher income people. Of course, in terms of take-home pay there is bound to be a considerable difference because if the group that the Senator from Tennessee is talking about paid no taxes, the increase in take-home pay still would be a relatively small amount in comparison with a large income bracket.

Senator SMATHERS. I notice in some of the tables that somebody put in the record that a man who makes $1 million, under present law pays $870,000 a year in taxes, that is, if he had not figured out a way to avoid that. But he pays $870,000 in tax.

Is it your judgment that because an individual, in getting a reduction, which he would get under the proposed law, of $184,000, that everybody should get the $184,000 savings proportionately even though they may happen to only make $6,000?

Mr. SAUNDERS. That is correct.

Senator SMATHERS. Or to look at it conversely, the man who only gets $3 in reduction a week, because he does not pay a very large tax, is it your belief that should thereby not limit the man who has worked hard and who does have a good income and who does pay, we will say, $100,000 in taxes, should be limited to just a tax relief of $3 a week?

Mr. SAUNDERS. We certainly do not, and if these extraordinary cases that have been cited here, if they are paying as little tax as is claimed, this bill is not going to affect them anyway because they are not paying any taxes now.

Senator GORE. Will you yield?

Senator SMATHERS. Yes; I will yield.

Senator GORE. You say "if," as though you doubted the figures that I read.

Mr. SAUNDERS. I do not doubt it at all. But I say this bill is not going to affect them apparently because they are not paying any tax now, according to those figures.

Senator GORE. I discussed taxable income. This is something which

people understand, take-home pay is something which people understand. Now the mass of our people I doubt are aware—I doubt if they are aware of the many loopholes, the many areas of tax favoritism which permit the result which I read to you from the table prepared by the Department of the Treasury.

This is not fictitious. I did not prepare the table. The Secretary of the Treasury prepared the table; that is, it was prepared at his direction.

Mr. SAUNDERS. I do not question that.

Senator SMATHERS. I have here a table apparently prepared by the Secretary of the Treasury which shows, speaking of percentage of reduction as a percent of present law taxes, that a married couple which have a taxable income of $1,000, and who under present law pay $200, if this bill is adopted they will then pay $140, thereby having a savings of, they will get back, $60, and that represents 30 percent return to them.

I look down this list and I see, just picking out random figures, here is $100,000. That fellow has an 18.2-percent return or 15.5 percent. You go up to $1 million, and it is a 21.9 percent.

So it appears from this table, which is found on page 350 of this hearing, that actually the greatest percentage of reduction is in those very low income groups. Do your figures support that?

Mr. SAUNDERS. Yes; that is my understanding; yes.

Senator SMATHERS. There is a middle group which does not do as well. There are people who made from, well, it is sort of the upper middle income, the lower upper group, I think we had better call it, $40,000 to $200,000. They seem to get less than anybody else, because after we get to $600,000 then, of course, they get even a higher percentage of return than do the people who are in the $100,000 or the $50,000. But the lowest group apparently get the greatest return. Is that your understanding?

Mr. SAUNDERS. That is my understanding; yes, sir.

Senator SMATHERS. Just one other broad question and I will stop. It is your belief, that as businessmen who are experienced, that we need this tax bill and we need it right away?

Mr. SAUNDERS. Yes, sir; that is our opinion. We think that this bill would be of great value to keeping our economy moving ahead in the short run, and we think it is vitally needed over the long run for stimulating the growth of this economy and trying to solve some of these perplexing problems of unemployment that we have, and things of that nature.

Senator SMATHERS. Do you believe this is the only way that is being talked about or that has some prospect of becoming law, of eliminating deficits, keeping the economy strong, and balancing the budget?

Mr. SAUNDERS. We firmly believe that. We think that this, as I stated this morning, is an investment in the economy of the future; that it is an experiment well worth trying.

Senator SMATHERS. Thank you.

Thank you, Mr. Chairman.

The CHAIRMAN. Mr. Ford, thank you very much, sir; Mr. Saunders, thank you very much; and thank you, Mr. Wilde.

The committee will adjourn until 10 tomorrow morning.

(Whereupon, at 4:15 p.m., the committee recessed, to reconvene at 10 a.m., Tuesday, November 5, 1963.)

REVENUE ACT OF 1963

TUESDAY, NOVEMBER 5, 1963

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, Long of Louisiana, Douglas, Talmadge, Hartke, Williams, Curtis, and Dirksen.

Also present: Elizabeth B. Springer, chief clerk.

The CHAIRMAN. The committee will come to order.

The first witness is Mr. Robert J. Casey, of the Association of American Railroads.

Mr. Casey, take a seat, sir, and proceed.

STATEMENT OF ROBERT J. CASEY, ATTORNEY, ASSOCIATION OF AMERICAN RAILROADS

Mr. CASEY. Mr. Chairman, Senator Douglas, my name is Robert J. Casey. I am a member of the law firm of Clark, Carr & Ellis, with offices at 120 Broadway, New York City. I am appearing here as representative of the Association of American Railroads, whose member roads operate 95 percent of the railroad mileage in the United States, employ 92 percent of the total railroad employees, and produce 96 percent of this country's gross railroad revenues.

I filed a written statement which, with the permission of the chairman, I ask to have incorporated in the record, and I will summarize it here.

The CHAIRMAN. Without objection.

Mr. CASEY. I am here today to present the views of the railroad industry with respect to the revenue bill of 1963 (H.R. 8363); in particular, those provisions dealing with:

1. The reduction of corporate tax rates;
2. The speedup of current corporate estimated taxpayments;
3. Amendment of the investment credit provisions;
4. The extension of the charitable contributions carryover period for corporations; and
5. Group life insurance.

At the outset, let me state, for the record, that our industry considers itself indeed privileged to be permitted to appear publicly before this committee, and present this statement.

REDUCTION IN CORPORATE RATES

Of vital concern to our industry is the 4-percent corporate rate reduction provisions of the revenue bill of 1963. As we pointed out in our testimony before the Committee on Ways and Means, in March of this year, the railroad industry has particularly suffered from the oppressive corporate rates of current years.

As the result of archaic regulatory restrictions, the railroads' rate of return is alarmingly low. Yearend 1962 saw a return of only 2.67 percent, favorably up from 1961's return of 1.97 percent, but decidedly less than 1963's 4.19 percent. Inasmuch as our return on investment is our primary source of new investment funds, it is clear that the existing corporate rate structure further restricts our ability to modernize our plant and equipment.

We are therefore heartened by the 4-percent rate reduction provided in section 121 of the bill, scheduled to take effect over a 2-year period. In this regard, we heartily concur in the statement of the Ways and Means Committee that:

> This reduction in corporate rates is important because * * * it again makes the Government a "junior," rather than a "senior partner in any venture a corporation may undertake, insofar as the sharing of corporate income before tax is concerned."

As we said in our appearance before that committee:

> It is time for the Federal Government to relinquish its claim to a majority of corporate profits.

Accordingly, we urge this committee to adopt the 4-percent corporate rate reduction provision of the 1963 revenue bill.

ESTIMATED TAX PAYMENTS

Correlative to the reduction of the corporate rate, H.R. 8363 provides for a speedup in installment payments of corporate estimated tax.

As originally proposed, this speedup would have been accomplished over a 5-year period, commencing in 1964. Thus, under the original proposal, by 1968, all corporate taxpayers would have been required to meet their liability for tax in excess of $100,000 in the year in which incurred.

In light of existing law, which requires payment of 50 percent of estimated tax liabilities in excess of $100,000, in two quarterly installments in the year incurred, and the balance in the succeeding year, we were greatly concerned as to the impact which too short a transition period from existing law would have on our available cash resources. This concern was the subject of our appearance before the Ways and Means Committee in March of this year.

We are highly gratified by the extension of this transition period incorporated in the bill passed by the House. Thus, section 122 provides for a 7-year period within which corporations will be permitted to become current with respect to tax liabilities in excess of $100,000.

In an industry such as ours, where current cash requirements are staggering when compared to available funds, it is important that the delicate balance between the two not be disturbed. Particularly is this so when it is considered that we are subject to highly restrictive regulation, which precludes full utilization of our abilities in a highly competitive market.

We therefore recommend this committee's favorable consideration of section 122 of H.R. 8363, urging its adoption in conjunction with the scheduled corporate rate reduction as set forth in section 121.

Turning to investment credit, on April 6, 1962, we appeared before this committee to urge the adoption of the investment credit provisions of the Revenue Act of 1962, as passed by the House.

At that time, we saw in this legislation, together with the administration's promise of realistic depreciation reform, an important means of enabling our industry to regain economic self-sufficiency.

Our original appearance was concerned with the House version which provided for the credit against tax with no reduction in basis. However, as enacted, the 1962 act requires that the basis of qualifying assets be reduced to the extent of the applicable credit, and the reduction is mandatory, whether or not the credit results in tax benefit to the investor.

Our first 2 years' experience with the modified investment credit has been heartening. Despite the limiting factor of basis reduction, our gross capital investment for 1962 was nearly 40 percent in excess of such expenditures for 1961.

Nonetheless, we fell short of replacing the units of rolling stock retired during 1962. Similar investments for the 6-month period ended June 30, 1963, show equipment expenditures of $354.5 million, compared with the $295.6 million for the 6 months ended June 30, 1962, and $243.9 million for the 6 months ended June 30, 1961.

Although in 1962 we installed some 4,000 more freight cars than were installed in 1961, we retired twice as many. In addition, however, we have been able to make notable strides in the modernization of our fleet, with particular emphasis on cars which meet the individual needs of our shippers.

Unquestionably, the investment incentive intended to be generated by the credit has been evidenced in our industry. Over the past 22 months progress has been made in meeting, in part, our current equipment needs as well as modernization of our plant. However, we are realistic enough to know that we are far short of our goal.

During the Cuban crisis of October 1962 we were called upon to serve this country again in time of emergency. We effectively met the challenge and moved 77 percent of the total tonnage of material, supplies, and men shipped during the period. Nonetheless, the shortage in our car reserve capacity was underscored during the course of this effort.

Again during the Cuban prisoner-of-war exchange, on extremely short notice, we transported necessary materials to assigned ports for transshipment to Cuba. We were proud of the manner in which our

industry performed then and the way it has always met its responsibilities to the Government.

At present, we foresee yet another test of our reserve capacity in the possible Russian wheat proposals. We will bend every effort to meet this demand, as we have always done, but we cannot overlook the problems involved.

Despite 1962's 40-percent increase of equipment expenditure over 1961, our industry saw a substantial decline in the ownership of locomotives, freight cars, and passenger cars. Yearend 1962 saw us 179 locomotives short compared with yearend 1961.

Our ownership of freight cars over the same period declined some 54,325 units; passenger cars fell some 764 units.

Senator DOUGLAS. Is that a misprint when you say that the number of freight cars diminished by over 54,000?

Mr. CASEY. No, sir; it is not. That is the fact. We have, of course, retired a good many of the obsolete freight cars. We have turned from the standard boxcar, that we had known for years, to specialized units designed to meet the needs of particular shippers. The investment credit has been one of the major incentives, along with the guideline lives, in permitting us to make these drastic changes. We are in this situation.

Senator CURTIS. Mr. Chairman, I think there are a few more facts that should be developed in reference to those boxcars. Not all the railroad companies have decreased their number of boxcars, have they?

Mr. CASEY. No, sir; they have not.

Senator CURTIS. And many railroads are attaining and holding the boxcars of other roads because it is cheaper to pay the per diem than to build them and own them; isn't that true?

Mr. CASEY. That is true.

Senator CURTIS. Yes.

As a matter of fact, there are approximately $20 million worth of boxcars now under construction and approved for construction by the Burlington, most of them at Lincoln, Nebr. The western roads continue to build boxcars, increase the number. The car is set in motion, it goes to the east coast with a load of freight, is not returned because the little pittance charged for using somebody else's boxcar is such that it is cheaper for the offending roads to steal somebody else's property—that is literally true.

It is confiscation of property without any compensation whatever.

Now, what companies have increased the number of boxcars?

Mr. CASEY. Well, we do not have the statistics, but I will be glad to obtain it for you if I can, Senator.

Senator CURTIS. I would like a list of the railroads that decreased the number of their boxcars.

Mr. CASEY. Yes, sir; we will be glad to furnish that for the record.

(The information referred to follows:)

Freight car ownership

Railroad	Total car ownership	
	Jan. 1, 1962	Jan. 1, 1963
Ann Arbor	857	794
Bangor & Aroostook	4,620	4,606
Boston & Maine	5,358	5,333
Central Vermont	869	849
Delaware & Hudson	9,446	9,221
Delaware, Lackawanna & Western (included in Erie-Lackawanna)		
Detroit & Toledo Shore Line	675	677
Detroit, Toledo & Ironton	4,551	4,520
Erie-Lackawanna	26,426	22,606
Grand Trunk Western	10,422	9,839
Lehigh & Hudson River	63	42
Lehigh & New England (discontinued, partially absorbed by Central of New Jersey)		
Lehigh Valley	10,961	10,707
Maine Central	4,542	4,532
Monongahela	0	0
Monon	3,362	3,181
New York Central System	99,716	92,941
New York, Chicago & St. Louis	24,337	22,814
New York, New Haven & Hartford	7,413	6,718
New York, Susquehanna & Western	11	4
Pittsburgh & Lake Erie	25,005	25,007
Pittsburgh & West Virginia	1,558	1,549
Rutland	465	331
Wabash	15,241	14,253
Akron, Canton & Youngstown	1,639	1,712
Baltimore & Ohio	87,622	78,658
Bessemer & Lake Erie	11,350	11,255
Central of New Jersey	7,478	6,872
Long Island	0	0
Pennsylvania	144,906	139,356
Pennsylvania-Reading Seashore Lines	0	0
Reading [1]	23,793	23,223
Staten Island Rapid Transit	0	0
Union (Pittsburgh)	3,715	3,692
Western Maryland	14,433	14,192
Chesapeake & Ohio	88,335	87,307
Norfolk & Western	75,500	73,214
Alabama, Tennessee, & Northern		
Atlanta & St. Andrews Bay	114	114
Atlanta & West Point-Western of Alabama	1,317	1,307
Atlantic Coast Line of Alabama	28,810	28,530
Central of Georgia	9,664	9,498
Clinchfield	6,446	6,191
Florida East Coast	[2] 853	845
Georgia & Florida	499	496
Georgia	1,662	1,638
Gulf, Mobile & Ohio	14,376	14,676
Illinois Central	49,740	48,711
Louisville & Nashville	58,741	59,048
Norfolk Southern	2,571	2,346
Piedmont & Northern	20	5
Richmond, Fredericksburg & Potomac	316	312
Savannah & Atlanta	678	806
Seaboard Air Line	26,626	27,417
Southern Railway System	53,411	53,262
Tennessee Central	559	566
Chicago & North Western-Chicago, St. Paul, Minneapolis & Omaha	43,068	41,432
Chicago Great Western	5,317	5,290
Chicago, Milwaukee, St. Paul & Pacific	43,778	41,144
Duluth, Missabe & Iron Range	13,787	13,711
Duluth, South Shore & Atlantic (included in Soo Line)		
Duluth, Winipeg & Pacific	35	35
Elgin, Joliet & Eastern	10,750	10,576
Great Northern	40,100	39,042
Green Bay & Western	556	597
Lake Superior & Ishpeming	3,039	3,059
Minneapolis & St. Louis (included in Chicago & North Western)		
Minneapolis, Northfield & Southern	301	305
Northern Pacific	34,420	35,488
Soo Line	15,639	15,655
Spokane International	104	100
Spokane, Portland & Seattle	3,543	3,488
Atchison, Topeka & Santa Fe system	87,065	83,450
Chicago & Eastern Illinois	8,057	7,898
Chicago & Illinois Midland	1,683	1,681
Chicago, Burlington & Quincy	42,292	41,289

See footnotes at end of table.

Freight car ownership—Continued

Railroad	Total car ownership	
	Jan. 1, 1962	Jan. 1, 1963
Chicago, Rock Island & Pacific	28,626	28,053
Colorado & Southern Lines	4,782	4,534
Colorado & Wyoming	653	653
Denver & Rio Grande Western	11,303	11,462
Illinois Terminal	1,912	1,813
Missouri-Illinois	1,809	2,188
Northwestern Pacific	38	33
Pacific Electric	0	0
Southern Pacific Co	78,650	76,957
Toledo, Peoria & Western	462	477
Union Pacific system	53,543	53,872
Western Pacific	5,551	5,543
Kansas City Southern-Louisiana & Arkansas	9,271	9,361
Mahoning Valley—Kansas, Oklahoma & Gulf—Oklahoma City-Ada-Atoka	287	235
Missouri-Kansas-Texas	9,226	9,568
Missouri Pacific Lines	43,010	41,414
St. Louis-San Francisco	18,267	17,654
St. Louis-Southwestern	7,633	7,730
Texas & New Orleans (included in Southern Pacific Co.)		
Texas & Pacific	6,942	5,789
Texas-Mexican	125	123
Algoma Central & Hudson Bay	1,794	1,722
Canadian National	94,421	92,319
Canadian Pacific	80,521	80,156
Ontario Northland	1,347	1,347
Toronto, Hamilton & Buffalo	1,188	1,215

[1] Previous on line.
[2] Previous figures.

Senator CURTIS. Your industry has a great burden and obligation on them, but it is unfair to a great section of our country, it is unfair to some of the competing roads, and it is certainly unfair to the shipping public.

I had a telephone call within the last 2 days from one farmers' elevator in a small community where they have 230 million bushels of grain on the ground, and have not had a boxcar for a long time. They were finally advised that they could have some hopper cars without any roofs on them, but the shipper would have to take the responsibility for the loss due to moisture. That elevator is on a western railroad that happens to be spending all this money to build boxcars. But as soon as they build them somebody else takes possession of them without adequate compensation.

I thank you, Mr. Chairman.

The CHAIRMAN. Senator Douglas?

Senator DOUGLAS. Mr. Chairman, the Senator from Nebraska has touched on a very important subject and a matter about which we in the Middle West have suffered for a long time.

It has been apparently a continuous habit of the eastern railroads to steal the middle western cars. That is really what have been done, and this has continued year after year, year after year, year after year, and I cannot understand why some method of returning these cars is not worked out.

It is especially severe at the present time because there are shortages of cars for the transportation of the big grain crop in the Middle West. I have tried to follow this for 40 years. It has been going on for at least 40 years, and it seems to me that the big eastern lines have a tremendous responsibility. I cannot understand why the Association of American Railroads does not work out some system to protect

the western lines and western shippers. We have been used for decades. Do you have any reply to make to that?

Mr. CASEY. Well, Senator, our law firm's primary railroad representation is the Union Pacific, so I find myself personally on your side of the fence.

Senator DOUGLAS. Good for you.

Mr. CASEY. But, at the same time, the Union Pacific and the other western roads have been in the fortunate position of earnings and of having the money to invest in cars. The eastern roads, some of them, are not so blessed, and if it were not for the industry's wholehearted implementation of its capital, the investment of its capital, in rolling stock—and you touch a point that is very near and dear to us, because at the same time we have invested some $18 billion, I think it is, in road property, which none of our competitors have had to do.

We have paid astounding taxes over the years to finance superhighways built along the rights-of-way; built along the rights-of-way not only of the Union Pacific, but the New Haven as well. The natural result of this attrition is that the New Haven is going downhill as fast as it can go and is forced to borrow our rolling stock.

Senator DOUGLAS. I would say steal. You use a very polite phrase "borrow." They get these cars, hold on to them, never return them. Whether the western lines are in cahoots with them or not, I do not know. [Laughter.] But certainly the grievance has never been remedied. It is very acute this fall because we lack cars to move our corn and wheat.

Mr. CASEY. That is right. It is acute, and I can assure you, as Senator Curtis has pointed out, that we do not achieve any return on our investment from per diem. We want the cars back.

Senator DOUGLAS. Why can't you get them? What is the trouble?

Mr. CASEY. I think we mentioned the trouble, Senator.

Senator DOUGLAS. If they were stolen automobiles, the FBI would recover them.

Mr. CASEY. Well now we have never been able to look at the car shortage problem from anything but a national level. We have not been able to do it. If a road has a Union Pacific car which it is employing, then there is nothing that the Union Pacific can do.

Senator DOUGLAS. You mean the Union Pacific cannot get the car back?

Mr. CASEY. Well, if you know of a way, Senator, we will be pleased to follow it.

Senator CURTIS. Would you yield to me right there? You are pronouncing a strange doctrine that the eastern roads, because they do not make any money, have a right to take the property of somebody who does make money.

If we carry that into all avenues of our economy it is not only ridiculous, it is immoral.

Certainly, if the railroads do not have the power to set the charge for the use of cars, the ICC could do it, and if the ICC needs further legislation, they should ask for it from the Congress.

As a matter of fact, there is a bill pending, we have been trying for a long time to get it out of committee, but apparently the Association of American Railroads condones this practice.

Mr. CASEY. Well, I do not think it is a question of condoning. If we wanted to get into strange doctrine, Senator, the entire area of ICC regulation is that. We are forced to subsidize our competitors through tax payments.

We have $18.2 billion in road properties. We have $3.6 billion in grading and tunnels alone, and we never get a tax benefit from that until we go out of business when, naturally, we do not need a tax benefit.

Senator WILLIAMS. Does the ICC set the rates that you can charge on these boxcars when they are in use by other roads?

Mr. CASEY. No; the rates are fixed by the industry itself.

Senator WILLIAMS. Has there been any application on the part of the western railroads to raise that rate on a per diem basis?

Mr. CASEY. I do not know, but I will be glad to find out.

(The following was later received for the record:)

CLARK, CARR & ELLIS,
New York, November 8, 1963.

MRS. ELIZABETH B. SPRINGER,
Chief Clerk, Senate Finance Committee,
New Senate Office Building, Washington, D.C.

DEAR MRS. SPRINGER: With respect to the statement of Robert J. Casey before the Senate Finance Committee on November 5, 1963, we would appreciate this opportunity to clarify a response given to a question asked by Senator Williams.

On the last line of page 1702 of the transcript of Mr. Casey's testimony, Senator Williams inquired:

> "Has there been any application on the part of the western railroads to raise that rate on a per diem basis?"

In response to this question, Mr. Casey stated on page 1703:

> "I do not know, but I will be glad to find out."

The answer to Senator Williams' question is:

> Approximately 6 months ago the railroad industry approved a new multilevel schedule of per diem rates which are to take effect January 1, 1964. The lowest of these rates is somewhat below the existing rate of $2.88, and the highest of these rates is somewhat in excess of $7. The rates to take effect on January 1, 1964, are based on some six brackets which are determined with respect to factors such as the age and the type of car in use.

Should any further information be desired, please do not hesitate to contact us.

Very truly yours,

JOHN A. CRAIG.

Senator WILLIAMS. That would be the only method by which you could correct this situation to which you are referring.

Mr. CASEY. Well, you see we run into a problem. If you make the per diem big enough to give the western roads a proper return on their investment, all it would do would be to run up the charges incurred by the eastern roads, which we are not collecting now.

The New Haven Railroad is in practical bankruptcy, and what can we do?

Senator WILLIAMS. I recognize that. But that gets back to the point that was made before. This is condoned and supported by the railroad industry as a whole.

Mr. CASEY. That is right.

Senator WILLIAMS. Yes.

Mr. CASEY. We are supporting the New Haven Railroad.

Senator WILLIAMS. One question that has been pointed out to me is that this investment credit is of little or no use at all to those railroads

which are in difficulty, because the tax credit means nothing to a company that owes no taxes.

Mr. CASEY. That is correct.

Senator WILLIAMS. So in reality this 7-percent investment credit is giving a further advantage to the western roads which are making the money; this particular tax concession is of no advantage at all to the eastern railroads which are not making money.

Mr. CASEY. Senator, there is not—pardon me—there is not any tax reform which will assist a railroad which does not pay taxes.

Senator WILLIAMS. That is the point I am making.

Mr. CASEY. And we feel that the requirement that basis be reduced on account of the credit further hurts the eastern roads because hopefully, some time in the future, and we have been saying this for a long time in the past, these roads will be back making money and paying taxes. If they are, the credit, the reduction in basis, will have forced them to lose the tax benefit which a railroad like the Union Pacific would have enjoyed.

Senator WILLIAMS. That same point can also be made in connection with any other segment of our economy. That phase of the industry which is having a difficult time to exist is not being helped by this tax credit. Their competitors, who happen to be in a more fortunate position, are given the break whereas they do not get the break at all.

Once an industry gets in trouble, it further widens the competitive disadvantage of its ever recovering; is that not true?

Mr. CASEY. Outside the railroad industry I would imagine that the availability to a taxpayer of the investment credit would give a competitive advantage only if that taxpayer ignored the foundation for the investment credit.

As we understand it, and in our industry, the credit was designed to put more capital to work in the business.

Now, with us, the Union Pacific Railroad, for example, through the credit and the guideline, depreciation reforms, has been able to put more money to work than it would otherwise have committed. When we put that money into cars, equipment of any kind, then we are benefiting our loss members of our industry. We have now cars available for the New Haven Railroad, additional cars, let us say, and then the western shipper is served, and so is the eastern shipper.

Without the guidelines and without the investment credit this is not possible.

Senator WILLIAMS. I recognize investment credit is of great assistance as far as those roads making money are concerned, but it is not of any assistance to a road which is not.

Could not some formula be worked out whereby these depressed roads could help themselves? Would this not be much better than having them get their assistance through other more prosperous railroads?

To extend that further, if a segment of the automobile industry is losing money, it gets no advantage under the investment credit, whereas a corporation making money does get an advantage. A tax credit is of no use to either you or me unless we owe taxes.

Mr. CASEY. That is correct.

Senator WILLIAMS. And if an industry is losing money a tax credit is not of any use whatever.

Mr. CASEY. And it is difficult——

Senator WILLIAMS. And those railroads which are losing money, and have been losing money over a period of years, to them the tax credit is of negligible value so far as they are concerned.

Mr. CASEY. We get back, of course, to the peculiar nature of our industry. In tax dollars and cents, the credit is of no value whatever to the New Haven Railroad. However, if it makes available to the New Haven Railroad additional rolling stock, then it is of very substantial value.

Senator CURTIS. To whom?

Mr. CASEY. For the New Haven Railroad and for the eastern shipper.

Senator CURTIS. Who is making it available; other taxpayers?

Mr. CASEY. That is right, the other roads.

Senator WILLIAMS. Other railroads.

Senator CURTIS. I think what we are confusing here is a tax problem with a matter of railroad management.

Now, building the Burlington boxcars I mentioned in Lincoln, Nebr., they are spending and will spend $20 million. If it is the policy of the Association of American Railroads that those are being built because some eastern railroads that are bankrupt cannot buy their own, that is not going to help western shippers. It helps them once with one load, and then they lose the car.

Mr. CASEY. Well, it is a problem admittedly that is peculiar to our industry, the interchange of rolling stock. It helps the western shipper to have a western road invest money in rolling stock to the extent that it releases from whatever terms you want to apply to the eastern roads acquisition of the rolling stock these additional cars.

Now, when we reach the millennium, perhaps the moneymaking railroads, and there are some in the East, will have enough equipment to go all around the horn, so that every shipper in the country will get the same service. When we reach that point we——

Senator CURTIS. So that the bankrupt railroads get them at a subsidized cost.

Mr. CASEY. Well, it amounts to that, sure; it does.

Senator CURTIS. And your association supports that?

Mr. CASEY. It is a fact of life with us, Senator.

Senator CURTIS. I do not think it is. I think people should pay a fair price for anything they obtain.

Mr. CASEY. Well, when you are in a business and you cannot get out of the business because of public responsibilities, then you do reach peculiar economic situations.

Now, there is not any reason in the world for the Union Pacific Railroad, which has not 1 mile of track east of Omaha, as yet, to subsidize a loss railroad. But, as a fact of public regulation, and as a measure of public convenience and necessity, and as the result of Interstate Commerce Commission regulation, we are in a very peculiar bind, and the only way that the loss railroad can service its customers is through the use of, for a large part anyway, of western cars, any cars it can get.

Senator DOUGLAS. Mr. Chairman, although this suggestion should more appropriately be made before the Commerce Committee, I want to try out a suggestion on Mr. Casey.

Everybody knows who owns these cars because the name of the owner is emblazoned on the car. Why not have a plate which gives the date at which the car left the jurisdiction of the owning railroad, and then provide that after a period of time, 30 or 60 or 90 days, the car should be returned, and then organize a force of cowboys or carboys, who will go out in the freight yards and find these cars, and cut them out and send them home. Very frankly, although I am not a chauvinist, a little midwesterner, we get a little tired of being exploited by the East and deprived of cars necessary for the shipment of our crops because the easterners kidnap our cars and hold them.

Now, there is a Federal law against the kidnapping of persons. There certainly should be a provision against the kidnapping of cars. I suggest that you organize a group of carboys. They would not have to ride horses or wear chaps, who will go out and round up these cars and send them home.

You confess to impotence. You say you are unable to do anything. You admit this has been going on for decades. You know it, and yet you say there is nothing you can do about it. This is a terrible confession.

Mr. CASEY. Well, I abjectly admit to that.

Senator DOUGLAS. What?

Mr. CASEY. At the same time, while our measures are not nearly as dramatic, we do spend millions and millions of dollars in centralized traffic control——

Senator DOUGLAS. You see, you are wearing two hats. Part of the time you talk as the attorney for the Union Pacific. Then part of the time you talk as the representative for the Association of American Railroads, and frequently you wear both hats in the same sentence.

Now, we will talk to you for a moment as the representative of the Association of American Railroads. Why don't you get your posses out, send those cars back? We need them.

Mr. CASEY. It would probably be cheaper to get the posses out, but I can tell you, Senator, that we have spent since 1932 millions in an attempt to speed the turnaround of cars through centralized traffic control systems, through improved signal devices.

I will certainly be pleased to report back to the association and suggest to them that more dramatic measures be taken.

Senator DOUGLAS. Simply have a plate put on the car giving the date which it left the jurisdiction of the western line, Union Pacific or Northern Pacific or Santa Fe, and then at a given period of time put out the order, "Lassie, go home."

You could patrol this through the freight yards of the East. In fact, we may organize some posses from the Midwest to go out and cut out those cars and bring them back, instead of having them stolen from us by the eastern roads. We are tired of exploitation by the Atlantic seaboard.

Senator DIRKSEN. Mr. Casey, there is a far simpler answer. You get your crowd to apply for a Federal loan in suitable dimensions to be used exclusively for building cars and to build so doggone many

that we will have cars running out of our ears, and then your problem is solved, and you won't have to put any company president in jail. [Laughter.]

Mr. CASEY. Thank you, sir.

Senator DIRKSEN. We got off the subject of taxes, didn't we?

Mr. CASEY. Yes, but pleasurably so.

In line with Senator Williams' suggestion with respect to the impact on our loss roads of the investment credit, we would strongly urge that the reduction in basis provision which presently attaches to the investment credit be removed, as is presently proposed in the statute.

The CHAIRMAN. Senator Hartke?

Senator HARTKE. Thank you, Mr. Chairman.

I want to thank you, sir, for your endorsement of S. 2231. Although, as you point out, it is not before this committee, it is a directly related matter, and I think it is very important that we give it serious consideration.

I was talking to the Treasury Department yesterday and, for your information, they told me they have also given this matter serious consideration and plan to give me some additional information in the next few days which, I think, will be very helpful in making up my mind as to which way we will go.

One thing I would like to ask you. You make the statement, "Thus, as an industry in dire need," and you say, "As an industry with many of its members presently in continuing loss positions," and then you point out on page 11 that, "From my own experience, I can testify to untold hours spent in determining proper methods to follow thousands of assets on our books so that their base may be properly stated," I think that from the tone of your whole statement you feel that the railroad industry is a vital part of the Nation's transportation system, do you not?

Mr. CASEY. I feel it is an indispensable part of the Nation's transportation system.

Senator HARTKE. All right, with that I can agree.

When an indispensable part of our transportation system continually and repeatedly is before Congress, and all of its efforts come up with these statements of dire need, that you have members with a continuing loss position, and when you point out that in some of these cases they have had losses which have been continuing for long periods of time, don't you think it is a proper matter of concern of the Nation that something be done to make a proper assessment as to how we can best meet that challenge?

Mr. CASEY. I most certainly do, Senator.

Senator HARTKE. I would hope then that you would carry this message back to your superiors and your employers. That is exactly what I have been trying to do for quite some time. The message is to get into this problem of railroad financing and have a complete revelation of what is the status of the railroads. Maybe some of these problems can be answered and maybe my distinguished friend from Nebraska will not have to worry about these economic matters, if we can come up with a complete answer to the facts rather than to try to guess at what the facts are; then, we would be in a better position.

You will recall that I have a resolution which I have introduced and which has as its purpose an impartial and objective consideration of railroad financing. I hope you would use your persuasive powers to ask them to support rather than to continue to object to such findings.

Mr. CASEY. I have always felt that the railroad industry is the one industry without which this country could not survive. It is dramatic for us to point to the problems which face the country in times of emergency, but even in times of peace, if we ever have them, this is an indispensable industry. It is also an industry which is hamstrung every time it turns.

Economically, and I am no economist, but I would imagine that if we took the wraps off the railroad industry and told them to go out and run their business just like any other entrepreneur in this country that we would not have any problems; but, we sure have them now.

Senator HARTKE. I would think that the problem is if we took the wraps off the financial background of this situation we might be a little bit more inclined to, perhaps, look into some of these matters with a different understanding. I mean, when you have Swiss bank ownership of some of these matters, and hidden ownership of some of them, which are not revealed in the ICC reports—I know this is a matter which does not directly concern the tax matter—but I supported the tax credit, and I am here on a measure which you support, and this does not indicate I am adverse to the railroads' interests, but with the stock prices of so-called losing railroad concerns going up, it is pretty hard for some people to understand exactly what the truth of the situation is with respect to the financial status of railroads.

Mr. CASEY. Well, the tax status of railroads is, of course, my more immediate concern, and it is in a god-awful way.

Senator HARTKE. I thank the chairman.

Mr. CASEY. We have, as I have mentioned, $3,600 million in grading which we get no return on whatever. We are met, particularly the western roads, with a short-hand answer that, "You were land-grant roads and, therefore, you got a great bonanza," without any regard to the fact that when we got the land grants these same lands were being held with no takers, or few takers, at $1.25 an acre, without any regard to the fact that by the reduction in tariffs we have now paid back, or did pay back until the reduction in tariffs was discontinued, some $1,250 million for land that, in aggregate value at its $1.25 price, was worth about $125 million.

You can see what kind of a bind the industry is in. When you look at the tax aspect of the railroad industry, it is incredible that we have, without any tax benefit, the enormous investments we have, while our direct competitors, to a large extent, are financed through public funds to which at least some of us are substantial contributors.

The CHAIRMAN. Any further questions?

Thank you very much, Mr. Casey.

(The statement of Mr. Casey follows:)

STATEMENT OF ROBERT J. CASEY, MEMBER OF THE FIRM OF CLARK, CARR & ELLIS, ON BEHALF OF THE ASSOCIATION OF AMERICAN RAILROADS

Mr. Chairman and members of the committee, my name is Robert J. Casey. I am a member of the law firm of Clark, Carr & Ellis, with offices at 120 Broadway, New York City. I am appearing here as representative of the Association

of American Railroads, whose member roads operate 95 percent of the railroad mileage in the United States, employ 92 percent of the total railroad employees, and produce 96 percent of this country's gross railroad revenues.

I am here today to prevent the views of the railroad industry with respect to the revenue bill of 1963 (H.R. 8363); in particular those provisions dealing with—

1. The reduction of corporate tax rates;
2. The speedup of current corporate estimated tax payments;
3. Amendment of the investment credit provisions;
4. The extension of the charitable contributions carryover period for corporations; and
5. Group life insurance.

At the outset, let me state for the record that our industry considers itself indeed privileged to be permitted to appear publicly before this committee, and present this statement.

REDUCTION IN CORPORATE RATES

Of vital concern to our industry is the 4-percent corporate rate reduction provisions of the revenue bill of 1963. As we pointed out in our testimony before the Committee on Ways and Means in March of this year, the railroad industry has particularly suffered from the oppressive corporate rates of current years.

As the result of archaic regulatory restrictions, the railroads' rate of return is alarmingly low. Yearend 1962 saw a return of only 2.67 pecent, favorably up from 1961's return of 1.97 percent, but decidedly less than 1953's 4.19 percent. Inasmuch as our return on investment is our primary source of new investment funds, it is clear that the existing corporate rate structure further restricts our ability to modernize our plant and equipment.

We are therefore heartened by the 4-percent rate reduction provided in section 121 of the bill, scheduled to take effect over a 2-year period. In this regard we heartily concur in the statement of the Ways and Means Committee that:

"This reduction in corporate rates is important because * * * it again makes the Government a junior, rather than a senior, partner in any venture a corporation may undertake, insofar as the sharing of corporate income before tax is concerned.

As we said in our appearance before that committee: "It is time for the Federal Government to relinquish its claim to a majority of corporate profits."

Accordingly, we urge this committee to adopt the 4-percent corporate rate reduction provision of the 1963 revenue bill.

ESTIMATED TAX PAYMENTS

Correlative to the reduction of the corporate rate, H.R. 8363 provides for a speedup in installment payments of corporate estimated tax.

As originally proposed, this speedup would have been accomplished over a 5-year period commencing in 1964. Thus, under the original proposal, by 1968, all corporate taxpayers would have been required to meet their liability for tax in excess of $100,000 in the year in which incurred.

In light of existing law, which requires payment of 50 percent of estimated tax liabilities in excess of $100,000 in two quarterly installments in the year incurred, and the balance in the succeeding year, we were greatly concerned as to the impact which too short a transition period from existing law would have on our available cash resources. This concern was the subject of our appearance before the Ways and Means Committee in March of this year.

We are highly gratified by the extension of this transition period incorporated in the bill passed by the House. Thus, section 122 provides for a 7-year period within which corporations will be permitted to become current with respect to tax liabilities in excess of $100,000. In an industry such as ours, where current cash requirements are staggering when compared to available funds, it is important that the delicate balance between the two not be disturbed. Particularly is this so when it is considered that we are subject to highly restrictive regulation, which precludes full utilization of our abilities in a highly competitive market.

We therefore recommend this committee's favorable consideration of section 122 of H.R. 8363, urging its adoption in conjunction with the scheduled corporate rate reduction as set forth in section 121.

INVESTMENT CREDIT

On April 6, 1962, we appeared before this committee to endorse wholeheartedly the investment credit provisions of the Revenue Act of 1962, as passed by the House in H.R. 10650.

At that time, we expressed our vital interest in this legislation, recognizing it as an important means of enabling our industry to regain economic self-sufficiency. We premised our endorsement of the credit on the administration's assurance that it was not intended to be in lieu of realistic depreciation reform, an assurance which has since been confirmed by the adoption of Revenue Procedure 62-21.

Our original appearance was concerned with the credit as passed by the House, which provided for a credit against tax for qualifying investment in depreciable property with no reduction in basis. However, as enacted, the investment credit provisions of the 1962 Revenue Act require that the basis of qualifying assets are to be reduced to the extent of the credit applicable thereto. This reduction is mandatory, whether or not the credit results in a reduction in tax in the year of acquisition.

Our first 2 years' experience with the modified investment credit has indeed been heartening. Despite the limiting factor of basis reduction, our gross capital investment for the year ending December 31, 1962, was nearly 40 percent in excess of such expenditures for calendar year 1961. Nonetheless, these outlays fell far short of replacing the units of rolling stock retired during 1962. Similar investments for the 6-month period ended June 30, 1963, reflect equipment expenditures of $354.5 million compared with $295.6 million for the 6 months ended June 30, 1962, and $243.9 million for the 6 months ended June 30, 1961.

Although in 1962, we installed some 4,000 more freight cars than were installed during 1961, nevertheless the new cars comprised less than half the number of 1962 retirements. However, the average 1962 freight cars carried 1 ton more than the average 1961 car. In addition, we have been able to make notable strides in the modernization of our fleet, with particular emphasis on cars which meet the individual needs of our shippers.

Unquestionably, the investment incentive intended to be generated by the credit has evidenced itself in our industry. Over the past 22 months, progress has been made in meeting, in part, our current equipment needs, as well as modernization of our plant. However, we are realistic enough to acknowledge the fact that we are far short of our goals.

During the Cuban crisis of October 1962, we were called upon once again to serve this country in time of emergency. Not only did we meet the challenge, but did so effectively. Of the total tonnage of men, materials, and supplies shipped during the period, 77 percent moved by rail. Nonetheless, our part in this effort clearly underscored the shortness in our car reserve capacity.

Again during the Cuban prisoner-of-war exchange, we served our Government, transporting necessary materials to assigned ports for transshipment to Cuba. In this regard we note with pride that our services were required and provided on extremely short notice. This, we believe, is indicative of the manner in which our industry has always met its responsibilities to its Government.

At present we foresee another test of our reserve capacity in the possible Russian wheat proposals. We will bend every effort to meet this demand, as we have always done, but we cannot overlook the problems involved.

Despite 1962's 40 percent increase of equipment expenditure over 1961, our industry saw a substantial decline in the ownership of locomotives, freight cars and passenger cars. Thus, yearend 1962 left us short 179 locomotive units compared with yearend 1961. Ownership of freight cars over the same period declined 54,325 units and passenger cars fell some 764 units.

Our reserve shortage is dramatized by the recent negotiations between a member of our industry and the Mexican railroads looking to a loan from the latter of some 200 freight cars to meet its current demand. As distressing as is our current reserve picture, we are well aware of the fact that without the additional investment generated within our industry by the credit provisions and guideline procedures this picture would be doubly black.

This is consistent with our statement before this committee in April of 1962, wherein we acknowledged we should make an annual investment in excess of $2 billion in order to reverse the effect of built-in economic obsolescence which is peculiar to our industry. Thus, it was that we indicated that an acquisition program of 100,000 cars a year would over a 7½-year period, result in a fleet no

unit of which was over 25 years of age. Translated into dollars, this represents $1 billion of freight cars per year. In addition, we pointed to our immediate need for an additional 1,200 locomotive units.

Accordingly, we are now before this committee, optimistic that the restoration of the investment credit provisions which originally appeared in the House version of the 1962 Revenue Act will enable us to continue to increase our program of modernization.

It is undeniable that the basis reduction provisions of the 1962 act decreased to a great extent the benefit originally intended to be gained from the credit itself. Inasmuch as the investment credit proposals which were adopted by the House in 1962, in conjunction with liberalized depreciation procedures promulgated by the Treasury, were intended to operate in tandem to enable the business community to increase its annual capital investment, and thereby modernize to meet existing needs, any change in these proposals resulting in the diminution of their economic impact unquestionably works at cross-purposes with the original objectives.

While we have not had an opportunity to poll our entire membership we have contacted six roads in order to determine what effect the basis reduction provisions had on their 1962 investment programs. Each of these roads indicated that the dollar amounts of their 1962 investments were in large measure dependent upon the benefits to be derived from the investment credit and the new guideline life procedures.

It is interesting to note the actual dollar effect the reduction-in-basis provision had on these six roads. Cumulatively, in 1962, these roads invested in qualifying section 38 property some $353 million, which produced an aggregate credit of approximately $25 million. These roads have advised us that their investment program was inaugurated with an eye to the requirement that some $13 million of credit must be restored over the life of the properties involved. They have also advised us that their investment program would certainly have been increased to the extent of the additional $13 million, and have further indicated that the availability of the total credit would have had an accelerating effect on investments which have presently been postponed to some future time.

Thus, as an industry in dire need, we foresee the restoration of the credit to its original state as a further means of enabling us to ultimately realize our modernization needs.

We might further add that this necessity for modernization is born of the serious competitive disadvantages in which we are forced to operate. Thus, as we stated previously, unlike our competitors we are required not only to construct and maintain our own rights-of-way, but also to finance them in full without recovery of our cost until abandonment of the propreties involved. We have previously alluded to our competitors' access to publicly financed and supported highways, airports, waterways, and harbor facilities, as contrasted with our investment as of the end of 1962 of $18.2 billion of our own capital funds in road properties. This disadvantage is all the more clear when it is noted that we have some $3.6 billion invested in grading and tunnels alone, which are not recoverable until abandonment.

Finally, we might note that our experience, with the basis reduction provision has been extremely burdensome, inasmuch as it necessitates the adoption of complex and cumbersome accounting procedures. From my own experience, I can testify to untold hours spent in determining proper methods to follow thousands of assets on our books so that their base may be properly stated.

We therefore recommend to this committee's consideration an adoption of section 202 of the revenue bill of 1963, which repeals the requirement of existing law that the basis of section 38 property be reduced to the extent of the credit claimed on account thereof. Not only will this give full effect to the original intent of the proposal, but so far as those members of our industry who are in a prolonged loss situation are concerned, will expunge the punitive effect of basis reduction which is mandatory, notwithstanding their inability to realize any portion of a credit for investment.

We further urge this committee adopt the statement of intention provision of section 202 of the bill as passed by the House, which prohibits regulatory agencies, without the consent of the taxpayer, from requiring the flow through of the benefits of the credit by means of a reduction in rate basis. It appears to us that any such mandatory flow through completely negates the intended purpose of the investment credit, and more particularly, operates as a depressant to investment rather than a stimulant.

EXTENSION OF CORPORATE CHARITABLE CONTRIBUTION CARRYOVER

We heartily endorse the decision of the House to extend from 2 to 5 years the corporate carryover period for unused charitable contributions. Today, no one can question the important role assumed by the corporate community in organized philanthropy. A responsibility, we might add, which is consistently met by corporate donors in years of losses as well as earnings.

Inasmuch as the present carry-forward period of 2 years, with respect to contributions in excess of the 5 percent of taxable income limitation, in many instances falls short of granting the benefit intended, it is clear that contributions which otherwise would be scheduled must be foregone. This is particularly true in regard to corporations whose income varies widely from year to year, a fact recognized by the Ways and Means Committee in its report. Thus, in the final analysis, the extension of the carryover period clearly benefits the community as a whole.

As an industry with many of its members presently in continuing loss positions, we believe there to be great merit in permitting the same 7-year carryover period, now afforded us for net operating losses under section 172, to be utilized with respect to our excess charitable contributions. To this end, we would recommend modification of section 209(b) of the bill before this committee so as to provide the same carryover period for contributions as now permitted by section 172(j) of the code for net operating losses of certain regulated transportation corporations.

We concur in the recommendation of Secretary Dillon that the effective date for the charitable contribution carryover period provisions be applicable to contributions made prior to the calendar year 1964. We would recommend that these provisions be made applicable to contributions made in taxable years beginning after December 31, 1960. It should be noted that the utilization of any such such effective date would in no way extend the carryover period for contributions as to which the present 2-year period has expired. Moreover, such effective date would preclude a disruption of current charitable giving programs which otherwise might occur should the corporate donor be required by current economic realities to insure deductibility of past contributions under the current 2-year carryover period.

With these two modifications, we recommend this committee's adoption of section 209 of the 1963 bill.

GROUP INSURANCE

While as an industry we view the House version of the revenue bill of 1963 with satisfaction, we feel we would be remiss if we failed to note some concern with respect to one of the so-called reform measures contained therein. To this end, I would direct this committee's attention to section 203 of the bill, which proposes to tax currently to employee, so much of employer-paid premiums as provides to such employee group life insurance protection in excess of $30,000.

As the corporate employer of some 700,000 employees, we question the efficacy of this proposal in light of what we believe will prove to be exorbitant costs of administration on the employer level. Keeping in mind that the principal purpose of this provision is revenue-raising, we have grave doubts that it can be achieved.

At the outset we note that an employer will be required at deductible expense, to account separately for two basic groups of employee-beneficiaries of its group insurance plan. The first such group includes all employees to the extent of the first $30,000 of group life coverage. A second group must then be established, which includes only those employees whose coverage exceeds $30,000, but only to the extent that their coverage is in excess of such amount.

The employer then must further segregate those members of the second group into employees who participate in contributory plans and employees who participate in noncontributory plans. But the employer may not stop here. An additional segregation of group two is necessary to set aside those employees entitled to benefits in excess of the $30,000 limit whose employment has either been terminated because of their retirement, or disability. Finally, the employer must determine if any of the remaining employees of the second group have designated charitable organizations as beneficiaries of their group policies, in order to exclude them from the operation of the statutory proposal.

Over and above the complex and costly system of accounting which the above procedure will entail, the employer must annually determine not only the changes

which will naturally occur in classification by virtue of employee turnover, and annual increases in coverage, but further must compute the cost basis of employee coverage under one of two alternative methods.

All the above procedures are required so that the employer may properly withhold on the cost of benefits includible in the employee's income, as well as inform the employee-beneficiaries of its group insurance program of its true economic consequences.

Since the above accounting steps will in most instances involve considerable cost to the employer, which cost will be deductible at the current corporate rate, we fail to appreciate the revenue gains to be derived.

Moreover, we question whether the field of employee benefits is the proper area in which to inaugurate questionable tax reforms. The social desirability of group life insurance is best demonstrated by the effective manner in which it provides economic security to the families of over 38 million employed Americans. Thus, anyone proposing to change the tax treatment afforded it undertakes a heavy burden.

Apparently, the principal argument urged in defense of the proposed change is that certain abuses exist by which unreasonable amounts of insurance are provided to a favored few. However, the facts indicate that group life insurance is ordinarily provided on a nondiscriminatory basis to all employees, coverage being based upon their earnings, service, occupational classification, or some combination of these factors. For this reason it is extremely doubtful that the abuses alluded to are actually widespread.

In any event, should it appear appropriate to preclude any such discriminatory coverage, it would seem far more feasible to adopt a simple requirement that group life insurance programs be nondiscriminatory. Should this approach be adopted, the greater portion of existing group insurance plans would be unaffected and the legislation would work directly upon those plans which in fact do produce discrimination.

S. 2231

Finally, I would direct this committee's attention to S. 2231 introduced by Senator Hartke on October 10, 1963, which codifies Revenue Procedure 62-21, with an amendment excluding therefrom the reserve-ratio test.

Our industry lends its complete endorsement to the principles underlying the introduction of this measure. In our April 1962 appearance before this committee, we pointed to a need for legislative action in the field of depreciation despite impending administrative relief. We felt at that time that this is an area in which absolutes are a necessity, pointing to the fact that administrative relief has a way of changing from administration to administration.

Our views have not changed. The benefits derived to date from the guidelines cannot be overlooked. In our judgment their adoption stands as a landmark in mature tax administration. We firmly believe legislative enactment of this monumental reform is in order.

However, the members of our industry have not as yet had an opportunity to completely study the measure. We also recognize that this proposal is not presently before this committee. Accordingly, at the proper time we would appreciate the opportunity to appear and definitely set forth our views on this proposal.

In conclusion, I would like to thank this committee for the courtesies which have been extended to me today.

The CHAIRMAN. The next witness is Mr. Charles Marshall, of Nebraska Farm Bureau.

Senator CURTIS. Mr. Chairman, I would like to welcome to this committee a distinguished Nebraskan, Mr. Charles Marshall. He is one of our leading farmers. He has devoted a great deal of time to the Farm Bureau. It is not the first occasion that he has appeared in Washington before this committee and others.

His testimony is always helpful, and, as one Nebraskan on this committee, I want to welcome you, Mr. Marshall.

The CHAIRMAN. You may proceed.

STATEMENT OF CHARLES MARSHALL, PRESIDENT, NEBRASKA FARM BUREAU FEDERATION

Mr. MARSHALL. Thank you.

Mr. Chairman and members of the committee, I appreciate the opportunity of appearing before this Senate Finance Committee in behalf of the position of Farm Bureau with reference to the proposed reduction in taxes. This statement is supplemental to and in support of the statement presented by Mr. Charles B. Shuman, president of the American Farm Bureau Federation, on October 24, 1963.

There have been numerous meetings of farmers and ranchers in Nebraska during the last several weeks in the review of public problems and in the consideration of alternative solutions. One of the most universal topics of discussion is taxation. It should not be necessary to dwell upon the burden of taxation in this country today. There is general agreement that taxes are an excessive burden and too often inequitable.

The issue is not whether taxes should be reduced, but the circumstances and implications of different situations relating to tax reduction.

Nebraska is one of the Great Plain States and is predominantly agricultural.

Being a Great Plains State places it in a high-risk geographical area, and thus, we are in a different situation with reference to climate than many other agricultural States. The Great Plains suffer more erratic weather conditions than many other sections of the country. We have fortunately been blessed with several years of good crops. It is quite common to hear conversation among those of the Great Plains to the effect that we cannot be so fortunate to continue to have weather like that of the last few years. It may not be easy to understand the caution exercised by those who have lived a lifetime in an area with insecure moisture supplies.

A State that is predominantly agricultural is affected differently and looks at situations differently than many other areas of the country.

We have tremendous sums invested in capital goods. It is well known that the investment per worker in agriculture is among the greatest.

Along with the heavy investment in capital goods, operating expenses continue to increase. Farmers and ranchers are finding that each year more and more of their expenses go for items which are not produced on the farm. While the number of different expenses has been increasing, the amount of individual expenses has reflected the general inflationary trend.

It is easily documented that the net income position of agriculture suffers more from increased expense than it does from decreased gross income. While the industrialization of agriculture has required more off-the-farm expenses, much of the impact of an unstable currency is reflected in agriculture more dramatically than in other segments of the economy. Farmers and ranchers have not had artificial and built-in monopolistic controls to guarantee the income that has been assured some other groups. Thus, many things, and inflation in particular, have a tremendous impact on the net income of agriculture.

There are now pending in Congress numerous bills which would increase Government expenditures, and inasmuch as we have been operating with a deficit most of the years in the immediate past, we in Nebraska feel that there must be a curtailing of expenses before we reduce taxes.

It is one of the cardinal principles of farm and ranch management that we refrain from extra expenditures if we anticipate lower income.

Capital investments in tangible items can sometimes be made to increase efficiency in farm and ranch management. We see no comparable increased efficiencies resulting from increased Government expenditures.

There should be tax reductions provided for the citizens of our country by reduced expenditures and not by increased deficits which will lower the value of the dollars left in the hands of the general public. A Government dollar buys no more than a private dollar and a borrowed Government dollar too often decreases the value of the remaining private dollars. This fraud should be stopped.

We respectfully request that there be no tax cut until expenses are reduced by an amount necessary to at least equal to the tax reduction.

Thank you.

The CHAIRMAN. Mr. Marshall, as a member of the farm bureau, American Farm Bureau, I want to congratulate you on making a very fine statement, as Mr. Shuman, the president of the American Farm Bureau Federation, did on October 24, before this committee.

I am in thorough accord with what you say. I am in thorough accord with whatever you have said in your statement. It is brief, to the point, and very convincing.

Any questions?

Senator Douglas, any questions?

Senator DOUGLAS. No questions.

The CHAIRMAN. Senator Williams?

Senator WILLIAMS. Mr. Marshall, I, too, want to congratulate you on a very sound statement. I am even more proud to be a member of the Farm Bureau Federation when it takes such a constructive position on Government finances.

Senator CURTIS. Mr. Marshall, I want to commend you on your statement. It is sound in principle, it is concise, and it is very understandable, and your position that there be no tax cut until expenditures are reduced certainly has my support. I am delighted that you are here.

The CHAIRMAN. Senator Talmadge?

Senator TALMADGE. No questions.

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

Mr. MARSHALL. Thank you, sir.

The next witness is Mr. Richard Berry of Salem, Va., representing the Virginia Chamber of Commerce of Salem.

Mr. Berry, if you will take a seat, sir, you may proceed.

STATEMENT OF RICHARD H. BERRY, CHAMBER OF COMMERCE OF SALEM, VA.

Mr. BERRY. Mr. Chairman and members of the committee, I want to first thank you on behalf of the Salem Chamber of Commerce, and myself personally for this opportunity.

I am a certified public accountant and a partner in the firm of Berry & Dail, with offices in Salem and Radford, representing the Virginia Chamber of Commerce.

We are not unaware of the relative weight the opinion of an organization numbering no more than 350 members might be expected to carry. To my knowledge, none of those members have any experience in drafting legislation, in Federal tax administration, or any particular facility with macroeconomics. We do not have available to us a wealth of statistical information and economic analysis, nor can we thoroughly understand all the data we have studied. In short, we are not technical experts, nor do we pretend to be.

We feel, however, our organization does possess certain qualities that make its considered opinion on this tax proposal to some degree at least meaningful. We are not a homogeneous group; we have no particular vested interest. Our membership does not represent a single political party nor political or economic philosophy. We have no ax to grind; the only interests our membership has in common with one another are that of geography and a sincere desire for a strong and healthy National Government.

Our recorded opposition to the proposal in question today and to the position of the U.S. Chamber of Commerce is not in regard to current tax levels; it seems that agreement is almost universal that those levels are too high. They are too high to provide the type of economic motivation we require in a relatively free capitalistic economy; they are too high to promote sound economic decisionmaking, and too high to be administered with equity. The large corporation, with most of its taxable income in the 52-percent bracket, seems to be discriminated against due to its lack of voting power. Yet, in our economic system, it certainly has the largest private investment potential; those individual percentage tax brackets in the 70's, 80's and even 90's are felt, by some of us at least, to be inherently offensive, despite the fact that we personally are not even acquainted with any individuals affected directly by them. This type of tax structure certainly does not stimulate the incentive of those individuals and those organized groups of individuals, who as a result of their talents and their available wealth, have the greatest potential to stimulate our economy and promote the development of new jobs. However, in regard to possible remedies, particularly the House bill under discussion here, we take sharp exception.

The elephant labored and brought forth a mouse in the form of H.R. 8363. Some months ago it appeared that we were going to get a reform in broad fiscal policy. Federal spending was going to be carefully checked. There was going to be a comprehensive revision and reform of the Internal Revenue Code of 1954, which in all likelihood would embody some rate reduction. We were not able to find any opposition to this proposal.

If our opposition to H.R. 8363 stemmed from some specific subsection or involved technicalities of wording, my job in summarizing our position would be simplified. However, our objection, while possibly not so sophisticated, is much more general and basic. Although we should, I guess, confine ourselves specifically to the proposal itself, we cannot. Any significant change in the manner by which the Federal Government obtains the vast majority of its total revenue almost

automatically becomes a broader issue involving any number of otherwise extraneous matters. We are immediately thrown into questions of broad fiscal policy, public morality, and in fact, our future as a Nation. Herein lies the basis of our position.

In the past few months we have witnessed the demise of that general approach we could have welcomed and sponsored. We have seen all reference to Federal expenditure reduced to vague promises concerning "essentials." We have seen reform all but perish, and we have left nothing but a scale of rate reductions aimed at giving everybody a little bit.

As best we can tell, this particular piece of legislation is considered by its sponsors to be very necessary to our national well-being. This new scale of reduced rates is going to be self-liquidating—that is, the economic impetus created will in the indefinite future actually enlarge total revenues from this source over and above current levels. Even many of the enemies of big Central Government see a perverse advantage to this bill—they can reduce Government expenditures by reducing Government revenues. It would seem to us that those two arguments are contradictory and might, by some, appear to contain a little rationalization and possibly a little politics. If this bill is going to be self-liquidating, how will it then result in reduced Federal expenditures and the scope of Central Government? Let us put the horse back in front of the cart. Promises in regard to expenditures sound somewhat hollow coming from an administration committed to the idea of self-liquidation. It does not seem to us prudent to give any administration, in a preelection year, the advantaige of unleashed spending in conjunction with a sizable tax cut. We cannot help but wonder why our economy has been allowed to hobble forward under the present rate structure all these years and then to be granted the relief necessary for its very survival on January 1, 1964.

We would like to suggest that the American people might welcome a fiscal policy which is somewhat more straightforward, and one not so terribly dependent upon projections and assumptions. If it is true that deficit spending is an economic stimulus, then our economy has had considerable stimulation in the past 30 years. However, I think we all agree that our gross national product growth rate has not been all that might be desired.

It is certainly true that the American economy has outlasted the doomsdayers despite this type of fiscal approach. The patient has survived in relatively good health—but not without some rather serious side effects. We have had, and continue to have, inflation, and we are bequeathing to future generations a rather large debt, a rather embarrassing debt, a rather awkward debt. A $309 billion imponderable has not brought economic disaster upon us yet, and it may not. But certainly the least that can be said for it is that it requires considerable and continuous legislative concern and untold man-hours in service that is at best a wasteful economic drag. I should imagine it causes concern, too, to international investors and traders.

It cannot be argued that governments, like individuals, do not need borrowing capacity as a buffer against crisis, economic as well as military. But does our Government's borrowing capacity extend indefinitely in terms of size and time? Is there not some limit to how much we can borrow from ourselves? Does not every additional dollar

we add to our debt reduce our protection somewhat against a future crisis? Still more important, is it not amoral to spend almost perennially more than we find either economically and/or politically expedient to collect, while at the same time we are admonishing our international neighbors in the necessity of fiscal integrity? Can we continue to demonstrate to our children how easy it is to put down the load and at the same time expect them to pick it up? Have we been faced with crisis each and every one of the years that we increased this debt? Have we been true to ourselves and the basic tenets upon which our economic system rests? Are the individual members of our society anxious and willing to pass on to future generations a system and a way of doing business that embarrasses us, that is awkward to us, that we are really quite unable to cope with? Are we really fooling ourselves or anyone else?

It takes no particular talent to spend money, and that is especially true when no regard need be given to the availability of that money. The proposition that there exists unmet Federal obligations, coupled with statements to the effect that our economy cannot stand the present tax burdens represents a paradox that we feel should be avoided. If these areas of national need are essential, let us pay for them. If the need is not as essential as the growth that might be forgone, let it be held in abeyance until such time as our economy can afford it. If this, or any administration, feels that our tax level has exceeded the economy's capacity to supply it in good health, let it demonstrate that conviction with budget proposals that do not exceed the Government's ability to spend with integrity. We feel that there is a large and growing group of people in this country who no longer feel comfortable in behaving collectively in a manner that they would not consider behaving as individuals.

The Salem Chamber of Commerce and the community which it represents are firmly committed to the proposition that local governments and local private enterprise can do for themselves much better, in almost every instance, than the Federal Government can do for it, and at less cost. In fact, Senator Byrd, the honorable chairman of this committee, had entered into the appendix of the Congressional Record of May 13, 1963, a recommendation by the Salem Chamber of Commerce that an effort be made by communities to reduce Federal expenditures. On May 27, 1963, the Council of the Town of Salem, Va., unanimously approved that recommendation. This, gentlemen, I think, is some proof that the membership of the Salem Chamber of Commerce is further supported by a community of more than 7,000 people.

If it is in truth agreed that present tax rates are too high, and that a reduction of those rates is the only, or best, solution to a sluggish growth rate, then the rate reduction here proposed does not seem to us the most appropriate from other than a political point of view. If it is agreed that we must increase our Federal tax base in order to meet pressing Federal obligations, then we, as members of this economy, cannot truly afford a tax cut in the classical sense, but must only be given one for expedience. It would seem, therefore, that the appropriate structure revision should not be one of "something for everybody." If we must cut taxes in desperation for economic stimulus, let us cut them in a manner calculated to do the most immediate good—

to provide the maximum in quick stimulation. If that is the only justification for the cut, and we can see no other, we should disregard such criteria as political expedience and even of equity and basic fairness. If we are going to maximize the immediate growth advantage in our tax base via rate reduction, let us confine all reduction to those rates that are most offensive to incentive. Let us, in order to enhance investment and stimulate the creation of new jobs, ease the tax burden only of those individuals and groups of individuals, calculated coldly and statistically, which would provide the maximum in quick investment potential. If elementary, classical, capitalistic theory has any application in reality, the dollar spent directly on new capital investment will provide greater gross stimulus than the same dollar reacting on investment through the consumer market. We can see little basis in fact for the contention that this proposal is a "rich man's bill." On the contrary, in an effort to be appealing politically the proposal forgoes a great deal of the effect for which it is expressly intended.

It does not seem to us that the $2 or $3 a week given to us in the 20-percent bracket will unleash nearly as much multiplier effect as dollars allowed to go directly into "after tax" corporate profits and incomes of those relatively few members of our society who directly make the significant investment decisions.

If, say, $9 billion were reserved entirely to this category, how many new machines and new jobs would become profitable and appealing that heretofore had not been? On the other hand, how decisive and immediate an effect can an extra few dollars a month in my pocket yield?

We are likewise disappointed in the failure of the House of Representatives to face squarely the tax reform issue. Although we would welcome several of the reforms contained in the House resolution, we feel that they are relatively minor in nature. We can see only political reasons for failure to grapple with larger issues such as percentage depletion and the deductibility of personal interest.

We would like to say by way of summary, that any amendment to the Internal Revenue Code which precedes a general agreement between the legislative and administrative branches of our Government in regard to an attitude toward expenditure, vis-a-vis revenue, is premature. We feel that the risk of recession in 1964 is not as great as the risk inherent in further fiscal lethargy. We believe the American taxpayer is willing to forgo the advantage of a quick tax cut in deference to some significant change in attitude of the Federal Government toward spending. If we are able to contain spending at a level which our economy can comfortably afford, needed tax reduction, we believe, would undoubtedly follow. If we cannot now take the time to build a strong and consistent framework upon which to construct a careful revision of the code, we should not bother the existing structure. If we can continue to spend indefinitely without reference to revenues, let us not worry about revenue. If we cannot spend in such a manner, let us stop now, and reserve deficit financing to those periods when we have no alternative. Can we forever cry "wolf" without ultimately receiving the obvious and classical retribution?

Although there are any number of well-informed individuals and groups of individuals who want this bill to pass now, at almost any

cost in terms of further amendment and revision, it is not so easy to find anyone who is really very satisfied with it either from among the public, the administration, or the Congress. It seems to us that this does not lend strong support to the proposal, and makes those organizations throughout the country who urge its immediate passage under almost any condition to appear somewhat suspect of short-sightedness. This proposal shows us what our country can do for us, it does not tell us what we can do for our country; it appeals to our selfishness rather than our selflessness.

Cannot some proposal be drafted that would completely satisfy a significant minority, or at least generally satisfy a significant majority? It does not appear to us that the proposal passed in the House of Representatives meets those criteria.

The CHAIRMAN. Mr. Berry, thank you very much, sir. You have made an excellent statement. I am very proud of the Salem Chamber of Commerce in my State for taking the position it has.

Mr. BERRY. It certainly has been my privilege.

The CHAIRMAN. Any questions?

The next witness is James B. Wold of the Associated Industries of Alabama.

Take a seat, please, sir, and proceed.

STATEMENT OF JAMES B. WOLD, THE ASSOCIATED INDUSTRIES OF ALABAMA

Mr. WOLD. Senator Byrd and members of the committee, it is an honor to have the opportunity to appear before you once again.

My name is James B. Wold. I am executive vice president of the Fly Ash Arrestor Corp., Birmingham, Ala. I appear here today in behalf of the Associated Industries of Alabama.

The member firms of the association I represent include companies of all sizes in a wide range of industries. Predominantly, however, our member firms employ fewer than 500 people, which makes them small business under the Government definition. Many are family-owned or closely held enterprises which have been built up from scratch by the owners or partners.

We are in favor of enactment of substantial net tax reduction for two reasons.

The first reason is that tax reduction would represent a choice for greater dependence on the private economy and less reliance on Federal spending. For too many years, both our economic and political thinking have been dominated by the thought that more Federal programs and more Federal spending would solve all problems that merit public concern. Many of us have opposed this approach because, even if it would work for a time, there inevitably would be erosion of the freedom of our economy, of the self-reliance of our people, and of the will and capacity of our State and local governments to solve problems peculiar to their jurisdictions. However, the record over the past 6 years now makes evident the fact that steady increases in Federal spending will not alone solve our economic and employment problems.

From fiscal year 1957 through the current fiscal year, Federal expenditures will have grown from $69 billion to an estimated $98 billion. Inadequate long-term growth and too much chronic

unemployment have developed over these years. I realize that, despite the great increase in Federal spending, some might say it simply has not been enough. To me, such a view has its parallel in the notion so widely held a few years ago that the only way to cope with inflation was to put escalator clauses in all economic contracts.

The second reason why we favor tax reduction is that it affords opportunity to deal at source with a major impediment to growth and job creation in the private economy, namely, incentive- and capital-destroying tax rates. Unfortunately, H.R. 8363 stops short of even reasonable reform of these rates, considering the magnitude of the total tax reduction which it would provide.

There is no virtue as such in a small business as compared with any other size business. The political interest in smallness centers in the prospects for growth. All businesses start out relatively small. Any small business will contribute to steady improvement in our Nation's economic well-being only, first, as it survives and, second, as it grows.

Much the same thing may be said about human beings. Nearly all men, and an increasing number of women, become workers in their youth and remain so throughout their lives. Our political and human concern for all who work or want to work is obvious, but the economic interest of the Nation must center on the individual who grows in his work, whether employed or self-employed. Over a lifetime, the people who simply want a job are, in large part, carried by the relatively few whose energies and ambitions are never abated. Without such people, any society would soon sink back into decay and then oblivion.

A tax policy which would be most compatible with optimum economic growth and job creation, therefore, would be one which did not unduly restrain the growth of businesses or the growth of people in business.

When we look at our present Federal tax structure, we find that it is weighted against both business growth and personal growth.

In its one-step graduation, the corporate tax penalizes the companies which grow beyond $25,000 in taxable income. In its multiple-step, dizzy rate of graduation, the personal tax thwarts growing individuals all the way up the income scale.

H.R. 8363 makes a substantial reduction—26.7 percent—in the corporate rate applying to income under $25,000. Above that level, the reduction is about 8 percent for corporations up to $1 million. For the medium to large size, growing corporations, whose capital needs are never fully met, even the 8-percent reduction would be significantly offset by the further speed-up in tax payments.

As an even greater deficiency in H.R. 8363, however, is the inadequate tax relief for the growing person, whether in business of himself or working for a company. In his testimony before this committee. Secretary Dillon stressed the importance of the 26.7 percent reduction in rate for the small corporation, and stated:

> The over 9 million small individual proprietorships will of course benefit from comparable reduction in individual income tax rates.

The bill before you, however reduces only by an average of about 17 percent the rates of tax on unincorporated business and other personal income through the substantial middle brackets.

Why this slighting of the person who grows in achievement and contribution? It occurs to me that the answer is found in a peculiar

obsession in politics with the problems of the poor and the contrasting image of the rich. For many years graduation has been rationalized as a means for making the rich pay what the poor cannot afford. This has always seemed to me to be a rather shallow philosophy, creating the impression, as it does, that we do not need to worry about the level of spending because the rich will pick up the tab. I will leave it to someone else to compute the days of Federal spending in any year which could be supported by the income of the rich, if all of it were confiscated. A philosophy of taxation which diverts attention from the truth—that high-level spending can be supported only by taxes which are directly or indirectly borne by all people—is not conducive to sound or equitable legislation.

Regardless, the persistent contrasting of the situation between the poor and the rich results in a rate scheme which unduly penalizes people which are neither. There are 22 graduated brackets between the top and the bottom rate. In relation to increase in taxable income, graduation is much steeper up through the substantial middle brackets than it is in the high brackets. The rate of tax increases 36 percentage points between $2,000 and $22,000 of taxable income, but only 5 percentage points between $80,000 and $100,000.

My purpose is not to justify an excessive increase of tax or rate of tax on any income, no matter how high that income may be, or whether it is earned or derived from accumulated wealth. The greater average standard of living of American citizens, as compared with the citizens of any other nation, is entirely the result of our greater capital accumulation per worker. When the average capital behind the average worker in any foreign country reaches the level of that in the United States, the average standard of living of that worker will approximate the level of his counterpart here. Employment opportunities abound in Europe because a greater proportion of current income there is being transformed into new capital or productive wealth. We will solve our problem of too little growth and too much unemployment in this country only when we have stepped up our rate of capital formation over that of recent years.

This brings me to the most telling point about our decadent tax philosophy. It is static in concept. It views taxpaying capacity as if the only function of economics were to more equitably distribute what people have. It seems completely oblivious to the fact that advance in human well-being, the lifting of people from subsistence to a good standard of living, is dependent upon the input of new capital.

Looking back, we know that if our economy had enjoyed a higher rate of capital formation since 1957, there would be fewer people in the subsistence income levels today. Looking ahead to 1970, we know that the rate of capital formation in the intervening years will determine whether those now unemployed or partially employed, and new workers, will have good jobs at good pay.

It is not a service to people who now or hereafter need new jobs or better jobs to tolerate tax rates which, in effect, convert capital-for-growth into current Government spending. A person who needs a job will find no solace in the fact that public policy ordains the taxing away of income or capital which would have provided that job. The greatest disservice of all, however, to those who must look to greater economic growth for good job opportunities, is the levying of tax

rates which stifle the growing business or restrain the growing person.

There is no jobmaker in the world comparable to that of the energetic individual who can acquire the capital to give expression to his drive and ambition. If not hampered by excessive and ascending rates of tax, these people not only will save more, and make the most effective use of such savings, they will pull into their enterprises the savings of others, and make maximum use of our banking facilities. Growing people are the pace setters of progress; but they cannot set a faster pace than tax rates permit.

Second only as jobmakers to the people who put their savings on the line in their own businesses are those who save and provide new equity capital for businesses run by others. I do not believe there is an economist or financial analyst who would not agree that, except for the widespread American interest in stockownership, we could not have achieved our present state of industrial development and living standards. If our economy is going to grow more rapidly hereafter, it will need greater capacity to invest than is possible under present tax rates—even with the existing small credit against double taxation of dividend income.

In Alabama, and throughout the Southland, we are acutely aware of our need for new businesses, new capital, and more homegrown investing power. While we have made better-than-average progress since the depression, we are quite aware that the price has been increasing dependence on out-of-State businesses and out-of-State capital. The broad industrial base in the North was developed in an era when tax laws did not prevent rapid accumulation of capital by businesses and individuals. We think the time has come when the South also should have the opportunity to show what it can do in the absence of tax rates which slice off the greatest part of income which otherwise would become venture capital.

There is no reason why growing businesses, growing people, or a growing South should be shortchanged in the legislation before you.

I therefore recommend amendment of H.R. 8363 as follows:

Personal tax rates: Double the reduction in rates up through the substantial middle brackets from the average of around 17 percent now in the bill.

Corporate rates: Provide more substantial rate reduction for corporations whose income has grown beyond $25,000.

Dividend credit: Retain, or preferably increase, the 4-percent credit.

In addition, eliminate or modify any other provisions which would curtail capital funds, or create new forms of discrimination against growing businesses or growing people.

In submitting these recommendations, I am aware that there is a general belief that tax reduction of the magnitude now provided in H.R. 8363 is adequate to get the economy moving faster. This view, however, springs from the demand or consumption philosophy of tax reduction. It is not related to the problem of pulling down the tax rate barricades to greater capital formation and growth. I would be inclined to agree that any tax reduction is better than no tax reduction, but it would seem a miscarriage of equity and economics to reduce taxes as much as $11 billion and neglect the problems which I have enumerated. If we keep our sights set on greater growth and

more jobs, I cannot see why there should not be a rebalancing of tax reduction under H.R. 8363 to take off more of the burden where it directly limits capital formation and prevents greater growth. However, if such a rebalancing is not considered feasible, then I urge that you increase the total tax reduction to serve the growth objective. If we cannot redress some of the economic harm done by highly graduated and excessive rates of income tax in a bill providing over $10 billion tax savings, when will a new opportunity come?

If a revised H.R. 8363 releases the tax brakes on growing businesses and growing people, and does not reimpose nearly the full burden of double taxation on most stockholders by repealing the 4-percent dividend credit, I believe its enactment will make an impressive contribution to high-level progress and high-level employment in good jobs.

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

Any questions? Thank you very much, sir.

Mr. WOLD. Thank, you, gentlemen

The CHAIRMAN. The next witness is our old friend, Mr. O. R. Strackbein of the Nation-Wide Committee on Import-Export Policy.

Mr. Strackbein, will you come forward and take a seat, sir. We welcome you to the committee.

STATEMENT OF O. R. STRACKBEIN, CHAIRMAN, NATION-WIDE COMMITTEE ON IMPORT-EXPORT POLICY

Mr. STRACKBEIN. Mr. Chairman and members of the committee, my name is O. R. Strackbein. I am chairman of the Nation-Wide Committee on Import-Export Policy

It is the purpose here to address the features of the tax bill that is designed to increase business activity and therefore enlarge the gross national product and increase employment.

As you know, a considerable difference of opinion has arisen about the causes of unemployment and the failure of the domestic economy to expand sufficiently to absorb the growing number of new workers who annually appear on the scene as a consequence (1) of our large population expansion since the war and (2) of the effects of automation.

The Chairman of the Council of Economic Advisers, Mr. Walter W. Heller, lays a large part of the blame for unemployment on the so-called structural factors, such as automation and supersession of some industries and products by new ones as a result of change in demand. Unemployment in the coal mining regions presents an excellent example. Not only has a vast increase in productivity released scores of thousands of miners in the past 12 or 13 years, but oil and natural gas have made deep inroads into the use of coal as a fuel.

Miners are specialized workmen and would require retraining in order to enter any other occupations above the unskilled level. When several hundred thousand of them are displaced in a span of a decade, it is obvious that a difficult problem has been created.

Mr. Heller in a recent statement before a Senate Subcommittee on Employment, maintained that the proposed tax cut of $11 billion would add $30 billion to the gross national product and that this

increase in output would reduce unemployment to 4 percent. This calculation seems to proceed on the assumption that growth in output automatically results in greater employment.

This is, of course, a speculative estimate and has little history to go on.

A different view has been expressed by Mr. Charles C. Killingsworth of Michigan State University. He regards the onslaught of automation as the source of a more stubborn type of unemployment. The unskilled workers are cast off more rapidly than they can be replaced. The demand for highly trained workers in fact outruns the capacity of the economy to supply them. Under these circumstances a tax reduction would be almost irrelevant to the problem. Retraining of the unskilled unemployed would be more important.

These two schools of thought are cited simply as evidence of the direction of thought in this field rather than for the purpose of answering them as such.

Among those who think that a tax reduction would benefit the economy a further difference of opinion exists about the character of reduction that would be most helpful. There are those who think that the greatest response would come from reducing the taxes paid by consumers, and particularly those of the lower income levels. Such a reduction, they perceive, would liberate more purchasing power at the consumer end and production and employment would be stimulated accordingly.

On the other side are those who are convinced that production enterprises are so heavily taxed that the burden carried by them retards business expansion. They believe that a significant lightening of this burden would stimulate business and that this activity in turn would result in plant expansion, plant improvement, and so forth, and thus lead not only to increasing employment but also to increasing purchasing power.

Yet another school believes that tax reduction should be accompanied by more liberal governmental spending. Prof. Seymour Harris of Harvard is an exponent of this view. This school seems to feel that if one spoonful of medicine is good for the patient, two spoonfuls would be at least twice as good if not more so.

Notable in all these views is the complete absence of any reference to the effect of rising import competition and the balance-of-payment difficulties of this country.

The omission borders on the neurotic or even pathological. The tariff, as a useful instrument, has been turned into a tribal taboo. It must not be mentioned in that vein as a useful instrument. The generality of mass-circulation newspapers shun any least contamination by positive thoughts of protectionism.

This amazing phenomenon explains why it is impossible in the United States, today, to gain consideration of all the factors that contribute to our economic problem. Much is said about the failure of this country to grow or expand as much as some other countries, or in any case not as rapidly as would be necessary to bring about employment of more of the unemployed. Much is also said of the need to become more efficient, meaning yet more automation, in order to export more and to withstand rising import competition in the domestic mar-

ket. High wages and high costs are both assailed, and both as quickly defended.

The Honorable William H. Roth, Deputy Special Representative for Trade Negotiations, said on October 24, 1963:

Technology and trade expansion are two sides of the same coin. Without support from advancing technology, trade expansion would not be entirely free of risk. Without access to wider markets through trade expansion, technological progress cannot achieve its full economic potential.

Mr. Chairman, the relevancy of that statement to a tax hearing may be questioned by some who do not see the connection. The difficulty, if any, will, however, disappear when we begin to look to technology to solve our employment problem.

There is so much confusion in this field that words are used without apparent reference to the realities in which we find ourselves. Let us see if we can put a few things straight.

Growth, of itself, Mr. Chairman, if it means an expansion of output, may or may not mean increasing employment. We may by improving our mechanical installations, indeed produce more; but we may do so with fewer rather than more workers. This is a fact that needs no further documentation. Examples abound on all sides.

In other words, automation is not necessarily the key to greater employment. Therefore, a tax reduction that would stimulate automation need not reduce unemployment. On the other hand, it might do so. It depends on the conditions and the products involved.

Automation and similar installations will, in all cases, result in immediate displacement of workers. To this there is no answer. Of course, that is the very purpose of automation.

Over a period of time—perhaps even in a year, but quite certainly in several years, demand may be expected to respond, but only under certain conditions:

1. If the lower costs achieved lead to lower consumer prices; they need not necessarily do so, but they may, if the cost savings are passed on to the consumer;

2. If the product happens to be one for which the demand is elastic, that is, increases rapidly if the price is reduced; and

3. If no counteracting influence is on the premises. These "ifs" represent very respectable obstacles.

It may be said that the only demand that responds sensitively to reduced prices (while other prices remain as they were or going up) is the demand for consumer goods. Of course, such a rising demand will produce a greater demand for the producer goods that are used in manufacturing the consumer goods.

A very important factor is that not all demand, even for consumer goods, is elastic. The demand for most staple food products, of which there are many, is notably inelastic and is quite rigidly fixed by the number of stomachs in the country, or the world, to be fed. Much of our agricultural production falls into this category.

When automation is introduced into the manufacture of products for which the demand is inelastic, net unemployment inevitably results, and the displaced workers must find work elsewhere or remain unemployed. An uncomfortably high number of our basic manufacturing industries fall into this category, and are being increasingly

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beset by the unemployed like a harvest of fallen leaves, victims of technological advancement.

Assuming the most optimistic results, both from elasticity of demand and fatter consumer pocketbooks (resulting among other things from a tax reduction) there remains the possible negative influence exerted by some counteracting market condition. This need not bother the consumers. They would open their pocketbooks as expected; if you reduce costs and reduce the prices, and demand is elastic, they will open their pocketbooks and more so if taxes are reduced, but they might be buying more goods from other than American sources and thus rob our manufacturers of the expected and classical bonanza following cost reduction.

Knowledge of this difficulty indeed stares many of our manufacturers in the face. Today the imported goods are already here. They have abundantly demonstrated their capacity to capture an increasing share of the market by the very simple process of doing so very effectively in the past 5 or 10 years.

This very fact creates pressure for more mechanization in our industries, as the quotation from Mr. Roth emphasizes, but unfortunately, under conditions that do not promise the reward usually expected of such improvements when an elastic demand is present. The consumers, who are the ones who furnish the demand, buy as readily from outside sources as domestic, and, particularly, Mr. Chairman, since the imported price is often below the price of the domestic manufacturers, this expected reward for reducing prices will not be enjoyed by our domestic manufacturers.

With this outlook confronting him, the domestic producer is not nearly so anxious to open new plants or to expand existing ones. He is more likely to replace obsolescent machinery by the most modern—not, indeed, in order to recapture the whole market, but to remain competitive and to hold his own. There is a great deal of difference between that, Mr. Chairman, and expanding and building new plants. The workers he thus displaces by replacement of existing machinery by the more productive variety will find no haven in the new and brightly efficient enivronment. They will not be needed. Nor will the importers find a place for them. The castoffs simply will become a part of the computers' tabulations.

The manufacturer who is well financed will decide, as hundreds have already done, to divert some of his investment to the countries from which the imports come. Billions of dollars, in the past few years, have been invested in the Common Market and the Far East by American companies, so this is a trend already established—therefore, this is not a forecast; this is a thing which has already happened, and continues to happen. Why not hedge the situation, our manufacturers ask themselves, by going where the costs are already lower, and start from scratch? Why try to manufacture more here where costs are higher, and then ship the output 3,000 to 6,000 miles or more when the same products can be manufactured overseas at lesser cost?

The question has been answered by the brisk trek of American companies to Europe and elsewhere in the past 5 years.

A tax reduction? Will it help?

It would help keep the boat afloat but it would not repair the damaging leakage. If the leakage were stopped or controlled first, tax reduction would provide incentive to both producer and consumer, and the benefits of automation, such as they are, could be consummated. The growing pool of residual unemployment would begin to diminish. With the leakage unrepaired, tax reductions would be dissipated with misdirected activity. The hoped for benefits would be despoiled by imports.

Mr. Chairman, I have a very short item of news here. This appeared in this morning's newspaper, talking about the increasing imports of steel, for example, and here is what it says, one little paragraph:

> The steel industry in the United States is currently investing heavily in rolling mills, but the wisdom of making such investments may be questioned if imports continue to rise, steelmen say.

In other words, it is very clear that tax reduction that is aimed at stimulating domestic investment will not take full effect if the industries are confronted with rising import competition, particularly if these industries are well enough financed to divert their investments from the United States to foreign countries where the same goods are produced and may be produced at lower costs than in this country.

Thank you very much.

The CHAIRMAN. Thank you very much, Mr. Strackbein, for your very interesting statement.

Senator Long?

Senator Williams?

Senator WILLIAMS. Mr. Strackbein, you say rising competitive imports prevent the market expansion that would ordinarily follow a cost reduction through mechanization and automation. You say that if the demand for the product is elastic and prices are reduced a greater output would become marketable?

Mr. STRACKBEIN. You mean you want an interpretation?

Senator WILLIAMS. Yes.

Mr. STRACKBEIN. As you know, the demand for goods, consumer goods, may be elastic or inelastic. A perfect example of a demand for consumer goods that is inelastic is sugar, for example. The per capita consumption of sugar has remained right at 100 pounds a year for the last 40 years, from 95 to 100 pounds. It does not make much difference whether the price goes up or down, the demand remains the same.

Much the same is true of wheat flour, wheat, and all of these staple products. You do not coax much more demand by lowering the price.

But there is a vast field of consumer goods where a reduction in price following a reduction in costs will generate a great increase in demand and that, of course, will then be reflected back, and there will be further expansion of the industry, and more employment thus provided.

But you must keep in mind that this type of demand is not something that is true of all consumer goods. In fact, many of our staple commodities have an inelastic demand. If you automate and throw out 15 or 20 percent of the workers and, as a result of that, reduce the price by 15 or 20 percent, you are left with net unemployment because

the demand does not increase, does not respond sufficiently to call for greater output which, in turn, would call for more employment. I think that this is one thing that we have overlooked. We have failed to classify our production of goods into those in which there will be a response in demand and those in which this will not take place.

We have apparently simply taken the idea that when you automate and reduce the cost, demand automatically increases, and as the demand increases you employ more people. This is a generalization that simply will not stand up, and this is one thing I wanted to point out.

Senator WILLIAMS. One other question: At the end of your statement you say tax reduction would help but only if the damage in leakage were stopped. What do you refer to by leakage?

Mr. STRACKBEIN. I refer here to import competition.

In other words, supposing you had a product, and you automate, you cut costs by 35 to 40 percent and, therefore, reduce the price, and suppose the demand for this product is elastic so that the consumers will respond by purchasing more. That is fine, unless your market is contested by imports.

The imports will then participate in this increased demand and, perhaps, deprive the American manufacturer of the usual reward that he would get under these circumstances. The imports might take half of the increase in consumption. This can be documented time and time again with the experience of different industries. The industry expands but imports take more and more of the total proportion of the increased demand. So, naturally, the market outlook for the manufacturer under such circumstances is not nearly as good as it would be if the leakage from the outside were stopped, or at least regulated, so that if the manufacturer reduced his costs by automation, and reduced his prices, he could be sure of reaping the benefit of the increased market.

If he cannot do this, well, he goes along and simply replaces his present machinery in his present factory with more modern machinery. He does not build another plant because he cannot be sure that there will be a market for the increased output simply because of what I call the leakage; that is to say, the imports coming into the country and taking the cream of the market away from him.

Senator WILLIAMS. I received a report the other day, and I will ask you to what extent that is true. It stated that under the recent so-called Dillon round of tariff concessions, with the Common Market, whereas our concessions go into effect immediately, the concessions which we receive from the so-called Common Market countries are not scheduled to go into effect until about 6 or 8 years from now.

Is that true or to what extent is it true?

Mr. STRACKBEIN. That is the first I ever heard of that, Senator.

Senator WILLIAMS. I hope it is in error. I just wondered if you had any information on it.

Mr. STRACKBEIN. I do not think that would be substantiated. It is hard for me to credit.

Senator WILLIAMS. Well, it seemed incredible to me, and I did not know whether you were aware of it. I am pursuing the rumor further with the department.

Mr. STRACKBEIN. The main point of what I am making here is simply this: If the American manufacturer cannot be assured of an expanding market when he expands his production he is not going to do that expanding. You can reduce all the taxes you want to, but if the outlook is that the market to which he caters will be overrun by imports, then he will not make the expansion. He will go overseas instead or reduce his investment here and put part of it overseas.

To this extent I think that the tax reduction, beneficial as it otherwise might be, would be to a great extent nullified. In other words, I see the trade expansion program and the tax program as being at cross purposes with each other.

Senator WILLIAMS. That is all.

The CHAIRMAN. Thank you very much, sir.

Mr. STRACKBEIN. Thank you, sir.

The CHAIRMAN. The next witness is Mr. Edward W. Newton of Meriden, Conn.

Mr. Newton, take a seat, sir, and proceed.

STATEMENT OF EDWARD W. NEWTON, MERIDEN, CONN.

Mr. NEWTON. I am Edward W. Newton of Meriden, Conn. I speak not for any group or organization, but as an individual who is deeply concerned about any proposal to lower the income tax when not enough is being done to curtail unnecessary governmental expenses. I am sure this concern is shared by millions of citizens of the country.

The very fact that Congress is considering an income tax reduction at this time is proof that you gentlemen feel that the burden of our present taxation is stifling our economy. If this were not your belief we would not be here today.

