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REVENUE BILL OF 1936

JUNE 1 1936.—Ordered to be printed

Mr. KING, from the Committee on Finance, submitted the following

REPORT

[To accompany H. R. 12395]

The Committee on Finance, to whom was referred the bill (H. R. 12395) to provide revenue, equalize taxation, and for other purposes, having had the same under consideration, report favorably thereon with certain amendments and as amended recommend that the bill do pass.

This bill was initiated in the House in response to the message of the President of the United States to Congress dated March 3, 1936. The message of the President was as follows:

To the Congress of the United States:

On January 3, 1936, in my annual Budget message to the Congress, I pointed out that without the item for relief the Budget was in balance. Since that time an important item of revenue has been eliminated through a decision of the Supreme Court, and an additional annual charge has been placed on the Treasury through the enactment of the Adjusted Compensation Payment Act.

I said in my Budget message:

"* * * the many legislative acts creating the machinery for recovery were all predicated on two interdependent beliefs. First, the measures would immediately cause a great increase in the annual expenditures of the Government—many of these expenditures, however, in the form of loans which would ultimately return to the Treasury. Second, as a result of the simultaneous attack on the many fronts I have indicated, the receipts of the Government would rise definitely and sharply during the following few years, while greatly increased expenditure for the purposes stated, coupled with rising values and the stopping of losses, would, over a period of years, diminish the need for work relief and thereby reduce Federal expenditures. The increase in revenues would ultimately meet and pass the declining cost of relief.

"This policy adopted in the spring of 1933 has been confirmed in actual practice by the Treasury figures of 1934, of 1935, and by the estimates for the fiscal years of 1936 and 1937.

"There is today no doubt of the fundamental soundness of the policy of 1933. If we proceed along the path we have followed and with the results attained up to the present time we shall continue our successful progress during the coming years."

If we are to maintain this clear-cut and sound policy, it is incumbent upon us to make good to the Federal Treasury both the loss of revenue caused by the

Supreme Court decision and the increase in expenses caused by the Adjusted Compensation Payment Act. I emphasize that adherence to consistent policy calls for such action.

To be specific: The Supreme Court decision adversely affected the Budget in an amount of $1,017,000,000 during the fiscal year 1936 and the fiscal year 1937. This figure is arrived at as follows:

Deficit to date (expenditures chargeable to processing taxes less processing taxes collected) in excess of that contemplated in the 1937 Budget	$281,000,000
Estimated expenditures to be made from supplemental appropriation approved in the Supplemental Appropriation Act, 1936	296,000,000
Estimated expenditures to be made under the Soil Conservation and Domestic Allotment Act	440,000,000
Total additional deficit 1936 and 1937, due to Supreme Court decision and adjusted farm program	1,017,000,000

For the purposes of clarity, I divide the present total additional revenue needs of the Government into the permanent and the temporary ones.

Permanent Treasury income of $500,000,000 is required to offset expenditures which will be made annually as a result of the Soil Conservation and Domestic Allotment Act recently enacted by the Congress and approved by me; and an additional sum recurring annually for 9 years will be required to amortize the total cost of the Adjusted Compensation Payment Act.

The net effect of paying the veterans' bonus in 1936, instead of 1945, is to add an annual charge of $120,000,000 to the $160,000,000 already in the Budget.

We are called upon, therefore, to raise by some form of permanent taxation an annual amount of $620,000,000. It may be said, truthfully and correctly, that $500,000,000 of this amount represents substitute taxes in place of the old processing taxes, and that only $120,000,000 represents new taxes not hitherto levied.

I leave, of course, to the discretion of the Congress the formulation of the appropriate taxes for the needed permanent revenue. I invite your attention, however, to a form of tax which would accomplish an important tax reform, remove two major inequalities in our tax system, and stop "leaks" in present surtaxes.

Extended study of methods of improving present taxes on income from business warrants the consideration of changes to provide a fairer distribution of the tax load among all the beneficial owners of business profits whether derived from unincorporated enterprises or from incorporated businesses and whether distributed to the real owners as earned or withheld from them. The existing difference between corporate taxes and those imposed on owners of unincorporated businesses renders incorporation of small businesses difficult or impossible.

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

This method of evading existing surtaxes constitutes a problem as old as the income-tax law itself. Repeated attempts by the Congress to prevent this form of evasion has not been successful. The evil has been a growing one. It has now reached disturbing proportions from the standpoint of the inequality it represents and of its serious effect on the Federal revenue. Thus the Treasury estimates that, during the calendar year 1936, over 4½ billion dollars of corporate income will be withheld from stockholders. If this undistributed income were distributed, it would be added to the income of stockholders and there taxed as is other personal income. But, as matters now stand, it will be withheld from stockholders by those in control of these corporations. In 1 year alone, the Government will be deprived of revenues amounting to over $1,300,000,000.

A proper tax on corporate income (including dividends from other corporations), which is not distributed as earned, would correct the serious twofold inequality in our taxes on business profits if accompanied by a repeal of the present cor-

porate income tax, the capital-stock tax, the related excess-profits tax, and the present exemption of dividends from the normal tax on individual incomes. The rate on undistributed corporate income should be graduated and so fixed as to yield approximately the same revenue as would be yielded if corporate profits were distributed and taxed in the hands of stockholders.

Such a revision of our corporate taxes would effect great simplification in tax procedure, in corporate accounting, and in the understanding of the whole subject by the citizens of the Nation. It would constitute distinct progress in tax reform.

The Treasury Department will be glad to submit its estimates to the Congress showing that this simplification and removal of inequalities can, without unfairness, be put into practice so as to yield the full amount of $620,000,000—the amount I have indicated above as being necessary.

Turning to the temporary revenue needs of the Government, there is the item of $517,000,000, which affects principally the current fiscal year. This amount must in some way be restored to the Treasury, even though the process of restoration might be spread over 2 years or 3 years.

In this case also the formulation of taxes lies wholly in the discretion of the Congress. I venture, however, to call your attention to two suggestions.

The first relates to the taxation of what may well be termed a "windfall" received by certain taxpayers who shifted to others the burden of processing taxes which were impounded and returned to them or which otherwise have remained unpaid. In unequal position is that vast number of other taxpayers who did not resort to such court action and have paid their taxes to the Government. By far the greater part of the processing taxes was in the main either passed on to consumers or taken out of the price paid producers. The Congress recognized this fact last August and provided in section 21 (d) of the Agricultural Adjustment Act that, in the event of the invalidation of the processing taxes, only those processors who had borne the burden of these taxes should be permitted to receive refunds. The return of the impounded funds and failure to pay taxes that were passed on result in unjust enrichment, contrary to the spirit of that enactment. A tax on the beneficiaries unfairly enriched by the return or nonpayment of this Federal excise would take a major part of this windfall income for the benefit of the public. Much of this revenue would accrue to the Treasury during the fiscal years 1936 and 1937.

The other suggestion relates to a temporary tax to yield the portion of $517,000,000 not covered by the windfall tax. Such a tax could be spread over 2 years or 3 years. An excise on the processing of certain agricultural products is worth considering. By increasing the number of commodities so taxed, by greatly lowering the rates of the old processing tax, and by spreading the tax over 2 or 3 years, only a relatively light burden would be imposed on the producers, consumers, or processors.

FRANKLIN D. ROOSEVELT.

THE WHITE HOUSE, *March 3, 1936.*

The President pointed out in his message that the need for a revenue bill at this time was due to two causes: First, the decision of the Supreme Court invalidating the Agricultural Adjustment Act; and, second, the enactment of the Adjusted Compensation Act of 1936, which requires payment, beginning on June 15, of the entire amounts which were to be due in 1945 on the veterans' adjusted-service certificates.

The President, while recognizing the power of the Congress to decide what taxes should be levied, invited attention to the following means of raising revenue:

1. A tax on corporate incomes which are not distributed, including intercorporate dividends, in lieu of the slightly graduated tax on corporate incomes and the capital-stock and excess-profits taxes provided for by existing law;

2. A windfall tax upon taxpayers who shifted to others the burden of processing taxes which were impounded and returned to them or which otherwise have remained unpaid; and

3. An excise tax on the processing of certain agricultural commodities.

The House bill gave effect to two of the President's suggestions by providing for a tax upon undistributed earnings and a windfall tax, but did not provide for an excise tax on the processing of certain agricultural products. This bill also provided for the repeal in full of the existing corporation tax and the repeal, after 1 year, of the capital-stock and excess-profits tax, the capital-stock tax being retained at one-half the rate under existing law for such 1-year period.

Your committee has considerably modified the tax on undistributed profits contained in the House bill. This tax has been changed to a tax of 7 percent on the undistributed net income. Instead of repealing the existing corporate income tax, the Finance Committee bill retains the principle of a flat rate of tax on corporate net incomes except for such slight graduations as were adopted in the Revenue Act of 1935, upon the recommendation of the President. The Finance Committee bill proposes to increase each of the existing rates by 3 percent. In addition, the committee bill provides for retention of the capital-stock and excess-profits taxes at existing rates, and an increase of 1 percent in the surtax rates upon individuals in the case of surtax net incomes between $6,000 and $50,000. Your committee, also, has retained the provisions of the House bill which removed the exemption of dividends from normal tax and has made certain changes in the House provisions dealing with the windfall tax and refunds of the Agricultural Adjustment Act taxes. These changes will be discussed in detail in a later part of this report.

The President requests the Congress to raise 620 million dollars of additional revenue annually by some form of permanent taxation. He also requests that additional revenue be obtained in the next 2 or 3 years amounting in the aggregate to 517 million dollars.

In order to secure annually the 620 million dollars additional in permanent revenue requested, the House bill proposes an undistributed profits tax which has been estimated to yield that amount of additional revenue annually over the amount estimated to be obtained under existing law. The House bill proposes to completely abandon the uniform or slightly graduated tax rate on corporations which has been the system in use for many years and to substitute therefor an undistributed profits tax which will result in rates on net income varying according to the proportion of income retained from 0 percent to 42½ percent. The House bill proposes to abandon the capital-stock and excess-profits taxes after June 30, 1936. The total amount of revenue thus abandoned is equal to $964,000,000 of corporate-income tax and $168,000,000 of capital-stock and excess-profits taxes, or a total of $1,132,000,000.

Your committee recognizes that our present system of taxation offers the opportunity, in certain cases, for individuals to avoid surtaxes by the retention of earnings in the corporations which they may control. However, your committee believes that the undistributed profits-tax plan proposed by the House bill has certain fundamental defects, some of which are as follows:

First. The plan proposes an entirely untried system which appears decidedly uncertain as to revenue yield.

Second. The plan will penalize many corporations not availed of for surtax avoidance in order that a comparatively few corporations availed of for that purpose may be reached.

Third. The plan will prevent the growth of new corporations in that they will be unable to build up reasonable reserves for working capital and future development.

Fourth. The plan may retard business expansion and seriously affect the unemployment problem.

Fifth. The plan penalizes the small corporation and the corporation with insufficient reserves and is of decided advantage to the large corporation and the corporation with excessive surplus.

Sixth. The plan tends to transfer the corporate control from the officers and directors of the corporation to the legislative branch of the Government.