The need to reduce taxes is urgent, but I humbly suggest that you are trying to cure an illness without attempting to diagnose the cause of it.

If you would remedy some of the glaring causes for exorbitant taxes, you would find it unnecessary to wrestle with the dilemma of reducing income taxes while your Government expense is skyrocketing.

I am only an officeworker from a New England city, but even from that vantage point it is not difficult to discern our Government is manufacturing its own economic troubles.

You gentlemen are allowing and encouraging practices by governmental agencies which make excessive taxation a necessity. And you try to reduce taxes because they are burdensome to us.

In my hometown of Meriden, Conn., our local government itself appropriated $4.8 million in July 1961, for necessary improvements in our water and sewer system. These improvements were not made then, but the funds for this public works program were in hand.

Nevertheless, a new greedy city administration asked for and was granted by the Housing and Home Finance Agency matching funds in the amount of $1,477,500 under its accelerated public works program in July 1963.

This grant, 2 full years after local funds were appropriated, covered 50 percent of the cost of a number of the very same projects covered by local appropriations. We had the money in July 1961, to complete the projects, but the Housing and Home Finance Agency matched

our city funds 2 full years later when there was no necessity or justification for it.

I have always believed that the Federal Government matched local funds to stimulate the undertaking of local projects which would not be undertaken if Federal funds were not contributed. In other words, the construction of necessary public works would be accelerated by a helping hand from the Federal Government.

But this is not the case in Meriden. Your Housing and Home Finance Agency was not matching funds at all. They were tapping the pork barrel for a completely unnecessary expenditure. That agency, apparently realizing this, then suggested that to keep the $1,447,500 in so-called matching funds, our local government would have to think up and budget for an additional $1,447,500 in local public works projects to match the funds which they had matched our first appropriation.

You must admit it gets pretty complicated and ridiculous. We in Meriden will now have about $7.7 million in projects.

Foolish as it may sound, we now have more money than we have projects to spend it on. The Housing and Home Finance did not really match or accelerate anything. They gave us money which we did not even need, and now our city has to stretch out for new projects to justify the grant.

In some instances Federal funds are already being expended even though no funds as yet have been appropriated locally.

If our local government should find it impossible to match the Federal grants, your $14 million may never be matched.

This is only my personal experience with Federal waste of tax moneys. If it is multiplied by the hundreds of cities eligible for Federal funds we cannot imagine its possibilities.

Your Federal agencies are stretching regulations to squander our tax dollars. They are encouraging greed; unthinking local public officials who think they are getting something for nothing to overburden municipalities with unnecessarily high taxes.

Only when abuses of this sort I have described are eliminated can we reduce taxes with any wisdom. When these flagrant abuses are stopped, taxes will automatically be reduced.

An analysis of some of the obvious reasons for high taxes will point directly to your solution to the problem.

Thank you for this opportunity to tell my story and express my views before your committee.

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

Are there any questions?

Senator LONG. Mr. Newton, as I understand it, you say that money is being squandered up there in Connecticut because the Federal Government is matching for so-called accelerated public works programs that are not needed. I believe that is correct, that is your statement?

Mr. NEWTON. Sir, we have some of these programs which were covered by that appropriation in 1961, before the Federal Government stepped into the picture, and some of those very same projects were put on applications to obtain more money from the Federal Government.

Senator LONG. I know the Government is slow to move on some of those things, and that probably helps to account for it, but if your

people up there have Federal matching for some things they do not need, why don't you turn it back now? We have a number of things in Louisiana where we are very much in need of some Federal matching. They turned us down on three projects out of four that our people requested, and some of our people are in very bad need. There is bad unemployment.

Why don't you people turn that money over?

Mr. NEWTON. Senator, I, as a citizen, have been following it for some time. I have no official responsibility with the administration within our hometown, and it seems that a citizen in his hometown can go to a town meeting or he can go to the official of that town and sit down and talk about the problem. But when the Federal Government gets into the picture it is pretty hard to do anything about it.

Senator LONG. I do not know about that. Up in the Fourth Congressional District of Louisiana, where there is a very substantial amount of unemployment, those people up there only asked for two projects, and both of those were in one small city.

Now, out of a whole congressional district there are only two applications, and those came out of one little city that needs some help, which did get about $25,000 of matching.

I think in the whole fifth district they only asked for about three projects in the whole congressional district, and if those people can restrain themselves to that degree, why can't your people up there, who certainly have a much higher per capita income than our people have, restrain themselves from matching on things which are not needed. Why not put it back in the program so that somebody can get it in Louisiana where we might need it or in West Virginia where we know they need it.

Mr. NEWTON. Well, that is up to you people to do, distribute it where it is needed.

Senator LONG. But assuming that money should never have been spent in your hometown, it takes two to bring about that result. One is you folks at the local level, and two, is somebody who made a mistake at the Federal level.

Mr. NEWTON. That is right.

Senator LONG. If the money is being wasted in Connecticut, in your hometown, I am sorry to see that. But I do not know why you people want to insist on bringing it about if that should be the case.

Now, down in my State we have a number of projects where we need some Federal matching and have not been able to get it, and if you can help us to get it down there we would appreciate your doing that part of it, to turn your part over and give it back to where we can use it.

I can show you a number of projects that are extremely more justified than that, in Louisiana or in West Virginia where, I think you would find they need it worse than that.

The CHAIRMAN. Thank you very much.

Senator DOUGLAS. Mr. Chairman, may I say there is one feature of Mr. Newton's testimony that I think should be commended, and that is the fact, as I understand it, he came here at his own expense; isn't that true?

Mr. NEWTON. Yes, sir.

Senator DOUGLAS. You are not being sent here by any organization, isn't that true?

Mr. NEWTON. That is correct, sir.

Senator DOUGLAS. As we all know in these matters, one of the great difficulties is to get small taxpayers and the people represented rather than merely those representing organizations who get fees for testifying, and expenses, and so forth, I think probably we are enriching the lawyers and lobbyists with respect to this bill, Mr. Chairman, by hundreds of thousands of dollar and possibly millions of dollars, and so I do think the witness does need to be praised for the public spirit which he shows in testifying, and I want to thank him personally.

I think, perhaps, you should appreciate our problems a little bit more. If you take the total of appropriations you will find that $52 billion, roughly, goes for national defense; $10 billion for interest on the existing debt; $6 billion or a little over for veterans; approximately $5 billion for atomic energy; $5.4 billion for space; and when you add all this up and try to cut, as many of us have tried to cut, it becomes very, very hard to get reductions.

Sometimes in the appeal for decreases people do not realize the pressures under which the National Government operates, national defense and security, and those features, and all too frequently when suggestions for economy are made they come out of, they are proposed for measures which would help the great majority of the American people. That seems to excite the opposition of many people who do not balk at an expenditure of $5.4 billion to put a man on the moon, which continues year after year.

I urge you, therefore, and I say this with real feeling for your public spirit in coming——

Mr. NEWTON. Thank you, Senator.

Senator DOUGLAS (continuing). To really consider where the appropriations go, and also really there are a lot of very needy people in this country.

Close to 25 percent of the people, somewhere between 20 and 25 percent of the people, are living on a poverty level. You may not see them. They are invisible to the average prosperous people, but they are tucked away, I happen to be one, and many others like me, who believes that it is the function of society to try to help those people in the present, and also try to help them get out of poverty.

That is all I wanted to add, but I do want to praise you for coming.

Mr. NEWTON. Senator, I do not want to leave the impression that I am against Government spending. I am not if it is prudent.

Senator DOUGLAS. Fine.

The CHAIRMAN. Thank you very much.

Senator LONG. Let me also, Mr. Newton, compliment you for criticizing as unnecessary a Federal expenditure in your own hometown. Very few people do that.

Senator DOUGLAS. Generally it is somebody else's expenditure they are talking about.

The CHAIRMAN. Thank you very much.

The committee will adjourn to 10 o'clock in the morning.

(Whereupon, at 12:15 p.m., the committee was recessed, to reconvene at 10 a.m., Wednesday, November 6, 1963.)

REVENUE ACT OF 1963

WEDNESDAY, NOVEMBER 6, 1963

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, Long of Louisiana, Anderson, Douglas, Gore, Talmadge, McCarthy, Ribicoff, Williams, Carlson, and Dirksen.

Also present: Elizabeth B. Springer, chief clerk.

The CHAIRMAN. The committee will come to order.

The first witness is Dr. Roger Freeman of the Hoover Institute of Stanford University.

Dr. Freeman, take a seat, sir.

Dr. Freeman, I note that you have a 60-page statement. I would suggest that we could put it in the record and then you could make some comments about it. Is that satisfactory to you?

STATEMENT OF ROGER A. FREEMAN, SENIOR STAFF MEMBER, THE HOOVER INSTITUTION ON WAR, REVOLUTION, AND PEACE, STANFORD UNIVERSITY, STANFORD, CALIF.

Mr. FREEMAN. With your permission, Mr. Chairman, I will summarize my statement.

The CHAIRMAN. Without objection it will be inserted in the record.

Senator DIRKSEN. Mr. Chairman, some years ago, Dr. Freeman came before the Labor Committee, when I was a member, to testify on the aid-to-education bill. He was, by all odds, one of the most superb and knowledgeable witnesses that I have ever heard, and he had everything at his fingertips. I regard him as one of the really great authorities in that field.

Incidentally, he was very much opposed to the bill that was sent up here to spend approximately $5.3 billion in that field, and I am delighted to see that he is before this committee this morning.

The CHAIRMAN. We are certainly glad to have you, Dr. Freeman. You may proceed, sir.

Mr. FREEMAN. My name is Roger A. Freeman. I am senior staff member of the Hoover Institution on War, Revolution, and Peace at Stanford University.

For the information of the committee, I might mention that previously I served on the staff of the U.S. Commission on Intergovernmental Relations; I have served on the White House staff, on the White House Conference on Education; for some years as assistant to

the Governor of the State of Washington, and in several other Federal and State positions.

The opinions which I may express are my own, and not to be attributed to the institution with which I am connected.

In the course of the past 2 years, a broad consensus seems to have been reached that what this country's economy needs is lower taxes.

Organizations of labor and business as well as many other groups, Members of Congress, and even most economists seem to be agreed on this general proposition. Most of the disagreement concerns not so much the question of "whether" but "how" taxes should be cut, and under what circumstances, what conditions should be attached to a tax cut.

By and large, the disagreements may be grouped under three major headings:

(1) How tax rates should be cut. Should they be cut mostly in the lower, in the medium, or in the high brackets; in other words, should we focus on stimulating consumption or on investment and incentive?

(2) Whether the rate cut should be tied in with so-called tax reform, that is, a narrowing or elimination of certain credits, deductions or exemptions; and

(3) Whether a cut in tax rates should be tied in with corresponding action on the expenditure side, that restraints should be placed on spending, or whether a curb on spending would nullify the economic benefits of tax relief.

The President's proposals and the bill before your committee appear to take a rather clear stand on these three questions.

The President, in his recommendations, suggested that the aggregate tax liability in the lowest income bracket be reduced 39, or close to 40 percent; in the highest bracket 9 percent, and graduated in between.

This was changed only very little by the House. It now runs from 38 percent in the lowest bracket to 13 percent in the highest bracket. The corporation taxes were to be cut from 52 to 48 percent, which is an 8-percent reduction. In other words, both the President's recommendations and the bill as passed by the House would tend to make our tax structure somewhat more steeply graduated or more progressive than it is at the present time.

Very little is proposed to be done on tax reform. In the year 1961 the difference between personal income, as defined by the Department of Commerce, and taxable income as it appears on the tax returns, was $235 billion, and neither the President's proposals nor H.R. 8363 would change that to any significant degree.

In fact, of the 16 changes in the bill which have a revenue consequence, 8 would increase revenues, 8 would decrease revenues, and, in the end, there would hardly be any broadening of the tax base if this bill were enacted as it stands at the present time.

On the question of tying in tax cuts with spending, there were amendments proposed in the House Ways and Means Committee and in the House itself that would have provided some restraint on spending; they all failed by narrow margins.

In my testimony I propose to discuss these major three issues and I would like to state my conclusions in advance.

It seems to me that the tax cuts which are proposed in H.R. 8363, which are estimated eventually to total about $11 billion, will, of

course, provide long-needed relief to many persons. They will give the economy a shot in the arm.

They are, however, in my opinion, not likely to stimulate the economy as much as an $11 billion tax cut could do if it were differently designed. I question very seriously whether the bill, as it now stands, will make a lasting and strong impact on unemployment.

No. 2. I believe that tax reform and revisions are necessary in our tax structure.

It seems to me, however, that at this point the most urgently needed type of tax reform is a lowering of the income tax rates, and this action, I believe, should not be delayed by tying it to some difficult and highly controversial reform issues.

No. 3. To cut taxes at a time of heavy budgetary deficits and an increasing rate of spending may temporarily produce favorable results in the economy. It seems to me, however, that in the long run it will prove self-defeating.

The counterargument usually is that there are several areas of public expenditures which need strengthening and that the Federal Government ought to help. This may be true, but it seems to me that the Government could aid more effectively in other ways than by initiating expenditure programs. I am using, specifically, the example of tax credits for educational expenses in colleges and universities.

Senator TALMADGE. Would you yield at that point, please?

Mr. FREEMAN. Pardon me?

Senator TALMADGE. Would you yield at that point?

Mr. FREEMAN. Yes, sir.

Senator TALMADGE. I realize, of course, there is some merit to grant tax deductions for someone who is fortunate enough to have children in college. But would not that method of deduction be discriminatory against those taxpayers who do not even have the means to send the child to college?

Mr. FREEMAN. Obviously, tax deduction will be of benefit only to those who do send their children to college. Most parents in the lower income brackets who have children in college, and who are in such a low bracket that they pay no income taxes, I believe, have the children there on a scholarship.

It is, however, possible, even under a tax credit bill, which is what I am proposing, and what I actually did propose a few months ago, when I testified before the Senate Labor and Welfare Committee, rather than deductions or exemptions whose benefits would mostly go to persons in the higher brackets. I suggested a tax credit which starts out at the lower tuition level at 100 percent and then gradually decreases as the tuition goes up.

Now, if this were felt necessary, it would be possible to make this not a conditional but an absolute credit; in other words, a father with children in college would figure his income tax, and, if after adding this credit for tuition and fees, he comes up with a credit balance on his income tax return, he would be entitled to a refund in cash from the Internal Revenue Service.

I personally am somewhat doubtful that this is necessary, but, of course, it is a possibility. We would then provide the benefits, unless the parents do not pay the tuition themselves. If the fees are paid out

of a scholarship, then, of course, the parents would get no benefit from this.

In other words, I will repeat here what Senator Humphrey said who, about a week after I testified before the Labor and Welfare Committee, introduced a proposal to implement this plan, quoting from my statement. He said that this plan will not solve all of the problems in higher education, and no single plan can possibly do that, but it will make a major contribution toward solving the financial problem in higher education.

Senator TALMADGE. Here is the point I am trying to make. It costs anywhere from $1,000 to $3,000 a year now to send a child to college. It varies depending upon the college, whether it is a State institution, a private institution, and so forth.

Now, a family in the from $3,000 to $5,000 bracket normally could not afford that cost, even the $1,000 per annum cost. The only way their child could go to college, of course, would be either a scholarship or on borrowed funds.

Now, if you grant a deduction or some type of tax credit to the family who has a child in college, would not that be discriminatory taxation against those who are so poor that they cannot send the child to college?

Mr. FREEMAN. I do not believe so, Senator, because, in the first place, if you make a tax credit available to about 90 percent, at least 90 percent of parents with children in college, those in the upper and medium brackets, that would free scholarships, because many people with an income of, for example, $8,000 or $10,000 whose children at the present time do have a scholarship will not need it if they get a tax credit; in the second place, I would say that persons in low income brackets most likely have their children, at least in the first 2 years, in a community college. They will have them live at home so that the only expense at that time is the tuition, of which, if they are in a low income bracket, they may have been freed. Some States charge no tuition. In California, the State institutions charge no tuition and very low fees. It seems to me that the parents who do send their children to college and pay their expense should get some of the benefit.

I would say, however, this, sir: that the main purpose of my plan is not to give relief to the parents or to the students. The main purpose of my plan is to increase the funds of the institutions.

In other words, if you grant a tax credit starting from 100 percent and then gradually declining as the tuition goes up, you give the institutions an opportunity to increase their tuitions without putting a corresponding burden upon the families and the students. At the present time, I believe that the primary need is to help the institutions, the colleges and universities to get unrestricted funds.

The pending bill which is now in conference, and is going back to both Houses since the conference committee has agreed, will provide about $180 million in annual grants for construction. This is a small amount compared to the present more than $8 billion annual budget in higher education which is expected to double in the next 10 years or in less than 10 years.

Furthermore, the main need of institutions of higher learning, I believe, is not for construction aid. The main need is for increasing the faculty and paying higher faculty salaries in order to attract and keep in the academic life high-caliber people.

The construction bill will not do that, and I do not believe that there is a chance within the next 2 years or within a future which we can foresee to get through Congress a bill that would make available funds for general operations or faculty salaries, for reasons which I believe are well known.

Senator GORE. Mr. Chairman, the witness has not, if I may suggest, responded directly to what seems to me a pointed question by Senator Talmadge; that is, the inequitable treatment or discriminatory treatment as between taxpayers who have the income with which to send a child to college, on the one hand, and a family, on the other, who is unable to do it from current income, but does it either out of family savings or debt against the family homestead. That is where, it seems to me, the real inequity is, and Senator Talmadge asked you about it.

Mr. FREEMAN. I do not believe it is an inequity, sir.

If, for example, you have an outlay for State taxes or for interest, this is deductible from your adjusted gross income. If you do not have an expenditure for property taxes or for other kinds of State and local taxes, you cannot use it as a deduction.

The same thing is true in higher education. If you do have the expense, then I believe you are entitled to some recognition. If you do not have the expense you are not entitled to it.

Also, if you are in a low bracket most likely your children are, as I mentioned, either on a scholarship or you will have your child in a community college with a very low tuition fee, if any.

May I proceed now?

Senator TALMADGE. Certainly, sir.

Mr. FREEMAN. On the general subject of the tax cut, the consensus that income taxes are too high is of comparatively recent origin. Until less than 2 years ago probably the majority of economists and others said time and again that our taxes are not too high, that taxes have not hurt the economy, that we have shown very remarkable growth, and that the main need is for increasing public expenditures rather than for cutting taxes.

In fact, there is a group of economists who have suggested that taxes are too low and ought to be increased. That group is led, as you know, by John Kenneth Galbraith. It includes Alvin Hansen of Harvard, and several others who, for years, have contended and, I believe, still contend, that what we ought to do is raise taxes rather than lower them.

Even the President, in his tax message of April 1961 made the statement that "this message recognizes the basic soundness of our tax structure."

I would say that the consensus developed in 1962, the reason that many economists shifted from an approval of the present taxes to a recognition that they ought to be cut, was that the economy did not expand as much or not at the rate at which the Council of Economic Advisers had predicted it would in 1962, and that the prospects appeared to be dim that under the present tax structure the economy would grow as fast as is needed and hoped.

The question then, if we accept the proposition, and, at the present time, I believe a majority do, that our taxes exert a repressing influence upon the economic growth, the question is how taxes ought to be cut.

One suggestion is that it is the magnitude of all—of all taxes combined—which bears down on the economy. This seems to be a plausible

proposition but, frankly speaking, it is very difficult to prove it empirically.

Several countries which have economically grown much faster than the United States and are still growing faster, such as Germany, France, Italy, Japan, and several others have a tax burden—that is, taxes, as a percentage of the total national income or product—which are at least as high at ours or possibly higher.

At the same time, there are many countries in the world which have a lower tax burden than we have and they are growing quite slowly.

Now, this does not necessarily prove or disprove the theory. But I am afraid that it is impossible with our present knowledge, to say categorically that it is the size or the magnitude, of our taxes which exerts a repressive influence upon our economy.

To be sure our taxes have grown not only absolutely but relatively, and on page 9 of my statement table I relates the total revenues of all governments to net national product. It shows that since the beginning of the century the tax burden has grown from 9 to 34 percent.

If you relate government revenues to national income rather than net national product, you find that the precentage last year was 38 percent. If you relate it to personal income it was 39 percent.

There is a growing suspicion that the drag on the economy is exerted not so much by the magnitude of the taxes but by the type of the tax structure that is characteristic of the United States.

The American tax system is unique in the world. No other country relies as heavily on income taxes, particularly on graduated income taxes and on corporation taxes as we do. Nor is there a major country in the world that does not have as the mainstay of its national treasury a major consumption tax, whether a sales tax, an excise tax, or a value added tax. There are different types of consumption taxes, but every other sizable country has a major tax of this type. We do not.

I do not want to take the time——

Senator DOUGLAS. There are about $10 billion collected in Federal excise taxes.

Mr. FREEMAN. Yes, sir.

Senator DOUGLAS. Then there are many billions collected, I think it is somewhere, at least $18 billion, in State and local sales taxes.

Mr. FREEMAN. Yes.

Senator DOUGLAS. Making a total of $28 billion in sales taxes; and then there is about $12 billion more collected on the general property tax, so I do not think you can say that the tax structure of the Nation, taken as a whole, is exclusively weighted on the Federal income tax.

Mr. FREEMAN. That is correct, sir. I did not say it was exclusively weighted. I said the United States leans more heavily on the income tax than any other country in the world.

Senator DOUGLAS. I thought you said that we were the only country in the world——

Mr. FREEMAN. That leans as heavily on income taxes, I believe; and we are the only country which does not have a consumption tax as a major national revenue.

The CHAIRMAN. You may proceed.

Senator DOUGLAS. I think you should be careful about making a sweeping statement on that score.

Mr. FREEMAN. Yes.

I did not put the statistics in my statement because I would have expanded it too much, but I can back it up anytime.

The President's proposals and the tax bill, as passed by the House, would cut income taxes but not other taxes, and since the other types of taxes have been increasing relatively faster than income taxes since World War II, this means that the income taxes are relatively losing importance in our country.

However, the type of proposal put forth in the bill would make the income tax and our total tax structure more progressive than it is at the present time. I put the comparison in table II of my statement where I show the details of the reduction in the aggregate tax liability by income brackets.

The question is, What causes the economic lag? Is it that there is not enough purchasing power among the lower income groups or is there not enough incentive, not enough investment from the higher income groups?

I have the feeling that in the last few years a majority of economists have come to the conclusion, and I cite a few of them in my statement, that even those who are convinced, for philosophical reasons, that we should increase the progression in our tax structure, that economic growth could be promoted more effectively by broadening the base and by shifting the weight to consumption taxes.

I quote here particularly Mr. Samuelson from MIT, who made the statement earlier this year that the replacing of graduated net income taxes by indirect taxes such as Federal excises or value-added taxes, and I quote "represented too stiff a price to pay for some extra growth."

It seems to be widely recognized today that by having so much emphasis on steeply progressive taxes, we are deterring economic growth.

Some feel that we could stimulate investment.

Senator LONG. May I ask you this question, because I want to get it straight. I have not heard this point made in the hearings.

Mr. FREEMAN. Yes, sir.

Senator LONG. You contend in table II that the net effect of this tax reduction, as far as personal income taxes are concerned, will be to make the rates even more progressive than they are now.

Mr. FREEMAN. To make the total structure more progressive.

Senator LONG. Total structure more progressive.

Mr. FREEMAN. Yes, sir.

Senator LONG. Not the rates themselves.

Mr. FREEMAN. No; the individual rates will not be.

This is—table II, which is taken partly from the House hearings and partly from the report of the Ways and Means Committee states——

Senator LONG. So what you are saying is that by the time you get through taking the increases that result from the so-called reforms, and then allow for that, and then allow for these other things in the bill that are weighted in favor of those in the lower income brackets, the net effect is that our tax structure will be more progressive than it was before.

Mr. FREEMAN. Yes, sir; in other words, the aggregate tax liability of taxpayers in the bracket under $3,000 income will be reduced according to the bill, by 38 percent.

The tax liability of persons with $50,000 income and more will be reduced, according to the House bill, by 12.6 percent.

Senator DOUGLAS. Mr. Chairman, I do not want to detain the witness unduly, but I think he is concentrating altogether too much on the rates in the personal income tax field. The corporation tax rate is to be reduced by 4 percent, and the vast majority of corporate shares are owned by the 3 or 4 percent of the upper income groups in the population. The capital gains tax is being reduced from 25 to 21 percent, and virtually all of this goes to the upper income groups, and in addition to all this, since the income tax is becoming much less important in the total tax structure, it follows that the sale taxes, whether excise or retail, whether Federal or State, will be assuming greater relative importance.

Therefore, I do not think the conclusion can be quickly drawn that within the total tax structure the rates are becoming more progressive.

As a matter of fact, Mr. Chairman, I am having tables prepared on this which I should like to submit at a later date after I have had time to check them more carefully. But I think the record should show that Federal income taxes are the only taxes affected by this bill.

Mr. FREEMAN. Well, sir, the corporate tax, in being reduced from 52 to 48 percent, will be reduced by approximately 8 percent, while the personal income tax will be reduced by a more substantial——

Senator DOUGLAS. I understand. But the people who benefit from that corporate reduction are overwhelmingly those in the groups over $10,000 and, particularly, groups over $20,000 a year.

Mr. FREEMAN. But, in the first place, there is, of course, a question to what extent corporate taxes are shifted. They are partly shifted, we all presume. How much I do not think anybody really knows. But the relative reduction in the corporate tax is far less than in the personal tax. In the second place, due to the advancing of the taxpaying dates there will actually be no relief in taxpayment for corporations until the late 1960's.

Senator DOUGLAS. That is a transitional situation.

Mr. FREEMAN. Yes.

Senator DOUGLAS. Merely applying to corporations the same principle which is now followed, not fully applying to corporations. but attempting to apply to corporations the same principle now applied to taxation of wages and salaries; namely, paying taxes during the period in which income is earned instead of postponing it to a later date and having the use of money destined for taxes, so that it can be invested in income-producing securities.

Mr. FREEMAN. That is correct, sir.

But I would like to mention that in 1954 a reduction of the personal income tax and the corporation income tax was scheduled to the pre-Korea levels, and while it took place in the personal income tax, the cut in the corporate tax was postponed year after year now 10 times, so that a reduction of the corporate tax to 47 percent would be justified at this time, without even doing anything on the personal tax if we want to maintain the relative standing that existed back prior to 1954.

Senator DOUGLAS. I do not wish to unduly interfere with your testimony.

Mr. FREEMAN. Now, the basic economic question here is whether the most effective tax reduction should aim to strengthen consumer purchasing power or favor incentive and investment.

When we look at what has happened since 1956, because in 1957, as you may remember, the rise in unemployment started, which is still plaguing us—since 1956 this is what happened, we find this in table III: the lag was not in personal consumption, it was not in personal income, it was not in labor income, which has continued to increase. The labor income increased in constant dollars 25 percent, personal consumption 21 percent.

But business and professional income increased only 3 percent in constant dollars. I have both the figures for actual and constant dollars in table III, and in corporate profits they actually declined over that period, as did expenditures for new plant and equipment declined if converted into constant dollars.

Now, some feel that the way to stimulate investment is to increase purchasing power, because if the consumer spends more, and then the merchants will increase the orders to the manufacturers, and the manufacturers will expand their facilities.

This reminds me that for some years now we have heard about the so-called trickle-down theory, and the idea of stimulating investment by increasing consumer purchasing power I would call the trickle-up theory.

But if the laws of physics have any validity, I believe a liquid tends to trickle down faster than up.

Senator GORE. Mr. Chairman, might I ask a question?

The CHAIRMAN. Senator Gore?

Senator GORE. Might I ask a question here?

The witness is touching on a very important point, that is, what kind of effect the proposed tax cut would have. I find, interestingly enough, Mr. Chairman, that the majority report of the House Ways and Means Committee supporting the 1954 tax cut claimed for it the magic results which the advocates of the pending bill now claim for it.

What happened after this 1954 tax cut? Corporate profits after taxes jumped from a level of $16.8 billion in 1954 to $23 billion in 1955; $23.5 billion in 1956. But thereafter the story is somewhat altered, Mr. Chairman.

There was a period of large corporate profits, and there was an increase in capital investment, but the failure of consumer demand to rise sufficiently to sustain the production of the increased plant capacity then caused a drop in corporate profits in 1957 to $22.3 billion, and an even more severe drop in 1958.

So we cannot, it seems to me, look back upon this experience of 1954, when a tax cut was made in approximately the same percentage of gross national product as a basis for advocating a tax cut now. That cut in 1954 resulted not in a curing of our economic ills but rather, in the long run, perhaps a worsening of the situation.

I wanted to contribute that to your thinking and to your store of information and, incidentally, I want to express my own appreciation for the fact that you have come here without pay, without fee, and have brought us an enormous volume of statistical information.

I am not sure I agree with all your conclusions, but you must be a public-spirited citizen.

Mr. FREEMAN. Thank you, sir.

As you may recognize, possibly by my accent, I was not born in this country. I feel I do owe a debt, and whatever I can do I always will do.

Thank you, sir.

Senator GORE. May I ask a question now?

Mr. FREEMAN. Yes.

Senator GORE. Were you aware that the 1954 tax cut did, in fact, stimulate higher corporate profits for a period, higher investment for a period, but not a corresponding accretion in consumer demand?

Mr. FREEMAN. I have two answers to that, sir. The 1954 tax cut did stimulate the economy temporarily but not in the long run. This is exactly what I suggested a little bit earlier would happen under the bill H.R. 8363, that it would provide tax relief, it would be a "shot in the arm" for the economy.

I do not believe, however, that it would stimulate the economy as much as a tax cut of that size could if it were differently designed.

The other point is that since 1954, we have, I think, learned a great deal. There are two things: in the first place, if you take the time since 1956, since the economy has taken, I would not say a downturn, but since unemployment has increased sharply, and since the growth has been slightly slower, since that time consumption has continued to increase, but investment has turned down, and corporate profits have not increased.

Incidentally, corporate profits as related to gross national product have consistently declined since about 1950.

The other point I would like to make is this: We have learned since 1954, some things which we could not know at that time, and I have that story starting on page 15 of my statement. We have since watched the countries of the European Economic Community grow at approximately twice the rate of the United States.

In fact, I showed on page 15 that between 1950, and 1961, which is the last year for which we have the complete data at the present time, the gross national product in the United States on a constant dollar basis increased 40 percent, and in the EEC countries 82 percent.

Table IV shows how the various segments of the economy have shifted in the United States and in the European countries:

In the United States, consumption expenditures as a percentage of gross national product have declined 3.8 percentage points, but in the European countries they have declined 6.7 percentage points.

You will find that the Government share increased 6.9 percentage points in the United States, only 1.4 percentage points in the European countries.

But the most significant shift between the European countries and the United States is the simple fact that capital formation and stock changes in the European countries increased 3 percentage points, in the United States, they declined 3.5 percentage points.

I could continue with these statistics, there are many; some of them in my statement; but the significant difference between the European development in the fast growing countries and the American development in an economy that has grown slowly and that has heavy unemployment, has been that consumer expenditures here have increased relatively more than in Europe, and capital investment has increased more in Europe than it has here.

There are several studies, and particularly a major work by Simon Kuznets which came out about 2 years ago "Capital in the American Economy," which traced economic trends back to the 19th century. I showed that it is capital investment which stimulates growth rather than preference for consumer purchasing power.

If it were possible to accelerate growth by increasing consumer purchasing power through spending, very few countries would have a problem. It would be quite easy for the governments of many of these countries to increase their spending, to have wages increased, and then experience economic prosperity.

I have served on foreign missions in some of these countries. I was sent to Bolivia by the U.S. Treasury and State Department some years ago as financial adviser to that Government, which tried to solve its problems by operating the printing press until the peso was worth only one fourteen-thousandths of $1 when originally it was about the equivalent of a dollar.

I have lived through several inflations of this type, so I am quite aware of the fact that to try to strengthen the economy this way may temporarily help but, in the long run, will probably be self-defeating.

Senator RIBICOFF. Dr. Freeman, would you be good enough to explain—there is some confusion in my own mind——

Mr. FREEMAN. Yes.

Senator RIBICOFF. When you keep on comparing the economic growth of the European countries as against the United States, is this an invidious comparison? After all, the European economy, most of it, was destroyed by the war; the American standard of living was much higher, the American industrial plant had gone so much further ahead than the European countries. They had much more to grow to than the United States today has to grow to, but yet they keep on comparing economic growth in the European countries with that of the United States to the disadvantage of the United States.

Is that a fair comparison or unfair comparison?

Mr. FREEMAN. I would agree with you, sir, that in the economic field we are not as fortunate as, for instance, researchers in chemistry or in physics who can run test series, maybe 10 or maybe a hundred or a thousand tests, and then come up with a definite answer.

In economics we cannot do that. We cannot experiment, and we can only arrive at certain conclusions through general comparisons, which are not in every case by themselves conclusive or definite. We can only say that we have these facts and these comparisons, and the indication is that quite likely this or that is happening. There is nothing absolute about it.

I would not say that these interstate comparisons prove the proposition. But I advance historical comparisons, theoretical considerations, and interstate comparisons.

You are perfectly right, of course, sir, that a comparison between two countries always has some shortcomings, partly because the economies are at a different stage, at a different level; partly because these statistics are not always fully comparable, and for several other reasons. After all it is a multiplicity of factors that influence the economy.

At the same time, we ought to be able to judge from the experience of other countries and experiences we have had ourselves in the past,

what happens and why. What has happened in this country since 1950 is, by and large, that relative to those other countries, consumption has expanded, although the consumption standards in those other countries were far lower and still are lower than ours.

While it is correct that we were in 1950, economically and industrially more advanced than some of the European countries, due to the war and several other reasons our consumption standards also were far higher than the European countries.

At the same time, as I point out here, the European countries cut back—relatively, not, of course, in absolute amounts, but as a share of the national economy—substantially in consumption. They kept consumption down deliberately because they felt that the way to make their economy grow faster was by investment rather than by consumption.

It is the same experience which, under purely governmental control, the Soviet Union has had, where deliberately consumption is being held down in order to put the money into heavy investment. What is holding back investment in this country, I believe, is the reduction in the profit share.

If you relate corporate profits either to national income or gross national product or to sales or to net investment or to any factor you care to select, you will find that in the long run these profits have relatively declined.

This does not prove a causal relationship. It only suggests that there may be a causal relationship. So often we do not have the proof as clearly as we could have it in chemistry, but there are many individual signs which point to that condition. I would not say that it is an absolute proof which, I believe, in this field is virtually impossible to obtain.

I do want to point to several studies and, particularly, to a study, published a few months ago, by George Stigler, of the University of Chicago, who is now president of the American Economic Association. He found historically a very strong correlation between the rate of return on investment and new capital investment.

In fact, if I remember right, the Economic Report of the President in 1962 pointed out, I believe I quoted it somewhere in my statement, that what was lagging, what caused the lesser growth of the economy than expected, was not a failure of consumption but a failure of investment.

Senator LONG. If I might just ask you a question there——

Mr. FREEMAN. Yes, sir.

Senator LONG. You are basing your case at this point on this table IV, and I have just been studying it some to see what that table means. You relate to a shift in shares of gross national product in the United States——

Mr. FREEMAN. Yes.

Senator LONG (continuing). And EEC.

I was confused when I first looked at it because I thought you were suggesting that we had less private consumption in 1961 than we had in 1950.

Mr. FREEMAN. No.

Senator LONG. You are not saying that. We had more. You are saying that other things increased relatively more than private con-

sumption did in the United States. But that, on the other hand, while private consumption relative to all the other things, to everything else in the economy, increased, it did not increase as much; it tended to increase more relatively in relation to other things than it did in Europe.

But it seems to me when you make that kind of comparison the basis, as your starting point, is so different here from that in Europe that I do not see that it has any meaning at all.

In other words, we do not know whether they were consuming too much or too little or what the relative requirements were for industry over there as they were over here.

If our industries were very fully developed and mechanized, more so than theirs, they would need to mechanize theirs more than we would. I cannot see with the tremendous difference there is between what the situation was in this country and what the situation was in those countries, I cannot see that it proves anything to say that their relative increase in private consumption was not as great as ours. You understand my point?

Mr. FREEMAN. Yes, I understand your point, sir.

The question is, How can we gain economic knowledge? One way is by pure theory, by logical reasoning. But then somehow or other we have to verify our reasoning by the facts. We can only study cases which are or were in existence. So we must survey other countries.

My table IV is based on statistics of OECD. They combined the economic statistics of six European countries into one average. That may not prove anything, but if you take the individual countries one by one, or if you compare our economy with that of many other countries, you will find roughly the same picture. If you find consistently that some countries have relatively cut back on consumption, by various means, partly are in the tax field and partly in other fields, and have succeeded in stimulating investment, and then grown fast and we, who have done the opposite have grown more slowly, then this at least suggests the possibility of a causal relationship. It does not necessarily prove it.

At the same time, if you go back historically in the United States, as I did in table III, you will find that personal consumption has continued to increase, but profits have not increased in constant dollars, and expenditures for plant and equipment have not increased.

If you follow it further——

Senator LONG. Yes, but let us just take this point. Let us assume that as your starting point——

Mr. FREEMAN. Yes.

Senator LONG (continuing). We have the most modern machinery in the world as our starting point, and those people have very backward, inadequate, inefficient machines, and they had a war going on over there, and they had a lot of it destroyed.

Mr. FREEMAN. Yes.

Senator LONG. Now, you compare the two and you say: "Well, the record shows those people did the wise thing by concentrating on rebuilding their factories." If they are building them to the same standards that we have, how can you say that would be the thing for us to do when we already have the most modern machines in our factories?

Mr. FREEMAN. The fact is, sir, however, that according to several reports at the present time, on the average, the plant equipment in some of the European countries, such as West Germany and France is of more recent origin and more modern than our own.

I point out what is happening at the present time. You are perfectly correct, of course, in saying that much of the European machinery was either destroyed or was not renewed during wartime and, therefore, they were in 1950 behind us.

If, however, you take the figures for 1961, which are the most recent ones which I had available, you will find that even at the present time they are investing a larger share of their national product in capital formation, in business plant and equipment than we are.

So that while at the present time we ought to be investing more heavily, we are not doing it, and the only reason I can see for the fact that we are not doing it is that there is not enough profit in doing so.

Senator LONG. But now, on the other hand, do you know of any particular commodity of any magnitude that we are not producing in full supply, and with excess capacity? Isn't it true that with regard to practically everything that our people have any need of in this country, our factories are not operating overtime, and a lot of them are operating far less than full time, and we have a substantial labor surplus?

Mr. FREEMAN. I was planning to talk about the unemployment picture in a few minutes, but if you prefer it I could take it up now.

Senator LONG. Well, the point I have in mind is that unless we are able to expand the sales of various commodities that are rolling off our production lines today, if we just go in for more automation, with bigger machinery and more efficient machinery, I do not see how we will do anything but just simply displace more labor.

Mr. FREEMAN. I will say this, sir——

Senator LONG. I am for more efficient machinery. I hope you understand that.

Mr. FREEMAN. That is right.

Senator LONG. But, at the same time, if we cannot expand the sales, on the other hand, if the public does not have money to spend to buy these commodities, how can any one justify producing a whole pile of products, I do not care whether they are steel or automobiles, for which they have no sales?

Mr. FREEMAN. The reason, of course——

Senator LONG. The way you operate your business is to shut it down when you cannot sell what is coming off the production line.

Mr. FREEMAN. Yes, and the reason we cannot sell enough is that the prices are too high, because the costs are too high.

I spent quite a few years in the retail business in the controlling end of the business. I was connected with R. H. Macy & Co. for some years quite a few years back, but I still remember my lessons from the time.

Senator GORE. Would the Senator from Louisiana yield?

Senator LONG. The witness would want to answer what I asked.

Mr. FREEMAN. If we cannot sell enough of our products, then the major reason is that our costs and prices are too high. Furthermore, it seems to me, that consumer purchasing power can best be increased by providing more jobs, and this will be done if business invests more, and builds new plants. Every job at the present time requires an

average investment of between $20,000 and $25,000, the capital requirements are very substantial, and these capital investments will not be made unless the profit prospects appear sufficiently promising.

Now, as to the purchasing power, I would like to refer you to table V where I show the distribution in shares of personal income going back to 1929. As you know, 1929 is the earliest year for which our economic statistics are available.

You will see that the shares of labor income and transfer payments—transfer payments are mostly welfare and social security—which are going to consumers, increased from 61 to 76 percent. Even since 1950 and since 1956, in a period of unemployment, the share of labor has increased; the most recent figure, I have there is for September of this year, seasonally adjusted. You will see that the share of dividends and business and professional income has consistently declined from 17 to 11.6 percent.

You will find that the share of all other personal income in the country, has declined from 29 to 12.1 percent. In other words, the change in the income distribution in this country as between labor and property and business has been dramatically in favor of labor.

I have in table VI the distribution of family personal income by size. It is computed in constant 1962 dollars, and you will see that the percentage of families with an income under $4,000 has consistently declined; figures for the year 1956 or 1957 which I would have liked to use, were not available in the statistics of the Department of Commerce, they did not compute it, otherwise I would have put it in there, but you will see that even since 1959 the percentage of families in the lowest bracket has declined, and in the highest bracket has increased.

In other words, income in this country not only has been increasing, it has increasingly been more widely diffused. It has been accumulating in the medium and lower brackets. In fact, there are very interesting comparisons you could make between this country and most other countries in the world as well as along historical lines.

Historically in this country and in all others, income was distributed in the shape of a pyramid, with a great mass of low income people or poor people at the bottom, narrowing to very few rich people at the top. This is still the case in many other countries in the world.

In this country income is distributed in the shape of a diamond. That means that there are a few rich people at the top, there is a narrow base of few poor people at the bottom, and there is the great mass of people in the middle, with middle incomes. Even those whom we call poor have a standard and an income which is envied by the workers in most other countries.

Now, I think I will not go into——

Senator LONG. I am pleased to hear you say that for one reason. I made a trip to the Soviet Union, and I was pleased to find, after I made a study of it, that my best study indicated that a person living on a welfare check in my State was living about as well as the average worker in the Soviet Union which, to me, was a matter of some encouragement anyway.

Senator GORE. Would the Senator yield?

Senator LONG. Yes.

Senator GORE. I have for some time wanted to get into the record of this hearing the relative productivity of American and European

workers, and since this has been a subject of discussion, I was wondering if the Senator would be so kind as to let me give some figures on that.

Output of U.S. agricultural workers is 2½ times that in France and Germany; American railroads hire 3.7 employees per mile, Germany uses 16.2, the United Kingdom 29.2, and Russia 29.6.

In steel we have a narrowing of the productivity gap, but partially because U.S. money has brought about a modernization of the European plant. But even here the U.S. steelworker produces 220 tons, the German steelworker 174, the Japanese 99.

So I thought, with the Senator's permission, I would like to point out that, despite the use of our money in modernizing the plants of Western Europe and Japan, and the fierce competition they are giving us, the productivity of the American worker is still the greatest of any nation in the world.

Senator DOUGLAS. Mr. Chairman, may I ask the Senator from Tennessee a question?

Do you have figures on per capita production in coal?

Senator GORE. I do not have them with me.

Senator DOUGLAS. As I understand it, and I think, perhaps subject to correction, the average output of coal per man-day in the United States is approximately 13 tons. In England the production is only a little over 1 ton a day. I think you will find that in Germany and in France it is not much greater, and there are many causes for this, but it is true that production costs, even with the high wage scales in the United States are much lower than they are in Europe, and if Germany had low tariffs or permitted coal to come in, we could sell coal, transport it across the Atlantic, take it up the Rhine, and go at least as far as Cologne, and undersell German coal.

I think what the Senator is doing is very valuable. We are always self-critical of this country. It is a good thing we are, but at times we sometimes downgrade what we have achieved.

Senator GORE. I thank the Senator from Louisiana.

Senator DOUGLAS. I thank the Senator from Louisiana, and I apologize to the witness.

Senator CARLSON. Mr. Chairman, I have an 11:30 appointment I must keep.

I want to compliment Dr. Freeman for the excellent study he has given to the committee, along with many other witnesses. I know of few who have had a more complete paper.

I was hoping that you would get into the problem of unemployment in this country before I had to leave, because we are, I presume, passing a tax reduction bill to increase the economy, increase the gross national production and to decrease unemployment.

I was interested in reading one sentence in your statement:

> The industry could have employed, at regular hours, all of its workers and all of its unemployed—and still have had to get over 2 percent of its work done on overtime pay.

Then you quote Labor Secretary Wirtz, and you quote him as saying this:

> I think we have got to start asking whether things are working right if 7 percent of our work is being done on an overtime basis, when we have got 5 to 6 percent unemployment.

The question I want to ask is do you believe a tax reduction would change that situation?

Mr. FREEMAN. No, sir; I do not think so.

Senator CARLSON. Well, I am greatly concerned about this tax bill as it affects unemployment, and I sincerely hope we can be of some assistance in it.

I appreciated that statement. Thank you very much.

Mr. FREEMAN. Thank you, sir.

Of course, Senator Douglas, you have pointed out very correctly and I agree fully with you, that the productivity of the American worker in most cases is higher than that of the European worker.

In coal we happen to be in the fortunate position of having far wider coal seams than Great Britain which, of course, has an effect on output.

But in the case of most manufacturing industries, our wage rates are relatively higher than our advance in productivity.

The last time I visited Osaka, which is the Japanese Pittsburgh, they showed me data that they can deliver certain types of Japanese steel, wire steel, and some others more cheaply in Pittsburgh than Pittsburgh steel.

I could give you a few other examples. The proof of the pudding is that while we still export more than we import, we have lost competitiveness in many areas, and from ocean freighting down to automobiles. We used to be a net steel exporter for many decades, and we are now a net steel importer. We have become deficient and less competitive to some of the foreign countries in many products.

Now, if I may I would like to talk about the unemployment picture which is widely regarded and, I believe justifiably so, as the most serious aspect of our total economic picture. Everybody would like to have his income increased. But if it does not increase faster, most of us can get by. But the people who are really hit hard are the unemployed. That is a serious social and economic problem, and we have to be concerned about it.

The latest figure which I have for September showed that the unemployment was 4.8 percent of the civilian labor force, and if seasonally adjusted, 5.6 percent.

But in the same month, in September of this year, the number of hours in manufacturing—and manufacturing is the only industry for which the Department of Labor compiles those data—the number of hours paid for at a premium, that is, overtime pay, equalled 7.4 percent of all hours.

A few years ago unemployment was relatively higher than the incidence of overtime pay. We can assume that most industrial managers do not pay 50 percent overtime premium pay unless they have to, because obviously all industries are in competition, and they like to keep their costs down, as much as they possibly can.

So the only reason I can imagine that they do keep such a large force on overtime pay is that they are unable to get at normal rates enough workers who are competent to perform the job.

In other words, there are many workers whose time is worth at least 150 percent of the basic rate while, at the same time, there are millions of workers available whose time apparently is not worth the basic rate or else they would be hired.

Senator RIBICOFF. How would you go about correcting that structural unemployment? That is the problem, to follow along with what Senator Carlson asked you——

Mr. FREEMAN. Yes.

Senator RIBICOFF (continuing). How would you go about correcting this problem of structural unemployment?

Mr. FREEMAN. I believe that our wage rate structure has become unbalanced.

Many reports tell us that what has been happening is that because of technological development, the demand has increased for higher skills, while many of the lower skills have become superfluous and can no longer be used, and that for this reason we have heavy unemployment of low-skilled persons and little unemployment at the high-skill levels. I have specifics on page 25 where I show the unemployment rates of the various occupational groups.

You would expect a skill which is scarce—just like a merchandise which is scarce—will relatively increase in price, and a skill which is available in surplus will relatively decline in price.

But what has been happening in the long run in this country—and I have a few data on that—is that the pay of the low skills has increased relatively more than the pay of the high skills.

In other words, in the professional and technical fields, earnings have increased relatively less than among the manual workers and even within the manual groups wages have increased percentagewise less, for the foremen and for the craftsmen than for the operative or factory worker. The pay rate has increased less for the factory worker than it has for the common laborer.

I just cite a few data on that. I did not want to get too deeply into statistics. They can easily be supplied.

Now, there seems to be a paradox. If we have a shortage of professional and technical workers, and a surplus of unskilled workers, how is it possible that the wage trends move in an obviously illogical direction? The only explanation I can possibly offer is that these wage rates were not set by the market, not by supply and demand, but by nonmarket forces, partly through collective bargaining, in union contract with Government participation and pressure, and partly by minimum wage laws.

It is socially understandable that we tend to increase minimum wages, because we want to help poor people.

I read in this morning's paper that the AFL presently is proposing a minimum wage of $2 an hour.

Now, as I mentioned a little bit earlier, I spent some years in the retail business with R. H. Macy & Co., and sometimes there were some goods we could not sell. We usually then found that the price was too high and that we could sell the goods if we marked them down. If somebody had suggested that we ought to raise the price of an item we could not sell, it would have been very favorably received.

If we were to raise minimum wages or wage rates at the lower levels of skill that would not mean that there would be more jobs for those people.

Companies hire workers if they can economically use them. Why do they use so many people at premium pay, and why are about 5 percent of our labor force now holding two or more jobs while, at the same time, 5 percent are unemployed?

The only reason I can think of is this: There is a large number of men and women whose work output is not worth the wages they would have to be paid. Therefore, they are not being hired. If it were economically justified to hire them they would be hired.

I think I have a citation here—from Senator Douglas' book which—I presume——

Senator DOUGLAS. I read that. I knew this was coming.

Senator ANDERSON. This is probably the wisest thing you have said all morning.

Mr. FREEMAN. What?

The CHAIRMAN. What page was that?

Mr. FREEMAN. I cited a few examples here.

As you know, unemployment is now relatively small among men of middle age; in fact, I think the 35 to 44 group has an unemployment rate of 2.1 percent which equals about 1 in 48.

Among married men, heads of households, the most recent figure, I believe, is 2.6 percent, which means about 1 in 38.

But among those who are not heads of households the rate is between 5 and 11 percent. That indicates that heads of households are under greater pressure to earn wages than are other groups. They may usually work, but can get by if there is another earner in the household.

There is a significant lesson we can learn from youth unemployment. As you know, by far the highest rate of unemployment prevails among our young people. The most recent figure, of 16- to 19-year-olds is about 15 percent unemployment, which is seven times the rate in the medium ages.

A study which our Bureau of Labor Statistics conducted in 1962 showing comparison between us and Great Britain revealed an amazing picture, and I am quoting here, that "in Great Britain the unemployment rate for young people aged 15 to 19 has generally been lower than for any other group, having seldom gone much over 1 percent in the postwar period."

Why does Great Britain have so little or practically no unemployment among young people? Less than 1 percent really is no unemployment. Why do we have a 15 percent rate of unemployment among the young people?

In Great Britain, and I spent quite some time there, young people get a different training in schools. I am afraid that takes us somewhat far afield, but the occupational training in Great Britain is far better.

They do not have, with a few exceptions, so-called comprehensive high schools, which try to educate in one class pupils of very widely disparate ability, nor do they promote them each year by residence.

The other major reason, besides occupational training in Great Britain compared to ours, is that in Great Britain when youngsters leave school at age 15 or 16, they must go through several years of apprenticeship, during which time they get paid only pocket money. The contribute very little to the employer but will be hired for pocket money because those who gradually acquire skill, will after several years be worth a regular wage.

In this country, however, they would have to be hired at regular wages, and many of them are not worth those wages.

In other words, by the skill they command after school, and in many cases also by their attitude and by various other factors, they are not

worth $2 or $1.50 or $2.50, whatever the rate may be, and they are not hired for that reason.

What causes the heavy unemployment among the lowest skills is not that the jobs do not exist any more. The jobs do not exist at the wage rate which the young people would have to be paid according to a legal minimum wage or under a union contract.

The reason that there is no unemployment among low skilled people in Europe is wage rates which correspond to their productivity. Senator Long mentioned conditions in the Soviet Union, where there is no unemployment. You probably saw women cleaning the subways there. Our New York subways are dirty because we cannot pay the wages which they would have to be paid under union contracts to clean the subway cars. So we have dirty subway cars, and keep those people on welfare.

In Moscow women clean the streets and the subways—maybe it could be men, I would not describe a situation where mostly women are doing it as particularly desirable—but they get paid, I believe, between 35 and 50 rubles a month, if I remember right, which they are worth. But we cannot pay that kind of money.

Here they would have to be paid under far higher contract wages. So they are not being hired. If we—and again I have quotations in here from several other reports—if we tried to inject more money into the economy it would lead to higher wages for those who are employed because there would be greater pressure in contract negotiations.

There would be more overtime, there would be more multiple job holders.

As I mentioned, about 5 percent of all workers at the present time hold two or more jobs. But it would not lead to the hiring of many low-skilled workers who are not worth the wages they would have to be paid. What it would lead to is wage inflation at the higher levels. It would benefit those who manage to hang onto their jobs, but the really poor would not be helped.

Senator GORE. Mr. Chairman, since we seem not to be following a set pattern, and this witness is so provocative, may I ask a question?

The CHAIRMAN. The Chair recognizes Senator Gore.

Senator GORE. Even though I recognize it is somewhat out of turn.

You said a moment ago that unemployment among young people was 15 percent, is that correct?

Mr. FREEMAN. Yes.

Senator GORE. Can you give the ages there?

Mr. FREEMAN. Yes. I have that. In September 1963 the unemployment rate was 14.7 percent for boys, and 15.8 percent for girls 16 to 19 years old. The rate has been increasing while the rate for other unemployment has been slightly decreasing.

Senator GORE. Senator Ribicoff asked you some moments back——

Mr. FREEMAN. Yes.

Senator GORE (continuing). What do you propose as a means of solving this severe structural unemployment. It is more severe in the younger group than any other group, you say, and it strikes me that people in this age group are susceptible to training.

Mr. FREEMAN. Yes.

Senator GORE. Now, another aspect of structural unemployment concerns the people who are my age, in their fifties, who have lost

jobs. The possibility of training people in their fifties in a new skill is far more limited, it appears to me, than is the case with these boys and girls under 20.

Mr. FREEMAN. Yes.

Senator GORE. What would you propose as a means of making these young people employable?

Mr. FREEMAN. May I first refer to the factor, Senator, you just mentioned the age factor. The experience has been in some of the training programs that the decisive factor was not necessarily the age but the prior occupation. If that man previously worked in a skilled occupation and had the intelligence or competence to do well in one field, it was usually possible to retrain him for some other skill field with not too much time lost.

However, those with little if any skill in one field, and are of low intelligence, who never rose any higher than common labor, often cannot be retrained because they just do not have what it takes.

Of course, this is harder at a higher age than it is at a young age; there is no question about it. There is only a limited amount we can accomplish with a man 40 to 50 years old. We can try to help, but I believe the prospects are certainly not as good as if we would get them at the age of 15 or at 16; there is no question about it.

Senator GORE. You might be interested to know, and I was certainly surprised to find, that in one city in my own State, there are several industrial concerns that have a fixed policy against employing, anew, a person in his forties. One concern—I make no criticism of those companies; they have the right to adopt their own employment policies for their own welfare; I am not speaking critically of them. But one concern, a sizable one, had a fixed board policy against employing a man anew in its plant who was past 35.

Now, whether this was entirely because of the diminution of the skills and the agility of hands which comes with age, or whether it was because they would be nearer to retirement age, I do not know. I do not know all the factors. But this seemed to me a very disturbing condition to find—a disturbing social condition.

Mr. FREEMAN. I agree with you, Senator, 100 percent.

Senator GORE. Do you find this situation somewhat widespread in industry?

Mr. FREEMAN. The practice of promoting only from the ranks and hiring of young people only has been growing. It is not a new experience.

Now, one of the reasons is this: when a large company, which has a formalized employment policy, hires people, it always hopes that among 100, for example, there will be 5 or 10 or 20 who will be outstanding, who will advance to become craftsmen or foremen, and, possibly rise to supervisory rank.

If you hire young persons, you might get a certain percentage who will occupationally rise. If you hire a man of 40 or 45 who never advanced beyond the laboring stage, you know that that man is very unlikely to develop beyond that level.

A company may hire men who can do a certain job, but any hope of developing, out of that group people who have ideas, people who will help that company in advancing its production process is, of course, quite limited. This is part of the reason.

Senator GORE. May I point out one other thing which my distinguished colleague, Senator Talmadge, suggested here in an aside. The health hazard, the possibility of sickness, heart attack or other physical impairment, the incidence of which increases with age——

Mr. FREEMAN. Yes.

Senator GORE. Makes the company liable to greater payments for compensation.

Now, please understand again I am not being critical of business for considering these factors. They have a right to fix employment practices of their own.

But all these things add up to, it seems to me, this problem of structural unemployment which you say will not be solved by this tax bill.

Mr. FREEMAN. If you increase the flow of money to consumer pockets, I do not think that will help a man 40 or 50 years old who cannot be hired because his output is not worth $2.50 or $3, whatever he would have to be paid, and we do not help him by raising the standard wage rate because it makes it harder for him to find employment. We are really condemning him to unemployment.

Now, the typical case, I believe, is in the coal field where a wage of $24 a day seemed highly desirable, and I wish they could be paid more.

But what it means is that either a man is worth and gets paid $24 or he does not get hired at all. So, men go out on their own, as we have learned recently, work under inadequate safety provisions in little worked-over mines or do some strip mining for just a few dollars a day. They can do it on their own, but they cannot be hired at $16 instead of $24, although some would love to work for $12 or $16, and maybe he is not worth more. If the contract provides that you cannot hire anybody for less than $24, that does not mean that everybody will be hired. You simply create a hard core of unemployment of a growing number of people who have very little chance of getting any employment except for casual work.

Senator GORE. Are you about to say then, that the proposed bill might make structural unemployment worse instead of better?

Mr. FREEMAN. Yes, I do. Not initially. Initially it will help employment, but in the long run it may not.

I use, in my testimony, one particular example which, however, does not relate to the cut in taxes, but to increased Government spending, particularly to public works spending.

As you know, there is presently a bill under consideration in the House Public Works Committee. I may mention that, back in 1955 and 1956, I was concerned with the coordination of public works planning in the White House, and I have since done some work in that field.

At first, it may appear quite obvious that if we increase public works spending by, shall we say, $1 billion, we could hire about 100,000 additional construction workers.

Since unemployment in construction is heavier than in any other industry, it has been so for about 5 or 6 years, it seems to be a wonderful opportunity to employ 100,000 people in addition to those working at the present time. That might be the initial effect.

But the secondary effect would be less favorable.

Construction prices have been increasing ever since our statistics were established in this field, back in 1915, at approximately twice the

rate of other prices, whether wholesale or retail. I have the specific figures in my statement.

The effect of that has been this:

A modest house might have cost $2,500 in 1915. If we applied that amount to some other goods at wholesale or retail today they may today cost $6,500 to $7,500.

A house that cost $2,500 in 1915 would today cost between $14,000 and $15,000. So we have pushed many marginal people out of the housing market, people who cannot afford to buy the house at $15,000. If construction prices had risen only at the rate of other prices, they would be able to afford a house at $8,000 or $10,000.

If another $1 billion of Government contracts in public works were to be offered, it would strengthen the hand of construction unions in collective bargaining at contract renewal time. Construction wages have been consistently going up faster than manufacturing or other wages. If an additional $1 billion in contracts were offered, the wage rates, of course, would go up even faster than they have.

The net result of that would be that construction prices would go up and we would drive many more marginal people out of the housing market. We would employ by spending $1 billion in additional public works an additional 100,000 construction workers but might, in the long run, eliminate more construction jobs by reducing the number of people who can afford to buy their own home or rent an apartment in a new building.

Senator GORE. Of course, there are many factors there. One is the change in the quality, the inclusion of kitchen appliances, utilities, bath facilities. This in itself is an interesting subject. But I do not want to trespass too long. I want to come back to the question that Senator Ribicoff raised with you.

You told us many things which are not going to be helped. I am interested in this 15 percent unemployment in people under 20.

It seems to me that here is a place where something can be done. What would you suggest?

Mr. FREEMAN. The basic fault, in my opinion, is this: we are the only country in the world which has tried for some years to educate all of its youth in the same school, in many cases in the same classroom, up to age 17 or 18. No other country has tried to do that, and I do not think it will be attempted anywhere.

Other countries have a dual secondary school system. All children go to the same elementary school—universal education was established in many European countries long before it was established in the United States—but at an age which ranges from 11 to 15, there is a division between those who have the ability and aspiration to acquire an academic or professional education and who can think in abstract terms, those who will follow a manual occupation.

Senator GORE. I would like to yield to Senator Ribicoff.

Senator RIBICOFF. First, I want to ask permission of the chairman. I do not want to trespass from this end of the table to my senior colleagues on the committee, but I think since one of the rationales of this tax cut bill is that it is going to do something about unemployment, I think we have opened up a field that is very important and should be pursued. So many Government policies and programs seem to be centered on just this group of young people, whether they

concern juvenile delinquency, education, unemployment, or all the great range of social problems. I think this committee now has reached a very important part of our inquiry, but I would not go further unless I had the chairman's permission.

The CHAIRMAN. I agree with the Senator from Connecticut. Let me say I think that the statement that is now being made is probably the ablest statement we have had during these hearings.

Senator RIBICOFF. Getting back to the problems of school curriculums, is a lot of this due to traditions that have grown up, much of them having to do with the basic status and snobbery that exists in American society today, that there is something wrong with a person if he wears a blue collar instead of a white collar?

Mr. FREEMAN. This class distinction is far greater in Europe than it is in this country. Actually there is in this country a far greater respect for the blue collar than there is in Europe.

In Europe, as you probably know, class distinctions are much greater than here.

Senator RIBICOFF. I understand. But is this a school system that grows up in community after community across this land where you do not have adequate vocational education?

Mr. FREEMAN. Yes.

Senator RIBICOFF. So you have young men and young women who go to junior high schools and high schools, completely indifferent toward the courses that are being taught them, have no motivation, no will or they may not have the ability; so, consequently, there are school dropouts, and there is nothing in the school systems or school curriculums to encourage these young men or women to go into a trade or a vocation where they could be useful to themselves and society.

So we get back basically to a problem of looking at the educational system and not just the problems of juvenile delinquency or the problem of tax cuts or the problem of labor policy.

Mr. FREEMAN. Yes.

Senator RIBICOFF. Is a lot of this then to be traced to the curriculum policies that we have in our various school systems throughout the land?

Mr. FREEMAN. Yes, sir.

I have traveled through quite a few countries, and the American high school is a mystery and a wonderment to people everywhere. They can hardly believe, and they do not understand how we can possibly keep all children in the same class, promote them more or less automatically in most cases, year after year, up to age 17.

I once phrased it that the schools discovered the secret of perpetual promotion. I do not want to be facetious about a serious problem, sir.

Senator RIBICOFF. This is very serious because——

Mr. FREEMAN. Yes.

Senator RIBICOFF (continuing). I do think there is a basic weakness in many of the areas you are talking about——

Mr. FREEMAN. Yes.

Senator RIBICOFF (continuing). In certain areas where corrections have to take place. People are being promoted although they do not have the qualifications to pass; the school administrators and the school principals and schoolteachers are closing their eyes to reality,

and automatically passing pupils who do not have the qualifications. They end up as dropouts, they end up on the unemployment rolls, and end up as juvenile delinquents because America is afraid to face up to the realities of our educational system and the corrections that have to be made.

This has nothing to do with Federal aid to education. It has nothing to do with where more money is being spent, and nothing to do with tax bills, but this is a question of whether America will look with hard reality at the problems of its educational system in a modern society.

Mr. FREEMAN. Yes; I enthusiastically agree with everything you just said. I believe that what will be necessary to keep those youngsters in school is to offer them a program that really offers something to them rather than having them sit there not being able to compete with others in their class, not being able to participate.

The system discriminates against two groups: the gifted children who lose out because the rest of the class is holding them back, and the less intelligent, those with less drive, lose out because they lost interest, and leave school as soon as they legally can. To keep them just sitting there helps little. All we gain by it is that he gets a diploma, but he really does not learn much that helps him get a job.

So I think a great deal of the trouble is not related to money but to the curriculum.

How that can be changed takes us far afield. I have written books on education, as you probably know.

Senator RIBICOFF. You are strongly opposed to all Federal aid to education.

Mr. FREEMAN. I plead guilty, sir.

Senator RIBICOFF. I understand.

Mr. FREEMAN. Not to all forms. I do not know whether you noticed, but I have a fourth section in my statement today in which I very strongly advocate, as I have earlier before another committee, tax credits in higher education, a subject in which I know you are very much interested.

Senator RIBICOFF. Yes; and we intend to try to do something in this bill, sir.

But getting back to the problem you and I were talking about with Senator Gore in this committee, it has nothing to do with Federal aid to education.

Mr. FREEMAN. Yes, sir.

Senator RIBICOFF. Any locality or any State has its own standards of curriculums. I personally think the Federal Government should stay out of the curriculum.

Where do you think the bottlenecks or the difficulties come in changing curriculums in America to accomplish what you want to do concerning this fantastic 15 or 16 percent of unemployment among the 16 to 19 years of age?

Mr. FREEMAN. To find an answer, of course, is extremely difficult.

What started, as you know, the so-called progressive movement back in the 1930's which insisted that it was undemocratic to promote some children and not to promote others or to develop, as New York City did, separate vocational high schools and a high school of science, and so on, and that we should operate only comprehensive high schools, which everybody attends up to age 17.

The system was particularly promoted when in 1947 the Office of Education started its first commission on life adjustment education.

What seems to me quite interesting is that the same man who headed the program on life adjustment education was a few years later, when after sputnik the interest arose in solid subjects, placed in charge of the project to strengthen the physical sciences and mathematics education. I do not know whether that was an accident or deliberate.

But, on the whole, I am afraid that the influence of the professional educators in elementary and secondary; not in higher education—in higher education they have generally been trying to raise standards—but in elementary and secondary education the professionals have suggested for many years that it is undemocratic to have children in different tracks.

Here in the District of Columbia the four-track system, I believe, is working quite well. There are many other school systems which have at least four parallel tracks. I think that is an excellent idea.

In other words, a high school may have one track for the highly gifted and one for the medium and one for those of lower intelligence—it may have two or three or four tracks. But in more than half the schools of this country this is not being done. The children are divided by alphabet or in some other way because to divide them by intelligence has been regarded as difficult by the administrators and it is difficult, with parents, I agree with that.

Parents, on the whole, have in the last few years tried to exert an influence toward raising standards, particularly since sputnik.

At the same time, when it means dividing children into group A, B, and C, it cannot remain a secret for very long and some will be called genius and others will be called dumb clucks. Then, of course, mother or father will come running to the school and say, "Now, my Johnny is intelligent, you shouldn't put him down there. He just hasn't bloomed fast enough. You should put him higher up."

That makes it difficult for the principal of the school, it makes it difficult for the teacher, to say no.

I think the only way how this can be done is by objective tests. In every European country I know—of course, I may be prejudiced because I happen to have come up through a European educational system, but I have seen several others—you are subjected to tests at a certain age, and either you pass them or you do not. If you do not, then you go to what is in England called a technical school or vocational school, it has different names. If you pass a test you may go to the academic type of secondary school.

This takes the onus off the principal who otherwise has a difficult time, because he and the superintendent must maintain their popularity. If they don't, the next time they have a school bond issue or a tax issue on the ballot they may have difficulty getting it approved if they have antagonized too many parents.

Senator RIBICOFF. In other words this tax bill in itself won't do anything to give jobs to these youngsters, 15 percent of youngsters, in the 16 to 19 age bracket?

Mr. FREEMAN. It will do very little.

Senator ANDERSON. Mr. Chairman, could I just ask to question there?

I understand you were a consultant to the Eisenhower administration and you were opposed to aid to education.

Mr. FREEMAN. Yes.

Senator ANDERSON. I understand you a little better now. But what in the world has a curriculum got to do with this tax bill? Is this a snowjob or a filibuster of some kind? We would like to get through with the bill some day. What has it got to do with the tax bill?

Mr. FREEMAN. Sir, the only reason I talked about curriculum is——

Senator RIBICOFF. I raised it.

May I say to the distinguished Senator from New Mexico I raised the question, so if there is a fault it is not the witness. The fault is mine. The reason the question was raised is this: this tax bill has been put forward with the idea that one of its basic ends would be to help solve the problems of unemployment.

The witness is correct in his figures that you have some 16 percent unemployment among youths between the the ages of 16 and 19. I think the witness' testimony, although I disagree with much of his philosophy in education, and some I do agree with, is that there is nothing in this tax bill that will help basically to solve the unemployment problems of the group between 16 and 19 in the United States of America.

So, therefore, it is not the witness' fault, Mr. Chairman; it is mine because I asked the question.

Senator ANDERSON. We do not have a rule of germaneness, and I guess you can go anywhere you want to go. It would be nice to hear something about the tax bill.

Mr. FREEMAN. Yes, sir.

Senator GORE. Mr. Chairman, if this tax bill has nothing to do with the solution of the problem of unemployment, then it has certainly been erroneously presented to this committee.

Senator ANDERSON. Does he make that contention?

Mr. FREEMAN. No, sir.

Senator ANDERSON. I did not think you did.

Mr. FREEMAN. In my summary I make a statement—

Senator GORE. While he is looking for that, I would like to quote from page 21 of the witness' prepared statement where the witness quotes a distinguished American. He says:

> The President remarked at his news conference of October 11, 1962, that "we could have a great boom and still have the kind of unemployment they describe."

Yet, Mr. Chairman, much of the rationale or attempted rationale, for and in support of this bill is that somehow or other it is going to solve the unemployment problem. The witness has just told us in his view it will not, and I think Senator Ribicoff has been pertinent in asking questions along that line.

The CHAIRMAN. You may proceed.

Mr. FREEMAN. The serious aspect of this I have pointed out.

In the last 7 years the civilian labor force increased by 5.6 million. In the next 7 years it will increase almost twice as much. In the last 7 years only 37 percent of the increase in the labor force found jobs in private employment; 41 percent were added to the governmental payrolls, and 22 percent, almost one-fourth, increased unemployment.

If the civilian labor force is going to increase 10 million in the next 7 years, the question is how big unemployment will be by 1970.

I believe that this is a very, very serious problem which will not be solved by this bill.

I also refer, incidentally, to a statement that was presented to the Senate Subcommittee on Employment and Manpower just 5 weeks ago by Professor Killingworth of Michigan State University. He comes up basically with the same answer with which I came up.

He says here:

> I think that it is extremely unlikely that the proposed tax cut, desirable though it is as part of a program, will prove to be sufficient to reduce unemployment to the 4-percent level.

I believe that a tax cut is needed. It will have certainly initially some favorable results, but it will, in the long run, if it remains the way it is, not do much to reduce unemployment.

The second section of my statement deals with the question of tax reform. I do not know whether I should proceed to that now or whether there are some more questions on changes in the rate structure and what we can do about unemployment.

The CHAIRMAN. Is it your opinion that this tax reduction will so stimulate business that it will not add to the deficits, that we will correct the deficits we now have?

Mr. FREEMAN. I do not believe that this tax cut, the way it stands now, is going to make the deficit disappear in either 1967, as Secretary Dillon said, or, even in 1972, as Dr. Burns said, which is a long time ahead. Revenues and expenditures seem to work like greyhounds chasing a mechanical hare. Somehow or other the hare always runs faster, and the greyhounds won't catch up.

The basic proposition of this bill seems to be, that in order to avoid a huge deficit we ought to plan for a big deficit. Frankly, I do not agree with that proposition for several reasons.

The CHAIRMAN. You indicated in one part of your statement that the plan of the economist was to increase expenditures——

Mr. FREEMAN. Yes, sir.

The CHAIRMAN (continuing). And, at the same time, reduce taxes.

Mr. FREEMAN. Right.

The CHAIRMAN. And the combined deficit seems to me it would be very much greater than it is now.

Mr. FREEMAN. Yes. I do not believe that if this tax bill stands as it is that it will actually reduce the deficit, at least not to any significant degree, for particularly a reason, which I outlined in the later part of section III.

While the President indicated in his letter to the chairman of the Ways and Means Committee that tax reduction—and I am quoting now from the President's letter—

> tax reduction must also, therefore, be accompanied by the exercise of an even tighter rein on Government expenditures.

Now, the question is to what extent this intent will be implemented. The President said at an earlier news conference, and I am quoting here:

> I am concerned

after mentioning that nondefense expenditures ought to rise faster—

> that we are not putting in enough, rather than too much, because the population of the country is growing 3 million people a year.

I point out here that in the preceding 10 years, the population grew 19 percent, but Federal Government non-war-connected expenditures jumped 245 percent. If an increase of that size within 10 years is held not to be putting in enough, the question is how much is enough?

Moreover, the President has submitted to the 88th Congress more than 100 proposals for new or expanded programs which would add vast amounts to the total spending. I have seen no indication that he has suggested either to withhold or to defer some of these programs.

It seems to me that if it is impossible even to hold back on programs which are not yet law, that it is far less likely that there will be restraint on programs which are already in operation, and which have a natural growth tendency.

I point out here that in his speech at Yale University on June 11, 1963, the President declared that for the last 15 years the Federal Government has grown less rapidly than the economy as a whole or any other major section of our national life and very much less than the noise about big government.

I have here the official record in table XI, that between the fiscal years 1948 and 1963, which are the most recent 15 years, the gross national product increased 129 percent, but Federal spending increased 220 percent; spending for domestic purposes only increased 525 percent.

In other words, the general trend is very steeply upward in nondefense spending. There is one thing that I personally, at least, feel is even more potentially dangerous than if spending were to increase at a rapid rate——

Senator DOUGLAS. Mr. Freeman, I want to congratulate you on the tremendous work that you have done in this paper. But I must say that these last figures somewhat startled me because when I came to the Senate 15 years ago, along with the Senator from New Mexico, the military budget was then approximately $14 billion a year. Now then the Korean attack came.

Mr. FREEMAN. Yes.

Senator DOUGLAS. To which we responded, and I assume you believed this was the correct thing for us to do.

The military budget is now $52 billion a year, or it has gone up to almost four times its original figure.

Granted there is some waste in this budget, and I have tried my best to isolate it, and Secretary McNamara is getting at this waste, I grant you that there is some waste, still it was inevitable, and I think desirable, in view of the Communist threat that we should defend ourselves and the free world.

To this has been added the expenditures for atomic energy. Senator Anderson knows much more about that than I do, but I assume those expenditures have increased, too.

Senator GORE. And space.

Senator DOUGLAS. And now we have space. I have been very dubious on some features of the space program, but the public certainly some years ago decided in favor of it. I think I was the first person in the Senate who said it was not worthwhile spending $40 billion to get a man to the moon, and the response I got in my mail was instantaneous, and I believe Stanford is doing a lot of work on space and atomic energy out there, too.

Mr. FREEMAN. Yes.

Senator DOUGLAS. And electronics.

Mr. FREEMAN. That is right.

Senator DOUGLAS. If you add all those, if you add space and atomic energy together with defense, you probably get $62 or $63 billion, which is at least four times probably what it was in 1948 when we had smaller atomic energy appropriations and military appropriations.

Well, the point that I make is please do not make these governmental expenditures the whipping boy that you do.

Mr. FREEMAN. This is exactly my plea, sir. I feel that the present tendency is, as it was for some years immediately after the war, to cut down on necessary security spending in order to be able to advance some domestic programs. This is the thing that scares me.

Senator DOUGLAS. I agree with the Senator from New Mexico with the comment he made, I understand while I was out of the room, that you got into the philosophy of the world in general. Perhaps I trespass in doing this, but let me say this, that judged from purely material standards of production of goods and services, I have always felt, and increasingly with the years, that investment in human beings, properly directed, is just as productive, indeed frequently more productive, than investment in machinery and material equipment, and I think that can be proved.

Secondly, I would say this, that man is an end, not merely a means. There is something more to life than the mere production of goods and services. Human beings are ends in themselves, and if one believes that government, as one agency, just one of many agencies, is designed to help promote the good life or to give people the chance to develop, then these expenditures, I think, are justified.

Granted that individual programs should be scrutinized, and granted that waste should be eliminated, I will still stand on two points:

First, that investment in human beings is as, and possibly more, productive than investment in capital goods.

And, second, that man is the end, after all, and not merely the means.

Now, I probably have violated the very just standard which the Senator from New Mexico, I understand, laid down.

Mr. FREEMAN. Yes, sir.

Senator ANDERSON. Could you supply us with a breakdown of this 7.1 and 44.6 so we will know what it is?

Mr. FREEMAN. Yes. This is simply taken from the budget.

Senator ANDERSON. I understand where this is taken from, but you selected the ones you wanted to select. Would you give the breakdowns so that we can see which ones you selected as purely domestic expenditures.

Mr. FREEMAN. Excuse me, if the committee clerk has a copy of the 1964 budget handy I can do it right now. Is a copy of the 1964 budget, the blue book, available? Then this is very simple.

What I point out in this chapter is that we have many examples of spending pressures over the ages, but deficit spending has never, to my knowledge, promoted lasting economic growth.

Senator ANDERSON. You can help me out by saying whether or not the $44 billion includes atomic energy and space.

Mr. FREEMAN. No. As you see in table XI the first item, "War-connected" includes: national defense, international affairs, space operations, veterans benefits, interest on the national debt. Here is the statement. It is taken from page 430, in the 1964 budget. If you add national defense, $53 billion; international, space, veterans, and interest, you get $72 billion as I have it here, and the remainder of $44 billion is simply the difference between $72 billion and the total of $116 billion.

The CHAIRMAN. I would like to see you go a little bit further in what you understand your position to be. You believe that this plan contemplates not only reducing taxes but increasing expenditures?

Mr. FREEMAN. I believe that the present tax bill in itself will only cut taxes. The tax bill in itself will not increase expenditures.

But it seems to me that the way the trend has been going, and the way I see the situation, I notice no change in the upward trend in domestic expenditures.

Some of the cuts, for instance, which were made in the 1964 budget such as, for example, in the appropriation for grants for public assistance, are purely paper cuts. I presume that Senator Ribicoff is quite familiar with the fact that there will have to be supplementary appropriations. I do not believe that public assistance requirements are going to go down.

Under the 1962 amendment, the 1962 Public Welfare Act, the requirements of the programs will increase very sharply, and the present cut will simply lead to deficiency appropriations. So I believe that the spending trend is up and will continue to go up unless some effective restraint is imposed.

The CHAIRMAN. As a matter of fact, expenditures have been going up from $4 to $6 billion a year for some time.

Mr. FREEMAN. Yes, right.

The CHAIRMAN. And the question now is whether they will be stationary or whether they will be reduced and, thereby, avoid increasing the deficits that have been predicted.

You say that there will be an initial deficit close to $10 billion. You mean that is the first year after the tax reduction?

Mr. FREEMAN. By the initial I mean this: In his presentation the Secretary of the Treasury made allowance for the amount by which he hopes that a tax cut will spur the economy and thus will increase revenues. By initial I mean the immediate effect of the cut would be so much.

To what extent the tax cut will stimulate the economy and increase revenues I do not know. I do not think it will be as much as the Secretary of the Treasury estimated.

This is what I mean by an initial budget deficit close to $10 billion, less possibly, a few billion by which the growth in the economy may improve revenues.

The CHAIRMAN. We have already had deficits for 3 successive years. When do you think the budget would be balanced, given reasonable consideration to the stimulation of business by this tax cut which I think has been greatly exaggerated? When do you think the budget will again be balanced under the plan that certainly seems to be what the administration and the economists connected with the administration had in mind; namely, to increase expenditures and reduce taxes

at the same time? I think one prominent economist said he did not think it would be balanced until 1972. Do you agree with that or not?

Mr. FREEMAN. I would not put down any particular year. At this time I can see no reason for predicting a balanced budget at any particular time unless effective steps are taken to restrain expenditures. You, Mr. Chairman, know that there are constant pressures from many groups on every Member of Congress and on the administration. They plead "We need more money for these various programs."

In each case they are very persuasive, and I think to some extent justified. If you say "No" to all of these people, why then, you antagonize too many people. So I believe that unless some restraint is put into the law, it probably will be impossible to control the expenditure growth sufficiently.

The CHAIRMAN. Let me ask you this: Do you know of any economist connected with the administration who favors holding the expenditures where they are now or reducing them? Let me put it another way: Do you know of any economist who does not favor increased expenditures instead of reduced expenditures?

Mr. FREEMAN. Well, there are a few such economists, but they are a small minority.

The CHAIRMAN. I am speaking of those connected with the present administration.

Mr. FREEMAN. No, sir; not with this administration. I am afraid if they do not think that expenditures should be increased then they are no longer with the administration.

The CHAIRMAN. Well, thank you very much.

I want to say this to you, sir, that you have given a lot of information while you have been on the witness stand for nearly something over 2 hours.

Mr. FREEMAN. Thank you, sir.

The CHAIRMAN. I think it is a valuable contribution that you have made. I do not mean that I agree with all of it, but you have documented, I think, what you have said here in a way that it could be followed and studied, and you have contributed very substantially to the consideration of this legislation.

Senator ANDERSON. Could I ask one question? In your list of $44 billion of expenditures for domestic purposes, did you include $25,799 million for health, education, and welfare?

Mr. FREEMAN. Yes.

Senator ANDERSON. If an insurance company collects $1,250 million in premiums and pays out $1 billion in losses, has it sustained a $1 billion loss that year?

Mr. FREEMAN. You are referring, of course, to the so-called social——

Senator ANDERSON. Yes, indeed. It collects and pays out, and you say that is an expense?

Mr. FREEMAN. It is.

Senator ANDERSON. I run a little insurance company, not of the caliber you are talking about, but I always try to make sure my receipts are greater than my expenditures, and if they are, somehow or other I regard it as a pretty good year.

If the receipts for health, education, and welfare are equivalent to the expenditures, do you regard that as a domestic drain on the taxpayers of the country?

Mr. FREEMAN. In the first place, sir, the expenditures and the income do not quite match.

Senator ANDERSON. That was not the question.

Mr. FREEMAN. You mean in a hypothetical case?

Senator ANDERSON. Yes.

Mr. FREEMAN. If the hypothetical case were, Senator, as you stated, then it would be so. But, in the first place, this is not an insurance company because no insurance company can force anybody to pay premiums.

In the second place——

Senator ANDERSON. We went through that in 1935. I am sorry you missed it, because we did.

Mr. FREEMAN. Yes.

Senator ANDERSON. We decided it.

Mr. FREEMAN. Yes.

Senator ANDERSON. All right.

Mr. FREEMAN. But, if any insurance company undertook to grant the benefits and did the blanketing-in which the social insurance system has done, it would not have been permitted to do so by any insurance supervisor in any State and, it would have been bankrupt a long time ago.

Senator ANDERSON. You think then the social security system is bankrupt?

Mr. FREEDMAN. No, I do not think so. Benefits will have to be paid from current taxes.

All I did there is to point out by how much—and these are not my figures—the spending grew according to the figures published in the President's budget. I take no stand——

Senator ANDERSON. You have listed here among expenditures for domestic purposes——

Mr. FREEDMAN. Yes.

Senator ANDERSON. $44.6 billion. My question to you is——

Mr. FREEDMAN. Yes.

Senator ANDERSON. And you can answer it yes or no. Did you include, in that, $25 billion worth of health, education, and welfare?

Mr. FREEDMAN. Yes.

Senator ANDERSON. That is what I thought.

Mr. FREEMAN. Yes, because my total is the total spending figure which appears in the consolidated cash statement.

Incidentally, I may mention that many people regard this preferable and, in fact, the President made a statement not very long ago that he believes the consolidated cash statement from which these figures are taken, to be a better instrument than the administrative budget.

Senator ANDERSON. I think if properly understood and properly explained that might be true.

Mr. FREEMAN. So I included the item just the way it was included in the 1964 budget, published early this year. I could not possibly leave it out.

Senator ANDERSON. I won't argue with you.

The CHAIRMAN. Any further questions?

Senator RIBICOFF. One more point. If you believe we have to do something with the curriculum to take care of the structural unemployment among our youngsters, this 15, 16 percent——

Mr. FREEMAN. Yes.

Senator RIBICOFF. Could you foresee this being done effectively without Federal assistance nationwide?

Mr. FREEMAN. I think a great deal could be accomplished. If the leadership from the Office of Education were exerted in that direction, rather than in a different direction, it could have some influence.

Senator RIBICOFF. I mean Federal financial assistance.

Mr. FREEMAN. I can see a place for Federal financial assistance, but I do not believe that to do it through direct grants is the best way or even a good way as such, because you would have to stipulate that a certain amount is available provided the school adheres to a federally prescribed curriculum.

That would run into such heavy crossfire about the Federal control of the curriculum that with all the other obstacles to Federal aid to education, I do not think——

Senator RIBICOFF. The Federal Government today spends about $2.5 billion on education in one form or another. Would you please give me an instance where in this $2.5 billion the Federal Government spends for education, the Federal Government tells the State what to do or how to spend this money?

Mr. FREEMAN. You asked, I believe, in your question what extent, how the Federal Government could improve the curriculum in the desired direction and strengthen it.

Senator RIBICOFF. Not improve the curriculum. You and I are in complete agreement on this.

Mr. FREEMAN. Yes.

Senator RIBICOFF. This bill will not solve the structural unemployment of the 16 percent of people between 16 and 19.

Mr. FREEMAN. Yes.

Senator RIBICOFF. You and I are in complete agreement, too, that there has to be a basic change in the curriculum of the high schools of America if we are going to help solve the problem of the unemployed who are 16 to 19 years of age.

You and I are in complete agreement on both these factors. Let us say we believe there should be a national policy to really do something——

Mr. FREEMAN. Yes.

Senator RIBICOFF (continuing). For this 16 percent of our young people.

Now, I ask you this question: do you think this could be done on a local level without Federal financial assistance to do this job?

Mr. FREEMAN. It could be done. Whether it will be done I do not know.

Senator RIBICOFF. Do you think without Federal encouragement, financial Federal encouragement, that many of the States or communities would undertake to help solve this problem?

Mr. FREEMAN. I do not believe that this program would cost more than the present program, so that it is not a question of adding money. The present expenditures would be sufficient to provide an adequate education. It is just a question of how they apply it.

Senator RIBICOFF. But you do believe, whether it is a change in how the expenditures would be made—that there is a place for Federal financial assistance in the field of vocational education?

Mr. FREEMAN. Yes. At the same time, there are some questions as to what form it should take, because if you provide Federal funds on condition that the curriculum is changed, I think you do have Federal control. It may not be as much of an obstacle, but at the same time, you are fully aware of how many difficulties it runs into if you suggest that we have a grant provided available if the school districts in the States do so and so. This is actual control.

I think that nonfinancial leadership by the President, by the Office of Education, could be successful. I believe that to the extent to which it is desired that the schools or the colleges be aided financially by the Federal Government they could be helped by indirect rather than by direct means. There are several such bills in, as you know.

If I may be permitted to say so, I followed your various statements over the past 2 years and, in principle, I think again enthusiastically we are on the same side.

I differ technically because I believe that by permitting deductions of expenses for for higher education, or also for lower education, you would not give enough aid to persons in the low income brackets to whom Senator Talmadge and Senator Gore referred, and we all are concerned. I believe the emphasis in a program of this type should be on helping students from low-income families who have difficulty going to college, and that can be done by a tax credit better than by the approach——

Senator RIBICOFF. For your information many of the Senators who have introduced bills of this sort, their administrative assistants have met with my administrative assistant to try to work out an agreement of how to accomplish this for submission to this committee and, as an amendment to this bill.

My administrative assistant happens to be in this room and will be pleased to talk with you; I think, in this, as I read your testimony, you and I and most Senators interested in this field are about on the same track today.

Mr. FREEMAN. Yes. There are two bills?

Sentor RIBICOFF. I am not going into that. I am talking about the 16 percent of young people who are not going to college.

Mr. FREEMAN. Yes.

Senator RIBICOFF. And the 16 percent who are out of work, and these 16 percent who come to the Federal Government, whether it is through relief, juvenile delinquency, or manpower training or a Youth Conservation Corps. It is costing the Federal Government substantial sums of money to try to help these 16 percent of youngsters between 16 and 19 who are out of work.

Let us say we want to do something about the problem, do you think you can solve the problem without Federal financial aid?

Mr. FREEMAN. I could see some point in Federal assistance to certain training procedures, some of which are in effect and maybe more could be done. I also believe that one of the major obstacles to employment is the wages which the young people would have to be paid if hired. As long as a regular wage has to be paid, too many of them just will

not be hired. So there is a two-pronged approach. One is to raise their competence, and the other one is to establish wage levels at which they have a chance of being hired, as is true everywhere throughout the world, for some years of apprenticeship.

Now, you are aware of the obstacles to apprenticeship which are of a diverse nature, and I think some action is needed, because in his first year, or first 2 years, a youngster does not contribute enough to his employer, so the employer may not hire him.

The other obstacle which the young people face is this: due to the increasing tendency of companies not to fire people if they need fewer men, they keep the older people, under the seniority system, but engage in what is called cold firing: they just do not hire young people.

In order to protect the employees they now have, they refrain from hiring young people. In other words, the young people suffer from the seniority system.

I do not know whether something can be done about it, but where something can be done, I think, is No. 1, training, and No. 2, a recognition that as long as we insist on processing all of our young people through the same kind of education, in the same class, up to the age of 17 or 18, we must fail, and that probably a different type of training should be provided, possibly with some Federal assistance.

This is one area in which though, on the whole, I do not favor it, I would be willing to make some concession.

The CHAIRMAN. Senator Anderson.

Senator ANDERSON. I want to return to these figures again.

Mr. FREEMAN. Yes.

Senator ANDERSON. If you go back to 1948 on social security, I do not have in mind what the expenditures were, as you call them at that time, the payout. They only go to 1954 where it was about $8 billion because I remember it was somewhere in the neighborhood of $4 billion.

Now, the figure is $25—$26 billion.

Mr. FREEMAN. Yes.

Senator ANDERSON. If you take out the $22 billion raise in that, it does not make your figures look quite so impressive, does it, on the other sheet?