Your committee takes the view that the evil sought to be remedied, to wit, the retention of profits by corporations to protect investors having large incomes against paying on larger incomes, may be soundly corrected without doing the injustices above described; and that this can be done by retaining the general corporate income tax with a 7-percent tax on retained income, supplemented by a strengthening of section 102 of the present law which deals with corporations improperly accumulating profits. Moreover, this plan contributes the indispensable element of certainty in the general revenue. The plan proposed is briefly as follows:

1. Levy a normal tax on the normal-tax net income of corporations equal to the sum of the following:

(*a*) Fifteen and one-half percent of the first $2,000 of normal-tax net income.

(*b*) Sixteen percent of the next $13,000 of normal-tax net income.

(*c*) Seventeen percent of the next $25,000 of normal-tax net income.

(*d*) Eighteen percent of the normal-tax net income in excess of $40,000.

2. Levy an undistributed-profits tax of 7 percent on the undistributed net income of corporations.

The result of this plan as compared with the plan proposed in the House bill is as follows, assuming a corporation with a net income of $100,000 not having in its income interest on Government obligations or dividends from other corporations:

Corporations with net income of $100,000

Dividends paid	Total tax, House bill	Total tax, Finance Committee bill
0	$42,500.00	$23,219.20
$10,000	37,500.00	22,519.20
20,000	32,500.00	21,819.20
30,000	27,500.00	21,119.20
40,000	22,500.00	20,419.20
50,000	17,500.00	19,719.20
60,000	13,125.00	19,019.20
70,000	9,375.00	18,319.20
80,000	6,000.00	17,619.20
90,000	2,857.14	17,440.00
100,000	0	17,440.00

In the judgment of your committee the above figures demonstrate that the Finance Committee bill, based on a system fully tested by experience, is more certain in its production of revenue than the House

bill, which is based on an experimental plan never before actually tried. As far as the individual is concerned both the House bill and the Finance Committee bill subject to normal tax the dividends received from corporations.

Your committee realizes that the Treasury should be conservative in its estimates, but greater conservatism is required with respect to a wholly new plan as proposed in the House bill, than should be the case with a plan based on past experience provided for in the Finance Committee bill. As to the estimates in respect to the House bill no comments are submitted, but your committee gives briefly its reasons why it believes the Treasury estimates in respect to the Finance Committee bill too conservative.

Estimates of Revenue

House bill.—To meet the revenue needs set forth by the President the House bill provided the following taxes, the estimates of additional revenue (over the revenue to be obtained under existing law) being submitted by the Treasury Department:

(*a*) Tax on undistributed corporate profits	$623, 000, 000
(*b*) Tax on unjust enrichment	100, 000, 000
(*c*) Extension of capital stock taxes for 1 year at one-half present rate	80, 000, 000
Total	803, 000, 000

Thus it was claimed that the House bill would provide a total additional revenue for the next fiscal year of $803,000,000. The House was of the opinion that the additional revenue required to take care of the balance of the temporary revenue requested, namely $334,000,000, could be provided for at the next session of Congress in the light of conditions then existing. Nevertheless, the House bill did fail to provide for the temporary revenue requested by the President.

Committee bill.—The bill submitted by the committee provides for the following taxes, the estimates of additional revenue (over the revenue to be obtained under existing law) being as submitted by the Treasury where available:

(*a*) Graduated tax on corporations	$215, 000, 000
(*b*) 7-percent tax on undistributed profits	217, 000, 000
(*c*) Normal tax on dividends	90, 000, 000
(*d*) Changing rule as to liquidations	33, 000, 000
(*e*) Foreign corporations	4, 000, 000
Total (as estimated by Treasury)	559, 000, 000
(*f*) Strengthening sec. 102 of existing law (committee estimate)	40, 000, 000
(*g*) Imposing taxes on certain oils (committee estimate)	10, 000, 000
(*h*) Taxing sale of oil leases at 30 percent (committee estimate)	10, 000, 000
(*i*) Increasing surtax (committee estimate)	50, 000, 000
(*j*) Windfall (Treasury estimate)	82, 000, 000
Grand total	751, 000, 000

The Treasury estimates that the graduated tax on corporations, plus the 7-percent tax on undistributed profits with the repeal of the exemption of dividends from the normal tax, will yield for the calendar year 1936 only $522,000,000 in additional revenue in spite of the fact that the capital-stock tax and excess-profits tax is to be retained.

This is believed to be considerably lower than the basic data submitted by the Treasury experts warrants, for the following reasons:

(1) The Treasury estimates the statutory net incomes of corporations for the calendar year of 1936 to be $7,200,000,000. This estimate was made last October and November when the Budget estimate was prepared, and provided for only a 30-percent increase over the previous year (Finance Committee hearings, p. 897). One of the Treasury experts, in appearing before the Senate Finance Committee (Senate Finance Committee hearings, p. 890) made the following statement as to increase in business profits over prior years:

> What are the dimensions of the increase in business profits? Reliable figures from impartial sources show that corporate profits during 1935 were 42 percent above those in 1934. They show also, one of the most reliable index reflecting profits of corporations, that during the third quarter of 1935, business profits were 69 percent above business profits during the third quarter of 1934. They show that in the fourth quarter of 1935, the increase over the corresponding period in 1934 was 117 percent. Figures for the first quarter of 1936 are not available. Preliminary estimates indicate a substantial increase, not as great as the last increase that I mentioned.

It is therefore believed that the data obtained subsequent to the estimate made in October and November of 1935 warrant some increase in the tax base of $7,200,000,000. In fact, one reliable witness stated before the committee that the additional revenue would be obtained even if there were no changes in existing laws.

(2) The Treasury, in arriving at the estimated revenues from the corporation income tax under the committee plan has reduced the computed tax by 6.8 percent to take care of uncollected items. Since the base upon which this tax is computed is the statutory net income reported by corporations on their returns, and does not include increases in corporate income resulting from Bureau audit, your committee is of the opinion that such a reduction is excessive in amount. Investigation discloses that the loss for uncollected items in the case of the tax reported by corporations on their returns is negligible in amount, being less than 1 percent. It is only when deficiencies in corporate income taxes are taken into account that this loss is a factor sufficient to warrant recognition in a budget estimate, and if deficiencies for back taxes outstanding in the calendar year 1936 are to be considered, the tax base of $7,200,000,000 should be materially increased.

3. The Treasury experts stated before the Ways and Means Committee and your committee that if the existing corporate income tax was increased to 25.5 percent, without making dividends subject to the normal tax on individuals, it would produce the additional permanent revenue of $620,000,000 requested by the President (hearings, Ways and Means Committee, pp. 24, 606, 653; Senate Finance Committee, p. 897). If this is true, a corporation tax of 18 percent, plus a 7 percent undistributed profits tax coupled with the repeal of the exemption of dividends from the normal tax ought to produce nearly the same amount for the following reasons:

The base of the 7-percent undistributed profits tax is increased by intercorporate dividends in the amount of $1,000,000,000 according to the statement made by the Treasury experts before the Ways and Means Committee (hearings, Ways and Means Committee, p. 36).

Instead of having a deterring effect upon dividend distributions, which might occur under a flat rate of 25.5 percent, the 7-percent

undistributed profits tax will encourage dividend distribution, thereby increasing the revenues to be derived from normal taxes and surtaxes.

The Treasury estimates that the increase of dividends in 1936 over 1935 will be from $3,600,000,000 to $3,900,000,000, or 8½ percent, in spite of the fact that the Treasury estimates the statutory net income in 1936 to be 30 percent above 1935. A distribution of only 54 percent of statutory net income seems entirely too conservative in view of the fact that for the period 1923–33 the aggregate dividends for all corporations approximate 75 percent. If 75 percent were distributed in dividends in 1936, the amount distributed would equal $5,400,000,000. While it is recognized that increases in dividends do not keep pace with increases in corporate profits when industry is recovering from a period of depression, the numerous increases in dividend distributions by large industrial corporations during the last quarter of 1935 and the current year lend strong support to the view which some of the witnesses expressed that increase in dividends payments will be substantially in excess of Treasury figures.

In view of the foregoing, your committee feels warranted in adding $78,000,000 to the $751,000,000 already referred to, making a total of $829,000,000. This is $26,000,000 more than the House bill, and will amply take care of the permanent revenue of $620,000,000 requested by the President and the temporary revenue for the next fiscal year.

On the basis of this modest and conservative increase in the Treasury estimates the Finance Committee bill will return 747 million in permanent revenue and 82 million in temporary revenue. The House bill only returned 623 million in permanent revenue and 180 million for 1 year. The Finance Committee bill is decidedly to the advantage of the Government both as to certainty and volume.

Even if the excessively conservative estimates of the Treasury are correct the Finance Committee bill will return more additional revenue over a 5-year period than the House bill, as can be shown from the following computation:

House bill

First year	$803,000,000
Second year	623,000,000
Third year	623,000,000
Fourth year	623,000,000
Fifth year	623,000,000
Total	3,295,000,000

Finance Committee bill

First year	751,000,000
Second year	669,000,000
Third year	669,000,000
Fourth year	669,000,000
Fifth year	669,000,000
Total	3,427,000,000

Finally, in respect to the revenue, it may be pointed out that the Finance Committee bill leads to a stable revenue while the House bill leads to an unstable revenue. It may be possible that the House bill would produce more revenue than the Finance Committee bill during periods of extreme prosperity, but, on the other hand, it cannot

be denied that the Finance Committee bill would produce far more revenue than the House bill during normal periods and during periods of depression. Your committee believes that a reasonably stable revenue from income tax is more to be desired than an unstable revenue.

Economic Effects

The probable economic effects of the House bill and the Finance Committee bill should also be considered.

In the first place, business should not be subjected to sudden changes in taxation systems retroactively applied. This is a feature of the House bill which will have an unfavorable effect on the confidence with which corporate enterprises would otherwise progressively increase. On the other hand, the Finance Committee bill retains the existing system, with only reasonable modifications.

In the second place, the House bill brings about unequal competitive conditions. The large corporation with an excessive surplus can pay out all its earnings in dividends and pay no tax. On the other hand, the small corporation with insufficient surplus which is in competition with such large corporation must pay a heavy tax on its earnings because it must retain the same in order to meet such competition.

In the third place, the tendency of the House bill will be to discourage expansion, to curtail the increase of corporate profits, and eventually to decrease the base from which our corporate tax must be collected.

The importance of volume of business profits cannot be underestimated when the productivity of the income tax is considered. In the fiscal year 1929 with tax rates about one-half, on the average, of those existing in the fiscal year 1935, the receipts from income taxes were $2,331,000,000. In 1935, with rates about double those imposed in 1929, the income-tax receipts were only $1,099,000,000. These figures clearly show that volume of profits is of the utmost importance with respect to the revenue received from the income tax.

Avoidance of Surtaxes by Incorporation

The Finance Committee bill not only has provided a 7-percent tax on undistributed profits but it has also made important changes in section 102 of existing law which deals with the subject of avoidance of surtaxes by incorporation. The section has been made fair and equitable but on the other hand it provides for the building up of evidence which will enable the Commissioner to properly enforce this section of the law. If a corporation retains more than $15,000 of its special adjusted net income, or more than 40 percent of its special adjusted net income, whichever is greater, then it must make a statement to the Commissioner setting forth the reason for such accumulation of profits. This will have a deterrent effect on unreasonable accumulations of profits. Furthermore, for the purpose of collecting the surtax provided for in section 102, the statute of limitations has been extended from 3 to 4 years. It is believed that the changes made in this section will produce directly or indirectly $40,000,000 of additional revenue annually.