Mr. FREEMAN. It does not make them quite as impressive. Instead of 500 percent maybe it will be only 300 percent.

Senator ANDERSON. Well, I do not believe it would be quite that much.

Mr. FREEMAN. I cannot tell you offhand, but if you would like me to——

Senator ANDERSON. Did you, in the preparation of these tables and putting them in, take into consideration that we have what is known as the Post Office Department? Does the Post Office Department sell stamps? Does it have revenues?

Mr. FREEMAN. Yes.

Senator ANDERSON. Are those revenues in the receipts of payments to the public in the table you used?

Mr. FREEMAN. In the consolidated cash, I believe——

Senator ANDERSON. In the table you used?

Mr. FREEMAN. I believe they are included in the cash, yes.

Senator ANDERSON. I believe they are not.

Mr. FREEMAN. Frankly, I cannot say for sure. They may not be.

Senator ANDERSON. And if you put the receipts and disbursements of the Post Office in, it would throw your figures off, too, would it not?

Mr. FREEMAN. I believe, sir, I recall it now, in the Census Bureau statistics of Federal expenditures it is included. In this table, which is taken, however, from the consolidated cash statement, I believe only the net of the Post Office is in.

Senator ANDERSON. That is right, exactly; and if you put the other figures in it would have thrown your table off, so why put them in?

Mr. FREEMAN. Yes.

Senator ANDERSON. Now, you say in your table war connected, national defense, international affairs, space operations, veterans' benefits, interest on the national debt. National defense is $53,438 million; international affairs is $2,467 million; you say space operations, and space operations and technology, $2,400 million; you say veterans' benefits and veterans' benefits are $6,367 million; you say interest on the national debt, $2,044 million. Would you add those up sometime and see if they come to $72 billion?

Mr. FREEMAN. I am sure they do.

Senator ANDERSON. You are sure they do?

Mr. FREEMAN. Yes.

Senator ANDERSON. Well, you just put down there the figures that I read off and start with $53.5 billion.

Mr. FREEMAN. Pardon me, these are 1963 figures.

Senator ANDERSON. I am taking 1963 figures. I cannot read well, but I can with a glass. I am taking the 1963 figures which are $53,448 million.

Mr. FREEMAN. Yes.

Senator ANDERSON. International affairs, which you just mentioned, are $2,467 million; space, $2,400 million; veterans' benefits services, $6,367 million; interest on the national debt, $7,496 million. You can get all of it into $72 billion, is that right?

Mr. FREEMAN. The figure is $72,168 million. The $168 million I abbreviated to $0.2 billion. So the total is $72.2 billion. I hope I did not make an error in addition.

Senator ANDERSON. You probably did not. Seventy-two billion dollars. But you did not put Post Office receipts or expenditures in there?

Mr. FREEMAN. I did not put anything in there——

Senator ANDERSON. You did not put anything in on what was taken in on the social security, but just what was paid out?

Mr. FREEMAN. Yes, because this is only the expenditure side.

Senator ANDERSON. I see. You think when a life insurance company pays a death claim that is an expenditure, but the premium is not a receipt?

Mr. FREEMAN. Sure, it is.

Senator ANDERSON. That is what I think. All right.

The CHAIRMAN. Thank you very much.

The Chair wants to express his regrets to the other witnesses who are here for the delay.

(The prepared statement of Mr. Freeman follows:)

STATEMENT OF ROGER A. FREEMAN, SENIOR STAFF MEMBER, THE HOOVER INSTITUTION ON WAR, REVOLUTION, AND PEACE, STANFORD UNIVERSITY, STANFORD, CALIF.[1]

In the course of the past 2 years a broad consensus seems to have been reached that what this country's economy needs is lower taxes. Organizations of labor and of business, wide sections of the public, many Members of Congress, and even most economists appear to concur in this general proposition. Most of the disagreements which almost always arise when tax revision is proposed concern the "how" of tax cuts more than the "whether." They tend to focus on the type of the suggested tax relief and on the circumstances accompanying the action rather than on the acknowledged fact that the American economy is not likely to develop its full growth potential as long as it is loaded down with its present tax burden.

Disagreements may be grouped under three major headings:

(1) How should tax relief be allocated by income classes? Should it be concentrated in the lower brackets so as to boost consumer spending? Or, should it aim primarily to stimulate incentives and investment by more sharply lowering high personal tax rates in the medium and upper ranges and by reducing the corporation tax rate?

(2) Should rate reduction be linked with a structural reform broadening the tax base? Should we narrow or eliminate some or many of the various deductions, exemptions, exclusions, or credits and thus recoup part of the revenue lost by rate cuts? Or is the most urgently needed tax reform a lowering of rates which should not be jeopardized or delayed by tying it to other changes of a highly controversial nature?

(3) Should a tax cut be accompanied by corresponding action on the outgo side of the budget or at least a restraint on future expenditure growth? Or would a curb on public spending nullify the economic benefits of tax relief?

The President's proposals and the bill before your committee appear to take a clear stand on these questions:

(1) The President proposed to reduce the aggregate tax liability of persons in the lowest income bracket by 40 percent, with the relief gradually declining to 9 percent in the highest income bracket. He recommended to cut corporate tax liability by 8 percent (lowering the rate from 52 to 48 percent) but to advance payment dates and thus to defer cash relief for several years.

Revisions approved in the House of Representatives would not change these results significantly. The aggregate tax liability of persons in the lowest personal income bracket would be reduced 38 percent from the present level, and of those in the highest bracket, 13 percent, with relief in the intermediate brackets somewhere in between.

This means that H.R. 8363 as passed by the House would make income taxes more steeply graduated and primarily augment consumer purchasing power.

(2) The President did not propose to eliminate or reduce any of the major exclusions, deductions, or exemptions which now account for most of the vast difference—$228 billion in 1960—between personal income and taxable income. Of the 16 structural changes with a revenue consequence in the personal income tax bill approved by the House, 8 would result in revenue gains and 8 in revenue losses. The net revenue gain would add an estimated 1.2 percent to prospective tax receipts; rate changes would reduce revenues by 20 percent. In other words, structural changes would be relatively minor and not broaden the tax base significantly, if at all.

(3) Amendments proposed in the Ways and Means Committee and in the House itself which would have conditioned the rate cuts upon restraints on increased spending failed by narrow margins. Thus H.R. 8363, as it now stands, reduces taxes but does not require corresponding action on the expenditure side.

In my testimony I propose to discuss these three major issues and shall try to evaluate whether the provisions of the bill, as approved by the House, are likely to have the hope-for impact on the rate of economic growth and on unemployment.

My conclusions may be summarized as follows:

(1) The tax cuts proposed in H.R. 8363, which are estimated eventually to total $11 billion, will provide long-needed relief to many persons. They will

[1] Opinions expressed are those of the author and do not necessarily reflect the views of the institution with which he is connected.

also give our economy a "shot in the arm" but are not likely to stimulate the rate of economic growth as powerfully as a tax cut of that magnitude could if it were designed primarily to promote growth rather than serve other ends. I question seriously whether the bill, as it now stands, will have a major and lasting impact on unemployment.

(2) Many improvements could and should be made in our tax structure. But the most urgently needed tax reform is a sharp cut in rates which ought not to be encumbered at this time with other revisions. Some of the structural changes in H.R. 8363 may hinder rather than advance economic progress.

(3) Cutting taxes at a time of heavy budgetary deficits without commensurate action to bring expenditures under firmer control may temporarily produce some favorable results. But it will, in the long run, prove to be self-defeating.

(4) Some public purposes can be served better by cutting taxes than by enlarging expenditures. One example of this is higher education which could be most effectively helped by the grant of tax credits for certain educational expenses and contributions.

This statement is divided into four sections:

I. How should income taxes be cut?

II. Should rate cuts be linked with tax reform?

III. Should a tax cut be accompanied by restraints on spending? page 40.

IV. Can tax credits help higher education more effectively than grants and loans?

I. HOW SHOULD INCOME TAXES BE CUT?

The broad consensus that income taxes are too high is of recent origin. To be sure, business groups and some economists have been contending ever since the end of World War II that excessive tax rates are repressing economic growth. But numerous other economists and labor unions have generally denied it. About 10 years ago Roy Blough, former Treasury official and member of the Council of Economic Advisers, wrote that "the pessimists who have continued to forecast the destruction of industry by high taxation have been faced instead by an expanding economy."[2] The late Randolph E. Paul, former General Counsel of the Treasury Department, told the Joint Economic Committee of Congress in 1955:

"Certainly, history fails to support arguments that high taxes have a ruinous effect upon the economy. I do not like high taxes myself, but I am obliged nevertheless, to admit that work and investment incentives have remarkably survived the high taxes of the last 20 years, and that venture capital is not lacking today after a long period of high taxation."

He cited approvingly a statement that "the higher our taxes go, the more we have left for investment and consumption," and asserted that "the bark of our individual income tax is much worse than its bite."[3]

The AFL-CIO proclaimed as recently as September 1960 in its handbook on Federal Taxes that "the period of high taxation that has prevailed for the last 20 years has also been a period of very high income, savings and investment, indicating that there has been little if any loss of incentive" (p. 6).

In his best seller "The Affluent Society"[4], John Kenneth Galbraith advanced the proposition that the level of taxation should be substantially raised: "The community is affluent in privately produced goods. It is poor in public services. The obvious solution is to tax the former to provide the latter—by making private goods more expensive, public goods are made more abundant" (p. 315). The Galbraith thesis was expanded in books by Francis M. Bator, of MIT, Frederick G. Mosher, of the University of California, David Demarest Lloyd, and others. Alvin H. Hansen, emeritus professor of political economy at Harvard, wrote in his book "Economic Issues of the 1960's[5] only 3 years ago: "If we are to meet at all adequately our growing public needs, we shall, I believe, need higher taxes."

The demands neither for higher nor for lower taxes were able to rally broad

[2] Roy Blough, "The Federal Taxing Process," New York, Prentice-Hall, 1952, p. 464.

[3] Randolph E. Paul, "Erosion of the Tax Base and Rate Structure," Federal Tax Policy for Economic Growth and Stability, papers submitted by panelists appearing before the Subcommittee on Tax Policy, Joint Economic Committee, 84th Cong., 1st sess., 1955, pp. 297 ff.

[4] Boston, Houghton Mifflin Co., 1958.

[5] New York, McGraw-Hill, 1960.

support. Many economists, and probably a majority at the time, agreed with Harvard Economics Professor Arthur Smithies, who told the Joint Economic Committee of Congress in 1957 that "the problem in the tax area is tax reform rather than tax reduction." [6]

Tax reform rather than tax reduction was the declared objective of the President's tax message of April 20, 1961. In proposing certain structural changes the President emphasized that the resulting revenue gains and losses would offset each other, that "the tax system must be adequate to meet our public needs," and that it was necessary "to maintain the revenue potential of our fiscal system." In his news conference of March 1, 1961, the President reaffirmed an earlier statement that he would suggest sources of revenue to finance the new spending proposals he was sending to Congress. The President announced that he would submit a more comprehensive tax reform program to the next session of Congress and proclaimed his confidence in the existing tax system: "This message recognizes the basic soundness of our tax structure."

Within slightly over a year, however, the tax structure fell from grace. In his television address of August 13, 1962, the President charged that our tax structure "is a drag on economic recovery and economic growth, biting heavily into the purchasing power of every taxpayer and every consumer." The rates, the President said, "are so high as to weaken the very essence of the progress of a free society—the incentive for additional return for additional effort." Four months later, speaking to the Economic Club of New York, the President stressed "the accumulated evidence of the last 5 years that our present tax system, developed as it was during World War II to restrain growth, exerts too heavy a drag on growth in peacetime—that it siphons out of the private economy too large a share of personal and business purchasing power—that it reduces the financial incentives for personal effort, investment, and risk-taking."

What happened between 1961 and 1962 to change from praise of the tax structure to outright condemnation? The hopes which had been held and the forecasts voiced for a faster rate of economic growth and declining unemployment failed to materialize. Gross national product (GNP) which had been predicted to reach $571 billion in 1962 fell short of that goal by $16 billion. Unemployment which had been close to 4 million, or 5.5 percent of the civilian labor force, in 1959 and 1960, did not fall below those levels. A growing number of economists came to suspect that taxes were partly or largely to blame for the unsatisfactory performance of the economy. But much uncertainty remained: Is the damage being done by the sheer magnitude of amounts extracted from the private economy or by the nature of the tax system, by the types and rates of taxes?

Does the size of the tax burden repress economic growth?

Many observers hold it to be self-evident that taxes whose total amount equals a large and increasing percentage of a country's national income or product retard economic growth. The proposition is most plausible: the greater a share of their income individuals and businesses must surrender to the tax collector, the less have they left for consumption and investment. Also, taxes are costs of production, and when recovered in prices, lower a country's competitive standing.

But empirical proof for a negative correlation between the size of the tax burden and the rate of economic growth is hard to come by. Germany, France, Italy, Japan, and several other countries bear taxes which in proportion to their national income are at least as high as ours or even higher. Yet, their economy has been growing at a much faster rate. On the other hand, we see many countries which levy relatively light taxes but seem unable to expand economically at more than modest rates. Nor do available historical studies give us conclusive evidence of a positive relationship between low taxes and fast economic growth.

Such comparisons, derived from inadequate statistics which lack uniform concepts, are admittedly crude. But even more refined analysis, wherever it is possible, yields no convincing proof of the growth-retarding effect of a heavy overall tax burden.

What the Government collects in taxes it usually spends and thus substitutes for the spending which otherwise taxpayers would have done. Whether investment by Government is as productive as by individuals or business—or more or less so—is highly controversial, with the answers more firmly rooted in political philosophy than in economics. It seems to me that at this stage of our economic

[6] "Federal Expenditure Policy for Economic Growth and Stability," hearings before the Subcommittee on Fiscal Policy of the Joint Economic Committee, 85th Cong., 1st sess. 1957, p. 354.

knowledge the proposition that the overall level of taxation (other factors being even) has a negative impact on the rate of economic growth is a hypothesis, which many of us believe to be correct but which so far we have been unable to prove. Most likely there is a level beyond which taxes become injurious to the economy. But we do not know just what that level is.

Taxes in the United States have shown a consistent tendency to grow, not only in amounts but also in proportion to the economy, as table I shows:

TABLE I.—*Governmental revenues (Federal, State, local) in the United States, selected years, 1902–62*

Fiscal years	Billions	Percent of net national product
1902	$1.7	9.0
1922	9.3	14.0
1932	10.3	17.3
1942	28.4	21.3
1952	100.2	31.8
1962	167.9	34.1

Sources: U.S. Bureau of the Census, "Historical Summary of Governmental Finances in the United States," 1959. U.S. Bureau of the Census, "Summary of Governmental Finances in 1962," 1963. "Survey of Current Business," July 1963, and supplement, "National Income, 1954." (National product for fiscal years 1902 and 1922: Raymond W. Goldsmith Associates, "A Study of Saving in the United States," vol. III, Princeton University Press, 1956.)

In the fiscal year 1962 the revenues of all governments in the United States—Federal, State, local—equalled 34.1 percent of the net national product, 38 percent of the national income, 39 percent of the personal income. This truly is a large share but it is no larger than in several countries whose national product has been showing much higher rates of growth than we have been able to achieve.

None of those countries uses a tax system similar to ours. This suggests the question whether the tax structure, the type of the major taxes employed, could have a more powerful impact on economic trends than the aggregate amounts collected.

Does the type of tax structure affect the rate of economic growth?

The American tax system is like no other in the world. All industrial countries levy a graduated personal income tax but none leans on it as heavily as the United States. The mainstay of public treasures in most countries is a general consumption tax and this is particularly true in the rapidly growing European economies. Personal and corporate income taxes tend to be important but secondary sources of revenue. This does not prove that heavy income taxation necessarily results in slower economic advance and that growth could be speeded up by a shift to consumption taxes. But it does nothing to weaken the suspicion that our economic ills are not entirely unrelated to reliance on extremely heavy income taxes in the United States over the past 20 years.

In his 1963 tax message the President declared that "the largest single barrier to full employment of our manpower and resources and to a higher rate of economic growth is the unrealistically heavy drag of Federal income taxes on private purchasing power, initiative, and incentive."

During World War II the United States was the only belligerent nation not to impose a major consumption tax. Instead, it pushed its income tax rates to near-confiscatory levels. This decision, which also meant that we would raise a lesser share of the war costs through current taxation than our allies, was not rooted in economic considerations but in the governing political and social philosophy. That philosophy continued to dominate policy through the postwar period and resulted in the rejection of all proposals to establish a more even balance between the major types of taxes which are now used in other countries throughout the free world.

To be sure, an unplanned gradual adjustment has been taking place. Between 1944 and 1962 receipts from income taxes in the United States doubled, from all other taxes almost quadrupled. The President's proposals would further slow down the growth of income tax collections, while other taxes are likely to continue increasing at a rapid rate.

The significant difference between consumption and income taxes is not the base on which they are levied but the fact that the former are more nearly

proportionate—in some cases regressive—while the graduated income tax is progressive. The principle of progressive income taxation is now employed by every industrial country and is presently not in question. But the schedules which have been in effect in the United States over the past 20 years push progression to an extreme which has had a deleterious effect on incentives, investment, and economic growth. While the proposals of the President and the provisions of H.R. 8363 would tend to deemphasize the relative role of income taxes in our fiscal system, they would also make the personal income tax more steeply progressive than it now is, as table II shows.

TABLE II.—*Reduction in aggregate tax liability by income brackets in the President's proposals and in H.R. 8363* [1]

Adjusted gross income class	President's proposals	H.R. 8363
	Percent	*Percent*
0 to $3,000	−39	−38.3
$3,000 to $5,000	−28	−26.2
$5,000 to $10,000	−21	−19.9
$10,000 to $20,000	−15	−16.4
$20,000 to $50,000	−12	−15.1
$50,000 and over	−9	−12.6
Total	−18	−18.8

[1] Excluding capital gains revisions.

Sources: "President's 1963 Tax Message," hearings before the Committee on Ways and Means, House of Representatives, 88th Cong., 1st sess., 1963, pt. I, p. 28. "Revenue Act of 1963," report of the Committee on Ways and Means, to accompany H.R. 8363, H. Rept. 749, 88th Cong., 1st sess., 1963, p. 17.

I do not propose to discuss the philosophical and political considerations underlying the design of the pending revisions. But a review of their economic implications appears essential.

What causes economic lag?

It is now widely recognized in economic theory that the effects of average taxation make people work harder and the effects of marginal taxation make people work less. This means that a shift away from graduated income taxation may promote greater effort, but that making income taxes more progressive may have the opposite effect.

The proponents of steeper progression base their case on noneconomic grounds. Robert J. Lampman, economics professor at the University of Wisconsin, told the Joint Economic Committee in 1959:

"The principal argument for an egalitarian tax policy is that its favorable consequences, in terms of social and political conditions, outweigh the unfavorable consequences, in terms of an undesirable possible slowing of the rate of economic progress." [7]

Talking to the American Bankers Association in February 1963, Paul A. Samuelson, economics professor at MIT, took a similar position and stated that, for example, replacing graduated net income taxes by indirect taxes such as Federal excises or value-added taxes "represented too stiff a price to pay for some extra growth." [8]

The economic considerations underlying the tax revisions in H.R. 8363 deem inadequate aggregate demand to be the major element responsible for unsatisfactory economic expansion and high unemployment, and regard a lag in personal consumption to be the primary weakness. Personal consumption now accounts for almost two-thirds of GNP, Government purchases of goods and services equal over one-fifth, and domestic investment and net exports the remainder. Tax cuts in the low brackets, it is held, will strengthen the purchasing power of families which are most likely to spend their tax savings quickly. This in turn will cause merchants to increase their orders and manufacturers to enlarge their

[7] "Income Tax Revision," panel discussions before the Committee on Ways and Means, House of Representatives, 86th Cong., 1st sess., 1959, p. 1198.

[8] "Proceedings of a Symposium on Economic Growth," sponsored by the American Bankers Association, New York, 1963, p. 89.

productive facilities. Thus more money in the pockets of low-income persons will spur the economy to faster growth.

Some believe that Government expenditures should also be stepped up, and a group of economists suggested in a statement submitted to the Secretary of the Treasury last July that stimulating aggregate demand "can be done by reducing revenues, by increasing Government expenditures, or by some combination of the two." [9]

The President declared in his tax message that he did not, at this time, recommend to raise demand by increased Government expenditures and thought that the proposed tax reduction would provide the needed stimulus.

The premise of the tax cut proposed in H.R. 8363, that the major economic lag in recent years occurred in consumption expenditures, is not borne out by the record. A review of developments since 1956—the year before the rise in unemployment began that still plagues us—suggests that consumption as well as Government spending expanded materially while business profits and investment lagged. Between 1956 and 1963 (first half, seasonally adjusted) personal consumption went up $100 billion, Government purchases $45 billion. Corporate net profits increased less than $3 billion; business investment increased $2.4 billion but, if expressed in constant dollars, actually declined.

Over the same period labor income grew $90 billion, transfer payments $18 billion, and the total disposable income $107 billion. But business and professional income advanced only $5.5 billion.

The picture may be even clearer when expressed in relative terms in the following table:

TABLE III.—*Economic trends between 1956–63 (1st half, seasonally adjusted)*

[In percent]

	Increase (+) or decrease (−)	
Number of unemployed	+49	
Unemployment rate	+38	
	In actual dollars	In constant dollars
Gross national product	+37	+22
Personal consumption	+37	+21
Labor income and transfer payments	+40	+25
Business and professional income	+16	+3
Corporate profits	+11	−1
Expenditures for new plant and equipment	+7	−5
Government purchases, defense	+40	+24
Government purchases, civilian	+74	+55

Source: "Economic Indicators," October 1962, and 1962 supplement

Expressed in constant dollars, labor income increased 25 percent over the past 7 years and personal consumption 21 percent. But business and professional income grew only 3 percent, corporate profits declined 1 percent, and investment in new plant and equipment shrank 5 percent. Government purchases for defense expanded 24 percent and for civilian purposes 55 percent.

If the economy is to be stimulated by Government, then it appears that such action ought to focus on the sectors which have been stagnating, business profits and productive investment, rather than on consumption which has continued to expand.

Some observers in recent years have commented sarcastically on what they called the trickle-down theory. What we are faced with in the demand to give priority to a boost in consumer purchasing power, it seems to me, is a trickle-up theory, and if the laws of physics have any validity then we may assume that a liquid is much slower in trickling up than in trickling down.

Consumption versus investment

The President's Economic Report, January 1963, discussing the disappointing trends in 1962, recognized that "it was, therefore, the failure of expenditures other than consumption to rise as far as had been expected that held down the rise in incomes and in turn consumers' expenditures" and that "the error then

[9] Congressional Record, Sept. 30, 1963, p. 6618.

was in the area of business investment, which fell about $8 billion short of the level that had been expected for the year 1962" (p. 15). It is unfortunate that neither that report nor the 1963 tax message drew the obvious policy conclusions.

A comparison of trends in the United States and the countries of the European Economic Community (EEC) throws light on the relationship between growth in consumption and in investment. Between 1950 and 1961 (the latest year for which these statistics are now available) GNP grew 40 percent in the United States, 82 percent in the EEC countries (in constant prices). The EEC countries had very little unemployment; some encountered labor shortages. The significant shifts in economic shares are shown in table IV.

TABLE IV.—*Shift in shares of gross national product in the United States and EEC countries, 1950–61*

[In percent]

	United States	European Economic Community
Private consumption	−3.8	−6.7
Public consumption	+6.9	+1.4
Capital formation and stock changes	−3.5	+3.0
Net exports	+.4	+2.3
Total	0	0

Source: OECD, statistical bulletin, "General Statistics," November 1962.

The most significant changes were: capital information expanded in the EEC countries but shrank in the United States. The share of private consumption declined somewhat in the United States but fell very substantially in the EEC countries. Government expanded slightly in the EEC countries, very substantially in the United States. Exports slightly better than held their own in the United States but expanded substantially in the EEC countries.

In 1961, private consumption and Government consumption accounted for a greater share of GNP in the United States than in the EEC countries—a reverse of the relative position in 1950. Capital information equaled a greater share of GNP in the European countries, both in 1950 and in 1961, but the difference between them and the United States widened. Investment in machinery and equipment in the EEC countries accounted in 1961 for more than twice as large a share of GNP as in the United States.

Simon Kuznets demonstrated in a major historical-analytical study, "Capital in the American Economy,"[10] that in the long run capital formation has been the prime determinant of growth in the American economy, and that investment has been in a sustained relative decline due to a general preference for consumption and to the effects of taxation. The remarkable growth of the Soviet economy may be attributed to the high rate of capital investment (by the Government) and not to expansion of consumption which remains at a comparatively low level.

What stimulates investment?

Some observers hold that we could stimulate investment by making consumption rise faster. But this avoids the real issue. If a nation wants its economy to expand at a more rapid rate then it must put a greater share of its resources into capital formation and less into consumption. To favor consumption is to start at the wrong end.

That industrial managers are reluctant to expand the plants while much of their present capacity lies idle is an oversimplification. It is undoubtedly true that some of our industrial capacity has not been fully used in recent years. McGraw-Hill reported last July an 87-percent utilization in manufacturing although companies prefer to operate at a ratio about 5 points higher. But industrial capacity and its relationship to output is an elusive concept as several studies have shown. A great deal of machinery dates back many years and is more or less obsolete. It is counted as active, kept in reserve, and utilized when unusually heavy orders justify this. But in normal operation only more up-to-date equipment is used. Also, only about one-third of plant and equipment investment is intended to add to capacity while two-thirds are for modernization and replacement. European and Japanese companies have been changing to more advanced technological methods at a more rapid

[10] National Bureau of Economic Research, Princeton University Press, 1961.

rate than our industries and now have, on the average, plants which are of more recent origin and, presumably, more up to date.

What stimulates investment is high profits and what deters it is low profits. In his just published book "Capital and Rates of Return in Manufacturing Industries,"[11] George J. Stigler, economics professor at the University of Chicago, shows that a close correlation exists between long run rates of return and rates of capital investment in manufacturing. The fact is that for some years now rates of return have been falling in the United States. The First National City Bank of New York reported return on net assets of leading corporations at a high of 13.3 percent in 1950, which declined to 11.3 percent by 1956 and has been below 10 percent ever since 1958. It stood at 9.1 percent in 1962.[12]

As a percentage of GNP, corporate profits before taxes declined from 14.3 percent in 1950, to 10.7 percent in 1956, and to 8.6 percent in 1963 (first half, seasonally adjusted). Treasury Secretary Dillon recently expressed hope that corporate profits would again rise to at least 10 percent of GNP but this may not soon happen without major changes in Government policy.

Relaxation of depreciation rules and investment credits enacted in 1962 have been of help. But depreciation provisions still are more restrictive in the United States than in many other industrial nations.

Moreover, a corporation tax rate of 52 percent is a deterrent to expansion. It means that $2.08 are required in gross earnings for every $1 of needed net return. This eliminates many potential new projects from further consideration.

Corporate tax relief

The corporate profits tax was scheduled in 1954 to drop from its (Korean) wartime high of 52 to 47 percent. Personal income tax rates were permitted to fall to their pre-Korean levels but corporate tax relief has been postponed every year since 1954.

In recent years a growing number of economists have come to recognize the ill effects of our high corporation tax rate. But the proposals of the President, implemented in H.R. 8363, would reduce the rate only to 50 percent and eventually to 48 percent. By advancing payment dates they would defer a reduction in corporate tax payments until the late 1960's. Whatever slight benefit might be derived from lower corporate rates would be more than offset by the suggested repeal of the 4-percent dividend credit.

The present proposals are a bitter disappointment to those who had hoped that the promised tax reduction would be so designed as to be effective in stimulating industrial growth.

Personal income tax relief

While the proposed reductions in the rates of the individual income tax will give effective and long-needed relief to many persons, they are not likely to produce as powerful a stimulative effect on economic growth as is hoped for and needed. The income tax structure has for the past 20 years been characterized by an excessively steep degree of progression which has stifled initiative and ventures and dried up investment funds. This will not be sufficiently mitigated by the proposed new scale.

The income tax acts somewhat like a schedule of speeding fines which are intended to discourage speeding; they rise by the number of miles by which the driver exceeds the speed limit. Speeding fines succeed in keeping most drivers within the bounds of permitted maximum limits. Likewise, our exorbitant graduated rates effectively restrain the natural dynamism of our economy.

While tax relief is needed and should be granted across the board to all income classes, it ought to be most substantial in the medium and upper brackets, not to help wealthy people but to help everybody by economic expansion. One example of such a plan is the Herlong-Baker bills (H.R. 348 and H.R. 265, 88th Congress) which would reduce the rate scale of personal income taxes to a range from 15 to 42 percent and the corporate rate from 52 to 42 percent over a 5-year period. The bills have long been waiting for action in the House Ways and Means Committee.

It appears unwise at this time to free 1.5 million taxpayers from all tax liability by establishing a minimum standard deduction. Particularly in a country in which economic well-being is at a high level and widely diffused, and which is the only industrial country without a broad-based national consumption tax,

[11] National Bureau of Economic Research, Princeton University Press, 1963.
[12] First National City Bank of New York, Monthly Economic Letter, April of each year.

there is little justification for increasing the incidence of "representation without taxation."

Income distribution

There has been much misunderstanding of trends in our income distribution and many wrong conclusions have been drawn. At hearings of the House Ways and Means Committee earlier this year President George Meany of the AFL-CIO stated that "the basic reason why the American economy has grown so slowly, why our national output is so far behind our productive capacity * * * is a shortage of customers with money to spend." He continued: "Income from property—dividends, interest, capital gains—has generally gone up at a rapid rate. * * * But all this time * * * the wage earners and salary earners have been getting a smaller share of the pie."[13]

In reviewing this charge it is apparent from table V that the share of wage and salary earners in the total personal income has substantially gone up for over three decades (which is as far as these statistics go back); it continued to increase even through the years of heavy unemployment since 1956. The share of business and professional income and dividends as well as other income has meanwhile just as steadily declined.

TABLE V.—*Distribution of shares in personal income (before taxes), selected years 1929–63*

[In percent]

	Labor income and transfer payments	Dividends, business, and professional income	All other personal income
1929	61.1	17.0	21.9
1940	67.5	15.6	16.9
1950	71.4	14.1	14.5
1956	75.1	13.0	11.9
1963 (September, seasonally adjusted)	76.3	11.6	12.1

Source: "Economic Indicators," October 1963, and 1962 supplement.

The incidence of low-income families has substantially declined and this trend is still continuing, as table VI shows.

The upward push in income and the consistent narrowing of the low-income segment of our population are among the most gratifying trends in American society and will, hopefully, continue. But a tax structure which tends to penalize effort, enterprise, and success is likely to slow up this wholesome development.

TABLE VI.—*Distribution of households by real income level (before taxes), selected years 1929–62*

[In percent]

Family personal income	1962 dollars (price adjusted)		
	Under $4,000	$4,000 to $7,999	$8,000 and over
1929	70	22	8
1947	44	40	16
1959	33	40	27
1962	31	39	30

Source: "Survey of Current Business," April 1963.

Taxes, wages, and unemployment

The most important benefit which many expect to result from pending tax revisions is a significant reduction of unemployment. The Chairman of the Council of Economic Advisers was recently quoted as predicting that "the proposed tax cut will add 2 or 3 million jobs to the economy in the next 2½

[13] "President's 1963 Tax Message," hearings, op. cit., p. 1957.

years," [14] and has expressed the hope that it will bring the unemployment rate down from its level of 5 to 6 percent, in recent years, to 4 percent or less.

This assumes that our present unemployment is of a cyclical nature, that it is due mainly to lack of sufficient aggregate demand, and that it will rapidly melt under the impact of a fast-growing GNP. But an increasing number of economists are coming to the conclusion that much of our large unemployment is due to a growing imbalance between the nature of available job openings, certain traits of the unemployed labor force, and the prevailing wage structure. If this view is correct, unemployment will not yield to accelerated economic growth. The President remarked at his news conference of October 11, 1962, that "we could have a great boom and still have the kind of unemployment they describe."

Until not so long ago it was widely taken for granted that lack of available work was the cause of our high rate of unemployment. The rate averaged 3.9 percent of the civilian labor force in 1946–48, 4.3 percent in 1955–57, 6 percent between 1958 and 1962. It stood at 4.8 percent (seasonally adjusted: 5.6 percent) in September 1963. This means that 1 in 20 of the men and women whom the Bureau of Labor Statistics counts as members of the civilian labor force reported that he or she wanted a job and did not have one. It does not mean that the total number of jobs available in the economy—i.e., work to be performed in terms of man-days—was 4.8 percent short of the number of persons willing to fill them.

In the same month, last September, 7.4 percent of all hours in manufacturing (the only industry for which this information is available) were overtime hours, paid for at premium rates. The industry could have employed, at regular hours, all of its workers and all of its unemployed—and still have had to get over 2 percent of its work done on overtime pay. Labor Secretary Wirtz was quoted as saying, "I think we have got to start asking whether things are working right if 7 percent of our work is being done on an overtime basis, when we have got 5 to 6 percent unemployment." [15]

There may be several reasons why a company prefers to keep its workers overtime and pay them a 50-percent premium. But since managers as a rule try to keep costs down and do not without good cause pay rates which are 50 percent higher than necessary, we may assume that there were not enough competent workers available for hire. In other words, what was in short supply was not work to be performed or job openings, but competent workers whose output was at least the equivalent of a regular hourly wage. Companies apparently found that some of their workers were worth 150 percent of the established wage rate, while some of those looking for jobs were not even worth the regular rate.

As stated, this may be an oversimplification and, unfortunately, there are no statistics available on the number of available job openings. By and large, however, this probably describes the situation correctly.

Many facts appear in employment statistics which ought to give us cause to ponder. Why are 5 percent of all workers able to locate and hold several jobs simultaneously while an equal number can't find even one? Why is the unemployment rate as low as 2.6 percent among heads of households living with their families but averages between 5.2 and 11 percent among the various other classifications which consist of persons not responsible for the support of a family? Why is the unemployment rate at 2.1 percent (equal to 1 in 48) among men 35 to 44 years old, 7.2 percent among men 20 to 24, 4.8 percent among women 35 to 44 and 9.6 percent among women 20 to 24 years old? Do such discrepancies suggest merely a lack of job openings or a more serious imbalance? Should an unemployment rate of 3.5 percent among white men and 8.5 percent among nonwhite men be wholly attributed to discrimination in hiring or are other factors partly responsible?

Many of the men and women who report themselves to be unemployed in the monthly labor force surveys are not hired either because they lack the necessary qualifications or because they do not have a productive capacity which is at least equal to the established wage rate. They form the "hard core" of the unemployed.

This suggests that (*a*) many persons lack the training to fill available openings, and that (*b*) wage rates have risen to a level which exceeds the value of the work output of a growing number of low-skilled or unskilled persons. If so, the cause of high unemployment is not inadequate demand and it is unlikely to be cured by tax relief and a faster growth of GNP.

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[14] Newsweek, Oct. 21, 1963.
[15] Wall Street Journal, Feb. 5, 1963.

In a recent study, Lowell E. Gallaway, Chief of the Analytical Studies Section of the Social Security Administration, concluded that:

"The post-1957 experience in the United States represents a classic case of wage-push inflation with its attendant unemployment effects. And, of course, alleviation of this unemployment through a deliberate stimulation of aggregate demand (such as the proposed tax reduction) merely alters the situation to one of "qualified" wage-push inflation."[16]

Unemployment is heaviest among persons with inadequate occupational training after school and little or no experience, and among the unskilled. About 1 in 7 teenagers, 16 to 19 years old, in the labor force, is listed as jobless. Unemployment is three times as frequent among teenagers as among adults. It is interesting to note that "in Great Britain, the unemployment rate for young people (aged 15 to 19) has generally been lower than for any other group, having seldom gone much over 1 percent in the postwar period * * *," according to a report of our Bureau of Labor Statistics.[17]

Even considering a difference in statistical methods, this contrasts sharply with an unemployment rate of 14.7 percent for boys, 15.8 percent for girls, 16 to 19 years old in the United States in September 1963. Part of the explanation may be found in a comparison of the British and the American school systems, curriculums, occupational training, and attitudes. But a major reason probably is that in Great Britain young people must first serve an apprenticeship of several years at merely nominal wages (virtually pocket money) until their work output justifies paying them a regular wage. Many of our teenagers are not hired because they are not worth the wage rate which they would have to be paid.

The unemployment rate among married men, with the wife present in the household, was only 2.3 percent (equal to 1 in 43) in September 1963 which is the lowest rate since early 1957. Since the incidence of unemployment declines conversely with the level of skill, we may assume that it was even lower among skilled workers. Unemployment rates of both sexes and all ages were, in September 1963:

	Percent
Managers, officials, and proprietors	1.6
Professional and technical workers	1.8
Craftsmen and foremen	2.8
Sales workers	4.0
Clerical workers	4.2
Operatives	6.2
Nonfarm laborers	[1]9.0

[1] "Monthly Report on the Labor Force," September 1963.

In an anaysis of trends during the 1950's, based partly on unpublished statistics, which was presented on September 20, 1963, to the Senate Subcommittee on Employment and Manpower, Prof. Charles G. Killingworth, of Michigan State University found: "Clearly, unemployment at the bottom of the educational scale was relatively unresponsive to general increases in the demand for labor while there was very strong responsiveness at the top of the educational scale."

Mr. Killingworth's conclusion was: "the lagging growth rate is only a part of the problem, and it may not be the most important part. I think that it is extremely unlikely that the proposed tax cut, desirable though it is as part of a program, will prove to be sufficient to reduce unemployment to the 4-percent level."

One reason often advanced for the concentration of unemployment, and particularly of long-range unemployment, among persons of low skill and little education is technological progress which has upgraded occupational requirements and wiped out hundreds of thousands of common laboring and other simple jobs. This, it seems to me, is not an adequate explanation.

In a free market the price of scarce goods will rise faster than the price of goods which are in surplus. But studies of wage trends have shown that occupational differentials have been narrowing and that the pay rates of skilled workers have been climbing more slowly than those of unskilled

[16] Lowell E. Gallaway, "Labor Mobility, Resource Allocation, and Structural Unemployment," the American Economic Review, September 1963.
[17] Joseph S. Zeisel, "Comparison of British and U.S. Unemployment Rates," Monthly Labor Review, May 1962.

workers. This was demonstrated in an analysis by Paul G. Keat of IBM, "Long-run Changes in Occupational Wage Structure, 1900-56." [18]

The "Economic Almanac" for 1962 (p. 60) showed that the earnings of members of skilled occupations as a percentage of earnings in unskilled occupations dropped from 205 to 138 over a 50-year period.

This suggests that the wages of less skilled and unskilled workers were not set in a free market but by nonmarket factors—largely union pressure with Government support—which boosted contractual or legal minimum wages to a level that exceeded the productivity of many. A large number of unskilled jobs were not wiped out by automation nor by too slow an economic growth rate but by wage rates which left an employer only the choice between hiring a worker at a loss or not hiring him. With the steady rise in legal and contractual minimum wages we may expect the unemployment rate to continue its long-range upward climb. A tax cut and even rapid economic growth are likely to be of only limited benefit to unskilled workers.

The outlook is truly grave in the light of recent trends. During the past 7 years the civilian labor force increased by 5.6 million persons, of whom only 37 percent located in private employment, more than two-fifths were added to Government payrolls, and almost one-fourth swelled the ranks of the jobless, as table VII shows:

TABLE VII.—*Increase in the civilian labor force between 1956 and 1963 (September, seasonally adjusted)*

	Number	Percent
Increase in private employment	2,069,000	37
Increase in governmental employment	2,299,000	41
Increase in unemployment	1,238,000	22
Increase in the civilian labor force	5,606,000	100

Source: "Economic Indicators," October 1963, and 1962 supplement.

In the next 7 years the civilian labor force is estimated to expand by about 10 million, or twice as much as in the past 7 years. How will those millions of new entrants find jobs while the present imbalance between productivity and wage rates continues?

It has occasionally been suggested to cure unemployment (and accelerate economic growth) by sharply boosting wage rates and particularly minimum wages. This is like telling a merchant that he ought to double the price of goods which he has been unable to sell. Instead of not selling them at $1 he will then not sell them at $2. Are workers who cannot find a job at $1.50 likely to improve their chances by having their wage rate lifted to $2 or $2.50? This will push up prices and make more people "unemployable." If raising wages were an effective method to stimulate rapid economic growth and employment, why don't we double them? Why don't some of the underdeveloped nations—where wages are truly low—lift themselves by their bootstraps by boosting wage rates?

To raise wages, in our present situation, to a substantially higher level would augment the purchasing power of workers able to keep their jobs and add to their effective consumer demand. But it would also make the competitive standing and profit picture of our industries more difficult, tend to channel orders and capital flow abroad, and further restrict the range of jobseekers with a reasonable chance to be hired at prevailing wage rates. It could turn out to be the most effective method of widening the ranks of the involuntarily idle.

Some regard it as a mere coincidence that in the United States, where workers enjoy by far the highest wages in the world, the incidence of unemployment also is much higher than in other industrial countries. The Council of Economic Advisers remarked in the "Economic Report of the President," January 1962, that "the post-Korean years were marked by the *coincidence* of relatively large wage increases with declines in industry employment." [Emphasis supplied.]

[18] The Journal of Political Economy, December 1960.

Further analysis could produce more cases of such "coincidence." It is likely that there is a causal relationship between wages that rise faster than productivity and an economy which is unable to employ all workers who are available at those rates.

Senator Paul Douglas once explained this relationship:

"As has been stated, the curve of the diminishing increments attributable to labor seems to be so elastic that if wages are pushed up above marginal productivity there is a tendency for the employed workers to be laid off at approximately three times the rate at which wages are increased. Labor under the capitalistic system, therefore, tends in the long run to lose appreciably more through diminished employment when it raises its wages above marginal productivity than it gains from the higher rate per hour enjoyed by those who are employed. The converse of this is that when wages are thus above the margin, a reduction in the wage rate will help labor as a whole and increase the total amount paid out in wages by causing appreciably larger increases in the numbers employed and hence a decrease in the volume of unemployment." [19]

An effective way to accelerate economic growth and combat unemployment would be not to raise wages in keeping with (or more than) advances in productivity but to keep wages stable and let prices fall. This would improve our international competitive standing and boost the purchasing power of persons whose income does not rise at the same rate as wages established by collective bargaining or minimum wages set by legislation.

American practice in the postwar period has favored continuous rounds of wage boosts. The 1962 "Economic Report" recorded the average annual increase in output per man-hour in private nonagricultural industries during the postwar period (1947–61) at 2.9 percent, the corresponding boosts in hourly compensation at 5.1 percent. Much of the steeper increase in wage rates was, of course, expressed in and consumed by the resulting price rises. But part of it benefited some of the workers—those who were able to hold on to their jobs.

Another part of the wage increases came out of profits. Under the pressure of growing competition from home and abroad and under Government influence, companies were reluctant to raise prices and absorbed part of the higher costs. This explains the oft-mentioned fact that prices have been rising at a slow rate, approximately 1.5 percent per annum, for the past 10 years. In fact wholesale prices have remained perfectly stable for the past 5 years. This found its expression in a shrinkage of profits. Corporate net profits declined as a percentage of sales from 5.3 percent in 1950 to 3.7 percent in 1956, and have ranged from 2.8 to 3 percent in the past 3 years. As a percentage of national income they averaged:

	Percent of national income
1948–52	7.7
1953–57	6.3
1958–62	5.4
1963 (first half)	5.5

The profit squeeze made companies increasingly cost conscious. In an attempt to economize they kept hiring at a minimum and became more selective in regard to skills and qualifications of new workers. This is not likely to be changed until the wage-price structure and lower corporate tax rates enable companies again to earn adequate profits.

It may be well at this point to recall a pertinent statement by John Maynard Keynes:

"Unemployment, I must repeat, exists because employers have been deprived of profit. The loss of profit may be due to all sorts of causes. But, short of going over to communism there is no possible means of curing unemployment except by restoring to employers a proper margin of profit." [20]

Summary

The proposed cuts in personal income tax rates will be of material help to most taxpayers and spur the economy. They will ease some near-confiscatory rates to lower, if still exorbitant, levels, and effectively reduce the liability of persons in low-income brackets. But a tax cut which makes our tax structure

[19] Paul Douglas, "Controlling Depressions," Chicago, Norton, 1935, p. 221.

[20] John Maynard Keynes, "Essays in Persuasion," New York, Harcourt, Brace & Co., 1932, p. 275.

more progressive by allocating the relatively greatest benefits at the lower end of the scale and gives little relief from the corporate income tax, is not likely to provide maximum stimulation to economic growth. It may lead to an increase in the number of jobs, but I doubt that tax reduction can make a major impact on our present type of unemployment which is caused by an imbalance between the type of available job openings, certain traits of part of the labor force, prevailing wage rates and profits.

The rate of economic growth could be more effectively stepped up by giving greater relief to the sectors which have lagged behind the rest of the economy, particularly behind private consumption and Government spending, namely business profits, and capital formation, and by increasing incentives for effort and enterprise. Government should not hold a majority interest in anybody's income, and the top rate of the personal income tax should not exceed 50 percent. The medium bracket rates would not be given sufficient relief under the provisions of H.R. 8363. I believe that they ought to be lowered by at least one-fourth from their present levels. The corporate tax rate should be gradually cut to about 40 percent, and depreciation allowances further liberalized.

II. SHOULD RATE CUTS BE LINKED WITH TAX REFORM?

In the lively tax debates of recent years the term "tax reform" has acquired a specific and somewhat restricted meaning: a broadening of the tax base through a reduction of exclusions, exemptions, deductions or credits. The principle of that type of tax reform is almost noncontroversial: everybody agrees that a broad tax base with low rates is preferable to a narrow base with high rates. But there is probably no more controversial subject in the tax field than the question which of the various provisions freeing certain types of income from the tax ought to be narrowed or eliminated. As a result, very few of the much-talked-about reforms have ever come close to enactment.

The most frequently heard assertion in this debate which reached its climax in the second half of the 1950's was that Congress by intent or oversight had permitted hundreds of loopholes to slip into our tax laws. Those escape hatches, it was said, enable the rich to avoid much or most of their tax liability while low-income persons, particularly wage earners who have their income taxes withheld, are subject to the full impact of the nominal rates of the law. One tax expert told the House Ways and Means Committee, in 1959, that "our tax law is riddled by the benefits that are given to the wealthy, and for the most part the benefits that are given to the average man are negligible."[21] That charge has a strong emotional appeal, but is contrary to the facts.

It is true that the personal income tax reaches less than half of all income. The percentage of personal income which appears as "taxable" on Federal income tax returns equalled only 43 percent in 1960, up from 37 percent in 1950, and 31 percent in 1945. Available statistics do not permit us to compare personal income with taxable income by income brackets. But we can relate adjusted gross income to taxable income. Such a comparison, as shown in table VIII, reveals a steeply progressive scale: 26 percent of the income of persons making less than $3,000 is taxable; then the percentage rises sharply, equals 58 percent in the $7,000 to $10,000 bracket, and reaches 80 percent between $25,000 and $100,000 income. At $100,000 and over it equals 78 percent.

TABLE VIII.—*Taxable income as a percentage of adjusted gross income, 1960*

Income class, AGI	*Percent*
All	54
Under $3,000	26
$3,000 to $5,000	42
$5,000 to $7,000	49
$7,000 to $10,000	58
$10,000 to $15,000	67
$15,000 to $25,000	74
$25,000 to $100,000	80
$100,000 and over	78

Source: U.S. Treasury Department, Internal Revenue Service, "Statistics of Income * * * 1960; Individual Income Tax Returns for 1960, 1962."

[21] "Tax Revision Compendium," papers submitted to the Committee on Ways and Means, H.R. 1959, vol. 1, p. 538.

A comparison, by brackets, between personal income according to concepts of the Department of Commerce, and taxable income according to tax returns, would, if it were statistically possible, undoubtedly reveal an even steeper progression than appears in table VIII.[22] The fact is that most of the income in the higher brackets is subject to the Federal income tax and much or most of the income in the low brackets is not.

Most of the $228 billion personal income not subject to Federal taxation—the difference between personal income and taxable income—accrued to the benefit of persons in the lower brackets, as is evident from table IX.

TABLE IX.—*Taxable and nontaxable personal income in 1960*

	Billion	Percent
Taxable income	$173	43
Nontaxable income	228	57
All personal income	401	100
Nontaxable income	228	100
Social welfare payments	29	
Exempt labor income (employee welfare plans, etc.)	10	
Computed rent on owner occupied homes	7	
Other imputed (nonreceived) income	11	
Income in kind	4	
Exempt military pay	2	
Property income of nonprofit organizations	2	
Other	5	
Total	70	
Items which are taxable, although not income:		
Capital gains	6	
Contributions to social insurance	9	
Other	3	
Total	−18	
Grand total	52	23
Personal exemptions	98	43
Itemized deductions	33	14
Standard deductions	12	5
Nonreported income	33	14

Source: Computed from: "The Tax Base for Individual Incomes," Survey of Current Business, May 1963, and IRS "Statistics of Income, 1960."

Personal exemptions, social welfare payments, standard deductions and imputed income account for close to three-fourths of the difference between personal income and taxable income. Unreported income is estimated at $33 billion (of which more than $5 billion may be disclosed in the audit process) and itemized deductions amounted to $33 billion. Itemized deductions have figured prominently in the debate as a means of escape from income taxes for wealthy persons. However, table X shows that deductions were relatively larger in the low brackets.

[22] Most of the items, which are counted as personal income by the Department of Commerce, but not included in adjusted gross income, accrue to low-income persons; e.g., social security, public assistance, unemployment compensation payments, income-in-kind, imputed income, etc. Capital gains, on the other hand, are included at 50 percent in adjusted gross income but not regarded as personal income and are wholly excluded by the Department of Commerce; see table IX.

TABLE X.—*Itemized deductions claimed on 1960 personal income tax returns as a percentage of adjusted gross income (AGI)*

Income class, AGI:	Percent
All	18.7
Under $3,000	24.1
$3,000 to $5,000	21.7
$5,000 to $7,000	20.1
$7,000 to $10,000	18.9
$10,000 to $15,000	17.4
$15,000 to $25,000	15.9
$25,000 to $100,000	15.0
$100,000 and over	20.4

Source: U.S. Treasury Department, Internal Revenue Service, "Statistics of Income, 1960; Individual Income Tax Returns for 1960." 1962.

It is, of course, true that much adjusted gross income in the top brackets is not taxed at the nominal rates of the personal income tax. If it were, our economy would have fallen into stagnation long ago. Capital gains are the major reason for the difference between nominal and actual tax rates at high income levels and account for close to two-thirds of total realized income in the top brackets. An attempt to tax capital gains at regular rates would sharply restrict capital mobility, freeze investments with unrealized gains, and might result in less revenue.

Most of the demands to close the loopholes have ignored the big nontaxable items of personal income and focused attention on relatively small items. Had the proposals been enacted they would have broadened the tax base by little and not added significant sums to revenue. But those revisions would have made the income tax more progressive. To redistribute income more drastically, rather than to broaden the tax base, seems to have been the purpose of the "close the loopholes" drive.

The late Senator Robert S. Kerr wrote in an article in Look magazine, March 13, 1962:

"One of our most persistent national myths is that U.S. tax laws include provisions that favor small groups of people and permit them to escape paying their fair share of taxes. The statement is frequently made—by some professors, editors, economists, authors, radio and TV commentators, and even a few politicians—that if Congress would close loopholes, substantial reduction in income taxes could be made. After serving on the Finance Committee of the U.S. Senate for over 12 years, I have come to the conclusion that the word 'loophole' is loosely used to apply to some provision of the Internal Revenue Code that some industry, group of persons or individual does not like, regardless of its merits."

Little revenue would be added by eliminating the most frequently mentioned loopholes. Several years ago, I concluded that "substantial reductions in tax rates through the closing of loopholes is not a hope but a mirage." [33]

Simplification of our tax laws is, of course, highly desirable. But it is unlikely to happen as long as taxes are as heavy as they now are. Theoretically, we could repeal all exclusions, exemptions, deductions, credits, and other differentials and collect as much revenue from a comprehensive income tax with a flat rate of 10 percent as we do now with rates ranging from 20 to 91 percent. But this is politically impossible.

That a tax statute as intricate as our Internal Revenue Code contains some inequities is virtually inevitable. As they are found and recognized as flaws they should be corrected. This is why tax reform must be a continuous process rather than a one-shot proposition.

The President recommended certain revisions in his 1961 tax message and announced that he would place a comprehensive tax reform program before the succeeding session of Congress.

Most of the changes which the President recommended in his 1963 tax message were not of a major character except the plan to place a 5-percent floor under itemized deductions. This would have sharply curtailed the use of deductions and adversely affected donations to many worthy causes. When 103 and 104 witnesses testified against it, the House Ways and Means Committee quickly killed the proposal.

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[33] Roger A. Freeman, "Taxes for the Schools," Washington, the Institute for Social Science Research, 1960, p. 96.

The President subsequently explained why he refrained from advocating more extensive tax reform at this time. He felt that the cut in tax rates—which he called the most important domestic economic legislation in 15 years—should not be jeopardized or delayed by injecting highly controversial issues which faced a doubtful reception by Congress. Several major organizations, of labor and of management, also have sugegsted that pending desired structural changes were of secondary importance (and some of questionable merit), and should not be permitted to interfere with prompt action on rate reductions.

A substantial majority of those who have participated in this debate expressed their belief that the most urgently needed tax reform is a lowering of our exorbitant income tax rates and that other desired changes should wait their turn. I agree with this proposition. While there are many provisions in the Internal Revenue Code which ought to be thoroughly scrutinized and amended, I can see no reason why this should be tied in with rate reduction. A structural revision which cannot find approval on its own merits without a "sweetener," may not necessarily be an improvement. I question whether it is good procedure to gain through simultaneous rate cuts the consent of a majority for the placing of heavier taxes on a vote-weak minority.

H.R. 8363 contains several structural changes with relatively small revenue consequences. Some of them, and I mention particularly the sick pay exclusion, casualty loss deduction, and moving expenses, are desirable.

Four changes in H.R. 8363 are more substantial. The elimination of gasoline, alcohol, tobacco, and certain other minor State and local taxes as deductible items serves to broaden the tax base. It also makes it somewhat harder for States and localities to finance their own highway construction and other activities, and establishes a questionable precedent.

To reduce from 50 to 40 the percentage of capital gains on items held more than 2 years which are includible in income is a desirable change. A reduction to 30 percent, as proposed by the President, would have been even better.

Is it good public policy to free 1.5 million taxpayers from all tax liability by the establishment of a minimum standard deduction? What effect will that have on their interest in the fiscal operations of the Government and on their attitude toward expansion of benefits in whose financing they do not share?

The purpose of permitting deductions from adjusted gross income is to give due consideration to relatively heavier burdens or to recognize donations to worthy causes. A modest "standard" deduction is justified for administrative convenience. But to expand that privilege, regardless of burdens actually borne, opens a loophole and narrows the tax base for no legitimate reason.

To repeal the dividend credit would prove detrimental to economic growth. The credit was established in 1954 to encourage equity investment and to give at least a token recognition to the fact that not all of the corporate profits tax is shifted to consumers, and that some part of it is borne by stockholders and taxed twice. The credit ought to be raised to 10 percent. The Treasury's argument in favor of repeal [34] can be reduced to the aim of making the tax structure more steeply progressive.

Summary

The most urgently needed tax reform is a reduction of personal and corporate income tax rates. Other tax revisions should be acted upon in due course and separately.

Some of the structural changes in H.R. 8363 are desirable improvements. I believe, however, that the creation of a minimum standard deduction and repeal of the dividend credit are detrimental and ought to be eliminated from the bill.

III. SHOULD A TAX CUT BE ACCOMPANIED BY RESTRAINTS ON SPENDING?

The House debate on H.R. 8363 turned almost exclusively on whether Congress was justified in cutting taxes at a time of rising expenditures and big deficits. There was, to be sure, concern over some of the substantive provisions of the bill, but lack of opportunity to amend it under the closed rule focused most attention on the merits of an action which, at least initially, would substantially increase the size of budgetary deficits and of the national debt. This fairly reflected the uneasy feeling among broad sections of the

[34] "President's 1963 Tax Message," hearings, op. cit., pp. 246 ff.

American public which was well summed up in the New York Times of September 22, 1963, by John D. Morris:

"Despite the heaviest tax burden in history, the average voter today seems to be less interested in getting some relief from it than in balancing the Federal budget."

The results of several Gallup polls were confirmed by dozens of polls which Members of Congress conducted in their own constituencies: About three-fourths of the American people are opposed to a tax cut which would boost the deficit and the national debt. They may be less sophisticated than some of our governmental economists but are reluctant to believe that we can create lasting prosperity by spending beyond income and providing the necessary money by printing it.

Do budgetary deficits create lasting prosperity?

A contracyclical policy of "leaning against the wind," and of balancing the budget not annually but over the business cycle, has become widely accepted, not only by economists but, as several polls have shown, also among the general public. But what is proposed here is something much more ambitious—to raise through planned sizable deficits the prevailing rate of economic growth.

The American economy is not now in a recession and has not been in one for some time. It is on the whole prosperous and gives no indication of an imminent or impending downturn. GNP is continuing to expand at least at its long-range historical rate.

Of course, everybody would be happy if national income grew more rapidly. Would a planned budget deficit in the next 2 fiscal years produce a lasting increase in the rate of economic progress and lead to rising Government revenues and balanced budgets several years hence, as the President promised? Or shall we be told 2 or 5 years hence that the rate of growth still is not high enough, or the rate of unemployment not low enough, to permit our budget-makers to keep expenditures within revenues?

The President warned the Business Committee for Tax Reduction last September: "If this program isn't successful, then other means must be suggested." He and his advisers have left no doubt but that they regard a tax cut as an alternative to sharply increased Government spending. The private economy is to be given a chance to grow more rapidly with a reduced tax burden, before enlarged spending is resorted to.

The President and his economic advisers maintain that a restraint on spending would nullify the beneficial effect of the tax cut. The latter would boost aggregate demand but lower spending would reduce it. The assumption behind this belief is that the drag on the economy is not caused by our lopsided and excessive tax structure but by the fact that budgetary deficits have not been big enough. This was clearly indicated by John P. Lewis, a member of the Council of Economic Advisers, who told his audience at Notre Dame University on September 11, 1963, that taxes "had gotten too high relative to Government expenditures."

A statement supporting the administration's proposals, signed by about 400 economists, suggested that the economy might be spurred to faster growth "by reducing tax revenues, by increasing Government expenditures, or by some combination of the two."[55]

The proposition that what this country needs is bigger deficits now, if it is to have balanced budgets later on, suggests, as George J. Stigler of the University of Chicago remarked, that "the way to avoid a huge deficit is to seek a large one."

The theory that large budget deficits raise the rate of economic growth or lift employment to sustained higher levels has never been proven. Federal outlays in the fiscal years 1933–34 through 1938–39 were twice as large as in the preceding 6 years with virtually all of the additional funds deficit financed. But unemployment declined only from an average of 12.4 to 9.9 million, which still left one of every six workers unemployed. The Federal deficits of the mid-1930's were, in relation to the size of the economy, equivalent to a present annual deficit of $20 to $25 billion. If a red balance of that magnitude for several successive years does not bring back full employment and prosperity, how big an annual deficit would we need, and for how long, to have the desired impact?

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[55] Congressional Record, Sept. 30, 1963, p. A6118.

Federal cash transactions in the dozen years 1946 through 1957 yielded an aggregate surplus of $11 billion, and the unemployment rate averaged 4.2 percent. In the succeeding 5 years, from 1958 through 1962, the Federal Government ran a net cash deficit of $24 billion, and unemployment averaged 6 percent. The President proposed in January 1963 an aggregate cash deficit of $18.6 billion for the fiscal years 1963 and 1964, but this is unlikely to reduce unemployment to the level that prevailed prior to 1957.[26]

Last February, George Terborgh, research director of the Machinery and Allied Products Institute, presented to the Joint Economic Committee a quarterly analysis of Government deficits and economic growth rates in the postwar period.[27] It showed a slightly positive correlation between budget surpluses and rising GNP (+0.39) when related to simultaneous economic data, and virtual zero correlation (—0.04) with a 6-month lag between budget and GNP figures.

There has been much comment on a study by Andrew H. Gantt according to which the United States incurred fewer and smaller budget deficits in the 1950's than Great Britain, France, and Germany.[28] Subsequent research by Michael E. Levy generally confirmed Gantt's findings but did "not indicate any systematic relationship between budget deficits and growth" in a comparison of the United States and six European countries. The study "does not support current arguments which imply that larger deficits, or low-saving budget structures, as such, are bound to result, almost automatically, in accelerated economic growth over the years."[29] Another comparative analytical study of the United States and several other countries by Beryl W. Sprinkel suggested that economic growth was more likely to be spurred by monetary expansion than by larger deficits.[30]

It is well known that some of the experts which the U.S. Government dispatched to West Germany after World War II advocated enlarged public spending and deficit financing as means to achieve prosperity but that the German Government disregarded their advice. In a recent illuminating book, "Fiscal Policy for Growth Without Inflation: The German Experiment," Frederick G. Reuss demonstrated how the German Government's conservative budget policy was followed by spectacular economic growth.[31] The proof is yet lacking whether a deficit policy improves a country's economy or whether it only helps temporarily to cover up an underlying imbalance or deficiency.

Does public spending reduce unemployment? The example of public works

It may well be said that such historical comparisons and analyses are interesting enough but cannot disprove an obvious fact: government can, by spending substantial sums which were not collected by taxation but created through the central banking system, place large numbers of jobless workers on its payroll or have them employed by giving contracts to private industry. The most frequently cited example of putting idle men to work is public works expansion. An enlarged public works program was approved in 1962, and additional authorizations are now under consideration in the House Public Works Committee.

It has been estimated that $1 billion in new public funds could put 100,000 additional men to work on construction.[32] Would this be a net addition to employment or could the award of 1 billion in Government contracts have an adverse effect on prices, private demand, and other employment?

Construction prices have been rising much faster than other prices for as

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[26] According to more recent estimates the deficit may actually be somewhat smaller; but this is immaterial to the basic argument over the growth-creating effect of deficits.

[27] "January 1963 Economic Report of the President," hearings before the Joint Economic Committee, 88th Cong., 1st sess., 1963, pt. 2, pp. 773 ff.

[28] "Central Governments: Cash Deficits and Surpluses," the Review of Economics and Statistics, February 1963.

[29] Michael E. Levy, "Fiscal Policy, Cycles, and Growth," National Industrial Conference Board, 1963, pp. 51, 56.

[30] "Relative Economic Growth Rates and Fiscal Monetary Policies," the Journal of Political Economy, April 1963.

[31] The Johns Hopkins Press. Reuss also showed what happened when the German Government abandoned the steeply progressive tax structure which the Allied Control Council had imposed in 1946, and sharply reduced progression in the income tax while increasingly relying on consumption taxes: the economy boomed and Government revenues increased.

[32] This does not consider the so-called secondary (offsite) employment, nor the fact that much of the need would be for skilled workers and technicians rather than for semiskilled workers and laborers who constitute the bulk of the hard-core unemployment.

far as our statistics go back (to 1915). Taking 1915 as 100, prices and wages stood in mid-1963 as follows:

Wholesale prices	263
Consumer prices	302
Construction prices	539
Building materials	465
Building trade union hourly wages	856

Sources: Construction Review, September 1963 and Statistical Supplement. U.S. Department of Labor, Union Wages and Hours, Building Trades, 1962. Economic Indicators, October 1963. U.S. Bureau of the Census, Historical Statistics of the United States, 1960.

Construction wages and prices continued to rise more rapidly than other wages and prices right through the period of heavy unemployment since 1957. The offering of huge Government construction awards would have an impact on wage negotiations, lead to steeper boosts in contract renewals and result in still higher construction prices.

A one-family house now costs 5.4 times as much as an equivalent house would have cost 50 years ago, while other prices, wholesale or retail, multiplied only 2.6 or 3 times respectively. Obviously, many more houses could be sold if construction prices had risen only in proportion to other prices and if a modest residence would now cost $8,000 instead of $15,000. Large numbers of low-income earners have been driven out of the housing market and remain in substandard dwellings.

In other words, a large public works program, while directly employing additional workers, would tend to push prices up even faster and to eliminate more marginal would-be buyers from the housing market. It would depress private demand and, in the end, might lead to less aggregate employment in construction.

Do budgetary deficits lead to inflation?

The widespread aversion to governmental deficit spending is related to one common fear: that it would lead to inflation. Few can forget that the dollar lost half its value between the mid-1930's and the early 1950's.

Opponents to spending restraint reply that prices have been rising very slowly over the past 10 years in spite of sizable deficits. Consumer prices increased an average of only 1.5 percent per annum and wholesale prices have remained stable for the past 5 years. This does not suggest an automatic or inevitable correlation between deficits and prices. Moreover, we are told, there is no likelihood of inflation as long as we have sizable unemployment and unused productive capacity.

But unemployment, though substantial, is not uniform across the board. It is concentrated at lower levels of skill. Added demand may not provide many new jobs for laborers or miners but would strengthen the bargaining power of employed workers and also lead to more overtime and more moonlighting.

The upward trend in wages continued through the period of heavy unemployment. Prices rose only moderately because companies managed to cut costs; i.e., did less hiring and narrowed profits, which in turn affected investment.

If deficit financing were an effective method to accelerate economic growth and reduce unemployment, few countries would have a serious problem. All their governments would need to do is to run the prining press and spend more than they take in. In fact, several dozens of countries in Asia, Europe, and Latin America, in various stages of economic development, have done exactly that time and again over the past 1,000 years; almost always with catastrophic results.

Such comparisons, we are told, are irrelevant because we are not faced with runaway inflation. A moderate and gradual expansion of public demand is not likely to boost annual price rises by much more than the 1.5 percent per annum which we have experienced for the past 10 years. This is a small price to pay for accelerated growth.

But a continued upward trend in prices of 1.5 percent per annum is not quite as harmless as it may appear. It means an increase of 50 percent in 27 years. It may cause mortgage money to cost 6 percent per annum instead of 4.5 percent. So the interest cost of buying a home, a large share of the total cost, will be one-third higher. It keeps the interest cost of Federal, State, local, and corporate bonds high because lenders will try to protect themselves against loss of principal value. It shrinks the purchasing power of millions of

persons whose income does not rise with the Consumer Price Index or the next contract renewal.

Last not least: the deficits we have experienced in recent years have not brought rapid economic growth or full employment. Has this caused the advocates of deficit spending to reexamine their premise? Quite the contrary; they now assert that deficits have not been big enough and ought to be enlarged. If larger deficits do not end high unemployment there will be clamor for still bigger ones.

Deficit financing is like taking narcotics; it is habit forming. To produce a pleasant sensation, the doses must be steadily increased and the patient becomes wholly dependent on them. If a $5 billion deficit won't bring full employment and 5 percent annual growth in GNP, why not try $10 or $20 billion? The President has already indicated that if the present program, which would mean an initial deficit close to $10 billion, is not successful, other means would have to be found. Those other means, it is implied, are enlarged Federal expenditures.

The growth rate of Federal spending—too rapid or too slow?

In view of the public's uneasiness over tax cuts at a time of big deficits, the President recently announced his intention to keep spending under control. In a letter to the chairman of the House Ways and Means Committee he declared that "our long-range goal remains a balanced budget in the balanced full employment economy" and that "tax reduction must also, therefore, be accompanied by the exercise of an even tighter rein on Government expenditures."[33] This was written in response to a request in the preamble of H.R. 8363 (sec. 1):

"Congress by this action, recognizes the importance of taking all reasonable means to restrain Government spending and urges the President to declare his accord with this objective."

We may ask: How serious are such general declarations to be taken? What recommendations have come forth to implement them? How do they harmonize with the administration's general policy?

The record provides the answer. At his news conference on April 3, 1963, the President declared that nondefense expenditures ought to rise faster, and added:

"I am concerned that we are not putting in enough, rather than too much, because the population of the country is growing 3 million people a year."

Over the past 10 years the country's population has grown 19 percent, while the Federal Government's non-war-connected expenditures jumped 245 percent.[34] If an increase of that size within 10 years is held to be "not putting in enough," how much is enough?

The President has sent to the 88th Congress over a hundred new or enlarged spending proposals which would add $3 billion in the fiscal year 1964 and more than $17 billion in a 5-year period. He demanded that the proposals be promptly enacted and did not indicate a willingness to withdraw or postpone any of them. In fact, the House was advised that the "exercise of an even tighter rein on Government expenditures" would not affect any of the President's recommendations for new programs.[35]

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[33] Congressional Record, Sept. 24, 1963, p. 16987.
[34] Computed as follows:

Federal cash expenditures 1954 and 1964 (payments to the public)

	1954 (actual) (billions)	1964 (proposed by President) (billions)	Increase (percent)
Total expenditures	$71.9	$122.5	+70
War-connected (national defense, international affairs, space activities, veterans benefits, interest on the national debt)	58.6	76.7	+31
Domestic purposes	13.3	45.8	+243

Source: The Budget of the U.S. Government, fiscal year ending June 30, 1964, p. 430.

[35] Congressional Record, Sept. 24, 1963, p. 16987.

We may ask: How are spending restraints to be implemented if they are not to affect programs which have not even been enacted yet? Would not a moratorium on new programs be easier to carry out than a cutback on established operations? If the administration intends to put the brakes on expenditures, why does it so strenuously object to formalizing restraints? Restraints of the type suggested in the House amendment to recommit H.R. 8363 could be speedily amended or repealed should circumstances arise which require and justify such action.

In his speech at Yale University on June 11, 1963, the President declared that for the last 15 years the Federal Government has grown less rapidly than the economy as a whole or any major section of our national life "and very much less than the noise about big Government."

The official record, however, reveals that between the fiscal years 1948 and 1963, GNP increased 129 percent, Federal spending 220 percent (table XI). War-connected outlays expanded 146 percent, while spending for domestic purposes jumped 525 percent, which is more than four times the growth rate of the GNP.

An analysis of expenditure trends, as summarized in table XI, suggests the possibility of a danger far worse than runaway expenditures or inflation: national security projects may be deferred or rejected in order to make resources available for welfare and other civilian purposes. That would not at all be a new experience. In a careful study of the postwar record of defense budgeting, Samuel P. Huntington of the Institute of War and Peace Studies at Columbia University wrote that, "the tendency was: (1) To estimate the revenues of the Government or total expenditures possible within the existing debt limit; (2) to deduct from this figure the estimated cost of domestic programs and foreign aid; (3) to allocate the remainder to the military." [36]

TABLE XI.—*Federal expenditures and gross national product, fiscal years 1948 and 1963*

	Fiscal year—		Increase (percent)
	1948 (billions)	1963 (billions)	
Federal cash expenditures (payments to the public)	$36.5	$116.8	+220
War-connected (national defense, international affairs, space operations, veterans benefits, interest on the national debt)	29.4	72.2	+146
Domestic purposes	7.1	44.6	+525
Gross national product	246.6	564.5	+129

Source: The Budget of the U.S. Government, 1962, p. 979; The Budget of the U.S. Government, 1964, p. 430; The Budget in Brief, 1964, p. 63.

There seems to be less reluctance than in prior years to recommend a higher debt ceiling. But recent experience with the abandonment of weapons systems projects, such as Skybolt, B-70 (later RS-70), Rover, and lately the nuclear carrier, which were requested by the armed services and declared to be essential by military experts but canceled by the administration, suggests that the tendency described by Huntington appears to continue. Priority for Federal funds is accorded to numerous new or expanded welfare and other domestic programs which are advanced simultaneously with the cancellation of national security projects.[37]

Officials of the Department of Defense have recently indicated that defense spending will level off or even decline in the next few years. But the President stated in a speech delivered only last week that he desired his many new domestic spending proposals to be enacted by Congress.

[36] Samuel P. Huntington, "The Common Defense: Strategic Programs in National Politics," New York, Columbia University Press, 1961, p. 221. Further details in Warner R. Schilling, Paul Y. Hammond, Glenn H. Snyder, "Strategy, Politics, and the Defense Budgets," New York, Columbia University Press, 1962.

[37] See W. Glenn Campbell, "Assuring the Primacy of National Security," and Roger A. Freeman, "Nation Security and Competing Costs" in "National Security: Political, Military, and Economic Strategies in the Decade Ahead," Center for Strategic Studies, Georgetown University, Hoover Institution Publications, New York, Frederick A. Praeger, 1963, pp. 803 ff., 963 ff.

The counter argument, favoring spending for domestic purposes, usually points at activities which are in the national interest and declared to be in need of Federal financial assistance. The question is whether many of those purposes could not be effectively promoted or aided by means other than Federal appropriations.

For example, education, which is the subject of more than two dozen programs submitted by the President to the 88th Congress could be more appropriately helped by tax concessions—for school taxes, for tuitions and other educational expenses, for gifts to educational institutions—than by the enactment of new expenditure programs. Many such proposals are pending.

Since revisions of the revenue laws are under the jurisdiction of your committee, and since several such amendments to H.R. 8363 have been introduced, with several more to follow, I am outlining in the fourth and last part of this statement, how higher education could be helped by tax credits.

Summary

The need to cut the exorbitant income tax rates is urgent and now generally recognized. But to cut taxes at a time of large budgetary deficits and rising public spending without tangible steps to apply expenditure restraints may prove self-defeating. It may produce an initial spurt in the economy and a slight reduction in unemployment. But a material and sustained rise in the rate of economic growth and in employment requires that the Government budget be balanced over the business cycle. Experience has shown that mere intent to control expenditures is not of itself strong enough to resist the ever-present pressures. It should be accompanied by tangible evidence and enforceable statutory restrictions.

IV. CAN TAX CREDITS HELP HIGHER EDUCATION MORE EFFECTIVELY THAN GRANTS AND LOANS?

The financial requirements of institutions of higher education (IHL) will sharply increase in the next few years as the wave of postwar babies starts to graduate from high schools in 1964 and enrolls in colleges and universities. Attendance at IHL is expected to increase 50 percent or more during the balance of the 1960's.

Educational needs and financial prospects

The foremost need is for an enlarged faculty of high caliber. This calls for substantial salary increases in order to attract a sufficient number of qualified men and women and to motivate gifted young people to seek an academic career. It also requires a substantial expansion in the physical plant.

Some observers believe that the present sources of income for instructional purposes, mostly State and local government appropriations, student tuitions and fees, gifts and endowment earnings, will not provide sufficient support in the years ahead and that revenues ought to be supplemented by Federal funds. Certainly the number of those who so believe has sharply increased over the past decade. The issue is controversial but I shall not discuss it further in this statement.

The fact is that no President of the United States ever has recommended Federal grants for the general support of IHL, either for operations or for capital improvements. President Kennedy has proposed construction loans and a few small grants for specified purposes. But loans to build academic facilities offer little help to most institutions and to many no help at all.

State constitutional and statutory restrictions prohibit public IHL from incurring general obligation debt without the approval of the legislature or the voters. If such approval is given, States, cities, or institutions can usually sell securities at lower interest rates than the Federal Government because of the exemption feature. Private IHL have shied away from debt financing except for revenue producing facilities such as student housing or dining halls. Bonds for academic construction would require principal and interest payments from general revenues and thus restrict funds available for salaries and operations in future years. No such bonds have been offered in the market for several years.

The loans available to private schools under title III of the National Defense Education Act have remained largely unused and 90 percent of the authorization lapses each year for lack of applicants.

Both Houses amended the President's recommendations in 1962 by inserting small construction grant programs. No agreement could be reached between the two Houses and no bill was enacted.

In 1963 both Houses again passed small construction grant bills. Conflict over the form of participation of private IHL divides the Senate and the House versions. This could again end in a deadlock. But even if the differences were compromised and subsequent litigation would not becloud the future of the program, the extent of aid would be small.

IHL expended in 1962 over $8 billion and will by 1970, according to some estimates, need almost twice as much or more. Construction grants of $180 million (Senate version) or $230 million (House version) would equal less than 2 percent of the total budget. Where will the other 98 percent come from if, as many believe, the existing sources prove inadequate? The difficulties which the approval of even the small construction grants have encountered, and the fact that final enactment of even that program is not yet assured, suggest that prospects for a substantial increase, let alone extension to the area which most urgently needs greater support; namely, salaries and opeartions, are dim indeed.

Tax relief to aid higher education

It is for this, among other reasons, that numerous proposals have been introduced to achieve by indirect means what apparently cannot be accomplished directly. In each Congress, over the past 10 years a growing number of bills were introduced providing for tax relief to those who now support higher education. About 100 such bills were introduced in the 87th Congress, and more than 120 were pending in the 88th Congress as of May 1, with many added since then. Close to one-fourth of all Members of the Senate have sponsored educational tax-relief bills.

However, none of those proposals has ever been advanced or come close to enactment. Upon analysis of the various proposals it seems to me that there is a good and valid reason why no further action was taken on those bills. They would not have achieved what they were expected to do and would have provided the least help where it is needed the most.

The purpose of indirect aid to higher education is:

(1) To augment the financial resources of institutions;

(2) To aid talented young persons with aspirations for higher education from families with limited means.

Most of the pending bills meet neither of these objectives. They either permit the deduction from adjusted gross income of tuitions and fees (and possibly also some other college expenses) or grant an increase in the number or amount of personal deductions.

Students and families in low-income brackets would recover 20 percent (or under the provisions of H.R. 8363, 14 to 17 percent) of their expenses and still have to bear 80 percent of the cost. Families in high-income brackets would be reimbursed for up to 91 percent (under H.R. 8363 schedules, up to 70 percent) of their outlays.

Boards of trustees of IHL would be reluctant to boost tuitions substantially if students from low-income families would have to bear 80 percent or more of the increase. Those plans would therefore not add substantially to the financial resources of IHL nor help students from medium- and low-income families sufficiently.

Educational tax-relief plans which permit deduction of college expenses or additional exemptions would channel most of the benefits to high-income families, because of the graduated structure of the personal income tax. Most criticism of educational tax relief has been directed at this feature and Treasury Secretary Dillon again emphasized it at the hearings of your committee on October 16. This "concentration at the top" is probably responsible for the lack of action on most of these proposals. Restrictions have been suggested such as an upper income limit for eligibility at about $20,000 in S. 2270 by Senator Goldwater, and deduction from expenses of 5 percent of adjusted gross income, in an amendment to H.R. 6143 introduced on October 21, by Senator Keating. Such provisions would prevent large benefits from going to families which do not need them, but they would not increase aid to low-income students or help the institutions.

This shortcoming would be slightly, but not very materially, remedied by the use of a tax credit of 30 percent of college expenses, as was proposed by the American Council on Education and several other organizations in the years 1954 through 1959, and as incorporated in S. 800 by Senator McCarthy.

A 100-percent credit—that is, a full offset of tuitions against tax liability—would be effective in aiding students from low-income families and would en-

courage institutions to raise fees because it could be done without adding to the burden on the students.

Objections have been raised to this proposal because it would involve a heavy revenue loss if the maximum dollar ceiling were set high, and would not be of sufficient help if it were set low, e.g., $100, because of the wide range in the size of tuitions among institutions. Equity between private and public IHL, between institutions with low and with high tuitions, also poses a difficult problem.

A sliding tax credit schedule

When I was asked by the Senate Committee on Labor and Public Welfare last spring to testify on pending aid to education legislation, I studied this problem and drafted a sliding tax credit schedule which would permit a 100-percent tax offset for the first $100 in tuitions and fees, a 80-percent credit for the next $400 (between $100 and $500), and a 20-percent credit for the next $1,000 (between $500 and $1,500).

My proposal appears in the hearings of the Committee on Labor and Public Welfare (pp. 1265 ff.) and was inserted in the Congressional Record on May 27, 1963. It is incorporated in S. 2269 by Senator Goldwater and in its companion bill, H.R. 8981, by Representative Thomas B. Curtis of Missouri.

For reasons of space I shall not repeat here all the details of the plan which I submitted to the other committee.

"While this tax credit proposal would not solve all the financial problems related to higher education, it would represent a significant contribution well within our national means. It would provide this assistance in a manner that avoids any argument about Federal control of education and also the nagging question of church-state relations. Moreover, it would provide this aid without having to expand the Federal bureaucracy to administer the program.

"Support in the Congress has been growing for this general approach to the problem of Federal aid to higher education. I know the appropriate committees in both Houses are giving these proposals careful scrutiny and consideration. I hope that the administration will consider seriously requesting such legislation from the Congress."

Senator Humphrey slightly modified the tentative schedule which I had drafted.

Educational tax credit schedules

FREEMAN	Percent	SENATOR HUMPHREY	Percent
Up to $100	100	Up to $100	75
$100 to $500	80	$200 to $500	40
$500 to $1,500	20	$500 to $1,000	30
Maximum credit, $420.		$1,000 to $1,500	20
		Maximum credit, $485.	

The tax saving, or revenue loss, under my schedule may be estimated at $700 million per annum or more. Institutions may be expected to recoup as much as three-fourths of that amount through increased tuitions. They could apply the added funds to salaries or earmark part for the service of bonds issued to finance the construction of academic facilities.

The concept of a sliding tax credit schedule for higher educational expenses was taken up in the Senate on June 6, 1963, by Senator Humphrey (*Cong. Rec.*, pp. 9676 ff.):

"It is essential that an across-the-board tax credit program be initiated to assist every person currently facing the considerable expenses associated with higher education * * *.

"I have sponsored similar tax credit legislation for many years. However, the bill I introduce today is, in my opinion, a significantly improved measure over all earlier versions.

"Tax deductible, additional exemption and tax credit bills share a common purpose: First, to assist persons financing a college education and, second, to provide indirect assistance to the institutions of higher education."

Senator Humphrey then cited from my testimony of May 27 and continued:

"The sliding tax credit schedule provides a sensible and workable system of Federal assistance that helps every student, inderectly helps both public and private institutions, and does so in a manner that in no way interferes with individual or institutional freedom of policies. This bill, providing for a declining tax credit for expenditures on tuition, fees, books, and supplies, mitigates

the distortion found in the large majority of bills that rely on tax deductions, additional exemptions, or nonvariable tax credit.

* * * * * * *

Congress could determine by how much it desires to aid IHL and revise the credit schedule accordingly as time goes on.

The point has been made that tax credits would be of no help to students from families with such low income that they pay no income tax. That point has little validity, if any. While no statistics are presently available on the number or percentage of families of college students which pay no Federal income taxes, it may be estimated that it is quite low and certainly not higher than 10 percent of all students. Most of those students are now recipients of scholarships and thus pay no tuition, nor would they have to pay the increased tuitions that would follow the enactment of such a plan.

It is also possible to make these tax credits unconditional. In that case the students or their parents would compute their income tax, apply the credit, and be entitled to receive a credit balance in cash.

Tax credits for donations to education

The National Government could also materially aid IHL by permitting tax credits, rather than mere deductibility from the tax base of private donations, as the American Association for the Advancement of Science proposed some years ago. The present high marginal rates make such donations inexpensive to wealthy individuals, while persons in low-income brackets must bear 80 percent (under H.R. 8363, 83 to 86 percent) of the cost of their gift. As a result, large numbers of alumni with modest incomes do not contribute. By permitting tax credits, at 100 percent with a specified dollar maximum or according to a graduated schedule such as I suggested for tuitions and fees, persons in low- and medium-income brackets could be encouraged to donate more liberally to higher education and hundreds of thousands of additional donors could be found.

Gifts to higher education amounted to more than $1 billion in 1961, according to the Council for Financial Aid to Higher Education. By materially widening the range of potential contributors, the granting of tax credits could very substantially augment this important source of support for IHL. The same principle could also be applied to elementary and secondary schools and tax credits permitted for local school taxes, as proposed in S. 2270, and for tuition payments and gifts.

Summary

The legislative history of proposals for Federal aid to higher education suggests that a program of grants-in-aid of substantial size for the general support of colleges and universities, whether for operations or construction, is not likely to be adopted. A small construction program such as is now pending in conference between the two Houses, even if enacted, would be relatively little help compared with the huge amounts which the institutions will need in the years ahead.

Higher education could be effectively aided by the Federal Government through the granting of tax credits for educational excuses which would help institutions as well as students and their families. Such a plan avoids the bitter controversies over aid to church-connected schools and over Federal control of education. A sliding tax credit schedule would allocate aid where it is needed the most and could best meet the diversity in the size of tuitions and fees and between the requirements of public and private institutions.

Donations to higher education could be effectively encouraged and the range of donors expanded by the granting of tax credits.

Tax credits for local school taxes and school tuitions would be of material assistance to elementary and secondary public and private schools.

Graduated tax credits for tuitions and fees in higher education, such as I outlined, and tax credits for donations to higher education, are proposed in S. 2269 by Senator Goldwater (and its companion bill H.R. 8981 by Representative Thomas B. Curtis). I suggest that H.R. 8363 be amended to incorporate S. 2269.

The CHAIRMAN. We will recess until 2:30.

(Whereupon, at 12:40 p.m., the committee recessed to reconvene at 2:30 p.m. the same day.)

AFTERNOON SESSION

The CHAIRMAN. The committee will come to order.

There will be other Senators on the way.

The first witness is Joseph R. Barnes, Illinois Manufacturers' Association.

Please come forward, Mr. Barnes, sir.

STATEMENT OF JOSEPH R. BARNES, DIRECTOR, TAX DEPARTMENT, ILLINOIS MANUFACTURERS' ASSOCIATION

Mr. BARNES. Mr. Chairman and gentlemen, I may say that my testimony is only four double-spaced pages.

Senator CARLSON. May I say as a member of the committee that we appreciate it.

Mr. BARNES. Thank you.

Mr. name is Joseph R. Barnes. I am director of the tax department of the Illinois Manufacturers' Association. The Illinois Manufacturers' Association, which has its main office in Chicago, Ill., embraces in its membership 5,000 manufacturing firms, large, small, and medium-sized, engaged in a wide variety of production. I wish to present to this committee our views on several provisions of H.R. 8363, the bill now under consideration by the Senate Finance Committee.

We do not believe it is necessary to repeat our complete statement made to the Ways and Means Committee of the House of Representatives. We will confine ourselves to a relatively few selective comments.

We recommend that the reductions in corporate and personal income tax rates contemplated by H.R. 8363 be approved. All taxpayers, corporate and individual, are overwhelmed with tax burdens and particularly with Federal taxes. Therefore, any program which offers tax relief, warrants your serious consideration. However, we are convinced that the stimulus to our economy which this proposed tax cut is intended to accomplish will not be a continuing and permanent one unless it is accompanied by substantial reductions in governmental expenditures.

The IMA has on many occasions during recent years submitted recommendations to appropriate congressional committees and to individual Members of Congress regarding specific areas where cuts could be made in Federal spending without impairing national security or necessary domestic activity. These, if the committee wishes, we would submit.

In many discussions of the Federal budget, the threat to national security is used as an attempted justification for the continuation of massive spending. Many advocates of big spending emphasizes the cost of national security with the apparent purpose of diverting attention from many opportunities for sizable reductions in nondefense spending.

The facts are that in the last 10 years Federal spending for national defense has increased by much less than Federal spending for domestic purposes. Substantially all of these increases in domestic expenditures were unnecessary and motivated by political considerations. Moreover, defense and space expenditures, and I believe Senator

Douglas himself expressed the opinion that they in themselves have reached levels which many authorities question.

Our national debt is already over $306.7 billion; a per capita debt larger than that which any major nation has ever known. We cannot continue present expenditures without a mounting national debt, continued budget deficits, and unremitting inflation—the sure road to ruin. How much further must the value of the dollar decline from its present 44 cents, as compared with the 100-cent value of the 1939 dollar, before our economy is destroyed?

Therefore, while we favor the proposed reduction in tax rates, we respectfully urge that the reduction be accompanied by substantial reductions in governmental expenditures.

With relation to certain other provisions of H.R. 8363, we respectfully submit the following suggestions:

We believe that the provision providing for current taxpayments should be rejected. Such a requirement could, in the case of many manufacturing corporations, nullify the beneficial effects of rate reduction, investment credit, and revised depreciation, and defeat efforts to spur the economy to greater growth.

We recommend rejection of the proposal to repeal the dividend credit. This credit and exclusions should be continued, and if possible, increased. At present they are only a token recognition of double taxation of corporate income.

The proposed changes in the existing provisions relating to investment credits should be approved. We believe these changes will assist in attaining the intended incentive effect, and will simplify the statutory language and the recordkeeping requirements.

The proposed changes in the stock option provisions should, we submit, be rejected. The suggested changes would further dull the incentives made available to qualified executives. The Federal Government has said it cannot show black figures until 5 years from now. Should managers of a competitive private business be asked to do better?

The provisions limiting tax exclusion to employer paid premiums on the first $30,000 of group term life insurance should be rejected. The proposed changes would upset tax treatment of 40 years' standing, which have been relied upon by both corporations and individuals in the establishment of insurance programs. Moreover, it would impose additional administrative expenses upon employers, which might well cancel the anticipated revenue gain. In addition, this is another tax without receipt of cash income to cover its payment.

The proposal to eliminate the 2-percent surtax on consolidated returns should be approved. The taxation of intercorporate dividends should be removed. The 85-percent deduction for dividends received should be increased to 100 percent to eliminate double taxation of corporate income.

The proposal regarding moving expenses should be adopted. However, the proposed provision should be amended to provide for the deduction of temporary living expenses for a period of at least 90 days in the case of a residential relocation.

The capital gains and losses proposals for an unlimited carryover of capital losses should be approved and be extended to corporations.

It is infrequent that manufacturing corporations realize capital gains against which such losses may be offset.

Thank you for granting us this opportunity to present our views.

The CHAIRMAN. Thank you very much, Mr. Barnes. I think the Illinois Manufacturers' Association have appeared before the committee before. We are always glad to hear you.

Are there any questions?

Senator WILLIAMS. Mr. Barnes, I have noted your recommendations for changes in this bill, but just assuming that no changes are made in the bill as it came over from the House, are you for the bill or against it?

Mr. BARNES. We are for the bill.

Senator WILLIAMS. Thank you.

The CHAIRMAN. Senator Carlson?

Senator CARLSON. No questions.

The CHAIRMAN. Thank you very much, sir.

The next witness is Mr. Carl A. Beck of the National Small Business Association.

STATEMENT OF CARL A. BECK, REPRESENTING THE NATIONAL SMALL BUSINESS ASSOCIATION; ACCOMPANIED BY WILLIAM J. DURKIN, COUNSEL

Mr. BECK. Thank you, Mr. Chairman.

I am accompanied by Mr. William J. Durkin of the law firm of Gosnell & Durkin. Mr. Durkin specializes in tax law, and is a tax counsel for the National Small Business Association.

Mr. Chairman, my name is Carl A. Beck. I am president of the Charles Beck Machine Corp. of King of Prussia, Pa. We are manufacturers of industrial machinery related to the packaging, paper, film, and textile converting industries. We are a small company with half a hundred employees. I am also secretary-treasurer of Aereon Corp., a new company of a handful of individuals whose purposes are the development and manufacture of lighter-than-air airships. In addition, I am a member of the board of directors of a so-called country bank in Norristown, Pa. I mention these connections, because I believe that they provide different viewpoints from the aspect of small business, to the subject of tax revision and reduction. I am also a vice president and a trustee of the National Small Business Association and I appear before you in that capacity today. In addition, I have been active in the field of manager education, both as a student and currently as vice president for education of the Society for Advancement of Management.

I might add parenthetically here that I appear before you here at this particular time with a certain amount of temerity after the very excellent and interesting testimony this morning of Mr. Roger Freeman, and I hope that some of my comments might in a small way be as germane as many of his were.

In May of 1961 it was my privilege to appear before the Committee on Ways and Means to discuss some tax problems of small business in general and those relating to depreciation in particular. These were principally concerned with the encouragement of investment in pro-

ductive plant and machinery, and the cash flow and equity capital problems of small business generally.

The only concretee proposal then under consideration was the investment tax credit. This by itself was somewhat inadequate, and was further weakened when it was provided that the 7-percent credit should be deducted from the depreciation base.

At that time, I also stated that economic growth depends upon investment in people, investment in innovation, investment in marketing, investment in inventory, as well as investment in the tools of production. I also recommended at that time that there was a great need for correcting the inequities in the depreciation schedule.

Since that time, considerable progress has been made in this direction. Major steps have been taken toward a comprehensive program of depreciation schedule reform. Far from being critical, I can speak with sincere appreciation of the difficult and effective work of the Treasury Department in this direction. I think it is important that we recognize this and express our approval and encouragement of the administration and of Congress in the work of building a comprehensive system of depreciation reform. But, this work is far from completed.

There are two measures which are needed to round out and complete this work which has been so well begun. These are:

(1) The elimination of the reduction of the tax base, already included in H.R. 8363; and

(2) The stabilization of the depreciation guidelines, covered by a proposed amendment to H.R. 8363.

As to the first item, section 202 of H.R. 8363 provides for the repeal of the requirement that the principal tax base of property on which an investment tax credit is allowed should be reduced by the amount of the credit. It also provides for the restoration to the depreciable tax base of those tax credits which were previously allowed under the Revenue Act of 1962. The tax credit is a partial answer to the problem of cash flow and depreciation for the small business, and this provision is required to make the investment tax credit function effectively. This provision should be retained in H.R. 8363.

Since our U.S. economy, including the vast majority of our small business, finds itself operating in and competing in a world ecology rather than just within a domestic framework, I think it is significant to note that this kind of tax credit is similar to the initial allowances which form part of several European systems.

Regarding the second item, the new depreciation guidelines are now in effect as a revenue procedure. This method of adjusting depreciation schedules through administrative action has both virtues and defects.

From the viewpoint of practicality, the revenue procedures can be adopted by the Treasury Department and the Internal Revenue Service without hearings and without any action or sanction outside the Department itself. It can be amended as easily as it was first issued. Administration is simplified because its interpretation rests with the same officials who drew it up and promulgated it.

Its weaknesses may be less apparent but are no less real. We would not expect those individuals, who have done such an excellent job in the preparation of Revenue Procedure 62-21 and its modifications, to

be prone to rescind or modify these regulations in any arbitrary or undesirable way. However, new men with other ideas, who might see fancied defects in the revenue procedure, or who disagree with its basic premises and who wish to start with a new approach, could occupy the positions of the men who have prepared these revenue procedures. In such case, the taxpayer would have no redress, either before the Internal Revenue Service or in the courts.

This kind of uncertainty makes it extremely difficult for a businessman, particularly a small businessman, to make adequate long-range plans regarding capital investment. The small businessman particularly, with his limitations on inadequate capital and close budgeting of funds, finds such potential lack of stability a real hazard, presenting him with real difficulty in any kind of expansion program.

Another basic weakness in the guideline depreciation concept, as embodied in the revenue procedures, concerns the revenue ratio. This is a mass of confused and elaborate calculations, involving many pages of tables, to determine, by a comparison of the asset and its depreciation reserve account, whether the asset lives are or are not too short. This is particularly onerous to the small businessman with his limited staff of experts in the field of accounting procedures and tax law, and even if it will produce an equitable result, its complications and uncertainties are such as to make it impractical for day-to-day tax administration, even, I would presume, by presently employed revenue agents.

Senator Hartke in his amendment to H.R. 8363 has proposed a remedy which, as he puts it in a statement in the Congressional Record of October 10, will do away with the necessity of—

> attempting to administer a procedure which calls for a strange mixture of judgment, prophecy, and higher mathematics on the part of both taxpayer and revenue agent.

This amendment makes the guideline lives a subject of statutory right, preserves the guideline lives and methods for all property acquired before the close of the transition period, and provides for the application of guideline lives to property acquired after the transition period, regardless of actual scrapping or dismantling. It is apparent that this amendment merely makes definite and positive what the guidelines are intended to accomplish. It is hard to see how any important revenue effect can result, except the more universal use and application of the guideline lives which have been published—which is presumably an outcome desired by the administration.

To substantiate this conclusion, I have attached to my written testimony appendix I, which has been prepared by tax consultants of the National Small Business Association, who have analyzed this amendment in detail. I would never consider myself to be well versed either in the field of accounting or tax law, yet I do feel I have more insight and understanding of the concept involved here than the average small businessman. I assure you that it is manifestly unfair to expect the small businessman, who does not have a staff of experts for ready reference, to be expected to understand and apply the present complicated procedure to a predictable cash flow resulting from depreciation calculations. On the other hand, the flexibility in the proposed amendment and the opportunity to greatly simplify this procedure by this amendment, will enable most businessmen to understand

and apply the depreciation schedule and asset accounts in a way which will be meaningful to him, and encourage the use of Internal Revenue Service guidelines by both large and small businesses alike.

In addition to the specific items I have mentioned, I would like to say a few words about tax reduction in general. In my testimony before the Ways and Means Committee in May 1961, I underlined the necessity for tax reform, not the least important of which was tax reduction.

It is well accepted today that a prime measure of the health of an economy is its rate of capital formation, and it is an accepted truism that capital formation can come from only one source, and that is from profits—and of course I mean profits after taxes. I am against the excessively high confiscatory rates of income tax for individuals as a matter of principle, since it is contrary to the basic tenets of a free enterprise society, and tends to dry up sources of capital for economic growth.

Regarding the present corporate tax structure however, it must be recognized that this hits hardest at the small businessman who does not have equity financing sources available to him, and must of necessity build his corporate growth through his own profit potential. Since small- and medium-size businesses are necessary in the operation of a private enterprise economy, the corporate tax reduction is necessary for adequate stimulation of economic growth to enable the U.S. ecology and private enterprise system to compete effectively and sustain an adequate level of growth—whatever that level may be—in both domestic and world markets.

I might add parenthetically that the present H.R. 8363 is in reality reducing the corporate tax level to the level that it was a few years ago, since to all intents and purposes corporate taxes have been increasing steadily for the last several years.

What I mean is this: The social security taxes which are paid by employee and employer jointly are in essence in the final analysis borne by the employer, and if you are to assume—and of course the ratio varies greatly, but if you were to assume—that the cost of labor is approximately 25 percent of the cost of manufacturing total, then you are talking about one-quarter of the sales as actually being taxed by the social security taxes.

So really we are talking about a progressive, in the last few years a progressive increase in corporate taxation, income taxation by an additional 4 percent, shall we say. So that when we talk about a 4-percent reduction here, we are really restoring in practicality corporate tax levels to the level that they were when social security taxes were much lower than they are today. I think this shouldn't be overlooked.

In the same breath I hasten to add, however, that I am a strong, and inveterate supporter of both Senator Byrd and Senator John Williams in their unceasing and multiple attempt at control and curtailment of Federal expenditures. Although I am convinced that a general corporate tax reduction is essential to the U.S. economic growth, I also recognize that it is mandatory that there be an equivalent curtailment and reduction of Federal expenses in order that we are not subjected to the inflationary pressures and economic evils of

large budget deficits through unbalanced Federal budgets. Yet, it appears that the groups and individuals who are urging tax reduction together with reduction of Federal expenditures have perhaps had some influence on the actual reduction of congressional appropriations.

I would presume that the Members of Congress have a much better feeling of the pulse of the American citizens regarding this ground swell for reduction of appropriations and expenditures than I did. But it is appearing more and more than we are faced with a situation of which came first—the chicken or the egg. If tax reduction, instead of being only a result of budget surpluses, could also be an incentive for reduction of Federal expenditures, Congress may well have a strong and firm base on which it can build a meaningful program of reduction, allocation and appropriation of funds, and tighter control of Federal expenditures.

Although depreciation tax credits may stimulate the investment in new machinery and equipment, only tax reduction can stimulate the investment in people, in innovation, whether it be product or management research development, in marketing, or in inventory, which are necessary concomitant investments required for the growth of an economy.

That is the end of my prepared testimony. I would like to if I might add one additional comment which I have not covered, and that has to do with stock options, particularly as they apply to the small business.

One thing which I think is frequently overlooked is the fact that restricted stock option plans can in truth be a possible source of equity capital for a small business, particularly a small, closely held corporation.

It is such a business which is not listed, which is not even public, so to speak, because it is held by one or a very few stockholders, has a very difficult time unless it has a revolutionary new product or idea, and is a new so-called growth company. It has a very difficult time in obtaining equity capital.

This is, I think, a truism and is well recognized. One of the true sources for equity capital is the encouragement of key employees in the company to own a small portion of that company. This is more than just an incentive as it is normally thought of in terms of large corporations where stock is listed on the board.

Now, of course there are several problems here. First, what is the market value of the stock? The present law, for example, refers to proportion in terms of equity capital investment or net worth, in other words.

You can't say that the value of a company is its net worth, at least if you have ever been involved with the Treasury Department in settling an estate in which a small business is a major part of the assets of that estate, the fair market value of the stock of this corporation is a very nebulous figure. The best that you can do is get an unbiased, outside appraisal, and even this has very little security to work on.

Yet in spite of this, the present comments on the present law by the Ways and Means Committee seem to make the assumption that by and large stock tends to rise in value automatically, this is the inference. When we talk about 100 percent of value for a stock option, we still

do have a profit and loss system, at least in small businesses, and the stock is just as apt to go down in certain cases, frequently in cases beyond the control of the management of the small company.

Therefore to assume that it is fair and attractive to a key employee in a small company to give him a stock option at 100 percent I think is begging the question. There is an entirely different situation here between this and the stock options in large corporations, and I would hope that some consideration would be given to this possibility of looking at stock options for small, closely held corporations as a source of additional equity capital as well as incentive to such employees, and permit companies to make it a little bit more attractive than just the equivalent of buying Treasury stock or buying stock at market value of the flat 100 percent.

One other aspect of this that bothers me is that frequently in such cases a company, because of the obvious difficulties of having a large number of stockholders in such a small company, for good and valid reasons does not want to go into an employee stock purchase plan as such without discrimination, but wants it instead for directors, to key employees.

Frequently there is involved in here for the sake of the employee the opportunity for the company either to have first refusal or repurchase of the stock, or to be obligated to buy the stock back from the employee, if it was acquired under an option, because there is no ready market for the stock. These are things which complicate the situation, and make it unrealistic to assume that the stock should be issued only in terms of 100 percent of value.

Also, and this is more than just the small business approach, I am concerned that it refers to continuous employment from the time that the stock option is granted until 3 months before the stock option is exercised, and this means that if, due to economic conditions or any reason, that the employee has been laid off and has another employment for a short period of time, or due to some catastrophe or some other thing, that the employee is temporarily nonemployed by this company, immediately the stock option ceases.

I think this is manifestly unfair. These various things I do not feel have been mentioned in previous comments or testimony, and are not in the bill or the comments of the Ways and Means Committee about the bill, and, therefore, I thought they should perhaps be brought up at this time.

Thank you, Senator.

(The attachments to Mr. Beck's statement follow:)

APPENDIX I

AMENDMENT TO H.R. 8363, MAKING GUIDELINE LIVES PERMANENT AND MATTERS OF RIGHT

The attached amendment requires the Secretary of the Treasury or his delegate to prescribe guideline lives for depreciation purposes by regulation. The lives prescribed cannot be longer than those contained in Revenue Procedure 62-21 as modified prior to September 30, 1963. The lives prescribed in the regulations may be shorter than those contained in the revenue procedure.

The amendment authorizes taxpayers to base their depreciation deductions with respect to assets in a guideline class on the life prescribed by the regulations for that class, whether or not the taxpayer meets a reserve ratio test.

Taxpayers may deduct depreciation based upon the guideline lives prescribed regardless of their own practice in replacing the depreciable assets.

Use of the guideline lives will be optional with the taxpayer, and the option may be exercised with respect to some or all of the guideline classes. The reserve ratio test will continue to be available to taxpayers who wish to use it, including those who wish to establish eligibility for depreciation deductions based on useful lives that are shorter than the guideline lives contained in the regulations as well as those who wish to apply depreciation rates based upon lives as long or longer than the guideline lives. For those using the reserve ratio test, the depreciation bases will include assets still in use fully depreciated on an item basis. Such taxpayers can justify their depreciation deductions by reference to the reserve ratio tables under the rules that have been provided in Revenue Procedure 62-21.

The amendmnt has the effct of continuing indefinitely, under statutory authority, the 3-year moratorium on application of tests designd to limit depreciation deductions on the basis of the taxpayer's own asset replacement pracetices.

Permitting taxpayers to use guideline lives indefinitely without reference to a reserve ratio test makes it necessary to change the treatment now provided under Revenue Procedure 62-21 for fully depreciated assets in multiple asset accounts. Their inclusion in such accounts was not previuosly thought to create a problem because, after the initial 3-year period, the reserve ratio test would ordinarily curb excessive deductions caused by the inclusion of fully depreciated assets in the depreciation base. In the case of taxpayers using straight-line or sum-of-the-year-digits depreciation, however, inclusion of fully depreciated assets would create a problem if deductions were to be based indefinitely on application of depreciation rates based on guideline lives to a base that included fully depreciated assets acquired after the expiration of the 3-year moratorium period. Consequently, the amendment provides for exclusion of fully depreciated assets acquired in the taxable years subsequent to the initial 3-year moratorium period provided by Revenue Procedure 62-21 from the depreciation base, thus placing taxpayers on a lapse schedule depreciation method for years subsequent to the 3-year initial period if they wish to continue to use the guideline lives without being tested by the reserve ratio standard.

The attached table illustrates the operation of this provision. The illustration assumes a position at the beginning of the first year after the close of the moratorium period. The asset life is 10 years and depreciation is calculated on the straight-line basis.

The beginning assets are those acquired before the close of the moratorium period and guideline lives are applied until they are completely written off. The beginning balance may include assets fully depreciated on an item basis but these are not, as would be the case if guideline depreciation on its original basis were in force, retained in the depreciation base for as long a time as they are in use. They are removed from the depreciation base as soon as the guideline life has expired and they cannot be added to or increased.

Property acquired after the close of the moratorium period is written off over the guideline life regardless of replacement or retention. For example, in the iluustration the reserve balance at the close of the 12th year, $110,000, is arrived at as follows:

Balance at close of 11th year	$100,500
Depreciation, 12th year 10 percent of $195,000	19,500
Total	120,000
Reduction of reserve and asset account by 1st year's additions	10,000
Reserve balance, end of 12th year	110,000
Depreciation, 13th year	20,000
Total	130,000
Reduction of reserve and asset account by 2d year's additions	20,000
Reserve balance end of 13th year	110,000

The second table, covering the second 10 years of operation, shows the manner in which property which is deemed to be fully depreciated at the close of the guideline life is removed from the depreciation base and the depreciation reserve.

APPENDIX I-A

Application of method described in amendment providing for permanent guideline depreciation

Beginning assets			Asset additions				Combined beginning assets plus asset additions		
Depreciable assets	Depreciation charge	Reserve balance	Year	Depreciable assets	Depreciation charge	Reserve balance	Depreciable assets	Depreciation charge	Reserve balance
$100,000		$45,000					$100,000		$45,000
$100,000	$10,000	55,000	1				100,000	$10,000	55,000
$100,000	10,000	65,000	2	$10,000	$1,000	$1,000	110,000	11,000	66,000
$100,000	10,000	75,000	3	30,000	3,000	4,000	130,000	13,000	79,000
$100,000	10,000	85,000	4	60,000	6,000	10,000	160,000	16,000	95,000
$100,000	10,000	95,000	5	80,000	8,000	18,000	180,000	18,000	113,000
	5,000	100,000	6	100,000	10,000	28,000	160,000	15,000	[1] 88,000
			7	110,000	11,000	39,000	170,000	11,000	[1] 99,000
			8	130,000	13,000	52,000	190,000	13,000	[1] 112,000
			9	145,000	14,500	66,500	195,000	14,500	[1] 116,500
			10	155,000	15,500	82,000	205,000	15,500	[1] 132,000
			11	185,000	18,500	100,500	235,000	18,500	[1 2] 150,500
			12	195,000	19,500	110,000	215,000	19,500	[1 2] 130,000
			13	200,000	20,000	110,000	200,000	20,000	[2] 110,000
			14	200,000	20,000	100,000	200,000	20,000	[2] 100,000
			15	205,000	20,500	100,500	205,000	20,500	[2] 100,500
			16	215,000	21,500	102,000	215,000	21,500	[2] 102,000
			17	220,000	22,000	114,000	220,000	22,000	[2] 114,000
			18	225,000	22,500	116,500	225,000	22,500	[2] 116,500
			19	225,000	22,500	124,000	225,000	22,500	[2] 124,000
			20	230,000	23,000	137,000	230,000	23,000	[2] 137,000

[1] Beginning assets are eliminated from asset and reserve account as they go out of use.

[2] Assets acquired in first 10 years are eliminated at end of 10-year life.

Appendix I–B

Second 10 years

RESERVE FOR DEPRECIATION

Year	Balance beginning of year	Add depreciation for year	Deduct additions 10 years before	Balance end of year
11	$82,000	$18,500	$10,000	$100,500
12	100,500	19,500	10,000	110,000
13	110,000	20,000	20,000	110,000
14	110,000	20,000	30,000	100,000
15	100,000	20,500	20,000	100,500
16	100,500	21,500	20,000	102,000
17	102,000	22,000	10,000	114,000
18	114,000	22,500	20,000	116,500
19	116,500	22,500	15,000	124,000
20	124,000	23,000	10,000	137,000
Total		210,000	155,000	

DEPRECIABLE ASSETS

Year	Balance beginning of year	Additions for year	Deductions for year	Balance, end of year
11	$155,000	$30,000		$185,000
12	185,000	20,000	$10,000	195,000
13	195,000	25,000	20,000	200,000
14	200,000	30,000	30,000	200,000
15	200,000	25,000	20,000	205,000
16	205,000	30,000	20,000	215,000
17	215,000	15,000	10,000	220,000
18	220,000	25,000	20,000	225,000
19	225,000	15,000	15,000	225,000
20	225,000	15,000	10,000	230,000
Total		230,000	155,000	

	Depreciable assets	Reserve for depreciation
Balance, beginning of 11th year	$155,000	$82,000
Additions	230,000	210,000
Total	385,000	292,000
Deductions	155,000	155,000
Balance, end of year	230,000	137,000

Appendix I–C

Text of Amendment to H.R. 8363 Making Guideline Lives Permanent and Matters of Right

Effective with respect to taxable years ending on or after April 30, 1962, section 167 of the Internal Revenue Code of 1954, relating to a deduction for depreciation, is hereby amended by relettering subsection (i) as subsection (j) and by inserting immediately after subsection (h) the following new subsection:

"(i) Guideline lives.—Notwithstanding subsection (a), regulations shall be prescribed by the Secretary or his delegate that describe classes of tangible property (including special purpose structures but not including general purpose buildings) used in trade or business or held for the production of income and that prescribe a useful life figure with respect to each such class. The useful lives prescribed shall not be longer than those specified in revenue procedure 62–21 and the modifications thereof announced before September 30, 1963. Such regulations under this subsection may be used, at the option of the taxpayer, as the basis for computing depreciation deductions under this section with respect to the assets in any such class without regard to the practice of the taxpayer in replacing assets in such class. No depreciation rate derived under such regulations shall be applied to a base that includes

assets acquired in taxable years ending on or after April 30, 1965, that were fully depreciated prior to the taxable year. Any depreciation rate derived under such regulations shall be applied to all assets of a class acquired in taxable years ending before April 30, 1965, as a group, and such rate shall be applied separately to each group of assets in such class that are acquired in a single taxable year that is a taxable year ending on or after April 30, 1965. This subsection shall not apply to the computation of depreciation on assets of a class for a taxable year in which 25 percent or more of the assets of such class are leased from others, unless the taxpayer establishes to the satisfaction of the Secretary or his delegate that the average life of assets of such class with respect to which a depreciation deduction is computed is not substantially different from the average life of assets of such class as are leased from others."

The CHAIRMAN. Thank you very much, Mr. Beck?

Are there any questions?

Senator GORE. No questions.

The CHAIRMAN. Senator Carlson?

Senator CARLSON. Mr. Beck, just this: your statement here indicates a need for some adjustments and changes in the proposed bill. Would you support it with or without these changes?

Mr. BECK. Yes, sir; I would

Senator CARLSON. That is all.

Mr. BECK. I think it is a step in the right direction.

Senator CARLSON. I think we all agree taxes are too high.

Mr. BECK. Well, it is a little bit more than that. I think that it is beyond that point, sir.

Senator CARLSON. That is all, Mr. Chairman.

The CHAIRMAN. Thank you, Mr. Beck.

Mr. BECK. Thank you, sir.

(Mr. Beck later submitted the following for the record:)

NATIONAL SMALL BUSINESS ASSOCIATION,
Washington, D.C., November 7, 1963.

Hon. HARRY F. BYRD,
Chairman, Senate Committee on Finance,
Senate Office Building, Washington, D.C.

DEAR SENATOR BYRD: We would like to place in the record one additional comment on H.R. 8363 which was not included in our formal statement.

We are glad to note that the House bill recognizes that among many medium-size companies it is a legitimate and common practice to employ the use of commonly owned, but separate corporations, which are properly entitled to the benefit of the multiple-surtax exemption as separate taxpayers.

Nevertheless the House committee felt impelled to impose a 6 percentage penalty for the privilege of doing business in this form, fully recognizing that in some cases the use of multiple corporations might be a device aimed primarily at tax avoidance, and that in a substantial number of cases the need for several corporations might be based on perfectly sound and legitimate business reasons. Under the circumstances we respectfully suggest that the 6 percentage penalty might be excessive.

There is also a serious question as to whether or not such controlled groups of corporations ought to continue to be subject to the intercorporate dividends received tax. Under existing law, corporations which are subject to the 2 percent penalty for filing consolidated returns do not pay the intercorporate dividends received tax. If corporations which, for sound business reasons, must operate through several corporations under common control are to be penalized for this privilege, it would seem that they should be relieved of the intercorporate dividends received tax at the very least.

Sincerely,

JOHN A. GOSNELL, *General Counsel.*

The CHAIRMAN. The next witness is Maurice E. Peloubet, of Price Waterhouse & Co.

Take a seat, sir, and proceed.

STATEMENT OF MAURICE E. PELOUBET, OF THE FIRM OF PRICE WATERHOUSE & CO.

Mr. PELOUBET. My name is Maurice E. Peloubet. I am a certified public accountant and a partner in the firm of Price Waterhouse & Co. I am appearing here as an individual interested in tax reform, which I have been interested in for many years previous to joining this firm.

Before I start on the formal statement, I would like to take the opportunity of saying that I am in very hearty agreement with a number of witnesses who have testified on Senator Hartke's bill or amendment making the guidelines permanent, and providing for the elimination of the difficult and troublesome reserve ratio.

Mr. Casey of the Association of American Railroads, Joel Barlow of the chamber of commerce, Charles Stewart of the Machinery & Allied Products Institute, Floyd Newton of the American Textile Manufacturers, and just now Mr. Beck of the National Small Business Association, constitute an impressive list supporting this proposal. I would say, from my own personal knowledge and acquaintance, that there is a widespread desire among businessmen to have these guidelines made permanent, and to get rid of the difficulties and troubles which we know will happen when the reserve ratio is applied.

I would also like to add my voice to those who wish to see the repeal of the provision for deducting the 7-percent investment credit from the depreciation base. I think that is very important, and I sincerely hope that this bill will still contain that provision when it is finally passed.

There is another proposal which has not been formally made, but which has been considered desirable by a good many businessmen. That is one which is designed to stimulate the use of new rather than secondhand or obsolete equipment in a way somewhat different from that envisaged by the investment tax credit.

This tax credit of 7 percent is intended to apply to the purchase of new machinery and equipment regardless of what happens to the old and presumably obsolete equipment it replaces. The proposal I am discussing is intended to discourage the use of obsolete and inefficient secondhand machinery and equipment by making it more profitable to scrap the discarded machinery and equipment than to sell it second hand by allowing an additional 7-percent tax credit if the discarded machinery is scrapped rather than sold second hand.

In the printing and lithographic industry, for example, there is rapid technological change and improvement, and a lively market in secondhand equipment. This is an industry with no very large units. Some are what might be called medium-sized. But the great number are small, probably in the 200 employee category or less.

The use of large quantities of obsolescent, secondhand equipment in an industry of this type is good for neither the public, labor, nor the industry.

Marginal businesses on the verge of insolvency operating with secondhand equipment may exist for some time, but they are not good employers. the quality of their product is generally low, and they offer unfair and damaging competition to the well-equipped and progressive members of the industry. I believe that there will be an amendment to the bill embodying this idea, this basis.

I believe it will be introduced later on, but I just wanted to get this

in the record now because I do think it is an important finishing touch to our present system of depreciation reform.

In my formal statement I am testifying on the subject of value-added taxes as they are now in force or are proposed in Europe, and on the subject of using a tax of this nature as a substitute for the present tax on corporate income.

Several research bodies are studying this type of taxation at the present time, such as the Brookings Institution, the National Bureau of Economic Research, the Committee on Federal Tax Policy, the American Economic Foundation, and the Tax Institute of America. This latter organization held a 2-day symposium on alternatives to present Federal taxes on October 10 and 11 in this city, and it is as a result of the interest aroused by this meeting that I am appearing before your committee.

My formal statement, which I will summarize, consists of a paper which I presented at that meeting and an additional statement covering the effect on foreign trade and the export position of substituting a value-added tax for the present tax on corporate income.

Before any legislation providing for a value-added tax can be put before the Congress there is a substantial amount of research and statistical work to be done. A reasonable estimate of the total of costs or value added and profits which would be subject to a value-added tax rate must be arrived at. The question of a single rate as opposed to a rate for the different types of industry should be carefully investigated.

My personal preference is for a single rate, but I do not pretend to have a complete statistical basis for this. Forms of return and the statistical use of information on the returns other than for tax purposes should be carefully explored.

Various total figures for the economy, such as the gross national product, could be compiled or checked by a compilation of information on these returns. The effect of the value-added tax on the export position should be carefully evaluated, and the various means and devices to bring the maximum benefit to American industry should be investigated.

While there is a substantial volume of work to be done in this field, most of the basic statistical materials are available in some form and I think it is quite possible to make all of these determinations with reasonable accuracy.

Perhaps the best way to do this would be to appoint a small commission consisting of, say, two or three each of economists, lawyers, and accountants experienced in this field. Such a group could work with the various Government statistical agencies and the other research organizations which have been mentioned.

While time would of course be required for this work, it could probably be carried out successfully in not more than a year's time. The two statements attached present a general view of this subject. The tables and figures do not pretend to any final accuracy or completeness, but they do, I believe, give a reliable indication of trends and the general situation.

The value-added tax as a substitute for the corporation income tax has many advantages. The corporation income tax is a misnomer. It is essentially an excise tax. It is a tax for the privilege of doing business in a corporate form.

A partnership is not taxed as such. The individual members of the partnership are taxed on their shares of income. However, if this partnership incorporates, it must pay a corporation tax. The only difference between the partnership and the corporation is the incorporation.

I think that makes it clear that the corporation tax is for the privilege of operating in the corporate form.

An excise tax based on corporate income has many weaknesses and deficiencies. Corporate income, as any accountant knows, is extremely difficult to determine. It fluctuates. It fluctuates between companies and fluctuates from year to year.

There is another strange effect of the corporation income tax. It acts as a subsidy for the inefficient, badly managed loss corporation, because while all corporations presumably receive the same service from the Government in proportion to their volume and their activities, the loss corporation pays nothing for this.

No one would suggest that the loss corporation should not pay for electric power or for gas for industrial purposes or for coal or for anything else. The only thing that the loss corporation doesn't have to pay for is Government service. Now this is a serious thing. About 15 percent of the volume of corporate business is represented by loss corporations.

The effect of this is that the profit corporations—figures for 1961 are the last I could get—but those figures indicate that the profit corporations are paying about $3 billion a year for the benefit of the loss corporations.

At this meeting of the National Tax Institute, alternatives to the corporation tax were studied, and the one which seemed the most practical, the one that seemed to be favored the most, was what is known as a value-added tax. This type of tax has been in successful operation in France for about 10 years.

The basic principle of the value-added tax is that a corporation pays Federal tax in proportion to its activities or operations, and that is arrived at by taking the total sales of the corporation and subtracting from that the purchases from the outside for materials and for whatever is purchased outside, equipment and so forth. That gives you a figure which represents the activities of the corporation, and the tax is based on that.

If we had corporation A that has 50 percent of outside purchases, 50 percent of operations and profit, corporation A pays on 50 percent. Now corporation B buys that product for further manufacture, and that represents, we will say, 60 percent of corporation B's costs and profit. Corporation B pays on 40 percent. As I say, that tax has been in use in France for about 10 years.

Western Germany, has just worked out a value-added tax which is supposed to go into effect in 1966. The European Economic Community is considering this type of tax.

If we had it in this country, I would say, as near as I can estimate, that we would need a rate of something in the neighborhood of 6 percent to get enough revenue to compensate for the present corporation tax. This tax, as I say, has been operating in France for 10 years. It has been discussed in this country for much longer than that.

While it was not given the name of value-added tax, Dr. Adams, one of the early students of income tax in this country, described a type of

value-added tax. Mr. Wadsworth Mount in the 1930's developed a tax of this sort, a method for it, and he has written on that subject several times. He has been in correspondence with foreign governments, particularly the German Government previous to their adoption of the value-added tax, so that the value-added tax has a respectable background.

Now apart from the value of the tax as a method of substituting a rational method of getting revenue from corporations in place of our present corporate income tax, which I don't thing is very rational, it also has an important bearing on foreign trade.

The substitution of such a tax for the corporate income tax would put American manufacturers on a parity, so far as taxation is concerned, with most of the European countries. One of the characteristics of our tax system that was brought out this morning by Mr. Freeman is our heavy reliance on direct taxes and the corresponding heavy reliance of European countries on indirect taxes.

Under the General Agreement on Tariffs and Trade, usually known as GATT agreements, they permit the levy of charges on imports in addition to customs duties equivalent to internal indirect taxes on similar domestic products, and they also permit countries to exempt exports from internal indirect taxes or to rebate such taxes if they have already been paid.

The corporation income tax does not fall within the definition of indirect taxes, and the American manufacturer and exporter is therefore placed at a heavy disadvantage in relation to his foreign competitor for this reason.

If the corporation income tax were a true income tax, then no matter how disadvantageous it might be, it might be proper to continue with our present system. However, the corporation income tax is an excise tax for the privilege of doing business in the corporate form.

It is an excise tax which is levied on a fluctuating base, and it operates most inequitably between different taxpayers. The value-added tax would be classed under the GATT agreements as an indirect or turnover tax in the same way as the French value-added tax or the various foreign turnover and excise taxes are classified.

The Committee on Tax Policy has studied these questions. It was constituted—

> in 1962 to undertake a study of the Federal tax system. Similar committees published two reports on "A Tax Program for a Solvent America" in 1945 and 1947, and issued additional studies in 1951 and 1954. These committees have included in their membership economists, attorneys, accountants, and businessmen, and have had as chairman Roswell Magill, attorney and former Under Secretary of the Treasury.

The Committee has this to say about the value-added tax and foreign trade in its report "Financing America's Future" issued in September 1963:

> A value-added tax would not penalize efficiency to the same extent as a net income tax may be said to do. No need would arise for averaging or for carryovers to offset the effects of fluctuating income. The tax base would be broader than profits. The lower the price at which goods are sold, the lower would be the tax per unit of sale.
>
> The complete exemption of exports would generally be possible. Other types of output, e.g., books sold to public schools, could also be exempted.

At the White House Conference on Export Expansion, held September 17 and 18, 1963, held under the auspices of the Department of

Commerce, the place of the value-added tax in the export picture was discussed. The following quotations from "Working Paper for Committee 1" the Committee of this Conference that was to deal with tax matters, outline the situation:

> The GATT permits countries to levy charges on imports (in addition to customs duties) equivalent to internal indirect taxes on comparable domestic products. It also permits countries to exempt exports from internal indirect taxes or to rebate such taxes if they have already been paid. Most of the major trading countries, including the United States, take advantage of these rules to impose compensatory import levies or grant tax exemptions or rebates in exports. The impact of these practices on trade varies from country to country, however, because some countries rely much more heavily than others on the types of taxes that are eligible for such treatment. The United States, for example, obtains nearly three-fourths of its total tax revenues from taxes on income and property; the Federal excise taxes that are imposed on imports and rebates on exports only apply to a limited number of goods and account for a relatively small part of the total tax take.
>
> Prospective changes in tax systems inject an element of uncertainty into the picture. The European Economic Community is now considering ways to harmonize the tax systems of the member countries, with initial emphasis on indirect taxes. The Community appears to be leaning in the direction of a value added tax of the French type. This would require the five member states now using a cascade-type turnover tax to change their systems. The impact of any such changes on trade would, of course, depend on the rates of tax under the new system and the rates at which border adjustments would be made.

I think that last is very significant because it distinguishes between a value-added tax and a sales tax. A sales tax similar to the Canadian sales tax has several undesirable features, probably the worst of which is what they call the cascading or cumulative effect, because everybody is paying a sales tax on what everybody before has put in the product. If you had 20 percent of your value added or operations and 80 percent of outside purchases, you would pay under this law the same sales tax as if you had 80 percent of value added and 20 percent of outside purchases, which is obviously unfair. So that the sales tax has definite disadvantages and weaknesses which I think are generally recognized.

One of the objectives of the new depreciation guidelines announced by the U.S. Internal Revenue Service in 1962 and the investment tax credit enacted in the same year, as well as the changes proposed in the tax bill now before Congress, is to provide an environment conducive to improved export performance. The depreciation guidelines, the investment tax credit and the proposed rate reductions should permit U.S. firms to produce more efficiently and, therefore, to compete more effectively with foreign producers. This should result in lower imports as well as greater exports as U.S. firms are provided both with greater cash flow, with lower equipment costs, and with greater profits after taxes.

Generally speaking, the manufacturing industries which account for the majority of U.S. exports of manufactured goods are capital intensive; i.e., they use a relatively large amount of capital equipment and a relatively small amount of labor per unit of output. The resulting high productivity per worker in these industries allows these industries to sell in foreign markets despite the higher hourly wages common in the United States. Since the guidelines and the investment tax credit favor those firms with large amounts of capital equipment, and, therefore with large capital equipment expense, these two changes in the tax regulations should serve to improve the performance of those industries on which we rely for most of our exports of manufactured goods.

The depreciation guidelines in 1962 resulted in increased depreciation for all corporations of $2.4 billion; the investment tax credit amounted to $1 billion. For manufacturing corporations alone, the corresponding figures were $1.7 billion and $0.5 billion. The attached table indicates that the major exporting industries are among the principal beneficiaries of the tax credit and the depreciation guidelines.

The tax bill now before Congress, combined with the depreciation guidelines and the investment tax credit, can therefore be considered a key feature of the program to solve our balance-of-payments difficulties.

The substitution of a value-added tax for the present corporation income tax would make comparisons of American and foreign costs of production more reasonable and meaningful and would put the American manufacturer and exporter on a more nearly equal footing with his foreign competitor.

Now the purpose of this testimony, which is given because members of this committee have requested it, is to, you might say, put this on the table, put it up for consideration. There are many people interested in this, particularly people that are concerned with exports, so that while no immediate action can be taken and while there is a certain amount of statistical spadework to be done before rates and bases can be determined, it nevertheless seems to be a live issue, and there is a great deal of business interest in it.

Thank you.

(The attachments to Mr. Peloubet's statement follow:)

EUROPEAN EXPERIENCE WITH VALUE-ADDED TAXATION, TAX INSTITUTE OF AMERICA, OCTOBER 10, 1963, WASHINGTON, D.C.

(By Maurice E. Peloubet)

There are two practical reasons for inquiring into the tax systems of foreign countries: to find out whether they can be taken as models for the revision or reform of our own system of taxation and to determine their effect on our nationals operating in foreign countries.

The first purpose requires an analysis of foreign systems and a comparison with ours, an inquiry into principles and philosophy as well as detailed operation. It is this aspect which will be discussed here. The second purpose, important as it frequently is, is merely to find out what can be done and how to do it without much reference to underlying principles.

Corporate taxation in this country has developed largely on the basis of the legal fiction that a corporation is a person. The very usefulness of this fiction makes it dangerous. Qualities, desires, and necessities which are essentially and uniquely human are attributed to the artificial corporate person.

A corporation is reproached for being "soulless" on the assumption that it should have a soul or praised for its concern for the welfare of its employees. It, as an artificial person, no more deserves the blame or praise than does an automobile which is involved in an accident.

One of the more curious results of treating a corporation as a person is to assume that a corporation has "income" in the sense that an individual enjoys income.

A natural individual may spend, save, squander or give away his income as he likes after his obligations are taken care of. A corporation is a mere custodian or trustee. It must distribute its available surplus funds to its stockholders or use them for the advancement of corporate purposes. No extraneous purpose, no matter how worthy, can be served, and no individual, no matter how deserving, can be rewarded or assisted if it does not further a corporate purpose.

From this, it follows that a corporation has no income in the sense that an individual has income. A corporate "income tax" is, therefore, a misnomer and an anomaly.

Federal and State income taxes on corporations are excise taxes, taxes on the privilege of doing business in the corporate form. A partnership pays no income tax as such because it is assumed that the partners will enjoy the income as

individuals. If the partners form a corporation and carry on exactly the same activities and business, they are liable for a corporation income tax. As the only difference is the use of the corporate form, the tax must be an excise tax for that privilege.

Corporate income is difficult to determine and is subject to great and unpredictable variations from year to year. The tax is, therefore, subject to wide fluctuations in total amount and is, as between corporations, frequently inequitable.

The greatest inequity, perhaps, is the effective subsidizing of inefficient and unprofitable enterprises. The losing or inefficient corporation requires and receives the same protection and services as its profitable competitor, but, as the tax is levied on an income, it does not pay for them. The life of the losing enterprise is thus prolonged to the detriment of its competitors and the economy. Although the unprofitable corporation does not pay its share of the costs of Government for which its members vote, nevertheless it is not seriously suggested that it pay a lesser rate or nothing at all for the electricity, for instance, it "votes for" by using.

While it is a fact that corporations do not have income, in the sense that an individual does, and that, therefore, so-called corporation income should not be taxed as such, it is, nevertheless, also true that, under present-day fiscal requirements, and because of convenience of collection, some tax must be levied on corporations, as nearly as may be, in proportion to the services and protection required by all the people employing their time and money in the business.

It is in devising such a system that we may learn from the methods and experience of foreign countries. Business taxes which seem to meet the requirements of an equitable and productive tax on corporate activities and operations have been in successful operation in some European countries for over 10 years:

High tax rates or high total tax collections have been unjustly blamed as being the sole or the major deterrents to industrial and economic growth. Not enough attention has been paid to the effects of the distribution of the tax among taxpayers.

The following table was compiled from statistics appearing on page 303 of "Statistics of Income, 1960–61" prepared by the U.S. Treasury Department and the Internal Revenue Service.

Corporation returns, year 1960–61

	Thousands of dollars	Percent
Business receipts:		
All corporations, with and without income	$802,790,920	100.000
Corporations with net income	685,691,937	85.414
Net income:		
Total all corporations	43,505,174	5.419
With income	50,382,345	6.276
Income tax	21,866,299	
Rate to produce equivalent revenue on total business receipts (rate of estimated net receipts 5.65 percent, see app. II)		2.724
Total receipts	802,790,920	100.000
Receipts of corporation with income	685,691,937	85.414
Untaxed receipts	117,098,983	14.586
Value-added tax to equal income tax, on total receipts: 802,790,920 ×2.724 percent	21,866,299	
Untaxed receipts: 117,098,983×2.724 percent	3,189,518	
Receipts of all corporations with income: 685,691,937×2.724 percent	18,676,781	

This gives an approximate idea of the turnover rates required to produce revenues equivalent to those now collected from corporations. The table also shows that 14.586 percent of the turnover of corporations now escapes a tax on which the remaining 85.414 percent must pay, on behalf of the loss corporations, a tax of $3,189,518,000 although all equally enjoy Government services and the advantages of the corporate form.

Business receipts, as used in this table, were defined[1] as: "the gross operating receipts of the corporation reduced by the cost of returned goods and by rebates

[1] P. 19, "Statistics of Income, Corporation Income Tax Returns," U.S. Treasury Department, 1960–61.

and allowances. They were the sum of gross sales and gross receipts from operations."

The French value-added tax, the most representative and longest established tax of this type was described in detail by Martin Norr at the 16th Tax Conference of the Canadian Tax Foundation, 1962. He describes this tax as:

"The value-added tax is a tax on sales. In France it is levied only on sales at the manufacturing and wholesale levels; there are some exceptions that need not detain us. But although this is a tax on sales, it is so arranged that it does not apply in any particular case to the total sales price received by the seller. The tax applies only to the value added to the total sales price received by the seller; that is, to the difference between the amount the firm takes in in sales proceeds, and the amount the firm spends to buy materials and services from other firms. Value-added is merely the difference between a firm's receipts and its expenditures in buying goods and services from other firms.

"Let's descend to the concrete. Suppose the factory selling price of a car is $1,000. Suppose the cost of the materials that went into the car—fenders, paint, glass, tires, parts, and so on—is $400. Then the value added is the difference between the receipts of $1,000 and the expenditures of $400; when the car is sold, the seller pays tax not on the selling price of $1,000, but on the value added, the difference of $600. Value added is equal to the total amount of wages, salaries, rent, interest, and similar outlays of the firm, increased by the amount of profits earned. Instead of striking the wholesale price charged by the seller, the value-added tax in effect strikes only his gross profit—gross receipts less cost of goods purchased.

"The essence of the tax is that it is not a cumulative or cascade sales tax like the taxes used by the other Common Market countries. These countries generally apply the full rate of their taxes to the full sales price paid in every transaction. Not so France. Each taxpayer making a taxable sale is liable to tax not on the full sales price but only on that portion of the price which represents the value added by him in the manufacturing and distribution process."

In France this tax is levied along with a 50-percent rate of corporate income tax, further mitigated by depreciation allowances under which something in the neighborhood of 50 percent of corporate income is charged to depreciation. It is also true that, while the basic concept of the French tax is sound, it omits substantial segments of the economy not involved in manufacturing.

Under the French value-added tax, the depreciation problem hardly exists because the rates are so liberal. If purchases of plant and equipment were included in the costs for value added, there would obviously be no tax depreciation problem as purchases for plant and equipment would, in effect, be applied as soon as they were made. In France, value-added tax is allowed on industrial buildings, plant, and equipment but not on administrative buildings or office furniture and equipment.

The experience of this country with a rigid rate structure in the corporate income tax, generally inadequate depreciation allowances, uncertainties in the methods of arriving at income and violent fluctuations in total income, does not point to the successful operation of the value-added tax as a supplement to the corporate income tax.

In my opinion, the corporation income tax should be recognized for what it is, a capricious and inequitable excise tax levied on an un[illegible]able base. It should be repealed and a broadly based, equitable, and productive tax such as the value-added tax should be substituted for it.

I have observed, over many years of experience, that the first thing to do when advocating a change or innovation in taxation or accounting practice is to make every effort to prove that you are doing no such thing. Novelty and originality are no recommendation.

So far as the value-added tax is concerned, a complete disclaimer of originality or novelty can be made. In this country, this tax has been advocated by Wadsworth W. Mount since the early thirties.[3] He has brought it to the attention of Congressmen, State Governors and Federal and State officials as a complete tax base applicable to every type of enterprise.

Many, if not most, of these Congressmen and officials agreed with Mr. Mount's arguments and methods, but nothing in the way of legislation has resulted. In principle, his proposal is an extension of the French value-added tax. Whether or not there is any agreement on the fairness and practicability of this tax, familiarity with it at least should have been achieved.

[3] "A Reexamination of Taxation Fundamentals." Wadsworth W. Mount, assistant director of research, Merchants' Association of New York, Financial Management Series No. 67, American Management Association.

A basic difference between Mr. Mount's method and the French value-added tax is that under the Mount method the value added covers all materials and services including the services of lawyers, accountants, engineers, and other consultants, as well as real estate and local taxes. This provides a somewhat broader base than the French tax and makes the case for the abolition of a corporate income tax even stronger than it would be if a tax on the French model were to be enacted.

Obviously, a return indicating value added somewhat on the line of the form proposed by Mr. Mount in the attached appendix I would be quite simple to fill out. An enterprise could hardly operate if it did not have current figures which would answer this purpose. Much of the time and effort which now goes into the administration of the corporate income tax both in the Internal Revenue Service and by individual taxpayer corporations could be diverted to more productive purposes.

The value-added tax and its calculation would not and is not intended to act as a model or to influence financial accounting and reporting in any way. The value-added tax has not had this effect in the countries in which it is now in force and there is no reason to believe that it would do so here.

Apart from simplicity of administration, the returns for the value-added tax which could be and should be submitted promptly within a few days after the close of a period would make the calculation of gross national product not only easier but much more accurate than is now the case. With modern data processing, many thousands of returns could be summarized in a few hours and the total results would form an accurate index of the operation of the economy.

Probably as a result of the success of the French value-added tax and following an extended correspondence between Mr. Mount and West German officials, West Germany has decided to put the value-added tax into effect.

The Federal Republic of Germany will be the first Common Market country besides France to substitute a value-added tax for the present system of multistage turnover tax. Last July the German Cabinet accepted the draft bill prepared by the various ministries, which includes the new tax. In the meantime, the bill was submitted to the various parliamentary committees concerned and, in addition, to trade, industrial, and professional organizations for review and suggestions. Although there is not much doubt that the bill will be enacted subject to possible amendments, it is expected that the effective date will be January 1, 1966. Under the bill, the proposed regular turnover tax rate will be 10 percent, from which turnover taxes included in the purchase of goods or services are deducted. The tax rate on professional fees and similar service compensation and that on the sales price of food and certain agricultural products will be 5 percent.

The introduction of graduated rates is a particularly interesting feature of the West German proposal. Graduation proportionate to the volume or size of a taxpayer would be unacceptable from an economic or equitable point of view, but graduation by industry might be necessary and desirable.

In the West German proposal, in industries where the value added is large in relation to the total, as in agriculture and the service industries, the rate is lowered. This should be carefully explored in drawing up any detailed plan or proposal for adoption in this country.

Going further back, Dr. T. S. Adams, one of the foremost of the early thinkers and theorists on the income tax in this country, suggested, in 1921, the value-added tax as an element, but not a complete substitute, for the income tax on manufacturers. The value-added tax described by Dr. Adams was similar to the French tax and did not include the service industries contemplated by Mr. Mount's proposal or, to some extent, by the proposed West German value-added tax.

It is possible, therefore, to go at least as far back as 1921 for the first mention of the value-added tax. The adoption of this tax by the European Coal and Steel Community in 1962 may also be cited as well as its adoption, as an added tax element, by the State of Michigan.

The article by Martin Norr already cited and "Theory and Background of the Value-Added Tax" by Carl S. Shoup[2] give a comprehensive and detailed description of the value-added tax in foreign countries. The "Report of the Fiscal and Financial Committee on Tax Harmonization in the Common Market" (1962), under the chairmanship of Prof. Fritz Neumark of Frankfurt, Germany, contains a description and discussion of value-added taxes. An English translation has been made by Commerce Clearing House.

[2] Proceedings of the 48th National Tax Conference, 1955.

In this discussion, it has been my purpose to relate the European experience with the value-added tax to American fiscal needs, and particularly to show that it is a fair and workable alternative to the anomalous and inequitable tax on so-called corporate income under which the economy is now laboring.

When, if ever, legislation providing for a value-added tax will be enacted is difficult to forecast, but it is almost axiomatic that reforms of this sort are the result of long and intensive research and public discussion which brings the need for the legislation before the Congress and the Government departments concerned. Unfortunately, they do not come about spontaneously or merely because they are sound and constructive. It is to be hoped that this meeting may be remembered as a large step in this direction and as an early cry in the wilderness of corporate taxation.

Appendix I

A Proposed Substitute for the Present U.S. Federal Personal and Corporation Income Tax Laws, Consisting of a Federal Business Tax Based on the Amount Collected From Customers Minus the Cost of Goods and Services Purchased From Others

BASIC PREMISES

1. Present Federal income tax laws are unpopular, induce corruption, defy equitable efficient administration, are incapable of covering all the income that should be taxed, retard the proper economic development of the Nation, and cost far too much to administer.
2. The present tax base of profits and earnings is unstable and could easily place the Treasury Department in a very embarrassing position.
3. What is needed is a fair, easily understood, easily administered law having volume of production as its assured tax base.
4. The ideal vehicle for tax collection is the business unit whose books of accounts automatically disclose the volume of business done and the outside costs incurred, the difference representing the taxable income of the business.

A New Base for Federal Taxation

(By Wadsworth W. Mount)

Every business and profession operated for profit, regardless of the product or service sold, or whether it operates as a corporation, partnership, or sole proprietorship, with one person or thousands engaging their time and money therein, adds its respective share to the Nation's production on the following basic formula:

$$X-Y=Z$$

X=Gross receipts from sales of goods and services.
Y=Payments for outside goods and services including State and local tax.
Z=Net addition of production.

Once the Federal Government has collected its Federal tax on Z, the matter of how the balance of Z is distributed as wages, salaries, dividends, and interest, or held as reserves, becomes entirely the internal business of the people inside each reporting enterprise.

Since Z represents the basic source of all personnel incomes, by taking its percentage of this new tax base the Federal Government has taxed the total production at the source.

The utter simplicity of applying, reporting, and administering this law may be seen by observing the following tax form which would serve every enterprise, large or small, corporate or noncorporate.

[Proposed Form—to replace all present forms now used.]

FEDERAL BUSINESS TAX

Quarterly Return Filed______________________19____

1. Business Name and Address ______________________________ ______________________________ For Calendar Quarter ending______________________19____
2. How Operated______________________ (Corporation, Partnership, etc.) Average total personnel___________

Kind of enterprise____
(Line of business, product, or service offered)

3. Credit, if any, carried over from Line 9 of last Quarterly Return........ $1,000
4. Received for goods and services sold........ $10,000
5. Cost of Outside Goods and services purchased........ $5,000
6. Enter sum of Lines 3 and 5 here........ $6,000
7. If Line 4 is greater than Line 6 enter difference here........ $4,000
8. Multiply Line 7 by 15% (current rate) and enter tax being paid with this return opposite this Quarter.
   - First Quarter Tax due April 15........ $600
   - Second Quarter Tax due July 15........ $...
   - Third Quarter Tax due Oct. 15........ $...
   - Fourth Quarter Tax due Jan. 15........ $...
9. If Line 6 is greater than Line 4 the difference is a credit and is to be entered here and carried over to Line 3 on next Quarterly Return.. $.....

Official signature........

Title of person signing........

NOTE.—A really sound guide to all business and government could result from currently tabulating the accurate and timely data on these reports; in comparison to what the government now puts out based on incomplete and out-of-date information so often published too late to be useful.

(Copyright 1957 Wadsworth W. Mount)

DEFINITIONS

Calendar quarter.—Any 3-month period starting with January.

Line 3 "credit."—The amount by which the cost of outside goods and services exceeds the amount received from the sale of goods and services.

Line 4 "goods and services."—This includes receipts from professional fees, from the sale, rental, or use of capital assets, including patents. It does not include dividends or interest on funds invested in other enterprises, or in Government securities.

Line 5 "outside goods and services."—This includes Government services represented by State and local taxes and insurance services purchased on behalf of employees.

Estimated value-added tax rate required to produce equivalent of personal and corporation income tax

Total business receipts:	
Corporations	$802,790,920,000
Sole proprietorships	171,257,205,000
Partnerships	72,771,424,000
Total	1,046,819,549,000
Gross national product [1]	519,000,000,000

	Billions of dollars	*Percent*
Business receipts	1,047	100.00
Gross national product	519	49.10
Estimated duplication	528	50.90

Corporation tax:	
Gross receipts, corporations	$802,790,920
49.10 percent thereof	$394,170,342
Corporation income tax	$21,866,289
Rate to be applied to $394,170,432,000 to produce revenue equal to corporate tax (percent)	5.55
Corporation income tax	$21,866,289,000
Personal income tax [2]	46,144,000,000
Total income tax	68,010,289,000
Value-added tax rate to produce this revenue (percent)	13.10

[1] U.S. Department of Commerce.
[2] Economic Almanac, 1962, "The Conference Board."

NOTE.—All other figures from U.S. Treasury Department, Corporation and Business Income Tax Returns, 1960–61.

The CHAIRMAN. Thank you very much.

Any questions, Senator Gore?

Senator GORE. No questions.

The CHAIRMAN. Senator Carlson?

Senator CARLSON. Only this, Mr. Chairman. I think Mr. Peloubet is entitled to credit for calling attention to a tax that we probably will be looking at in future years, if we expect to continue our export trade.

Mr. PELOUBET. I think that is an extremely important feature of it.

The CHAIRMAN. Mr. Peloubet, Senator Dirksen was unable to be here this afternoon. He has been detained on the floor. He asked me to ask you eight questions.

The first question is, Do you think the tax reductions should be put into effect even though there were no reductions in expenditures?

Mr. PELOUBET. I think that the tax reduction and the reduction in expenditures are not necessarily related. Of course, an easy answer is to say that they are all within the control of Congress, which they are.

However, let us assume that we are in earnest about reducing expenditures. I think the only way this can be done is with something similar to the Hoover Commission. I was on one of the task forces there. We knew at that time there was $5 billion that could be taken out of Government expenses without diminishing any service. I presume that at the present time that figure may be 50 percent more or 100 percent more. We need something like that if we are going to reduce expenditures.

I think the two things should be considered, but I don't think one should preclude the other. We do need a tax cut. We do need reduction in expenditures.

The CHAIRMAN. You say the tax on corporate income is an excise tax rather than an income tax. Would you give briefly your reasons for this statement.

Mr. PELOUBET. It can't be an income tax because a corporation doesn't have any income in the sense that an individual does. A corporation is merely a trustee. An individual can spend his income, give it away, squander it, save it. But all a corporation can do it to use it for corporate purposes or give it to the stockholders. It is not disposable income, and it is not a suitable base for taxation.

The CHAIRMAN. Should the value added tax be substituted for the corporate income tax or should it be additional and suplemental to it-

Mr. PELOUBET. It should be substituted. The idea of a supplementary or additional tax has been proved by experience to be doubtful because the State of Michigan tried that, and at the meeting of the National Tax Institute on October 10, the tax commissioner of the State of Michigan testified that it was not a good way to use the value added tax. There should be a complete substitute.

The CHAIRMAN. The next question is the value added tax in successful operation anywhere in the world?

Mr. PELOUBET. It is in successful operation in France, and I think in the International Steel Community.

The CHAIRMAN. Is it a new development or an old idea?

Mr. PELOUBET. It is an old idea. I think I covered that in my statement.

The CHAIRMAN. Why do you say that the corporation income tax operates inequitably as between taxpayers?

Mr. PELOUBET. For two reasons. First, because the loss corporation escapes tax, and secondly because a corporation's taxable income is not the best index of what it should pay for the services it receives from the Government.

The CHAIRMAN. Would there be any difference or need there be any difference in revenue if a value added tax were substituted for the corporation income tax?

Mr. PELOUBET. No. If you determine your base, which I imagine would be something like the corporation's proportion of the gross national product, once you get an idea of your base, all you have to do is to set a rate and you can bring in the same income. I am not talking at all about whether the amount of tax that is taken from a corporation is too great or too small, just simply the method.

The CHAIRMAN. Thank you, Mr. Peloubet.

Mr. PELOUBET. Thank you.

The CHAIRMAN. The next witness is Mr. Stephen T. Dean of the Florida Bar Association. Mr. Dean, please proceed.

STATEMENT OF STEPHEN T. DEAN, FLORIDA BAR ASSOCIATION

Mr. DEAN. Senator, coming at the end of the day, I will do my best not to test your patience, and also to catch my plane.

The CHAIRMAN. I hope you will be safe on the latter.

Mr. DEAN. I am here representing the tax committee of the Florida Bar Association, and I would like to first emphasize that in expressing the views that we have set forth in the statement already provided, we do not express the views of the Florida bar generally but the tax committee only.

We have pursued the study of H.R. 8363 at the time it was being born in the House Ways and Means Committee with some concern. Having seen H.R. 8363 come into being, we have a few of our old concerns and we have a few new ones.

In our statement which we have filed with you we have expressed an opinion as to all of the provisions in the structural part of the code. We express no opinion on tax reduction. We believe that is a matter of policy, and we do not believe that a bar association should express its views in that regard.

But briefing the written statement submitted, we are for, and in accord with, 15 of the provisions. We have serious reservations as to five and we are not in accord with eight. It would seem to me appropriate, therefore, to limit my discussion to the eight with which we are not in agreement.

We did have a problem in determining what standards we should use and whether or not we do agree with a particular provision.

The standard which we use is this: that there is a substantial amount of goodness and stability in continuing law, and there is goodness and stability in simplified law as distinct from a complicated code.

We believe that wherever there is hardship, this hardship should be remedied; wherever there is a loophole, this loophole should be closed; but we believe in each case it should be substantial in order to warrant a further complication of an already complicated code.

With this in mind, while we are not in accord with some of the provisions, we would like to state that they might result in a small hardship or create a small loophole, and we don't think that the light is worth the candle.

The first provision I would like to refer to is section 215(a). This provision deals with the case where property has been sold on an installment basis with a small cash downpayment and a large amount to be paid over a period of years. Buyer and seller get together and negotiate as to whether or not those deferred payments should carry interest.

The proposed section 215(a) suggests that even though no interest is negotiated, that by administrative fiat there should be 5-percent interest, for example, and that if the interest actually stipulated in the agreement does not come within 1-percent tolerance of whatever might be administratively determined by the commissioner, then the interest should automatically be carved out of the installment payment and taxed as ordinary income to the seller, and, I presume, deducted by the buyer.

Now, to us, what is remarkable about this proposal is that the House report states that negligible revenue will result from this provision. If that is so, apparently the effort of 215 is to police a negotiated agreement between a buyer and a seller, and those two men may have had excellent reasons for including or rejecting an interest element. Interest will differ depending upon the security of the debtor. Interest will differ for many reasons, and it does not seem to us that it is appropriate for the Government to step in and say that we will administratively declare that there is interest present where the parties have not so bargained.

In addition, this could well throw many people off the installment basis where they have elected the installment basis for the payment of the tax.

The second provision with which we do not agree is section 220, which in the case of buildings erected on real estate, and as to which the tax owner has elected to take accelerated depreciation, this provision carves out just the accelerated portion, the portion in excess of standard straight line depreciation and says that if this building is ever sold, then so much as represents that accelerated depreciation segment shall be taxed as ordinary income if the sale indeed did report gain.

This provision further states, however, if you hold this building for 20 months, then every month 1 percent of this ordinary income will be reincarnated as capital gain, so that if you hold it for a long period of time, then this accelerated depreciation will no longer, upon sale, produce ordinary income.

We believe that this provision deals with so small a loophole as not to warrant the rather complicated language which is essential for its portrayal in the Internal Revenue Code. This accelerated depreciation in producing, if indeed it did, ordinary income versus capital gain, only deals with a differential between a capital gain rate and an ordinary income tax rate, and generally speaking we think here once again someone in the Treasury Department has perhaps sold an idea which is, from a legislative standpoint, impractical.

Section 213 deals with the nondeductibility of interest on loans incurred to purchase certain insurance and annuity contracts so that if under circumstances you take your insurance policy which you have had a number of years to a bank and borrow on it the interest thereon will not be deductible.

We suggest that younger men should be in the position of being able to take out larger policies on a borrowing basis which, at a later year, they might very well not be able to take out, due to health problems which might develop. The ability to take an insurance policy for borrowing, even on a periodic and systematic basis, is a proper economic tool for the younger man.

Section 204 deals with an attempt to tax the excess of health or accident insurance over the medical expenses actually expended. We know that there are a few people who will take out a single policy of accident or health insurance with three or four companies, particularly insurance agents seem to do this, and then if they get sick, they have a double or a triple payoff. But they have paid the premiums for this insurance. The premiums probably have not been deductible because they are within the 3 percent of adjusted gross income limitation on medical expense deductions. Therefore we do not think that this is any substantial loophole.

In fact, neither does the House of Representatives think that it is a substantial loophole, because they state in their report that there would be only a negligible increase in the revenue, and we can hardly detect a large loophole where its closure would result only in negligible increase in revenue.

Finally, section 205 deals with the $100 sick pay exclusion. This new provision states that one must be sick for 30 days before the sum of $100 a week received from one's employer will be excludable.

The justification for inserting this 30-day waiting period as stated in the House Ways and Means Committee is that within industry there are some employees who take advantage of it and stay out to get the $100, whereas a nonmalingerer may return to the job just as soon as he gets on his feet, and therefore the 30-day waiting period would prevent the malingerer from getting these benefits.

We suggest that perhaps the reason the Internal Revenue Code is as complicated as it is, is because it has tried to do much too much policing as distinct from revenue gathering, and we think that this provision with respect to the 30-day waiting period for the sick pay exclusion takes on the appearance of a policing provision, and that if this exclusion is socially justified in the first place, as was evidenced by the fact that it was indeed enacted, and as evidenced by the fact that the exclusion should exist after 30 days, then we see no reason, it being socially justified, why it should not be continued without amendment.

The next provision with which we are not in accord is section 122, which places corporate tax payments on a pay-as-you-go basis by a very complicated system which progressively prepays over a 7-year period these corporate taxes.

It would appear to us that the most honest approach to this problem would be to forget the prepayment because the prepayment is nothing less than a recapture of taxes which would be reduced by the reduction provisions of the code, and that rather than do this, simply defer the corporate tax rate reduction. You will arrive at exactly the

same monetary result insofar as revenue is concerned, and I think a little more forthrightly.

Finally, the provision with which we are not in accord is section 112 which is the so-called minimum standard deduction. If you go back to the original recommendations of this so-called minimum standard deduction in the February 6, 1963, letter of Secretary Dillon, and if you follow through the motivation for this minimum standard deduction as stated in the House report, you find this. It says that:

> We would like to give the lower bracket taxpayers another $300 exemption to raise them from $600 to $900. But if we do it to these people, then everybody will get the same $300 additional exemption.

And the statement in the House Ways and Means Committee report is, and I literally quote what they say, that, "This is wasting revenue." Now we can't quite understand why giving an equality of deduction to all taxpayers is wasting the revenue. Nevertheless, this is the official statement on this particular problem.

As we understand the constitutional and legal tax structure which is required to be followed by our Federal Government, it is this: that discrimination between taxpayers is appropriate insofar as concerns the progressive rates of taxation, and that the more income you have, then on the higher segment of income, there can be a higher rate, because the 16th amendment permits this.

And taking it next to the level of the deductions and exemptions that where you have a deduction or where you have an exemption, that everybody who undergoes this particular expense or has this particular dependency situation should have this exemption or should have this expense deduction.

Senator GORE. Off the record.

(Discussion off the record.)

Mr. DEAN. To hide an additional personal exemption which is not desired to be extended to one group of taxpayers, but to call it instead a minimum standard deduction which the February 6, 1963, statement of Mr. Dillon clearly implies, and to substitute this for this $300 additional personal exemption, which he does not want to extend because to do so would lose too much revenue, is not proper legislation in our view.

We believe that if there is a deduction or if there is an exemption, all persons in like circumstances should receive it.

Senator GORE. You think that would, in effect, be discriminatory?

Mr. DEAN. I think there is a possibility of it being illegal. That the discrimination between taxpayers that is permitted by the Constitution is that which is integrated into the progressive rates of taxation, as permitted by the Constitution.

Senator GORE. Thank you.

Mr. DEAN. Finally, we have two concerns which I should mention. The Treasury Department suggested that section 170(b)(1) which gives an unlimited charitable deduction to certain taxpayers whose contributions, plus taxes, equal 90 percent of their adjusted gross income for the taxable year in 8 of the 10 preceding years, will no longer be bound by the 30-percent charitable deduction limitation, that thereafter they could take an unlimited deduction and, as was pointed out in earlier testimony when Mr. Dillon appeared, there are a great number of taxpayers who pay no taxes whatsoever.

We have reviewed this section. We feel that this is an unwarranted exemption, and we would express our accord with the Treasury Department in suggesting the repeal of this section 170(b) (1).

Finally, there is an item with which we are most deeply concerned. Starting with the February 6, 1963, letter of Mr. Dillon, there was enunciated a new concept which, personally, I have never seen before, and that is when one dies this is the equivalent of a sale, and that any accrued gain on capital assets should be taxed.

We would like to state our position as adamantly being opposed to that and adamantly opposed to any provision other than the traditional basis viewpoint which we have had in the tax law for 47 years; that at death, when an estate tax becomes payable, if the estate does reach taxable brackets, that there is then a tax on capital in the form of the estate tax. That this is the equivalent of a capital gains tax and, in addition——

Senator GORE. I did not hear your statement. This is what?

Mr. DEAN. And that this estate tax on capital as of the date of death is justifiable reason for there coming into existence a new cost basis equal to the fair market value of the asset at the date of death. That to carry forward a decedent's cost basis into a later year in order to have a second tax in the nature of the income tax on capital gains, which is also a tax on capital, would be to impinge two capital levies on the same asset.

Now, there are a number of administrative problems which would be almost insuperable in our opinion, which would occur should this carryover basis ever be accepted.

One of the reasons sometimes that assets are not sold is because we do not know the basis. At least death does give a fair market value determination which gives us a new starting point for basis.

I appreciate your forbearance with me, and I would like to answer any questions which you may put to me.

(The prepared statement of Mr. Dean follows:)

THE FLORIDA BAR, TAX SECTION.

Re H.R. 8363. revenue bill of 1963.

Hon. HARRY FLOOD BYRD,
Finance Committee of the Senate,
Senate Office Building, Washington, D.C.

DEAR SENATOR BYRD: The tax section of the Florida Bar submits its views on H.R. 8363 on the assumption that, to produce tax laws of maximum benefit to both the Government and all of its citizens, any change in existing law should be evaluated in the light of the following general objectives:

1. In areas where taxpayers have geared their business, estate, and earnings plans to existing laws (often enacted to induce those very plans), a proper objective is the continuity of such laws. It is this continuity that provides necessary stability for long-term planning. Unjustified tampering with the code (perhaps reflecting the personal views of some dominant persons in the Treasury Department who have initiated the proposed changes) is the cause of instability in our tax laws and in the general planning programs of the taxpayers.

2. Simplification of the Internal Revenue Code is desirable; complexity is to be avoided. The February 6, 1963, statement of the Secretary of the Treasury states that "The President's program of tax reform is designed to * * * promote tax simplification." It seems appropriate, therefore, to evaluate H.R. 8363 in part on the complexities which it adds to the code.

3. Proposed changes in the tax laws which nullify existing business planning, or which further complicate the code beyond the understanding of all but the most expert, can be justified only if necessary—

(*a*) To correct a manifest inequity, or
(*b*) To close an obvious loophole.

Objectives in evaluating H.R. 8363: It is apparent that the existence of a manifest inequity or an obvious loophole should be a prerequisite in evaluating H.R. 8363 because that bill adds extreme complexities to the code and it changes the rules pertaining to existing plans, such as those for stock options and group insurance.

EVALUATION OF EACH PROPOSED CHANGE

1. Tax rate reduction (section 111 amending code section 1; section 121 amending code section 11): We do not comment on matters of policy, such as the proposed rate reduction. However, we suggest that the Senate should not approve undesirable changes in the substantive law simply because the Treasury Department "guesstimates" that those changes will produce additional revenue to offset some of the revenue lost by the tax cut.

The administration has stated that it is necessary to cut taxes in order to create additional taxpayer savings for new investment in our free economy, which in turn will add to capital momentum as insurance against a recession. Manifestly, it is net savings which will achieve this result. Capital momentum will not be enhanced by reducing taxes at one point and adding taxes at another point. Especially is this true if taxes are added to the investing taxpayer group (reducing their savings available for new investment), and at the same time taxes are reduced for the consuming taxpayer group which has lesser savings for new investment—yet this is the net effect or emphasis of H.R. 8363.

2. Minimum standard deduction (section 112 amending code section 141): We are not in accord.

The deduction floor of $300-plus depending upon one's status as single, married, or head of household and upon the number of dependents, is in effect an additional amount of personal exemption allowed only to the lower income group. It is not available to taxpayers who have otherwise reached the $1,000 maximum standard deduction or who have elected itemized deductions.

This is a new approach originated by the Treasury Department which urged that a deduction floor be used, rather than an increase in personal exemption, because:

"* * * an increase in exemptions offers greater tax savings the higher the income of the taxpayer, thus wasting much of the revenue that it would cost if the objective were to be achieved through this route, i.e., the route of the minimum standard deduction" (February 6, 1963, statement of Douglas Dillon).

We do not understand how equality-of-deduction treatment among taxpayers is to be regarded as wasting much of the revenue. Nevertheless, in enacting section 112, the Ways and Means Committee appears to adopt that viewpoint.

Up to this time Congress has applied personal exemptions and graduated tax rates across the board. The amount of one's income was not a matter of discrimination except through the graduated rates of tax as permitted by the 16th amendment to the Constitution. The proposed $300-plus deduction floor for the first time carves out a segment of income which will not be taxed at all to some taxpayers but will be taxed to all other taxpayers. This is far different than the several categories of exemptions which are based, not on income, but on dependency conditions.

We believe that the minimum standard deduction proposal injects a dangerous precedent into the code. For this reason, we recommend that section 112 be rejected, and that if lower bracket "hardship" relief is to be given, this be done by an increase in the personal exemption or a decrease of the tax rate in the lower brackets.

3. Pay-as-you-go basis for corporate taxes (sec. 122 amending code sec. 6154): We are not in accord.

This is a complex provision which, by progressively larger percentage prepayments over the 7-year period 1964–70, eventually requires current payments of corporate taxes on corporate income exceeding $100,000. During this 7-year period, according to the House report (p. 29), "the acceleration in payments is offset or more than offset by the tax reduction." In other words, the net effect for these 7 years may not be one of generating additional cash capital at the corporate level for investment.

Actually, tax payment acceleration over the 7-year period takes back a substantial part of the rate reduction for that period.

Moreover, many corporations have set their tax years to permit use of the "tax cash" during a part of the year when cash otherwise would be at a low point, and these corporations would be forced to borrow. Accordingly, it is

recommended that, rather than to accelerate the payment schedule, the code would be simplified by leaving the present payment schedule undisturbed and, instead, extending the proposed corporate tax rate reduction over a period longer than the 2 years now proposed.

4. Repeal of the dividend credit and increase of the dividend exclusion (sec. 201 amending code secs. 34 and 116) : We are, qualifiedly, in accord.

Our principal qualification is that taxation of the same income at the corporate and shareholder-dividend levels is a form of double taxation and, as such, is undesirable. Section 1371 et seq. which imposed a single tax at the shareholder level in the case of closely held corporations, recognizes this inequity.

Manifestly, the proposed change in the dividend credit of 4 percent is adverse to those receiving large dividend income, and it favors those receiving little dividend income. Curiously, the removal of the dividend credit of 4 percent to all dividend recipients is said by the House to remove "the discrimination in present law in favor of high-bracket sharesholders." (House report, p. 33.) But, if discrimination is the key to change, it is the high-bracket tax rates which make those high-bracket shareholders the prime target of discrimination, and it is that discrimination which is increased by removal of the dividend credit.

It seems unfortunate that the need for any tax change is measured by who it is in favor of. Doubtless this philosophy has become an inherent ingredient in tax legislation policy, and we do not comment further on this change since it is one of policy, except that we note that it is a step toward simplification of the code.

5. Repeal of basis reduction by 7-percent investment credit; inclusion of elevators and escalators as qualified property; establishing value for credit in case of leased property (sec. 202 amending code secs. 48 and 1245) : We are in accord.

We recommend adoption of this change as a step toward simplification. The House report (page 34) concedes that the 1962 act, in minimizing the benefit of the 7-percent credit by reducing the depreciable cost basis in like amount, resulted in burdensome recordkeeping problems and severely complicated the statutory language; and the House report further states that the elimination of such recordkeeping and complicated statutory language is sufficient reason for the change.

We would only wish that the House had been equally concerned to eliminate "severely complicated * * * statutory language" when it adopted some of the other provisions discussed in this letter.

6. Limitation of tax-free group term insurance benefits to premiums on first $30,000 coverage (sec. 203 adding new code secs. 79 and 218) : We are in partial accord.

This changes involves a policy decision to exclude from the income of an employee only those premiums on the first $30,000 of coverage, and to extend unlimited tax-free coverage to employees who are retired due to age or disability.

We suggest that it is not desirable to provide a deduction (under the new sec. 218) to younger employees who, by contribution, carry a part of the premium burden of older employees under a uniform rate plan. The proposed deduction is relatively insignificant in that it becomes effective only above the $30,000 insurance level. Moreover, it fairly can be assumed that any given group plan is a permanent one, and that a particular employee who pays more than his actuarial portion when young will pay less than his actuarial portion when he reaches an older are. Assuming a continuity of employment, the burden eventually will be offset by a benefit.

Accordingly, it is submitted that, in view of additional complexities inherent in section 218, and additional recordkeeping requirements, the foregoing deduction provision should not be enacted.

7. Income measured by excess of accident and health insurance over medical expenses incurred (sec. 204 adding new code sec. 80) : We are not in accord.

The fact is that in most cases this excess health insurance is purchased with premiums which are not deducted for tax purposes because such premiums are usually within the 3-percent nondeductible portion of general medical expenses. We, therefore, conclude that nontaxation of excess insurance proceeds is so minor a matter that it can hardly be termed an "obvious loophole." This seems self-evident from the statement in the House report (p. 44) that the change would "result in a negligible increase in revenues."

8. Sick pay exclusion of $100 per week not applicable to wage payments during first 30 days (sec. 205 amending code sec. 105(d)) : We are not in accord.

This proposal merely injects a 30-day waiting period as opposed to present law which requires no waiting in the case of accident and a 7-day waiting in the case of sickness.

The existing $100 per week limitation, and the limited 30-day period involved in the proposed amendment, are so small in scope that we are not here concerned with an obvious loophole. Moreover, there is no substantial evidence that the exclusion should be eliminated (as indicated in the House report, page 44) because of abuse by a stay-at-home employee as opposed to his coworker who is on the job despite minor ailments.

We suggest that if the sick pay exclusion is socially justifiable at all, it is not a function of the Internal Revenue Code to provide or withhold disciplinary inducements as between willing and unwilling employees.

9. Exclusion of $20,000 gain from sale of residence by over-65 persons (sec. 206 adding new code sec. 121): We are not in accord.

We are favorably disposed not only to the aged, but also to the infirm, lame, blind and all afflicted and disabled persons even though they have not attained 65 years. Many of the more unfortunate under-65 persons, as contrasted with the more fortunate over-65 retired employees who are receiving social security, pension, profit sharing and/or other deferred cash benefits, have a greater need for "some or all of the funds obtained from the sale of the old residence to meet his and his wife's living expenses" (House report, p. 45).

The real questions are: How many exceptions and exemptions should there be? At what point should the proposed favorable tax treatment be cut off? Why limit the tax favors to one group when other groups have an equal or greater need for those favors?

We note that this exclusion was not a part of the Treasury Department proposals contained in the February 6, 1963, statement of the Secretary of the Treasury. The Treasury Department had recommended that a simplified $300 tax credit be substituted for the existing over-65 exemption and the complicated retirement income credit. However, the House did not agree and under H.R. 8363 the over-65 exemption and the credit for the aged are both retained, as are special provisions relating to medical expenses, retirement pay, group insurance, social security benefits, governmental pensions and perhaps some other items all but lost in the labyrinth of exceptions which now permeate the code.

And now, to these numerous exceptions, H.R. 8363 suggests that there be added still another. The House would make exception of the first $20,000 gain on sale of a residence by an over-65 taxpayer—and this exception itself contains at least seven special rules or exceptions. Thus, there is no exclusion unless it was a principal residence for 5 out of the preceding 8 years; nor does it apply to other than the first sale after 65, unless (this is an exception to an exception to an exception) the taxpayer later revokes a prior election to exclude gain from a prior sale; nor if husband and wife own the property jointly but file separate returns; nor in the case of a nonqualifying surviving spouse unless the deceased spouse held the property for the required presale period, etc., etc. (See House report, pages 46–47.)

We do not believe that our over-65 citizens, many of whom can outrun, outwork and outwit their younger breathern, should be wooed at the expense of further complicating the code. The bald fact is that the code has become a mass of exceptions, and it can be deciphered only by the specially trained expert.

We suggest that if there is no manifest inequity in taxing the gain on the sale of a residence by an under-65 taxpayer who is afflicted and disabled then there is no equity in taxing the same gain to over-65 taxpayers, most of whom enjoy good health.

10. Deduction for State and local taxes limited to property, income, and general sales taxes (sec. 207, amending code sec. 164 and adding new code sec. 275): We are in acocrd since auto, liquor, gasoline, admissions, and similar local taxes are frequently estimated in excess of the taxpayer's actual expense, and proof is difficult or impossible.

We are also in accord with the rejection by the House of the Treasury Department's proposal to allow itemized deductions only to the extent that their aggregate exceeds 5 percent of adjusted gross income. As stated in our April 2, 1963, letter of comments to Congressman Wilbur D. Mills:

"The disallowance as deductions of the aggregate of real estate and other taxes, interest, charitable contributions and medical expenses, up to 5 percent of adjusted gross income, represents a radical departure from existing law which cannot be justified on the grounds of simplification of the tax structure or the

closing of loopholes." The existing tax structure, which permits these deductions without limit, has produced the current pattern of homeownership and financial planning by individuals, and it would be wrong to change the structure simply because fewer deductions would be claimable."

Accordingly, we recommend that deduction revisions be based upon an evaluation of each particular deduction item.

11. Personal casualty and theft losses allowed only to the extent that each loss exceeds $100 (sec. 208 amending code 165(c)(3)): We are in general accord. However, we recommend that the limitation of loss "from each casualty, or from each theft" be explicitly defined to require the aggregation into a single loss of whatever multiple losses may flow from the same event. To accomplish this objective, we suggest that the second sentence of the proposed new subparagraph (3) read as follows:

"Losses described in this paragraph shall be allowed to such individual only to the extent that the aggregate of all losses arising from each casualty, or from each theft, exceed $100."

12. Charitable contribution limit of 30 percent (of adjusted gross income) extended to all charitable organizations except private foundations (section 209(a) amending code section 170(b)): We are in qualified accord.

We believe that further study should be given to extending the 30 percent limitation to private foundations which meet certain minimum requirements of current distribution to public charitable organizations.

13. Charitable contribution carryover for corporations extended from 2 to 5 years (section 209(b) amending code section 170(b)): We are in accord.

14. Charitable contribution which is subject to a retained interest (except retained life interest) to be deferred for deduction until the retained interests are released (section 209(c) adding new subparagraph (f) to code section 170): We are in qualified accord.

We note that the "retained interest" form of contributions has been a favorite tax reduction procedure of many taxpayers. This cannot be justified simply because the tax deduction (measured by the value of the remainder interest) "has been a strong inducement for giving pictures and art objects to museums and other cultural centers in the United States." Moreover, this discrimination is enhanced where—as is often the case—the art object is valued at a figure much greater than cost; and the greater value figure is used as the base for computing the deduction.

We recommend that further study be given to this matter, to the end that any retained interest, including a retained life interest, be treated as cause for deferral of the charitable deduction; and perhaps that no income tax deduction be allowed at any time if the retained interest is released or transferred by reason of death.

15. The unlimited deduction of charitable contributions: H.R. 8363 does not adopt the Treasury Department suggestion of repealing section 170(b)(1)(c) which provides an unlimited charitable deduction if contributions plus income taxes have exceeded 90 percent of taxable income for the taxable year and 8 out of 10 of the preceding years.

There are a few persons who, by reason of the foregoing provision, have paid no income taxes for many years; and some continue to enjoy the art objects which are gifted with the reservation of life interests, as described in item 14 above. As stated by the Secretary of the Treasury in his statement of February 6, 1963:

"Under this rule, for example, an individual may receive $1 million a year in dividends, give charitable contributions equal perhaps to only a fraction of the year's appreciation in the value of his property holdings, pay no tax, and have both a large tax-free income available for consumption and wind up the year with assets worth more than they had been worth the previous year."

We suggest that further study be given to this problem to determine whether it would be appropriate to repeal section 170(b)(1)(c).

16. Repeal 1-percent limitation on medicines and drugs for persons over age 65 (section 210 amending code section 213(b)): We are in accord.

17. Liberalizing the deduction for care of dependents where the supporting taxpayer must be gainfully employed (section 211 amending code section 214): We are in accord.

18. Liberalizing and extending the deduction for moving expenses to nonreimbursed expenses and to expenses reimbursed by a new employer (section 212 adding new code section 217): We are in accord.

We note that a self-employed person, not being an "employee," is denied the benefit of this deduction. Not infrequently the small business entrepeneur is required to "follow the work" and to move his residence. We recommend, therefore, that section 217 be further amended to change subparagraph (f) to (g), and inserting a new subparagraph (f) to read as follows:

"(f) The term 'employee' as used herein shall include a self-employed person who, for at least 39 weeks during the 12-month period immediately following his arrival in the general location of his new principal place of work, carries on substantially the same business as theretofore was carried on at his former principal place of work."

19. Disallowance of deduction for interest on loans incurred to carry insurance (section 213 amending code section 246): We are, qualifiedly, not in accord.

We first suggest that systematic borrowing is a proper economic tool for the younger man who wants to take out a large ordinary life insurance policy when the annual premiums are considerably less than they would be if he defers taking out the policy until he is older and perhaps is then a "rated" person due to health problems which seem to increase with age. Such a procedure provides the younger man with a reasonable means of providing protection to his family should he die at an early age.

Subject to four exceptions, the proposed amendment disallows any interest deduction where, after as well as before the insurance policy is purchased, the cash surrender value is used periodically and systematically for borrowing purposes not related to a business or similar need for funds. Two of the exceptions (which permit the interest deduction) are dependent upon the insured's "intent" or "purpose" and, for this reason, it is inevitable that there will be adverse administration determinations and ultimately there will be substantial litigation.

We do not believe that this situation presents a sufficient "loophole" to justify the trouble and complexities which will result from the statutory effort to close so small a hole in the revenue dike. We respectfully submit that there are larger holes in the revenue dike which should be closed first, and that where the escape hole is as small as that with which section 213 is concerned, the legislature has gone beyond the point of diminishing returns.

20. Qualification of, and participation in, employee stock option and purchase plans restricted in order to correct abuse situations (sec. 214 amending code sec. 421 and adding new secs. 422, 423, 424, 425): We are in accord.

The Treasury Department's original recommendation of complete repeal disregarded the incentive benefits to be derived from these plans. We commend the House decision to reject that recommendation, and we believe that the extensive amendments by section 214 of H.R. 8363 should obviate existing abuses.

21. "Unstated" interest is imputed to deferred installment payments which by contract carry no interest at all, or carry interest at a rate more than 1 percent below the interest market (sec. 215(a) adding new sec. 483): We are not in accord.

This amendment amounts to nothing less than a "police provision" because the House report (p. 74) concedes that it "is expected to result in a negligible increase in revenues." We protest this amendment for several reasons:

(*a*) The amendment assumes that any sale contract which defers payment beyond 1 year must carry an interest element. This assumption disregards the hard fact that the existence or nonexistence of interest is usually a major item for negotiation. The adverse interests of the parties (the buyer wants interest for its deduction benefit; the seller rejects interest because of its ordinary income effect) serve to assure an "interest bargain" which expresses the true intent of the parties.

(*b*) In the case of a large sale with a small downpayment and extended installment terms, the total price will be substantially more than it would be had the sale been for cash. Under these circumstances, a part of the deferred installments are extracted for the increased risk incurred by the seller; and, economically, such installments cannot be regarded as "purchase loans" made by the seller to the buyer. However, by judicial decisions and past administrative rulings, the term "interest" means a charge for money borrowed. Accordingly, it would be clearly wrong to impute interest to those deferred installments which (1) are solely related to a negotiated credit risk and (2) are not negotiated nor intended as a "purchase money" loan.

(*c*) The proposed "imputed" interest rate would be uniformly established by administrative fiat which necessarily would disregard the local money market, variance in adequacy of security, differences in the credit and personal

liability (if assumed) of the buyer, presence or absence of service charges which are often a part of the sales contract, and many other factors which affect the interest rates. In other words, the imputed interest would itself be arbitrary, and for that reason would be unfair in many instances.

(*d*) All of the repercussions from such imputed interest cannot be assessed at the present time. For example, assume the case where exactly 30 percent of the selling price is paid in cash in the taxable year of sale; the seller reports gain on the installment basis under section 453; later the Commissioner contends that a portion of the selling price is "unstated interest" under the proposed new section 483. Is such interest a reduction of selling price—so that the cash received in the year of sale is more than 30 percent of the selling price, and the taxpayer is thus denied the deferred tax benefits of section 453? This would result even though 3½ percent interest had been charged on the deferred installments, since that charge is more than 1 percent less than the 5 percent which the House report suggests might be a fair beginning rate. (See proposed sec. 483(c) and H. Rept., pp. 72–73).

Since the House report (p. 74) admits that the new provision would produce a "negligible increase in revenues," the situation cannot be one which presents an "obvious loophole." Nor can it be said that there is a "manifest inequity" to either the buyer or seller who negotiate the installment sale at arm's length. Why, then, complicate the code with the proposed change which itself is complicated with five "exceptions and limitations" in its subparagraph (f)?

We think it appropriate to repeat our statement made on page 1 of this letter:

"Unjustified tampering with the code (perhaps reflecting the personal views of some dominant persons in the Treasury Department who have initiated the proposed changes) is the cause of instability in our tax laws and in the general planning programs of the taxpayers."

22. Service charges treated as interest on purchases of personal property under section 163(b) extended to include similar charges on purchases of services (sec. 215(c) amending code sec. 163(b)) : We are in accord.

23. Scope of personal holding company provisions broadened and extended (sec. 216 amending code secs. 541–543) : We are, qualifiedly, not in accord.

We do not object to the proposed rules which restrict the use of rents and royalties as tax shelters, and which in other respects nullify the effectiveness of an incorporated pocketbook. It is common knowledge that the rental income source has been widely used to avoid qualification as a personal holding company and, at the same time, to obtain the corporate limitation of tax on only 15 percent of dividend income. However, we are concerned that the rather complete revision of these personal holding company rules may produce unanticipated inequities and traps which Congress could have prevented by requiring further study. Obviously, this is a change formulated by the Treasury Department and consultation with taxpayer groups such as the Tax Committee of the American Bar Association might be helpful.

We are particularly concerned with the amendment which would reduce the gross income test from 80 to 60 percent of personal holding company passive income. We suggest that 60 percent is an unrealistic minimum measure of passive income because, depending on the circumstances of nonpersonal holding company business income in a given year, many more corporations will unintentionally (and inequitably) be caught in the personal holding company trap.

Time has not permitted a more detailed study of section 216, but we note with approval that corporations which would not have been personal holding companies, except for the new rules, are permitted to liquidate without incurring tax other than on capital gain measured by the underlying earned surplus. This is a proper remedial provision.

24. Rewriting and limited liberalizing of foreign personal holding company provisions with respect to (*a*) increase of cost basis on death by adding to decedent's cost basis the estate tax attributable to decedent's unrealized gain; (*b*) permitting liquidation with limited tax consequences under section 333 (sec. 216 amending secs. 316(b)(2), 333, 551(b), 553, 554, 562(b), and 1014(b)(5)) : We are in partial accord, with the reservation that time has not permitted a total analysis of these extensive revisions applicable to foreign personal holding companies.