Income-tax Complexities

Even our existing income-tax law is concededly complicated, and the need for its simplification has long been recognized. The Finance Committee bill does not simplify existing law, but on the other hand it does not increase its complexities. On the other hand, the House bill has increased the complexities of existing law. The five tax schedules in the House bill are complicated and confusing but they are not as objectionable as the so-called "cushion" provisions dealing with deficits and debts which, in the opinion of your committee, would lead to endless confusion and litigation. The Finance Committee bill retains the contract "cushion" which is free from the inherent, fundamental complexities of determining the earnings and profits of a corporation from the time of its organization, which determination is required with respect to the deficit and debt "cushions" of the House bill.

The contents of the bill will now be considered more in detail and the essential differences between the House bill and the Finance Committee bill will be discussed.

CONTENTS OF THE BILL, INCLUDING DISCUSSION OF ESSENTIAL DIFFERENCES BETWEEN HOUSE BILL AND FINANCE COMMITTEE BILL

The bill is divided into nine titles, which are as follows:

Title I. Income tax.

Title IA. Additional income taxes.

Title II. Capital-stock and excess-profits tax.

Title III. Tax on unjust enrichment.

Title IV. Export, charitable, etc., refunds and floor-stock adjustments under the Agricultural Adjustment Act.

Title V. Amendments to tax on certain oils.

Title VI. Miscellaneous provisions.

Title VII. Refunds of amounts collected under the Agricultural Adjustment Act.

Title VIII. General provisions.

TITLE I. INCOME TAX

This title is a restatement of the existing income law with the necessary changes to carry out the recommendations of your committee.

Surtax Increase

Your committee has in section 12 of this title increased by 1 percent the rate of surtax on surtax net incomes of individuals between $6,000 and $50,000. The House bill made no change in the surtax rates.

As a result of this increase surtax net incomes in excess of $6,000 are taxed at 6 percent instead of 5 percent as under existing law, and the 1 percent increase in rate continues up to and including surtax net incomes of $50,000 which are taxed at 28 percent instead of 27 percent as provided in existing law. The following table shows the effect of the increase on surtax net incomes ranging between $6,000 and $50,000:

Surtax net income	Surtax under existing law		Surtax under committee bill	
	Percent on bracket	Total surtax on upper limit of bracket	Percent on bracket	Total surtax on upper limit of bracket
$4,000 to $6,000	4	80	4	80
$6,000 to $8,000	5	180	6	200
$8,000 to $10,000	6	300	7	340
$10,000 to $12,000	7	440	8	500
$12,000 to $14,000	8	600	9	680
$14,000 to $16,000	9	780	10	880
$16,000 to $18,000	11	1,000	12	1,120
$18,000 to $20,000	13	1,260	14	1,400
$20,000 to $22,000	15	1,560	16	1,720
$22,000 to $26,000	17	2,240	18	2,440
$26,000 to $32,000	19	3,380	20	3,640
$32,000 to $38,000	21	4,640	22	4,960
$38,000 to $44,000	24	6,080	25	6,460
$44,000 to $50,000	27	7,700	28	8,140

It should be noted that surtax net income means the net income after the personal exemption and credit for dependents are deducted. Therefore a married man with no dependents must have a net income of over $8,500 before he will be subject to this 1-percent rate increase in surtax, and a married man with a dependent must have a net income of over $8,900 before he will be subject to such increase. It should also be noted that the $440 increase in surtax on the individual with a surtax net income of $50,000 will also apply to the same extent to every individual who has a surtax net income in excess of $50,000.

Normal Tax on Corporations

Section 13 of the committee bill increases the existing rates of tax upon corporations to a maximum of 18 percent. The House bill completely eliminates any normal tax on corporations. The following table shows the changes over existing law in both cases the rates applying by bracket and not by totality:

	Existing law	Committee bill
	Percent	*Percent*
Normal tax net incomes not in excess of $2,000	12½	15½
Normal tax net incomes in excess of $2,000 but not in excess of $15,000	13	16
Normal tax net incomes in excess of $15,000 but not in excess of $40,000	14	17
Normal tax net incomes in excess of $40,000	15	18

The bill as reported follows the House bill in including in statutory net income all dividends received, whereas existing law takes out 90 percent of dividends received from domestic corporations. Section 13 of the bill as reported gives, for the purposes of the normal tax alone, a credit of 90 percent of the dividends received from domestic corporations.

Surtax on Undistributed Profits

Section 14 of the committee bill imposes a surtax of 7 percent upon the amount of the undistributed net income of corporations. This, together with the normal tax on corporations, is a complete substitution for the undistributed-profits tax provision of the House bill. Instead of having a graduated undistributed-profits tax like the House bill with rates ranging as high as 42.5 percent, your committee has adopted a flat rate of 7 percent. By this moderate rate your committee has eliminated most of the complicated relief provisions in the House bill relating to debt and deficit corporations. However, the principle of the House bill affording relief to corporations which are unable to pay dividends because of express prohibitions in contracts entered into prior to March 3, 1936, have been retained for the purpose of the 7-percent undistributed-profits tax.

The term "undistributed net income" is defined in the bill to mean the adjusted net income minus (1) dividends paid during the taxable year, and (2) the amount of the adjusted net income which the corporation is prohibited by contract as defined in section 26 (c) from paying as dividends during the taxable year. The adjusted net income consists of the net income of the corporation reduced by the following:

(1) The normal tax on corporations imposed by section 13;

(2) Interest on United States and Government obligations;

(3) The amount allowed as a credit to a bank holding company affiliate under section 26 (d).

The following example will show how the 7-percent tax is applied in the ordinary case:

A corporation has a net income of $190,000, including $100,000 in dividends received from other corporations, but has received no interest on obligations of the United States or Government corporations. It distributes to its shareholders $61,000 in dividends. Its tax will be determined as follows:

Net income	$190,000
Credit for dividends received from other corporations	90,000
Normal tax net income	100,000
Normal tax, 18 percent	18,000
Net income	190,000
Normal tax	18,000
Adjusted net income	172,000
Dividends paid	61,000
Undistributed net income	111,000
Undistributed profits tax, 7 percent	7,770
Total normal and surtax	25,770

Corporations Exempt From Undistributed-Profits Tax

The following corporations are wholly exempt (sec. 14 (c)) from the 7-percent undistributed-profits surtax:

(1) Banks and trust companies (see discussion under that heading);

(2) Domestic corporations in bankruptcy or receivership (see discussion under that heading);

(3) Domestic or foreign insurance companies;

(4) Foreign corporations;

(5) Corporations subject to the tax under section 251 by reason of their receiving a large portion of their income from sources within a possession; and

(6) China Trade Act corporations.

Of course, corporations which are exempt under section 101 from tax (mutual, charitable, religious, cooperative, and other corporations) are exempt from the undistributed-profits surtax.

Banks and Trust Companies

Banks and trust companies, as under the House bill, are not subject to the undistributed-profits tax, but are subject only to the normal corporation tax at the graduated rates provided in the bill. The definition of such institutions has been broadened to include incorporated trust companies, a substantial part of the business of which consists of exercising fiduciary powers similar to those exercised by national banks under section 11 (k) of the Federal Reserve Act. Such institutions, however, must be subject to the supervision and examination of the banking authorities. The definition has been clarified to make certain that banks and trust companies in the District of Columbia of the character described are included. A similar exemption of banks and trust companies is contained in section 351 (the tax on personal holding companies). The bill as

reported omits the provisions of the House bill under which foreign corporations are given the same rate of tax on banking business done in the United States as in the case of domestic banks. Under the bill as reported such corporations are subject to the same taxes as other foreign corporations.

Holding Company Affiliates of Banks

Holding company affiliates of banks, which under the provisions of law contained in the Banking Act of 1933, are required to invest a part of their funds in readily marketable assets other than bank stocks, are given relief from the surtax on undistributed profits and the tax imposed under section 102 on improper accumulation of surplus with respect to amounts devoted by them to the acquisition of such assets. (Sec. 14(a) (1) (C) and sec. 102 (c) (1) (B).)

Under the Banking Act of 1933 such holding company affiliates, in order to be entitled to retain the permit issued them by the Federal Reserve Board, must acquire and maintain the ratio of marketable assets other than bank stocks to their investment in bank stocks which is required under that act. The act also requires them to invest a portion of their current earnings in such assets. The bill as reported gives such affiliates a credit against adjusted net income for the purposes of the undistributed-profits surtax of an amount equal to the company's earnings or profits devoted during the taxable year to the acquisition of readily marketable assets other than bank stock. The provision allows the credit for whatever amount is used for the purpose during the year, thus including amounts used in anticipation of complying with the requirements of the law.

The amount with respect to which the credit is given must not come out of capital but out of earnings and profits. If after once investing to meet the minimum requirements of the Banking Act more sums must be invested to comply with its provisions, the credit is allowed with respect to such additional sums. In no case is credit to be allowed for amounts invested in excess of what the Banking Act requires to be invested. Amounts invested by the taxpayer prior to his taxable years affected by the bill which are invested in anticipation of compliance with the Banking Act are not allowable as a credit—the credit in such cases being allowed only with respect to the difference between amounts already invested and the remainder required to be and actually invested.

Provision is made for certification by the Board of Governors of the Federal Reserve System to the Commissioner of the amounts with respect to which the credit is to be given.

Provisions similar to the above apply in the case of the surtax on improper accumulation of surplus imposed under section 102.

Domestic Corporations in Bankruptcy or Receivership

Section 105 of the House bill exempted domestic corporations in bankruptcy or receivership from the undistributed-profits tax in that bill and subjected them to a flat 15-percent rate of tax. The bill as reported (sec. 14 (c) (2)) similarly exempts such corporations from the 7-percent undistributed-profits surtax and applies to them the graduated rates applicable to other corporations. The committee proposal spe-

cifically exempts the corporation in this situation from the undistributed-profits surtax for its entire taxable year even if it is bankrupt or in receivership for only a part of the taxable year. This proposal is founded on the principle that if a corporation goes into bankruptcy or receivership after its taxable year has started, it is so weak that an undistributed-profits surtax ought not to be or cannot be imposed upon it. Similarly, if it comes out of bankruptcy or receivership during its taxable year, it should be allowed to operate free of such tax during the remainder of the year in order to recover its strength. The Finance Committee bill also avoids the possibility of tax avoidance by collusive receiverships by limiting the provision to cases in which the corporation is in bankruptcy under the Federal bankruptcy laws, and to cases in which it is insolvent—i. e., its liabilities are in excess of its assets or it is unable to pay the claims of creditors as they mature—and in receivership in Federal or State courts.

Similar provisions apply in the case of corporations which may file consolidated returns under section 141 (railroad and street-railway companies). The provision of the House bill that the character of all the corporations in the affiliated group is to be determined in accordance with the character of the parent corporation is retained.

SECTION 23. DEDUCTION FOR TAXES

This section allows a deduction, in computing the net income of corporations for the purposes of any tax imposed under title I and IA, of the excess-profits tax imposed by the Revenue Act of 1935. Congress in the Revenue Act of 1935 allowed, as a deduction against the net income subject to the excess-profits tax imposed by that act, the amount of the income tax paid for the corresponding excess-profits tax year. However, since the excess-profits tax is a proper deduction in computing the undistributed-profits tax, complications will arise if the undistributed-profits tax is also allowed as a deduction for the excess-profits tax, for the computation of one tax will offset the computation of the other tax and vice versa. To avoid this complication, your committee has changed existing law as indicated above.