We are not in accord with the proposed after death cost basis of foreign personal holding company stock, which the new bill establishes as the decedent's basis plus such part of the estate tax as is attributable to the unrealized gain (apparently the excess of the date-of-death value over the decedent's cost basis).

Apart from the undesirable complexity of such a rule, we are adverse to any after-death cost basis except that which is equal to the value at death which presumably will have been subject to estate tax. We see no reason why the code should depart from the traditional view that an heir is a different taxpayer than the decedent, and that the heir's acquisition price should be the value used for computing the decedent's estate tax liability.

In short, the proposal in the case of foreign personal holding company stock, to use a carryover of the decedent's cost basis as increased by a portion of his estate tax, may represent only the head of the camel which is inside the cost basis tent; and we are concerned that the whole camel may be let into the tent, in the sense first proposed (and later withdrawn) by the House whereby the after-death cost basis of all assets would be subject to a similar determination.

25. Withdrawal of the operating unit rule for oil and gas percentage depletion, and extending capital gain treatment to iron ore royalties (sec. 218 amending code secs. 272, 631(c), and 1231(b)(2): We are, qualifiedly, in accord.

Our first qualification concerns the rejection by the House of the Treasury Department's February 6, 1963, suggestion that:

"Under present law the special tax benefits provided to income from foreign mineral production sometimes permits companies operating abroad to realize excess foreign tax credits which may be used to reduce the U.S. tax liability on other foreign income. In addition, deductions for explorations and development of foreign mineral properties may reduce taxable income from domestic sources.

"The President's tax message proposes changes that would prevent the application of excess foreign tax credits against tax liabilities otherwise due on other foreign income and the reduction of taxable income from domestic sources resulting from foreign exploration and development costs which lead to production. The proposals would not affect the deductibility of abandonment losses or nonproductive properties."

We are without knowledge of the economic or other reasons why this asserted loophole has not been closed. Certainly it would be improper, if true, that a U.S. taxpayer should be able to reduce his U.S. taxes by excess foreign tax credits. We would, therefore, recommend further study of this matter.

Our second qualification involves the full gamut of the percentage depletion rates on many different mineral deposits. The covered minerals, and their relative status as to depletion rates, present a deduction panorama which has evolved substantially by chance rather than by sound economic planning. Inasmuch as the Treasury Department has been so concerned with closing even those loopholes which involve a negligible revenue gain (House report, p. 44), we recommend that further study be given to the depletion deductions which, if revised, might well result in very large revenue gains.

26. Taxation of capital gains (sec. 219 amending code sec. 1222, 1231, and related provisions dealing with capital gain). We are in accord.

However, we are concerned with the changing views expressed by the Treasury Department and the House which indicate, perhaps, that the capital gains tax reduction issue has become a pawn to be traded for agreements on rate reduction and on the sociological issue of the after-death cost basis of property subjected to estate tax. A chronological review is interesting:

"On February 6, 1963, the Treasury Department recommended that long-term gains be recognized only to the extent of 30 percent (reduced from 50 percent); and, based on the lowered ordinary income rates, the effective tax rate was to range between 4.2 percent and 19.5 percent. At the same time the Treasury Department recommended that death be treated as the equivalent of a sale to produce a constructive taxable gain. The latter recommendation, to say the least, raised a hurricane of comments, including our own (pt. 5, pp. 2843, 2844, Hearings before the Ways and Means Committee on March 19-20, 1963) which lists eight substantial objections.

"The tentative bill first published by the Ways and Means Committee adopted a middle road. Conditioned on asset classification and a 2-year holding period, capital gain would be recognized at 40 percent subject to an alternative tax thereon of 21 percent. In lieu of taxation of the constructive capital gain supposedly accrued at death, the committee substituted a carryover of the decedent's basis, increased by the estate tax apportionable to the property item in question.

"The carryover-of-basis provision was deleted before H.R. 8363 was reported out of committee, but the committee's version of the capital gain provision remained intact. The reduction in capital gain is said to be required to unlock capital investments for reinvestment in new and riskier investments needed by

the economy (House report, p. 96). In his February 6, 1963, statement the Secretary of the Treasury said:

"'Independent outside surveys, our own studies, and letters and comments which are received daily from taxpayers throughout the country indicate clearly that these substantial reductions will increase taxpayer's willingness to realize capital gains and stimulate a larger turnover of capital assets.'

"Nevertheless, on October 15, 1963, Mr. Dillon disregarded the quoted motive for capital gains tax deduction, and now he recommends against it because, according to him, it will largely benefit our wealthier citizens."

These two attitudes, expressed by the same administration spokesman, are hardly compatible. If a capital gains tax reduction is good for the country's economy (as stated by Mr. Dillon on February 6, 1963), the resulting benefit to the whole country should not be withheld simply because it will largely benefit our wealthier citizens (as stated by Mr. Dillon on October 15, 1963). We regret the appearance, however inadvertent, that Federal tax policy involves a vendetta against the high bracket taxpayers who already are paying out a higher portion of their income as taxes.

It is possible that this adverse attitude against our wealthier citizens may include an administration effort to reinstate the concept of constructive capital gain being taxed by reason of the event of death, or, in the alternate, the carry-over-of-basis concept which the House at first proposed but then abandoned.

In view of the foregoing, we here state that we are unalterably opposed to either of these concepts. We believe that the levying of an estate tax at death is the economic equivalent of the capital gains tax which would have been paid had the decedent sold the property item during his life; and, further, that just as fair market value in fact paid by a purchaser becomes his new cost basis as of the date of sale, so fair market value in fact used as a basis for estate tax should become the heir's new cost basis as of the date of death.

27. Gain from sale of real estate taxed as ordinary income measured by excess of accelerated over straight line depreciation (sec. 220 adding new code sec. 250). We are not in accord.

If one makes a business of improving and selling property, all of the gain is ordinary income. Therefore, the proposed new section 250 could affect only property acquired or improved as an investment—which implies that the property will be held for a long period.

Not only is this section concerned with property held for a long time, but its impact is on only a small segment of any gain, i.e., on only the accelerated portion of the depreciation reserve. Moreover, under the proposed section 250, that small segment of income is reincarnated as capital gain at the rate of 1 percent per month after 20 months of ownership.

Despite an effort to equate the real estate situation against that of tangible personal property (with respect to which the 1962 Revenue Act already requires a recapture of the depreciation out of the gain from a subsequent sale), see the House report, pages 101, 102, those two asset types are not the same and should not be treated the same. All depreciable tangible personal property is used in a business, and the depreciation deduction reduces business income. But a great deal of improved real estate is held as an investment (and itself is not used in a business), and the depreciation reserve ultimately must be loked to as the source of replacement of the investment. The new section 250 recognizes this distinction in that all depreciation can be recaptured on the sale of personal property, whereas it is only the small segment of accelerated depreciation which is subject to recapture on the sale of improved real estate under section 250.

Finally, section 250 is concerned with only the differential between the capital gains and ordinary income tax rates as applied to a narrow element of income. This small loophole is closed with one of the most complicated provisions imaginable, replete with seven exceptions and limitations (which, themselves, have their own exceptions), and necessitating special rules where the improvement is constructed by a lessee and where a substantial improvement is added at a later date.

We sincerely ask the members of the Committee on Finance: have you tried to read this section 250? Can you say that this new complication of an already complicated code is justified by the result?

On the contrary, we suggest that the proposed recapture provision will deter the future sale of real estate, and for that reason may reduce the amount of

construction of new improvements to real estate. In short, weighing its shortcomings against its limited benefits, it is our recommendation that this provision be rejected.

28. Averaging income over a 5-year period where current year's income exceeds 133⅓ percent of average income over 4 prior years (sec. 221 substituting new code secs. 1301–1305 for old secs. 1301–1307): We are in accord.

Without any question, this section adds complications to the code. However, the new sections 1301–1305 are fully justified because they replace prior sections 1301–1307 which themselves are not uncomplicated: and the new sections remove the occasional inequity of the bunching of income within a single taxable period which is arbitrarily limited to 12 months.

29. Repeal of the consolidated return 2-percent penalty surtax (sec. 222 amending code sec. 1503(a)): We are in accord.

30. Reduction of benefits of the surtax exemption in the case of 80 percent common controlled corporations (sec. 223 adding new code secs. 1561–1563): We are in general accord.

We suggest that section 121, amending code section 11(d), should be changed to insert the words "the lesser of" between "the surtax exemption for any taxable year is" and "$25,000 or the amount determined under section 1561 * * *."

We nominate section 223 for the title: "Most Complicated and Wordy Tax Statute of the Year."

We acknowledge the ingenuity and perseverance required to draft many of the complicated provisions of H.R. 8363. However, candidness requires that we indicate our general opinion that H.R. 8363 is a cumbersome and complicated appendage to an Internal Revenue Code that already challenges the interpretative abilities of even the most expert tax practitioner. It is a simple maxim that the light should be worth the candle; and, as indicated above, there are instances where the light shed by H.R. 8363 is simply not worth the great candlepower generated by its many pages of complex and interrelated statutory language.

We are hopeful that you will give consideration to the views stated herein. They represent the views of the tax section of the Florida bar rather than of the Florida bar generally.

Respectfully,

SHERWIN P. SIMMONS,
Vice Chairman, Tax Section.
STEPHEN T. DEAN,
Chairman, Special Committee on Legislative Recommendations.

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

The committee will adjourn until 10 o'clock tomorrow morning.

Senator GORE. Yours is a very able statement.

Senator CARLSON. Yes, it was.

(By direction of the chairman, the following is made a part of the record:)

WE, THE PEOPLE,
Chicago, Ill., November 7, 1963.

Senator HARRY F. BYRD,
Senate Office Building, Washington, D.C.

DEAR SENATOR BYRD: Will you kindly insert We, the People in the printed record of the hearings as supporting the statement made by Mr. Steve Stahl, president, Investors' Union of America, Inc., Oklahoma City, Okla.

We sent this request to Mr. Stahl too late for his presentation for the record, but he suggests that we write you directly to have it inserted. Thank you for doing so.

With our best,

HARRY T. EVERINGHAM, *President.*

(Whereupon, at 4 p.m., the committee adjourned to reconvene at 10 a.m., Thursday, November 7, 1963.)

REVENUE ACT OF 1963

THURSDAY, NOVEMBER 7, 1963

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

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

Present: Senators Byrd (presiding), Long of Louisiana, Douglas, Gore, Talmadge, Williams, Carlson, and Dirksen.

Also present: Elizabeth B. Springer, chief clerk.

The CHAIRMAN. The committee will come to order.

The first witness is Mr. Raymond A. Hoffman, of the Illinois State Chamber of Commerce.

Mr. Hoffman, you take a seat, sir, and proceed.

STATEMENT OF RAYMOND A. HOFFMAN, CHAIRMAN, FEDERAL TAXATION COMMITTEE, ILLINOIS STATE CHAMBER OF COMMERCE; ACCOMPANIED BY NORMAN J. BEATTY, MANAGER, TAX DEPARTMENT

Mr. HOFFMAN. My name is Raymond A. Hoffman. I am a partner in Price Waterhouse & Co., a firm of certified public accountants, and the current chairman of the Federal Taxation Committee of the Illinois State Chamber of Commerce. I am accompanied by Norman J. Beatty, manager of the chamber's tax department. Mr. Beatty is on my left.

This statement is presented on behalf of the Illinois State Chamber of Commerce, a statewide organization with a membership of more than 18,000 businessmen in 441 communities in every part of the State of Illinois. The members are engaged in virtually every type of business and range from the self-employed to those associated with some of the Nation's largest corporations.

The recommendations set forth in this statement were prepared by the State chamber's Federal taxation committee of 90 members and follows the policies established by the State chamber's 70-member board of directors. The viewpoints presented broadly represent those of Illinois business with respect to the proposals for income tax reduction and structural changes being considered in connection with the revenue bill of 1963.

The Illinois State Chamber of Commerce has long supported fiscal responsibility, reductions in Federal spending, a balanced Federal budget, and reform of the Federal tax structure. The most basic re-

form that we have advocated has been a reduction in Federal income tax rates to materially reduce their stifling effect on business. It is, and has been, the position of the Illinois State Chamber of Commerce that a reduction in corporate income tax rates and a reduction in the degree of graduation in the rate schedule applicable to personal income would most effectively stimulate the free economy of this country.

Meeting in connection with the 45th Annual Meeting of the Illinois State Chamber of Commerce last week, the board of directors applied its longstanding policies to H.R. 8363 in the following resolution, which was unanimously adopted:

Whereas the Illinois State Chamber of Commerce regards present high rates of income tax as producing many undesirable consequences; and

Whereas the present high rates of income tax, both as applied to corporate and individual income, impair incentives to work, produce, and invest; and

Whereas the Illinois State Chamber of Commerce has consistently urged reduction in taxes, but never at the expense of fiscal responsibility, and the position has consistently been that there should be an unrelenting effort to reduce spending, and that any tax cuts should stimulate intensified efforts to this end; and

Whereas the revenue bill of 1963 (H.R. 8363 as passed by the House of Representatives and currently the subject of hearings before the Senate Finance Committee) reflects an important step in reform in Federal income tax rates: Now, therefore, be it

Resolved, That the Illinois State Chamber of Commerce supports the proposal for tax reduction of a magnitude reflected in the revenue bill of 1963; and be it further

Resolved, That the Committee on Federal Taxation is hereby authorized to make representations before the Senate Finance Committee in support of the proposed reductions in Federal income taxes, with the hope and expectation that the reduction in Federal tax revenue resulting from the revision of tax rates will be a stimulant to the administration and to Congress to cut spending, balance the budget, and to effect further reform of the Federal tax structure.

This action was immediately reported to the members in attendance at the annual meeting last week. In doing so it was emphasized that our support of the reduction makes effective efforts to reduce Federal spending even more important and that support for a tax reduction is a matter of longstanding policy of the Illinois State Chamber of Commerce, and is not prompted by fears of a business recession.

With respect to the proposed tax rate revisions, our specific recommendations are—

1. Adopt the proposals to reverse the present corporate normal tax and surtax rates and to reduce the corporate income tax from 52 to 48 percent.
2. Adopt the proposal to eliminate the 2-percent penalty tax presently paid by corporations for the privilege of filing consolidated returns.
3. Adopt the proposal to reduce the range of individual income tax rates from 20 to 91 percent to 14 to 70 percent, but revise the schedule so that the ascension in rates is more gradual.
4. Adopt the proposals relating to the taxation of capital gains, and add a provision allowing corporations a capital loss carryover of unlimited duration similar to that provided for individuals.

According to the report of the Committee on Ways and Means, the bill is expected to result in a revenue reduction of $2.2 billion in the Government's fiscal year ending June 30, 1964, and an additional reduction in revenue of $5.2 billion in the fiscal year 1965. The reduction in tax liabilities is estimated at $11.1 billion over a 2-year period—$2.3 billion of corporate and $8.8 billion of individual tax liabilities.

From the standpoint of the impact of the proposed tax rate revisions on our economy, the reduction in the Government's revenue collections is more important than the reduction in computed liabilities. Also, the lower set of estimates relating to Government revenues are the only ones which will be reflected in future Federal budgets. Therefore, the most significant estimate is that the bill could adversely affect the budgeted receipts for the period July 1, 1964, to June 30, 1965, by $7.4 billion, but—according to the report of the Ways and Means Committee—it is anticipated that income levels will be substantially higher as a result of the economic stimulus of the tax cut and will generate revenues significantly offsetting the budgetary impact of the rate reductions.

Under the revenue bill of 1963, neither the proposed reduction in the corporate income tax rate to 48 percent nor the proposed 14- to 70-percent range of individual rates would become effective January 1, 1964. These proposals are considered as objectives. It is recognized that adoption of other recommendations would require further deferment of these objectives in order that the magnitude of the tax reduction pending curtailment of expenditures will not exceed that reflected in the bill, as passed by the House; however, it is felt that other corrections in the bill are even more important than the immediate realization of the suggested rate levels and that this should be only the first of a series of rate reductions which should be enacted as spending is reduced and the budget balanced.

Our attention has been directed primarliy to those proposals which affect business in general or are of broad application. We have not attempted to submit detailed recommendations with respect to each section of the revenue bill of 1963 or all facets of even the ones to which attention is specifically directed; however, the absence of a recommendation as to any particular proposal should not be interpreted as either an implied endorsement or condemnation.

I do not propose to read the entire prepared statement. It will be appreciated if the statement can be reproduced in full in the record of these hearings.

The CHAIRMAN. Without objection.

Mr. HOFFMAN. Specific comments are submitted with respect to 11 topics in the current bill.

The Illinois State Chamber of Commerce favors the proposal to repeal the requirement that the basis of property be reduced by the amount of the investment credit. The Illinois State Chamber favors the proposal for the averaging of income for individuals.

We favor adoption of the provisions relating to taxation of capital gains and losses, with a further suggestion, as mentioned, that there be unlimited loss carryover of capital losses allowed to corporations.

It is urged that the provision for the taxation of premiums paid by employers on group term life insurance either not be adopted or be modified.

We propose that or recommend that the provision dealing with moving expenses be expanded.

We feel that the provisions relating to the employee stock option purchase plans should probably be modified substantially.

Our recommendations as far as in opposition to some of the provisions of the bill are reflected in our statement, and they relate to only two items.

The first is that the provisions for current tax payments by corporations should be eliminated or at the very least materially modified.

The acceleration of income tax payments by corporations when fully effective will result in the payment of tax in advance of both the time when earned as well as before the realization of earnings in the form of cash receipts.

It is important to note that the table provided in the House committee report which purports to indicate—

> the combined effect of the rate reduction wth the acceleration of corporate payments in all years results in a net reduction in tax payments, even for a corporation with a taxable income of $10 million. Corporations with smaller incomes would fare still more favorably in this respect—

is based on corporate estimates of 75 percent of income. If a corporation with reasonably predictable income accurately estimated income and based its estimates on 100 percent of income as it is required to do under penalties of perjury, it would if it fell in some income ranges pay materially more than is required under the present law.

Most business corporations, and particularly those with income tax liabilities in excess of $100,000, report taxable income on the accrual basis of accounting rather than on the basis of cash receipts and disbursements. This means that expenditures for goods for resale do not become deductible until the time of sale and the sale is included in taxable income when the related billing is made to customers and the collection may not be made from 30 to 60 days thereafter.

The proposed schedule calls for 50 percent of the tax to be paid by June 15, whereas half of the taxable year will not have expired until June 30. Similar installments on September 15 and December 15 must take into account transactions for the balance of those quarters.

Further, there is a nondeductible penalty of 6 percent for substantial underestimate. This penalty applies whether the underestimate is willful or whether it results from errors made from computations made in good faith or from events which transpire after the date on which the estimate is made. For example, a company may have calculated income from foreign operations and a change in the rate of foreign exchange between December 15 and the close of the year may result in the realization of a substantially greater amount of taxable income than contemplated. The penalty should be either made deductible like interest or should be reduced. Consideration should be given to providing for a credit where the payment of estimated tax exceeds the minimum amount which would be due. Possibly such overpayment should be limited to an amount which would extinguish a penalty for underestimate which otherwise might occur.

To avoid financial hardship, provision should be made for prompt refund of payments on account of estimated tax which subsequent events prove to be substantially in excess of requirements.

One of the arguments for rate reductions is that it will make funds available to business which will stimulate the general economy. The scheduled acceleration of income tax payments by corporations will offset the reductions in installments arising from rate reductions. As a result, it will be over 5 years before corporate management will have any additional cash available for investment, assuming level earnings. It seems questionable whether there will be any present incentive derived from such a long-deferred benefit.

Next, the Illinois State Chamber of Commerce recommends that there be no change at the present time concerning the dividend credit and the exclusion.

The inclusion in the 1954 code of the dividend credit and exclusion proved to be one of the most controversial items in the code. The exclusion and credit for dividends were justified on the grounds that under the 1939 code the earnings of a corporation were taxed twice, once as corporate income and again as individual income when paid out as dividends to the shareholders. This result is due to the fact that dividends, unlike wages or other deductible expenditures, do not constitute deductions from a distributing corporation's taxable income.

It was said in the Senate Finance Committee report in connection with the Revenue Act, the Internal Revenue Code of 1954, that this double taxation results—

in a higher tax burden on distributed corporate earnings than on other forms of income. In addition, it has contributed to the impairment of investment incentives. Capital which otherwise would be invested in stock is driven into channels which involve less risk in order to escape the penalty of double taxation. This restricts the ability of companies to raise equity capital and has forced them to rely too heavily on borrowed money. The penalty on equity financing has been especially harmful to small business which cannot easily borrow funds and must rely on equity capital for growth and survival.

The reasons for the enactment of the dividend exclusion and dividend credit in 1954 are still valid and indeed are compelling today if stagnation is to be avoided and the economy and investment are to expand.

The Treasury's statement that the ratio of equity to debt financing by corporations has not increased despite the presence of the 4-percent credit can well be answered by the practical result of debt financing. Such financing totally eliminates double taxation of debtor corporation income because interest is fully deductible from corporate taxable income. The cost of financing is thus reduced substantially.

The relatively slight reduction in corporate taxation in no way reduces the desirability of avoiding double taxation of dividends.

There are three items included in our statement that are discussed, starting on page 15, that are not part of the revenue bill that are so closely related to it that we would like to direct your attention to these points.

The first relates to the treatment of accretions in value of property passing at death.

The Illinois State Chamber of Commerce believes that existing law respecting the income taxation of capital assets passing at death does not involve serious inequities, and it recommends that no change be made in the law.

Although H.R. 8363 would not change existing law with respect to the income taxation of property passing at death, there are reports that the administration will recommend to this committee that current law be amended in this regard.

The administration's original recommendation to the Committee on Ways and Means called for capital gains taxation on the accretion in value of capital assets passing at death. The Illinois State Chamber of Commerce voiced its opposition to this proposal in appearing before that committee, and would continue that opposition were the

proposal to be renewed. This measure departs radically from the basic concepts that underlie income taxation. In treating such transfers as a sale or exchange, the proposal would unfairly tax income before its realization.

Of particular concern is that, by increasing the overall tax burden, the measure would render even more difficult the continued operation of closely held companies upon the death of a principal shareholder. Congress in recent times has been sufficiently interested in this problem to enact sections 303 and 6166 of the Internal Revenue Code: the enactment of such could not but seriously impair the effectiveness of the relief extended by those sections.

The original proposal submitted to the Ways and Means Committee was thus further objectionable on the grounds of its sheer complexity, since surely a prime aim of any tax reform must be a simplifaction of our tax laws. Similar considerations caused that committee to reject the suggested alternative whereby an inheritor would take the decedent's basis with respect to inherited property.

Also we recommend that there be eliminated from section 274 all of the provisions not needed to effectively preclude the application of the "Cohan rule" to travel and entertainment expenses.

The Illinois State Chamber of Commerce reaffirms its recommendation that section 274 of the Internal Revenue Code with regard to deduction of travel and entertainment expense and gifts be modified. Concern about this subject was previously expressed in testimony before the Senate Finance Committee when it was considering the Revenue Act of 1962, before the Ways and Means Committee in the public hearings on the President's tax reform proposals, and to the Commissioner of Internal Revenue at the time of the hearings on his proposed regulations.

The Revenue Act of 1962 added section 274 to the Internal Revenue Code. The primary factor which resulted in enactment of this section is the more frequent application in recent years of the judicial doctrine known as the "Cohan rule." The application of this rule permitted the partial allowance of deductions on the basis of unsubstantiated estimates. Among the other factors which led to the enactment of section 274 was claimed to be the difficulty in establishing a practical administrative procedure to distinguish between an ordinary and necessary business expense allowable as a deduction and a personal expense which is not deductible.

Section 274 limits deductions for amounts which are admittedly ordinary and necessary business expenses, unless they meet statutory tests which are not phrased in clear language. Phrases are used such as "associated with" and "directly related to" the active conduct of the taxpayer's trade or business. Further, with reference to an entertainment facility, the statute requires that the facility be "used primarily for the furtherance of the taxpayer's trade or business," and there is no specific standard for making the determination.

Although the Commissioner of Internal Revenue took many months to formulate his regulations and has supplemented his extensive regulations with revenue rulings, there is still a great deal of uncertainty as to the manner in which the statutory provision will ultimately be applied.

The delay in issuing regulations and the necessity for supplementing the regulations by revenue rulings are unrefutable indications of difficulties involved in the application of the statutory language.

The Illinois State Chamber of Commerce endorses the principles underlying the proposals in H.R. 6164 through 6175 and in S. 2068; however, the language of S. 2068 appears preferable and adoption of that proposal as part of the revenue bill of 1963 is strongly recommended.

Need for enactment of amendatory legislation is pressing. Confusion and doubt have resulted from section 274, and the amendment should be retroactive to apply to all expenses paid or incurred during the current calendar year.

The last recommendation which I would like to comment upon this morning relates to the use of the reserve ratio test with reference to depreciation guidelines.

It is recommended that a new provision be added to the bill to make the use of depreciation guidelines a matter of right and to avoid the ultimate limiting effect of the reserve ration test, as has been suggested by Senator Hartke in S. 2231.

Many companies, particularly small ones, have hesitated to put the new depreciation guidelines into effect because of uncertainty as to their status and because of the limiting effect of the reserve ratio test. Inclusion of the suggested provision would open the door to greater use of guidelines and would stimulate investment with no substantial revenue loss.

We sincerely appreciate the opportunity to be here this morning and make this statement on behalf of the Illinois State Chamber of Commerce.

(The prepared statement of Mr. Hoffman follows:)

STATEMENT OF RAYMOND A. HOFFMAN, FOR THE ILLINOIS STATE CHAMBER OF COMMERCE

My name is Raymond A. Hoffman. I am a partner in Price Waterhouse & Co., a firm of certified public accountants, and the current chairman of the Federal Taxation Committee of the Illinois State Chamber of Commerce. I am accompanied by Norman J. Beatty, manager of the chamber's tax department.

This statement is presented on behalf of the Illinois State Chamber of Commerce, a statewide organization with a membership of more than 18,000 businessmen in 441 communities in every part of the State of Illinois. The members are engaged in virtually every type of business and range from the self-employed to those associated with some of the Nation's largest corporations.

The recommendations set forth in this statement were prepared by the State chamber's Federal taxation committee of 90 members and follows the policies established by the State chamber's 70-member board of directors. The viewpoints presented broadly represent those of Illinois business with respect to the proposals for income tax reduction and structural changes being considered in connection with the revenue bill of 1963.

The Illinois State Chamber of Commerce has long supported fiscal responsibility, reductions in Federal spending, a balanced Federal budget, and reform of the Federal tax structure. The most basic reform that we have advocated has been a reduction in Federal income tax rates to materially reduce their stifling effect on business. It is, and has been, the position of the Illinois State Chamber of Commerce that a reduction in corporate income tax rates and a reduction in the degree of graduation in the rate schedule applicable to personal income would most effectively stimulate the free economy in this country.

Meeting in connection with the 45th annual meeting of the Illinois State Chamber of Commerce last week, the board of directors applied its longstanding policies to H.R. 8363 in the following resolution, which was unanimously adopted:

Whereas the Illinois State Chamber of Commerce regards present high rates of income tax as producing many undesirable consequences; and

Whereas the present high rates of income tax, both as applied to corporate and individual income, impair incentives to work, produce, and invest; and

Whereas the Illinois State Chamber of Commerce has consistently urged reduction in taxes, but never at the expense of fiscal responsibility, and the position has consistently been that there should be an unrelenting effort to reduce spending, and that any tax cuts should stimulate intensified efforts to this end; and

Whereas the revenue bill of 1963 (H.R. 8363 as passed by the House of Representatives and currently the subject of hearings before the Senate Finance Committee) reflects an important step in reform in Federal income tax rates: now, therefore, be it

Resolved, That the Illinois State Chamber of Commerce supports the proposal for tax reduction of a magnitude reflected in the revenue bill of 1963; and be it further

Resolved, That the committee on Federal taxation is hereby authorized to make representations before the Senate Finance Committee in support of the proposed reductions in Federal income taxes, with the hope and expectation that the reduction in Federal tax revenue resulting from the revision of tax rates will be a stimulant to the administration and to Congress to cut spending, balance the budget, and to effect further reform of the Federal tax structure.

This action was immediately reported to the members in attendance at the annual meeting. In doing so it was emphasized that our support of the reduction makes effective efforts to reduce Federal spending even more important and that support for a tax reduction is a matter of longstanding policy of the Illinois State Chamber of Commerce, and is not prompted by fears of a business recession.

With respect to the proposed tax rate revisions, our specific recommendations are:

1. Adopt the proposals to reverse the present corporate normal tax and surtax rates and to reduce the corporate income tax rate from 50 to 48 percent.
2. Adopt the proposal to eliminate the 2-percent penalty tax presently paid by corporations for the privilege of filing consolidated returns.
3. Adopt the proposal to reduce the range of individual income tax rates from 20 to 91 percent to 14 to 70 percent, but revise the schedule so that the ascension in rates is more gradual.
4. Adopt the proposals relating to the taxation of capital gains, and add a provision allowing coporations a capital loss carryover of unlimited duration similar to that provided for individuals.

According to the report of the Committee on Ways and Means, the bill is expected to result in a revenue reduction of $2.2 billion in the Government's fiscal year ending June 30, 1964, and an additional reduction in revenue of $5.2 billion in the fiscal year 1965. The reduction in tax liabilities is estimated at $11.1 billion over a 2-year period—$2.3 billion of corporate and $8.8 billion of individual tax liabilities. From the standpoint of the impact of the proposed tax rate revisions on our economy, the reduction in the Government's revenue collections is more important than the reduction in computed liabilities. Also, the lower set of estimates relating to Government revenues are the only ones which will be reflected in future Federal budgets. Therefore, the most significant estimate is that the bill could adversely affect the budgeted receipts for the period July 1, 1964, to June 30, 1965, by $7.4 billion, but—according to the report of the Ways and Means Committee—it is anticipated that income levels will be substantially higher as a result of the economic stimulus of the tax cut and will generate revenues significantly offsetting the budgetary impact of the rate reductions.

Under the revenue bill of 1963, neither the proposed reduction in the corporate income tax rate to 48 percent nor the proposed 14-percent to 70-percent range of individual rates would become effective January 1, 1964. These proposals are considered as objectives. It is recognized that adoption of other recommendations would require further deferment of these objectives in order that the magnitude of the tax reduction pending curtailment of expenditures will not exceed that reflected in the bill, as passed by the House, however, it is felt that other corrections in the bill are even more important than the immediate realization of the suggested rate levels and that this should be only the first of a series of rate reductions which should be enacted as spending is reduced and the budget balanced.

Our attention has been directed primarily to those proposals which affect business in general or are of broad application. We have not attempted to submit detailed recommendations with respect to each section of the revenue bill of 1963

or all facets of even the ones to which attention is specifically directed; however, the absence of a recommendation as to any particular proposal should not be interpreted as either an implied endorsement or condemnation.

Specific recommendations are being submitted with respect to the following topics:

Section 122. Current tax payments by corporations.
Section 201. Dividends received by individuals.
Section 202. Repeal of requirement that basis of section 38 property be reduced by 7 percent.
Section 203. Group-term life insurance purchased for employees.
Section 212. Moving expenses.
Section 214. Employee stock option and purchase plan.
Section 219. Capital gains and losses.
Section 221. Averaging of income.
Capital gains at death.
Travel and entertainment expense.
Depreciation-reserve ratio.

SECTION 122.—CURRENT TAX PAYMENTS BY CORPORATIONS

Recommendation: Provisions for current tax payments by corporations should be eliminated or at the very least materially modified.

Explanation: The acceleration of income tax payments by corporations when fully effective will result in the payment of tax in advance of both the time when earned as well as before the realization of earnings in the form of cash receipts.

It is important to note that the table provided in the House committee report which purports to indicate "the combined effect of the rate reduction with the acceleration of corporate payments in all years results in a net reduction in tax payments, even for a corporation with a taxable income of $10 million. Corporations with smaller incomes would fair still more favorable in this respect," is based on corporate estimates of 75 percent of income. If a corporation with reasonably predictable income accurately estimated income and based its estimates on 100 percent of income as it is required to do under penalties of perjury, it would if it fell in some income ranges pay materially more than is required under the present law.

Accrual basis companies report earnings before collection.—Most business corporations, and particularly those with income tax liabilities in excess of $100,000, report taxable income on the accrual basis of accounting rather than on the basis of cash receipts and disbursements. This means that expenditures for goods for resale do not become deductible until the time of sale and the sale is included in taxable income when the related billing is made to customers and the collection may not be made from 30 to 60 days thereafter.

Tax must be paid before earnings are generated.—The proposed schedule calls for 50 percent of the tax to be paid by June 15, whereas half of the taxable year will not have expired until June 30. Similar installments on September 15 and December 15 must take into account transactions for the balance of those quarters.

Penalties for errors in estimating are a one-way street.—There is a nondeductible penalty of 6 percent for substantial underestimate. This penalty applies whether the underestimate is willful or whether it results from errors made from computations made in good faith or from events which transpire after the date on which the estimate is made. For example, a company may have calculated income from foreign operations and a change in the rate of foreign exchange between December 15 and the close of the year may result in the realization of a substantially greater amount of taxable income than contemplated. The penalty will apply even though it can be demonstrated that the reason for the underestimate lies wholly in circumstances which occurred after December 15. The penalty should be either made deductible like interest or should be reduced. Consideration should be given to providing for a credit where the payment of estimated tax exceeds the minimum amount which would be due. Possibly such overpayment should be limited to an amount which would extinguish a penalty for underestimate which otherwise might occur.

Provision should be made for refunds of installments of estimated tax.—To avoid financial hardship, provision should be made for prompt refund of payments on account of estimated tax which subsequent events prove to be substantially in excess of requirements.

Acceleration of tax payments postpones the benefit of rate reduction.—One of the arguments for rate reductions is that it will make funds available to business which will stimulate the general economy. The scheduled acceleration of

income tax payments by corporations will offset the reductions in installments arising from rate reductions. As a result, it will be over 5 years before corporate management will have any additional cash available for investment, assuming level earnings. It seems questionable whether there will be any present incentive derived from such a long deferred benefit.

SECTION 201. DIVIDENDS RECEIVED BY INDIVIDUALS

Recommendation: Do not modify at this time the present dividend credit and exclusion.

Explanation: The inclusion in the 1954 code of the dividend credit and exclusion proved to be one of the most controversial items in the code. The exclusion and credit for dividends were justified on the grounds that under the 1939 code the earnings of a corporation were taxed twice, once as corporate income and again as individual income when paid out as dividends to the shareholders. This result is due to the fact that dividends, unlike wages or other deductible expenditures, do not constitute deductions from a distributing corporation's taxable income.

It was then said in Senate Report No. 1622, 83d Congress, 2d session, page 6, that—

"This results in a higher tax burden on distributed corporate earnings than on other forms of income. In addition, it has contributed to the impairment of investment incentives. Capital which otherwise would be invested in stock is driven into channels which involve less risk in order to escape the penalty of double taxation. This restricts the ability of companies to raise equity capital and has forced them to rely too heavily on borrowed money. The penalty on equity financing has been especially harmful to small business which cannot easily borrow funds and must rely on equity capital for growth and survival."

The reasons for the enactment of the dividend exclusion and dividend credit in 1954 are still valid and indeed are compelling today if stagnation is to be avoided and the economy and investment are to expand.

It is obvious that the objections to the dividend credit are based on two considerations: (1) The desire to find additional revenue by way of further "reforms" of the 1954 code and (2) the political aspect of refusing a higher percentage of relief to taxpayers in the higher brackets. The first reason is inconsistent with the purpose of the bill to create growth through investment and the second reason is inequitable and invidious.

It is submitted that in fact granting a 4-percent dividend credit should have been but a first small step toward elimination of double taxation of domestic corporate income.

The Treasury's statement that the ratio of equity to debt financing by corporations has not increased despite the presence of the 4-percent credit can well be answered by the practical result of debt financing. Such financing totally eliminates double taxation of debtor corporation income because interest is fully deductible from corporate taxable income. The cost of financing is thus reduced substantially.

The relatively slight reduction in corporate taxation in no way reduces the desirability of avoiding double taxation of dividends.

SECTION 202. REPEAL OF REQUIREMENT THAT BASIS OF SECTION 38 PROPERTY BE REDUCED BY 7 PERCENT

Recommendation: This provision should be adopted.

Explanation: The tax reduction inherent in the investment credit was substantially cut by the inclusion in the Revenue Act of 1962 as it became law of provisions requiring that the credit be applied against the cost basis in computing allowable depreciation and gain or loss upon disposition. Further, this requirement has greatly complicated the use of the investment credit.

As part of the current tax reduction program the Illinois State Chamber of Commerce recommends that the Internal Revenue Code be amended retroactively so as to allow the investment credit without requiring any reduction of cost basis. This would eliminate unnecessarily complicated accounting and financial problems of taxpayers and aid the Internal Revenue Service by greatly simplifying the administration of the law.

SECTION 203. GROUP TERM LIFE INSURANCE PURCHASED FOR EMPLOYEES

Recommendation: Section 203 of the bill which requires an employee to include in gross income the cost of any group term life insurance coverage in

excess of $30,000 provided under a policy carried by his employer, should not be adopted.

Explanation: The social desirability of group term life insurance has been recognized for more than 50 years. Because of its low cost, administrative simplicity and universal coverage, irrespective of physical condition, it is one of the more effective and efficient means for providing financial protection to the family of a deceased wage earner. Contributing to its uninterrupted growth has been the position of the Internal Revenue Service, first stated in 1920, that employer-paid premiums on group life insurance "are in no sense 'gain derived' or realized or capable of being realized by the employee in dollars and cents, but only in the feeling of contentment that provision has been made for dependents" and consequently do not constitute taxable income.

The Illinois State Chamber of Commerce believes that the proposal to tax employees on the cost to the employer of group term life protection in excess of $30,000 would seriously retard the growth of this socially desirable family insurance coverage for the wage earner. The cost of this protection would be materially affected by the additional administrative expenses entailed in maintaining the necessary records for taxable cost computations and tax withholding. It is probable that these administrative expenses will exceed the annual revenues of $5 million which the administration has estimated will result from the enactment of this provision. Furthermore, the proposal would effectively destroy the simplicity of group term life insurance. There is also a psychological factor which should deter adoption of this provision; i.e., the difficulty in explaining to employees the differential tax effect on persons of various age groups—are the younger employees really carrying the burden for older employees, etc.?

It is understood that the primary reason of the administration for recommending taxation of group insurance was to curb abuses in plans favoring higher paid executives. The Illinois State Chamber of Commerce believes that the amount of insurance coverage should not be the determinative factor as to whether an abuse exists. The criterion should be whether the operation of the plan itself unfairly discriminates in favor of highly paid employees. If, however, a provision requiring the taxation of employer-paid group term life insurance premiums is to be enacted to prevent abuses, it should apply only to insurance coverage in excess of $30,000 or twice the employee's annual salary, whichever is the greater.

SECTION 212. MOVING EXPENSES

Recommendations: 1. Expand the definition of "moving expenses" to include all reasonable expenses incurred by an employee in excess of the ordinary living expenses of his family prior to the time his household effects are established in his new location.

2. Provide for a definition of "employee" for the purpose of the proposed section 217 of the code to include a member of a partnership.

3. Provide either that where an employee was reimbursed for a loss incurred in selling his home the reimbursement will be considered as an addition to the sales price, or that the loss on the sale of a residence incident to a change of location will not be recognized for tax purposes and the basis of the old residence will be carried over to the new residence.

Explanation: An employee's moving expenses are obviously incurred in connection with being able to earn income, and it is properly proposed that expenses be allowed to new employees and employees receiving no reimbursement from the employer. This proposal should continue to the revitalization of the economy by removing one of the artificial barriers to the free mobility of talent.

The proposed definition of "moving expenses" for the purposes of the section which would be added to the Internal Revenue Code by the bill does not, however, cover all of the additional out-of-pocket expenses required to be incurred by an employee in moving to a new location. In addition to travel and living costs incurred in excess of what would otherwise be the ordinary expenses of the family are such items as expenses of altering and remodeling carpets, draperies, and custom-built furniture. To fully accomplish the objective of section 217, the definition of "moving expenses" should include all reasonable expenses incurred by an employee in excess of the ordinary living expenses of his family prior to the time his household effects are established in his new location.

The allowance of a deduction for moving expenses should not be restricted to an employee. Equity requires that the same allowances be made to a member

of a partnership. This is particularly important in occupations such as public accounting, stock brokerage, and investment firms which traditionally have been organized as partnerships, have offices in various parts of the country, and transfer partners from time to time. The necessity for granting comparable allowances to members of partnership is not limited, however, to any particular field of professional or business endeavor.

As presently drafted, the revenue bill of 1963 contains no provision clarifying the position of an employee who is reimbursed for a loss incurred in selling his home. Should it be determined that no statutory provision is to be added which would establish this reimbursement as an addition to the sales price of the residence, it is suggested that consideration be given to providing (through an amendment to section 1034 or otherwise) for the nonrecognition of loss and carryover of basis from the old residence to the new residence, if (1) a taxpayer's principal residence is sold at a loss, (2) the condition set forth in section 217(c) are met, and (3) the present section 1034 would be applicable had the old residence been sold at a gain.

SECTION 214. EMPLOYEE STOCK OPTION AND PURCHASE PLAN

Recommendation: Do not adopt this section without material modification.

Explanation: This is an extremely technical area having differential application to the existing plans of various businesses. We are confident that a considerable body of material will be presented to you from various other groups and at this time we wish to limit our comments to the enumeration of two widespread objections.

1. The plan suggested has retroactive effect in that outstanding options issued prior to the drafting of H.R. 8363 affect options to be issued under the new provision. We suggest that existing options plans be allowed to be completed without affecting the issuance of new options, and

2. There are sound reasons in many circumstances to prohibit the exercise of an option for a period of time. A requirement that an option be exercised within 5 years makes this most difficult. We, therefore, suggest that the 5-year limitation be discarded or that it run from the date when the option can first be exercised rather than from the date of issuance of the option.

SECTION 219. REVISION OF CAPITAL GAINS PROVISIONS

Recommendation: Adopt section 219 of the bill, with an amendment that corporations shall be entitled to a capital loss carryover of unlimited duration similar to that provided for individuals.

Explanation: The creation of the "class A capital gain," on the sale by individuals of capital assets held for more than 2 years, would result in a reduction of capital gains tax in many situations. The Illinois State Chamber of Commerce supports this provision as a logical complement of the reduction of ordinary income tax rates.

A stated objective of this measure is to effect an "unlocking" of capital investments, so that new and riskier investments needed by the economy will be undertaken. In this connection, the committee may wish to consider the creation of yet another class of capital gain with respect to the sale of capital assets held by individuals for more than 3 years. The percentage inclusion factor as to such gain might be reduced to 30 percent, with a maximum tax rate of 17 percent. The Illinois State Chamber of Commerce believes that a provision of this nature would more effectively stimulate the expansion of risk capital, and in all likelihood would increase revenue.

The provision permitting unabsorbed capital losses incurred by individuals to be carried forward for an indefinite period, rather than the 5 years allowed by existing law, is warranted by considerations of tax equity. It is obvious, however, that tax equity also requires allowance of a carryover period of unlimited duration in the case of net capital losses sustained by corporations. At the present time, corporations are frequently unable to utilize capital losses for tax purposes, despite the fact that they have borne the full economic burden of these losses. Moreover, this situation will unquestionably be aggravated by reason of section 1245 of the Internal Revenue Code of 1954 (enacted in 1962), which requires that gain realized on the disposition of depreciable personal property be taxed as ordinary income to the extent of post-1961 depreciation deductions. The certain effect is to reduce the capital gains of corporations against which capital losses may be applied. Section 220 of H.R. 8363 would adopt similar

recapture provisions with respect to depreciable realty, and should that section be enacted, this problem would become even more acute.

For the foregoing reasons, the Illinois State Chamber of Commerce urges that corporations be permitted to carryover capital losses for an indefinite period.

SECTION 221. AVERAGING OF INCOME

Recommendation: That this section do be adopted.

Explanation: The provision for averaging income for persons whose income fluctuates widely from year to year would substitute for the restricted provision now in effect a fair, equitable, and workable provision. That new provision would treat taxpayers more nearly equal for tax purposes without regard to how their income is spread over a period of years. In this light the provision is helpful and should be supported.

TREATMENT OF ACCRETIONS IN VALUE OF PROPERTY PASSING AT DEATH

Recommendation: The Illinois State Chamber of Commerce believes that existing law respecting the income taxation of capital assets passing at death does not involve serious inequities, and it recommends that no change be made in the law.

Explanation: Although H.R. 8363 would not change existing law with respect to the income taxation of property passing at death, there are reports that the administration will recommend to this committee that current law be amended in this regard.

The administration's original recommendation to the Committee on Ways and Means called for capital gains taxation on the accretion in value of capital assets passing at death. The Illinois State Chamber of Commerce voiced its opposition to this proposal in appearing before that committee, and would continue that opposition were the proposal to be renewed. This measure departs radically from the basic concepts that underlie income taxation. In treating such transfers as a sale or exchange, the proposal would unfairly tax income before its realization.

Of particular concern is that, by increasing the overall tax burden, the measure would render even more difficult the continued operation of closely held companies upon the death of a principal shareholder. Congress in recent times has been sufficiently interested in this problem to enact sections 303 and 6166 of the Internal Revenue Code; the enactment of such could not but seriously impair the effectiveness of the relief extended by those sections.

The original proposal submitted to the Ways and Means Committee was thus further objectionable on the grounds of its sheer complexity, since surely a prime aim of any tax reform must be a simplification of our tax laws. Similar considerations caused that committee to reject the suggested alternative whereby an inheritor would take the decedent's basis with respect to inherited property.

TRAVEL AND ENTERTAINMENT EXPENSES

Recommendation: Eliminate from section 274 all of the provisions not needed to effectively preclude the application of the "Cohan rule" to travel and entertainment expenses.

Explanation: The Illinois State Chamber of Commerce reaffirms its recommendation that section 274 of the Internal Revenue Code with regard to deductions of travel and entertainment expenses and gifts be modified. Concern about this subject was previously expressed in testimony before the Senate Finance Committee when it was considering the Revenue Act of 1962, before the Ways and Means Committee in the public hearings on the President's tax reform proposals, and to the Commissioner of Internal Revenue at the time of the hearings on his proposed regulations.

The Revenue Act of 1962 added section 274 to the Internal Revenue Code. The primary factor which resulted in enactment of this section is the more frequent application in recent years of the judicial doctrine known as the "Cohan rule." The application of this rule permitted the partial allowance of deductions on the basis of unsubstantiated estimates. Among the other factors which led to the enactment of section 274 was claimed to be the difficulty in establishing a practical administrative procedure to distinguish between an ordinary and necessary business expense allowable as a deduction and a personl expense which is not deductible.

Section 274 limits deductions for amounts which are admittedly ordinary and necessary business expenses, unless they meet statutory tests which are not phrased in clear language. Phrases are used such as "associated with" and

"directly related to" the active conduct of the taxpayer's trade or business. Further, with reference to an entertainment facility, the statute requires that the facility be "used primarily for the furtherance of the taxpayer's trade or business," and there is no specific standard for making the determination.

Although the Commissioner of Internal Revenue took many months to formulate his regulations and has supplemented his extensive regulations with revenue rulings, there is still a great deal of uncertainty as to the manner in which the statutory provision will ultimately be applied.

The delay in issuing regulations and the necessity for supplementing the regulations by revenue rulings are unrefutable indications of difficulties involved in the application of the statutory language.

The Illinois State Chamber of Commerce endorses the principles underlying the proposals in H.R. 6164 through 6175 and in S. 2068; however, the language of S. 2068 appears preferable and adoption of that proposal as part of the revenue bill of 1963 is strongly recommended.

Need for enactment of amendatory legislation is pressing. Confusion and doubt have resulted from section 274, and the amendment should be retroactive to apply to all expenses paid or incurred during the current calendar year.

DEPRECIATION-RESERVE RATIO

Recommendation: That a new provision be added to the bill to make the use of depreciation guidelines a matter of right and to avoid the ultimate limiting effect of the reserve ratio test, as has been suggested by Senator Hartke in S. 2231.

Explanation: Many companies, particularly small ones, have hesitated to put the new depreciation guidelines into effect because of uncertainty as to their status and because of the limiting effect of the reserve ratio test. Inclusion of the suggested provision would open the door to greater use of guidelines and would stimulate investment with no substantial revenue loss.

Senator DIRKSEN. Mr. Hoffman. I am glad to see you, and I know what an active Federal tax committee you have got in the Illinois Chamber.

Mr. HOFFMAN. Thank you.

Senator GORE (presiding). Senator Byrd asked me to announce that he had been called to an executive session of the Armed Services Committee, and he was sorry that he could not be here for the termination or the conclusion of your statement.

Mr. HOFFMAN. Thank you, sir.

Senator GORE. Senator Talmadge.

Senator TALMADGE. I have no questions, Mr. Chairman. I want to compliment the witness on his able presentation.

Senator GORE. Senator Dirksen.

Senator DIRKSEN. One question, perhaps. I was quite interested in that penalty which goes along with accelerate payments.

Mr. HOFFMAN. Yes, sir.

Senator DIRKSEN. I wonder if you could not submit an extra memorandum citing a few examples of where the flow of income is so unpredictable at given times that without any laches on the part of any corporation or anybody else there might be a penalty attached that really is not deserved.

Mr. HOFFMAN. Very glad to do it.

Senator DIRKSEN. I think it would be helpful.

Senator GORE. Thank you very much.

Mr. HOFFMAN. Thank you.

(The material referred to was not received by the committee at the time pt. 3 of the hearings was printed. When received it will appear in a subsequent part.)

Senator GORE. The next witness is Mr. Tyre Taylor, representing the Southern States Industrial Council.

STATEMENT OF TYRE TAYLOR, GENERAL COUNSEL, SOUTHERN STATES INDUSTRIAL COUNCIL

Mr. TAYLOR. Mr. Chairman and gentlemen of the committee, my name is Tyre Taylor, and my address is 1511 K Street, Washington, D.C. I am here representing the Southern States Industrial Council, the headquarters of which are in the Tallman Building in Nashville, Tenn.

The council was established in 1933. Its membership is comprised of some 2,000 industrial and business concerns in the 16 Southern States from Maryland to Texas inclusive. This membership includes all lines of manufacturing and processing, transportation, communications and related industries and accounts for very substantial employment throughout the southern region. On behalf of our officers, directors, and members, Mr. Chairman and gentlemen of the committee, I wish to thank you for the opportunity to be heard. I shall be brief.

At a meeting held in Hot Springs, Va., on May 20-22, 1963, the board of directors of the council unanimously reaffirmed the following statements—among others—on Federal fiscal policy:

> The national debt now amounts to $302.5 billion—up $4.5 billion from this time last year. This does not include Government-guaranteed loans and other contingent liabilities, conservatively estimated by Senator Harry Byrd and others to aggregate more than $1 trillion.
>
> Taxes are far too high—in certain brackets closely approaching confiscatory levels.
>
> In the light of these facts, the council urges the Congress to take the following actions (among others):
>
> 1. Reduce the Federal budget by reducing expenditures that are not essential to the functioning of the Government as defined in the Constitution with the ultimate purpose of eliminating entirely nonessential spending.
>
> 2. Provide for an orderly, step-by-step reduction in individual and corporate income tax rates, together with a commensurate reduction in Government spending.

We oppose H.R. 8363 because, while it would reduce individual and corporate income tax rates by slightly more than $11 billion, no firm commitment has been made for a commensurate reduction in spending. Discussing this on a motion to recommit the bill to the Ways and Means Committee, Representative Howard Smith of Virginia said:

> Somebody has said this motion to recommit is a phony.
>
> There is some language in the bill itself on economy. It says:
>
> "Congress by this action recognizes the importance of taking all reasonable means to restrain Government spending and urges the President to declare his accord with this objective."

"Now," continued Judge Smith—

> if there can be anything more phony than that, I do not know what it is. What force and effect is there in that language? It does not mean a thing except the pious hope which many of us have expressed here in vain for many years past and everybody who is voting for this bill knows it does not mean anything and that it is not going to accomplish anything * * *.

The Council shares Judge Smith's misgivings. For notwithstanding some noises recently made by the administration about holding the line on expenditures, we recall President Kennedy's statement in his tax message last January that it would be a "grave mistake to require that any tax reduction today be offset by a corresponding cut in expenditures."

We also recall his comment on the action of the House in cutting some $580 million from the foreign aid authorization bill. He said it was a—

shortsighted, irresponsible, and dangerously partisan action * * * unprecedented, unwarranted, and unwise.

It also recalls his sour comment when the House voted down the bill to increase the appropriation to the Area Redevelopment Agency. He said:

The tragic defeat of area redevelopment legislation could not have come at a worse time * * *. This program must not be allowed to die—and it is my intention to give the Congress another opportunity to support it.

In addition, it is only necessary to review the administration's pending programs—foreign aid, area redevelopment, Domestic Peace Corps, urban mass transportation, accelerated public works, general aid to education, and so on—to blast forever any lingering idea that this administration entertains the slightest intention or purpose of retrenching. It has neither the will nor the desire to reduce nonessential spending, and in our opinion, any conclusion to the contrary is the product of mere wishful thinking.

This conclusion is further borne out by the record of the past 3 years. When the Kennedys took over the budget was balanced for fiscal 1961. This was soon converted to a deficit of $3.8 billion. For fiscal 1962, the deficit was $6.4 billion. For fiscal 1963, the administration submitted a balanced budget—which ended up with a deficit of $6.2 billion even after deducting some $2 billion in nonrecurring revenue from the sales of Government loans and other assets. For fiscal 1964, the administration forecasts a deficit of $9.2 billion. The whole trend is toward constantly increasing deficits. As of June 30, 1963, the Kennedy administration had already added $19.8 billion to the public debt.

In the Wall Street Journal of November 1, under the heading of "Washington Wire," the following appeared:

Budgetmakers slyly shape spending plans to avoid wrecking tax cut chances. They figure the tax bill will still be pending when the budget goes to Congress in January; conservatives will rebel unless spending boosts are limited. So policymakers warn agencies that big new job-creating projects must be kept out of the original budget. They promise to seek extra funds for some later on, when the tax bill is out of the way.

But now something new has been added. This is the idea—or concept—of the planned deficit. Heretofore, deficits were regarded as more or less temporarily and accidental and something to be deplored and not repeated. Now they are to be permanent, planned, and welcomed as something that is good for us and good for the country. As Dr. Arthur F. Burns, professor of economics and former Chairman of the Council of Economic Advisers, put it:

If Congress sanctions long-range budget deficits, it will be adopting a novel concept for our country. This concept marks a departure not only from the old-fashioned theory that the budget should be balanced every year, but also from the modern theory that the Federal budget should be balanced over a business cycle or over a few years.

What it will cost, nobody knows. Estimates of the increase in the public debt over the next few years if the administration's program is adopted range from $50 to $150 billion. Somewhere along the line, tax reduction financed through borrowing which increases the money

supply must inevitably produce additional inflation—and yet of such fears Dr. Walter W. Heller, present Chairman of the Council, said that it is—

quite obvious that the basic puritan ethic of the American people should be such that they want to deny themselves tax reduction—because of their fears of deficits, and the additions to the national debt.

What they are really talking about here, Mr. Chairman and gentlemen of the committee, is a theory that flies in the face of all human experience, all the laws of economics and all the dictates of commonsense. It is like saying you can get rich by going further in debt when you already owe more money than you can ever pay.

In his presentation to this committee, Secretary of the Treasury Dillon said:

Therefore, paradoxical though it may seem, tax reduction today provides the best and quickest route to a balanced budget * * *. Thus, our real choice regarding budget deficits is whether we shall have a small and temporary increase in our deficit as a byproduct of much needed tax revision designed to stimulate the economy and lead to budgetary balance, or whether we shall continue to live with the deficits of recent years and which, in the absence of tax reduction, will stay with us no matter how much we attempt to cut expenditures * * *.

That not only seems paradoxical—it is paradoxical—and what the Secretary proposes is nothing less than a reckless and unnecessary gamble with the future of the country.

There is no evidence that increasing deficits, whether planned or unplanned, will produce either accelerated economic growth or full employment. What if the program fails? Will the administration then abandon its philosophy of planned deficits? Or will Congress be called upon further to reduce taxes? And what effect would this have on our already critical gold and balance-of-payments position and the ever-declining purchasing power of the dollar?

In this connection, we were very much interested in a colloquy that took place between the chairman and the Secretary. The chairman introduced a table prepared by the staff of the Joint Committee on Internal Revenue Taxation which showed the average reduction for the individual taxpayer would be $110. Now how, he wanted to know, is $110 a year, or about $9 a month, or a little more than $2 a week per taxpayer going to spark any great improvement in the economy? To which the Secretary replied:

It is true, of course, that for an average single taxpayer, the average workingman, the individual reduction which he will get is not large in dollars and cents. However, in the aggregate, this adds up to a very substantial amount of disposable income that will be spent.

In conclusion, may I reiterate that the council supports substantial tax reduction. It goes along with all that has been said about the regressive influence of the present paralyzing and, in certain brackets, nearly confiscatory rate structure. It also goes along with the statement of Representatives Herlong and Baker that—

the extra and increasing burden of rate graduation placed on these productive citizens (in the middle income brackets) smothers incentive, severely limits the accumulation of new venture capital, discourages the venturesome use of such new capital as it is accumulated, and, in general, inhibits the starting of new businesses and the expansion of old ones.

However, we do not believe in tax reduction at the expense of a further unbalanced budget. That way we feel lies potential disaster.

We also recommend that H.R. 8363 be held in this committee until after the President submits his budget in January and Congress has had an opportunity to examine it.

Thank you.

Senator GORE. Senator Talmadge?

Senator TALMADGE. No questions.

Senator GORE. You represent members in how many of the Southern States?

Mr. TAYLOR. Sixteen, from Maryland to Texas, inclusive.

Senator GORE. I notice you say you represent some 2,000 concerns.

Mr. TAYLOR. Concerns, yes.

Senator GORE. How was the position arrived at? Was there a national meeting?

Mr. TAYLOR. Yes, there was a meeting of the board on May 20–22, this year, in Hot Springs, Va. The board unanimously reaffirmed the statements I have read.

Senator GORE. I notice with interest that you agree with and concur in the judgment of Congressman Howard Smith that this sense of Congress provision in section 1 of the bill is nothing more than a pious hope. I wonder why he used, and I wonder why you endorsed, the word "pious"?

Mr. TAYLOR. That is just a figure of speech, I think, Senator, to characterize anything that is very hackneyed or has been many times expressed. It was not used to mean anything in the sense of religion.

Senator GORE. I agree.

Do you think it wise for Congress to get into the habit of codifying stump speeches?

Mr. TAYLOR. I must say I just do not quite follow you.

Senator GORE. Well, Congressman Smith described this section 1 as a pious hope, and I have referred to it as a stump speech. I doubt the advisability of placing in law such a stump speech or such a pious hope or such meaningless language. Why clutter up the statutes of the United States with meaningless sense of Congress resolutions?

Mr. TAYLOR. I quite agree with you.

Senator GORE. They have no force or effect in law, no binding effect upon the Congress, either the present or the future Congresses, so one must ask what purpose is served. Do you know of any good purpose that is served by this?

Mr. TAYLOR. Judge Smith said that it would accomplish nothing, and we concur in that.

Senator GORE. You say the action of your group was unanimous?

Mr. TAYLOR. Yes, sir.

Senator GORE. Did you have a chance to read the testimony of Mr. Henry Ford and Stuart Saunders?

Mr. TAYLOR. Yes, sir; I read the newspaper accounts of what they said.

Senator GORE. Well, the newspaper accounts were interesting, but I think their actual testimony was far more interesting, and if you have an opportunity to read it I think you would find it quite revealing.

Mr. TAYLOR. I do not believe it has been published in the hearings yet.

Senator GORE. I think that is correct.

Senator Williams?

Senator WILLIAMS. No questions.

Senator GORE. Thank you very much.

Mr. TAYLOR. Thank you, Mr. Chairman and gentlemen.

Senator GORE. Mr. C. Lowell Harriss, professor of economics, Columbia University.

STATEMENT OF C. LOWELL HARRISS, PROFESSOR OF ECONOMICS, COLUMBIA UNIVERSITY

Mr. HARRISS. Mr. Chairman and gentlemen, I am C. Lowell Harriss, professor of economics, Columbia University, New York City. I am also economic consultant for the Tax Foundation, a member of Joel Dean Associates, Inc., management consultants, and have various other connections. I appear in a personal capacity only and at my own expense. The views expressed are my own and not necessarily those of any group with which I am associated.

THE LONG VIEW

Tax changes on any large scale, especially reductions, are rare. Anything done now is likely to mold our future for years, even decades. Today's changes, therefore, should be those with which we should like to live permanently.

In looking beyond what may appear to be desirable for the next few months or so, I see key provisions of H.R. 8363 which would not be best for the long run. Moreover, adoption of these provisions would probably forestall future changes of the type which would be in the public interest, specifically: (1) The high personal income tax rates would remain too high, (2) the lowest rates too low, while (3) a continuing rate of 48 percent on corporation earnings (over $25,000) would burden unwisely the process of income production.

PERSONAL INCOME TAX RATE

Consideration of personal income tax rates changes may benefit from a brief look at the issue of progression itself.

Most Americans, I believe, endorse the principle that income tax should be progressive. If asked, "Why?" if asked to provide logical reasons for holding this view, most of us might find the task unexpectedly difficult, if challenged by someone familiar with the history of the debates over the years.

Finely spun theories developed in the 19th and early 20th centuries once seemed to provide theoretical foundation for progression. Today, I think, the specialist in public finance attaches rather little weight to theories which once seemed persuasive. Their weaknesses a bases for public policy have been portrayed often enough for scholars, at least, to avoid repeating the worst of old errors. Nevertheless, public attitudes favoring progression and public policies may rely heavily, albeit implicitly, on long-discredited theories.

One argument for progression is that it is "fair," that it leads to a more "just," more "equitable," sharing of the costs of Government. Often the idea is expressed as puting taxes on an "ability to pay" basis.

Where do such statements get us? Not far because two enormous difficulties remain:

(1) What definition of these terms—"justice," for example—will the public accept for use in deciding upon how the costs of Government are to be shared?

(2) To the extent that we agree on what "fairness" is, or what we mean by "ability to pay," we must then see how the concept is related to progression in taxation. The solution proposed will usually rely upon another line of theorizing.

The key element is a belief that rate progression will enable the public to bear the costs of Government with less "sacrifice" than if taxes were proportional or regressive. The argument will rely heavily upon a belief that the larger the income, the less urgent the needs served by the last or marginal dollar.

The marginal dollar of an $8,000 income, it is argued, provides more utility—the ability to satisfy a want—than the marginal dollar of a $9,000 income, other things the same. If so, the total sacrifice that taxes impose on the public as a whole will be, or can be, less than a larger percentage is taken from larger than from smaller incomes.

Instinctively, most of us probably support this line of argument. It does seem sensible, especially if one uses extreme cases, $5,000 and $50,000. Yet, on a purely theoretical basis, declining marginal utility of income does not necessarily lead to progressive taxation.

And one practical requirement of no small significance remains to be satisfied, analysis and facts have not yet filled a gap revealed long ago—the lack of a reliable measure of the decline in the utility of income.

Such a measure is needed if progression is to be applied with reasonable confidence of getting the results desired. One scale of progression might, on balance, result in less overall sacrifice than proportionality or regressivity, while another might bring more sacrifice.

In short, there is undeniable emotional appeal—in the argument that progession will assure less sacrifice in bearing tax burdens than will proportionality. The logic, too, seems persuasive at first sight. But the considered judgment will be that the theoretical support for any practical application of progression on "sacrifice" arguments is, to say the least, weak.

The case is unproved and unprovable. So is disproof. But one conclusion seems to me beyond question: The higher the rates and the steeper the progression, the weaker the defense and the greater the possibility that the results are contrary to those presumed. A firm defender of progression may condemn the steepness of present rates as excessive on the very grounds he uses to justify the principle.

Two other points must now be made:

(1) Progression is not needed to collect more in taxes from persons with high, than from those with low, incomes. Proportional and regressive taxes can do that. A flat 20-percent tax, which takes $1,000 from the $5,000 income, will take $10,000 from the $50,000 income.

(2) Progression is needed, however, to make the burden of taxes on the poor as low as we might like.

Humanitarian considerations alone must be highly persuasive in any discussion of taxing persons in greatest need.

Let me be clear. My position does not rest on debatable conclusions about fairness or justice but upon mercy and compassion. Whatever

we may think about tax discriminations against those with high incomes, the "soak the rich" support of progression, many of us will endorse the aspect of progression that affords tax relief for those at the bottom of the income scale.

First, let me emphasize one point: I favor relatively large tax relief for individuals and families at the very low end of the income scale. But by what method? The familiar methods—an increase in the personal exemption or a reduction in rates—have serious disadvantages.

For each dollar of tax relief which will bring to persons at the bottom of the income scale, the Government loses many dollars from taxpayers higher up. A change in either the exemption or first bracket rate which is large enough to bring significant tax relief to the poor would use up so much of the potential tax reduction now feasible that other highly desirable changes would be impossible.

Therefore, and with misgivings, I recommend—

(a) Some form of a tax credit, or

(b) An increase in the minimum standard reduction, or

(c) A vanishing exemption as the major device for aiding those at the bottom of the income scale.

In addition, I assume rate reduction for those remaining subject to tax.

Nevertheless, reducing the starting rates to 14, 15, 16 percent, et cetera, even with the narrowing of the brackets, seems to me risky for the longer run. These are the rates which apply to the vast bulk of taxable income, the rates with most significant revenue potential. The Treasury may need more revenue than such a rate structure would yield. At present, the average rate on all taxable income is somewhat over 23 percent. The 20-percent rate on the first $2,000 ($4,000) yields about 85 percent of the total.

If the tax rates which apply to the great bulk of taxable income are much below the average rate required on all income, now over 23 percent, there is more than a minor possibility that revenue will be inadequate.

The personal exemption can do so. An income tax with an exemption can accomplish this end. In fact, it can do so with a flat rate. Society can get those humane benefits of progression which come from relieving the poor without imposing a progressive rate structure, yet these tax rates will bring more revenue from high, than from low, incomes.

Advocates of progression may frankly rest their case on the argument that reduction of economic inequality is desirable. There are issues to be debated, but I am not aware of any serious public interest today in the equality-inequality problem. Although little of the animus which marked the debates of the 1930's is now evident, a considerable element of our present rate structure is the result of depression-inspired feelings against the prosperous. More of today's rate progression than most Americans will realize has, I think, grown out of malice rather than of mercy, or any reasoned or reasonable attempt to relate means to ends.

A rate schedule adopted in the past, for whatever combination of reasons, is not, merely because of its existence, one whose pattern should be retained. Yet the administration and the House have

chosen to retain much of a pattern of progression developed under highly abnormal conditions.

Lacking a rudder or compass, we may feel that the easiest course is to hold to an existing pattern of progression. Progress, in the truer sense, I am sure, requires a break with the past.

Of course, taxable income will rise over the years. Spending may be held in check. If so, an average rate of less than 23 percent on all taxable personal income may suffice. But an average rate of about 15½ percent on the first $2,000 for a single person ($4,000 for a married couple), as provided in H.R. 8363, may lead to deficits when budget balance or surplus would be desirable. Then, however, political considerations would make raising these rates later difficult.

Although H.R. 8363 would reduce the starting rates more than seems to me desirable for revenue reasons, the bill would do too little to reduce the rates above, say, twice the lowest rate. I say "twice" because I am not so high; this level, I think, is unduly high. The last percentage points of the upper bracket rates, as you know, yield little revenue—if any at all; after allowance is made for (1) avoidance, (2) evasion, and (3) the adverse effects on national income, I suspect, but cannot prove, that the extreme rates yield "negative" revenues.

What is clear is that the net revenue cost of substantially greater reductions would be small. The apparent "cost" of an additional 10-percentage-point reduction in rates on brackets over $22,000 would be about $330 million. This is approximately the revenue loss from a cut of one-fourth of a percentage point under $2,000.

The benefits for the general public, for the economy as a whole, would be real. Unfortunately, most of the benefits—just as is true of most of the bad effects of high rates—could not always be identified. Rarely, if ever, could they be measured. While there is no clear basis for setting a top rate (nor for detailing the steps by which it is reached), a ceiling of 50 percent seems to me on the high side. And the top rate ought to apply at considerably above the $100,000 ($200,000) of H.R. 8363.

The rate proposals of the Committee on Federal Tax Policy, with which I worked, appear to me the best I have seen.[1]

Why are high rates bad for the public as a whole, for people who never pay them?

High rates distort economic decisions and direct some effort into less than the best of activity. High rates reduce the supply of certain kinds of productive capacity. High and progressive rates, in effect, reduce the attractiveness of risky undertakings. High rates create and enlarge injustices.

Tax rates of 20 to 30 percent will not ordinarily exert much influence on the willingness to work, on the kind of work undertaken, or on personal investment. Where much higher rates apply, however, the tax will lead to significant changes in activities. Such influence may be obvious. It may be subtle and indirect.

Yet can there be any doubt that if the fruits of additional effort are to go in large part to government rather than to one's family, men will often prefer leisure—longer vacations, for example—to work, conservative to venturesome investment, easier to more demanding careers, staying put to trying something new or distant.

[1] Committee on Federal Tax Policy, "Financing America's Future: Taxes, Economic Stability and Growth" (the Committee, 84 West 51st Street, New York, 1963), p. 5.

Even a person whose marginal tax rate is not near the top will find that tax considerations can make a big difference in the relative attractiveness of different activities. Effort gets directed into those lines with least unfavorable tax consequences. The economy loses when energies are directed to activities other than those which would seem best in free markets without regard to tax effects.

A decision which is inferior from the point of view of the inherent economic factors may become best when taxes are taken into account. To the extent that taxes enter into the choice of what to produce or how, of how to finance a business, or invest savings, of what to consume or how much to work, the results are likely to be less good for the economy than if taxes had no such influence. Taxes "distort." In doing so, they lead to some loss for society—to misallocation, misdirection, misuse of economic potential.

When tax rates are high—and when the differences in the tax consequences of different actions are large—purely tax considerations can be decisive.

No one can measure the effects of taxation on the supply of human effort and skill, nor on the uses to which they are directed. Human beings will respond differently to taxes as well as to other conditions of life. One thing does seem certain. Very high tax rates will not increase incentives—except to channel efforts toward tax avoidance, into directions of less than the greatest real productivity of which a person is capable.

The highest tax rates fall on men and women whose efforts are most productive. The heaviest rates fall with greatest weight on the fruits of additional effort. The supply of such effort will be less than if marginal rates of tax were lower.

Initiative must suffer. Adverse effects on incentive are inevitable. Such policy is ill suited to a future which needs ever more skill.

While I said earlier that "justice" in taxation is difficult to define, one aspect is reasonably clear. People in essentially similar circumstances should be taxed equally. When they are not, the results can be highly unfair if tax rates are high. You have heard a lot about "loopholes" and defects in the tax structure. All of us would like to see reform, but in trying to get agreement, we may make things worse Rate reduction is a sure way to reduce the ill effects of present defects.

Respect for Government, morale, and fiscal morality, suffer from high and unequal tax rates. When inducements for cheating, for breaking the tax law, are large, there is danger of some erosion of public respect for law in general. The present tax system tends to defeat the kind of conduct which has contributed so fruitfully to making our economy progressive and which has constituted a priceless intangible of our society.

The steeper the progression, the more (per dollar of revenue) will saving be reduced, relative to consumption. And the less will be the attractiveness of new investment projects. Some of the new saving and investment "lost" would be exceptionally important for economic growth because it would go into relatively small, successful, and growing businesses. For the personal income tax is also a tax on business.

Unincorporated businesses play a larger role in our economy and in its growth than is often recognized. High tax rates hinder the expansion of such firms.

CORPORATE TAX RATES

Substantially more should be done than in H.R. 8363 to "disengage" ourselves from heavy taxation of business. More important than any reduction in rates possible immediately can be the establishment of a program for systematic, even though gradual, reduction.

It is through business that we produce most of our income. Businesses provide most of our jobs. They are the agencies we use to employ human and material resources to get more of what we want. The pairing off of "individuals" and "business" in tax discussion is unfortunate. Every individual has a vast, many faceted, personal interest in "business" in general (over and above any tie to particular companies).

Taxes on business cannot help in the process of income creation. They can hurt. We can live better—the country can produce more and more efficiently, have better jobs, and more of them, expect more in product and service innovation—if business decisions are not influenced by very high tax rates, if the returns on capital are not taxed so heavily as would be those of corporations over $25,000.

Heavy taxation of corporations is the result of wartime and Korean emergencies. Actions which were presumably temporary when originally made would, I fear, be with us indefinitely under H.R. 8363—a 48 percent rate (minus the investment credit) and without any credit at the stockholder level. Who would then press for moderation? (The great majority of businessmen, enjoying a competitive advantage, might even oppose reduction for large corporations.)

Corporations earning less than $25,000 would get a reduction of roughly one-fourth—from 30 percent to 22 percent. The result would be a rate reasonably close to the rates on most unincorporated businesses but below the rates on the more successful. A corporation earning $25,000 can be a rather substantial enterprise. The owners may enjoy incomes of considerable size, often much larger than the incomes of stockholders of big corporations.

At present, the rate differential between large and small corporations is about 70 percent. After the change, it would be nearly 120 percent. Such a gap has little to justify it and much to condemn it. Competitive relations would be disturbed. Big corporations are important as employers, as producers, as innovators, and as places for investment by persons of all income groups. To discriminate so sharply against such organizations—their customers, owners, employees—can hardly be wise.

For the long run we should plan for tax rates on large businesses much below 48 percent—to reduce distortion in resource allocation, to speed growth, to achieve more fairness. Unfortunately, trying to move in this direction seems to have little political appeal. The impersonality of big corporations is only one of the factors making difficult the reduction of high rates.

The greatest obstacle is that each percentage point of the corporate rate involves revenue of over $500 million (gross). No immediate return to the pre-Korean rate of 38 percent is feasible. But could we not make a more impressive start than 4 percentage points by providing for a series of small, annual reductions beyond 1965?

Over a period no longer than that since Korean fighting ending the 38 percent rate we should be able to get down to 30 percent. I com-

mend to you the proposal of the Committee on Federal Tax Policy for annual reductions of the normal and surtax by 1 percentage point each until the total is 30 percent (20 percent normal, 10 percent surtax).

As the economy grows, so will corporation earnings. Such growth will offer an offset to declining tax rates.

The benefits, I am convinced, would spread broadly throughout the economy—to consumers, employees, and those who supply capital. National income would grow more rapidly than if a 48 percent rate persisted.

Senator GORE. Thank you, Dr. Harriss.

Senator Talmadge.

Senator TALMADGE. Dr. Harriss, I take it from your testimony that you think all individuals ought to pay the same rate regardless of their income, is that correct?

Mr. HARRISS. No, I do not mean to imply that. What I was trying to say is that the arguments or the bases for progressive rates are less firmly based than is generall recognized; that the progression we now have grew out of highly abnormal circumstances; that it is not a desirable basis on which to build a permanent structure.

Senator TALMADGE. If you could write the Tax Code what progression rate would you have?

Mr. HARRISS. Well, I would, given present revenue needs, start somewhere around 16 or 17 percent and rise to around 50 percent at, perhaps, half a million.

I would like to say, however, that I do not think an immediate move in this direction is called for. The change can very well be in stages over 2, 3, or 4 years.

Senator TALMADGE. I judge from your testimony now that you think all corporations regardless of income ought to pay at one fixed rate, is that correct?

Mr. HARRISS. No, not quite. I think there are arguments, valid arguments, for lower rates on smaller corporations. The 20 and 30 percent which I proposed seems to me reasonable, but I do not believe that differentials as large as exist now, or as large as would exist under the bill, are desirable.

Senator TALMADGE. If you could write the Tax Code with reference to corporate income taxes, what progression would you have?

Mr. HARRISS. The rate on the smaller corporations, and the income dividing line might be less than $25,000, should not be much above, certainly twice as high as, the starting rate of the personal income tax. The reason is competition between incorporated and unincorporated businesses and the possibilities of tax avoidance.

Senator TALMADGE. You would have it less than 20 percent then?

Mr. HARRISS. No, not necessarily. It should be somewhat over the personal income tax starting rate but not twice as much.

Senator TALMADGE. And the largest corporation, what rate would you fix?

Mr. HARRISS. Well, 30 percent is perhaps reasonable for the near future; I would rather see it lower, but revenue requirements make the highest New Deal rate of 19 percent an unrealistic goal.

Senator TALMADGE. The purpose of taxation, of course, is to levy the necessary money to run the Government. How would you make up the difference?

Mr. HARRISS. The proposals I make would, in effect, utilize economic growth to pay for tax rate reduction. There would probably be some gap. One always hopes that expenditures will be held in check. If expenditure growth is not reduced, then the alternatives are either more intensive use of existing taxes or some kind of a move toward a value added or broader based tax on consumption.

Senator TALMADGE. Would you, if you could then, reduce rates even more than this bill before us and precipitate a greater deficit than has been advocated by the administration on the hope that increased business will ultimately make up the deficit?

Mr. HARRISS. I would propose that rate reductions be spread over a longer period of time than in H.R. 8363. I certainly would not advocate larger deficits than the administration proposes. But the big rate reduction, the big revenue loser, in the present bill is cutting the rate to 14 percent. This seems to me very unwise.

Senator TALMADGE. Thank you, Mr. Harriss. No more questions, Mr. Chairman.

Senator GORE. Senator Carlson?

Senator CARLSON. Dr. Harriss, I was interested in your discussion in your paper here in regard to arriving at a tax base for personal income taxpayers, that is in regard to exemptions. I note you say:

"I recommend," you say with misgivings, that you recommend three things, and I was interested on how we would work them out. You recommend (1) some form of a tax credit; (2) an increase in the minimum standard reduction; and (3) a vanishing exemption as the major device for aiding those at the bottom of the income scale, the taxpayer. What kind of a tax credit? How would you word it? This is interesting. What do you have in mind?

Mr. HARRISS. A tax credit would be an offset against tax. After a person computes his tax, he would be allowed to deduct $25 or $50 or some such amount from the tax, in effect, eliminating the tax on the very lowest income groups and substantially reducing it for those somewhat above.

Senator CARLSON. Would this vary? Would you have certain tax brackets of $25 and certain of $50 or is this an across-the-board approach; what is your thought?

Mr. HARRISS. I think it would be across the board, with adjustments for size of family.

Senator CARLSON. And then a vanishing exemption as a major device for aiding those at the bottom.

Mr. HARRISS. The vanishing exemption is a possibility. It is alien to our experience and, therefore, probably not a realistic possibility. But the idea is that a person starts with an exemption, presumably larger than the present. Then, let us say, for each dollar increase in income or each $10 increase in income, the exemption would decline by some amount so that beyond some level there would be no personal exemption.

Senator CARLSON. Those of us who work with taxes are always looking for new ideas and new devices or new methods. I notice you suggested these with some misgivings, and I think it might be well for us to look at them, at least.

Mr. HARRISS. Well, these are not new; none of these suggestions are new, Senator.

Senator CARLSON. Thank you, Mr. Chairman.

Senator GORE. By vanishing exemption, do you mean that you would permit an exemption from taxation of a certain amount of income, but that an amount would be diminished as you go up, advance upward, in the income brackets?

Mr. HARRISS. Yes, that is the idea; perhaps dollar for dollar, perhaps 50 cents for each dollar increase in income.

Senator GORE. Now, is your purpose, in suggesting this, to aid those in the low-income brackets or to deny the personal exemption to those in the high-income brackets or both?

Mr. HARRISS. I certainly do not want to appear to endorse hurting persons higher in the income scale.

As you know, the great problem of enlarging the existing type of personal exemption is that so much revenue would be lost, not from the people it exempts from income tax, but because of reduction in taxable income higher up in the scale. The vanishing exemption is a device for enlarging the exemption lower down without increasing the exemption for the people above. Presumably with rate adjustments one could offset the effect of the decline in their exemption, if that is desirable.

This would not be my preference of the three alternatives. But I think it is preferable to making such large rate reductions which, of course, at the very lowest end of the income scale do not enlarge after-tax income very much. The rate cut costs an awful lot in revenue, but the lowest incomes after tax would not be increased a great deal.

Senator GORE. Had you considered the possible constitutional question involved in the vanishing exemption?

Mr. HARRISS. No, I have not.

Senator GORE. Well, is not the minimum deduction provided for in the bill a device which has some of the effects of a vanishing exemption?

Mr. HARRISS. Somewhat, yes. Since the House has approved it, since the administration has supported it, I think it would be my first preference, even though it is rather crude and may not give as much benefit to the large family as may seem desirable; it discriminates against the person who itemizes deductions as contrasted with a person who does not.

Senator GORE. You suggest that one possible way of giving more equitable treatment to taxpayers in the lower brackets would be a tax credit. Would you think earned income would be an appropriate basis for a tax credit?

Mr. HARRISS. No, at least not to achieve this purpose. Many of the people in the low-income brackets do not have much earned income, although, of course——

Senator GORE. What do you mean? Most of them have entirely earned income.

Mr. HARRISS. I was thinking of people who are retired. But, I was going to say, people who are retired get the double exemption.

Senator GORE. What better credit can you suggest than a credit for earned income?

Mr. HARRISS. A flat dollar amount of credit regardless of the source of income would seem to me better for achieving this purpose, to achieve this purpose——

Senator GORE. And you would substitute that for exemption?

Mr. HARRISS. I would add it to the type of exemption we have now to achieve the purpose I was talking about.

Senator GORE. Well a flat dollar exemption per taxpayer, it would seem to me, avoids the distinction between taxpayers as to family and social responsibilities. The family with five children would, say, receive the $50 tax credit the same as the bachelor.

Mr. HARRISS. No, I would favor credit for the number of children. I believe that is ordinarily——

Senator GORE. I beg your pardon?

Mr. HARRISS. My thinking is in terms of credits for the number of children, not a flat amount per taxpayer but that plus allowance for dependents.

Senator GORE. I notice in your statement that you somewhat decry high rates on the ground that they do not raise a great deal of revenue. It seems to me that the policy of taxation should follow the principle that if we are truly to have taxation according to ability to pay then, whether there is one man or a hundred men or a million men in a high bracket, it is immaterial so far as the application of the principle is concerned. This comes as strange thinking to me that because it does not raise a great deal of revenue, therefore, we should abandon the progressive character of our income tax rate structure.

Mr. HARRISS. Senator, I was not advocating the abandonment of progression. I was trying to say that the progression we have now grew out of highly unusual, highly abnormal, conditions; that it has led to high rates which in themselves have bad effects on the economy as a whole.

Now, if we had clear principles as to the proper scale of progression, or a scale of progression which would be effective in achieving desirable ends, then we would be on much sounder ground in deciding what scale is in the public interest.

Senator GORE. Senator Douglas?

Senator DOUGLAS. May I apologize for not having been here earlier. The Committee on Banking and Currency was holding a simultaneous hearing to deal with an appointment to the Federal Reserve Board. I have been occupied there, and I apologize to the witness for not having been persent. I have only had time to read a portion of his testimony.

You teach courses in public finance?

Mr. HARRISS. Yes.

Senator DOUGLAS. And, therefore, on the Federal tax structure?

Mr. HARRISS. Yes.

Senator DOUGLAS. I do not know whether you read the Congressional Record or the hearings before this committee.

Mr. HARRISS. I have looked at them, yes.

Senator DOUGLAS. I got hold of an internal memorandum of the Treasury Department which the Treasury admitted was correct, which showed that in 1959 there were five people in the country with adjusted gross incomes in excess of $5 million for that year, and that did not include income from interest on State and municipal bonds; did not include writeoffs due to oil drilling and developmental costs; and did not include half of capital gains, so that the income of these people might well have been in excess of $10 million. But nevertheless these five persons did not pay a single cent in income taxes.

There were 15 with incomes over $1 million a year who did not pay a cent, and 20 with incomes over $500,000 who did not pay a cent.

In your judgment, is this an abuse, and should Congress and the country try to deal with it?

Mr. HARRISS. I think the Congress should certainly try to deal with it. May I point out that if any group is not going to be aided by tax rate reduction it is just these people.

Senator DOUGLAS. I did not hear you.

Mr. HARRISS. If any group is not going to be aided by reduction in high tax rates it is these people.

Senator DOUGLAS. Do you think what some people call loopholes and what I call truck holes, which have permitted this to exist should be plugged or at least partially stopped?

Mr. HARRISS. Certainly.

Senator DOUGLAS. You do.

Mr. HARRISS. Of course, they exist all up and down the line. I think the biggest in dollar amounts, Senator, will be the exemption of social security benefits.

Senator DOUGLAS. Well, we are talking about this group first.

Well now, the Secretary of the Treasury has said that it is approximately $12 billion a year which is transferred at death on which no capital gains tax is paid and, as I understand it, in a later discussion of this measure before the House Ways and Means Committee, the Treasury offered to modify its original proposal so that the capital gains tax would only be levied on transfer at death when these gains were realized by sale, and that there would be deducted from the computation of capital gains any inheritance taxes paid.

If those two conditions were met would you approve of applying the capital gains tax to transfer of property at death which is presently untaxed?

Mr. HARRISS. I have been on record for a long time as favoring some taxation of these accrued gains. Many problems would arise, however, and I think we should go slowly.

Senator DOUGLAS. The problem of original cost.

Mr. HARRISS. Oh, yes, the problem of determining original cost, the sharing of liability among heirs and estates, trusteed property, and so on.

Senator DOUGLAS. But in principle you agree with this?

Mr. HARRISS. In principle, I agree.

Senator DOUGLAS. Good.

As you know, there is a provision for the oil and gas industry whereby not only can drilling and developmental costs be deducted almost entirely in the first year of earnings, which is the most rapid depreciation rate in existence, and the cost of dry holes met, operating loss, and so forth, but in addition to this there is an exemption from taxation of 27½ percent of gross income up to one-half of net income, and the figures of the Treasury which they submitted to the House Ways and Means Committee indicate that these amounts are approximately $3 billion a year.

Now, do you approve of that feature of our tax laws?

Mr. HARRISS. No.

Senator DOUGLAS. You do not?

Mr. HARRISS. No.

Senator DOUGLAS. Do you think that we should try to recapture at least some of this $3 billion?

Mr. HARRISS. I think we should reexamine the problem carefully and try to move gradually toward a more rational taxation of the income from natural resources.

At one time I thought I knew how to do it. I am much more humble now as to my ability to recommend the procedures that would be best, but I think——

Senator DOUGLAS. You say gradualness. Should gradualness be discernible?

Mr. HARRISS. Yes.

Senator DOUGLAS. Some of us have been trying to do this for 12 years, with absolutely no effect. Do you think we should make a start?

Mr. HARRISS. I do not really know enough about the problem to be confident whether the Treasury proposals are desirable and the most desirable.

Senator DOUGLAS. This is a subject of taxation about which you should not be ignorant. This is one of the largest truck holes in our tax system, and I think there is a moral obligation upon the professors of taxation and authorities to be well informed on this matter.

Mr. HARRISS. Well, we know——

Senator DOUGLAS. Is it not true that this rather unique tax benefit granted to oil and gas leads to the investment of capital in the oil and gas industry which would not be invested if the industry did not have this tax favor?

Mr. HARRISS. Exactly.

Senator DOUGLAS. Therefore, does it not lead to a malapportionment of what the economists call economic resources——

Mr. HARRISS. It does.

Senator DOUGLAS (continuing). And factors of production?

Mr. HARRISS. Yes.

Of course, Senator, a lot of the capital is already there now; precipitate change would have somewhat the same kind of bad allocative effects in reverse. But I agree with you.

Senator DOUGLAS. They have had a lot of favors in the past.

Are you using the vested interest argument that you should not disturb people already established?

Mr. HARRISS. Well, a version of it, yes. Congress should act with reasonableness or restraint.

Senator DOUGLAS. I do not think there is any danger that this will be done with excessive zeal. [Laughter.]

Mr. HARRISS. Senator, I am inclined to think that the best way to deal with this problem is to reduce tax rates so that extra deduction does not make much difference.

Senator GORE. It does not make much difference?

Senator DOUGLAS. You mean you would reduce everybody down to the level of gas and oil companies? There is one gas and oil company which had $65 million of profits in 5 years, and not only paid no tax whatsoever but got a refund.

Now, would you reduce everybody down to the point where they paid no taxes, so it would not make much difference whether this company claimed any benefits or not?

Mr. HARRISS. No. If the general level of tax rates were more moderate, there would not be anywhere nearly the inducement to in-

vest capital in these lines. Rates of return and prices would adjust. It takes time, but the return on capital would tend to equal out. It would not take a generation.

Senator GORE. Would the Senator from Illinois yield?

Senator DOUGLAS. Surely.

Senator GORE. Dr. Harriss may have given us something to which we should give serious consideration. Having failed in our efforts to take this 27½ percent of gross income up to one-half of net income away from a special industry, do you not think it worth while to consider letting other business groups have an exemption of 27½ percent of gross? Most businessmen operate on the basis of net. This is an unusual thing, and the doctor has made a suggestion here on which I wish to solicit your views.

Senator DOUGLAS. Are you addressing your question to me?

Senator GORE. I am.

Senator DOUGLAS. I would like to ask Dr. Harris, would you say 27½ percent of gross income up to one-half of net income should be deducted from all corporations and all businesses?

Mr. HARRISS. This is not the way to go about reducing the burdens on business. We have that on one line of activity and ought not to extend it. I do think that we should reduce the taxes on business gradually over time to get back——

Senator DOUGLAS. You see, the Senator from Tennessee, my good friend, has implied I want to eliminate the 27½ percent. I have no ambitious purposes. I propose to retain it for firms having a gross income of less than $1 million a year, reduce it to 21 percent for firms with gross incomes of from $1 to $5 million; to 15 percent for those with incomes of over $5 million. It is a very modest proposal, but it would bring in about $500 million a year, and somewhat reduce the advantages.