SECTION 26. CREDITS OF CORPORATIONS

This section sets forth certain credits allowed to corporations in computing the various taxes imposed under title I. In general, they are as follows:

(1) Interest on obligations of the United States and its instrumentalities: This is allowed (*a*) as a credit against net income for the purpose of the normal tax on corporations imposed by section 13, and (*b*) as a credit against the adjusted net income for the purpose of the surtax on undistributed profits imposed by section 14.

(2) Ninety percent of the amount received as dividends from a domestic corporation subject to taxation under this title, except China Trade Act corporations and corporations doing business in possessions of the United States entitled to the benefit of section 251. This credit is allowed for the purpose of the normal tax imposed on corporations by section 13.

(3) Contracts not to pay dividends: This credit is in principle similar to a relief provision allowed in the House bill for the purpose

of the undistributed-profits tax imposed by that bill. It is allowed as a credit in computing undistributed net income for the purpose of the surtax on undistributed profits imposed by section 14 and in computing retained net income for the purpose of the tax imposed by section 102.

(4) Bank affiliates: This credit is explained in another part of this report. It is allowed as a credit against net income for the purpose of surtax on undistributed profits imposed by section 14, and as a credit against the special adjusted net income for the purpose of the surtax imposed by section 102 on corporations improperly accumulating surplus. This is a relief provision which was not provided for in the House bill.

INTERCORPORATE DIVIDENDS

Your committee has omitted the provisions of the House bill (sec. 27 (i)) denying to a corporation paying dividends a credit for dividends paid to corporations owning 50 percent or more of the stock of the corporation paying the dividends. This provision is no longer necessary, for under the bill as reported the opportunity for evasion which this provision was designed to prevent has been eliminated.

SECTION 27 (G). PREFERENTIAL DIVIDENDS

The clause eliminated by the amendment to this subsection is surplusage. Subsections (g) and (h), taken together, have the same effect whether the clause is stricken out of subsection (g) or not.

SECTION 32. CREDIT OF TAX WITHHELD AT SOURCE

Section 32 of the existing law provides that the tax withheld at the source under section 143 from payments to an individual taxpayer shall be a credit against such taxpayer's tax. A committee amendment expressly states that the same rule shall apply in the case of the tax withheld under section 144. By the terms of section 144 of existing law withholding in the case of payments to foreign corporations is subject to the same conditions as withholding from individuals under section 143. Under section 143 (d) of existing law credit of the tax withheld from an individual is given against his tax. The committee amendment is therefore declaratory of existing law, and also makes it clear that the tax withheld in the case of a foreign corporation shall always be a credit against the tax, whether collected by return or not.

SECTION 102. SURTAX ON CORPORATIONS IMPROPERLY ACCUMULATING SURPLUS

The reported bill recommends important changes over existing law and the House bill in section 102, which imposes tax on domestic and foreign corporations accumulating profits in order to avoid the imposition of surtaxes on their stockholders or the stockholders of other corporations. One general effect of the changes is to strengthen the section by reasonable deductions in determining the retained net income subject to the tax so that the tax will not be thought to be arbitrary by courts and their disposition will be to give effect to its

provisions. Another aspect of these changes is that they will facilitate administration of the tax by clarifying its intention and by arming the Treasury with additional means of enforcement. The two most important changes in this respect are the one which requires a statement of reasons for accumulation in the case of certain corporations and the one extending the period of limitations on assessing and collecting the tax under the section. The significant changes from the House bill are as follows:

(1) The reported bill strikes out the provision of the House bill which limited the section to personal holding companies, banks, insurance companies, foreign corporations, China Trade Act corporations, and corporations receiving a large portion of their income from sources within a possession. As reported, the section applies to every corporation (domestic and foreign) which improperly accumulates surplus, except personal holding companies. They are treated separately in section 351.

(2) The bill as reported makes it clear that the surtax imposed by the section is in addition to surtax imposed by section 14.

(3) The reported bill adds the requirement that every corporation subject to income taxation (except personal holding companies) whose retained net income is more than 40 percent of the special adjusted net income, or more than $15,000, whichever is greater, must include a statement in its return fully explaining the reasons for accumulating the earnings or profits. The Treasury, if it has in its possession such a statement, is in a better position to check from year to year the nature of the accumulations and the intention of the stockholders and the corporation.

(4) The 3-year statute of limitations on assessment and suit for the collection of income taxes is increased to 4 years for the assessment and collection of the amount of the tax under this section (sec. 276 (b)). This provision is particularly important, not only in its obvious effect of permitting a longer time for ascertaining liability for this tax, but also because of its force when taken in connection with the requirement of a statement of reasons for accumulation. The longer period permits a more thorough check on the bona-fide nature of the reasons assigned for accumulation.

(5) The bill as reported substitutes for the word "gains" the word "earnings" wherever "gains" is used in the section in connection with the word "profits." The phrase describes the fund out of which taxable dividends are paid. The substitution makes no change in existing law but more accurately describes such fund and uses the same expression as is employed in section 115 and elsewhere in the act.

(6) To avoid confusion between the description of the measure of the tax for the purposes of this section and the tax in section 14 and section 351, the bill as reported (subsec. (d)) uses the term "special adjusted net income." This term is defined as net income less the sum of (*a*) that part of the Federal income, war-profits, and excess-profits taxes (except taxes imposed under this section and similar sections of prior revenue acts) paid or accrued during the taxable year which is not allowed as a deduction from gross income under section 23; (*b*) charitable contributions disallowed under section 23 (o) because in excess of the limitations provided in that subsection; and (*c*) capital losses disallowed under section 117 (d). In the case of a

holding company affiliate (within the meaning of sec. 2 of the Banking Act of 1933), "special adjusted net income" means net income less the amount allowed because of compliance with that act as a credit under section 26 (d) in addition to the deductions enumerated in (*a*), (*b*), and (*c*) above.

(7) The term "retained net income" is defined as "special adjusted net income" reduced by the sum of the credit for dividends paid, allowed under section 27, and the credit allowed under section 26 (c), relating to contracts not to pay dividends.

(8) The House bill provided that the surtax under the section shall not apply if all the shareholders take up their pro rata shares of the retained net income on their returns. The bill as reported adds the further limitation that the tax will apply unless 90 percent of the retained net income is included in the returns of shareholders other than corporations—i. e., taxpayers subject to normal and surtax on individuals.

SECTION 104. INCOME FROM SALE OF OIL OR GAS PROPERTIES

The bill as reported inserts a provision not found in the House bill, but similar to provisions contained in revenue acts prior to 1934, limiting the surtax in cases of taxpayers who sell oil or gas property where the principal value of the property has been demonstrated by prospecting or exploration and discovery work done by the taxpayer. The effect of the provision is to limit the surtax on that portion of the individual's net income attributable to the sale of such properties to not more than 30 percent of the selling price of the property or interest. It was brought to the attention of the committee that the effect of the omission in the 1934 act of a similar provision was, in many cases, to prevent the sale of such properties and thus a tax loss has resulted, and individuals have been discouraged from embarking upon or continuing such enterprises. The result was to throw the business into the hands of corporations which, being subject only to the corporation-tax rate, would pay less tax than individuals would. It is believed that the result of the proposed change will be to stimulate individuals to develop oil and gas properties and to sell, thus increasing the tax yield from this source.

SECTION 115 (a). DIVIDENDS OUT OF CURRENT EARNINGS

In order to enable corporations without regard to deficits existing at the beginning of the taxable year to obtain the benefit of the dividends paid credit for the purposes of the undistributed profits surtax, section 115 (a) changes the definition of a dividend so as to include distributions out of the earnings or profits of the current taxable year. The amendment simplifies the determination by providing that distributions during the year, not exceeding in amount the current earnings, are dividends constituting taxable income to the shareholder and a dividends paid credit to the corporation. As respects such dividends the complicated determination of accumulated earnings or profits is rendered unnecessary.

SECTION 115 (f). STOCK DIVIDENDS

This subsection of the House bill, under which stock dividends are made taxable to the full extent permitted by the Constitution, is

retained by your committee, except for changes made necessary by virtue of the reported amendment of section 115 (a) and in the interest of greater clarity.

SECTION 115 (D). DISTRIBUTIONS FROM CAPITAL

This subsection of the House bill, relating to the effect of certain distributions from capital upon the basis for determining gain or loss, is retained by your committee with but a slight change in wording made necessary by the proposed revision of section 115 (a).

SECTION 115 (H). EFFECT OF DISTRIBUTIONS ON EARNINGS AND PROFITS

The rule, under existing law, with respect to the effect on corporate earnings or profits of a distribution which, under the applicable tax law, is a nontaxable stock dividend or a distribution of stock or securities in connection with a reorganization or other exchange, on which gain is not recognized in full, is that such earnings or profits are not diminished by such distribution. In such cases, earnings or profits remain intact and hence available for distribution as dividends by the corporation making such distribution, or by another corporation to which the earnings or profits are transferred upon such reorganization or other exchange. This rule is stated only in part in section 115 (h) of the Revenue Act of 1934, and corresponding provisions of prior acts, but is the rule which is applied by the Treasury and supported by the courts in *Commissioner* v. *Sansome*, 60 Fed. (2) 931; *U. S.* v. *Kauffman*, 62 Fed. (2) 1045; *Murcheson* v. *Comm.*, 76 Fed. (2) 641. While making no change in the rule as applied under existing law, the recommended amendment is desirable in the interest of greater clarity.

SECTION 141. CONSOLIDATED RETURNS

The provisions of the House bill relating to consolidated returns are retained by your committee including the change made in existing law by extending the privilege of filing a consolidated return to street, suburban, or interurban electric railways that are members of an affiliated group. (See subsec. (d).) In view of section 14 (c) (2) of the reported bill and the omission of section 105 of the House bill from the reported bill, your committee, however, has made a necessary revision in subsection (j) of this section (relating to special treatment for surtax purposes of an affiliated group filing a consolidated return where the parent is insolvent or bankrupt). The privilege of filing a consolidated return, once the election to file such a return has been exercised under the provisions of this bill, extends to both the normal tax and surtax but not to either one separately. Among the matters to be covered by regulations which it is expected that the Commissioner will prescribe (under the provisions of subsec. (b) of this section) are (a) treatment of intercompany dividends in computing consolidated net income, (b) definitions of "adjusted net income" and "undistributed net income" of the affiliated group, and (c) computation of "dividends paid credit" of such group.

SECTIONS 143 AND 144. CHANGE IN WITHHOLDING RATES

Sections 143 (g) and 144 (b) of the House bill provided that the changes in the withholding provision of existing law shall apply only to amounts withheld on or after the date of enactment of the bill. It seems to your committee that a period should be given for withholding agents to become acquainted with the new provisions, and committee amendments therefore propose that existing law shall apply to withholding for any period prior to the tenth day after the date of enactment of the bill.