Senator GORE. What I was suggesting was that you give consideration to Dr. Harriss' suggestion. The 27½ percent of gross which is permitted as a deduction by the oil industry has no relationship whatsoever to depletion of a natural resource. This 27½ percent continues whether the resource is depleted or is augmented. There is no relationship at all. It is merely a formula for tax reduction.

If one businessman is to be allowed to calculate on the basis of gross, why should all others be calculated to pay upon net?

Mr. HARRISS. As a matter of fact, the 50 percent limitation on net income would come into effect pretty quickly on most businesses, Sears, Roebuck, A. & P., and so forth.

Senator GORE. Senator Douglas?

Senator DOUGLAS. I have been struck with the argument with respect to professional athletes. They say that a baseball player can get $10,000 or $20,000 a year, and then when he gets in his upper thirties, he is retired, his natural skill and dexterity have depleted, and therefore that we should have a depletion allowance to provide for the wasting of physical abilities. What would you say to that, applied to athletes, singers, or entertainers whose talents wax for a day and then wane?

Mr. HARRISS. To the extent that this is a tax problem, and it is not primarily a tax problem, but to the extent it is, it is a problem of high progressive rates. The proposals in the bill for averaging would do something, and rate reduction——.

Senator DOUGLAS. I thought you were sort of blunting the edge of my comments about the depletion allowance, and I was going to say if you sort of defended the depletion allowance why not defend the depletion allowance on natural ability.

Senator GORE. Except the depletion allowance for oil is not related to depletion.

Senator DOUGLAS. I know. You recover many times over the original costs.

Senator GORE. When I buy a building and depreciate it, when my total cost is recovered through depreciation, there is no further depletion available to me.

Mr. HARRISS. That is right.

Senator DOUGLAS. That is depreciation.

Senator GORE. The depletion and depreciation are not the same thing at all.

Senator DOUGLAS. Do you approve the depletion allowance on clam shells and oyster shells which this body put through in 1951, as a wasting natural resource?

Mr. HARRISS. No, Senator, not after the amount deducted exceeds the owner's investment.

Senator DOUGLAS. What?

Mr. HARRISS. No.

Senator DOUGLAS. Or sand and gravel?

Mr. HARRISS. No, although if it is given in one case then if there are materials that are competitive and the——

Senator DOUGLAS. Exactly so. You start with a loophole and it becomes a truckhole, exactly so.

Senator GORE. Repetitively.

Senator DOUGLAS. That is right. It spreads out.

Now, do you see any tendency for income, what is real income, to be disguised as a capital gain in our tax structure?

Mr. HARRISS. Well, the term I use is convert; disguise has a somewhat different connotation.

Senator DOUGLAS. And if this is done then the tax on capital gains is only one-half what the tax would be on income subject to a maximum of 25 percent, isn't that true?

Mr. HARRISS. Yes.

Senator DOUGLAS. What do you think about this feature of the tax bill extending capital gains to income from iron ore?

Mr. HARRISS. I would, in principle, be against extension. I do not know enough about iron ore to express an opinion on it specifically.

Senator DOUGLAS. Do you think it should be removed from timber?

Mr. HARRISS. The Treasury's case on timber seemed to me quite persuasive, but I do not know enough about the industry.

Senator DOUGLAS. I am not trying to be sarcastic, Mr. Harriss, and I know college professors are busy with many tasks. I was one once, and am very proud of that position, but I think this is a subject that professors of finance might properly devote themselves to to become experts on.

Have you ever gone into the question of personal holding companies?

Mr. HARRISS. A little. I have never had one.

Senator DOUGLAS. I know.

Mr. HARRISS. I know just a little bit about them.

Senator DOUGLAS. You realize that you can set up a personal holding company with a man owning 79 percent of the stock and on dividend income be taxed at 7.8 percent?

Mr. HARRISS. Yes.

Senator DOUGLAS. Don't you think something needs to be done in this field of personal holding companies?

Mr. HARRISS. Yes.

Senator DOUGLAS. Let the record show the witness nodded his head at that point.

Mr. HARRISS. I was not trying——

Senator DOUGLAS. The nods do not get into the record.

Mr. HARRISS. I am sorry.

Senator GORE. Let the record show that he said "Yes" and nodded for emphasis. [Laughter.]

Mr. HARRISS. That is not quite fair either, Senator. [Laughter.]

Senator DOUGLAS. Don't you think it is a proper subject for Congress and professors of taxation and the general public to concern themselves with matters of tax reform as well as with tax reduction?

Mr. HARRISS. Yes, Senator, but the best reform is rate reduction.

Senator DOUGLAS. Well, I know, it is much more attractive always; but if you do not get tax reform at the time you are reducing rates, when will you?

You see, we had hoped that the prospect of cuts might sweeten and reduce the opposition to reform. Now we find people very enthusiastic about taking cuts, but they reject reforms. The molasses does not make the castor oil go down any better, and if you have to take castor oil without molasses, then the chances for reform are even less; isn't that true?

Mr. HARRISS. Yes. But the bill does have some provisions about personal holding companies.

Senator DOUGLAS. Yes. There is a question as to whether they are sufficiently adequate, and also a question as to whether they are retroactive, a very real question on that point.

Well, Mr. Chairman, I do not think I should take up any further time. I studied under the predecessor to Mr. Harriss at Columbia, the great Professor Seligman who was the father of the progressive income tax of this country, and I learned a great deal about the advantages of progression from his books and his teachings. He was the greatest authority in this country, and he gave me a predilection in favor of progressive taxation which, I must confess, his successor has thus far been unable to undo.

Mr. HARRISS. This is all a matter of degree. Professor Seligman, I wager, would never have taught you the virtues of the present rate scale.

Senator DOUGLAS. I read your paper hastily, but I thought it consisted in large part of an attack on the theory of progression.

Mr. HARRISS. No, that was not my intention. I said the theory is much weaker than is generally recognized, and that as a practical guide to setting rate schedules, it is sadly inadequate.

Senator DOUGLAS. Would you discard the theory of progression?

Mr. HARRISS. I would not attempt to discard the practice of progression. As to the theory, my reservations grow.

Senator DOUGLAS. Would you say our tax structure should have some progressive principle that increments of income be taxed at successively lower rates?

Mr. HARRISS. Successively lower rates? The part of progression that involves removing the tax on the lowest income groups is important on humanitarian grounds. Above that, my answer would be, "Yes." But how could I defend a case, how could I prove it?

Senator DOUGLAS. But you do not oppose some progression in the tax structure?

Mr. HARRISS. No, that is certainly not my intention.

Senator DOUGLAS. Of course, you are aware of the fact that though the individual income, Federal individual income, tax and the Federal corporation tax are progressive so far as income structure is concerned, that the excise taxes, which amount to $12 billion of Federal money, are probably regressive; isn't that true?

Mr. HARRISS. Yes, at the tails of the distribution. I think at the lowest and the highest incomes these taxes are regressive. Throughout the income ranges that include the great masses of families, I would suspect that the tax burden is dominated by proportionality more than regressivity.

Senator DOUGLAS. Are you speaking of excise taxes or the tax structure as a whole?

Mr. HARRISS. Excise taxes.

Senator DOUGLAS. Are you saying that a man with $20,000 smokes five times as much tobacco as a man with $4,000?

Mr. HARRISS. No.

Senator DOUGLAS. But he drinks five times as much liquor?

Mr. HARRISS. No, but he may buy more fur coats or automobiles.

Senator DOUGLAS. Of course, it is the tobacco and liquor which are the big yielders.

Mr. HARRISS. He may use the telephone more, a fairly big tax yielder. But $20,000 is getting a little high. The masses of incomes are below the $20,000 range.

Senator DOUGLAS. Well now, you are also aware, are you not, that about $18 billion is collected by the States and the localities in the form of sales taxes, is that not true, and they are regressive, are they not?

Mr. HARRISS. In about the same way—clearly regressive at the very lowest end of the income scale and, of course, at the highest end, not so much——

Senator DOUGLAS. Wait a minute. Services are excluded from the State and local taxes, investments are excluded.

Mr. HARRISS. For the most part.

Senator DOUGLAS. And any study of family budgets shows that the income elasticity of services and investment is very high as you go up in the income scale, so that you get a smaller proportion of the income of the well to do spent for services and savings, I should say, rather than investment.

Mr. HARRISS. Yes, sir.

Senator DOUGLAS. And this in itself would mean a decrease in the percentage paid in sales taxes.

Mr. HARRISS. Oh, yes. This is just a matter——

Senator DOUGLAS. You are acquainted with the studies of Professor Musgrave?

Mr. HARRISS. Yes.

Senator DOUGLAS. Those studies show that if you take the tax structure as a whole, what you say is true. Yes, I think that is true.

Now, if you exclude the upper part of the income scale, the tax structure tends to be proportional.

If you take indirect taxes as well as income taxes, it becomes progressive only in the upper brackets. Therefore, any decrease in progression so far as the lower brackets are concerned tips the scale toward the regressive factor, the middle bracket rather than toward the proportional bracket.

Mr. HARRISS. I was not proposing——

Senator DOUGLAS. Of course, it throws the emphasis of Government finance upon the indirect sales and excise tax.

Mr. HARRISS. This is not what I was trying to say. But, Senator, there are two points that might well be made here. One is that the estate and gift taxes now yield as much as one-third of the total of the progressive portion of the personal income tax rate. That is, the portion of the rates over 20 or 22 percent, the yield over that is only about three times as great as the estate tax is.

Senator DOUGLAS. Which is 2¼ billion.

Mr. HARRISS. Yes.

The second point is all of these studies have to make very arbitrary assumptions about the corporation income tax shifting, and I just do not know what the facts are; the actual results.

Senator DOUGLAS. Have you read Professor Lampman from the University of Wisconsin's book which was published by the National Bureau of Economic Research?

Mr. HARRISS. Yes.

Senator DOUGLAS. That seems to show that as of 5 or 6 years ago 1 percent of the population owned 75 percent of the corporate stock.

Mr. HARRISS. I am not sure about the figures but——

Senator DOUGLAS. I think that is true.

Thank you, Mr. Chairman.

Senator GORE. Senator Long, any questions?

Senator LONG. I just want to ask about one or two questions.

As much as I would like to ask the witness more questions, I would like to see these hearings concluded at some time and I think if both the Senator from Illinois and I tried to persuade every witness to our views on the general theory of taxation, we would be here until some time about March of next year before we ever close the hearings. By the time we ever get through with the executive session it would be the next administration recommending a tax cut, if anybody does, although I am very much interested in what my friend has to say, and he brings out some very interesting points.

Let me ask you if you agree with this general theory which, incidentally, is my theory of it, that near confiscatory tax rates on income actually bring less revenue than a reasonable tax rate.

Mr. HARRISS. I think that is true, Senator.

Senator LONG. Now, the reason I say this is that the Treasury studies on incomes show that people earning between $250,000 and $500,000 actually wind up paying about twice the percentage of their overall income in taxes that people making over $5 million do.

The reason is that the people making over $1 million seem to go to accountants and go to lawyers and seek ways of not giving all their

money to Uncle Sam. You have people with churches and other groups calling on them, and knowing that tax situation exists, they say, "You can find a better use than giving it to the Government, give it to our church, to our foundation; give it to the Heart Fund or give it to the Cancer Fund." The result is, by large contributions to private foundations and matters of that sort, they dispose of a great portion of that income in ways which Congress has in its wisdom seen fit to permit them deductions.

In some ways they can even make money. If they are giving something which has appreciated in value since they acquired it, they make money against other taxes which they would owe.

In addition to that, such people find it necessary to change their way of doing business, to have large amounts of borrowed money and to realize most of their gains as capital gains on which they pay a tax of only half, and against which the interest expense is fully deductible.

Those are two of the most obvious ways, but they do all kinds of other things, such as setting up owner-manager corporations which, in turn, have profit-sharing and pension plans, and the result is that taxes are almost completely avoided by many high-income taxpayers.

I would like to ask the witness if he would not agree that under a reasonable rate which allows a person to keep at least half of his income, the taxpayers would be more likely to go ahead and pay on the overall income he realizes rather than seeking tax avoidance gimmicks and seeking advice that tends to lessen the tax take of the Government.

Mr. HARRISS. Yes. Whether 50 percent is the significant point or 40 percent, or 55, I do not know. But in principle I should think so. My contacts do not include many such people but the principle seems correct; but in saying that I do not mean to express a judgment on the entire proposal.

Senator LONG. Well, as you know, I am offering an amendment to the committee in support of the principle that if a person would pay a tax on practically all of his income, and waive the benefit of many of the deductions that he can now claim, that person would have the benefit of a 50-percent tax rate. Only a small percentage of people would use it. I do not think I could find an accountant in America who knows anything about taxes who would use it, or a lawyer who knows anything about taxes would use it, but there are some people who prefer to pay taxes that way rather than going to tax avoidance schemes.

My thought is that in the long run if we do that sort of thing it might bring the Government a lot more revenue than it now collects by encouraging all these people to find tax avoidance measures.

Incidentally, I know at least one Senator who has on occasion voted for things which would give people one tax advantage or another because the rates appeared to be confiscatory. Therefore, I am inclined to think both on this end and on the practical end, both on the legislative end and on the paying end, that we bring in less revenue with near confiscatory rates than we would with a rate that the taxpayer would regard as reasonable.

Mr. HARRISS. Yes.

Senator LONG. Thank you, Mr. Chairman.

Senator CARLSON. Mr. Chairman?

Senator GORE. I would like for a minute to comment that I find it most interesting that the distinguished junior Senator from Louisiana

speaks so eloquently and knowledgeably of the legal means of tax avoidance. But instead of joining in an effort to strike those means from the law, he wants to give them a sufficiently low rate of taxation so that they will not be tempted to tax avoidance. I cannot endorse that theory of government or responsibility of a member of the U.S. Senate.

Senator LONG. Well, since the Senator saw fit to direct that at me, let me just say that there are a great number of deductions to which I can make reference which neither he nor I are going to do anything about. For example, I invite him to see what he can do about charitable contributions. I predict he will not do anything about them, even though he has had some success, I might say, with regard to some so-called loopholes, and I have helped him.

He is making a mistake in presuming that I am not going to narrow or deny or restrict the benefit of a lot of loopholes. I made mention of the "magic carpet" device, and I supported the Senator in some which he offered.

Some I am not going to support. That depends upon your definition of a loophole.

One Senator once defined a loophole before this committee as a provision of tax law that benefits the other fellow. If it benefits you it is very sound legislation. At least, that is how some people look at it.

Senator DOUGLAS. I am sure that no present member of this committee would vote that way.

Senator GORE. Dr. Harriss, we are not going to charge you anything for this.

Senator Carlson?

Senator CARLSON. Dr. Harriss, before you leave I noticed in your statement, and I heard it, too, that you have been working with the Committee on Federal Tax Policy.

Mr. HARRISS. Yes.

Senator CARLSON. As I read your statement, you have made some studies of rates. If those studies are available or any of this material is available that would be helpful, I would appreciate it very much, if there is no objection, if you would make it a part of your remarks.

Mr. HARRISS. I would be delighted, sir.

(These rates appear on p. 809 of these hearings.)

Senator GORE. Thank you very much. I am sure you will go back to Columbia and impact a greater democratic spirit to your students. [Laughter.]

Mr. HARRISS. Thank you very much.

Senator GORE. I hope so.

The next witness is Mr. Rolf H. Berg, representing the National Tool, Die, & Precision Machining Association.

STATEMENT OF ROLF H. BERG, PRESIDENT, NATIONAL TOOL, DIE & PRECISION MACHINING ASSOCIATION

Mr. BERG. In order to conserve the time of the committee, I would like to submit my entire written statement for the record and orally excerpt the key points.

Senator GORE. Thank you. Your prepared statement will be placed in the record following your oral remarks.

Mr. BERG. My name is Rolf H. Berg, I appear on behalf of Atols Tool & Mold Corp., Schiller Park, Ill., of which I am vice president, and on behalf of the National Tool, Die & Precision Machining Association of which I was president until last Friday 3d. They had an election at that time and somebody else succeeded me.

I summarize my main points.

Tax rate reform is essential to the economic expansion required for a fully and productively employed economy.

Today's pent-up demand is for capital spending, not consumer spending.

The deficit dilemma is not necessarily a deterrent to the economic goal of accelerated growth within the political goal of fiscal integrity. Fiscal responsibility must relate long-term to short-term aims; today this requires balance between the requirements of sound taxing and spending before it calls for balance of tax revenues and expenditures.

Tax reduction falls short of tax reform.

Structural reforms should be judged on individual value and potential for capital formation, not as an offset for aspects of rate reform; retention of the present dividend credit and revision of the capital gains treatment for individuals as proposed would strengthen the economic creativeness of the legislative package.

The public police framework which has obtained in the middle-third of this century is one of the aggressive central-government assumption of responsibility for economic welfare, and reliance on heavy Federal spending—primarily deficit spending—as the means of discharging that responsibility. If, as that kind of public policy presumed, programs of heavy Federal spending were the key to generative, economic expansion, the volume of Federal spending would certainly have accelerated our rate of economic growth. But it hasn't.

The slow pace of both economic growth and Federal revenue is, I am convinced, directly attributable to what the Ways and Means Committee report on H.R. 8363 calls the high-tax straitjacket. The drag of existing tax rates on economic efforts must be relieved if the full potential of our free enterprise system is to be released.

Although a fundamental corrective of our fiscal situation has to come from the refreshment of the revenue base, there is no reason the line cannot be held on Federal spending. But it is obvious even to a layman that some $20 billion cannot be cut from spending to insure tax reduction within a balanced budget. However, if enactment of tax rate reform has a good effect, as is expected; and if the spending volume is contracted—the result should be a rapidly dimishing deficit.

Improving Federal revenues presupposes expanding, profitable businesses, an increase in the number of people earning their livings, and a better living being earned by them. This in turn depends on the optimum formation and use of capital.

Senator GORE. You realize these same things were said in behalf of the tax cut in 1954?

Mr. BERG. I appreciate that.

Senator GORE. But you still loyally and faithfully proclaim the nostrum.

Mr. BERG. Well, I feel that we did not go far enough last time.

Senator GORE. Oh, instead of $7 billion in 1954, how far do you think the Congress should have gone, to $11 billion then?

Mr. BERG. The tax cuts, Senator, are a thing that should be weighed in the effect they have on the balance of the total economy of the country, and where you have high tax rates which tend to strangle the incentive of a businessman in investment and creating new jobs.

Senator GORE. Do you think tax rates are strangling General Motors? They seem to have done quite well this year. Just how has that strangled General Motors?

Mr. BERG. I am speaking mostly on behalf of the small businessman.

Senator GORE. Well, a small businessman does not pay taxes except on the profits he earns. You, of course, realize that, and unless he is prosperous, unless he is operating well in the black, he certainly does not have a tax liability.

Mr. BERG. He has to make money in order to pay taxes.

Senator GORE. Yes, of course.

Mr. BERG. But it is the amount of money that he is able then to retain for further expansion uses that determines how fast he is going to progress in the future.

Senator GORE. Well, all of us would be better off if we did not pay any tax at all.

Mr. BERG. I do not think we could go that far. There is a certain amount of responsibility that each one has in his duties, and in supporting the Government, and the good works that the Government does.

Senator GORE. Do you think that amount of responsibility should be equitably shared by people, according to their ability to pay?

Mr. BERG. To a large extent, I do. I think that the more each one of us shares in Government expense, within limits of what we are able to pay, the more conscious we become of the full responsibility that we have toward seeing that Government is properly run, and that we behave as responsible citizens.

Senator GORE. Do you think Government is properly run when we borrow $11 billion to give a tax cut and then borrow the money to pay the interest on the money we borrowed?

Mr. BERG. Had the economy of this country risen or grown, I think commensurate with what its potential was in the last few years, I believe that it would have not been necessary to borrow the money.

The suggestions that I am recommending are rooted in the fact that there is expected new revenues being realized by the Government due to the fact that the economic situation should be improved.

Senator GORE. I understand. But you did not answer my question. Do you think the Government is being properly run when there is already a debt of $306 billion on which the carrying charge is more than $10 billion per year? That then, on top of this, and on top of the second biggest deficit in peacetime history, the Government then borrows $11 billion to give a tax cut, and then has to borrow the money to pay the interest not only on what it already owes, but on what it borrows in order to give a tax cut? Do you think that is proper Government?

Mr. BERG. On the basis of a short-term concept, I would heartily agree with you that it is not good practice.

However, everything that we propose should be weighed in the balance of the ultimate effect it has, not just next year, but what is beneficial for this country 2, 3, or 10 years from today.

Senator GORE. All right. Let us go back to 1954. Then a cut in taxes in the approximate proportion of the gross national product as what is now proposed was made. It has been 10 years. Yet we seem to have a bigger deficit rather than a smaller one.

Mr. BERG. A lot of my testimony is based on the fact that these are the results of the fact the people who are most capable of reinvesting money to create added revenues for the Government are being held back because of the deterrent effect of the present tax structure.

Senator GORE. I looked at your statement, but nowhere do you say there is a shortage of investment capital. The facts are that there is an abundance of investment capital. Even the Secretary of the Treasury has said that an excess of savings characterizes our times. So I wonder just what you mean by the responsibility of citizens to contribute to their Government if it is run properly.

Mr. BERG. Well, for instance, you just stated that there seems to be an excess of savings, that capital——

Senator GORE. No, I did not say that. I said the Secretary of the Treasury said that.

Mr. BERG. It may be true in certain fields. I do not know enough about it to really make a valid statement. But speaking on behalf of a small businessman, myself, I fail to see where there is an overabundance of capital.

As a specific example, yesterday, before I left to come to Washington, I had a conference with supervisors in our organization. We have a 120-man shop. On my desk, by the time I return tomorrow, will be a request for new machines and assets which will be required, in their conviction, for us to continue operating profitably and competitively with the growth of our industry.

I know, for sure, that I will have to turn down at least 50 percent of these requests, simply because we do not have the capital, and we have no means of getting it through borrowing. We cannot float a stock issue because we are not on the public market. So this is the type of a situation, I think, that is faced by a great many small business people, that they simply cannot do what they know for sure would lead to expanded business opportunities, growth in the economy, creation of more jobs, simply because of the stranglehold that this lack of capital has on them.

Senator GORE. What, it seems to me, the situation, which you describe, needs is credit rather than a tax cut. This is one means of stimulating the national economy, the availability of credit at reasonable rates.

Mr. BERG. You have to pay it out of earnings. You are talking about a means whereby a small businessman can borrow money.

Senator GORE. Yes.

Mr. BERG. These are good steps forward, but I do not think that they serve the full purpose of building up the total strength of the small business organization.

Senator GORE. You have presented a very interesting statement and very interesting testimony, particularly with respect to the needs and desires of small business, and the committee appreciates your effort, your time and attention and willingness to come to the committee and give us the benefit of your views.

Mr. BERG. Thank you, Senator. I appreciate the opportunity of presenting these views.

Senator GORE. Thank you.

(The entire prepared statement of Mr. Berg follows:)

STATEMENT OF ROLF H. BERG, PRESIDENT, NATIONAL TOOL, DIE & PRECISION MACHINING ASSOCIATION

It is a privilege to have this opportunity to appear before this committee, and a pleasure to represent here both my own company and an association of companies in the same industry. My name is Rolf H. Berg. I appear in behalf of Atols Tool & Mold Corp., Schiller Park, Ill., of which I am vice president, and the National Tool, Die & Precision Machining Association of which I am president. The association's member companies are all small, with employment ranging from under 5 persons up to 200—with the average size company employing 20 to 25 toolmakers. We are small business, but essential business—being what might be termed producers' producers.

I am here because of the extreme importance of the committee's decisions on the tax bill now before you. Your judgments will have the utmost significance to the producers, employers, consumers, savers, and investors—to the employed and the unemployed—of the country; to all the individuals whose needs, resources, and efforts make up the economy and determine its quality and tempo.

My comments will be confined to points I believe are directly related to the key issue facing the Nation today. That issue is the need for realizing greater economic potential through our free private enterprise system, and how this may be achieved.

My major convictions are these:

Tax rate reform is essential to the economic expansion required for a fully and productively employed economy.

Today's pent-up demand is for capital spending, not consumer spending.

The deficit dilemma is not necessarily a deterrent to the economic goal of accelerated growth within the political goal of fiscal integrity. Fiscal responsibility must relate long-term to short-term aims; today this requires balance between the requirements of sound taxing and spending before it calls for balance of tax revenues and expenditures.

Tax reduction falls short of tax reform.

Structural reforms should be judged on individual value and potential for capital formation, not as an offset for aspects of rate reform; retention of the present dividend credit and revision of the capital gains treatment for individuals as proposed would strengthen the economic creativeness of the legislative package.

I do not intend to belabor these beliefs with lengthy discussion of documentation, but I do hope to enlist your favorable response at least with respect to rate reductions which would release new, forwarding energy and resources into the private sector of the economy and I would hope these might be made effective beginning January 1, 1964.

Tax rate reform is essential

Like military security, the best economic security of the Nation is a generally acknowledged "must." And, since optimism is our tradition as a people, we all believe an increase in our economic forward motion can and will be achieved. The differences of opinion lie in the questions of how, and in connection with what governmental and fiscal framework.

The public policy framework which has obtained in the middle third of this century is one of aggressive Central Government assumption of responsibility for economic welfare, and reliance on heavy Federal spending—primarily deficit spending—as the means of discharging that responsibility. If, as that kind of public policy presumed, programs of heavy Federal spending were the key to generative, economic expansion, the volume of Federal spending would certainly have accelerated our rate of economic growth. But it hasn't. Accelerated Federal expenditures have not led to accelerated economic growth. Growth has been sluggish. And this in turn, has resulted in a slowdown of revenue, making for larger—and chronic—deficits.

The slow pace of both economic growth and Federal revenue is, I am convinced, directly attributable to what the Ways and Means Committee report on H.R. 8363 calls the "high-tax straitjacket." The drag of existing tax rates on economic efforts must be relieved if the full potential of our free enterprise system is to be released.

Although a fundamental corrective of our fiscal situation has to come from the refreshment of the revenue base, there is no reason the line cannot be held on Federal spending. But it is obvious even to a layman that some $20 billion cannot be cut from spending to insure tax reduction within a balanced budget. However, if enactment of tax rate reform has a good effect, as is expected, and if the spending volume is contracted—the result should be a rapidly diminishing deficit.

Improving Federal revenues presupposes expanding, profitable businesses, an increase in the number of people earning their livings, and a better living being earned by them. This in turn depends on the optimum formation and use of capital.

It is the economic significance of capital that relates employment and the state of the economy to tax policy. Creating and improving jobs, and bettering the earnings of people and businesses, require two things in the economic sense: (1) Capital—money put to work to build factories, plants, machines, tools, dies, etc., and (2) a prospect that the employment of capital and labor will be profitable. Therefore, when we have substantial unemployment, and a flagging economy, it means there is neither enough capital, nor prospect enough of profit for economic activities to create the jobs and produce the earnings needed.

High rates of Federal income taxes comprise one of the most important reasons for lack of capital because: the only source of capital is savings, the put-aside returns of our people from their economic efforts and the economies of their governments; and the only source of savings is the income individuals have left from their earnings, and business has left from its profits, after taxes.

Reducing tax rates to permit greater capital spending is thus the premise for new economic growth and the policy for Government to effect now—not more spending programs designed to augment consumer purchasing power.

The need is for capital spending, not consumer spending

A policy of greater Government expenditures would support the doctrine that increased consumer spending is the key to improved economic growth. It is not increased consumer spending which is required now; however, it is more capital spending.

Some indication of the demand for capital goods may be suggested by these facts. Funds applied to industrial research and development have more than tripled in the past 10 years, but private domestic investment in producers' durable equipment has advanced by only 29 percent. Furthermore, the spur of such research to investment needs is increasing. In 1953, industrial research funds of $3.6 billion represented only 16 percent of the $22.3 billion invested in producers' durable equipment, but in 1962, research funds amounted to $11.6 billion and was 40 percent of the $28.8 billion producers' investment.

Over the decade Federal Government funds have, of course, become an enlarging portion of funds spent for such research, as the Government raised its outlays for defense ad space. Company industrial research funds alone were only 10 percent of producers' investment in 1953 and did not even reach 17 percent in 1962. However, from the viewpoint of the capital required to apply the results of research, the composite totals are the more pertinent. (An appended table gives the 10-year detail.)

Research and development lead to new products and better values in old products. Actual achievements here depend on technological progress. Thus the need is first for innovation in the tools, dies, and machines which will make new and better products. This requires new capital and investment. Research, development, and the creation of plant and equipment form a chain process which puts people to work producing producers' goods before it puts people to work producing new consumer goods. Consumer spending is not the lead factor here, it is only a subsequent one. Thus the kind of pent-up demand which needs satisfying today is for capital goods.

There is no question but that the demand in our industry is for capital. The problem in the tool, die, and precision machining area today is not one of excess capacity and idle plant or weakened customer demand; it is one of improving and modernizing productive facilities in order that we may accommodate our full customer potential. We need more capital even to serve the customers we already have, to say nothing of developing more customers. Additional new capital would be needed for new customers to be effectively served.

The United States has been devoting a shrinking portion of its gross national expenditures (product) to new machinery and plant equipment. A declining

portion of a greatly enlarging total will still produce large aggregates of expenditures, but the point here is not that the aggregates have increased but that the ratio between expenditures for producers' equipment and product has decreased. Here are indicative figures:

Ratio, new machinery and other plant equipment to GNP

Year:	*Percent*
1939	4.6
1950	6.6
1960	5.5
1961	4.9

For contrast the ratio in West Germany with its fine growth record rose from 9.7 percent in 1950 to 12.1 percent in 1960; and in the United Kingdom over the decade, from 7 percent to 9.1 percent.

One of the natural results of a diminishing relationship of new machinery and plant equipment to increasing total product is the growing obsolescence of existing machinery and plant. This is shown in the American Machinist for June 10, 1963:

Machinery, etc., 10 years or older

Year:	*Percent*
1963	64
1958	60
1953	56
1949	43
1945	38

The current contrast of other countries' ratios is also indicative:

Country:	*Percent*
Soviet	50
West Germany	55
France	58
Great Britain	59

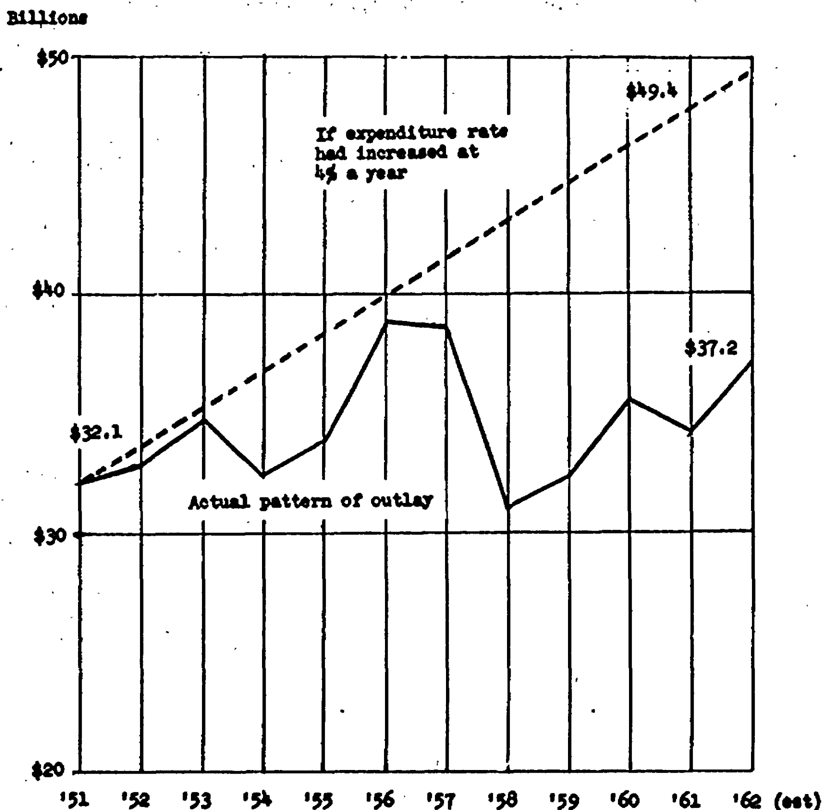
Our industry is composed of small business, and in small business the need for capital potential to be released by tax rate reform is particularly significant. Neither incorporated nor unincorporated small business (and the two are well represented in our industry) have the availability or flexibility of sources of financing usually open to large businesses. In general, equity and debt financing are more difficult for small businesses. To a much greater extent, for capital purposes, small businesses must rely on retained corporate earnings and the savings, after individual income taxes, of the owners of unincorporated business. The problem of self-supplied capital is intensified for unincorporated concerns competing in business with incorporated concerns because of the disparate tax rates. Where earnings are reinvested, a higher individual rate of tax discriminates against the unincorporated business because it limits to a greater extent the amount of after-tax income available for immediate reinvestment.

The capital gap can be pointed up graphically by contrast of fact and what might have been. This is shown in chart I.

CHART I

BUSINESS EXPENDITURES FOR NEW PLANT AND EQUIPMENT

(in 1961 prices)



In 1961 dollars, business expenditures for new plant and equipment were $32.1 billion in 1951 and an estimated $37.2 billion in 1962. The high was $39 billion in 1956 and the low was $31.1 billion 2 years later. But if a 4-percent annual increase had been achieved with the release of potential through tax reform over this period, the 1962 level could have been $49.4 billion. That $12 billion difference has a lot of leverage in it for job creation, business expansion, and economic growth.

The deficit dilemma

We are facing a $9 or $10 billion budget deficit on present tax and expenditure bases, in the absence of spending curbs. The tax legislation before you will involve another $9 or $10 billion deficit.

Adherence now to the restraints of a wholly traditional fiscal approach could defeat release of the economic resources and energies which will later assure reestablishment of strong traditional patterns. Cure or control of addiction sometimes requires gradual withdrawal of the drug. And we have been fiscally addicted to deficits.

If tax reform must await budget balance, I feel we will not have what we so badly need in this decade. Secretary Dillon has indicated that the administration would increase spending as an antirecession measure if the tax cut does not materialize. The character of that kind of deficit, experience has shown us, has

no special regenerative power for the economy, and it will not be self-correcting in any degree.

It will simply leave us, in due time, exactly where we are now—in need of a basic, long-term, fiscal corrective for a slowed economy.

Every time we avoid taking this ultimately necessary step, we increase the difficulties of doing it. Two phrases describe the choice between deficits for more spending or for tax rate reform. Neither is a gentle expression, but both are self-explanatory, and at least to me, extremely apt. They are "throwing good money after bad," and "cutting your losses."

There is no doubt which theme a good business manager would put into practice. And this is the policy I believe this committee should adopt.

Secretary Dillon's prophecy that the country will face additional antirecession spending deficits if tax reduction is not enacted does put the Congress in something of a box. But if continued deficits are inevitable for a while, isn't it better to enact tax rate reform which deals with the cause of the slow economic pace, than face the prospect of renewed pressures for spending?

This attitude does not at all condone spending as usual. The President's Consumer Advisory Council, adhering to the theme of consumer spending for prosperity, says that "much, if not all, of the stimulating effect of a tax cut might be nullified if it were accompanied by a reduction in spending." I disagree completely. As I have indicated, it is neither Government nor consumer spending that will release the potential in the economy; it is capital spending by private enterprise.

There is every reason to reduce Federal spending. Budget Director Gordon's statement outlined to you not only the administration's continuing intent in this regard, but the results of its efforts so far. The appropriation and substantive committees of Congress have made evident their intent by cuts in the financing of defense, foreign aid, science research—the big spending areas.

No doubt the combined will of Congress and the administration can do more than has been already done. Forbearance is one avenue. For example, Mr. Gordon's statement submitted to this committee showed a net drop of $1.7 billion in the 1963 expenditures from the first estimate to the actual results. Without the offset of about $700 million for a variety of items which were increased, the reduction made would have cut the budget by about $2.5 billion. Similarly his figures for the drop of $1 billion in the estimate for 1964 spending is a net of $1.1 billion of increases and $2.1 billion of decreases.

Of course, this is oversimplified. I recognize there are some Federal costs which rise or fall due to circumstances outside the administration's immediate control. Some of these would respond to legislative control, however. The point nevertheless is that the administration, the Congress, and segments of the public can forgo, in the broader interests of the Nation's economic welfare, the particular interests they have in one or another spending program such as Federal aid to education, area redevelopment, public works, and others. I believe that combined, dedicated efforts can substantially reduce the expenditure level.

In Tibet they say, "If your horse will not carry you up hill, it is no horse, while if a man will not walk downhill to rest his horse, he is no man."

Let us be men, and walk downhill on Government spending for awhile, so the inner resources of the enterprise system can be refreshed and strengthened by tax rate reform enacted in good conscience.

Tax reduction falls short of rate reform

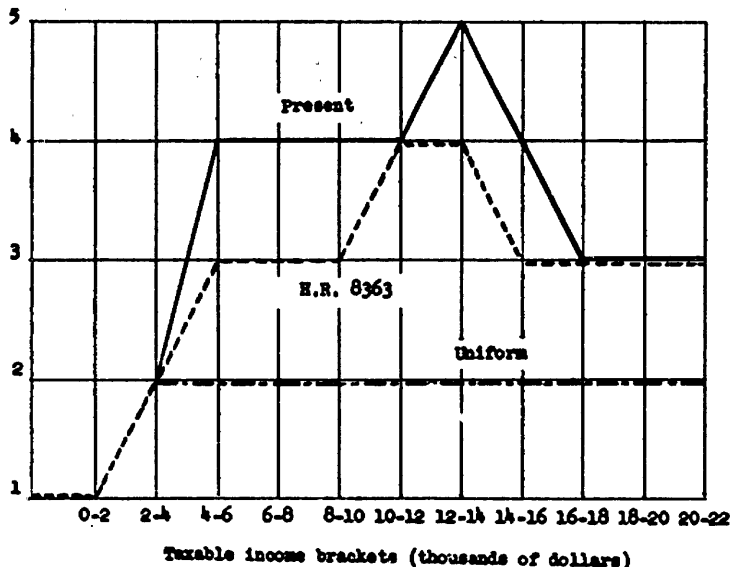
The bill before you will mean out-of-pocket savings for people and business, but it is primarily a vehicle of tax reduction not of tax rate reform. It reduces the rates, but the spread of percentage points of tax between brackets is as irregular and arbitrary as in the present law.

Roughly the first half of the rate scale has 11 taxable income brackets of $2,000 each and 10 changes in rate. The simplest way to see the profile of the changing rates is to graph the "risers," the percentage points of change from bracket to bracket. Chart II graphs three such profiles: of present law "risers," of those proposed by H.R. 8363, and a uniform series of 2 percentage points each. All graduated rates are necessarily arbitrary, but a uniform set at least has the appearance of logic. (See chart II.)

CHART II

PROFILES OF TAX RATE CHANGES
Up to $22,000

Points in
rise of
rates
between
brackets



In 5 of these 10 "risers," there is no reduction under the proposed law. The same degree of graduation is retained at $2,000 to $4,000, $10,000 to $12,000, and in the three brackets between $16,000 and $22,000. The points on the graph coincide here. The several other brackets apparently were believed to merit some reduction in the risers. Another curious contrast is the five-point riser in present law at the $12,000 to $14,000 bracket; what specifically justified one—and only one—five-point jump in the scale?

I mention these particulars simply to indicate inconsistency of graduation is still the pattern in H.R. 8363 and has not been materially reduced in the important middle brackets where individual incentive to prosper is so vital an asset to our economy. Thus, the proposed rate scale has no better justification from this point of view than the existing one.

For your consideration I have applied a uniform scale of 2-percentage-point "risers" to the entire stair of present taxable income brackets. I have begun with a 16-percent tax rate. (This exhibit is attached.) Its revenue results compared to the present law are as follows:

	Millions
Present law	$47,933
Uniform "risers"	37,265
Economic potential released	1,668

If the lowest and the highest brackets were each to be split into three, with a one-point "riser" each in these first new brackets (beginning at a 15-percent rate) and a three-point "riser" in these last new brackets, the total revenue change would be only $526 million. This would result from a drop of $533 million in the revenue from incomes in the zero to $2,000 bracket, and an increase of $7 million from incomes in the new top three brackets. (The detail is part of the appended exhibit.)

The value of such a uniform rate, beyond its simplicity and lack of discrimination among brackets, is the evening of graduation and the release of incentive it would provide in the middle brackets. These brackets are the key to motivation for earnings, savings, and investment which are so important to a vigorous, growing free enterprise economy.

Revision of the graduated rates through the middle brackets is the most important corrective for the House bill. Regardless of the level at which you begin the first rate, I urge that the minimum adjustment through the middle brackets be the evening of graduation by no more than a 2-percentage-point rise between brackets.

Structural reforms should be judged for their own values

The 25 structural changes proposed by H.R. 8363 should be considered on their individual values and not tied in any way into a give-and-take relationship to corporate or personal tax rate decisions. Also, whenever a structural change would have inimical influence on the formation and use of more capital, this fact should be weighed against it. I believe priority should be given those aspects of tax legislation which would most directly, promptly, and substantially bring new resources into economic action.

For this reason I should like to comment particularly on the dividend credit and taxation of capital gains. These are integral parts of an income tax legislative package which would contribute, I believe, to the economy's need for greater savings and investment. Income from dividends, and capital gains, are both directly related to the equity financing of our enterprise system; and the people benefiting from them are a prime source of the country's capital supply.

Investment in American enterprises is a growing industry in itself. There are reportedly 17 million or more investors in the Nation today—about 9 percent of the population. Their savings and income from savings are part of our creative capital structure. In Japan, incidentally, where the economic growth rate has been so phenomenal, 22 percent of the population own securities. Many of the small businesses of our country are held in narrow framework of ownership or owner-managed. Return and investments in either dividends or capital gains can play a serious role in the financing of growth and expansion in such businesses.

For these reasons I would support the provisions for taxation of capital gains as contained in H.R. 8363.

However, I would not support the changes proposed for dividend credit and exclusion, but would prefer to see the existing provisions retained.

In regard to dividends, there is the problem of double taxation, first on corporate earnings and then at individual rates, on payout. The relief provided in 1954 in this regard has been meaningful: the amount of stock sold has been substantially greater since 1954 than in the 8 years before; from 40 percent in 1955–56 to 67 percent today; retained earnings were $11.8 billion in 1955 but only $8.1 billion in 1962.

H.R. 8363 would reduce by 4 percentage points the tax rate on those earnings retained by corporations; but this is no reason to repeal the 4-percent credit against the individual tax on earnings paid out as dividends. These are not matters for trade. Repealing this relief would revive the punitive policy toward equity funds for business which the Congress only a few years ago mitigated by enacting the credit.

Conclusion

The core of my statement has clearly been on the need and significance of replenished capital for economic growth. I do not mean to slight other matters of tax policy, structure, or equity, but to me the release of more capital is the overriding issue.

A free enterprise economy grows, lags, or bumps bottom as it is nourished, deprived of, or starved in its supply of private capital. The energy, earnings, product, and saving of our people have changed the United States from a land of great promise into a land of great achievement. We became the first country in history to have a majority of its people well provided for. Today the United States is the leading capitalist country, and has the foremost industrial position in the world. Our standard of living is the envy of other nations.

This happened because in our early years we developed a creative balance between the public and private sectors, between the drains of government and the demands of the economy on the capacities of our free enterprise system to support them. In short we found a political and economic formula that

worked wonders. It can again, if we let it. All that is required is Federal policy that imposes minimum restraint on the creative processes of private enterprise. Tax rate reform is essential to such policy.

In behalf of the National Tool, Die & Precision Machining Association, and the owners and employees of my own company, I think you sincerely for this opportunity to present our views.

APPENDIX 1

Industrial research and development and investment in producers' durable equipment

[In billions of dollars]

	Total	Funds for industrial research and development performance, by source		Private domestic investment in producers' durable equipment
		Federal Government	Company [1]	
1953	3.6	1.4	2.2	22.3
1954	4.1	1.8	2.3	20.8
1955	4.6	2.2	2.5	23.1
1956	6.6	3.3	3.3	27.2
1957	7.7	4.3	3.4	28.5
1958	8.4	4.8	3.6	23.1
1959	9.6	5.6	4.0	25.9
1960	10.5	6.1	4.4	27.6
1961	10.9	6.3	4.6	25.5
1962	11.6	6.7	4.8	28.8

[1] Company funds include all funds for industrial research and development performed within companies' facilities, except funds provided by the Federal Government. They do not include company-financed research and development contracted to colleges and universities, research institutions, or other nonprofit organizations.

Source: Research and development: National Science Foundation, "Reviews of Data on Research and Development," No. 40, September 1963. Producers' durable equipment: U.S. Department of Commerce, "Survey of Current Business," July 1963.

APPENDIX 2

Two-point uniform versus present arbitrary gradution in personal income tax rates and revenue results

Taxable income bracket (thousands)	Taxable income (millions)	Rate (percent)		Revenue (millions)		Tax saving (millions)
		Present	With uniform risers	Present	Under uniform risers	
0 to 2	$129,348	20	16	$25,870	$20,696	$5,174
2 to 4	42,226	22	18	9,290	7,601	1,689
4 to 6	13,216	26	20	3,436	2,643	793
6 to 8	6,941	30	22	2,082	1,527	555
8 to 10	3,916	34	24	1,331	940	391
10 to 12	2,541	38	26	966	661	305
12 to 14	1,866	43	28	802	522	280
14 to 16	1,436	47	30	675	431	244
16 to 18	1,109	50	32	555	355	200
18 to 20	727	53	34	385	247	138
20 to 22	517	56	36	290	186	104
22 to 26	761	59	38	449	289	160
26 to 32	740	62	40	459	296	163
32 to 38	423	65	42	275	178	97
38 to 44	265	69	44	183	117	66
44 to 50	195	72	46	140	90	50
50 to 60	213	75	48	160	102	58
60 to 70	130	78	50	101	65	36
70 to 80	96	81	52	78	50	28
80 to 90	68	84	54	57	37	20
90 to 100	46	87	56	40	26	14
100 to 150	136	89	58	121	79	42
150 to 200	58	90	60	52	35	17
200 and over	149	91	62	136	92	44
Total	207,123			47,933	37,265	10,668

Possible change in 2-point uniform scale: 3-way split of lowest and highest bracket and effect on totals

Taxable income bracket (thousands)	Taxable income (millions)	Rate (percent)		Revenue (millions)		Tax saving (millions)
		Present	With uniform risers	Present	Under uniform risers	
0 to 1	$76,690		15	$15,338	$11,504	$3,834
1 to 1.5	29,289		16	5,858	4,686	1,172
1.5 to 2	23,369		17	4,674	3,973	701
Total	129,348			25,870	20,163	5,707
200 to 300	63		63	57	40	17
300 to 400	25		66	23	16	7
400 and over	61		70	56	43	13
Total	149			136	99	37
Effect of total	207,123			47,933	36,739	11,194

Senator GORE. The committee will adjourn until 10 a.m. tomorrow. Thank you.

(Whereupon, at 12:15 p.m., the committee was in recess, to reconvene at 10 a.m., Friday, November 8, 1963.)

REVENUE ACT OF 1963

FRIDAY, NOVEMBER 8, 1963

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

The committee met, pursuant to recess, at 10:25 a.m., in room 2221, New Senate Office Building, Senator Harry F. Byrd (chairman) presiding.

Present: Senators Byrd, Douglas, Gore, Hartke, Williams, Carlson, and Morton.

Also present: Elizabeth B. Springer, chief clerk.

The CHAIRMAN. The committee will come to order.

Senator GORE. Mr. Chairman, before we hear the witnesses, may I put something in the record at this point?

The CHAIRMAN. Without objection the insertion will be made.

Senator GORE. I asked Mr. Stam to prepare a table relating to corporate profits and cash flows to gross national product, following the outline of a table which I had previously prepared. I would like to insert at this point Mr. Stam's letter to me, and the table.

The CHAIRMAN. Without objection.

(The documents referred to follow:)

CONGRESS OF THE UNITED STATES,
JOINT COMMITTEE ON INTERNAL REVENUE TAXATION,
Washington.

Hon. ALBERT GORE,
U.S. Senate,
Washington, D.C.

DEAR SENATOR GORE: Your assistant gave us a table on corporate profits, dividends, etc., for the period 1952 through first half 1963, and asked that we verify the figures and provide corresponding data for the period 1946–51.

We have prepared a table similar to yours but covering the longer period 1946 through first half 1963. The data for the earlier years was obtained from the 1962 Supplement to Economic Indicators, and for the recent years from the October issue of the Economic Indicators.

Sincerely yours,

COLIN F. STAM, *Chief of Staff.*

24-532—63—pt. 3——35

[Dollars in billions]

	Gross national product	Dividends paid	Corporate profits after tax	Corporate profits after tax plus capital consumption allowances	Dividends as a percent of gross national product	Dividends as a percent of corporate profits after tax	Corporate profits after tax plus CCA as a percent of gross national product	Dividends as a percent of corporate profits after tax plus CCA
1946	$210.7	$5.8	$13.4	$18.6	2.8	43.3	8.8	31.2
1947	234.3	6.5	18.2	24.5	2.8	35.7	10.5	26.5
1948	259.4	7.2	20.5	28.2	2.8	35.1	10.9	25.5
1949	258.1	7.5	16.0	24.5	2.9	46.9	9.5	30.6
1950	284.6	9.2	22.8	32.2	3.2	40.4	11.3	28.6
1951	329.0	9.0	19.7	30.7	2.7	45.7	9.3	29.3
1952	347.0	9.0	17.2	29.6	2.6	52.3	8.5	30.4
1953	365.4	9.2	18.1	32.2	2.5	50.8	8.8	28.6
1954	363.1	9.8	16.8	32.7	2.7	58.3	9.0	30.0
1955	397.5	11.2	23.0	41.4	2.8	48.7	10.4	27.0
1956	419.2	12.1	23.5	43.5	2.9	51.5	10.4	27.8
1957	442.8	12.6	22.3	44.1	2.8	56.5	10.0	28.6
1958	444.5	12.4	18.8	41.4	2.8	66.0	9.3	30.0
1959	482.7	13.7	24.5	48.7	2.8	55.9	10.1	28.1
1960	502.6	14.5	22.0	47.6	2.9	65.9	9.5	30.5
1961	518.2	15.3	21.8	48.6	3.0	70.2	9.4	31.5
1962	554.9	16.6	24.6	55.4	3.0	67.5	10.0	30.0
1963	575.7	17.4	26.1	58.0	3.0	66.7	10.1	30.0

The CHAIRMAN. The first witness is Mr. William M. Horne, Jr., of the Manufacturing Chemists' Association.

Mr. Horne, please proceed.

STATEMENT OF WILLIAM M. HORNE, JR., MEMBER, TAX POLICY COMMITTEE, MANUFACTURING CHEMISTS' ASSOCIATION, INC.; ACCOMPANIED BY RAPHAEL SHERFY, SPECIAL COUNSEL

Mr. HORNE. Mr. Chairman and members of the committee, my name is William M. Horne, Jr., and I am appearing today as a member of the Tax Policy Committee of the Manufacturing Chemists' Association.

On my left is Mr. Raphael Sherfy, special counsel for the MCA, and formerly Associate Head of the Legal Advisory Staff with the Treasury Department.

On behalf of the association, I would like to thank you for this opportunity to present the views of the MCA on H.R. 8363.

We have with our statement an appendix which, with your permission, I would like to incorporate in the record.

The CHAIRMAN. Without objection.

Mr. HORNE. The Manufacturing Chemists' Association, Inc., is a national trade association which was established in 1872. It is the oldest chemical trade association in the United States. Its membership includes some 200 companies representing more than 90 percent of the productive capacity of the chemical industry in the United States.

We have a few general comments on H.R. 8363, and then some particular recommendations on some of the technical aspects of the bill.

We believe that a substantial rate reduction in individual and corporate tax rates should stimulate our Nation's economic growth. The rate reductions contained in H.R. 8363 represent significant progress toward this goal. At the same time, any substantial tax reduc-

tion, in our view, should be coupled with a major effort to reduce nonessential Government expenditures.

We do not believe that the benefits of tax reduction should be achieved at the expense of seriously inflated and continuing budget deficits. Unless the tax reduction program has a realistic chance of stimulating economic growth and thereby increasing tax revenues, the inflated budget deficits will undoubtedly lead to serious inflation. This could erode our real economic growth and more than offset the benefits of tax reduction.

To achieve sustained economic growth and to reduce the level of unemployment, we strongly believe that any rate reduction, such as provided for in the bill, should be coupled with congressional and executive expenditure restraint which will confine appropriations within bounds of fiscal responsibility. The soundness of our currency and our fiscal system, both domestically and internationally, can only be maintained if Congress and the executive branch adopt a rigorous policy of self-discipline and frugality in Federal spending.

H.R. 8363 packages technical revisions with rate reduction. If this bill is to achieve its objectives, its proposals for tax revision should be limited to those which will stimulate economic growth. Tax revision which is inconsistent with rate reduction is unsound, in our view. It will only detract from the beneficial effect of rate reduction.

We believe that tax revision can also be unsound for two other reasons. It may be unsound if the underlying policy is based on erroneous assumptions. Also, it may be unsound if it introduces such complexities into the law that collection procedures tend to break down or operate haphazardly with a resulting loss of confidence in the fairness of our self-assessment system.

We recommend that all the tax revisions proposed in H.R. 8363 be subjected by your committee to these tests: First, will the proposed change stimulate economic growth by eliminating tax disincentives? Second, are the underlying policy assumptions valid? Third, do the administrative complexities and compliance problems outweigh the policy need for the proposed change?

We believe if the committee tests the various tax revisions proposed in the bill in the light of these tests, we will have a sounder bill.

I should like now to turn to specific provisions in the House bill which are of particular interest to the chemical industry, and to comment on them in light of the tests.

The first provision we support in the bill is the elimination of the 2 percent consolidated returns tax.

We believe that the elimination of this 2 percent penalty tax will remove a tax disincentive and ease the problems of tax compliance and administration for a number of taxpayers.

We have some more comments on this in our appendix.

The next provision of the House bill to which we would like to refer is the investment credit, the proposed amendment to the investment credit made in the House bill.

We support section 202(a) of the bill which would repeal the requirement that the basis of property qualifying for the 7-percent investment credit be reduced by the amount of the credit.

Here again we have a provision which would remove an artificial tax barrier and which should have some stimulative effect on economic growth.

The extremely detailed recordkeeping requirements resulting from the basis adjustment in present law make tax compliance unduly expensive. This basic adjustment greatly complicates the administration of the investment credit, to the detriment of both taxpayers and the Internal Revenue Service. We believe this detailed recordkeeping is not at all consonant with the approach the Treasury has taken in respect of the new guideline rules on depreciation. The guideline approach emphasizes broad classifications of assets, thereby simplifying recordkeeping and eliminating many potential controversies in classifying assets.

We believe that the repeal of the basis provision on investment credit would similarly simplify recordkeeping requirements and ease the compliance burden of both the Government and the taxpayer.

There is another reason why the provision of the present law creates difficulties for taxpayers, and that arises from the difficulties which come about as the result of the fact that the States have not adopted the investment credit, by and large. This causes the taxpayers to keep two sets of records, two sets of property records, in effect, for tax purposes, one for State tax purposes, and one for Federal tax purposes.

Actually, the investment credit, because of the basis reduction provided in present law, can result in a tax penalty or detriment to taxpayers even though enacted by the Congress as an incentive provision. This comes about because of the limitations of section 46(a)(2). A new taxpayer, one starting a business, may lose depreciation which cannot be utilized as a deduction for a period as long as 6 years later.

For these reasons our association favors the enactment of section 202(a) of the House bill.

There is another provision of the House bill dealing with depreciation to which we would like to allude at this time. This is section 220 which introduces complicated new provisions dealing with gain on disposition of depreciable real property.

The apparent reason for this provision is the so-called tax shelter available under present law to investors in buildings and similar depreciable real property.

We think there is little reason to apply these rules in the case of industrial real property. By industrial real property, we mean factory buildings, warehouses, and similar structures used by a manufacturing concern in the operation of its business.

Industrial real property is not acquired for the purpose of generating "tax-sheltered" income. Its disposition is generally determined for the reasons wholly apart from tax considerations.

We would advocate a simplified, but tougher, tax treatment for gain on the disposition of industrial real property. This would be to apply the same recapture rules that Congress enacted in 1962 when it added section 1245 to the code.

We make this proposal only on the condition that the Treasury Department provide more realistic guideline lives for all industrial buildings.

The guideline lives for buildings which the Treasury announced in 1962 in its new guideline procedure are far less liberal than the guideline lives for machinery and equipment. In fact, in some cases the building lives are actually longer than the lives under the outmoded and obsolete Bulletin F.

Treasury officials indicated at the time the guideline lives were under consideration that the reason for excluding buildings from more realistic guideline lives was because Congress was going to exclude real property from the recapture provisions of section 1245 which it was then considering.

The Treasury did, in the guideline rules, take a partial step toward meeting the problem when it permitted taxpayers to depreciate special-purpose structures under the same guideline lives as the machinery and equipment housed in such structures. Unfortunately an unduly restrictive test is applied to determine whether a building qualifies as a special-purpose structure; and, furthermore, the problem is really broader in scope.

The special-purpose structures are limited to those buildings which actually house the machinery and equipment, and where the retirement of such machinery and equipment would simultaneously require the retirement of the building. We believe that all industrial real property, not only the special-purpose structures, but also warehouses, all the related servicing buildings, and real estate, should be depreciated on a realistic basis. If section 1245 is applied to this type of property, we see no reason for not applying a more realistic depreciation rule to that type of property.

If our Nation is to rebuild its industrial plant to improve our competitive position in world markets, realistic depreciable lives should be accorded to industrial buildings as well as to machinery and equipment. The need to modernize and rebuild factories, to install more efficient power stations, and to add more functional warehouses and other service structures is equally as important to our competitive position as the replacement of machinery and equipment.

We strongly recommend that your committee add to section 220 of the House bill certain new elective provisions dealing with these problems of industrial real property. We have suggested the form such provisions might take in the appendix to this statement.

If your committee will adopt provisions along these lines, it will be enacting a real tax reform—one that should stimulate economic growth and which will simplify the law for the great majority of taxpayers who are not concerned with real estate "tax shelters."

In addition, we strongly suggest that your committee favorably consider S. 2231, a bill introduced by Senator Hartke, which would remove the reserve ratio test from the guideline rules laid down by the Treasury Department. Adoption of this bill will encourage new investment, eliminate complications in the depreciation area, and will go a long way toward removing depreciation controversies from the tax system at little or no loss of current revenues.

At this time I would also like to invite the committee's attention to S. 736, a bill introduced by Senator Ribicoff dealing with expensing and amortization of facilities which are used for abatement of stream pollution, air pollution, and water pollution.

Senator Ribicoff, in a statement made on the floor of the Senate on February 7 of this year, outlined very well the reasons for the enactment of this provision.

The member companies of our association who have had occasion to review this bill, and comment on it, have all commented favorably on the principle of the bill. If this is a type of bill which should be

considered by the committee in the current session, we hope the committee will give consideration to this important question.

I would like to turn now to the elimination of the intercorporate dividend tax.

In the recommendations to the Ways and Means Committee by the administration, the administration recommended the elimination of the intercorporate dividends tax in the case of an affiliated group. The administration explained that this proposal would facilitate adjustment to the proposed elimination of the multiple surtax exemption for the affiliated corporations.

We believe that, in principle, the intercorporate dividend tax should be eliminated entirely. Basically there is no sound justification for imposing a tax at the corporate level on dividends flowing from one corporation to another.

We think that elimination of the intercorporate dividend tax in its entirety would be a genuine tax reform. We recognize that the revenue considerations may preclude the consideration of this reform at this time.

But, unfortunately, the House bill does not even adopt the partial repeal of the intercorporate dividend tax that the administration proposed. And there are a number of instances where an affiliated group would not wish to file a consolidated return even though it can do so without penalty tax. For example, differences in fiscal years of corporations within the affiliated group or complications in the filing of State income tax returns may make a consolidated return undesirable.

I would like to point out that we are talking about the elimination of the intercorporate dividend tax only within controlled or affiliated groups, and that this is only one of several benefits which can be obtained by filing consolidated returns. If you file a consolidated return, of course, you can always consolidate loss situations, as well.

We would recommend that your committee add an elective provision to section 223 of the House bill which would permit a controlled group of corporations to pay dividends within the group free of intercorporate dividend tax, provided the group received only a single surtax exemption. This would give the group only one of the benefits which it could achieve by filing consolidated returns.

Such a provision would be consistent with the administration's objective of removing the intercorporate dividend tax where multiple surtax exemptions are eliminated.

We also would like to bring to your committee's attention the fact that in certain industries so-called joint venture arrangements are now common where two separate and independent corporations each own 50 percent of a third corporation which they jointly control and manage. This subsidiary company of the two parent companies is essentially either a manufacturing or extracting operation, and serves as a manufacturing or extracting arm of the two parent companies. We believe the intercorporate dividend tax on dividends from such a jointly owned subsidiary to its parents should be eliminated provided the subsidiary waives entirely its right to a surtax exemption.

We would like to turn now to the removal of individual dividend credit and exclusion.

The Manufacturing Chemists' Association has consistently opposed any proposal that the present 4-percent credit and $50 exclusion applicable to dividends be removed. It was only after careful consideration and study of this problem by Congress, the Treasury and other groups for many years preceding 1954, that this small step was taken in 1954 toward the elimination of double taxation of corporate profits. At that time it was anticipated that the credit would ultimately be increased in the ensuing years.

MCA is therefore opposed to section 201 of H.R. 8363 to the extent it repeals the 4-percent credit. However, we are in favor of the increased dividend exclusion from $50 to $100 provided this increase is not contingent upon a concurrent repeal of the dividend credit.

We urge your committee to reject the repeal of the dividend credit.

I would like to turn now to the question of group term life insurance, which is a measure in the bill which we believe introduces a disincentive to economic growth. The tax revenues are estimated to be only $5 million from this provision.

We oppose section 203 of the House bill which would tax an employee on group term life insurance premiums. We urge the committee to delete this section from the bill. This proposal would tax an employee even in those instances in which the employer had contributed nothing to the cost of the group term insurance. Under these circumstances, the employee is said to be in receipt of taxable income because he has benefited from the group concept. The Treasury would propose to tax the older employees and allow a deduction to younger employees in such cases. This is the same theory of imputed income which led to the theoretical proposal that homeowners should be taxable upon the rental value of their homes.

The imputed income concept can only lead to a morass of administrative complexities and difficulties. From a revenue standpoint, it is probably self-defeating. The administrative and compliance costs to the employer and to the Government will undoubtedly more than offset the relatively minor increases in taxable income on the part of a few employees.

Most group insurance plans today provide for a stated premium cost per employee without regard to age. This is done for ease of administration of the group insurance programs.

If this provision of the House bill becomes law, employers will have to determine group insurance cost on an individual employee basis, both with respect to the employee's age and the amount of group insurance for which he is covered under the plan. The employer will be required to report for withholding tax purposes the premiums on the portion of group protection in excess of the $30,000 exclusion.

These additional costs of administering group insurance programs may lead some employers to abandon their programs. Since the principal purpose of group insurance is to provide financial protection to families on the death of the income producer, it seems doubtful that elimination of these programs is a socially desirable result.

We urge the committee to delete this provision from the House bill.

I would like to comment briefly on the interest on installment sales. This is again a section of the House bill which has a negligible revenue effect, but would again provide disincentives to economic growth because it would introduce new complexities into our tax system.

Section 215 of the House bill would impute an element of interest to installment sales and other deferred payment transactions where the parties may not have provided for interest. Furthermore, even if the parties have provided for an interest payment, this provision would apply if the interest is deemed "inadequate" in comparison with an interest rate prescribed by the Treasury.

This provision adds substantial complications to the code and yet is expected to have only negligible revenue significance.

The provision seems wholly unnecessary since it applies to situations in which the parties have adverse interests. The interest factor in these situations is by necessity negotiated on an arm's-length basis. And yet the proposed tax treatment would negate the adverse positions of the parties and thereby relegate bona fide business considerations to a subservient role.

The effect of this provision of the House bill is to say that parties can never, in good faith, negotiate a deferred payment which does not provide for interest at a rate which the Secretary of the Treasury prescribes as the going interest rate. This does not accord with economic realities. There are frequently situations in which parties, wholly apart from tax considerations, will determine that deferred payments may be made without regard to interest or at relatively low interest rates. For example, a creditor in the hope of retaining the debtor as a customer may be willing to attempt to keep the debtor solvent by extending favorable terms either without interest or at low interest rates. This type of consideration would be ignored under the House bill. An interest factor would be imputed to the transaction even though the parties, acting at arm's length, and without tax motives, had intended that no interest be paid.

We again urge that this provision be stricken from the House bill.

I would like to turn briefly to the capital gains and losses.

In the case of individuals, as you know, the House bill provides for a reduction in the capital gains rate for capital assets sold after a 2-year holding period. It would also extend the 5-year capital loss carryover for an indefinite period.

Secretary Dillon in his testimony before this committee has objected to the reduction in the capital gains rate for individuals so long as there is no provision for a carryover basis or taxation of appreciation at time of death. The Secretary does not, however, recommend deletion of the indefinite loss carryover for individuals.

We believe that the reasons which impelled the Ways and Means Committee to adopt these provisions for individuals are equally applicable in the case of corporations.

We agree with the Ways and Means Committee that there should be an indefinite carryover period since there is no economic justification for cutting it off at 5 years. We think, however, that an unlimited carryover should apply equally to both individuals and corporations. If your committee adopts this provision of the House bill, we hope that a change be made to make it applicable to corporations as well as to individuals.

In the case of the reduction of the capital gains rate for individuals, the Ways and Means Committee suggested that the rate reduction corresponded in part with the overall reduction in tax rates but that a more important consideration was the committee's desire to "unlock"

capital investments. Both of these reasons are equally applicable in the case of capital gains incurred by corporations. If your committee adopts the reduction in tax rates for individuals, we believe that, on the grounds of equity and long-term benefits to the economy, the capital gains rate reduction should also apply to corporations.

I next would like to refer to the moving expense provision in the House bill, section 212.

This provision provides a new deduction for all employees for moving expenses. Secretary Dillon has indicated that this provision will promote the mobility of labor and thereby enhance employment.

The new provision would not affect a transferred employee who, under present law, is entitled to exclude reimbursements for moving expenses which he receives from his employer.

We support this proposal in the bill. We believe it should help remove a distinction which exists under current law between new and old employees.

In addition, we would like to urge your committee to resolve certain other problems which are becoming more acute in this area.

The existing practice of many corporate employers is to reimburse the employee for incidental losses or expenses incurred in connection with his move as well as the actual cost of transferring his household effects. For example, under many established personnel policies, the employee is reimbursed for such items as penalties incurred in breaking a lease, mortage penalties, and similar losses or expenses which the employee would not incur except for the move. The employer reimburses the employee for these losses and expenses since the expenses are occasioned by the move which the employer has requested. There is no economic benefit to the employee resulting from this reimbursement. He has an economic loss. I would say in most instances the employee is never fully reimbursed for the entire economic loss that he has on a move. Even under the most liberal personnel policies the employee frequently has an additional economic loss which is incurred by reason of the move.

I had occasion to participate in a panel in Chicago recently in which this question was discussed. We had at that time on panel several distinguished representatives from the Internal Revenue Service, including one of the Assistant Commissioners and one of the assistant heads of the Chief Counsel's office and, at the same time, we had a representative from the regional commissioner's district in Chicago. This representative had been transferred, and he told the audience at that time that his move had actually cost him a considerable amount; that the Government's policy of reimbursement did not fully compensate for the loss that he had on this move.

I think that we have here a problem of administration that requires a clear recognition on the part of the Government as to these losses which are incurred on the part of the Government employees as well as private employees and requires that provision should be made for it. The Government has recognized this in the case of some of its employees, such as transfers of Foreign Service employees.

In summary, we would recommend that your committee extend section 212 of the House bill to provide a specific exclusion in the case of all reimbursed moving expenses which are incurred for the benefit of the employer.

We have a few comments on restricted stock options.

Stock options have been used for a number of years as a means of attracting and retaining key executive personnel. Stock options have become a useful personnel management tool. They are a basis for rewarding exceptional performance and for stimulating further efforts by those executives whose abilities will determine the success or failure of the corporation.

The Ways and Means Committee put this matter succinctly in the following language:

This committee believes that this provides important incentives to expand and improve the profit positions of the companies involved. This is not only good for the specific businesses involved, but also for the economy as a whole.

In your consideration of the stock option provisions of the House bill, we urge you to take into account two ways in which the House bill will operate unfairly.

Under the House bill, a qualified stock option must by its terms provide that it is not exercisable while there is outstanding any qualified stock option or restricted stock option which was granted at an earlier date.

The problem, in brief, here is that the House bill would apply to options granted prior to the effective date by making it impossible to grant new options to existing employees unless the new options provided that the old options will have to be exercised before the new options themselves could be exercised.

To take a simple case, suppose that the corporation has granted a 10-year option under an existing option plan in 1961. The option price at that time might have been $100. If the price of the stock has fallen to $50 at the time this bill becomes effective, this proposed rule, in effect, will bar the employee from receiving a new option even though the employer would like to grant him such a new option. I say it will effectively bar it because if the new option is granted it will require by its terms that the old option at $100 be exercised before the new option at $50 is exercised, and this may not be possible under the market conditions then prevailing.

The answer may be given that the old option can be terminated, but this is not always a practicable solution. In many instances there will be legal reasons which will prevent, or effectively preclude, the termination of the old options.

There is another problem relating to stock options that comes up as a result of the effective date provisions. This problem arises because the House bill provides that June 11, 1963, is the effective date for the stock options.

Of necessity, employers may have had to go ahead and grant options after that date under the provisions of existing law. They do not know whether or not the new provisions will be enacted or in what form. The result can well be that, if the effective date of June 11 is retained by your committee, the options which have been granted since that time in reliance upon present law will be invalidated.

We believe that any options which arise while the present law is in effect should be permitted to qualify under the existing law.

We would hope that your committee would make the effective date of these provisions the date of enactment to accomplish this purpose.

In conclusion, we support the rate reduction features of the bill and those other provisions which are consistent with the objectives of rate

reduction; that is, to stimulate economic growth. We invite the committee's attention at this time to our statement which includes other desirable tax revisions of the same nature. Thank you very much.

(The appendix previously referred to follows:)

APPENDIX TO THE STATEMENT OF WILLIAM M. HORNE, JR.

DETAILED EXPLANATION AND ADDITIONAL RECOMMENDATIONS FOR TAX REVISIONS

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DETAILED EXPLANATIONS

I. ELIMINATION OF THE 2-PERCENT CONSOLIDATED RETURNS TAX

Under present law an affiliated group of corporations which meets the 80-percent stockownership test has the right to elect to file consolidated returns, but, except for regulated public utility enterprises, must pay a 2-percent additional tax. The net result of this election, of course, is that the entire affiliated group is treated as one single enterprise and taxed as such under the Internal Revenue Code. As a general matter, once an affiliated group has elected to file consolidated returns, that group is required to continue to file on such basis unless the Commissioner gives it the privilege of revocation, or there is a significant change in the income tax law, or a new affiliated corporation is acquired.

In computing the consolidated taxable income of the group, profits and losses from intercompany transactions are eliminated, dividend payments from one member of the affiliated group to another are excluded from tax and one surtax exemption is allowed.

It has been alleged that the 2-percent tax is imposed because of the fact that it is in return for the basic advantages of the consolidated reporting; namely, exclusion of intercorporate dividends and the ability to offset losses of one corporation against profits of another. This is not a sound basis for supporting this 2-percent additional tax because it is impossible to determine in individual situations whether the advantages of the consolidated filing equal this tax. It seems obvious that any correlation between the advantages of the consolidated filing and the 2-percent tax would be purely by happenstance. The imposition of such a tax on such an unsound and unscientific basis is arbitrary and should be discontinued.

A single corporation can operate through multiple branches and divisions with the same economic effect as an affiliated group of corporations and still

obtain the advantages of consolidated returns; namely, no income tax on transfers of profits from one division to another and the right to offset losses of one activity against the profits of another. The imposition of the 2-percent consolidated return tax on a similar economic enterprise operating through separate corporations is accordingly inequitable and unfair. With the more liberalized net operating loss carryover and carryback provisions of present law, the significance of the intercorporate loss offset is less important. The sacrifice of multiple surtax exemption, although not necessarily relevant to the savings or advantages of consolidated returns, is a sufficient compensation for the privilege of filing consolidated returns.

For the foregoing reasons the Manufacturing Chemists' Association, Inc., recommends the elimination of the 2-percent consolidated returns tax regardless as to whether the Congress limits to one the number of surtax exemptions allowed an affiliated group.

II. Investment Credit

The provisions concerning the investment credit, as enacted in the Revenue Act of 1962, involve a number of problems which require corrective legislation. Although the repeal of the requirement that the basis of property be reduced by the amount of the credit goes a long way toward removing much of the complexity in this area, the requirement of applying the credit on a property-by-property basis results in the necessity of keeping much more detailed records than heretofore required. It is quite burdensome, and in some cases almost impractical, to keep such detailed records on an item basis, not only to determine the proper credit but also for possible credit restoration. This additional burden is only for Federal tax purposes since most State income tax laws do not embody the provisions of the investment credit.

In order to take further steps toward easing the administrative burdens for taxpayers by making compliance requirements more simple, it is recommended that legislation be enacted which would accomplish the following:

(*a*) Require credit restoration only on allowable or complete retirements; or

(*b*) Alternatively, if S. 2231 is not enacted into law and the reserve ratio test is retained for depreciation purposes, require credit restoration only by depreciable accounts or by guideline classes so that no credit restoration would be required unless application of an appropriate reserve ratio test indicates that the useful life of the entire class or account is less than that upon which the credit is based; if so, a complete restoration for the entire class or account would be required.

III. Real Estate Depreciation

MCA recommends that provision be made in the law to authorize the Treasury Department to provide more realistic guideline lives for all industrial buildings provided the taxpayer elects to extend the recapture provisions of section 1245 to any disposition of the property. In addition, MCA suggests that strucures which house manufacuring or research activities should, by legislation, be given the same depreciable rates under the guideline rules as the machinery or equipment which they house, provided the taxpayer consents to the recapture provisions of section 1245.

In order to accomplish the two foregoing objectives, it is suggested that section 167 of the 1954 code be amended by adding the following new subsection:

"(j) Guideline rates for industrial real property—

"(1) *Delegation of authority.*—The Secretary of the Treasury, or his delegate, is hereby authorized to prescribe, by ruling or regulation, new, shorter, and more realistic guideline lives for depreciation of all industrial real property, except special purpose structures falling within paragraph (3).

"(2) *Definition of industrial real property.*—Industrial real property means a building together with its structural components which is owned and used by a corporation engaged in manufacturing, production, or extraction. The structural components include equipment which serves normal heating, plumbing, air conditioning, fire prevention, electric wiring, lighting, and other equipment relating to the operations and maintenance of the building.

"(3) *Special purpose structures.*—In the case of industrial real property which is a building in which an integral part of manufacturing or research activities are carried on and which building is designed and used almost entirely for the purpose of carrying on such activities, such building shall be treated as a special purpose structure for the purpose of being classified

under revenue procedure 62-21 with the machinery or equipment which it houses, serves, or supports, and its depreciable life shall be determined by reference to the appropriate guidelines for the particular industries.

"(4) *Election.*—Any guideline lives prescribed by the Secretary, pursuant to paragraphs (1) and (3), shall be applicable to all of the industrial real property of a taxpayer only if such taxpayer makes an election, pursuant to regulations prescribed by the Secretary or his delegate. If the taxpayer makes an election under paragraph (1), all of his industrial real property shall, for purposes of section 1245, be considered as 'section 1245 property.'"

IV. Elimination of Intercorporate Dividend Tax

Although it is claimed that one of the main reasons for imposition of an intercorporate dividend tax is to combat and offset the tax savings from multiple surtax exemptions, this is not a valid claim. The intercorporate dividend tax applies to corporations which hold small amounts of stock in other corporations bearing no business or economic relationship to each other. In such situations the additional surtax exemption permitted to the paying corporation results in only insignificant tax savings. Whether or not the intercorporate dividend tax imposed on dividends coming from a particular corporation is greater or less than the savings of that corporation from the surtax exemptions depends wholly on the dividend policy pursued by its management. Where large amounts of dividends are distributed by the corporations, the intercorporate dividend tax is greater; where the dividend distributions are relatively small, the savings from surtax exemptions may be greater.

The alternative filing consolidated returns, made available without penalty by section 222 of H.R. 8363, involves many other complications and objections making it unsuitable in many instances. For example, if consolidated returns are filed, it is necessary that the parent and subsidiaries have identical fiscal years. In some cases subsidiaries now have different fiscal years from the parent's fiscal year and wish to continue this arrangement. This is true, for example, where the subsidiary is engaged in international operations and the parent is engaged in domestic operations. A 1-month difference in fiscal year ending is more convenient because of the lag in obtaining information from foreign countries. A decision to file consolidated returns also involves other complex and inconvenient changes such as: (1) Changes in accounting methods where members use different accounting methods, (2) elimination of intercompany profits in inventories, and (3) complications in filing of State income tax returns.

Also, affiliated groups containing regulated companies may not wish to file consolidated returns so as to avoid controversies over allocation between regulated and nonregulated companies of overhead and other joint services, depreciation, and the consolidated income tax liability in the determination of cost of service under FPC and ICC rules, and in the determination of excess earnings under certain consent decrees.

V. Employees' Moving Expenses

Our association is in favor of additional liberalization in the treatment of moving expenses of employees.

In the case of old employees, the present treatment of intransit moving expenses appears to be substantially uniform. Where an employee is transferred for the benefit of the employer, reimbursement for actual moving expenses are excluded from the gross income of the transferred employee. This exclusion should be continued and, in the interest of uniformity, should be extended to new employees as well. The employee receives no economic benefit from these reimbursed expenses and there is no basis for attributing gross income to the employee as a result of such reimbursement.

In the case of expenses incurred in connection with an employee's move other than actual moving expenses, the present administrative treatment by the Internal Revenue Service is inconsistent and divergent in its application. Even though the transfer is for the employer's benefit, some reimbursements of this kind are being administered on the basis that they are taxable as additional compensation to the transferred employee without any offset for the expenses actually incurred. It is unreasonable to consider such reimburse-

ments as income to the transferred employee since the entire amounts received are spent on items which result in no economic benefit to him and are incurred for the benefit of the employer.

Accordingly, we recommend that there be excluded from the gross income of employees in a transit status, whether new or old, reimbursed expenses incurred for the benefit of the employer, such as—

(*a*) Actual transportation expenses of the employee, his family, and household effects, including food and lodging en route.

(*b*) Food and lodging while in temporary quarters at the new location, for employee and his family.

(*c*) Other nonrecurring miscellaneous expenditures occasioned by the move, whether they pertain to the old location or new location.

RECOMMENDATIONS FOR ADDITIONAL TAX REVISIONS

A. Taxation of Foreign Income

1. REPEAL OF INTERNAL REVENUE CODE, SECTION 367

Under section 367 of the Internal Revenue Code, the Secretary of the Treasury or his delegate, in this case, the Commissioner of Internal Revenue, is given an absolute and nonreviewable authority to prevent application of certain reorganization sections of the law to exchanges where a foreign corporation is involved by holding that the transaction is in pursuance of a plan having as one of its principal purposes the avoidance of Federal income taxes. A similar authority has been lodged in the Commissioner since 1932, but until only recently there has been little cause for complaint with its exercise. However, within the past several years an almost intolerable situation has arisen because of the delay, uncertainty, and, in some cases, almost arbitrary refusal to rule, involved in the administration of section 367.

Except for foreign personal holding companies, during the period from 1932 to 1963, the Federal income tax law has never applied to undistributed foreign profits of foreign corporations controlled by American ownership. U.S. parent corporations could establish foreign subsidiary corporations through which to carry on business abroad, and not be subjected to U.S. tax until the profits were distributed as dividends. It was within this framework of the law that section 367 and its predecessor were effective.

However, in view of the 1962 amendments, there is no longer the same need for section 367. The Congress has laid down rules for the current taxation of U.S. shareholders of controlled foreign corporations. These provisions were finally enacted only after very extensive hearings by both the Senate Finance Committee and the House Ways and Means Committee. Furthermore, the Treasury Department submitted for congressional consideration far more extensive proposals for the current taxation of foreign profits of foreign subsidiaries than were ultimately adopted by the Congress in the Revenue Act of 1962. It is evident that to the extent that the new provisions of the Revenue Act of 1962 did not tax foreign profits of foreign subsidiaries it was the result of a deliberate policy decision of the Congress.

For 1963 and future years, U.S. shareholders will be subjected to tax on the undistributed profits of controlled foreign corporations to the extent they are derived from foreign personal holding company income, foreign base company sales income, foreign base company services income, and any earnings and profits invested in U.S. property. Except for the foregoing, earnings of foreign subsidiaries are not subject to current taxation. This was the result of a deliberate policy decision of the Congress. In addition, sales and exchanges of stock of, and liquidations of, foreign corporations have been specifically examined and any gain realized in such transactions is treated as ordinary income to the extent of earnings derived after 1962.

In view of the complete revamping of the Federal tax provisions applicable to foreign profits earned by foreign subsidiary corporations, we believe that for the future there is no further need for section 367 with respect to formation and organization of foreign subsidiary corporations. Furthermore, with respect to other transactions presently subject to Internal Revenue Code, section 367, the Manufacturing Chemists' Association, Inc., recommends that the Commissioner's determination of whether or not they involve tax avoidance be subject to court review.

2. COORDINATION OF FOREIGN TAX CREDIT WITH TAXATION OF CONTROLLED FOREIGN CORPORATIONS

The Federal income tax law since 1918 has permitted a credit against U.S. tax for foreign income taxes paid in order to remove burdensome international double taxation of foreign profits derived by U.S. taxpayers. In a nutshell, the portion of the U.S. income tax attributable to foreign income may be offset by foreign income taxes imposed on the same income. In addition, ever since the early 1920's a foreign tax credit has been permitted against the U.S. tax imposed on dividends received by a domestic corporation from a foreign corporation for the amount of foreign income taxes paid by the foreign corporation in respect of the ratable portion of the earnings and profits which were distributed. The credit is allowed a domestic corporation under Internal Revenue Code, section 902(a) only where the domestic corporation receiving the dividend owns at least 10 percent of the voting stock of the foreign corporation. A foreign tax credit is also allowed under Internal Revenue Code section 902(b) for foreign income taxes paid with respect to earnings ultimately received by the domestic corporation from a foreign corporation, 50 percent of whose voting stock is owned by the 10-percent-owned foreign corporation. Thus, the foreign taxes paid by the 50-percent-owned subsidiary passes through its foreign parent corporation to the domestic corporation. In other words, foreign income taxes paid by a 50-percent-owned foreign subsidiary of a 10-percent-owned foreign subsidiary follow the dividend on up to the domestic corporation.

We believe that the 50-percent test is too high and that it should be liberalized.

Under subpart F of part III of subchapter N of the 1954 code, added by the 1962 act, every U.S. shareholder who owns directly or indirectly 10 percent or more of the combined voting power of all classes of stock of a controlled foreign corporation is subjected to tax on his pro rata share of the undistributed subpart F income or his pro rata share of the increase in investment in U.S. property of such corporation. Accordingly, not only is a U.S. shareholder subjected to tax under subpart F where there is a 10 percent or more direct stock ownership of a controlled foreign corporation but also where there is a 10 percent or more indirect stock ownership through one or more foreign corporations. Thus, a domestic corporation owning directly or indirectly stock in a controlled foreign corporation is taxed on the income of such foreign corporation whether or not the foreign corporation is one or more links removed in a chain of ownership.

Despite the requirement that a domestic corporation be taxed currently on certain undistributed profits of indirectly owned controlled foreign corporations down the chain of ownership, there is no allowance for a foreign tax credit for foreign income taxes paid on those profits except in situations where a credit would be allowed had those profits been distributed. In other words, the foreign tax credit provisions under subpart F have been made to cover only situations presently covered by IRC section 902 in the case of actual distributions.

The Manufacturing Chemists' Association, Inc., recommends, therefore, that the foreign tax credit should be completely coordinated with the application of the U.S. tax on undistributed profits of controlled foreign corporations.

The principal objection to the liberalization of stock ownership requirements in situations involving foreign income tax credits has been based upon administrative difficulties. When the stock ownership percentages were reduced in 1951 from a majority ownership requirement for the first foreign subsidiary and from a 100-percent ownership requirement for the second foreign subsidiary, the main reason the percentages were not reduced lower was that the administrative burden of checking the relevant facts necessary to prove the proper credit was considered too difficult and burdensome for the Internal Revenue Service where the stock ownership tests were significantly small. However, in view of the recent extensive expansion of the information procurable by the Internal Revenue Service there can be no further valid basis for objection on this ground. The Internal Revenue Service receives or will receive detailed information relating to the activities and financial conditions of foreign corporations. In IRC section 6046 an information return is required from each U.S. person who owns 5 percent or more in value of stock of a foreign corporation. Moreover, since under subpart F of subchapter N of the code a U.S. shareholder owning directly or indirectly 10 percent or more of the stock of controlled foreign corporations in a chain is taxed on the ratable portion of their subpart F income, there should be no objection from an administrative viewpoint for providing a foreign tax credit.

There can be no question as to the soundness of the foreign tax credit. The elimination of the foreign tax credit would result in many situations where the income tax burden would be of a penal nature and would ultimately result in the loss of U.S. private investment abroad. The foreign tax credit traditionally has been a sound mechanism for the elimination of this burdensome double taxation. Theoretically, there is no reason for any limitation on the amount of stock which should be owned by the domestic corporation or one of its foreign subsidiary corporations before credit is allowed for the foreign income taxes paid with respect to distributed earnings.

For the foregoing reasons, the Manufacturing Chemists' Association, Inc., strongly urges—

(a) The reduction of the 50-percent test in IRC section 902(b) to 10 percent; and

(b) The allowance of a foreign tax credit for foreign income taxes imposed on undistributed profits taxed to domestic corporations under subpart F.

3. FOREIGN TAX CREDITS WITH RESPECT TO MINIMUM DISTRIBUTIONS

Under subpart F of part III of subchapter N, certain U.S. shareholders are taxed currently on the undistributed foreign base company income of their controlled foreign corporations. One of the reasons among others why the present administration urged this new and unprecedented type of taxation was that it felt that U.S. corporations were establishing foreign subsidiaries so as to pile up large foreign profits abroad without paying income taxes on those profits to the United States or any foreign country. The Treasury Department repeatedly pointed out that "pocketbook" and "nameplate" companies were being established in "tax haven" countries so as to completely escape income taxation.

During the consideration of these proposed tax measures by the Senate Finance Committee, Senator Kerr sponsored a relief provision which ultimately was adopted and which eliminates from the application of subpart F controlled foreign corporations which distribute a certain percentage of their earnings and profits during the taxable year. This percentage which is required to be distributed is related to the effective foreign income tax rate applicable to the earnings and profits of the particular controlled foreign corporations. The higher the effective foreign rate the smaller is the required minimum distribution. Under the schedule provided in IRC section 963(b), the interrelationship between the minimum distributions required and the effective foreign tax rate will result in the sum of foreign and U.S. income taxes equaling approximately 47 percent of the earnings.

This relief provision, at the election of the U.S. corporation, can be applied to each controlled foreign corporation separately, to a chain of controlled foreign corporations as a group, to all controlled foreign corporations of the U.S. corporation as a group, and to all controlled foreign corporations other than less-developed country corporations as a group. Regardless of the election made by the parent U.S. corporation as to the group or groups which it will combine for the purposes of Internal Revenue Code, section 963, the general principle is that if a minimum distribution is made with respect to the group involved, none of the controlled foreign corporations in the group will be subject to subpart F.

During the consideration of this Kerr proposal prior to the reporting out of H.R. 10650 by the Senate Finance Committee, it was generally understood that if distributions were made by any member or all members of an electing group of controlled foreign corporations and such distributions met the required percentage of the combined earnings and profits during the year, those controlled foreign corporations would not fall within the provisions of subpart F. It was also generally believed that the distributions made by the foreign corporations would qualify for foreign tax credit purposes under the general foreign tax credit rules. However, both the Senate Finance Committee report and a statement made by Senator Kerr on September 5, 1962, on the floor of the Senate indicate that a portion of the foreign tax credit otherwise allowed with respect to the distributions will be disallowed in part and will be "reallocated" in cases where the total U.S. income tax and foreign income tax paid on the earnings of the controlled foreign corporations would be less than a 47-percent effective rate.

Senator Carlson proposed an amendment to H.R. 10650 to prevent this reduction of the foreign tax credit in such cases, but it was not adopted. Furthermore, Senator Carlson also proposed a companion amendment which would have allowed as deductions in determining earnings and profits all payments made on, or all amounts set aside to pay off, bona fide business indebtedness. By per-

mitting these offsets against earnings and profits, this last amendment would have reduced the amount of the minimum distribution required to be distributed under section 963, and would have given some relief to companies with outstanding commitments.

One of the reasons these two amendments were not adopted was that Senator Kerr stated on the floor of the Senate that his illustrations would take care of Senator Carlson's objectives. However, a careful reading of Senator Carlson's amendments show that this is not the case because his amendments would have (1) prohibited any reallocation and reduction in the amount of any foreign tax credit, and (2) reduce the required distribution where there exists bona fide business indebtedness.

We believe that the basic reason for Internal Revenue Code, section 963, is that the Congress believed that U.S. corporations should not be subjected to subpart F where distributions from the entire group operating abroad are of such relative magnitudes that it is apparent that the purpose of the group is not to pile up profits abroad tax free. Under this approach a minimum distribution test is a sufficient basis for exemption from subpart F without combining it with the elimination of a part of the foreign tax credit. Furthermore, it is manifestly unfair to tax earnings which cannot be distributed and which must be retained to pay off business-incurred commitments.