SECTION 165. EMPLOYEES' TRUSTS

Your committee has changed the provisions of the existing law, which were continued in the House bill, as to the taxability of distributions of stock to an employee from a trust created by an employer as part of a stock bonus, pension, or profit-sharing plan for the benefit of his employees to which contributions are made both by the employer and the employee. Under existing law, the employee is taxed not only upon the amount contributed to the trust by the employee and the dividends and interest distributed to the employee, but also upon all unrealized appreciation in the value of the stock, when he receives it from the trust. This in effect taxes the employee upon the appreciation in the value of the stock he receives before he sells or otherwise disposes of it. This seems an unfair rule. The Finance Committee bill corrects this situation by providing that upon such distribution there shall be taxed to the employee, the amount contributed by the employer toward the purchase of the stock, all cash dividends on the stock, and interest paid to the employee, and any other income received by him, but that any appreciation in the value of the stock purchased under the plan over the cost to the trustee shall not be taxed unless and until the gain is actually realized, which ordinarily occurs when the employee sells the stock.

SECTION 169. COMMON TRUSTS

The Finance Committee has adopted an amendment which will permit banks and trust companies qualifying under the section to operate common trust funds free of tax as corporations. It appears from recent court decisions that common trust funds, where the funds of many individual trusts are mingled, are taxable as corporations. Common trust funds serve a good social purpose in that they permit a bank or trust company to diversify the investment of such funds and result in a greater and more certain yield to those that desire to establish trust funds which are small in amount.

INSURANCE COMPANIES

The amendments proposed to sections 201, 203, 204 (a) and (f) of the House bill are for the purpose of applying to stock insurance companies of all classes and to mutual life insurance companies, the graduated normal tax provided in section 13, giving to these companies the same credit for Liberty bond, etc., interest and for dividends received as are allowed to corporations generally, but preserving the provisions of

existing law relating to the determination, in the case of foreign life insurance companies, of the Liberty bond credit and the net income from United States sources by using the ratio of reserve funds upon United States business to reserve funds upon all business. The House bill did not give the credit, provided in these amendments, of 90 percent of dividends received from domestic corporations.

Insurance Companies Other Than Life or Mutual

Under existing law and the House bill (sec. 204 (b) (1) (C)) insurance companies other than life or mutual must include in gross income all items of income, and are given certain deductions, which were thought to include all deductions allowed other corporations. It was brought to the committee's attention that some deductions (especially bad debts and losses) are not fully allowed under the language of section 204. An amendment to section 204 provides that such companies shall be allowed all deductions not already specified in section 204, but not in excess of the amount of the gross income included under section 204 (b) (1) (C).

Nonresident Aliens and Foreign Corporations

Your committee concurs in the main in the substantial changes made by the House bill in our present system of taxing nonresident aliens and foreign corporations. It seems obvious that a surtax on undistributed corporate profits is not well adapted to the taxation of a foreign corporation with foreign shareholders in respect of its income from sources within the United States. In section 211 (a) it is proposed that the tax on a nonresident alien not engaged in a trade or business in the United States and not having an office or place of business therein, shall be at the rate of 10 percent on his income from interest, dividends, rents, wages, and salaries and other fixed and determinable income, with no allowance for the deductions from gross income and credits against net income allowed to individuals subject to normal tax and surtax on net income. Your committee recommends, however, an amendment fixing the rate at 5 percent in the case of nonresident alien residents of contiguous countries. There is some precedent for such difference in treatment of residents of contiguous countries in prior revenue acts. It is believed to be justified at this time by the relatively low rates of tax imposed by such countries on income flowing therefrom to residents of the United States. This flat tax (in the usual case) is collected at the source by withholding as provided for in section 143. Such a nonresident alien will not be subject to the tax on capital gains, including so-called gains from hedging transactions, as at present, it having been found administratively impossible effectually to collect this latter tax. It is believed this exemption from tax will result in considerable additional revenue from the transfer taxes and from the income tax in the case of persons carrying on the brokerage business. The principal increase in revenue will result, however, from withholding tax on dividends heretofore not required.

In the case of a nonresident alien engaged in trade or business in the United States or having an office or place of business therein, the same tax is levied upon his net income from sources within the United

States as is levied upon the American citizen or resident under the House bill. Your committee concurs in this plan but recommends amendments to section 211 (b) of the House bill which are intended to clarify the meaning of the phrase "engaged in trade or business in the United States." Your committee is also of the opinion that the credit of $1,000 against that portion of the net income of nonresident aliens attributable to compensation for personal services, as provided in section 214 of the House bill, should be changed to a general credit of that amount limited to nonresident alien individuals engaged in trade or business within the United States or having an office or place of business therein, and that section 214 of the House bill should be further amended to allow the credit for dependents provided by section 25 (b) (2) to nonresident alien individuals of the same class who are residents of contiguous countries.

One other change in the taxation of nonresident aliens is recommended by your committee in the form of an amendment to section 119 (a) (3) of the House bill. This amendment would operate to exclude from the definition of income from sources within the United States compensation received by a nonresident alien individual for labor or services performed in the United States under an employment or contract with a nonresident alien individual or a foreign partnership or corporation, provided such services are rendered by such nonresident alien individual while temporarily present in the United States for a period or periods not exceeding a total of 90 days during the taxable year and that the aggregate compensation for such services does not exceed $3,000. The purpose of this amendment is to permit residents of other countries to make brief visits to the United States for business purposes, such as the buying and selling of goods, without being subject, before leaving the country, to a demand for payment of tax on their compensation during the period of their stay here. Numerous cases of this character arising under the present law have created irritation and ill will quite disproportionate to the slight revenue involved. The limitations contained in the amendment are, it is believed, adequately drawn to prevent any serious abuse of the exemption. This change is consistent in purpose with the amendment to section 211 (b) which the committee has recommended.

In the case of a foreign corporation engaged in trade or business within the United States or having an office or place of business therein, your committee recommends that the rate of tax imposed upon the corporate net income from sources within the United States be 22 percent, as compared with 22½ percent imposed by section 231 (a) of the House bill. Under section 119 (a) (2) (B) of the House bill the dividends of such foreign corporations would be made not taxable to foreign shareholders unless 85 percent or more of their corporate gross income is from sources within the United States, in which case they would be made taxable to the foreign shareholder only to the extent that the dividends represent American income. It is the view of your committee that, in order to prevent tax avoidance by our own citizens through the organization of foreign corporations this provision of the House bill should be amended to accord with the existing law to the extent that it makes such dividends where the foreign corporation derives 50 percent or more of its gross income from sources within the United States. The committee concurs, as a matter of fairness and

equity, with the provisions of the House bill which limit the tax to that portion of the dividend representing American income. Your committee also agrees, as a matter of policy, with the House bill in restricting the requirement of withholding of tax by such foreign corporations on dividends paid to their foreign shareholders to those which derive more than 85 percent of their gross income from sources within the United States and are engaged in trade or business within the United States or have an office or place of business therein.

In the case of a foreign corporation not engaged in trade or business within the United States and not having an office or place of business therein, the House bill would levy a flat rate of tax of 15 percent on the gross income of such corporation from interest, dividends, rents, salaries, wages, and other fixed and determinable income from sources within the United States (not including capital gains), the tax being collected in the usual case by withholding at the source, with no deductions or credits allowed. Your committee concurs in the substance of these provisions but recommends an amendment to section 231 of the House changing the rate of tax on such income, except for dividends, from 15 percent to 18 percent, and in the case of dividends, fixing the rate at 5 percent in the case of corporations organized under the laws of a contiguous country and 10 percent in the case of other foreign corporations. For various reasons, it is believed the tax on dividends should be the same in the case of a corporate as of an individual recipient. It should be noted that under the House bill corporate profits distributed to stockholders abroad may never have been taxed, while under the Finance Committee bill they would have been subject to at least the normal corporation tax.

Your committee does not concur in the provision of the House bill, section 231 (c), relating to foreign banks, which would tax such banks 15 percent on their net income from their banking business and 22½ percent on their net income from other sources within the United States, and recommends that this provision be stricken from the bill and such corporations taxed at the same rate, viz, 22 percent, applied to other foreign corporations. Such foreign banks are commonly limited by law to the receipt of deposits from foreigners and their income therefrom is believed to be too inconsiderable to warrant special treatment which would involve a very difficult problem of allocation.

Your committee believes that the proposed revision of our system of taxing nonresident aliens and foreign corporations will be productive of substantial amounts of additional revenue, since it replaces a theoretical system impractical of administration in a great number of cases.

TITLE IA. ADDITIONAL INCOME TAXES

The House bill omitted section 351 of existing law imposing a surtax upon personal holding companies. Your committee has retained, with changes, the provisions of existing law as this section has proved very effective in preventing accumulations in corporations to prevent the imposition of surtax on shareholders. The following changes have been made over existing law:

(1) The rates have been decreased by 7 percent on account of the 7-percent undistributed profits tax.

(2) An exemption has been granted small-loan companies making loans to individuals in principal not exceeding $300 outstanding at any one time in the case of any individual, if such interest is lawful, is not payable in advance or compounded, and is computed only on unpaid balances. These companies are subject both to the normal tax and the 7-percent undistributed profits tax applicable to ordinary corporations.

(3) Contributions or gifts to charitable organizations pledged by an individual who died prior to January 1, 1936, and assumed by a corporation organized to take over the assets and liabilities of the estate of such decedent after that date are allowed as a deduction in computing the adjusted net income for the purposes of this tax. This deduction seems meritorious, for the liabilities assumed by the corporation are with respect to gifts going to charitable organizations and were actually incurred prior to January 1, 1936, but due to the delay in the organization of the corporation were not actually incurred by the corporation as such until after that date.

(4) Under existing law, the tax imposed by section 351 does not apply if all the shareholders of the corporation include at the time of filing their returns their pro-rata shares, whether distributed or not, of the adjusted net income of the corporation for such year. Your committee adds a further limitation that the tax will apply even in such cases unless 90 percent of the retained net income is included in the returns of shareholders other than corporations—i. e., taxpayers subject to normal and surtax on individuals.

TITLE II. CAPITAL-STOCK AND EXCESS-PROFITS TAXES

The capital-stock and excess-profits taxes are continued in force for future years at the same rates as provided for in the Revenue Act of 1935. The House bill repealed the capital-stock tax for years ending after June 30, 1936, and reduced the rate from $1.40 per $1,000 to $0.70 per $1,000 even in the case of the capital-stock tax imposed as of that date. The House bill also repealed the excess-profits tax as to all income-tax taxable years ending after June 30, 1937. The Finance Committee bill disallows the deduction from income for excess-profits tax purposes of the income taxes imposed by title I. On the other hand the excess-profits tax is allowed as a deduction from the income subject to tax under title I. The reason for this change has already been described in connection with section 23.

TITLE III. TAX ON UNJUST ENRICHMENT

Your committee recommends the enactment of title III of the House bill, with amendments designed to relieve hardship in certain cases and to provide for simpler and more equitable determination of tax liabilities.

This title imposes a tax of 80 percent on the unjust enrichment accruing to any person as a result of shifting to others the burden of Federal excise taxes.

In the case of persons on whom a Federal excise tax was imposed but not paid, the 80-percent tax will apply to the net income from the sale of articles with respect to which the excise was not paid, to the extent that this net income is attributable to the fact that the taxpayer shifted all or part of the excise-tax burden directly or indi-

rectly to others. This, of course, does not depend on whether or not the shift of the excise-tax burden was to his vendees or his vendors, or on whether or not it was intentional or express, but depends upon the extent to which the taxpayer's margin between prices and costs covered his normal profit margin and also all or part of the amount of the excise. However, the amount taxable in these cases as unjust enrichment during any taxable year will be limited to the net income for the whole of such year from the business with respect to which the excise was levied.