Accordingly, the Manufacturing Chemists' Association, Inc., recommends that legislation be adopted to the effect—

(1) That if the minimum distribution requirements are met, subpart F will not apply and the foreign tax credit will never be reduced; and

(2) That the earnings and profits of a controlled foreign corporation for this purpose should be reduced by outstanding bona fide business indebtedness.

4. APPLICATION OF FOREIGN TAX CREDIT TO ADDITIONAL TAXES

The foreign tax credit has been the basic mechanism adopted by the United States for the elimination of double taxation. Until 1942 this credit was allowed only for foreign income taxes. However, in 1942 legislation was enacted which permitted credit for taxes paid "in lieu of" foreign income taxes otherwise generally imposed. The Senate Finance Committee in its report on the 1942 legislation indicated that it was extending the credit to taxes imposed "in lieu of" income taxes by foreign countries because in many situations foreign countries impose taxes on the simplest basis possible in order to avoid the administrative difficulties in enforcing a complicated net income tax. The Treasury Department issued regulations which have required as conditions to the allowance of a tax credit based on a tax paid "in lieu of" an income tax the following:

(1) That the foreign country in question have in force a general income tax law.

(2) That the taxpayer claiming the credit would, in the absence of a specific provision applicable to the taxpayer, be subject to such general income tax, and

(3) That such general income tax is not imposed upon the taxpayer thus subject to the substituted tax.

These conditions have been extensively criticized as being not within the intent of the Congress at the time the provision was enacted as evidenced by the Senate Finance Committee report. Senator George, during the period 1950 to 1954, repeatedly requested the Treasury Department to liberalize its interpretation, but to no avail.

During the consideration of tax revision by the Treasury Department in 1953 and 1954, further consideration was given to the inclusion of additional foreign taxes for foreign tax credit purposes. As the result of these studies, the Treasury Department recommended in 1954 that the foreign tax credit be expanded to include the principal business tax imposed by a national government. In general, under this proposal any type of national business tax could qualify for foreign tax credit purposes. If the foreign country involved also imposed a national income tax, either one of the two could be taken as a foreign tax credit by the taxpayer, but not both. A principal tax was generally defined as a nonincome tax attributable to the operation of a trade or business and constituting the principal source of revenue paid by the taxpayer to the national government. However, social security, sales, turnover, property, or excise tax generally imposed by the government would not qualify. Accordingly, under the proposal in 1954 a taxpayer could choose to credit either the national

income tax of a foreign country or a principal tax applicable to his trade or business.

The objective of the proposal in 1954 to expand the types of creditable taxes was a step in the right direction, but it did not go far enough. Many countries rely heavily on nonincome taxes because they serve better their policy objectives. Some of these taxes are very heavy and burdensome on U.S. business abroad. furthermore, many foreign countries do not rely upon the income tax for their revenue needs to the same extent as the United States does. The payment of these nonincome taxes without a credit against the U.S. tax results in a very burdensome double taxation.

For the foregoing reasons the Manufacturing Chemists' Association, Inc., recommends that the present foreign tax credit provisions be expanded to include, in addition to income taxes, other taxes which are relied upon by foreign governments, as major sources of revenue but which do not qualify under present law.

5. ALLOWANCE OF FOREIGN TAX CREDIT FOR TAXES SPARED

The foreign tax credit allows a dollar-for-dollar offset of foreign income taxes against the U.S. tax imposed on foreign income. Accordingly, any reduction in the foreign income tax inures to the benefit of the U.S. Treasury.

For many years U.S. taxpayers and foreign governments have seriously criticized this aspect of the foreign tax credit because any tax reduction granted by a foreign country for the purpose of encouraging U.S. private investment is nullified. In the winter of 1954–55, Secretary Humphrey announced that the Treasury would look with favor on a treaty arrangement whereby the tax concession of a foreign government would not be nullified.

Quite a few underdeveloped countries badly in need of capital investment have adopted tax provisions designed to encourage foreign private investment through tax reduction. These provisions generally have no effect insofar as U.S. enterprises are concerned because no credit is given under U.S. law for the amount of taxes spared. Thus, the U.S. tax policy has had the indirect effect of neutralizing the incentive measures of less developed countries. In recognition of this adverse effect of our foreign tax credit upon the economic objectives of a less developed country, the Treasury Department in the past few years has negotiated income tax treaties which would have granted credit for foreign income taxes waived. The first treaty which contained such a tax-sparing provision was negotiated with Pakistan in 1957. In transmitting this treaty to the President for his approval, the Secretary of State pointed out that a credit was being allowed for taxes which were waived by Pakistan in order that the United States would avoid nullifying its efforts to encourage industrial development through its tax law. However, the Senate at the time it approved this treaty made a reservation as to the tax-sparing provision because, in the meantime, the tax concessions had become inoperative. Although the principle of tax sparing has been included in treaties with India, Israel, and United Arab Republic, none has been approved.

We believe that the principle of tax sparing is a sound one both from the point of view of the U.S. Government and from the point of view of fulfilling, and not nullifying, the purposes and objectives of the foreign countries adopting such measures. Through a credit for taxes spared, additional private investment may be induced to go abroad into underdeveloped countries and contribute to their economic advancement and development of their natural resources. Accordingly, the Manufacturing Chemists' Association, Inc., recommends that legislation be adopted to accomplish this objective.

6. CARRYOVER OF FOREIGN TAX CREDIT IN REORGANIZATIONS AND LIQUIDATIONS

Under the Revenue Act of 1954, major tax benefits, privileges, elective rights, and obligations of one corporation were permitted to be carried over to successor corporations in certain reorganizations and liquidations which were tax free. This was accomplished by section 381 of the Internal Revenue Code which provides that a corporation which acquires the assets of another corporation in certain liquidations and reorganizations shall succeed to, and take into account, various tax attributes of the distributor or transferor corporation, subject to certain conditions and limitations. These tax attributes include such items as loss carryovers, unamortized bond discount, installment sales reporting, LIFO inventory method, and earnings and profits. Since 1954, section 381 has been amended to include unused pension trust deductions, pre-1954

adjustments resulting from change in method of accounting, and certain items relating to successor life insurance companies.

Noticeably missing as one of the tax attributes available for carryover is the foreign tax credit carryover provided for in Internal Revenue Code section 904(d). The foreign tax credit is a dollar-for-dollar offset against the U.S. tax and when it is available for carryover purposes is of much greater value than the net operating loss which is merely a deduction. The loss of a foreign tax credit carryover can be very serious because of this reason.

The Manufacturing Chemists' Association, Inc., believes that in order to eliminate any possible doubt as to the carryover of the foreign tax credit in reorganizations and liquidations, Internal Revenue Code section 381(c) should be expanded to include, as a carryover item to an acquiring corporation, the foreign tax credit carryover of the prior corporation.

7. MINIMUM DISTRIBUTION PROVISIONS SHOULD INCLUDE FOREIGN BRANCHES OF DOMESTIC SUBSIDIARIES REGARDLESS OF WHETHER CONSOLIDATED RETURNS ARE FILED

Under subpart F of part III of subchapter N certain U.S. shareholders are taxed currently on the undistributed foreign base company income of their controlled foreign corporations. One of the reasons among others why the present administration urged this new and unprecedented type of taxation was that it felt that U.S. corporations were establishing foreign subsidiaries so as to pile up large foreign profits abroad without paying income taxes on those profits to the United States or any foreign country. The Treasury Department repeatedly pointed out that "pocketbook" and "nameplate" companies were being established in "tax haven" countries so as to completely escape income taxation.

During the consideration of these proposed tax measures by the Senate Finance Committee, Senator Kerr sponsored a relief provision which ultimately was adopted and which eliminates from the application of subpart F controlled foreign corporations which distribute a certain percentage of their earnings and profits during the taxable year. This percentage which is required to be distributed is related to the effective foreign income tax rate applicable to the earnings and profits of the particular controlled foreign corporations. The higher the effective foreign rate the smaller required minimum distribution. Under the schedule provided in Internal Revenue Code section 963(b), the interrelationship between the minimum distributions required and the effective foreign tax rate will result in the sum of foreign and U.S. income taxes equaling approximately 47 percent of the earnings.

This relief provision, at the election of the U.S. corporation, can be applied to each controlled foreign corporation separately, to a chain of controlled foreign corporations as a group, to all controlled foreign corporations of the U.S. corporation as a group, and to all controlled foreign corporation other than less developed country corporations as a group. In addition, Internal Revenue Code section 963(c)(4)(B) permits the domestic parent, in effect, to elect to include as controlled foreign corporations its own foreign branches; and, if consolidated returns are filed, the foreign branches of any of its affiliated domestic subsidiary corporations can under Internal Revenue Code section 963(e)(3) also be treated as foreign corporations. For purposes of the minimum distribution requirements, the earnings of a branch will be treated as having been fully distributed to the U.S. shareholder.

As passed by the Senate, the election to include foreign branches as controlled foreign corporations applied also to foreign branches of the parent corporation's domestic subsidiary corporations if they were eligible to file consolidated returns, although consolidated returns were not filed. The affiliated group could have elected to be treated as single taxpayer for purposes of applying Internal Revenue Code section 963. However, in the joint conference between the House and the Senate the present requirement was added that the affiliated group must actually make a consolidated return for the year of the election. Accordingly under present law an affiliated group of corporations which chooses not to file a consolidated return is treated less favorably than one which does.

There is no sound basis for this change requiring the filing of a consolidated return. The U.S. tax burden is not necessarily less on the group if consolidated returns are not filed. And there appears to be no compelling administrative reason for this requirement.

The Manufacturing Chemists' Association, Inc., recommends that the privilege of treating foreign branches of affiliated corporations as controlled foreign corporations be allowed regardless of whether consolidated returns are filed.

B. Full Taxation of Co-ops

The Manufacturing Chemists' Association, Inc., is convinced that in order to perpetuate the free enterprise system commercial endeavors which compete must be subject to the same governmental and tax burdens.

The failure of existing tax concepts to keep up with developments in industry and commerce as they bear on the activity of cooperatives and the resulting gaps in our income tax system is a matter of great concern. It results in an inequitable and unfair situation where certain cooperative corporations, whose earnings go largely untaxed, compete for sales and customers with increasing effectiveness and in an ever-increasing number of fields against other corporations which pay a 52-percent tax on their earnings.

The provisions of the Revenue Act of 1962 recently enacted to deal with the co-op problem fall far short of the ultimate goal of adequately and fairly dealing with it. The purpose of that legislation was directed toward taxing co-op income either to the co-op or its patrons. While we believe that these 1962 provisions constitute a step in the right direction, they are small steps toward the goal and merely eliminate the loophole which had been existing in the law as a result of judicial interpretation of the 1951 legislation.

Where cooperatives move into an industrial or commercial area in direct competition with taxpaying entities, the tax-free status of the cooperative is an imposing and unfair advantage. This is particularly true because the 52-percent tax rate is such a substantial charge on doing business.

The objective of our tax laws should be to strive for equality and uniformity in their application. The fact that a co-op's structure differs from that of a business corporation does not mean that the cooperative should have an unfair advantage. It merely means that a different set of rules should be applied to achieve an equitable allocation of the tax burden.

It is, therefore, the recommendation of the Manufacturing Chemists' Association, Inc., that natural and logical extension of present Internal Revenue Code provisions, taxing investment income to co-ops, would be to include income from the use of capital in manufacturing, processing, or mining activities. Such earnings should be designated as from "unrelated business activity" and should be taxed to the co-op, just as unrelated income from rentals, interest, etc., are now taxable to it even though distributed to patrons.

Precedent for such an approach lies in the 1950 amendment to the Internal Revenue Code which taxes currently and at corporate rates the earnings of charitable or nonprofit organizations received from unrelated business activities. It is in just such "unrelated business" areas where the cooperatives effort ceases to be mere cooperative purchasing and selling and becomes a competing business endeavor with reinvestment of earnings and with capital expansion. It is also in the manufacturing, processing, and mining areas that the competitive advantages of tax-free operation at the cooperative level is most marked.

The enactment of this recommendation would be equitable to all concerned. Cooperatives could continue to enjoy their tax-free status to the extent they derive their income directly from transactions with their patrons or from activities immediately incidental thereto. On the other hand, if a cooperative were to engage in manufacturing, processing, or mining activities in direct competition with taxpaying organizations, the co-op also would be placed on a taxpaying basis. Thus, the cooperative would not enjoy an unfair advantage over its competitors and the tax burden would be more equitably borne.

C. Acquisition of Industrial Processes

Liberalization is needed in regard to the tax treatment of acquisitions of industrial processes. The indefiniteness of the present law has caused some revenue agents to interpret the law in a manner detrimental to the taxpayer and in a manner which is uneconomical and inefficient from the viewpoint of the Nation's economic well-being.

A taxpayer presently may deduct his own research and experimental expenses currently. He may also deduct "expenditures paid or incurred for research or experimentation carried on in his behalf by another person or organization. * * *" (Reg. 1.174-2(a)(2)). However, he may not deduct as research expense the cost of acquiring another's process (Reg. 1.174-2(a)(1)). In the latter case,

where the process is not covered by a patent, some revenue agents have categorized the acquisition as an intangible asset, the life of which is indeterminable, and have proposed to disallow either a deduction for the cost or any amortization thereof.

Such interpretation and application is inequitable, inefficient, and contrary to the administration's policy to modernize the country's industrial plant. For example, the President in his "Special Message on Tax Reduction and Reform," dated January 24, 1963, recommends that current deductions be allowed for expenditures for machinery and equipment used directly in research and development activities. These costs presently have to be capitalized and written off over the useful life of the machinery and equipment.

Very often there is only a small difference in degree separating research carried on in the taxpayer's behalf and the acquisition of a process. Often what some may consider a "process" is merely an adjunct of a large research project in which the taxpayer is engaged. Most important is the fact that the acquisition of industrial property, regardless of whether it consists of research carried on in behalf of the taxpayer, or a process, or any combination thereof, is a highly efficient and economical way of doing business from a national welfare viewpoint. Rather than continue researching a problem on his own, a taxpayer will often find it advantageous to purchase another's knowledge or process and then proceed to incorporate that knowledge or process into his own research project. However, if the interpretation and application proposed by some revenue agents becomes a recognized and approved policy of the IRS (i.e., permitting no writeoff whatsoever), taxpayers may actually be persuaded to engage in their own research and not avail themselves of another's knowledge. This discourages the pooling of knowledge and is, therefore, inefficient and detrimental to the Nation at a time when all personnel engaged in research should be utilized to the maximum advantage. On the other hand, by permitting these costs to be deducted, an artificial barrier to interchange of industrial knowledge will be removed resulting in a reduction of time-consuming duplication of effort.

1. Where the acquisition of another's industrial processes can be shown to be an adjunct to the taxpayer's own research program, such acquisition costs should be considered research and experimental expenditures deductible currently under Internal Revenue Code, section 174.

2. Where the acquisition of industrial processes is unrelated to the taxpayer's research program, the taxpayer should be permitted to amortize the cost over some reasonable period in view of the fact that in an age when rapid changes are being made, it is unreasonable to treat such acquisitions as having indefinite value. A reasonable life might be one similar to that used for the plant where the process is to be used, or the guideline life applicable to the taxpayer's assets or some other reasonable measurement such as a 5-year period now applicable under section 174(b) for expenditures of the taxpayer not treated as current deductions.

D. Amortization of Trademark and Trade Name Expenditures

Section 177 of the 1954 Internal Revenue Code gives taxpayers an election to amortize over a period of not less than 60 months any trademark or trade name expenditure paid or incurred during a taxable year after December 31, 1955. However, in defining trademark and trade name expenditures, an expenditure which constitutes the consideration paid for a trademark, trade name or business does not qualify for the writeoff. Thus a taxpayer may deduct, over a 5-year or longer period, expenditures in acquiring and developing his own trademark or trade name but may not amortize the cost of acquiring another's trademark or trade name.

If the trademark or trade name had been developed by the taxpayer himself, such taxpayer would be allowed also to deduct currently the advertising and sales promotion expenses which make the mark and name valuable. The purchase of another mark or name represents in reality a purchase of another's advertising expenditures which if expended by the buyer to develop his own mark or name would be fully deductible.

A mark or name has value in proportion to the continued advertising employed in keeping the image of the mark or name before the public. The value of the mark or name is also influenced by the technological obsolescence of the underlying products as new and improved products are introduced. Consequently, the value of an acquired mark or name frequently suffers from a gradual loss in value, but not a 100-percent loss. However, no deduction is allowed whatever

for loss of value or obsolescence until there is a completed transaction; i.e., a formal sale, abandonment, or other disposition of the mark or name. Serious questions have also arisen as to the act and timing of abandonments of marks or names.

The acquisition of a mark or name, whether developed internally or acquired from another, is often an efficient and economical method of developing a taxpayer's trade position. Rather than spend years of advertising effort (the cost of which is fully deductible) to develop his own mark or name, the taxpayer may find that the assimilation of another mark or name into his marketing structure will enable him to accelerate his growth in a particular field with the result that more overall business may be generated. However, the inability to amortize the purchased mark or name even in the face of a subsequent decline in value presents a serious deterrent to the would-be purchaser. Provision for amortization of purchased marks and names thus provides added marketing flexibility to taxpayers, leading to industrial growth.

To place taxpayers with purchased marks and names on a par with taxpayers who have developed their own marks and names, to avoid the inequity resulting from the inability to deduct partial losses in value of purchased marks and names, and to provide marketing flexibility to taxpayers leading to continued business growth, the Manufacturing Chemists' Association, Inc., recommends that amortization over a period of 60 months or more of all trademarks and trade name expenditures be permitted, whether or not such expenditures represent payment for existing trademarks or trade names.

E. Scholarships and Fellowships

Section 117 of the 1954 Internal Revenue Code provides tax-free scholarship and fellowship grants. The statute recognizes that there may be an employer-employee relationship between the grantor of the scholarship or fellowship and the recipient, provided that only in the case of individuals who are candidates for degrees, tax-free treatment of the grant shall not apply to that portion of any amount received which represents payment for teaching, research, or other services in the nature of part-time employment.

MCA believes that it was the intent of Congress to provide a gross income exclusion, if the conditions of section 117 are fulfilled, whether or not the recipient of the grant was an employee of the grantor. Some instances have come to the attention of MCA which indicate that the law is being administered to deny this exclusion in all cases where there is a relationship of employer-employee. This is so even though all other conditions of the law are met.

An example of such an instance involves the case of a company which is a member of this association. It has a tuition aid program, the object of which is to assist those of its employees who have sufficient interest in furthering their education, to take courses of study on their own account and at their own expense by granting such employees one-half the tuition cost. It is required under the plan that any employee who wishes to take advantage of it make aplication for the assistance at least one week before the beginning of the course which the applicant desires to take. The range of choice open to the prospective students is quite broad but the company does not permit grants for courses which commonly might be thought of as frivilous, for example, ballroom dancing. Upon satisfactory completion of the course, payment of the grant is made in the amount of one-half the cost of tuition. The grants are entirely voluntary and are open to all employees, new or old. The employees must take their course on their own time, outside of regular working hours, and they are not committed to render any special or additional services to the company or to remain with the company.

Section 117(b)(1) provides, in the case of an individual who is a candidate for a degree at an educational institution, the exclusion shall not apply to that portion of any amount received which represents payment for teaching, research, or other services in the nature of part-time employment required as a condition to receiving the scholarship or fellowship grant. Section 1.117-4(c) states with respect to that limitation that amounts paid, or allowed to, an individual to enable him to pursue studies or research are considered to be amounts received as a scholarship or fellowship grant if the primary purpose of the studies or research is to further the education or training of the recipient in his individual capacity and the amount provided by the grantor for such purposes does not represent compensation or payment for services. This section of the Treasury regulations also states that neither the fact that the recipient is required to furnish reports of his progress to the grantor nor that the fact that

the results of his studies or research may be of some incidental benefit to the grantor shall, of necessity, be considered to destroy the essential character of such amount as a fellowship or scholarhip grant.

In every case the question naturally arises as to whether the payment is compensation for services rendered or to be rendered. But it is clear from both the law and the regulations that the mere existence of the employer-employee relationship does not, without more, preclude scholarship treatment. MCA believes that in respect to tuition aid programs, which are given by an employer to employees regardless of past service, regardless of whether the recipient will remain in the company, and regardless of the subjects which can be pursued, the law should be clarified so as to make certain that these grants are not considered additional compensation but that they fall within section 117 of the code. This action on the part of the Congress will contribute greatly toward preventing internal revenue agents questioning every such fellowship or scholarship grant where there is an employer-employee relationship. In addition, a deterrent which might prevent other employers adopting such plans will have been removed, and the intent of section 117 will be restored. These types of programs can contribute vitally toward the national objective of broader education for our citizens.

F. ANNUAL REPORTING OF WAGES FOR SOCIAL SECURITY PURPOSES

Under present law and Treasury regulations, every employer is required to make a return under the Federal Insurance Contribution Act on form 941 for each calendar quarter. The wages subject to social security are required to be reported in the return for the return period involved. Information with respect to each employee to whom the employer paid wages subject to such taxes must include his account number, name, total amount of wages paid during the calendar quarter, and such other information as may be called for on the form.

In 1955 the Hoover Commission recommended (a report to the Congress by the Commission on Organization of the Executive Branch of the Government, January 1955; Paper Work Management, pt. II) that employer quarterly reporting of OASI wage records be eliminated. It proposed that the Federal Withholding Tax Form W-2 be revised in such a manner that it could be utilized both by the Internal Revenue Service and by the Department of Health, Education, and Welfare for OASI tax and wage purposes. The Commission estimated that about 200 million wage entry tabulations would be eliminated at a saving in administrative costs running into the millions of dollars.

Subsequent to the Hoover Commission recommendation, implementing legislation was at various times introduced in the Congress but was never enacted into law.

We believe that annual reporting would be a great economic benefit both to the Government and to the employers who must keep these records. Accordingly, the Manufacturing Chemists' Association, Inc., recommends that legislation be adopted to permit the computation of social security benefits upon an annual basis in order that the Treasury may by regulation permit employers to file an annual report rather than quarterly reports.

The CHAIRMAN. Thank you very much.

Any questions, Senator Gore?

Senator GORE. I have no questions, Mr. Chairman.

The CHAIRMAN. Senator Carlson.

Senator CARLSON. Mr. Horne, I appreciate very much the excellent statement you made in regard to some suggested changes in this tax bill that we are considering. I have two or three questions that I think we might discuss briefly.

One of them deals with group term life insurance premiums. You said that your association is opposed to the provisions of the House bill which would tax an employee on group term life insurance premiums.

Now, Secretary Dillon has told us that the executives may receive free from any tax on the premiums from life insurance coverage of amounts of nearly $1 million.

Do you disagree with the Secretary's statement that the term insurance coverage provides high income executives with substantial tax-free compensation?

Mr. HORNE. Yes, Senator; I think we do take exception to that, and for these reasons.

In the first place, the House bill would tax the employee in those cases in which the employer paid no part of the premium, so you could have a case in which the employer makes no contribution to the group insurance program. However, the employee, because of his age and because of his salary, is deemed to have taxable compensation. This is the theory of imputed income. We do not see how there is any element of compensation in this case.

Then, going on down to those casese in which the employer may pay all or part of the premium cost, we again think that there are considerations which your committee may want to take into account. There is no permanent benefit, as you know, under this insurance, and I think this is probably the reason why the premiums were excluded in the first instance under a rule which the Treasury has adopted going way back to the early twenties.

The executive who has such a high insurance coverage has to die in order to acheive the benefits of the group insurance. Once he retires from the employment of the company, under most of the plans, he has no continuing protection, no asset, no valuable asset.

Furthermore, the insurance proceeds, if the employee should die while in the employ of the company, would be taxable in the employee's estate.

Finally, I think it is a little misleading to refer to these high dollar amounts because the measurement of taxable compensation, if there is any, is measured by the premium cost and has no relationship to the high dollar amounts. In other words, the element of compensation, if there is any, is the premium which the employer pays on behalf of the employee. So I think if there is to be any element of compensation it seems to us that the premium should be based—the premium cost, which is an element of compensation should be based—upon the average premium cost to the employer that he is paying for all employees and not to tax discriminatorily the older employees and allow the deduction of the younger employees.

What you are trying to tax if you do that, it seems to us, is the group concept.

Senator CARLSON. Mr. Horne, we have had previous witnesses testify on this, on the group term life insurance provision of the bill, and we have heard some suggestions from these witnesses that we should consider alternatives to the House bill, either a provision which would eliminate the amount of the group term insurance to some multiple of salary, say, two or three times the salary, or we should consider a single average premium cost method which, I understand, has been adopted by the Canadians.

Do you want to comment on some of these alternatives?

Mr. HORNE. Well, our recommendations, Senator, of course, are that you delete the provision in its entirety. We think, as we said in our statement, it is a tax disincentive, and there is very little revenue involved.

But if your committee thinks that some measure is necessary we hope you will consider these alternatives.

The alternative that you mentioned about a multiple salary is one that is present in a number of plans today. In other words, most major corporate employers who have such group insurance provide that the coverage will be based on a multiple of the employee's salary, so if there is no discrimination each employee gets the coverage based upon two, three times his salary, whatever the multiple may be. All employees are getting the same benefit, if you want to look at it on that basis. We suggest that that would be a possible alternative provided you would have a nondiscriminatory plan extending to all employees, and based upon some salary multiple.

I think you referred also, Senator, to the so-called Canadian method. We have looked into this method. It has been of some interest. I have here the computation under the Canadian method. It is a fairly simple way of calculating the insurance coverage. I can submit this for the record if you would like.

Senator CARLSON. If there is no objection, Mr. Chairman, let us make it a part of the record.

The CHAIRMAN. Without objection.

(The document referred to follows:)

DEPARTMENT OF NATIONAL REVENUE—TAXATION DIVISION

INFORMATION WITH RESPECT TO THE TAXABLE PORTION OF GROUP LIFE INSURANCE PREMIUMS

Section 6(1)(db) of the Income Tax Act provides that where an officer or employee is insured for a total amount in excess of $25,000 under one or more group life insurance policies, a portion of the premiums paid by his employer or former employer in respect of such group life insurance policies will be included in the income of the officer or employee.

The employer will report the taxable portion of such premiums as a "taxable benefit" on form "T4—Supplementary Statement of Remuneration Paid."

The portion of the premiums that is to be reported on form T4 supplementary and included in the income of the officer or employee is that portion of the premium paid by the employer that is in respect of the employee's coverage in excess of $25,000. The method of calculating that portion is stated in section 6(1)(db) of the Income Tax Act, and examples are set out below.

BASIS OF EXAMPLES

In each of the following examples the assumed group life insurance policy has particulars as follows:

Mean total amount of life insurance in effect under the policy in the policy year ending in the taxation year	$1,000,000
Total premium for policy year	8,000
Less experience rating refund	1,000
Net premium cost for policy year	7,000
Average cost per $1,000 of insurance:	
$\$7,000 \times \frac{\$1,000}{\$1,000,000} =$	7

EXAMPLE I

In an uncomplicated case where the employee's coverage under the assumed policy was $100,000 throughout his taxation year and the employee paid $300 of the premium, the calculation would be as follows:

Annual premium on employee's coverage of $100,000 at $7 per $1,000	$700
Less premium paid by employee	300
Balance—Premium paid by employer	400
Employee's coverage	100,000
Exemption	25,000
Excess over exemption	75,000
Portion of premium paid by employer that is to be reported as a taxable benefit on form T4 supplementary:	
$\$400 \times \frac{\$75,000}{\$100,000} =$	300

EXAMPLE II

If the case in example I was complicated by the fact that the employee's coverage under the policy did not commence until the 1st of February of his taxation year, the annual premium would be prorated in accordance with the number of days that he was covered and, assuming that during that period the employee pid $275 of the premium, the calculation would be as follows:

Annual premium on employee's coverage of $100,000 at $7 per $1,000	$700.00
Premium applicable to period covered in taxation year:	
$\$700 \times \frac{334}{365} =$	640.55
Less premium paid by employee	275.00
Balance—Premium paid by employer	365.55
Employee's coverage	100,000.00
Exemption	25,000.00
Excess over exemption	75,000.00
Portion of premium paid by employer that is to be reported as a taxable benefit on form T4 supplementary:	
$\$365.55 \times \frac{\$75,000}{\$100,000} =$	274.16

EXAMPLE III

To illustrate a more complicated situation where the amount of the employee's coverage under the same group policy varied throughout his taxation year, assume the following:

The employee was covered during the taxation year as follows: For 90 days at $20,000, for 180 days at $50,000, for 95 days at $75,000—

and during the taxation year the employee paid premiums of the following amounts in respect of his insurance: For a period of $20,000 coverage, $20; for period of $50,000 coverage, $100; for period of $75,000 coverage, $75.

No calculation is required in respect of the period during which his coverage was less than $25,000 and a separate calculation must be made for each of the other two periods. The amount to be reported on form T4 supplementary is the sum of those two calculations which are as follows:

A

Annual premium on employee's coverage of $50,000 at $7 per $1,000	$350.00
Premium applicable to period covered for this amount:	
$\$350.00 \times \frac{180}{365} =$	172.60
Less: Premium paid by employee	100.00
Balance—Premium paid by employer	72.60
Employee's coverage	50,000.00
Exemption	25,000.00
Excess over exemption	25,000.00
Portion of premium paid by employer that is to be included in income per this calculation:	
$\$72.60 \times \frac{\$25,000}{\$50,000} =$	36.30

B

Annual premium on employee's coverage of $75,000 at $7 per $1,000	$525.00
Premium applicable to period covered for this amount:	
$\$525.00 \times \frac{95}{365} =$	136.64
Less: Premium paid by employee	75.00
Balance—Premium paid by employer	61.64
Employee's coverage	75,000.00
Exemption	25,000.00
Excess over exemption	50,000.00
Portion of premium paid by employer that is to be included in income per this calculation:	
$\$61.64 \times \frac{\$50,000}{\$75,000} =$	41.09

The portion of premium paid by employer that is to be reported as a taxable benefit on form T4 supplementary is the sum of:	
Calculation under A	$36.30
Calculation under B	41.09
Total	77.39

NOTE.—The foregoing examples are based on the assumption that the employee is covered only under one group life insurance policy. Where an officer or employee is covered under more than one group life insurance policy a separate computation must be made in respect of each policy, with the $25,000 "exemption" being apportioned among the policies.

Examples

Item	(1)	(2)	(3)	
	Policy No. G-000000, period Jan. 1, 1960, to Dec. 31, 1960	Policy No. G-000000, period Mar. 1, 1960, to Dec. 31, 1960	Policy No. G-000000, period Jan. 1, 1960, to June 30, 1960	Policy No. G-000000, period July 1, 1960, to Dec. 31, 1960
1. Amount of group life insurance in force	$75,000.00	$75,000.00	$50,000.00	$40,000.00
2. Net annual average premium per $1,000	$7.00	$7.00	$7.00	$7.00
3. Annual premium for amount of insurance in item 1 (item 1 times item 2)	$525.00	$525.00	$350.00	$280.00
4. Number of days during taxation year amount in item 1 in force	365	306	181	184
5. Number of days in taxation year	365	365	365	365
6. Percentage of taxation year amount of insurance in item 1 in force (item 4 divided by item 5) percent	100	83.84	49.59	50.41
7. Premium for amount in item 1 for part of taxation year it is in force (item 3 times item 6)	$525.00	$440.16	$173.57	$141.15
8. Employee's contribution for amount of insurance in item 1 during taxation year	$450.00	$375.00	$150.00	$120.00
9. Employer's share of cost of amount in item 1 during taxation year (items 7 and 8)	$75.00	$65.16	$23.57	$21.15
10. Amount of exemption ($25,000, or pro rata portion if more than 1 policy)	$25,000.00	$35,000.00	$25,000.00	$25,000.00
11. Excess of amount of insurance in item 1 over exempt amount (item 1 minus item 11)	$50,000.00	$50,000.00	$25,000.00	$15,000.00
12. Percentage excess is of amount of insurance in item 1 (item 11 divided by item 1) percent	66.67	66.67	50	37.5
13. (a) Amount includable in employee's income (item 12 times item 9)	$50.00	$43.44	$11.79	$7.93
14. Amount to be included as income on employee's form T-4 supplemental (item 13(a))	$50.00	$43.44		$19.72

Example: 1. Employee insured for $75,000 throughout 1960. 2. Employee insured for $75,000 commencing Mar. 1, 1960, for balance of year. 3. Employee insured for $50,000 from Jan. 1, 1960, to June 30, 1960, and his insurance was reduced to $40,000 commencing July 1, 1960, for the balance of the year. The net annual average premium and employee contribution figures are assumed and are used for illustrative purposes only.

Canadian Income Tax Worksheet

Computation of taxable premium—Employee's group life insurance in excess of $25,000

Name of employee..............................	Payroll or location	Certificate number	Taxation year
Group policy or policies....................	Premium per $1,000 of insurance Policy No. .... Average premium .... Policy No. .... Average premium		

Item (see examples on reverse side)	Policy No. ...... period ...... to	Policy No. ...... period ...... to	Policy No. ...... period ...... to ......
1. Amount of group life insurance in force............			
2. Net annual average premium per $1,000............			
3. Annual premium for amount of insurance in item 1 (item 1 times item 2)..............			
4. Number of days during taxation year amount in item 1 in force..............			
5. Number of days in taxation year..............			
6. Percentage of taxation year amount of insurance in item 1 in force (item 4 divided by item 5)..............			
7. Premium for amount in item 1 for part of taxation year it is in force (item 3 times item 6)..............			
8. Employee's contribution for amount of insurance in item 1 during taxation year..............			
9. Employer's share of cost of amount in item 1 during taxation year (item 7 minus item 8)..............			
10. Amount of exemption ($25,000, or pro rata portion if more than 1 policy)..............			
11. Excess of amount of insurance in item 1 over exempt amount (item 1 minus item 11)..............			
12. Percentage excess is of amount of insurance in item 1 (item 11 divided by item 1)..............			
13. (a) Amount includable in employee's income (item 12 times item 9)..............			
(b) Item 13(a) carried over from other computation, if any, for current taxation year..............			
14. Total amount to be included as income on employee's form T-4 supplemental (item 13(a) plus item 13(b), if any)..............			

The term "group life insurance" includes insurance on the lives of retired employees as well as active employees. It includes group paid-up life insurance. It does not apply to group accidental death and dismemberment benefits or to other forms of accidental death benefits.

Where the insurance of any employee is provided under more than one policy, computation of the premium subject to tax must be made separately with respect to each policy. The $25,000 "exemption" must be prorated between the policies on the basis of the amount of insurance. (See item 10.) This proration must be made as to all policies, regardless of whether the employee contributions constitute the entire premium. If the amount of insurance changes during the taxation year, separate computations must be made with respect to each amount for the period the amount is in force. Provision for separate computations is made on this form and each should be identified at the head of the column by policy number and period covered.

The "premium per $1,000 of insurance" in the heading is the net annual average premium per $1,000 calculated by the insurance carrier for use in item 2.

Calculated by .... checked by ....

Date ....

Mr. Horne. And, at the same time, there is a statement which was made in the House of Commons of the Canadian Parliament by Secretary Fleming, the Minister of Finance, at the time the Canadians took up this proposal.

He pointed out that under the Canadian method they would tax the employee on the insurance paid by the employer, not on the basis of this group proposal of the House bill but on the coverage paid by the

employer in excess of $25,000. They would base the system of taxation upon the average premium cost to the employer. This provides a relatively simple method of determining taxability, and the employee himself can make this determination based upon the figures the employer gives him as to how much the premiums cost.

When Minister Fleming introduced this bill in the House of Commons he commented on the fact that this type of provision would not penalize older employees and jeopardize their rights, but would act equitably on the basis of group insurance coverage.

If you like, I can introduce this statement by Mr. Fleming in the House of Commons which explains why Canada adopted the provisions that they did in this fashion.

Senator CARLSON. It will be made a part of the record.

(The document referred to follows:)

Mr. FLEMING (Eglinton). No, Mr. Chairman, I am speaking about group policies. These are commonly known, I believe, as jumbo policies, and they exist in many cases where there is no general provision assuring equality of treatment or even proportionate treatment on the part of employees of the company concerned. Therefore it seemed to us that there should be some limitation placed upon the exemption now enjoyed. That is why we brought forward the proposal that premiums paid on these policies should be exempt in the case of any person up to $25,000 of life insurance, but as to the excess of the insurance over $25,000, whatever premium is paid on behalf of the individual should be regarded as income received by him and he should be taxable upon it. Otherwise, it would be relatively simple for a senior executive to take a substantial portion of his remuneration not in the form of salary but in the form of an extraordinarily large insurance policy upon which premiums would be paid on his behalf. That is the background out of which this proposal has come to the committee.

This clause deals—and deals in a straightforward way, I think—with the person who has been enjoying the benefit of a policy of more than $25,000, or who will in future be enjoying the benefit of such a policy under one of the group insurance plans. How are you going to tax such a person in respect of the premium on the excess over $25,000? That is the situation with which this clause deals. One could go about it in two ways, broadly speaking. One could say: We will regard as income in the hands of such a man the premium which he would pay at his age on that particular policy according to its amount and its provisions. But that might not be fair, because the man might be advanced in age; he might, indeed, have reached a point where insurance premiums are very heavy. He might even have passed the point where he can obtain insurance on an individual policy. What we have done, therefore, is, in effect, to work out an average so that what such a man will have to pay is the average premium on the whole group under the group plan. That is the essence briefly, of this clause. It is well understood, I can assure the honorable gentleman, by the insurance companies. They understand what this means, and the way in which the plan works out.

Senator DOUGLAS (presiding). Any other questions?

Senator CARLSON. May I conclude, Mr. Chairman?

Senator DOUGLAS. Yes.

Senator CARLSON. Those of us who have studied this section dealing with term life insurance realize that it is going to bring about a great difficulty, and it could be a very expensive operation for corporations. I believe you stated that the revenue would be only $5 million?

Mr. HORNE. That is the estimate, I believe, that the Treasury made.

Senator CARLSON. It occurs to me that it might cost more than that before we get through with it, particularly for those who are involved in it, and I think will cause some problems.

You made some interesting comments on moving expenses of employees. That, too, now is getting to be a problem in view of what seem to be shifts of our industrial economy.

I believe you said that employers may reimburse the transferred employees for expenses over and beyond the cost incurred in moving their household effects.

Tell us what other facts of expenses might be involved in this moving.

Mr. HORNE. Well, in the case of most large employers today they recognize that the employee is never going to be made whole, Senator, if they reimburse the transferred employee for only his cost of household effects and his in-transit moving expenses, so the usual policy is to pick up some incidental expenses, but to put some limitation on them. The reimbursement is made on some reasonable basis, and frequently the provision is that they will reimburse miscellaneous expenses but not in excess of 1 month's salary.

The type of expenses involved are such things as losses on breaking a lease; temporary living expenses that he has while he and his family are in the new location looking for a new place to live. There are limitations on how long this type of reimbursement will occur.

I understand that Congress in 1960 enacted provisions for the Foreign Service employees, and provided that they will be reimbursed similarly on temporary living expenses for a limited period while they are in a new location looking for new quarters and this, as I understand it, is not treated as taxable income in the case of Foreign Service employees.

Senator CARLSON. I was just going to say, Mr. Horne, I am on the Civil Service Committee, and have been for years and, of course, at various times Government agencies move entire operations from one city to the other, and it makes a very difficult problem for the employees.

One of the complaints we have had is that people own their homes and they have to sell them and buy a new home, and as far as I can determine there is no provision or no effort made to take care of the loss they actually had to take in changing homes, other real estate problems.

Mr. HORNE. This is another very important problem. Many companies meet it today by providing an appraisal at the time the employee is transferred. After they have determined from that appraisal the value of the house, they will enter into various reimbursement arrangements for the loss that the employee has sustained by reason of having to sell his house at a loss.

Now, at one time the court decisions indicated that this type of reimbursement was not considered taxable compensation.

There has been a recent Tax Court decision which tends to overrule the earlier case, or has overruled the earlier case. So the question is very much up in the air at the present time, and it would be helpful if your committee could clarify this question.

Senator CARLSON. One more question, Mr. Chairman. Do you recommend that an affiliated group of companies have an election to pay dividends within the group free of any intercorporate dividend tax if the group received only one surtax exemption?

Now, I am interested in your reasons as to why such an election is necessary when the affiliated group could file consolidated returns and achieve the same result.

Mr. HORNE. Well, it could, sir. But in many instances there are other reasons for not filing a consolidated return. For example, an

affiliated group may have different fiscal years. Under the consolidated return provisions all of the members of the group would have to adopt the same fiscal year. In some cases, where a domestically incorporated subsidiary may be operating abroad, it would be difficult for the company to change its fiscal year.

Another reason is that many companies would not want to file on a consolidated return basis for State income tax purposes. If they do file a consolidated return for Federal tax purposes, under the laws and practice of many States they would have to file on the same basis for State tax purposes. I think these are only some of the principal reasons.

Another reason is that you have a problem when you file a consolidated return of dealing with minority stockholders. If there are substantial minority stockholders, say 10 or 15 percent in a subsidiary, any tax benefit from the consolidated return filing will have to be allocated in an equitable manner among the group, and this problem of allocation sometimes causes difficulties in satisfying minority stockholders.

So, for these reasons, many companies would prefer not to file consolidated returns. Obviously this is not the only benefit that you get from filing consolidated returns, that is, the elimination of the intercorporate dividend tax. You get other benefits such as your ability to offset your loss corporations against your profit companies. But we do think it is equitable to eliminate the intercorporate dividend tax for a group eligible for consolidated returns, if it waives the multiple surtax exemption, and claims only one surtax exemption for the entire group.

Senator CARLSON. Thank you very much.

The CHAIRMAN (presiding). Senator Douglas?

Senator DOUGLAS. No questions.

The CHAIRMAN. Senator Morton?

Senator MORTON. Mr. Horne, you say that this date that the House put in on stock options of June 11, 1963, might offer some problems, and I can see how it could.

Mr. HORNE. Yes.

Senator MORTON. This could be remedied by whatever we do in stock options—I do not say we will accept the House version—but whatever we do we can make the date the time of enactment of the bill.

Mr. HORNE. I think that would cover the problem arising because employers are going ahead with stock option plans under the present law because they do not know what the ultimate provisions would be, sir.

Senator MORTON. Most other dates in this bill are, of course, January 1, 1964. If, by chance, we should pass this bill, let us say, February 10, 1964, it is still conceivable that there would be some stock options under present law going on during the first 40 days of the next year so, therefore, for this particular purpose it seems more equitable to make the effective date the date of enactment of the bill.

Mr. HORNE. Yes, sir.

Senator MORTON. Thank you.

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

Our next witness is Mr. William Kuhfuss of the Illinois Agricultural Association.

Senator DOUGLAS. Mr. Chairman, may I say Mr. Kuhfuss is a distinguished citizen of Illinois, a highly honorable man with reputation. We do not always agree on farm policy, but he is very able and a very fine citizen.

The CHAIRMAN. You may proceed, Mr. Kuhfuss.

STATEMENT OF WILLIAM J. KUHFUSS, PRESIDENT, ILLINOIS AGRICULTURAL ASSOCIATION

Mr. KUHFUSS. Thank you.

I am William J. Kuhfuss, a farmer, and the elected president of the Illinois Agricultural Association, Bloomington, Ill., which is the statewide Farm Bureau organization in Illinois, and is composed of 195,281 voluntary members. We appreciate the opportunity to present our views on the very important subject of Federal tax policy.

Mr. Charles B. Shuman, president of the American Farm Bureau Federation, appeared before this committee on October 24 and presented a statement concerning the Federal tax policy, outlining Farm Bureau's policy position as adopted by delegates at the 1962 American Farm Bureau Federation annual meeting. The Illinois delegates at this meeting wholeheartedly supported this position. We are in agreement with the statement presented by Mr. Shuman.

To summarize Mr. Shuman's statement, I would like to have the privilege of reading a very short paragraph in order to bring back to your minds this particular statement.

> In summary, Farm Bureau believes that Federal taxes are excessive and should be reduced. However, tax reduction should be based on reduced Federal expenditures, not on deficit financing. We firmly believe that the task of first priority for Congress is effective control of the Federal expenditures through a substantial reduction of new obligational authority. Since this task has not yet been accomplished, Farm Bureau opposes the enactment of H.R. 8363.

Rather than repeat a number of the points made by Mr. Shuman in his testimony, I would like to direct my remarks to the importance of Federal taxation and spending policy to Illinois farmers and to relate some of the concerns of Illinois farmers regarding this subject.

In Illinois, we have just completed our annual intensive effort to give every Farm Bureau member an opportunity to participate in developing the policy position for his organization. Even though our annual meeting, where the official position of the Illinois Agricultural Association is adopted by more than 500 voting delegates, will not be held until the 18th through 21st of this month, I can report to you that one of the subjects receiving the greatest attention in our policy development program was the whole area of Federal taxation and spending. Recommendations on this subject were stated in many different words, but can be categorized into several major general statements:

(1) Our members were nearly unanimous in recommending that taxes should not be cut until the budget is balanced or spending is materially reduced. If a meaningful reduction is made in spending, they would support a reduction in Federal tax rates.

(2) Our members were insistent that the Federal Government operate on a pay-as-you-go basis and that the Federal budget be

balanced. At this point it should be noted that representatives of the American Farm Bureau Federation have recently made specific recommendations to congressional committees on budget reduction in many areas of Federal Government activity, including agriculture.

(3) Illinois Farm Bureau members suggested that expenditures be cut, specifically mentioning foreign aid, the space program, and the Federal payroll, including the USDA.

These expressions of Farm Bureau members indicate a vital concern on the part of Illinois farmers with the taxation and spending policies of our Federal Government. Farmers in their own business know full well the consequences of constantly living beyond their means. They are concerned about the solvency of their Government when it continues, year after year, to live beyond its means.

The fiscal record of the Federal Government justifies their concern. In only 6 of the past 30 years has the Federal Government lived within its means. The public debt at the end of the 1933 fiscal year was $22.5 billion. In 30 years this debt has increased to $303.5 billion. The budget for the current fiscal year projects a deficit of $11.2 billion, even before a tax cut. This current deficit is equal to about one-half of our total national public debt of just 30 years ago. In fact, the fiscal 1964 interest charges alone of more than $10 billion on our current national public debt are equal to nearly one-half of the total national public debt at the end of 1933. Farmers often ask: What nation has followed this course and long endured without ruinous financial consequences? We know of none.

Farmers are well aware of our present taxload, not only at the national level, but also at the State and local levels. They would welcome a reduction in this load, if they could be assured that it would not result in either an even greater tax burden in years to come or further inflation. But until such assurances can be made, we will stand firm on our position of opposing a tax cut until such a cut can be made without increasing our current budget deficits.

To illustrate here a little bit, I would like to point to the 1963 budget deficit of $6.2 billion which was budgeted with a $400 million surplus.

In 1962 we had a deficit of $6.4 billion and we had a budgeted surplus that year of $1.5 billion.

I think this points out the justification for farmers' concern, and they need more than just a promise and an intent for their justification.

I would like to discuss the farmers' tax burden and the problem of inflation in more detail. In the past 10 years, Illinois farm property taxes have increased from less than $87 million to nearly $160 million, an increase of 64 percent. Last year, these property taxes represented more than 9 percent of farmers' total production expenses and were equivalent to more than 20 percent of their realized net income. In addition to these heavy property taxes, farmers pay State and local sales taxes, Federal income taxes, excise taxes and the other taxes paid by any other citizen. In view of this overall tax burden, I am sure Illinois farmers would welcome a tax reduction, but they know a tax reduction at this time, which would increase current deficits, must result in either increased taxes later or paying off the deficits and debts with cheaper dollars through inflation. Neither of the alternatives is acceptable in the long run. We are opposed to both.

Inflation has already put the Illinois farmer in a painful price-cost squeeze. Since 1949–51, total expenditures for production items by Illinois farmers have increased from an average of $1,234 to $1,704 million, or by 38 percent. During this same period, cash receipts from farm marketings in Illinois have increased by only 20 percent, or from $1,825 to $2,198 million. True, part of the increase in production expenses reflects an increase in the amount of feed, fertilizer, petroleum, and similar production items purchased. However, a good part of the increase is attributable to an increase in the cost per units of the purchased items. The index of prices paid by farmers for production items, interest, taxes, and wage rates increased from 263 in 1949–51 to 306 in 1962, or by some 16 percent. Increases have been particularly large for interest, taxes, and wages. During this same period, the index of prices received by farmers decreased from 270 to 243, or a decrease of 10 percent.

Further inflation, which we believe would be generated by larger budget deficits and an increase in the national debt, would put Illinois farmers and farmers throughout the United States at an even greater economic disadvantage. Increased costs would seriously reduce net farm income and would impair the farmer's ability to compete in world markets. Our farmers need to expand existing markets and to develop new markets both at home and abroad. Efforts to this end will be largely unsuccessful, if increasing costs force products to be priced out of these markets. The same is true for any other industry.

We respectfully urge you to avoid any action that will increase the tax burden in the future or trigger a new round of inflation. Any tax cut at this time must be earned by a meaningful reduction in spending.

Thank you for the opportunity to express our views to this committee.

The CHAIRMAN. Mr. Kuhfuss, I want to congratulate you, sir, on a very able and sound statement. I am impressed especially by this:

> I am sure Illinois farmers would welcome a tax reduction, but they know a tax reduction at this time, which would increase current deficits, must result in increased taxes later or paying off the deficits and debts with cheaper dollars through inflation. Neither of the alternatives is acceptable in the long run. We are opposed to both.

That is a very accurate and a very fine statement of the situation that now confronts us. I want to commend you and the Farm Bureau.

I am very happy to say I have been a member of the Farm Bureau for many, many years, and they have done great work to preserve the sound principles of our democracy. I want to congratulate you, sir.

Mr. KUHFUSS. Thank you, sir.

The CHAIRMAN. Senator Douglas.

Senator DOUGLAS. No questions.

The CHAIRMAN. Senator Carlson.

Senator CARLSON. I just want to commend Mr. Kuhfuss for the statement he has made. I am somewhat familiar with the way you arrive at these recommendations through your policy committees with which I happen to be familiar in our own State of Kansas.

I wonder if folks realize that a group of representative citizens, at least in Kansas, from every county gather around the table and have discussions of these problems and express their views, and that is the way the State gets its information in Kansas, and, I assume, in Illinois.

Mr. KUHFUSS. That is right. We are never completely satisfied with our policy development system nor with the participation we have. We would like to have every member take part, and they do not all take part. But when we have from 20,000 to 25,000 in our State sit down around the table and decide what the issue is, we think the system is pretty good.

This is what happened: The way we make our decisions is the delegates, from each of these counties decide what the position of this organization should be; this is carried to the State Farm Bureau on national issues, and then it is hammered out at the American Farm Bureau in the same manner.

Senator CARLSON. That is all, Mr. Chairman.

The CHAIRMAN. Senator Gore.

Senator GORE. No questions.

The CHAIRMAN. Senator Morton.

Senator MORTON. No questions.

The CHAIRMAN. Thank you very much indeed, sir.

The next witness is Garner M. Lester of the National Tax Equality Association.

Mr. Lester, take a seat, sir, and proceed.

STATEMENT OF GARNER M. LESTER, CHAIRMAN, BOARD OF DIRECTORS, NATIONAL TAX EQUALITY ASSOCIATION

Mr. LESTER. My name is Garner M. Lester, I live at Jackson, Miss., and I am engaged in several small business operations. I appear here today as chairman of the board of directors of the National Tax Equality Association. This association, organized in 1943, numbers nearly 8,000 members who are faced with tax-favored competition of one kind or another. They represent practically every aspect of wholesale and retail distribution, country assembly, the manufacture of farm supplies, and the processing of farm produce. NTEA also has members in such seemingly unrelated businesses as funeral parlors, housing, insurance, banking and many consumer services.

As your committee is well aware, it was in 1961 that the present administration began a massive reform of our Federal tax structure. As President Kennedy stated in his tax message of that year, this reform was aimed—and I quote—

> at providing a broader and more uniform tax base, together with an appropriate rate structure.

He went on to state that—and I quote:

> * * * special provisions have developed into an increasing source of preferential treatment to various groups. Whenever one taxpayer is permitted to pay less, someone else must be asked to pay more. The uniform distribution of the tax burden is thereby disturbed and higher rates are made necessary by the narrowing tax base.

Gentlemen, our membership endorses that statement unqualifiedly. In it the President expresses the basic concept which led to organization of the National Tax Equality Association 20 years ago. This same philosophy has been expresed in our testimony before your committee for years. We, of course, pointed out time after time that such unfair treatment under our tax laws creates an intolerable competitive situation. Taxpaying small businessmen have been forced to liquidate or

sell out to the cooperatives. Others have seen their profits dwindle as the tax-favored cooperatives expand.

Heeding the President's request, the 87th Congress included, in the Revenue Act of 1962, basic legislation to tax somewhat more effectively the income of cooperatives. The new law also narrowed the tax advantage of savings and loan associations, mutual savings banks, and mutual fire and casualty insurance companies. Although this legislation did not go far enough to solve the problem, we are deeply appreciative for it as a first step toward the goal the President set forth. We also appreciate last year's depreciation reform and investment credit.

These 1962 improvements in our tax laws undoubtedly contributed to the present well-being of our economy. Nevertheless, we still agree with the President when he stated in his 1963 tax message that in spite of these improvements—and I quote:

> * * * our tax system still siphons out of the private economy too large a share of personal and business purchasing power and reduces the incentive for risk, investment, and effort—thereby aborting our recoveries and stifling our national growth rate.

TAX REDUCTION

The President was referring, of course, to the need for reductions in individual and corporate tax rates. These tax reductions are incorporated in the bill, H.R. 8363, now before your committee.

Our members are strongly in favor of the reduction in tax rates on corporation income. They share the President's feeling that such reduction would stimulate business investment and increase the Nation's rate of economic growth. It will also narrow the inequitable gap between business corporations that are fully taxed and those that are only partially taxed. We feel certain of this attitude on the part of our membership because of their expressions during the regional meetings held throughout the country and their discussions with our Washington staff.

Our people are also in favor of a substantial reduction in the individual income tax rates. However, we consider the elimination of the inequities in the present tax law as being far more important for reasons that we shall explain later.

There is an important qualification to our members' approval of both these tax reduction proposals. It is abundantly clear that a majority of our members do not believe that the Government's revenue can be safely reduced without a planned program to control expenditures which will in the near future produce a balanced budget. While our members regard an immediate tax cut as necessary to stimulate our economy, they agree it must not be of such magnitude as to threaten inflation nor, on the other hand, should it be so small as to be ineffective.

The National Tax Equality Association generally approves of the new rates that would apply to corporation income. In the bill now before you, these are: 22 percent on the first $25,000, to be effective for calendar year 1964; and 48 percent on income above that amount to be reached in two annual steps.

Frankly, most of our association's members are small businessmen who would benefit from the decrease in the normal bracket rate. We recognize that this 22-percent rate of taxation would enable many

small companies with great growth potential to retain more of their earnings and thereby expand more rapidly. This is good for the economy. Even more important, such a reduction would narrow the tax advantage that cooperative competitors now enjoy over the smallest of the small businessmen. However, we are not unmindful that rate reduction in the interests of expanding the economy is highly desirable for all corporations, regardless of size.

The proposal to place corporations with tax liabilities in excess of $100,000 on a pay-as-you-go basis over a 7-year period is strongly opposed by our members, even by those whom it does not affect directly. This provision does not even appear consistent with the President's announced goal of making more investment capital available through tax reduction.

Such corporations operating on a cash basis would not realize the full effects of the corporate tax reduction until 1971. As a matter of fact, they would experience very little advantage until 1968. The Ways and Means Committee report (H. Rept. 749, 88th Cong., 1st sess., 1963, p. 31) shows that these corporations would pay approximately 99.1 percent of their present taxes annually through 1968.

Such corporations operating on an accrual basis, of course, would lose the use of cash equal to their tax funds annually for the period of the speedup. To the extent this reduces the cash flow, it affects indirectly every investor and every businessman. For these reasons we urge that your committee give careful consideration to eliminating the speedup in corporate tax payments.

When it comes to increasing investment capital, the Ways and Means Committee admits that the corporate tax acceleration in the current bill largely nullifies the advantages from the reduction in the corporate tax rate. In its report, the committee states and I quote:

> * * * since in each year the acceleration in payments is offset or more than offset by the tax reduction, the speedup of corporate payments will not decrease internal funds available at the corporate level for investment.

In effect, the committee is pointing out that the internal funds available for investment at the corporate level will not be materially increased. The tax speedup would, therefore, do nothing to achieve the President's overall objective.

The dividend credit and dividend exclusion provisions in the present tax law were adopted in 1954 to encourage capital investment by individuals. As many of you will remember, these provisions were enacted because it was felt that the double taxation of distributed corporate income was a deterrent to investment in corporations. At the time, it was stated frequently that while this was only a step in the direction of the removal of double taxation, it did represent a desire to eliminate such an inequity.

This year, in eliminating the 4-percent dividend credit, the House now seems to discourage investment by individuals. The Ways and Means Committee defended this section of its tax bill against the double taxation argument (H. Rept. 749, 88th Cong., 1st sess., 1963, p. 32). The committee wrote and I quote:

> * * * the reduction in corporate rate by 4 percentage points provided by this bill probably does as much to remove any double taxation involved with respect to corporate distributions as would the continuance of the present 4-percent dividend credit.

From the standpoint of encouraging investment, we cannot believe that the corporate rate reduction offsets the elimination of the 4-percent dividend credit. Both have the same announced purpose of increasing investment income. They do not, however, encourage investment capital from the same sources.

The corporate rate reduction encourages the corporations themselves to invest the increased funds that would be available from decreased taxation.

The 4-percent dividend credit encourages individuals to furnish capital for corporate investment.

The first encouragement to investment comes from the increased earning power of the corporation while the latter comes from the savings of the individual.

It seems to our members that the 4-percent dividend credit should not be eliminated in the tax bill now before you if we are to achieve the President's objectives. Actually, we would favor taking steps to increase the dividend credit to the end that double taxation be eliminated.

Our members must compete with cooperatives whose income is subject to only a single tax at the individual level. Therefore, the elimination of the 4-percent dividend credit, to the extent that it increases double taxation, widens the competitive advantage that cooperatives enjoy.

Our chief criticism of the legislation before you concerns what it overlooks. As you will recall, President Kennedy, in his tax message of 1963, proposed:

> Broadening of the base of the individual and corporate income taxes, to remove unwarranted special privileges, correct defects in the tax law, and provide more equal treatment of taxpayers thereby permitting a larger reduction in tax rates than would otherwise be possible and making possible my proposals to alleviate hardships and inequities.

The full taxation of cooperatives certainly falls within the scope of this statement. The President proposes to subject all business establishments which compete in the marketplace to the payment of full Federal income tax.

Mr. Chairman, full Federal taxation of cooperatives at the corporate level will bring the Treasury more than $150 million a year in additional revenue. While this amount may seem small, it looks pretty significant when you compare it with the net recovery of $600 million the House put in H.R. 8363 after months of deliberation.

When you add to this $150 million the $250 million which will result from full taxation of the savings and loan associations and mutual savings banks you have $400 million in revenue. Your committee heard Arthur Roth of the autonomous Bankers Committee for Tax Equality testify last week as to the merits of equal taxation for all financial institutions.

To us, $400 million is a lot of money, especially when our country is faced with a long series of unbalanced budget and a balance-of-payments problem.

We all realize that legislation affecting the taxation of cooperative income was included in the Revenue Act of 1962. Unfortunately, from the viewpoint of those who must compete with cooperatives, that legislation attempted only to restate the law that Congress thought it had passed in 1951. It did not face up to the issue of taxing coopera-

tive income at the source—the corporate level where the competitive impact on business is felt. When your committee and your staff examine the complexities of the legislation approved last year, then it cannot help but realize the opportunity for simplification that exists in this area. It is safe to say that the terminology, the conditions of taxation, consent requirements, disqualification, treatment of redemption payments, etc., are confusing not only to the smaller cooperatives and the farmer patrons, but also to legal and tax experts.

Not only is the law confusing, but it works a downright hardship on all farmers not in the lowest tax brackets. The farmer patrons find themselves forced to report their entire share of the cooperative's income in their individual income tax exen though they may never receive more than 20 percent of that amount in cash.

To the extent that double taxation of income from regular corporations is continued, we believe the income generated by cooperatives should be subject to the same provisions. To the extent that relief from such double taxation is provided, it should also apply to cooperative corporations and their patron owners. We refer to:

1. The 85-percent intercorporate dividend credit to grant relief to corporate dividend recipients;
2. The proposed $100 dividend exclusion for the relief of individual recipients of corporate dividends (this amounts to $200 in the case of joint returns);
3. The 4-percent dividend credit; and
4. The proposed normal rate of 22 percent on the first $25,000 of taxable income to replace the present normal rate of 30 percent.

The new proposals now before you in H.R. 8363 would increase the dividend exclusion and cut the normal rate on corporations to 22 percent. This development suggests a simple method of taxing cooperative income which would be more equitable both to taxpaying businessmen competing with cooperatives and to the patron-owners of cooperatives themselves.

This proposal will also remove a number of objections of cooperative managers to the cumbersome provisions of the 1962 Revenue Act. In a news release dated October 25, 1963, the National Council of Farmer Cooperatives disclosed three principal difficulties resulting from the 1962 tax provisions. Listed in order of significance they are:

> (1) additional compliance costs which are bound to be reflected in reduced amounts available to distribute to members and other patrons;
> (2) the deterrent influence on capital investment by farmers in their cooperatives; and
> (3) creation of obstacles to retaining present members and obtaining new members.

Mr. Chairman, you will remember that under the new law cooperative corporations must pay out 20 percent of their income in cash patronage dividends if they are to escape taxation at the corporate level. May I point out to you that this 20 percent represents a very small difference from the 22-percent normal corporate tax rate proposed in H.R. 8363.

From a standpoint of capital retention, it would make very little difference for the great majority of cooperatives whether they paid a corporate tax of 22 percent or paid a cash patronage dividend of 20 percent.

The Nation's 9,360 local cooperatives (those that deal directly with the farmer) enjoyed average annual net incomes of $22,528 in 1954, the latest year for which figures are available. This figure comes from a special report of the Farmers Cooperative Service of the U.S. Department of Agriculture issued in 1957; 438 regional cooperatives reported an average annual net income of $279,861. These regional cooperatives, for the most part, represent wholesaling, manufacturing, and processing cooperatives, and are owned by other cooperatives rather than by farmer patrons.

Under the present law, a local cooperative must include the entire dividend payment from the regional cooperative in its income. The local cooperative, in turn, distributes this dividend payment to its farmer owners. If cooperatives were subjected to the tax law which applies to regular corporations, the local cooperatives would, of course, be able to take advantage of the 85-percent dividend credit.

At the present time patronage dividends paid by cooperatives are neither eligible for the 4-percent dividend credit nor for dividend exclusion. This is because no corporate income tax is collected on the income from which such dividends are paid.

We suggest, Mr. Chairman, it would be more advantageous to the recipient of patronage dividends if such income were fully taxed at the corporate level and excluded from the income of the farmer or other recipient to the extent allowed for dividends of regular corporations.

Mr. Chairman, it is not generally realized that 92 percent of cooperative patronage dividend payments are for amounts of less than $100. This was reported to your committee in 1962 by Mr. Homer L. Brinkley, executive vice president of the National Council of Farmer Cooperatives. At that time Mr. Brinkley was suggesting that the withholding taxes on dividends and interest should not only apply to patronage dividends (see "Hearings on Revenue Act of 1962, Part 5, Senate Finance Committee," pages 1700–1706).

Under the House bill now before you, the exclusion of $200 in dividends is permitted on a joint return. This would not only take care of the taxes of the 92 percent mentioned above but of a large portion of the remaining patronage dividend payments in excess of $100.

Under the present tax law a cooperative is required to distribute 20 percent of its patronage dividend in cash. For example, a cooperative would distribute in cash $20 on a patronage dividend of $100, or $40 on a patronage dividend of $200. This requirement is a wise provision. It was inserted in the tax bill last year by our committee to provide the farmer with cash to pay the tax on his patronage dividend. This 20 percent is sufficient to pay the tax for those in the lowest tax brackets. It does not provide enough cash to pay the tax on the patronage dividend of the man who is in a higher tax bracket.

Under our proposal, cooperative income would be taxed on the same basis as the income of any other corporation, mostly at the new 22 percent rate. The farmer would be allowed the same dividend exclusion of $200 on a joint return as the stockholder in a regular corporation. To the extent that patronage dividends do not exceed $200, cooperative income would be on a single tax basis.

Under our proposal, Mr. Chairman, the $200 exclusion on a joint return would give a farmer in the 20-percent tax bracket the equiva-

lent of $40 in cash and a farmer in a 50-percent tax bracket the equivalent of $100 in cash.

The adoption of our proposal would simplify greatly the farmers' reporting problems and eliminate the necessity for the farmer in the higher bracket to reach in his pocket to pay taxes on paper dividends with no cash value.

Mr. Chairman, at this point I would like to quote from a statement sent us by Mr. H. B. Tilton who is here beside me today to answer any questions which may arise. This is Mr. Tilton's statement.

My name is H. B. Tilton. For the past 30 years, I have owned two farms, of 640 acres each, in Trail County, N. Dak. In general, I favor the proposed tax bill now before the Senate Finance Committee if certain serious inequities are corrected.

I think I should say that until very recently I was a member and patron of the Farmers Union Elevator Co. at Buston, N. Dak. I resigned from this organization when I received a notice on January 2, last, that they had passed a resolution which would hold me responsible for paying Federal income taxes on patronage dividends over and above the amount I receive in cash. I refused to place myself in the position of owing taxes based on pieces of paper which, in my opinion, will not have a cash value when received and which may never have a cash value.

I am sure the Senate Finance Committee, and for that matter, the whole Congress, tried very hard to work out sound legislation when the tax bill of 1962 was passed. Most of the farmers with whom I have talked, however, still do not realize that they are now placed in a position where they are going to have to pay Federal income taxes on sheets of paper (stock certificates, scrip, etc.) which may or may not be redeemed.

If my co-op pays me a patronage dividend of $100, they are required, under the 1962 law, to send me $20 in cash and some kind of paper representing the additional $80. I realize that your idea was that if I were in the lowest tax bracket, I could use the $20 to pay my Federal income taxes on the whole amount which the co-op paid me as a patronage dividend.

First, I am not, and many other farmers are not, in the lowest tax bracket, so the 20 percent is not enough cash to pay our income taxes on these patronage dividends.

Second, I see no reason why the farmer members of cooperatives should be singled out and required to pay Federal income taxes on paper which will not have a cash value when received and which, in many cases, may never have a cash value.

If the cooperative pays me $20 in cash and $80 in scrip, I believe I should be required to pay my income tax on the $20 I received in cash, but I believe I should not owe anything on the $80 in scrip until such time as it has a cash value. That is, if I am in the 20-percent bracket, I should pay $4, which is 20 percent of $20. I should not be required to pay 20 percent of the $80 scrip.

I can think of no other class of taxpayers in the country who are penalized to this extent, and I believe, Mr. Chairman, once the farmer members of the cooperatives have become aware of this injustice, they will have no alternative but to resign from the co-op, as I have, or urge that the Congress remedy the injustice.

I suggest that the cooperatives be taxed the same as regular corporations, and that the farmers be taxed on the actual cash received as dividends. This should add substantially to the $600 million which the pending bill would produce by certain of its changes of present law.

Even if the cash payment required under the present law be increased, the injustice and inequity would continue if the farmer were required to pay income tax on the portion of the dividends represented by scrip.

A shareholder in a regular industrial corporation is not so penalized. For example, if I own stock in a regular industrial corporation that earns $5 a share and it pays a cash dividend of $2 a share, I pay income taxes on the $2. I do not pay income taxes on the $3 retained by the corporation.

Farmers are not seeking charity. They merely want justice and the removal of inequities. A farmer who resigns from a co-op may be without a market as in some areas a particular co-op may be a monopoly, and he may not have any convenient place to market his grain.

That closes Mr. Tilton's statement.

Mr. Chairman, the question as to whether cooperatives do or do not earn income has been debated before your committee and the House Committee on Ways and Means for many years.

Together, the staffs of the Treasury and the Joint Committee on Internal Revenue Taxation settled this issue in part 3 of their April 1951 study when they said and I quote:

> That a cooperative itself earns income seems difficult to dispute. It has assets and employees, it buys, sells, and performs services. The Supreme Court has recognized that profits derived from activities of this type are the profits of the organization owning the assets, employing the workers, and carrying out the commercial activities, even though another person has a legally enforcible claim to these profits.

Quoting further, the conclusion of the Treasury and joint committee staffs is:

> 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.

In summary, the National Tax Equality Association endorses the proposed reductions in corporate and individual income taxes as a step toward lower tax rates. Our members believe the proposed revenue reductions should be accompanied by more realistic attempts to bring the budget in balance through meaningful tax reform and expenditure reduction.

We call the committee's attention to the fact that the speedup in corporate payments and the elimination of the 4-percent dividend credit largely nullify the benefits to be obtained through tax reduction. The President's hope to produce increased investment to sustain high levels of business activity and employment will be seriously impaired.

Further, we wish to point out that the tax bill before you falls short of creating the equity in taxation the President requested. It leaves many cooperative business enterprises free of income tax at the corporate level.

We pointed out that the proposed 22-percent normal tax rate on corporations with profits of $25,000 a year or less is very close to the 20-percent cash payout now required of the cooperatives. The $100 dividend exclusion ($200 for joint returns) if applied to patronage dividends, would remove the majority of such payments from taxation on the part of the farmer.

On this basis we propose that cooperatives should be fully taxed at the corporate level and the proposed $100 dividend exclusion applied to patronage dividends. This would simplify greatly the tax laws for millions of farmer-recipients of patronage dividends. It would result in tax equality between the cooperatives and competing corporations. To this objective our association has devoted close attention for many years.

In closing, gentlemen, I want to compliment you as members of this important committee of the U.S. Senate for the thorough consideration that you are giving to the President's tax reduction and reform proposals. Through your efforts and deliberations there may emerge a new concept of taxation, and perhaps a whole new tax system which would remove for all time the impediments standing between our people and a larger, stronger, and more rapidly growing American economy. Thank you very much, gentlemen.

The CHAIRMAN. Thank you, Mr. Lester. Any questions? Thank you very much, sir.

The next witness is Mr. Roland Bixler of the Manufacturers Association of New Haven County, and J-B-T Instruments, Inc.

Take a seat, sir, and proceed.

STATEMENT OF ROLAND M. BIXLER, REPRESENTING MANUFACTURERS ASSOCIATION OF NEW HAVEN COUNTY

Mr. BIXLER. Mr. Chairman and members of the committee, I have entitled these remarks "Tax Justice and Economic Growth."

My name is Roland M. Bixler, and I am a founder and president of J-B-T Instruments, Inc., of New Haven, Conn. I appear here today in behalf of the Manufacturers Association of New Haven County and my own company. Like my company, most of the 75 members of the association are small or moderate in size. We certainly appreciate the opportunity to be heard.

As to specific suggestions, they are these for the amendment of H.R. 8363:

(1) Revise the personal tax rate scale to achieve a much more moderate graduation, especially through the middle brackets.

(2) Reduce the top corporate rate by a minimum of 5 percentage points rather than the 4 in the proposed or pending legislation.

(3) Retain the 4-percent dividend credit.

(4) Eliminate the provision for taxation of the value of group term life insurance above $30,000.

(5) Repeal the 15-percent intercorporate dividend tax for all affiliated members of a parent corporation which do not take advantage of the multiple surtax exemption.

I am well aware that other witnesses have provided and will provide detailed information backing up these and other recommendations for amendment, and I therefore will confine the rest of my statement to some of the philosophic and economic considerations which we in New Haven County believe should underlie tax action at this time.

COMPETITION BETWEEN TAX MOVEMENTS

H.R. 8363 in a sense brings to a head the competition between two movements which got underway in the mid-1950's.

One movement dealt with the injustice of steeply graduated rates of personal tax, and the restraint which excessive rates of both individual and corporate tax place on our free economy's potential for growth and employment.

The other movement from the mid-1950's dealt with the claimed injustice of many features of the tax law, sometimes called tax loopholes, tax shelters, and so forth.

The objective of the first movement was to achieve reform of the graduated rates and overall reduction in both income and corporate tax rates, to achieve conformity with elemental rules of justice, and to release the incentives and capital necessary for sustainable, high-level prosperity, and employment.

The objective of the competing movement is somewhat more difficult for me to pin down. Proponents of closing so-called loopholes

have seemed generally content to keep alive the notion that the tax law is essentially structured to protect successful and rich people, and business, from paying a fair share of taxes.

I am prejudiced, of course. As a businessman, I experience the burden which the corporate rates impose on my company's income, and which the personal rates impose on my personal income. I look, as any taxpayer would, to find legal shelters which will enable my company, and myself, to reduce our total taxes, but I don't find anything which offers much comfort. It perhaps is natural that I would view the deductions and credits under the present tax law, which are available to me, as sound and reasonable; further, that I would emphasize the inadequacy of these provisions, for example, the 4-percent dividend credit, in providing evenhanded justice for me under the law.

It has been said that a tax loophole is somebody else's tax deduction. However, I have never been impressed with the claim that the people, generally, who own and run businesses, or the businesses themselves, are the beneficiaries of unwarranted provisions in the tax law. To the contrary, on total balance, and with special regard to the inadequate dividend credit, it is my belief that the injustice of the tax rates is more compounded by omissions in the tax law than softened by its provisions.

THE PROTECTION OF INCOME FROM TAX

I do not need to inform this committee that the great bulk of income protected from tax enjoys this status because of personal and dependency exemptions, and deductions available to and generally used by taxpayers in all income levels. However, it has been illuminating to me to have put in tabular form, from U.S. Department of Commerce data available this year, the major items accounting for the difference between total personal income and the total taxable income of individuals.

(The table referred to follows:)

Personal income versus taxable income (1960)

	Billions of dollars	Percent of total
Total personal income	$401	100.0
Not carried forward to taxable income:		
(1) Transfer payments (social security benefits, unemployment insurance, etc.)	29	7.2
(2) Income in kind	22	5.5
(3) Other labor incomes (employer contributions to welfare funds, workmen's compensation, etc.)	10	2.5
(4) Reported income of nontaxable individuals	18	4.5
(5) Personal exemptions of taxable individuals	81	20.2
(6) Standard deductions of taxable individuals	12	3.0
(7) Itemized deductions of taxable individuals:		
(a) Adjusted gross income, $0 to $50,000	31	7.7
(b) Adjusted gross income, $50,000 and over	2	.5
(8) Other miscellaneous items, net	24	6.0
Total	229	57.1
Taxable income	172	42.9
Subtotals:		
(1), (2) and (3)	61	15.2
(4) and (5)	99	24.7
(6) and (7a)	43	10.7

Source of data: Survey of Current Business, May 1963, U.S. Department of Commerce.

Mr. BIXLER. The totals show that 57.1 percent of personal income is not carried forward to taxable income. However, 24.7 percent results from income of nontaxable individuals plus personal exemptions of taxable individuals; in other words, that is the totals of items (4) and (5) in the table, looking at the last column which gives the percentages; 10.7 percent, a little over one-tenth, from the standard deduction and itemized deductions of taxable individuals up to the $50,000 adjusted gross income level (parenthetically, less than 1 percent of the total results from itemized deductions about $50,000); and 15.2 percent is not taxed because it comes from social security and other nontaxable transfer payments, income in kind, and other labor income. Of course, some part of the nontaxable items, such as $800 million of interest on State and local bonds, and employer contributions to benefit plans in behalf of top executives, are attributable to people with more than $50,000 in adjusted gross income. However, we can't avoid the statistical fact that personal income not carried forward to taxable income is overwhelmingly attributable to provisions of the tax law which are used across the board, with the great bulk providing substantial protection from payment of tax only for people in modest income circumstances.

Looking back, it may be worth noting that the most thorough study of structural reforms ever undertaken seemed to have become a prisoner, so to speak, of the data shown in the table. This was the 5 weeks of study hearings conducted by the Ways and Means Committee in the fall of 1959. In advance of the hearings, there was a great deal of attention given in the press to the notion that the structure of the tax law favors the higher incomes. Participation in the hearings was by invitation, and approximately 58 of the 170 panelists were academic people. In advance, the hearings had been billed as providing the substance for conclusions which would subsequently be incorporated in proposed legislation. Nevertheless, there was no report, no conclusions, and no recommendations of the committee from the hearings.

THE AWAKENING ON TAX RATE INJUSTICE

In contrast to the failure of the record to document the claim that the tax law is unjustly structured, I believe there has been quite an awakening recently as regards the injustice of the rate structure.

Regardless of how stated, the substance of the philosophic case for graduation has been that it protects the poor and burdens only the rich. This case fails under simple analysis.

First, the people whose incomes are on the very low side are either completely or largely spared from paying tax by the system of personal exemptions. The higher the exemptions, the higher must be the basic rate of tax to which all taxable income is subject. The point is that the protection afforded by exemptions is not signficantly affected by graduation in rates above the basic rate.

Second, income taxation is not applied to wealth, but to income. Hence, the great burden of graduation falls upon people who are dependent upon income, not accumulated wealth, for their well-being

and advancement. The aggregate income of wealthy people is a small part of the Nation's total income. Sharp graduation effectively keeps people from becoming wealthy out of income, but this is quite different from redistributing established wealth.

The mores of our society are that a man or woman can stand as high as he or she will during life, that a person or a business from small beginnings has unlimited opportunity for growth; that people who put in the effort or the time, or subject themselves to the discipline of saving, are community and national assets.

If an employer suggested that a salesman who produces more of a given kind of business would have to take a lower rate of commission, or that another employee who works overtime would have to take a rate of pay lower than for normal time, such an employer would be considered unfit to manage.

Why is it that the things we believe and the rules we live by, outside of the tax field, are in effect repudiated by our laws on taxation? Why do we pile extra rate upon extra rate of tax upon the most useful and productive members of our society?

THIS IS NOT JUSTICE

A few years ago a French economist, whose name I do not recall, made the following observation: "All economic progress is nothing, basically, except an incessant struggle between the call of the future and the defense of the past."

Today, we are in a struggle to free our economy from a tax policy bedded in illusions of the past, so that our economy may respond to the call of the future for better growth and more jobs. I submit that it is not justice:

(1) To promote the idea that the tax law is essentially structured to protect the successful and the rich, and business, from paying a fair share of taxes.

(2) To take the position that people generally subjected to the discriminatory, noneconomic graduated rates cannot have substantial relief until any or all alleged loopholes are eliminated or modified.

(3) To slide over the need of the unemployed, the inadequately employed, and new workers who will benefit the most from a freer play of incentives and more capital, and pose tax reduction as a contest between taxpayers who need more income for personal living and those who do not.

(4) To accuse our private enterprise system of inability to grow adequately and provide needed jobs, while continuing to encumber the private enterprise system with outmoded tax concepts.

IS THIS JUSTICE?

Before framing our specific recommendations on H.R. 8363, which I gave at the outset, we in our association asked ourselves the question: Is it justice—

To intensify the steep graduation through the middle brackets?

Ten years after the Korean war, to relieve corporations of only 4 of the 5 percentage points of tax which were originally scheduled to terminate way back on January 1, 1954?

Is it justice to recognize the fact of double taxation of dividend income and then strike from the law the modest credit which applies evenly to all dividend income?

To tax the value of group term life insurance above $30,000, regardless of its relation to the employee's salary, and exempt the value below that level, even though it may be several times an employee's salary?

To continue to impose the 15-percent intercorporate dividend tax for all affiliated members of a parent corporation which does not file a consolidated return, though the members do not take advantage of the multiple surtax exemption?

THE RELATION OF CAPITAL TO ECONOMIC PROGRESS?

It always seems strange to a businessman that there would be two sides for discussion regarding the importance of capital formation to economic progress and the spread of human well-being. Whatever the nature of a political society—closed, as in Soviet Russia; semiclosed, as in other nations; or relatively open, as in America—the basic source of progress is capital. This seems to be recognized by every developing nation in the world, and our Government when we supply capital to developing nations. Over any period of time, the nation which accumulates the most capital will enjoy the greatest progress and its citizens will have the highest average standard of living. These points seem so commonplace as to not require stating. Yet the injustice of past tax concepts results in a U.S. tax system heavily oriented against such basic truths.

I am not a person who subscribes to the belief that, regardless of the adverse impact on our national welfare, politics requires that the feet of the successful be held to the tax flame, so to speak. Pragmatically, it does not seem to me that the record indicates that tax increases or decreases are a factor which significantly affects voting of the average citizen. However, even if my observation here is questionable, we know that men in public life will take risks regarding their political careers if they are convinced that this is necessary to serve the national interest. I do not believe that the successful man in public life is much different from the successful man in business. Risks are an inherent part of our way of life.

Moreover, the environment for fundamental reorientation of our tax structure to permit greater growth has been greatly improved by the present administration's outspoken recognition of the importance of capital, profit, and incentives. The unfortunate thing is that this recognition is not effectively translated into H.R. 8363 as sent over from the House.

Pondering on these thoughts and facts, I have asked myself the question: What is it that inhibits a breakthrough to a tax policy more compatible with optimum growth? Perhaps the answer lies in the persistent belief that, despite present tax rates, there is no present or impending shortage of capital for growth. I can tell you, members of the committee, from firsthand knowledge, that the heads of many small and growing businesses would find this view difficult to comprehend. However, the belief that there is capital abundance seems to stem from two factors: First, the fact that so many businesses have improved their liquidity over recent years; and, second, that an established business can go to the bank and borrow more money if the management so decides.

THE SIGNIFICANCE OF LIQUIDITY

The first point seems to create the impression that liquidity means a storing of capital for future use. This may be so for a particular company but it is not so for the economy as a whole. Wherever the liquidity of one business is represented by an interest-bearing asset, the savings represented are being used by whoever pays the interest. When one business draws down on such an asset, funds from some other source must move in as replacement. The shuffling around of existing assets of this kind does not, therefore, release any net new funds for investment. The economic fact is that past savings are always invested in one form or another. Future capital formation, therefore, always is dependent upon future accumulations of capital. There is no such thing as an existing stock of financial resources which can be called upon to shoulder the growth job of the future.

THE LIMITS OF CREDIT EXPANSION

The second point—availability of additional credit to an established business—also can be an illusion as regards the potential for future growth. An individual business can substantially expand its credit use just so long as all business does not attempt to do it at a particular time. If every business, which today believes that its credit is unlimited, should undertake to operate on this basis, the business community as a whole would quickly find that there are very tight limits indeed on credit expansion; that is, without inflation. By and large, our banking mechanism is one of transferring capital from savers to users. There is, of course, some elasticity beyond this point because under stable prices it is necessary for the volume of credit and money to expand as the volume of total business expands. This elasticity is not a substitute for business or personal savings.

As a matter of fact, the greater the volume of business and personal savings, the greater the expansion of credit which can take place without causing inflation. In a favorable business climate, the problem always is finding enough new capital to match the opportunities for investment and expansion.

CAPITAL TO GROW ON

When we look back only a few years, we can see how important it is to reform or reduce the rates which impede capital formation as the condition precedent to stronger growth. Capital spending last moved strongly upward from 1955 through mid-1957. Because cumulative wage increases were in excess of overall productive increases, inflationary pressures were great. In this setting a subcommittee of the Joint Economic Committee, reporting in June 1957, made the acute observation:

> The basic problem is an inadequate level of savings out of current income. An ever-increasing volume of real savings is needed to meet the economy's requirements for replacement of plant and equipment under inflated prices and for growth based upon full exploitation of rapid technological advances.

To slow down the inflation, at that time, the Federal Reserve Board put tight reins on the expansion of money and credit. However, tax rates were not reduced to permit greater after-tax savings. The in-

evitable result was a slowdown in capital formation and of economic growth, and the beginning of the problem of chronic unemployment, all of which continue to the present time.

At this stage in history, the realities of two conditions: (1) international competition and (2) the discipline of the balance of payments prevent a return to inflation as a means for financing greater growth—even if there were no moral or other domestic reasons for avoiding such a course. We have no alternative but to rely on after-tax business earnings and personal savings.

Revision of the tax law in the direction of justice is the one means by which the Federal Government can better assure to the private economy the capital which it will need to grow on over the years ahead.

CONCLUSION

The economy is still burdened with substantially higher rates of both corporate and personal taxes than existed before the Korean war. H.R. 8363 provides what may well be the last opportunity in this decade to reduce and reform the rates which hold our economy back from a better long-term performance. I submit to you that tax justice and more growth and more jobs go hand in hand. Thank you.

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

Any questions? Thank you.

The next witness is Mr. H. L. Thompson, Jr., of the National Wholesale Hardware Association.

Take a seat, sir, and proceed.

STATEMENT OF HENRY L. THOMPSON, JR., PRESIDENT, NATIONAL WHOLESALE HARDWARE ASSOCIATION; ACCOMPANIED BY GENE SMITH, PRESIDENT, THE OKLAHOMA HARDWARE CO.; AND BRUCE WALL, SECRETARY, NATIONAL WHOLESALE HARDWARE ASSOCIATION

Mr. THOMPSON. Mr. Chairman and committee members, my name is Henry L. Thompson, Jr. I reside in Perrysburg, Ohio, but conduct my business in Toledo, Ohio, where I am president of the Bostwick-Braun Co., a wholesale hardware firm with sales of over $20 million. I am representing the National Wholesale Hardware Association as president of this association. With me today, on my right are Mr. Gene Smith, president of the Oklahoma Hardware Co., of Oklahoma City, Okla., who is also chairman of our association's committee on equal taxation. Also, on my left, Mr. Bruce Wall, the secretary of our association, who is from Philadelphia. These men will be available at the end of my testimony if there are any questions that you might wish to ask them.

Within the wholesale hardware industry there are more than 600 hardware wholesalers and it is estimated that the combined sales volume of this group amounts to over $2 billion. The business of our members is conducted in every State of the Union. For the year 1962 the average net profit, as reported by our members, amounted to 1.18 percent on sales and this figure showed an improvement over 1961 when the same figure was 0.71 percent. Expressed as a percentage of net profits to the net worth the averages show a return in 1962 of just

under 4 percent, 3.95 percent, compared to 3.32 in 1961. When you can consider that Government bonds will yield a return of between 3 to 4 percent you can readily see that our industry is not one which would readily attract investment capital.

Under the proposed bill, which you are considering, you are providing for certain tax reductions for both corporations and individuals. From the figures that I have already mentioned you can readily see that we, in our association, strongly favor any tax reduction that you may pass. However, we do feel very strongly that to enact a tax reduction without developing savings in Government expenditures or obtaining new sources of tax revenue, does not really give the people of the country a true tax reduction. If by a tax reduction we are merely increasing the debt which we will all have to pay for in increased taxes in the future, we, in my opinion, are accomplishing nothing.

There are many areas where it seems to us that new tax sources could be developed by taxing those who are not carrying their share of the load at the present time. Within our own industry we have multimillion-dollar merchandising cooperatives who are paying substantially no taxes at all at the corporate level. We understand that full taxation of all types of cooperatives, including dealer-owned cooperative wholesalers who are our competition, could possibly produce revenue in excess of $200 million which certainly could help greatly in partially offsetting any tax reduction. Equal taxation with out competitors would greatly enhance our opportunities to earn a fair return on our investment, and also increase the revenue potential of the Treasury.

Under the bill which you are currently considering, we understand that the step-up of payments of tax will be adjusted so that by the year 1970—25 percent of the current year's tax will be paid each quarter. As we see it, this in effect would produce additional revenue so that in spite of the tax cut it might appear that the budget was balanced because of the stepped-up payments. This, we feel, is an unwise move and is only putting off the day when corrective action must be taken to balance the budget.

From the point of view of our industry the speeding up of tax payments would eliminate any advantage of a tax reduction. May I refer you to the graph of my own company's accounts receivable, which you see right here. The vertical scale is in millions of dollars; the horizontal scale represents the months of the year. This is our accounts receivable by months.

You will observe that we reach high peaks in both April and again in October. In fact, from the low point to the high point is a difference of more than $1 million.

It has been a custom in our industry to help the small hardware dealers of the country finance their inventories of seasonal merchandise. In the spring of the year such items as power mowers, fertilizer, lawn, and garden equipment, are sold to the dealers with dating terms permitting them to discount their bills in May of that year. Again in the fall dealers purchase sporting goods such as guns and ammunition on which we extend dating terms permitting them to discount their bills in November. Also, toys are purchased in June and July and not paid for till January. In other words, our industry does an

important job of financing the small dealer, and at these peak periods it is quite common for most of us to borrow sizable sums to aid in this financing.

A tax reduction might make more funds available for this purpose, but then if taxpayments are stepped up to a current basis, we would in no way receive any benefit, and would have to continue our heavy borrowings.

When you consider that we have to borrow money at around 6 percent and have a return of below 4 percent, you can see what a tremendous burden this stepping up of payments will be in our case.

We are indeed distressed to see in the bill you are considering a proposal to eliminate the 4-percent dividend credit allowance. It is our understanding that this was initially enacted into law to help offset the unfairness of double taxation. If anything, we feel that this 4 percent credit should be increased.

If all corporations paid full tax at the corporate level and all recipients of dividends paid full tax at the personal level, we could understand your considering a change. However, such is not the case. Large merchandising cooperatives today are paying practically no tax at the corporate level, and Mr. Lester, who testified before me, amplified this to a much greater extent. The act, which you passed in 1962 does make it mandatory for all recipients of patronage dividends to pay full tax at the personal level, however permits complete tax freedom at the corporate level.