Excise-tax payers will also be taxable on refunds of the excise taxes, to the extent that they did not absorb the entire burden of such excise taxes.

Dealers who receive reimbursement from their vendors for any amount of excise-tax burdens will be taxable on such reimbursement to the extent that such dealers have shifted such excise-tax burdens, in whole or in part, to their customers in any manner.

The principal amendments proposed by your committee are as follows:

(1) Where the unjust enrichment arises from the nonpayment (during a portion of a taxable year) of a Federal excise tax, and the taxpayer suffered losses during the remainder of such year in the business with respect to which he paid such excise tax, he is allowed an offset for such losses by a provision that the net income to which the unjust enrichment tax relates shall not exceed his net income for the entire year from the business with respect to which the excise tax was imposed.

(2) There is excluded from the computation of unjust enrichment the income relating to transactions of such character that the nonpayment or recovery of the amount of the excise tax can be assumed not to have constituted a windfall. These cases are enumerated in section 501 (b) (explained below).

(3) At his option the taxpayer may simplify the computation of net income and profit margins by using annual averages in lieu of establishing the actual facts with respect to specific transactions.

(4) In order to give more equitable comparisons, the representative period for determining the taxpayer's basic average profit margin (used in the prima-facie computation of the extent to which he shifted the burden of the tax) has been lengthened from 5 to 6 years. In addition, provision is made for the inclusion of direct manufacturing costs, as well as material costs, in the application of this presumption.

(5) Credit is allowed for any rebates on account of the excise tax made to purchasers on or before the thirtieth day after the enactment of the act, whether or not made in pursuance of an existing contract. The House bill allowed credit for rebates after March 3, 1936, only when made under a written contract entered into on or before that date. Rebates made at any time under such a contract will be credited under the reported bill as under the House bill.

(6) The Commissioner is granted power to postpone payment of the tax not to exceed 3 years in order to prevent undue hardship to the taxpayer.

(7) The Commissioner is granted authority to settle the taxpayer's liability for the unjust enrichment tax in conjunction with

his claims for refund of taxes paid under the Agricultural Adjustment Act.

The committee amendments are explained in detail below:

Section 501 (a) (1).—A clause is added limiting the income taxable under this paragraph to the amount of net income for the entire taxable year from the business with respect to which the excise tax was imposed, thus granting an offset for net losses incurred during the same taxable year from transactions with respect to which the excise tax was paid. Example: A processor on a calendar-year basis paid the processing tax for the first 6 months of 1935 but obtained an injunction and did not pay it for the last 6 months. His processing business for the last 6 months showed a net income of $10,000. The unpaid processing-tax liability for this 6 months was $8,000, of which $7,500 was passed on to customers. But during the first 6 months, when he paid the tax, his processing business showed a net loss of $4,000, making his net income for the year from the processing business $6,000. Under the House bill the 80-percent tax would apply to $7,500 (the portion of the $10,000 net income for the last half of the year which is attributable to passing on the unpaid tax). Under the committee amendment he would be taxable at 80 percent on $6,000, since the taxable income is limited by the amount of his net income from the processing business for the entire year. Profits and losses in other lines of business would be disregarded.

Section 501 (a) (2).—This paragraph is rewritten merely to clarify its meaning. It imposes the 80-percent tax on dealers who are reimbursed by their vendors for excise-tax burdens which they have in turn shifted to their customers.

Section 501 (a) (3).—This paragraph is new. It imposes the 80-percent tax on a person who obtains from the Government a refund of an excise tax erroneously or illegally collected from him, the burden of which he shifted to others. Under the House bill such persons were taxable under section 501 (a) (1). (See sec. 501 (j) of the House bill.) The new paragraph applies the theory that the refund is income, instead of the theory (applied in the House bill) that it should be handled by a recomputation of income for the year in which the tax was allowed as a deduction.

Section 501 (b).—This is a new provision. It excludes from the computation of the income resulting in unjust enrichment any income with respect to articles in the taxpayer's stocks on the day after the date of termination of the tax; any income from articles with respect to which the taxpayer has reimbursed his vendee for the excise-tax burden; and any income from articles with respect to which some special statutory provision for refund existed, as in the case of exports, charitable deliveries, etc.

Section 501 (c).—This is a revision of section 501 (b) of the House bill. It provides an option to the taxpayer for the computation of net income for the purposes of the 80-percent tax by the use of the average income per unit during the taxable year, instead of the calculation of profit from specific transactions.

Section 501 (d).—The amendments in this section are clerical.

Section 501 (e).—This is a revision of section 501 (d) of the House bill. It provides the presumptive rule for determining the extent to which the burden of the Federal excise tax was shifted. The changes are as follows:

(1) The taxpayer is given an option to make the computation of his profit margin on the basis of averages for the year in terms of the unit on the basis of which the excise tax was imposed.

(2) Where the nonpayment or refund of the processing tax on cotton automatically increased the tire tax under the Revenue Act of 1932, the taxpayer is allowed an offset for the increase. An offset is also allowed for partial rebates to purchasers for the tax burden (cases where the rebate was complete are taken care of under section 501 (b)).

Section 501 (f).—The amendments to this subsection change the representative period from 5 to 6 years; include direct manufacturing costs in the calculation of profit margins; and, in the case of rebates to purchasers made on or before the thirtieth day after enactment of the act, eliminate the requirement that they be made under a written contract entered into on or before March 3, 1936.

Section 501 (g).—This subsection contains a clerical amendment and an amendment providing for the use of conversion factors where necessary to establish quantities of commodities used in articles sold by the taxpayer.

Section 501 (i).—The amendments to this subsection are clerical.

Section 501 (j).—This subsection contains definitions. These have been revised for clarity and to conform to the changes made in the other provisions.

Section 501 (k).—This subsection has been amended to conform to changes explained above.

Section 503 (b).—The amendment to this subsection requires a return from every person who may be liable for the tax, whether or not he is actually liable. This is necessary to give the Commissioner an opportunity to audit the computations.

Section 503 (c).—This section authorizes the Commissioner to grant extensions for payment of the tax, not in excess of 3 years, in order to avoid undue hardship on the taxpayer.

Section 505.—This section extends the geographical scope of the title to the possessions of the United States. The amendment provides that the tax, when applicable in any possession, shall be collected by the appropriate officers thereof and that the proceeds shall accrue to the possession.

Section 506.—This is a new section, providing for closing agreements between the Commissioner and the taxpayer to settle the taxpayer's liability under this title in conjunction with his claims for refund of taxes paid by him under the Agricultural Adjustment Act.

TITLE IV. EXPORT, CHARITABLE, ETC., REFUNDS AND FLOOR STOCKS ADJUSTMENT UNDER AGRICULTURAL ADJUSTMENT ACT

SECTION 601. REFUNDS ON EXPORTS, DELIVERIES FOR CHARITABLE DISTRIBUTION OR USE, ETC.

Your committee is in general agreement with the purposes of this title of the House bill, but proposes certain clarifying textual amendments and minor changes in substance, and several other amend-

ments which it is believed will tend to simplify the administration of the title.

Section 601 of the House bill would reenact into law certain sections of the Agricultural Adjustment Act, as amended, viz, sections 10 (d), 15 (a), 15 (c), 16 (e) (3), and 17 (a), for the sole purpose of allowing refunds in accordance therewith in cases where delivery for charitable distribution or use, or exportation, or the manufacture of large cotton bags, or a decrease in the rate of the processing tax (or its equivalent under sec. 16 (e) (3)), occurred prior to January 6, 1936. The enactment of this section will serve to remove serious doubts as to the legal authority of the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, which have existed since the decision of the United States Supreme Court holding the Agricultural Adjustment Act invalid, to continue the making of such refunds.

Your committee recommends that section 601 (a) of the House bill be amended by striking out the parenthetical clause beginning in the third line of the subsection. The purpose of this provision, it is believed, will be better subserved by the proposed amendment adding a new section, 603, to the title, which is discussed hereinafter.

Your committee is of the opinion that the House bill should be amended by striking out section 601 (b) and substituting a new subsection. This provision of the House bill would deny the benefits of the section to any processor or other person who paid the processing tax with respect to the articles on which a claim is based. The amendment recommended by your committee would make an exception to this limitation in the case of refunds under section 15 (a) of the Agricultural Adjustment Act, as reenacted herein, to remove an inadvertent discrimination against a limited number of manufacturers of large cotton bags who are also processors of cotton yarn and to correct what would otherwise be an unfortunate competitive situation.

The claims for refund of other processors are adequately provided for by title VII which your committee recommends be added as an amendment to the House bill. The second and third sentences of the proposed subsection (b) are intended to safeguard the interests of the revenue by denying refunds in cases in which credit against tax has previously been taken and allowed and cases in which the claimant does not establish that he has not received and is not entitled to receive reimbursement of the burden of the tax from the processor or other vendor. The last sentence of the subsection would operate to relieve claimants under section 601 (except processors claiming under sec. 15 (a) of the Agricultural Adjustment Act as reenacted therein) of the burden of proving payment of a processing tax with respect to the articles or commodities on which such claims are based. This change will accommodate section 601 to the provisions of section 602 (e) relating to refunds to holders of floor stocks on January 6, 1936. It is believed the same rule should apply to both classes of claims and that the rule proposed will simplify and expedite their administrative disposition. The rule is not and should not be applied to claims of processors under section 15 (a), since the validity of such claims necessarily depends upon tax having been paid.

It is recommended that section 601 (c) of the House bill be amended by striking out the provision limiting claims thereunder to a minimum of $10. While it is unlikely that such small claims will be filed in large numbers, it is the view of your committee that a discrimination based upon size alone is unwise.

The amendment to section 601 (g) of the House bill recommended by your committee is merely a clarification of text.

SECTION 602. FLOOR STOCKS AS OF JANUARY 6, 1936

Your committee is in full accord with the purposes of this section of the House bill and believes it should be enacted into law as a matter of fair dealing and sound public policy. Its effect will be to place all holders of floor stocks on January 6, 1936, of articles processed wholly or in chief value from commodities subject to processing tax on that date, except the processor or other person who paid or was liable for the tax, in substantially the same position they would have occupied had the processing taxes been terminated by proclamation by the Secretary of Agriculture in the manner provided by the Agricultural Adjustment Act, subject only to the equitable limitation that the burden of the tax was not passed on to others after that date.

Two amendments to section 602 (a) of the House bill are recommended by your committee, both of them clarifying in character.

Two of the three proposed amendments to section 602 (b) are also clarifying changes in the text. The purposes of the third amendment which your committee strongly recommends are to simplify the requirements of proof of claims filed under the section and to enable the Commissioner to make as speedy disposition of such claims as proper protection of the interests of the Government will permit. The amendment would empower the Commissioner to base his action on such claims upon claimants' affidavits setting forth the essential facts showing whether the burden of the tax has been absorbed or passed on, without the necessity of submission by the claimants of detailed schedules of articles, purchases, sales prices, and sales, the cost of the preparation and audit of which would in many cases be disproportionate to the size of the claim. The power is reserved to the Commissioner, however, to direct such investigation in any case as he may deem necessary.