We feel very strongly that until this unfair advantage has been fully adjusted that the 4-percent dividend credit allowance should remain effective, or better yet, should be increased.

In summary then, first, we strongly favor corporate rate reductions provided the budget can be balanced at the same time by making up tax losses in closing loopholes.

Second, we are strongly opposed to the stepping up of tax payments to put it on a current year basis as this would eliminate any benefits from a tax reduction and prevent any improvement in the profitability of our industry.

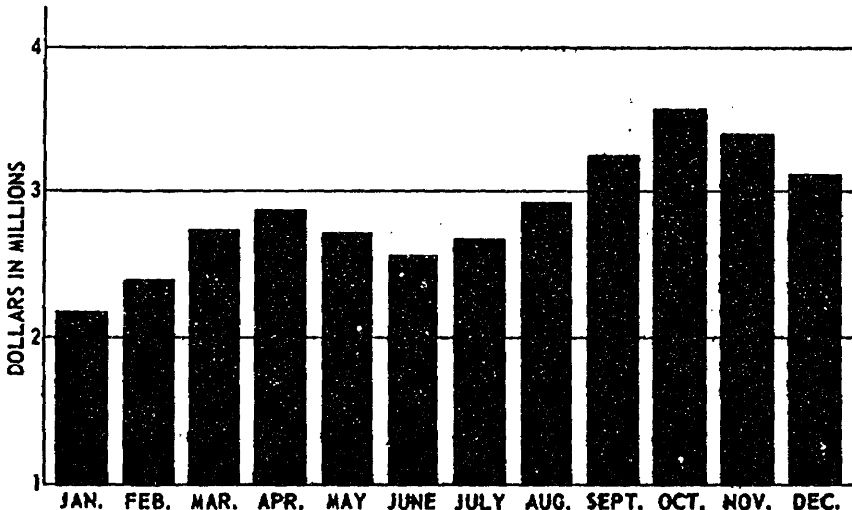
Third, we are violently opposed to any reduction in the 4-percent dividend credit and would prefer an increase until we, as full taxpaying companies, are on equal basis with our competitive merchandising cooperatives.

Gentlemen, I thank you for the time you have granted me to present this case to you. Should you have any questions, we will be most happy to do our best to answer them.

(The graph previously referred to follows:)

THE BOSTWICK-BRAUN COMPANY
TOLEDO, OHIO

ACCOUNTS RECEIVABLE
5 YEAR AVERAGE 1958-1962



The CHAIRMAN. Thank you very much, Mr. Thompson. Any questions?

Senator GORE. As a part owner of a very small hardware store, I find your statement very interesting. I wonder if this credit you extend to your customers is without interest, generally speaking.

Mr. THOMPSON. Yes, sir, Senator; it is without interest. This merchandise is put on a dating term. For example, we will ship the power mowers in January and February, and we give them what is known as April 1 dating. I am not sure whether they use the same terminology in your part of the country, but the April 1 dating means they can discount their bill in May, on May 10. The same thing is true for toys which they buy in July and pay for in January. There is no interest charge whatsoever on this financing. This enables the dealer to have the merchandise in stock prior to the season so that he, in turn, will not miss sales. He will have it available for his community.

Senator GORE. One of your very able members, Orgill Bros. in Memphis——

Mr. THOMPSON. Yes, sir.

Senator GORE (continuing). Asked me to be sure and hear your testimony. Will you report to them that I listened attentively?

Mr. THOMPSON. Senator Gore, I will be glad to report to Joe Orgill; yes, sir.

Senator GORE. Well, I find your statement quite interesting and well prepared. Thank you.

Mr. THOMPSON. Thank you very much.

The CHAIRMAN. Senator Morton.

Senator MORTON. You tell the president of the Belknap Hardware that I was here, too. [Laughter.]

Mr. THOMPSON. I will be delighted to do that; yes, sir, Senator.

Senator MORTON. What percentage of your competition, or do you have any estimate, is from merchandising cooperatives? Do you have any estimate on that?

Mr. THOMPSON. Senator Morton, it is pretty difficult to know for sure. Naturally they are not members of our association so they do not report to our association. We can only make some very broad estimates. It varies in different areas.

The Middle West, out of Chicago, Minneapolis, and in that area that seems to be one of the cooperative's strong points—and in that area—this is where I am competing—I would say that 50 percent of the business is going through these large dealer-owned wholesale cooperatives. It is just a broad guess, sir. I have no figures to back it up.

Senator MORTON. That is all, Mr. Chairman. Thank you.

The CHAIRMAN. Thank you, Mr. Thompson. You are a very interesting witness.

Mr. THOMPSON. Thank you.

The CHAIRMAN. The committee will adjourn until 10 o'clock next Tuesday morning.

(By direction of the chairman, the following is made a part of the record:)

STATEMENT BY SECRETARY OF LABOR W. WILLARD WIRTZ

It is a great tribute to the American citizen that although he carries—and complains about—one of the heaviest income tax burdens in history, and one which exceeds that of most persons abroad, he shows reluctance in laying down even a portion of his load before he is thoroughly convinced that a tax reduction no longer embodies a threat to the economy or to our national goals.

It is my sincere opinion that we now have in the United States a conjunction of circumstances which assures us that the proposed tax cut program marks the course not of weakness, but of wisdom, indeed of necessity.

There have been substantial gains in the economy in the past 2½ years—since the first quarter of 1961. Our rate of expansion, adjusted for price changes, has been well over 5 percent a year during this period. In the past, such a prolonged expansion would have meant that we were nearing a practical peak in our ability to produce—that bottlenecks of capacity and manpower could be expected to appear in the near future, that unit costs would be rising with a resultant squeeze on profits, and that higher interest rates would be needed to suppress incipient inflation.

Today the situation is quite different. Despite the long and vigorous expansion, we are still considerably short of capacity utilization of either our productive facilities or our manpower. From the manpower standpoint, the improvement in the amount of time lost due to unemployment and short hours was much less in the past recovery than in the two preceding ones.

Thus, if the business cycle were to turn downward in 1964, it would not be because of the strains and bottlenecks and overextensions such as preceded other downturns. It would be, instead, because of a failure to generate enough consumer demand and enough investment initiative. Such failure would be the direct result of a tax structure which was designed to hold down demand when the economy was under great strain. It is still holding down demand, but that it is no longer needed. There is every reason to believe that if we take measures to increase purchasing power and stimulate investment we can expand production at an even faster rate than has occurred over the past few years, and at the same time increase our economic stability.

As Secretary of Labor, I confine my remarks to two crucial factors in the manpower area. First, in the past few years there has been a relatively strong rate of increase in output per man-hour in the entire private economy. In the 5-year period, 1952–57, the annual rate of gain in productivity among wage and salaried workers was 2.8 percent. While this was well below the rate earlier in the immediate postwar period, it greatly exceeded the average growth rate of 2 percent between 1909 and 1947. Between 1957 and 1959, productivity

rose 3 percent a year, but then slowed to 1.9 percent in the recession of 1960. From that point on, however, gains have been rapid. The annual increase from 1960 through 1963 will approach 3½ percent, according to preliminary estimates, and we see no reason to anticipate a significant slackening next year.

Productivity gains have been as large or larger than this in earlier periods—generally years of sharp recovery in the economy. But for such large productivity gains to be sustained over so long a period has been unusual. Technology may be giving us a new dimension of growth. Production can grow faster than ever before. Unless we have a sharply stepped-up demand, however, such gains in production as do occur may not be large enough to forestall a decline in job opportunities.

The other factor I call to your attention is the reservoir of labor in the United States. The modern economy places a premium on literate, trained, and flexible workers; unfortunately many of our unemployed are lacking sufficient skill and education to be readily absorbed by industry today. We in the Department of Labor would be the last to underestimate this problem and the first to call for programs to improve the education and adaptability of the less readily employable elements of our labor force. We consider large-scale and broadly conceived educational and training programs to be absolutely essential in the years ahead, especially as the economy approaches the new levels of manpower demand to be expected from the tax cut.

However, as a means of reducing present unemployment, we consider a tax cut even more important than these manpower programs. There will be, for some time to come, a good supply of high-caliber workers. Among the 4 million unemployed today there are many workers who are in no way inferior to those presently holding jobs. Reports on the labor market situation the country over indicate no major areas of general labor shortage in this country and only 15 where the unemployment rate is relatively low; that is, less than about 3 percent. Employers do not have to search for employees except in unusual cases; well-trained competent help is generally available. In addition, highly experienced men and women in the older age brackets have retired because of lack of work opportunities, and would be glad to avail themselves of suitable jobs.

Considerable notice has been given to the fact that the postwar baby crop has now been reared and educated and has arrived at the age of gainful employment. This summer the number of young jobseekers rose significantly and this was a factor contributing to high unemployment rates. This influx of new workers will be accelerating in the years ahead. These new workers will have, on the average, a higher educational attainment than the experienced labor force.

Between 1955 and 1960, about 800,000 people were added to the labor force annually. During the first half of this decade the annual increase should average nearly 1.2 million—although our ability to employ so many new workers depends on the degree of prosperity we can maintain. In the latter half of the decade we will be adding people to the work force at an even higher rate—more than 1.3 million per annum, assuming we maintain high employment.

It is difficult, even for those of us who work almost daily with the figures, to conceive of the upward thrust to the production of goods and services that the combination of these two factors—rapid productivity increases and stepped-up labor force growth—makes possible and urgently necessary. They present us with both a sharp challenge and a vast opportunity for economic betterment. We cannot hope to rise to the opportunity if we fail to remove, as fully as possible, the heavy drag of our present tax burden on initiative and consumption.

Personal income taxes (by Federal, State, and local governments) alone have increased from 9 percent of the gross national product in 1955 to 10.4 percent in 1962, when they amounted to nearly $60 billion. (This does not take into account increases in property taxes, sales taxes, and other levies which bite into the consumer's income.) The proposed tax reduction does not represent a drastic shift in the proportion of consumer income going to governments—it merely restores a relation which existed earlier.

We have to expand output, at a faster pace than is typical of peacetime years if we are to provide jobs for the newcomers to the labor force and keep our present labor force fully employed. The chairman of the CEA has called for increases in GNP of $40 to $50 billion a year, or 6 percent to 8 percent for the next few years. The President stated the same objective in manpower terms when he said we needed 10,000 new jobs a day for 2½ years to attain satisfactory employment levels.

We still need all that we can possibly produce. Our major remedy for meshing our two basic economic needs—our need to increase production and our need to

increase consumption—is remarkably simple. It requires no new economics—only the understanding that our tax structure must be revised downward now for the same reasoning which impelled us to raise it in 1942—the attainment of levels of private demand consistent with our ability to produce.

Much of the hesitation about a tax cut rises from fear of inflation, but this fear derives from an inadequate appreciation of the growth potential of our economy. As long as productivity keeps rising strongly, as long as the supply of workers keeps expanding numerically and improving in quality, and so long as American business retains its initiative and its competitiveness, there is no need to fear inflation.

Fortunately, a much better balance has been achieved in the last few years between productivity and wage gains than prevailed throughout much of the fifties. Employee compensation per unit of output in the private nonfarm economy rose only very slightly between 1960 and 1962, in sharp contrast to the 5 preceding years, when it rose by 14 percent.

In my opinion, the wage and price restraint exercised by labor and management is a persuasive reason for passing on the benefits of productivity gains in a tax cut.

A tax cut in January would be excellently timed because the economy still has upward drive and consumers and business are optimistic. In a recession, or even a period of leveling in business activity, the favorable impact of an increase in income might be less. At lower levels of capacity, business would still hesitate to expand. But coming at a time of high business momentum, a tax cut will supply the impetus that over a period of time will bring us much nearer our goal of full employment.

NATIONAL OLD LINE INSURANCE CO.,
Little Rock, Ark., November 7, 1963.

Hon. JOHN L. MCCLELLAN,
Senate Office Building,
Washington, D.C.

DEAR SENATOR MCCLELLAN: As you know, the President's tax bill, H.R. 8363, is now pending further action by the Senate Committee on Finance. Certain provisions in the bill as passed by the House of Representatives relate to the eligibility of transactions for capital gains treatment.

The purpose of this letter is to request your support of S. 2154 introduced by Senator Long on September 18, 1963, which is a capital gains amendment to H.R. 8363, the effect of which is to accord equity to small mutual insurance companies and life insurance companies, so that they will be taxed on gains realized from the sale of bonds purchased at less than par value in the same manner as all other taxpayers are taxed. As Senator Long explained in his statement appearing in the September 18, 1963, issue of the Congressional Record, and I would hope that if you have not already read his brief statement, you will review it on pages 16451–16452 of the Congressional Record, life insurance companies and small mutual fire and casualty companies are the only taxpayers denied capital gains treatment on market profits realized from bonds purchased at less than par value. This results because these particular taxpayers are required to accrue annually a pro rata part of the difference between the par value of the bond and the lower price at which it was purchased. All other taxpayers report bond discount as capital gains when the bond is sold, called, or matured.

S. 2154 will, by eliminating the required accrual of market discount for all bonds, correct a matter which was overlooked when the Life Insurance Company Income Tax Act of 1959 was enacted.

It will be helpful if you will refer this letter to Senator Byrd, chairman of the Finance Committee, and have it included in the hearings on H.R. 8363.

Most sincerely,

R. D. LOWRY.

OREGON HIGHWAY USERS CONFERENCE,
Salem, Oreg., November 1, 1963.

Subject: H.R. 8363.
Hon. MAURINE B. NEUBERGER,

U.S. Senator, Senate Office Building, Washington, D.C.

DEAR SENATOR NEUBERGER: At its membership meeting held in Portland, October 22, 1963, the enclosed resolution was unanimously adopted by Oregon Highway Users Conference.

Paragraph 1 outlines the structure of the conference membership. Paragraph 4 explains the concern the conference has if H.R. 8363 is enacted.

The subject is presented for your consideration trusting you will aid in deleting that section of the proposed act which would disallow as deductions from Federal income tax returns, payments of State gas taxes, license fees, and related State taxes.

Copies are also being sent to Senator Morse.

Sincerely,

GEORGE W. DEWEY, *Chairman.*

RESOLUTION OF THE OREGON HIGHWAY USERS CONFERENCE, SALEM, OREG.

SUBJECT: H.R. 8363

Whereas the Oregon Highway Users Conference is a nonprofit organization whose membership is composed of trade associations, commercial haulers, private passenger car owners, suppliers of transportation equipment, rural mail delivery people, and other highway users; and

Whereas owners of equipment used in the above operations pay taxes such as those imposed on the purchase price, on replacement parts, on rubber recap material and related material; and

Whereas a proposal now is before Congress to impose an additional and inequitable tax burden upon these users by eliminating the present deduction of State gasoline and other motor vehicle taxes from income taxes; and

Whereas the Oregon Highway Users Conference fears that if State gas taxes, license fees, and other State taxes are disallowed as deductions for income tax purposes, such action may be the opening wedge in removal of State income and property taxes as deductions: Now, therefore, be it

Resolved, That the Oregon Highway Users Conference vigorously opposes the injustice of this proposal and urges Congress to reject this unfair and unjustified special application of taxes to the user of motor vehicle equipment.

PORTLAND, OREG., *October 22, 1963.*

PACIFIC SCIENTIFIC CO.,
San Francisco, Calif., November 11, 1963.

Subject: H.R. 8363—Revenue Act of 1963—Employee group-term life insurance (sec. 203).

U.S. SENATE,
Senate Finance Committee,
Washington, D.C.
Attention: Senator Harry F. Byrd, chairman.

MR. CHAIRMAN AND GENTLEMEN: In the process of private industry's endeavor to provide greater financial security for their employees, industry has used the employee group-term life insurance as one of the prime instruments. It is of great concern to us to see the present limiting proposal which would have a disrupting effect on long-established plans.

The effect of the proposal on the older worker seems contrary to public policy. Group insurance provides him with a lightening of the insurance premium costs which for the worker past the middle 40's increase very rapidly.

Customarily the Treasury Department's concern is that insurance coverage be related to level of earnings and length of service which provide a consistent yardstick and that, therefore, the application in this manner is nondiscriminatory. Many older employees are including this as part of their long-range financial planning but may find that paying the additional cost is beyond their financial resources.

There can be a very minimal increase in tax receipts from this program, especially compared with the upset to the employee groups in terms of potential financial hardship. This group which is older and probably higher on the salary bracket is already subject to progressively heavier taxation. If the real concern is with the "jumbo" insurance coverage, a maximum dollar limitation could be set but certainly not down at the $30,000 level which has an almost punitive effect on the older employees in industry.

Another aspect is the effort in terms of administration and the expense of calculating costs and taxable income on each individual covered. If this additional income would also be subject to tax withholding, the administrative problems would be increased even more. Some consideration should be given to this

cumulative cost increase to all industry even though this is not a direct cost to the Federal Government.

We respectfully ask your consideration of our comments and that they be made part of the committee's record.

Very truly yours,

PACIFIC SCIENTIFIC CO.
SHIPHERD ROBINSON, *Treasurer.*

SCREEN ACTORS GUILD,
Hollywood, Calif., November 11, 1963.

Hon. HARRY F. BYRD,
Chairman, Senate Finance Committee,
Washington, D.C.

DEAR MR. CHAIRMAN: This statement is submitted by the Screen Actors Guild, Inc., in support of section 221 of the revenue bill of 1963 which repeals sections 1301–1307 of the Internal Revenue Code of 1954, relating to the averaging of income in six specific situations, and subtsitutes therefor new sections 1301–1305, relating to a general income averaging provision.

The Screen Actors Guild is a branch of the Associated Actors and Artistes of America and is recognized as the exclusive bargaining agent in the United States, its territories, and possessions, for actors and actresses in the motion picture industry. The guild has collective bargaining agreements with over 1,000 producers of theatrical, television, industrial and educational motion picture producers, and with producers of filmed television commercials.

Guild membership consists of more than 15,000 motion picture actors and actresses, ranging from top stars to the smallest bit players who receive minimum union scale pay for each day of work and only for such days as they actually work. Contrary to popular belief, the majority of the guild's membership is in the average to low-income groups, 85 percent of its members last year earning less than $7,500, and 65 percent of its members earning less than $3,000, from their services as motion picture actors and actresses.

It is this average to low-income group, forming the majority of guild membership, which will realize the most benefits from the enactment of the general income averaging provision of section 221 of the revenue bill of 1963. It is not at all uncommon for such persons to experience marked fluctuations in their income, dramatice examples being those persons who once in their careers score a major, but unfortunately, short-lived success, finding themselves with peak earnings bunched in 1 or 2 taxable years.

Under current law, a taxpayer whose earnings fluctuate from one taxable year to the next, or who experiences a bunching of income, bears a greater tax burden than a taxpayer who during the same period receives a more or less level income of the same total amount. The income-averaging provisions of current law, due to their rather restricted scope of operation, ordinarily afford no degree of relief from this additional tax burden. And in this period of high taxation of income from personal services generally, in comparison to other classes of income, such as for example, gains from investment, taxpayers receiving fluctuating or bunched personal service income find themselves with substantially less after-tax income than their fellows, merely as a result of the fortuitous circumstance of income fluctuation and the character of the income received.

Enactment of the general averaging provision section 221 of the revenue bill of 1963 will provide a measure of long overdue tax relief to the majority of those taxpayers who experience marked fluctuations in, or a marked bunching of, income. The provision in its current form will materially lessen the disparity of tax treatment between such taxpayers and those who, during the same period, receive a more or less level income of the same total. In light of the real need for an averaging provision of general applicability and recognizing the many administrative advantages of the averaging provision of section 221, the Screen Actors Guild supports enactment of the provision by this Congress. Its enactment will represent an important step in the creation of an income tax structure which is both sound and fair to taxpayers generally.

Equally important, the general averaging provision of section 221 in actual operation should prove on the whole to a relatively simple provisions for both taxpayers and revenue agents alike. The provision does not require the reopening of prior taxable periods or amendments to returns previously filed by a taxpayer, and so, avoids many of the administrative complexities normally associated with income averaging. The mathematical computations required

to be performed by the average taxpayer are relatively simple and the average taxpayer should have little trouble in understanding and applying the provision to his specific circumstances. Complexities do arise, however, where taxpayers receive capital gains income or cease to, or first elect to, file joint returns during the 5-year period involved in the averaging computation. But even the more complex computations invoIed in these situations should be within the understanding of the taxpayers involved.

We have applied the general averaging provision of section 221 to a number of actual cases involving members of the Screen Actors Guild. The following schedule reflects, in summary form, the effect of the provision. In order to provide a direct comparison with the examples which accompany section 221, we placed the highest income in the "computation year" and applied the proposed rates for 1965. It will be seen that although the tax reduction may appear to be relatively small in amount and percentage when compared to the tax otherwise due for the computation year, the effect of the provision is to place a taxpayer receiving fluctuating or bunched income materially closer to the position of a taxpayer who during the same period received a more or less level income of the same total amount.

	Case 1	Case 2	Case 3	Case 4	Case 5
1. Taxable income:					
1961	$16,335.98	$10,402.31	$9,213.17	$11,028.82	$1,445.93
1962	7,554.41	15,587.71	11,475.41	9,242.91	6,000.02
1963	30,058.34	4,031.85	15,309.18	7,415.69	12,495.12
1964	39,551.99	6,290.42	11,287.71	5,797.68	14,395.16
1965	60,991.66	23,928.89	22,145.55	17,045.75	16,261.80
2. Tax liability for computation year (1965) without the benefits of averaging	29,424.66	7,994.44	7,102.77	4,769.21	4,439.95
3. Tax liability for computation year with averaging	28,081.64	7,194.70	6,882.49	4,512.25	4,275.43
4. Tax saving	1,343.02	799.74	220.28	256.96	164.52
5. Percentage reduction in tax for computation year	4.56	10.00	3.10	5.38	3.70
6. Total tax payable for period 1961-65 without the benefits of averaging	63,005.44	16,381.97	18,397.22	11,835.84	12,598.64
7. Total tax payable for period 1961-65 by a taxpayer receiving a level income of the same total amount	58,130.80	14,236.68	17,545.10	11,119.85	11,129.10
8. Tax saving (item 4 above) as a percentage of the difference between (6) and (7)	27.55	37.27	25.85	35.88	11.19

It should be noted, however, that even with the averaging provision of section 221, a substantial disparity in treatment will continue to exist between taxpayers receiving fluctuating or bunched income and those receiving a more or less level income of the same total amount.

This continued disparity in treatment arises from the base-income concept of section 221. Section 221 would provide that only that portion of the income which exceeds base income (133⅓ percent of averageable income), and not all income in excess of average income for the prior 4 years, is to be included in the averaging computations. This serves to reduce the degree of relief afforded by the averaging provision below that which would be available if average, rather than base, income were used as the starting point of the computation. One of the functions of the base-income concept, however, is apparently to avoid the creation of disparity in treatment between taxpayers whose fluctuations in income qualify them for averaging relief and those whose fluctuations are not sufficiently great to qualify them. If base income were not used as the starting point for the computation of averaging relief, the tax burden sustained by the taxpayer not qualifying for averaging could be greater than that sustained by the taxpayer qualifying for averaging.

As a result, some base-income concept, even though it reduces the relief provided by section 221, appears to be an administrative necessity.

The averaging provision of section 221, however, may be criticized in that it offers no relief to taxpayers experiencing marked decline in their taxable income. In its statement before the House Ways and Means Committee, the guild called attention to the fact that the President's proposal, now incorporated in section 221, offers no relief to taxpayers, such as professional athletes, who rather quickly attain levels of fairly high income which are maintained for fairly short

periods, and then fall off sharply. With such persons in mind, the guild suggested, and again suggests, that consideration be given to enlarging the general averaging provision of section 221 to offer a degree of relief to persons experiencing marked declines in income. A provision, consistent in principle with that of section 221, which permits averaging of income to reflect a marked decline in income, appears to be possible of formulation, and, as with section 221, appears administratively feasible.

More important, such an enlarged averaging provision would also reduce the disparity in treatment between taxpayers receiving fluctuating or bunched income and those receiving a more or less level income of the same total amount which will continue to exist under section 221 in its present form. With reference to the illustrative cases above, such an enlarged averaging provision would have offered further relief, in most, if not all such cases, and as a result, would be a more meaningful averaging provision for taxpayers generally.

In summary, the Screen Actors Guild, on behalf of its membership, supports enactment of the general averaging provision of section 221 of the Revenue Act of 1963. And while it feels that an enlargement of the scope of the averaging provision in the manner outlined above is advisable, the averaging provision in its present form offers long overdue relief to taxpayers receiving fluctuating or bunched income. It significantly reduces the existing disparity of treatment between such taxpayers and those receiving more or less level income and thereby lessens the tax importance which now flows from the merely fortuitous event of the timing of income receipt, and for this reason, should be enacted into our tax law.

The Screen Actors Guild takes this opportunity to express its appreciation for the consideration to be extended by your committee to this matter.

Respectfully,

SCREEN ACTORS GUILD, INC.,
JOHN L. DALES,
National Executive Secretary.

ERSKINE & TULLEY,
San Francisco, October 1, 1963.

Hon. HARRY F. BYRD,
Chairman, Senate Finance Committee,
Senate Office Building, Washington, D.C.

DEAR SENATOR BYRD: The revenue tax bill of 1963 as ordered reported by the House Ways and Means Committee on September 10, 1963, contains a grossly unfair and unreasonable provision for retroactive application of the amendments proposed by section 214 of the bill. This section would amend the provisions of the Internal Revenue Code dealing with employee stock options. With certain qualifications, the amendments would apply to options issued or modified after June 11, 1963.

The unfairness of designating June 12, 1963, as the operative date of the amendments is illustrated by the effect it would have upon a client of my office. (I have no doubt that many other attorneye are facing similar situations.)

In California a permit of the corporations commissioner is required to issue stock options. In this particular case we applied for such a permit in April of 1963. The application included the option plan, which had been prepared to qualify the options as restricted stock options for income tax purposes on the basis of present tax law. The permit was not issued until after June 11, 1963. By that time we were aware that certain retroactive amendments of the restrictive stock option provisions of the Internal Revenue Code were being considered but information as to the specific form these amendments would take was not available. For this reason it was impossible, as a practical matter, to revise the plan to conform with what the amendments might be. We advised our client of this dilemma and suggested that issue of the options be postponed until Congress had acted on the proposed amendments or at least until they were drafted and reported by the Ways and Means Committee. However, the practicalities of the situation made this inadvisable. The plan to issue the options had become known to the employees, and there was a possibility that the market price of the company's stock would increase. Under those circumstances, an undesirable employee relationship problem may well have developed if issue of the options had been postponed. Therefore, the options were issued in conformity with the law as it then existed.

We did feel, and we so advised our client, that it was unlikely that the retroactive provisions of the possible amendments would be unduly prejudicial or

unfair. In previous amendments of the Internal Revenue Code unreasonable retroactivity has been scrupulously avoided by Congress. We believed that this policy would continue to be observed. However, if section 214 of the bill is enacted with June 12, 1963, as the effective date of the amendments, unreasonable retroactivity will be the result. Therefore, I respectfully urge that you exercise your influence and vote so that the effective date of all of the amendments recommended by section 214, which are to have retroactive effect, be advanced to at least the date when the proposed amendments were first made known to the public and the legal profession in specific form. This date was about September 12, 1963.

Respectfully yours,

MORSE ERSKINE.

U.S. SENATE,
Washington, D.C., November 6, 1963.

MRS. ELIZABETH B. SPRINGER,
Chief Clerk, Senate Finance Committee,
New Senate Office Building, Washington, D.C.

DEAR MRS. SPRINGER: Enclosed is copy of a letter and attachment which I recently received from a constituent. I would appreciate your making the statement a part of the record of the Finance Committee hearings on the tax bill if such a statement has not already been submitted for the record.

With every good wish, I am,

Sincerely,

RUSSELL LONG.

TRAILMOBILE,
NEW ORLEANS BRANCH,
New Orleans, La., October 17, 1963.

HON. RUSSELL B. LONG,
U.S Senate, Washington, D.C.

DEAR SENATOR LONG: The present 2-percent penalty tax on consolidated returns is an unjust and unwise tax. It penalizes the very type of tax return that should be encouraged. I am, therefore, pleased that section 222 of the revenue bill of 1963 would repeal this tax. All industry will welcome this action.

It is perhaps unfortunate that from time to time the proposal to repeal the 2-percent penalty tax has been linked with the proposal to reduce the number of surtax exemptions given to an affiliated group. The two measures should be considered independently. I mention this point only because it may be that some opposition will develop with respect to section 223 of the bill which would reduce the surtax exemptions of certain controlled corporations. If so, it would be unfortunate if opposition to section 223 affected section 222, for the elimination of the 2-percent penalty tax should stand on its own feet.

I enclose a statement which has been submitted for the record which elaborates our views on this subject.

I appreciate that many items in this tax bill are controversial, but I would like you to be aware of my views on this particular section, and I would certainly appreciate your help in seeing that this much-needed reform is adopted.

Very truly yours,

TRAILMOBILE,
GEORGE DENNIS, *Branch Manager.*

STATEMENT OF PULLMAN, INC., IN SUPPORT OF SECTION 222 OF H.R. 8363 REPEALING THE 2-PERCENT TAX ON CONSOLIDATED RETURNS

Section 222 of the revenue bill of 1963 would repeal the present 2-percent penalty tax levied on the consolidated net income of affiliated corporations filing consolidated returns. We heartily endorse the repeal of this inequitable and unwise tax.

An affiliated group of corporations may, in general, report their taxable income either by one consolidated return or by separate returns for each corporation. The consolidated return combines the income and deductions of the several members to arrive at a consolidated net income figure for the economic unit.

The inequity of assessing a 2-percent penalty on consolidated returns has been

recognized by all who are familiar with this aspect of the law. Both President Eisenhower and President Kennedy have recommended to Congress that this penalty be repealed. Many organizations have advocated its repeal. The most recent example was the action of the section of taxation of the American Bar. Association in August of this year.

A start was made by the 1954 Code which removed the penalty with respect to returns of regulated public utilities. The second step was taken by the passage by the House of Representatives of H.R. 8363. Favorable action by the Senate on this proposal would complete the removal of this unjust tax.

I. THE USE OF CONSOLIDATED RETURNS SHOULD BE ENCOURAGED RATHER THAN PENALIZED

A consolidated tax return more properly reflects the taxable income.—Businessmen, accountants, and others have long recognized that a consolidated financial statement is the best way to reflect the income of an affiliated group of companies. This is illustrated by the fact that, almost without exception, financial reports to stockholders are on a consolidated basis.

An affiliated group is an economic unit and should be taxed as such.—This principle is already recognized in the tax law. For example, an affiliated group of corporations is treated as a single entity for the purpose of the $25,000 and $50,000 limitations of the investment credit. An affiliated group is also treated as a single taxpayer in computing the additional first year depreciation allowance on the $10,000 limitation.

Consolidated returns reduce the administrative task of the Revenue Service.—The auditing of one return from a central Internal Revenue Service office involves far less work than auditing many returns which may be scattered in various Internal Revenue Service offices. Furthermore, a consolidated return minimizes the need to audit intercompany transactions , such as intercompany sales, loans, service fees, and dividends. These transactions are frequently complex and require much audit time and effort.

The 2-percent penalty tax is economically unwise.—Despite the proposed reduction in corporate rates, the tax burden will continue to make it difficult for corporations to provide the capital for the replacement and expansion of machinery and equipment which is so necessary for a healthy economy and full employment. To add to this burden by an additional levy on consolidated returns is economic folly, particularly in view of the small revenue loss estimated to be only $50 million a year.

The 2-percent penalty is inequitable.—Only those companies which for legal or economic reasons must operate through subsidiary corporations are subject to the tax. Other companies which can and do operate through branches and divisions rather than through subsidiaries pay no such penalty. The exclusion in 1954 of regulated public utilities from the operation of the 2-percent penalty was predicated on the fact that such businesses are usually required to operate through subsidiary companies. However, there are many other business enterprises besides regulated utilities which cannot readily function as a single corporation. The tax treatment of such businesses should be equated with that of the public utilities by the elimination of the 2-percent penalty.

The historical reason for the 2-percent penalty no longer exists.—A penalty on consolidated returns was first imposed for the year 1932. Prior to 1932, operating losses could be carried forward 2 years. Starting with 1932, this provision was eliminated. It was realized at that time that the effect of eliminating loss carry forwards could be avoided by an affiliated group filing a consolidated return. In such a return, the loss of one company could be offset by the profits of another company. The penalty tax was thereupon conceived and enacted to offset this advantage of the consolidated return. All remnants of this reasoning have now disappeared. The present law permits operating losses to be carried back 3 years and forward 5 years. This is a far more liberal arrangement than that which was repealed in 1932.

II. THE REPEAL OF THE 2-PERCENT PENALTY SHOULD NOT BE DEPENDENT UNPON OTHER PROVISIONS OF H.R. 8363

Section 222 repealing the 2-percent penalty tax is complete in and of itself and should in no way be dependent upon or coupled with the proposed reduction of surtax exemption contained in section 223. An affiliated group of corporations which files a consolidated return is automatically limited to one surtax exemp-

tion and in no way is concerned with the problems which the proposed reduction of surtax exemption seeks to correct.

The proposed change in normal tax rates for corporations will increase the value of the surtax exemption from the current $5,500 to $7,000 in 1964 and to $6,500 for 1965 and subsequent years. To prevent this increased benefit from being proliferated, section 223 reduces the benefit to certain groups of multiple corporations whether or not they can file consolidated returns. Thus, the proposed reduction of the surtax exemption is the product of change in the tax-rate structure and should not be related to the 2-percent penalty imposed upon consolidated returns.

III. RECOMMENDATION

For the reasons set forth above, we respectfully urge that the Finance Committee of the U.S. Senate take favorable action to repeal the 2-percent additional surtax now imposed upon affiliated corporations filing consolidated returns.

PULLMAN INC.,
D. H. LARMEE, *Assistant Vice President, Taxes.*

THE WELCH GRAPE JUICE CO., INC.,
Westfield, N.Y., November 8, 1963.

Hon. HARRY F. BYRD,
Chairman, Senate Finance Committee,
U.S. Senate, Washington, D.C.

MY DEAR SENATOR BYRD: We wish to indicate our strong opposition to the proposals of the new tax bill (H.R. 8363), providing for taxing employees on the "cost" of group term life insurance over $30,000, which is currently under consideration by the Senate Finance Committee.

We can understand the purpose of the proponents of this revision since there may be instances where the device of life insurance protection has been used to favor certain individuals but I believe you will find this to be true primarily of small, closely held organizations. We cannot understand, however, why the longstanding insurance programs of the majority of companies, around which employees have built their own plans, must be affected and modified just to correct the possible abuse of a few. Why should tax legislation, which is intended primarily to raise revenues, have as its obvious effect the limitation of group life protection for employees?

With the increase in average earnings and the usual application of a multiple of earnings to life insurance coverages, it is perfectly natural for many employees to receive the $30,000 of protection but this is strictly proportionate to their earnings. This appears to be an opening in the door to tax other fringe benefits of this nature because if it is logical to tax life insurance, why not medical insurance. Medical plans today provide tax-free benefits which also serve to reduce the direct outlay of taxable moneys. We could be opening a pandora's box with respect to an area of demands that were originally forced upon many companies in lieu of wage demands by unions, wage stabilization policies; and governmental pressures and encouragement.

Our plan of group life insurance is noncontributory, with benefits based on income and years of service. This aspect of our employee benefits program is tied closely to our hospital and surgical insurance program, and is underwritten by the same carrier. Premiums for these coverages are experience rated and thus to arrive at a group-life cost determination for the relatively few individuals who exceed the $30,000 limit in our organization would be extremely difficult. The net effect of disrupting the advantageous balance of these related programs will, in our opinion, create costly administrative procedures and serve to undermine morale.

It should also be noted that the normal practice of most firms is to determine an average group life premium rate for all covered employees regardless of age. The proposed bill would require an increasing rate as the employee grows older—a situation which does not appear to be equitable (since the identical coverage may be involved) and one which undoubtedly will lead to more work for the corporation.

To complicate a longstanding benefit which has been fairly and equitably established, in order to correct the abuses of a minority of firms, does not appear to be justified as part of a tax bill. The relatively little tax income resulting from this proposal hardly seems to justify its passage, particularly in light of its

negative overall effects. Enclosed are two additional copies of this letter so that these comments may be entered as part of the committee's record.

Sincerely yours,

H. HARROW, *Personnel Manager.*

NIAGARA MOHAWK POWER, CORP.,
Syracuse, N.Y., November 8, 1963.

Hon. HARRY F. BYRD,
Chairman, Senate Finance Committee,
Senate Office Building, Washington, D.C.

DEAR SENATOR BYRD: We would like to call your attention to certain problems which would arise if section 203 of H.R. 8363, now being considered by your committee, is retained in the bill.

We believe that taxing group life insurance as income to employees is a radical departure from the well-established precedents that have influenced the adoption and extent of group life insurance plans and, if enacted, could logically lead into taxing other employee benefits.

Also, this tax could have the effect of restricting amounts of group life insurance which, under the McCarren Act, should be a function exercised by the various States. In addition, the proposed tax is the only one which, where applicable, would increase with an employee's age although his actual income might not have increased.

Finally, we have made a study of the effect of this tax in our own case and are taking the liberty of attaching a memorandum giving the results of this analysis.

Briefly this study indicates that some 47 of our employees would currently be affected and that the total amount of withholding would approximate $3,061 a year. We believe the administrative cost of making the withholding and keeping track of the changes will be materially in excess of this amount for the reasons outlined in the memorandum.

Since the estimate of the entire amount of tax expected to be raised by this provision is only $5 million and it is probable that it would cost employers more than this amount to collect it, this does not appear to us to be an appropriate item in a revenue bill.

May we respectfully request that your committee give consideration to eliminating this feature of the bill?

Very truly yours,

R. D. CONSTABLE, *Vice President.*

COMMENTS ON THE PROPOSAL OF THE HOUSE WAYS AND MEANS COMMITTEE TO TAX THE VALUE OF AMOUNTS OF GROUP LIFE INSURANCE IN EXCESS OF $30,000

As presently incorporated in the provisions of the tax bill being developed by the House Ways and Means Committee, it is proposed that, subject to certain conditions, the value of amounts of Group Life Insurance in excess of $30,000 will be considered as taxable income to the insured employee.

To arrive at this valuation, the committee has established a table of average values per thousand in 5-year age groupings. Using this table, the value of the excess amount may be calculated and from this value may be deducted any contributions made by the employee to the cost of the insurance, including contributions applicable to the first $30,000. Retired persons would be exempt from this tax.

The life insurance industry is opposed to this proposal even though the present version has been softened materially from the basis originally suggested by the administration. There are numerous arguments advanced in opposition, including the fact that it will be a tremendous nuisance to employers with liberal group life insurance programs and that the amount of tax which will be developed will not be commensurate with the cost to employers in arriving at the tax figures.

To check this, an analysis has been made of the people who would presently be affected under the Niagara Mohawk Power Corp. plan. The present number totals 47 and the total amount of withholding would be approximately $3,061 a year. Considering that the total Federal tax withheld in 1962 was $9,470,000, this small additional tax seems futile on the face of it.

In order to make this withholding and keep it accurate, we would have to perform the following functions:

(1) Determine who is presently affected and establish the amount of taxable income in each case, together with the additional amount to be withheld.

(2) Each employee affected would have to be advised of the amount of taxable income.

(3) Whenever an employee's earnings entitle him to an increase in his group life insurance that will bring it above $30,000, his case would have to be analyzed to determine if there were any taxable income involved.

(4) Whenever the insurance of an employee already having more than $30,000 group life insurance was increased, his taxable income, if any, would have to be recalculated and, where necessary, adjustments made in the withholding and renotification given to the employee.

(5) The age of each employee with more than $30,000 life insurance would have to be flagged since, when he passed into the next 5-year-age bracket, a recalculation would have to be made to determine whether or not any taxable, or increased taxable, income had developed. The same changes in withholding and notification to the employee as mentioned above would have to be accomplished.

It is difficult to make any exact estimate of the cost of these procedures but it would appear on the surface that these costs would exceed the taxes collected. Considering that the House Ways and Means Committee estimate of the additional tax to be developed by this change in the law is only $5 million, the value to the Government in increased revenue is insignificant and far exceeded by the nuisance cost to employers.

NATIONAL ASSOCIATION OF SMALL BUSINESS INVESTMENT COS.,
Washington, D.C., November 7, 1963.

Re H.R. 8363.

Hon. HARRY F. BYRD,
Chairman, Committee on Finance,
U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: I write on behalf of our association and to urge early and favorable action by your committee on H.R. 8363.

Our association represents approximately two-thirds of all companies licensed to operate under the Small Business Investment Act of 1958, and our member companies account for approximately 75 percent of the funds committed to the SBIC program to date.

The more than 675 SBIC's in operation have capital and surplus of nearly $590 million of which approximately $425 million has been invested in about 8,500 small firms. We believe that the experience gained by our member companies in dealing with these small firms qualifies us to comment on the effect of H.R. 8363 on small business.

First and foremost, it is clear that the proposal to reduce both corporate and individual income tax rates will be most beneficial to small business. The proposal to reverse the normal and surtax rates on corporations effective this year will be extremely helpful to small corporations since it will mean a reduction of about 27 percent in the tax liabilities of companies having taxable incomes of $25,000 or less. The vast majority of SBIC investments are in small corporations whose income is such that they are not now subject to the corporate surtax. Permitting these corporations to retain a larger portion of their earnings and profits will materially assist them in generating internal funds to finance their growth and producing a better return on the funds invested in them by SBIC's.

By the same token, the proposed reduction in personal income tax will likewise materially assist unincorporated small business concerns by permitting them to plow back a larger portion of their earnings and profits into the business.

The proposal to permit only one surtax exemption to an affiliated group of corporations under common control would, of course, mean increased taxes for such corporations and thus would counteract to a certain extent the proposed reduction in corporate income tax rates. Among small corporations in which SBIC's invest however, this proposal would not have a materially adverse effect for the reason that our corporate borrowers are generally not affiliated with other corporations within the meaning of H.R. 8363. Numerically at least, the small corporations receiving funds from SBIC's are predominantly independent corporations not subject to the 80-percent common control test contemplated by H.R. 8363.

Speaking from the SBIC standpoint however, I would hope that your committee would clarify this particular proposal to make certain that small corporations being assisted by SBIC's are not regarded as multiple corporations under common control simply by virtue of the fact that a particular group of small corporations may all be receiving financing from one SBIC. I urge this clarification from an abundance of caution, our industry having been disappointed on a number of occasions by interpretations of existing tax law by the Internal Revenue Service to the serious detriment of our industry.

The proposal to reduce from 80 to 60 percent the gross income test for determining whether a company is a personal holding company should have no effect on small concerns receiving SBIC financing for the reason that our industry is engaged in financing operating businesses as distinguished from mere holding companies. Indeed, the regulations and policies of the Small Business Administration governing our industry specifically prohibit the use of SBIC funds to finance holding companies.

On the other hand, viewed from the standpoint of the operations of an SBIC, this proposal will aggravate a most serious problem now confronting the SBIC industry. The great majority of SBIC's are small, closely held corporations where more than 50 percent of the stock is owned directly or indirectly by five or fewer individuals. All of the income which SBIC's are authorized to receive qualifies as personal holding company income except for fees which they may receive for managerial and counseling services.

Where such an SBIC earns such fees to the extent that they constitute more than 20 percent of their gross income, then under present law they are not subject to the extremely harsh personal holding company surtax. But under the present proposal, reducing the percentage test from 80 to 60 percent, the same type of SBIC would have to show more than 40 percent of its income coming from such fees for managerial and counseling services.

S. 297, the SBIC tax bill now pending before your committee, would specifically exempt SBIC's from the imposition of the personal holding company surtax. In light of the congressional purpose underlying the Small Business Investment Act of 1958, we respectfully request your committee to include in H.R. 8363 a similar exemption for SBIC's from the imposition of the personal holding company surtax.

The proposal to eliminate accelerated depreciation of real estate and to recapture excessive depreciation by taxing it as ordinary income could adversely affect many small business concerns now enjoying the benefits of SBIC financing. Recent statistics published by the Small Business Administration indicate that SBIC's have made more investments in real estate ventures than in any other single element of the economy. It is clear to me, that this particular proposal will undoubtedly result in SBIC's looking with less favor on applications for funds submitted by small business concerns engaged in real estate operations. This raises serious policy questions which I trust will receive the careful consideration of your committee in its consideration of this particular proposal.

It is our view that the proposal to curtail the tax benefits now available for employee stock options qualifying under section 421 of the Internal Revenue Code could have a materially adverse effect on the small business concerns which our industry serves. We believe that restricted stock options, as now authorized under the code, provide a very real and meaningful incentive for the principals of small corporations to assist in the growth and strengthening of the companies employing them. The small corporations which we serve, like the SBIC's themselves, are seldom able to offer salaries or other cash compensation sufficient to attract and hold the talent necessary to manage a successful business. The restricted stock option as authorized by present law does accomplish this purpose and at virtually no cost to the employing corporation. We would, therefore, oppose those provisions of H.R. 8363 proposing to curtail the benefits now extended to restricted stock options, and we urge your committee to reject this particular proposal to amend the present law.

I have referred previously to S. 297, the SBIC tax bill now pending before your committee. As the name of our program indicates, SBIC's are in business for the purpose of assisting small business. It is our position that anything which will facilitate our operations as SBIC's will be of direct benefit to the small business concerns which we serve. We, therefore, respectfully suggest that your committee consider and act favorably on S. 297 as a logical and necessary complement to H.R. 8363.

In light of the many benefits for small business implicit in H.R. 8363, our membership is most anxious that your committee act promptly and favorably on the bill to insure its enactment into law this year. Accordingly, and in order to avoid extending your hearings further than necessary, I am not requesting an opportunity to appear in person, but I do respectfully request that the foregoing comments be incorporated in the printed record of your hearings.

Sincerely yours,

JAMES W. HOWARD, *President.*

FIRST NATIONAL BANK IN DALLAS,
Dallas, Tex., November 7, 1963.

Senator HARRY F. BYRD,
Chairman, Senate Finance Committee,
Washington, D.C.

DEAR SENATOR BYRD: We understand that tax bill, H.R. 8363, passed by the House and now before your committee for hearings, contains a provision for taxing employees on the "cost" of group term life insurance over $30,000.

In the case of our bank, we have a group term life insurance plan providing for maximum coverage of $40,000, the cost of which is partially borne by the bank in that the insurance is made available to employees at a favorable rate actually lower than the amount charged by the insurance carrier. Only for people 60 years or older would there be a tax liability and the amounts involved are too small to be consequential. In the case of other businesses, the tax would be less or greater, of course, depending on amount of the cost borne by the employer. The figuring we have done leads us to believe that relatively little tax income would result and that there would be a great deal of confusion in getting the members of group life insurance plans to understand and report correctly the small amounts of taxable income which the newbill seeks to trap.

Additional applicable logic is that unless there is some gross inequity to be corrected, or some substantial important revenue involved, it would seem questionable wisdom to disrupt the tax basis on group term life insurance plans, most of which have been in effect for a long period of years. Many of us actively engaged in business feel that employee benefit programs should enjoy favorable tax treatment, and should not be subjected to changes of the character involved in the new bill.

Thank you for the privilege of registering our opinion.

Very truly yours,

F. O. CARTER, Jr.,
Senior Vice President.

EMPIRE STATE CHAMBER OF COMMERCE, INC.,
Albany, N.Y., November 5, 1963.

Hon. HARRY F. BYRD,
Chairman, Committee on Finance,
Senate Office Building, Washington, D.C.

DEAR SENATOR BYRD: This letter gives a full statement of the views of the Empire State Chamber of Commerce on the pending Federal tax revision bill. These views were arrived at after careful study by our committee on taxation. Our committee recommendations, in turn, have been reviewed by our board of directors which formally authorized us to transmit them to you as an expression of the chamber's views.

Broadly speaking, the chamber supports the bill now before your committee, since we believe that a reduction in Federal taxes is long overdue. We believe further that tax redution should be accompanied by a substantial reduction in Federal spending. In achieving such cuts, we commend your attention to the specific proposals that have been submitted to the two Appropriation Committees by the Chamber of Commerce of the United States. However, we do not believe that reduction in taxes should be tied to, and made contingent upon, an expenditure cut as was proposed but rejected in the House.

While we support the bill in general, we find in it some objectionable features which we definitely oppose. These are:

(1) The proposed speedup in corporation taxpayments which in effect will largely offset the decrease in taxpayments for some years to come. This is, in effect, a tax increase which will have a seriously harmful effect

upon the cash position of many companies. Some companies may have to borrow to pay their income taxes. The bill makes no provision for corporations with fluctuating incomes, many of which earn the bulk of their profits during the final quarter of the fiscal year. We strongly object to this proposal.

(2) The 6-percent penalty tax on corporations using multiple surtax exemptions: This is unfair to many companies who by force of circumstances or law are called upon to operate with corporate subsidiaries in each individual State where they do business.

(3) The minimum standard deduction of $300 for the personal income tax. This is an obvious part of the bill's plan to give a disproportionately large reduction to the low-income group. It impairs the "ability-to-pay" theory on which the income tax is based and will eliminate about 1,700,000 people from the income tax rolls. This group, and its spokesmen, are among the most vociferous advocates of heavy Federal Government spending. Certainly if they want Government to spend they ought to be willing to pay part of the cost.

(4) Allowing tax-free reimbursement of moving expenses for new employees is a desirable change but is insufficient. The committee believes reimbursement of such expenses should not be confined to costs of moving of household goods, but should cover any expenses incidental to moving for which the employee is reimbursed by his employer.

(5) Proposed $30,000 ceiling on group life insurance is opposed as wrong in principle. The committee feels that if the company has an insurance plan with gradations in insurance related to, and consistent with, various salary levels, such as premium payments by a company should not be taxable to the employee.

(6) Stock options: The retroactive application of the proposed change back to June 11, 1963, is opposed as unfair. Application of any such change should be prospective only.

(7) Dividend credit: The committee recommends opposition to the reduction and eventual elimination of the 4-percent credit on dividends. This credit was adopted as a first step toward eliminating double taxation of corporate income, and to eliminate it is a retrogression. Instead it really should be increased.

(8) Change in depreciation allowance on sales of real estate in the proposals for treatment of so-called real estate "tax shelters." This in effect would restore the straight line depreciation method when real property is sold. This will lay the groundwork for future adoption of a straight line basis when figuring capital gains on sale of machinery and equipment. This philosophy, if allowed to get into the law, may eventually do away with the benefits of the faster writeoffs now allowed under recent changes in depreciation rules.

This letter supplements, in effect, the testimony of Mr. John L. Connolly, chairman of the Committee on Federal Finance of the Council of State Chambers of Commerce, in which testimony we concur, generally speaking, with the exception of one item which Mr. Connolly referred to. We submit this fuller statement of our views in the hope that it may be helpful to your committee members and staff in your consideration of this bill. We ask that it be included in the record of the hearings now being conducted by your committee.

Sincerely yours,

JOHN J. ROBERTS,
Executive Vice President.

STATEMENT OF DANA LATHAM, OF LATHAM & WATKINS, LOS ANGELES, CALIF., IN OPPOSITION TO CHANGING INTERNAL REVENUE CODE, SECTION 1014 (BASIS OF PROPERTY ACQUIRED FROM A DECEDENT)

General agreement exists that income taxes should be reduced. Numerous debates, however, are taking place over how the reduction should be distributed and as to what reforms should be adopted. One proposal not presently in the House bill deserves the most serious consideration of all the controversial issues. I will in any event limit my views to this one topic—namely, the proposal to carry over the decedent's basis for capital assets.

Notwithstanding any reduction yet proposed, taxes are going to be so high for the foreseeable future that they will have a major part in the shaping of indi-

vidual and business economic decisions. However presented, the carryover basis idea or the proposed tax on capital appreciation at death must be considered openly for what they both are—namely, substantial, indirect increases in the estate tax. Any increase in the tax on capital at death without a complete overhaul of that statute will only accentuate its present undesirable impact on the economy. Such an increase without appropriate reform cannot be justified on any theory.

The thought that a carryover basis is somehow a more acceptable vehicle for increasing the estate tax than the originally suggested tax on appreciation at death can be met head on and scotched. Small estates, which are present in large numbers, pay little or no death tax and thus have few problems. The really large estates are usually made up of assets which can be liquidated readily. Although onerous, the taxes can be paid. Also, even though the rates on large estates are higher than in most other Western nations, enough usually remains to sustain the surviving family adequately.

The real victims of the proposed death tax increase are decedents in the middle brackets with individually owned or closely held family businesses. I justly feel that these enterprises form the backbone of, and the showcase for, our democratic, capitalistic society. At death, the estates of these people require funds varying from 25 to 40 percent of the total value of the estate to pay estate and inheritance taxes. After high income tax rates, future earnings can't pay the tax directly and net after taxes usually isn't sufficient to pay off loans if the tax money is borrowed.

The only asset available for sale to pay the tax is this business interest. Family and closely held businesses generally can't be sold piecemeal. Thus, at or near death, a substantial sale realizing all of the unrealized appreciation is required. The higher tax resulting from the new levy on the appreciation increases the cash needed. The vital man in the middle of our economy thus really winds up in the midle of the tax muddle. He is the "goat."

Taxpayers facing such problems have not, will not, and cannot stand idle particularly in the face of a tax increase such as the Treasury proposal under discussion involves. Because of fears as to the outcome of valuation disputes over interests in businesses which have no readily ascertainable market value, and because rates are so high now that owners are unwilling to risk distress sales after death, small- and middle-sized entrepreneurs are combining by mergers and other means with larger entities. Usually these steps can be completed free of tax. When this course is not possible, a lifetime sale involves less tax and none of the ruinous uncertainties which arise at death. Thus the small entrepreneur which the present administration states it wishes to foster and protect may well be forced from our business scene.

The Government nevertheless justifies its proposal on the specious theory that "capital appreciation" has "escaped tax" if the basis is increased at death. This is in blatant disregard of the levy of a death tax on the full value, including all appreciation. Claimed justification on the theory that a seller of property before death who is thus liable for both the appreciation tax and the death tax should be taxed the same as the person whose estate sells after death is similarly fallacious. A voluntary realizing transaction places a taxpayer in possession of the capital gain and presumably the means for paying any tax. While such gains are and have for many years been taxed, partly to protect the revenues, they have been taxed at lower rates. As gains are realized they must be taxed whether death is near at hand or far distant.

Death usually is not voluntary and rarely is a tax-saving device. A heavy death tax under present law is due on the appreciation, if any, and on all other elements comprising the much disputed and highly theoretical concept of market value. Death usually does not create cash from which the tax can be paid. While sales in the middle-sized estates are likely, they would not necessarily occur because of the death, but for compulsory tax liquidations. The argument then that these two extremely different cases should be taxed alike falls of its own weight. Under the carryover basis plan it is cheaper to realize a gain before death because the capital gains tax paid not being a part of the estate is not taxed for death tax purposes. Why, in such a case, a decedent should pay more tax defies explanation.

Many Government policies are designed to promote the growth and welfare of smaller business enterprises and to encourage the free movement of investment capital into business risk investments. The placing to the largest possible extent of control over spending and investment decisions in private rather than

governmental hands is a goal ardently sought by all who believe in our economic system.

Any change which adds a tax to the death tax immediately or at some later time encourages investments in bonds, insurance, and other forms of fixed value property. True, insurance companies, banks, and similar organizations may supply risk capital to business, but this system is certainly less desirable than the situation presently existing under which risk investments are still made by individual businessmen.

Transfer taxes have some basis in revenue needs but the overriding purpose is to limit the accumulation of family fortunes. If, in this conflict of sense and nonsense, we feel an attraction for the carryover basis approach, one has but to read proposed amendment No. 225 to H.R. 8363 to see how 17 pages of complications plus unreasonably harsh civil, and perhaps criminal penalties could plague millions of innocent, decent, law-abiding citizens. The complications and unfairness in the compliance burdens placed on taxpayers are appalling. The apparent philosophy would seem to be only an opening wedge for a plan which, in time, would confiscate all inheritances above some nominal figure. In the long run, even the "have nots" might decide not to accept such a ceiling upon the economic prospects of their descendants.

Since the estate tax is a capital levy, we don't need any semantic mechanics to justify the tax by calling the appreciation "income." Whatever we call it is immaterial. The fact that a tax has been levied on the appreciation is not subject to real challenge. The only question which can remain is—"Is the tax high enough?" It would be presumptous for one not having the burden of decision to answer the last question; but rates which go to 77 percent are certainly getting fairly near to a tax which is high enough.

The effort of the Treasury to impose a tax on appreciation at death was unsuccessful in the House. Undaunted, they next advanced the carryover basis approach. Commonsense ultimately prevailed and this proposal was also abandoned. Current news releases would indicate that if the Secretary cannot secure the reinstatement of the carryover basis provisions, then Treasury would not reduce the capital gain rate to 25 percent. Each of these proposals increases the tax, either actually or relatively, which would be paid from the Nation's risk capital. The adoption of any one in the present context would merely provide the opening for the full realization at a future time for the Treasury's original scheme.

Ideologies are at war—tax incentives to promote consumption spending versus tax incentives to promote savings. Savings foster investments in ways which will make jobs and increase the production of goods at the same time that consuming power is increased by added employment. Such consuming power is clearly preferable to that created by free money. Free money is "easy come-easy go," not wisely or carefully spent, and it drives up prices. If production of goods can go up as effective purchasing demand increases, then price inflation is less probable and everyone benefits.

We have sufficient tax impediments now to the accumulation of, and productive investment of, risk capital. We certainly should not add a disguised increase in estate taxes to these burdens.

U.S. SENATE,
COMMITTEE OF APPROPRIATIONS,
November 6, 1963.

Hon. HARRY F. BYRD,
Chairman, Finance Committee,
Senate Office Building, Washington, D.C.

DEAR MR. CHAIRMAN: Yesterday, I introduced a bill to clarify the components of, and to assist in the management of, the national debt and the tax structure. I appeared before your committee when the debt limit was under discussion last summer to suggest that the committee might wish to add language similar to this bill to the debt limit legislation at that time. Unfortunately, the situation was such that this was not practical, but I still think that the principle involved is worth pursuing.

When I appeared before your committee, I suggested that the language of the bill I introduced in the last two Congresses be used as the basis for the amendment. That bill asked for a combined report of the statutory debt, contingent debt, real estate leases and other long-term commitments, and uncommitted appropriations on the principle that these categories include most Federal commitments in one way or another.

The Treasury Department feels that this legislation is not necessary because statutory debt is well reported on a daily basis, and real estate operations and uncommitted appropriations are reported to the Senate Appropriations Committee. The leaves the contingent liabilities of the Government as the remaining item. The question on these revolves around the strength of the commitment and the chances of its being called upon by the holder. Many of these are reported upon but not all. Some of them are vague and others very specific. I would include among those presently reported rather vaguely the insurance liabilities for pensions, veterans medical programs, and even the social security obligations of the Government. Though these are not in all cases completely statutory obligations of the Government, they certainly are obligations which our veterans or social security card holders expect the Federal Government to honor, and as such, I think they should be part of our financial planning. Unless we have a reasonably accurate idea of how much money is involved, the planning is hindered. To my mind, our veterans obligations, for instance, should be stated regularly on an actuarial basis, including not only the veterans life insurance, but also the pension and medical insurance programs. The same should be true of other pension programs of the Government.

There is no question in my mind over the ability of the United States to pay these obligations. There may be some question as to the method of financing them and the value of the dollar when the obligation is paid if we do not plan for them now. For this reason I hope that your committee will be able to consider this bill, perhaps using it as an amendment either to the debt limit bill or to the tax legislation now under consideration.

Sincerely yours,

LEVERETT SALTONSTALL, *U.S. Senator.*

P.S.—I enclose a copy of a letter I have received from the Comptroller General which gives a brief description of some of these programs. I have the supporting material in my office. It is quite extraordinary how broad the coverage has become and how large the possible commitments are.

[S. 2281, 88th Cong., 1st sess.]

A BILL To clarify the components of, and to assist in the management of, the national debt and the tax structure

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That the reports required by law to be prepared by the Secretary of the Treasury for the information of the President, the Congress, and the public with respect to the financial operations of the Government shall include a separate semiannual report setting forth—

> the aggregate and individual amounts of the contingent liabilities of the Government including without limitation: trust fund liabilities, Government-sponsored corporations' liabilities, indirect liabilities not included as a part of the direct debt, and liabilities of insurance and annuity programs, including their acturial status on both a balance sheet and projected source and application of funds basis; each agency's statement to show the collateral pledged or other assets available (or to be realized) as security therefor (Government securities to be separately noted), and an analysis of their significance in terms of past experience and probable risk.

The report shall set forth the financial data in a concise form, with such explanatory material as the Secretary may determine to be necessary or desirable, and shall include total amounts for each category according to the agency involved.

COMPTROLLER GENERAL OF THE UNITED STATES,
Washington, July 31, 1963.

B-151876.

HON. LEVERETT SALTONSTALL,
U.S. Senate.

DEAR SENATOR SALTONSTALL: Herewith are certain data assembled pursuant to your letter of June 17, 1963, requesting information on various programs administered by the Federal Government which may be classified as "insurance" programs (five copies of apps. A thorugh C and one copy of app. D). The material supplied herewith gives recognition to the conversations between a representative of our staff and Mr. William Saltonstall, your administrative assistant.

It is our understanding that you are seeking information regarding all forms of Federal insurance programs and those programs that might be construed to have insurance characteristics when compared with similar activities that are conducted by the private sector of our economy. Accordingly, many of the programs reported upon herein are not generally known as insurance programs of the Government but do have certain income maintenance or financial protection characteristics that permit their classification as insurance programs. These programs have characteristics which (1) assure income maintenance to individuals who are disabled or have reached retirement age, through systems such as social security, military retired pay, and other retirement and disability plans; the public assistance programs of the Department of Health, Education, and Welfare; and the compensation, pension, and life insurance programs of the Veterans' Administration; or (2) assure the collectibility of loans or bank deposits, such as Federal Housing Administration insured home loans, the loan guarantee program of the Veterans' Administration, and Federal Deposit Insurance Corporation bank account insurance; or (3) provide a service for which the Government appears to be indefinitely committed, such as the hospitals and outpatient clinics of the Public Health Service and the Veterans' Administration, the medicare program for dependents of military personnel, and the group health plans for Federal civilian personnel.

We are submitting information for 89 programs administered by 9 departments and 11 independent agencies. The data submitted include certain details regarding each of the programs which we identified as being within the framework of the broad concept of insurance programs. Among these details, where the information was readily available, are the number of persons benefiting from the program through Federal payments and the number of persons covered by the program where its nature provides a measure of insurance protection to the individual although payments may not have been made at this point in time or may never be made. For example, there are approximately 110 million persons covered by the social security program by reason of having earned some wages that were taxable under the program; however, during any given year a majority of these persons do not receive benefit payments but, if eligible under the Social Security Act, they are insured against the possibility of death or disability and are assured a retirement income in later years. The disability insurance benefits would provide income to the wage earners and their families during a period of disability, and the death insurance benefits would provide income to surviving widows, children, and dependent parents.

We have included in the appendix detail a citation to the United States Code or the United States Statutes which set forth the authority to operate each of the programs. This citation will facilitate reference to full details regarding existing law and the legislative history for each program, if needed. We have indicated the date each program began operations and the termination date, if any, provided in law or the probable date of termination if such is determinable; otherwise, we have indicated that the program appears to be perpetual in character. Most of the programs do not have a termination date.

We have indicated the probable obligations for each program for the 5 fiscal years 1964–68. We have shown this type of information for the respective programs since generally it is not possible to state the total liabilities of these programs. A program that is perpetual in nature, or for which a liability arises only in the event of a future action or development that cannot be predicted too well at this point in time, cannot be stated to have a specific dollar amount of liability.

If an attempt were to be made to state the liability, then a given time period would have to be elected arbitrarily, and certain assumptions would have to be made regarding the occurrence of events in the future. Therefore, an estimated 5-year total obligation as shown in the appendixes discloses the order of magnitude, and a trend which we believe will serve your purposes when considering these programs in relation to the outstanding Federal public debt. Likewise, wherever possible, we have shown the probable number of persons benefiting from a program in fiscal year 1968, a year that is 5 years removed from today.

Following is a summary of the estimated obligations, for a 7-year period, under all of the 89 programs reported:

Fiscal year 1962	$27,204,276,000
Fiscal year 1963	29,227,347,000
Fiscal years 1964 to 1968, inclusive	167,948,861,000
7-year total	224,380,484,000

Although the commitment and obligation of the Federal Government for these several programs are substantial and from current indications will continue to grow over the years, it is well to recognize that the character of these programs is such that generally the benefit to be received by the Government or the benefit to be received by various segments of the American public (veterans, retirees, the disabled, the ill, etc.) from the operation of such programs will be payable in future years only as events occur to make a person eligible for a benefit. For example, the cost of operating the veterans' and public health hospital programs has not yet been incurred for the forthcoming 5-year period; however, in all probability these programs will continue during the 5-year period and the beneficiaries who incur an illness, disability, or accident will receive the benefits at various times during such 5-year period.

In contrast, the public debt of the Federal Government represents borrowings made primarily from the public (and from many Government-operated trust funds) to meet obligations for goods and services already received by the Federal Government. Accordingly, if there is to be consideration of the obligations under long-range programs already authorized by the Congress in relation to the public debt, it is necessary to recognize the distinction between (1) many of these insuarnce programs, which involve goods and services to be received hereafter by the Government or which involve benefits to be provided in the future, under certain circumstances, to certain segments of our population and (2) other programs under which goods and services have been received but for which the Government owes through the public debt.

The various types of insurance programs for which the Federal Government is committed, the diversity of bases for providing the benefits already authorized by the Congress for these programs, and the uncertainty of future events in many programs make it difficult to tabulate insurance, commitments, or guarantees in some meaningful fashion, and make it impossible to present a grand total figure representing the outstanding commitment or obligation of the Government since there is no clear common denominator that can be applied to all such programs. Accordingly, we are transmitting to you selected data regarding insurance and guarantees in force, without summarization, for each of the programs as shown in appendix B and appendix D. Column 16 of appendix B identifies insurance in force, commitments, guarantees, etc., where applicable to a given program.

Particular attention is invited to the revenue aspects of some of those programs which show that substantial obligations are being incurred. For example, veterans' life insurance, housing insurance programs, and others will receive substantial income to offset the obligations incurred; also, some programs, notably social security and railroad retirement programs, receive income in the form of special taxes imposed on wages and salaries received. The amount of revenues from all sources for these 89 programs is shown in appendix C and is summarized as follows:

Fiscal year 1961	$17,128,037,000
Fiscal year 1962	17,535,180,000

The material transmitted herewith was compiled by us from a number of sources without any audit or verification. While we have endeavored to use reliable information in making this compilation, the material may contain some inaccuracies or discrepancies, or may be somewhat at variance with other published material. Some of the data were estimated by us. However, we believe that the data are adequate for general purposes and for identifying and disclosing the order of magnitude of the several insurance-type programs. When using the data, full consideration must be given to qualifying and explanatory footnotes as shown in the appendixes.

We will be glad to discuss this material with you and your staff and to informally provide explanatory information regarding any of the programs.

Sincerely yours,

JOSEPH CAMPBELL,
Comptroller General of the United States.

THE KNOXVILLE ASSOCIATION OF LIFE UNDERWRITERS,
Knoxville, Tenn., November 6, 1963.

Hon. HARRY BYRD,
U.S. Senator,
Senate Office Building, Washington, D.C.

DEAR CONGRESSMAN BYRD: The board of directors of the Knoxville Association of Life Underwriters, an association of 800 members, has voted unanimously to

express their opposition to certain sections of the 1963 tax bill which discriminate against life insurance as property, and especially section 218 relating to the deduction of interest on moneys borrowed to pay certain life insurance premiums.

Many people in our industry will agree that there are some abuses connected with "minimum deposit" insurance and certain "split dollar" practices. But our association feels that the proper approach to whatever problem that exists is the direct approach of changing industry practice, policy and philosophy, not the indirect approach of a discriminatory tax. Thus, the answer to the problem would seem to lie within the industry whose long record of good citizenship seems to be well established.

Respectfully yours,

JACK K. WESTBROOK,
O.L.U. President.

TOWNSEND CO.,
Beaver Falls, Pa., November 6, 1963.

Subject: Group term life section of H.R. 8363.

Hon. HARRY F. BYRD,
Chairman, Senate Finance Committee,
Senate Office Building, Washington, D.C.

DEAR SENATOR BYRD: It is my understanding that your committee has started hearings on the above bill and that a provision would be included taxing employees on the cost of group term life insurance over $30,000.

I am sure that you and your colleagues have found already that the matter of group life insurance is very complicatd. For example, who knows what the cost actually is, since it depends entirely upon experience ratings.

It is my firm opinion that there is nothing to be gained as far as tax income is concerned by writing anything as outlined above into a tax bill since, from a practical standpoint, you cannot take away from employees something they already have.

Most companies would have to substitute some other fringe benfit, and I am sure there are many other loopholes in our tax structure which would provide greater income to the Federal Government.

Very truly yours,

F. R. DICKENSON, *President.*

HOUSTON, TEX., *November 5, 1963.*

Hon. HARRY F. BYRD,
Chairman, Committee on Finance,
U.S. Senate, Washington, D.C.

DEAR SENATOR BYRD: These comments relate to the definition of component members of a controlled group of corporations as contained in section 1563(b) as proposed by section 223(a) of H.R. 8363.Sections 1561 and 1562 as proposed would require either the allocation of a single surtax exception among the component members of a controlled group of corporations or the payment of an additional tax of 6 percent of taxable income not in excess of $25,000. Section 1563(a)(2) defines a "brother sister" controlled group of corporations as two or more corporations 80 percent or more of whose stock is owned by one person. This definition, as proposed, could include in the controlled group a corporation whose stockholders have elected to be taxed under the provisions of subchapter S. If a subchapter S corporation is included in the controlled group and the literal language of section 1561 and 1562 is followed, an unintended result would occur. Under section 1561(a)(1), a portion of the surtax exemption would be allocated to the subchapter S corporation which would derive no benefit therefrom. The taxpayer corporations could elect to apportion the surtax exemption under section 1561(a)(2) and avoid the inequitable allocation of section 1561(a)(1), but it does not appear reasonable that a special election under one provision must be made to prevent the unintended result of another provision.

Presumably the exemption of subchapter S corporations from taxes imposed by this chapter contained in section 1372(b) would prevent any possible adverse effect created by section 1562 if a subchapter S corporation is included in a controlled group of corporations.

To prevent the unintended allocation of a portion of the surtax exemption to a subchapter S corporation under section 1561, and to clarify the effect of section 1562, it is suggested that section 1563(b)(2) be amended to add subchapter S corporations to the list of excluded members contained therein.

Respectfully yours,

WAYNE K. GOETTSCHE.

CELINA INSURANCE GROUP,
Celina, Ohio, November 4, 1963.

Senator HARRY F. BYRD,
Chairman, Senate Finance Committee,
U.S. Senate, Washington, D.C.

DEAR SENATOR BYRD: I would like to take this opportunity to give you my thoughts and comments on the new tax bill (H.R. 8363) as regards the provision which proposes to tax employees on the cost of group term life insurance over $30,000.

For over 40 years, group term life insurance on a favorable tax basis has been a factor in the establishment and maintenance of employee benefit programs. It is very possible that changing the role now might have a disrupting effect upon many long-established group benefit plans. Actually, the bill appears to be more of an attempt to limit group term life insurance than to produce revenue since relatively little tax income will result if the bill is passed.

Actually, from an employer's standpoint, the computation and withholding of additional taxable income could become a very complex and costly procedure. The continuing rising cost of doing business makes it hard enough to maintain a profitable operation without throwing in additional clerical work.

I am personally opposed to the new tax bill, at least the provision relating to group term insurance, and want to take this opportunity to express my comments and request that these comments be made a part of the committee's record.

Thank you for any consideration you may be able to give us.

Sincerely,

EDWARD R. BAILEY,
Vice President, Personnel.

GREDE FOUNDRIES, INC.,
Milwaukee, November 4, 1963.

Hon. HARRY F. BYRD,
Chairman, Senate Finance Committee,
Senate Office Building,
Washington, D.C.

DEAR SENATOR: Tax bill H.R. 8363 now before the Senate Finance Committee contains a new provision taxing employees on the cost of group term life insurance over $30,000. I strongly object to this provision for the following reasons:

For over 40 years group term life insurance on a favorable tax basis has been a factor in the establishment and maintenance of employee benefit programs. To change the rule now would have a disrupting effect upon many long-established plans.

The bill appears more an attempt to limit group term life insurance than to produce revenue, since relatively little tax income will result.

Computing and withholding each employee's additional taxable income would be a complex and costly procedure for employers because: two methods of determining cost are permitted; employee contributions and experience rating refunds must be taken into account; and package plans of health and welfare benefits must be split up for cost purposes.

Insurance costs under the bill rise sharply with age notwithstanding the fact that the common practice is to determine an average group life premium rate for all covered employees regardless of age.

I respectfully request that the above comments be made part of the committee's record.

Sincerely,

L. T. NEWMAN, *Secretary and Treasurer.*

THE NATIONAL SCREW & MANUFACTURING CO.,
Cleveland, Ohio, November 4, 1963.

Senator HARRY F. BYRD,
Chairman, Senate Finance Committee,
Senate Office Building,
Washington, D.C.

DEAR SENATOR BYRD: The group term life insurance provisions of the new tax bill H.R. 8363, in my opinion, should be eliminated from this bill. Group life insurance on a favorable tax basis has for many years been the cornerstone of employee benefit programs. Favorable experience with group life insurance

undoubtedly was a key factor in expanding group employee benefits into many other areas, such as hospitalization, surgical insurance, accident and sickness indemnity, accidental death insurance, and pensions—to name just the obvious ones.

Restrictions on group life insurance in this bill would result in very, very little tax income, but would seriously limit life insurance programs now in effect. Increased taxation on group life insurance premiums might result in a net loss of Federal tax income if taxable death benefits from group life insurance were reduced because of increased taxation of the premiums.

Not only would the computing of withholding tax due under this program be very complex and costly, but the method of taxation proposed on the basis of the current age cost for each employee is absolutely contrary to the historical financing of group life insurance on the basis of average group life premium rates for all employees in the group. This bill would, therefore, in effect destroy in part the group nature of group life insurance.

I respectfully urge your committee to reject this proposal in H.R. 8363, and that these comments be made a part of the committee's records.

Yours very truly,

R. H. LEUKART.

MARYLAND NURSES ASSOCIATION, INC.,
Baltimore, Md., November 4, 1963.

Senator HARRY F. BYRD,
U.S. Senate, Washington, D.C.

DEAR SENATOR BYRD: The Maryland Nurses Association, a constituent of the American Nurses' Association, requests your favorable consideration of H.R. 8363 with Senator Maurine Neuberger's amendments which provide for more liberal tax deductions for child care.

The growth of our country's economy and the increase in the size of the labor field have forced women to participate in gainful employment outside the home, thus taking many mothers away from their families and homes.

Mothers employed outside the home must provide for their children when left during the working hours. Protective and healthy care of the child should be assured to the mothers and to the child left with others.

More liberal tax deductions are needed for parents who by necessity must incur additional expenses to provide adequate care of children while they are employed.

The Maryland Nurses Association urges your support of the child care deductions bill with Senator Neuberger's amendments.

Sincerely yours,

ALICE M. SUNDBERG, R.N.,
President.

STATEMENT OF LINCOLN NATIONAL LIFE INSURANCE CO. ON SECTION 222 OF H.R. 8363

Introduction

The Lincoln National Life Insurance Co. is an Indiana corporation which was organized in 1905 and which is presently licensed to do business, and is doing business, as a life insurance company in all States of the United States other than the State of New York. For several years prior to 1960, it contemplated entering the State of New York. However, it did not wish to subject its entire operations to the regulatory power of the State of New York. Accordingly, in 1960, the Indiana corporation organized the Lincoln National Life Insurance Co. of New York as a New York corporation which said New York corporation obtained a license to do business in New York, and is doing business, as a life insurance company only in the State of New York. The Indiana corporation is the owner of all the outstanding shares of stock of the New York corporation, and has owned all of such shares throughout the entire life of the New York corporation. Both corporations are life insurance companies subject to the tax imposed by section 802 of the Internal Revenue Code of 1954, as amended.

STATEMENT OF PROBLEM

In each year of its existence, the New York corporation has sustained a loss from operations. If the New York corporation were to be liquidated at the

close of the taxable year 1963, and its activities continued thereafter by the Indiana corporation, the amount of the New York corporation's net operating loss carryovers could be utilized by the Indiana corporation to offset taxable income subsequently derived from any source. (See sec. 381 of the Internal Revenue Code of 1954, as amended.) If the New York corporation were not liquidated, but both corporations were to elect to file a consolidated return for the taxable year 1964, existing statutes and regulations would limit the amount of such net operating loss carryovers which could be so utilized to the amount of taxable income realized by the New York corporation in such year and the next succeeding 4 years. (See sec. 1502 of the Internal Revenue Code of 1954, as amended; and regulation sec. 1.1502–31.)

Section 222 of H.R. 8363 would repeal the present additional tax of 2 percent which is imposed upon the consolidated income of affiliated corporations which elect to file consolidated returns. Section 223 of H.R. 8363 would require a controlled group of corporations either to prorate the $25,000 surtax exemption or to pay an additional tax of 6 percent upon the first $25,000 of taxable income of each member corporation. These two sections indicate an intention to encourage the filing of consolidated returns by all qualified corporations. (See pt. IV Report of the Committee on Ways and Means, House of Representatives to accompany H.R. 8363, Sept. 13, 1963.)

Further, it was stated in the report of the Ways and Means Committee: "Your committee's bill removes the special 2 percent penalty tax on the privilege of filing a consolidated return, in part because the return of commonly controlled corporations as a single economic unit for tax purposes is in accord with the reality of the situation. Moreover, there appears to be no reason why, where a group of commonly controlled corporations are willing to have their operations consolidated for tax purposes, the mere presence of more than one corporate organization in the group should result in any penalty tax. No such penalty, for example, is exacted in the case of other corporate organizations operating through divisions rather than separate corporations." (See Pt. IV, Report of the Committee on Ways and Means, House of Representatives, to accompany H.R. 8363, Sept. 13, 1963.)

Since it is intended that commonly controlled corporations should not be penalized for electing to be taxed as a single entity, but should be accorded the same treatment as a single corporation operating through divisions, provision should be made to ensure that commonly controlled corporations which do elect to have their operations consolidated for tax purposes will be accorded the same treatment as though they had consolidated in fact. However, no provision has been made to permit such electing corporations to utilize net operating loss carryovers in the same manner as if they had consolidated in fact. In order to achieve this result, provision should be made to permit the electing corporations to utilize any net operating loss carryovers in the same manner as if they had consolidated in fact.

However, no reason is perceived justifying similar treatment for a net operating loss incurred by an affiliated company prior to affiliation. Accordingly, it is suggested that the recommended amendment to section 222 of H.R. 8363 be limited in its application: (1) to corporations which were members of an "affiliated group" on December 31, 1962; and (2) to the portion of the "net operating loss carryovers" attributable to "net operating losses" sustained during the period of affiliation. So limited, the recommended amendment would not encourage the purchase of "loss carryover companies."

RECOMMENDATION

It is suggested that section 222 of H.R. 8363 be amended by striking out paragraph (1) of subsection (b) thereof and substituting the following:

"(1) Section 1503 is amended—

"(A) by amending subsection (b) to read as follows:

"'(b) NET OPERATING LOSS CARRYOVERS OF MEMBER COMPANIES.—In the case of an affiliated group of corporations which was an affiliated group (within the definition contained in section 1504(a)) on December 31, 1962, and which files a consolidated return for a taxable year beginning after December 31, 1963, there shall be allowed as a deduction in determining the consolidated taxable income for such taxable year, the aggregate of the net operating loss carryovers of the member companies to the extent that such net operating loss carryovers are attributable to net operating losses sustained by the member com-

panies during the period of affiliation, and limited only by the amount of the consolidated taxable income computed without regard to the deduction herein granted.'

"(B) by striking out subsection (c) and by relettering subsection (d) as subsection (c)."

Submitted by THE LINCOLN NATIONAL LIFE INSURANCE Co.,
HENRY F. ROOD, *Executive Vice President.*

CANONSBURG, PA., *October 28, 1963.*

Senator HARRY F. BYRD,
Chairman, Senate Committee on Finance,
Washington, D.C.

DEAR SENATOR BYRD: This is to express my opposition to a tax cut because I believe it would weaken our paper dollar at a time when it needs defending. It is requested that this leter be included in the records of the hearings on H.R. 8363.

Our dollar is vulnerable to gold losses, as is well known, but our silver coinage could also disappear if even a small fraction of the public should lose faith in the paper currency and seek safety in silver:

	Billion dollars
Demand deposits	116
Federal Reserve notes	32
Silver certificates	2
Total	150
Silver dollars in the Treasury	0.1
Subsidiary coins in circulation	1.8
Total	1.9

The next table shows that silver dollars are now disappearing from the Treasury, following the same trend as the "free" silver during 1961:

End of month	Millions remaining in the Treasury [1]	
	Ounces of free silver during 1961	Silver dollars during 1963
January	121.1	90.4
February	112.9	88.4
March	105.2	83.3
April	95.2	79.2
May	85.5	69.7
June	79.7	65.8
July	76.4	58.7
August	64.9	50.3
September	57.9	46.8
October	43.7	
November	28.6	
December	28.5	

[1] From the daily statements of the Treasury for the last day of each month.

Likewise, the recent study of future coinage demand [1] indicates a higher loss rate of the coinage already in circulation than is reflected in the circulation statement of U.S. money:

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[1] "Production Facilities for the United States Mint," by Arthur D. Little, Inc., contract No. EB-88. This report is summarized in the hearings by the Senate Committee on Banking and Currency on S. 874. The particular details referred to here are in A. D. Little's Working Memorandums Nos. 6 and 22.

[Dollars in millions]

	Calculated fraction of coins in circulation that are lost annually	Calculated value of coins in circulation on Jan. 1, 1963	Calculated rate of annual loss
Dimes	0.038	$360	$14
Quarters	.022	482	11
Halves	.028	275	8
Total		1,117	33
Same total, from circulation statement		1,756	

This calculated rate of loss is a significant part of the $104 million in silver coins minted during 1962, and the $639 million calculated discrepancy in coins in circulation may explain the present coin shortage.

The mint report shows why U.S. coins are vulnerable to hoarding:

	Dollars per ounce of silver in the coinage
England	[1]
Germany	5.56
France	3.10
Switzerland	2.87
Italy	2.72
Canada	1.55
U.S. subsidiary coins	1.38
U.S. silver dollars	1.29

[1] Zero silver content.

Our coinage is undervalued relative to gold since, at the pre-1933 parity of one-sixteenth of the gold price, silver would cost $2.18 per ounce. Hence, the Treasury is selling silver bullion domestically to hold the price at $1.293, while part of our gold losses are going to private individuals abroad, who also absorb most of the new gold supply:

[In billions of dollars]

Year	U.S. Treasury gold stock year-end	Worldwide private gold holdings [1]	New gold coming to market [2]	Gold added to free world monetary stock [2]
1955	21.8	11.4	1.0	0.7
1956	22.1	11.9	1.1	.5
1957	22.9	12.4	1.3	.7
1958	20.6	13.8	1.3	.7
1959	19.5	13.2	1.4	.7
1960	17.8	13.8	1.4	.3
1961	16.9	14.7	1.5	.6
1962	16.1	15.5	1.5	.5

[1] Estimates from Pick's Currency Yearbook. Some similar figures were published by Time magazine in the issue of Aug. 3, 1962.
[2] Annual reports of International Monetary Fund and Bank for International Settlements.

I conclude that we cannot afford the luxury of a tax cut, but instead we must cut the cost of government and defend our currency. Our paper dollar may be jeopardized if only a small fraction of the people lose faith in it.

Respectfully,

WILLIAM B. RETALLICK.

LOS ANGELES, CALIF., *November 1, 1963.*

Hon. HARRY F. BYRD,
Chairman, Senate Finance Committee, U.S. Senate,
Washington, D.C.

SIR: As you know, the 1963 tax bill now pending before your committee is a proposal which would disallow interest as a deduction for any amount paid

or accrued on indebtedness incurred or continued to purchase or carry a life insurance, endowment, or annuity contract, pursuant to a plan of purchase which contemplates systematic direct or indirect borrowing of part or all of the increases in cash value of such contract (either from the insurer or otherwise).

There are certain exceptions: It would not apply (1) if the policies were bought before August 6, 1963; (2) if such indebtedness were incurred in connection with a trade or business; or (3) if at least four out of the first seven premiums had been paid without borrowing.

Senator, may I ask your consideration of these points:

(1) This proposal would discriminate against life insurance as a form of property. Interest paid on any other form of a loan is deductible in calculating income taxes and to remove this privilege from life insurance is bound to work a great hardship on a large number of perfectly honest insureds.

(2) I am seriously concerned that if such a provision becomes law, it will lead to the harassment of taxpayers by revenue agents in the field. This would be the inevitable result if the words "direct or indirect" were construed to mean that if the taxpayer owed any money or borrowed money at the time he took out a new policy, he could be said to be "borrowing" money to pay his premiums, even though the loan was really a mortgage on his house. Such a rule would authorize agents to inquire into a taxpayer's personal affairs in far greater detail than ever before permissible.

(3) There appears to be no really good reason for this provision in the tax law. Cash values are the most universally held asset. They are usually considered the safest and best form of savings that any man can have. Even though only 3 percent of the national income goes to life insurance premiums, over 80 percent of all estate values come from life insurance. In short, life insurance serves a fundamental social purpose.

Why should our tax laws be changed to downgrade the value of this wonderful safeguard for all of our people? I respectfully ask that you do whatever you can to have this provision removed from the tax bill.

Very truly yours,

GEORGE B. BYRNES.

LONG BEACH, CALIF., *October 27, 1963.*

HON. CRAIG HOSMER,
House Office Building, Washington, D.C.

DEAR REPRESENTATIVE HOSMER: I wish to propose an amendment to the administration's tax reform bill for your consideration.

Graduate education is largely financed by the student himself either by obtaining a fellowship or by working part time. The IRS considers a fellowship as nontaxable income, but if you work part time for the university as a teaching or research assistant, the income is taxable. If such income, generally between $2,000 and $3,500, were nontaxable it would encourage graduate education and also help to stimulate the economy.

Yours truly,

CONRAD HOUSLEY.

THE INDUSTRIAL HOME FOR THE BLIND,
Brooklyn, N.Y., October 17, 1963.

Re S. 2227 by Mr. Hartke.

HON. HARRY F. BYRD,
Chairman, Committee on Finance,
U.S. Senate, Washington, D.C.

DEAR SENATOR BYRD: May I request that this letter be made a part of the record concerned with the discussions of H.R. 8363 and the Senate bill 2227 concerned with the creation of an additional exemption for a taxpayer with a blind dependent.

I know that you and members of your committee have been fully aware of and familiar with the very serious problems of all kinds arising out of the handicap of blindness. The generosity and good will of the Congress of the United States in its consideration of blind citizens is well known and has been magnificent over the years. With the present concern for the taxpayer as reflected in the new text legislation now before you, we believe that one of the very thoughtful and simple ways to assist the taxpayer is to take into account some of the unusual demands which may be made upon him when he is the sole support of a severely disabled person.

Blindness as one of the most severe of all handicaps has always demanded the expenditure of more money for simple things than most of us in the community are required to consider. When we realize that large numbers of blind persons—the very young and the very old—are dependent either on their families or on public assistance, we can appreciate the need of giving special thought to the tax problems of the taxpayer who must support blind dependents. Aid to the blind, as a program federally sponsored and jointly financed by the Federal Government and the States, has already taken this differential of expense into account in its budgeting for individual blind persons.

May we respectfully urge that you and your Finance Committee give the same consideration to the taxpayer who must bear the expense of maintaining a blind dependent. While a single additional exemption will by no means take care of all of the additional expenses implicit in blindness, it will to some degree relieve a little of the burden; in doing this it may help, too, to create a better climate of acceptance of responsibility for such expense by the taxpayer. What are some of these unusual expenses? Depending on the degree of dependence, they cover a very wide variety of major and incidental expenditures ranging from the more frequent purchase of shoes because of the scuffing implicit in moving about without sight to the employment of a constant companion for an older person or for transportation of a blind child to a nursery and other facilities for service and training. It certainly includes more continued medical attention than most of us are confronted with, including the getting to and from doctors, hospitals, and clinics, with a guide or companion. It certainly includes special care and service for newly blind persons in a family during the period of adjustment to the loss of sight and often, if this period of adjustment is difficult, for very long periods of time after the loss of sight. The normal participation in household affairs, such as shopping, writing letters, doing other simple things which the very young and the very old in most households can do, are denied to the taxpayer with a blind dependent. I believe that these few references are sufficient and you, yourself, and the members of your committee could add to these indefinitely.

One final word, however, I think is important. Because of the magnificent program of rehabilitation, again sponsored by and inaugurated by the Congress of the United States as well as substantially financed by it, the number of such blind dependents has reduced substantially over the past 20 years, so that we are speaking of a relatively small number of persons. Public assistance, too, has absorbed a substantial part of the burden, still further reducing the number of those who are dependent upon taxpayers.

The American Association of Workers for the Blind has over the years proposed and supported any legislative program that will improve the environment and circumstances within which blind persons must live. We believe that S. 2227 is a very thoughtful and beneficial proposal, and we respectfully urge your usual generous and thoughtful consideration of this bill as an amendment to the 1963 tax proposals now before you.

Faithfully yours,

GEORGE E. KEANE,

Chairman, Legislative Committee, American Association of Workers for the Blind.

(Whereupon, at 12:25 p.m., the committee adjourned, to reconvene at 10 a.m., Tuesday, November 12, 1963.)