Your committee recommends that section 602 (c) of the House bill be amended by the addition of a provision defining the term "sale price" which appears in several places in the section. This amendment is merely in the interests of clarification.

Two amendments to section 602 (e) of the House bill are proposed by your committee, the first of which would eliminate the minimum limitation of $10 on claims under the section for the same reasons urged in support of a similar amendment to section 601 (c). The purpose of the second amendment is to prevent the possibility of a double allowance of the same claim.

Your committee recommends four amendments to section 602 (f) of the House bill. The first and fourth would add "gluten" to the articles processed from wheat and held in retail floor stocks and stocks other than retail stocks, with respect to which claims may be filed under the section. The second amendment would limit refunds with respect to direct-consumption sugar to sugar processed

from sugar beets or sugarcane, since other kinds of sugar were not subject to processing tax. The third amendment is clarifying in character and is intended to include stocks other than those of retailers and processors who paid tax or were liable for tax and are not entitled to the benefits of the section.

It is the opinion of your committee that the House bill should be further amended by the addition of two new sections to be numbered 603 and 604. The purpose of section 603 is similar to the provision in section 601 (a) of the House bill which would be stricken by the amendment proposed to that section. It will operate to assure that the same yardstick is applied in computing the amount of possible refunds or payments authorized under sections 601 and 602 as was used in determining the amount of the processing tax.

The purpose of section 604 is to avoid a possible conflict between the procedure in connection with claims under this title with that prescribed in section 21 (d) (2) of the Agricultural Adjustment Act, as amended.

TITLE V. AMENDMENTS TO TAXES ON CERTAIN OILS

This title contains amendments to the existing taxes on the importation and processing of certain oils and products thereof. The principal changes are as follows:

(1) The following are added to the products subject to the import tax: Tallow, inedible animal oils, inedible animal fats, and inedible animal greases at the rate of 3 cents per pound; olive or sesame oil (if denatured so as to be entitled to free entry under the Tariff Act), sunflower oil, rapeseed oil, kapok oil, and hempseed oil at the rate of 4½ cents per pound; hempseed, rapeseed, sesame seed, and kapok seed at the rate of 2 cents per pound.

(2) Sesame oil and sunflower oil are transferred from the processing tax at 3 cents a pound to the import tax at 4½ cents a pound, but no tax will apply to sesame oil unless denatured as above specified.

(3) Palm oil used in the manufacture of tin plate will no longer be exempt from the processing tax.

(4) Section 602½ of the Revenue Act of 1934, imposing the processing tax, is amended to include fatty acids and salts derived from the taxable oils, and combinations or mixtures containing a substantial quantity (held by the Bureau of Internal Revenue to be 10 percent or more) of such fatty acids or salts. However, in order to avoid double taxation, the processing tax will not apply to any fatty acid, salt, or combination or mixture on which an import tax has been imposed under section 601 (c) (8) of the Revenue Act of 1932, nor will the processing tax apply to any fatty acid, salt, combination or mixture on account of its containing an oil, fatty acid, or salt which has been previously processed in the United States or which has borne an import tax under section 601 (c) (8).

(5) The import tax is made applicable to the fatty acids and salts of the oils, fats, and greases subject to that tax, at the rate applicable to the kind of oil, fat, or grease from which such product is derived.

(6) Section 402 of the Revenue Act of 1935, imposing a compensatory tax on products derived in chief value from the oils subject to import or processing tax, is repealed, and a substitute com-

pensatory tax is incorporated in section 601 (c) (8) of the Revenue Act of 1932. This tax will apply to articles, merchandise, or combinations if 10 percent or more of the weight thereof consists of, or is derived from, a product or products (other than seeds) enumerated in the import tax or processing-tax provisions. The compensatory tax is based on weight, rather than value, in order to reduce the administrative difficulties encountered by the Bureau of Customs in its efforts to collect the compensatory tax under section 402 of the Revenue Act of 1935.

(7) The compensatory import tax will not apply to glycerin, stearin pitch, or to articles made from waste and not named in the law. In view of the difficulties encountered in fixing the rate of tax applicable to glycerin and stearin pitch under section 402 of the Revenue Act of 1935, the Secretary of the Treasury is directed to remit or refund all such taxes accrued or paid.

(8) Fatty acids, salts, and other articles containing or derived from olive oil or sesame oil will not be subject to the import tax, as the oil from which such imported products are made will not have been denatured in the manner specified in the law.

(9) Provision is made that no tax shall be imposed under section 601 (c) (8) of the Revenue Act of 1932, as amended, in contravention of any trade agreement heretofore entered into under the Trade Agreements Act of 1934. This reservation is necessary because the products which will be subject to the compensatory tax under that section are not individually enumerated and might include an article in respect of which the United States has undertaken not to impose any import tax other or higher than that specified in a trade agreement.

TITLE VI

SECTION 801. DEDUCTIONS FOR ESTATE-TAX INSURANCE

Your committee had added to the House bill a provision allowing a deduction from net estate of proceeds of life-insurance policies payable to the United States in satisfaction of death taxes imposed by the Federal Government, if such policies do not exceed $1,000,000 and if the premium-paying period provided in the policy is not less than 10 years. It is believed that this provision will add materially in removing the necessity of liquidating estates to pay taxes and will expedite the collection of the Government revenues.

SECTION 802. COMPLETE LIQUIDATION IN PRIOR TAXABLE YEARS

Under the House bill gain to an individual upon complete liquidation of a corporation is made taxable like any other gain from the exchange of a capital asset, according to the length of time his stock was held by him. Your committee has extended this provision to apply to the computation of income under the Revenue Act of 1934 or such act as amended.

SECTION 803. EXEMPTION FROM ADMISSION TAX OF CERTAIN CONCERTS

Your committee has added to the House bill a provision exempting from the admissions tax admissions paid to nonprofit community, civic, or membership concert courses or series. The organizations

furnishing these courses serve a very useful purpose to many local communities.

TITLE VII. REFUNDS OF AMOUNTS COLLECTED UNDER THE AGRICULTURAL ADJUSTMENT ACT

General Statement

Your committee recommends the adoption of this title, as an amendment to the House bill, as necessary to the protection of the revenue and to the practical administration of a large and extremely difficult class of refund cases.

This title will introduce certain necessary provisions into the internal-revenue laws relating to a particular class of refunds. The provisions of the title relate to the making of refunds of amounts which have been collected under the Agricultural Adjustment Act. It is of the utmost importance that the provisions of section 21 (d) of the Agricultural Adjustment Act, which now deals with that subject, be revised, both from an administrative standpoint and to remove certain legal objections that have been urged with respect to that section.

Necessity for Title VII

Title VII consists entirely of a revision of the provisions of section 21 (d) of the Agricultural Adjustment Act and related provisions. That section now provides that no recovery or refund shall be made or allowed of any amounts paid or collected under the Agricultural Adjustment Act, unless the claimant establishes to the satisfaction of the Commissioner of Internal Revenue that he has borne the economic burden of the tax for which refund or recovery is sought. The Commissioner of Internal Revenue is required to give a hearing to each claimant and to find and declare of record whether or not the claimant has absorbed the burden of the tax. A transcript of such hearing must be made for use as a record in the case, if a court review of the Commissioner's action is desired.

The imperative need of revising these provisions is apparent from a consideration of the administrative burden which confronts the Bureau of Internal Revenue, if claims for refund under the Agricultural Adjustment Act must be passed on under the provisions of section 21 (d) in its present form. The invalidation of the Agricultural Adjustment Act by the decision in the *Butler case* has given rise to possible claims for approximately $960,000,000 which has been collected under that act. This amount consists of approximately $850,000,000 in processing taxes; $98,000,000 in floor-stocks taxes; and $12,000,000 in compensating taxes. Processing taxes were paid by approximately 73,000 taxpayers; compensating taxes, by 75,000 taxpayers; and approximately 1,000,000 taxpayers paid floor stocks taxes. The possible number of claims, therefore, exceeds 1,000,000, in all of which the present provisions of section 21 (d) require that the Commissioner hold formal judicial hearings for the purpose of passing on each claim.

The revision of the provisions of section 21 (d) contained in title VII adheres to the fundamental principle of equity applicable in respect to claims for refund, namely, that the claimant secure a refund only with respect to the amount of tax of which he bore the economic burden. However, the procedure in the handling of these claims has been modified so as to diminish insofar as possible the administrative burden involved in passing on them. The greater number of claims which may be filed relate to claims for compensating taxes and floor-stocks taxes. In these cases the issue of fact as to whether or not the claimant bore the economic burden of the tax will be relatively simple. The bill therefore proposes that such claims shall be handled in the same manner as any other claims for refund under existing law. The claimant will merely present his claim to the Bureau of Internal Revenue, and it will be passed on without formal hearing. If the claimant is dissatisfied with the decision of the Commissioner, he will then have recourse to the district court or the Court of Claims.

The question as to whether processing taxes were passed on, however, involves extremely complicated economic and accounting considerations. The great bulk (approximately $850,000,000) of the moneys collected under the Agricultural Adjustment Act consisted of such taxes, but they were paid by a relatively small number of taxpayers. With respect to such claims, therefore, it is contemplated that the claimant present his claim for consideration by the Commissioner initially without any formal hearing. If the claimant is then dissatisfied with the Commissioner's decision, he may obtain a formal hearing in the Bureau of Internal Revenue. A transcript of the record of such hearing will be prepared and will serve as a basis of review by the circuit courts of appeal and the Supreme Court.

Apart from the administrative considerations which necessitate a revision of the provisions of section 21 (d) in its present form, the contentions raised by taxpayers in over 200 suits, which are now pending in the courts, present legal considerations which make such revision equally necessary. The validity of section 21 (d) has been challenged in the courts in several respects. It has been contended that while that section states the conditions under which the Commissioner may deny a refund of taxes paid, it does not establish affirmatively any conditions, compliance with which will enable the claimant to secure a refund. It has been further argued that section 21 (d) is so vague and indefinite as not to provide a claimant with an adequate remedy at law for a recovery of the amounts illegally exacted. Section 21 (d) has also been challenged by the contention that the statute in terms seems to forbid a refund with respect to any amount, if any part of such amount has been passed on by the taxpayer. Another serious legal argument advanced relates to the fact that section 21 (d) does not provide that the Commissioner must hold a hearing with respect to a claim within a fixed period of time. Because of that fact, it has been urged that the Commissioner may defer action indefinitely until after the statute of limitations has run, and thus deprive a claimant of his right of recourse to the courts.

The revision of the provisions of section 21 (d) contained in title VII deals with each one of these contentions and seeks to meet all the legal objections which have been raised in the courts with respect to that section. Section 907 of title VII contains provisions under which a claimant may establish a prima-facie case for securing a refund and sets forth definite factors and considerations to be taken into account in determining whether or not a claimant bore the burden of the tax for which refund was sought. Provision is made requiring the Commissioner to hold a hearing on processing-tax claims within 2 years after such hearing is sought by the claimant.

EXPLANATION OF TITLE VII

Section 901 repeals section 21 (d), section 21 (e), and section 21 (g) of the Agricultural Adjustment Act, as amended. A substitute for section 21 (e) is contained in section 914 of the bill, with certain necessary formal changes. Section 21 (g), which relates to periods of limitation for filing suits, has been repealed, since the bill carries special periods of limitations relating to suits under title VII.

Section 902 adheres to the basic principle that no refunds may be made of amounts collected under the Agricultural Adjustment Act, except to the extent to which the claimant establishes to the satisfaction of the Commissioner of Internal Revenue, or to the satisfaction of the trial court, as the case may be, that he bore the economic burden of such amounts. The reference to the trial court is necessary, since in all cases where the claimant is dissatisfied with the determination of the Commissioner, except with respect to processing taxes, as defined in section 913, the claimant will have recourse to the district courts or the Court of Claims. Whether the claim is acted on by the Commissioner or such courts, the burden of proving that the tax was not passed on will be on the claimant.

Section 902 (b) contains a provision which is not contained in section 21 (d) in its present form. It provides that where the claimant has repaid unconditionally an amount of tax which he had previously passed on to his vendee and such vendee bore the ultimate burden of such amount, the claimant may obtain a refund therefor. This provision is similar to a provision now contained in section 621 (d) of the Revenue Act of 1932, relating to refund of amounts collected under the automobile accessories excise tax. Section 902, basically adopts the same principle with respect to refunds that is contained in section 621 (d).

Section 903 requires that claims be filed after the date of enactment of the act and prior to January 1, 1937. While a great many claims for refund have been filed under section 21 (d), the great majority of such claims do not set forth the evidence relied upon in support of such claims. The reason for this is largely due to the uncertainty surrounding the present provisions of section 21 (d). There are also a large number of suits now pending in the Federal courts for the recovery of amounts paid under the Agricultural Adjustment Act. It is, therefore, necessary that new claims be filed so that each claimant's right to secure a refund may be established in accordance with the procedure set forth under title VII. Section 903 gives the Commissioner the authority to prescribe the number of claims which may be filed by any person. The purpose of this provision is to give the

Commissioner power to segregate the types of claims which may be filed, for purposes of administrative convenience. If, for example, a taxpayer made 30 payments of processing taxes, it is imperative that the Commissioner be authorized to require by regulation that all such payments shall be embraced in a single claim, since the complete tax picture with respect to the incidence of the taxes paid by the taxpayer may not be properly reflected in facts relating to a claim for each payment. Furthermore, several commodities, as in the case of different types of tobacco, were subject to different processing taxes, and articles were sold by taxpayers which resulted from the combination during the "first domestic processing" of several different types of commodities. In order, therefore, to obtain a proper determination of the incidence of taxes paid with respect to such commodities, it is necessary that the Commissioner be permitted to require that a single claim be filed with respect to the taxes paid with respect to such commodities. In the case of compensating taxes, it may be necessary that the taxes paid with respect to each importation be segregated in a single claim and considered separately. It is important, therefore, that the Commissioner of Internal Revenue be given power to prescribe by regulations the number of claims which any person may file, so that necessary flexibility, in the interest of the claimant and Government alike, may exist.

Section 904 relates to the period of limitations within which suits may be brought with respect to amounts collected under the Agricultural Adjustment Act. This section is comparable to section 3226 of the Revised Statutes, and is similar to section 21 (g) of the Agricultural Adjustment Act. The commissioner is permitted a period of 18 months (except in the case of processing taxes) within which to act on a claim before suit may be filed with respect to such claim. This is necessary in view of the large number of claims that the Bureau of Internal Revenue will be required to adjust.

Section 905 contains provisions now incorporated in section 21 (d), relating to the jurisdiction of the district courts. The district courts and the Court of Claims will have jurisdiction of all cases relating to amounts collected under the Agricultural Adjustment Act, except amounts collected as processing taxes. With respect to processing taxes, a special procedure is provided in section 906 of the bill. The $10,000 limitation on the jurisdiction of the district courts which would otherwise be applicable, is dispensed with in order to relieve the Court of Claims of congestion which would otherwise result.

Section 906 provides an exclusive remedy for the recovery or refund of any amount paid or collected as processing tax under the Agricultural Adjustment Act. The claimant, after filing his claim within the prescribed period, is to secure a disallowance or allowance of such claim within 3 years after it has been filed, unless such time has been extended by written consent of the claimant. If the taxpayer is dissatisfied with the decision of the Commissioner, within 90 days after mailing of notice of disallowance the claimant may file a petition with the Commissioner, requesting a hearing and reconsideration of the action of the Commissioner. Such hearing must be held within 2 years from the filing of the petition, either in Washington or in the collection district, in which is located the principal place of business of the claimant, as the claimant may

designate in his petition. The hearings are to be conducted before a presiding officer designated by the Commissioner. Such officers will recommend findings of fact and conclusions of law to the Commissioner, who will then make his decision. Review of the decision of the Commissioner may be obtained by the claimant by filing a petition in the Circuit Court of Appeals within 90 days after the date of mailing to the claimant of the Commissioner's decision. The review of the Circuit Court of Appeals will be limited to questions of law. The determination of the courts will not extend to a consideration of the facts, except to the extent that the Constitution requires. In view of the decision in the case of *St. Joseph Stockyards Company* v. *United States*, decided April 27, 1936, there is some indication that it is possible that the Supreme Court will hold that the reviewing court must not merely determine that the facts found are supported by substantial evidence, but must exercise its independent judgment on the facts. If the decision in that case is applicable to cases involving a review of the Commissioner's determination with respect to refunds of processing taxes, it is felt that the phrase "in accordance with law", employed in section 906 (d), is sufficiently flexible to permit the reviewing court to exercise its independent judgment on the facts, if the Constitution so requires.

Section 907 sets forth presumptions whereby a claimant may make out a prima-facie case as to the extent to which he bore the burden of the tax, and show that he is entitled to a refund to that extent. The method employed is a comparison between the average margin, i. e., the spread between the tax and the cost of the basic commodity subject to the processing tax and the receipts of articles derived from the commodity, for the period during which the claimant actually paid processing taxes, and the margin for a period combining the 24 months preceding the effective date of the tax and the 6 months after the invalidation of the Agricultural Adjustment Act from February to July 1936, inclusive.

Section 908 permits interest to be allowed only with respect to the net amount, refund of which is made or allowed. Section 910 is designed to frustrate any efforts on the part of claimants to bring suits against collectors for amounts collected under the Agricultural Adjustment Act. Such suits would merely be remedial expedients for suing the United States with respect to such amounts, and since remedies are provided for against the United States, there is no need for alternative remedies against either the collectors or the United States. It is important that no suits be brought against collectors, since, under existing law, a suit against collectors is not res adjudicata so far as the United States is concerned, and the claimant may sue the collector and thereafter sue the United States with respect to the same cause of action.

Section 911 is designed to prevent two refunds with respect to the same amount collected under the Agricultural Adjustment Act. Section 911 also provides that the provisions of this title do not apply to export, charitable, and certain other refund claims, the adjustment of which is authorized by sections 15, 16, and 17 of the Agricultural Adjustment Act and section 601 of H. R. 12395. It is necessary to provide specifically that this title does not apply to such claims so that there will be no confusion between the pro-

visions of this title and section 601 of H. R. 12395. It is not the intent of this section, however, to limit the rights of processors who have paid processing taxes on articles or commodities which they have themselves subsequently exported or delivered for charitable distribution or use to obtain refunds of such processing taxes subject to the requirements of this title, since such processors are, with one minor exception, not entitled to the benefits of section 601 of title IV.

Section 912 is for the purpose of preventing suits or claims which are barred on the date of the enactment of the act from being revived. Section 914 contains provisions almost identical to section 21 (g) of the Agricultural Adjustment Act, which is repealed by section 901 of this title. The purpose of section 915 is to make available to the Treasury Department funds appropriated under the appropriation to pay all obligations and commitments incurred under the Agricultural Adjustment Act, so that funds may be immediately available for administrative expenses in carrying out the provisions of this title.

Section 916 authorizes the Commissioner, with the approval of the Secretary of the Treasury, to make such rules and regulations as may be necessary to carry out the provisions of this title. Section 917 authorizes the employment, without regard to the Classification Act of 1923, and the civil-service laws or regulations, of officers, attorneys, economists, and other experts. As to such employees no salary in excess of $8,500 per annum may be paid.

TITLE VIII. GENERAL PROVISIONS

This title contains the general definition of terms, used in the act, the separability clause, and the provision relating to effective date of the act. No change is made in this title.

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74TH CONGRESS, 2d Session } SENATE { REPT. 2156 Part 2

REVENUE BILL OF 1936

JUNE 1, 1936.—Ordered to be printed

Mr. BLACK, for himself and Mr. LA FOLLETTE, from the Committee on Finance, submitted the following

MINORITY VIEWS

[To accompany H. R. 12395]

Although we voted to report H. R. 12395 to the Senate, we did so for the purpose of bringing it before this body for discussion and action. We are opposed to the measure in its present form, and herewith submit some of our reasons for this opposition.

The President's message asking for additional revenue suggested that the additional amount he deemed necessary at this time might be raised by enacting the proper legislation to prevent tax avoidance, and that this object could be accomplished by imposing a tax on undistributed corporation profits. A tax on undistributed corporation profits must be considered in the light of the fact that it presents a double aspect as to prospective effects.

(*a*) If corporate profits should be retained by the corporation, the corporate tax would be increased, thereby bringing additional revenue to the Government.

(*b*) If the imposition of the tax caused a larger distribution of corporate profits, this would increase the amount of income received by individual stockholders. Since all plans contemplate imposing the normal tax on dividends received by individuals, an additional distribution of corporate profits would increase the aggregate amount received by the Government from individual income-tax payers in the higher income-tax brackets.

Let us consider now the effect of the present corporate-tax system, the proposal submitted by a part of the Finance Committee, and the principle of taxing undistributed corporate profits as advocated by the President.

Under our present tax system, we lay an income tax of 12½ to 15 percent upon the annual profits of corporations. We also impose a graduated income tax upon individuals ranging from 4 to 75 percent. The major portion of America's trade, commerce, and finance is transacted through the medium of corporations. The tax system,

therefore, as it relates to corporate profits and individual profits, can function in such manner as to work a gross injustice to a major proportion of individual corporate stockholders and the public, and at the same time bestow an unwarranted privilege upon another group of stockholders. This can be readily seen when it is remembered that the individual income-tax rate of those in the higher income-tax brackets may be six times as much as the rate of tax on corporation profits. It is also true that the corporation tax rate may be as much as four times the rate of tax on a stockholder of the corporation who is in the lower individual income-tax bracket.

From this simple statement it is clear that it is decidedly to the interest of individual corporate stockholders in the high income-tax brackets not to receive their share of annual corporate profits into their individual income. They prefer that the corporations should pay a flat corporate rate, whether that rate be 15 or 18 percent, and retain the profit in the corporate treasury, rather than to have the profits distributed to these individuals, where they would be compelled to pay an individual tax rate of from 50 to 75 percent of the profits. Thus we find the high income-tax individuals prompted by the most powerful self-interests to have corporate profits remain in the corporate treasury and thus save themselves a large amount of taxes.

Evidence before the Senate Finance Committee showed that approximately 90 percent of all corporate business in the United States is done by 10 percent of the corporations. This 10 percent of the corporations constitute the smallest in number, but their far-flung interests extend into every corner of our country. It is well known that these large corporations doing 90 percent of the corporate business of the Nation are actually controlled by a very small group of stockholders. While there are thousands of small stockholders in these vast corporate enterprises, it is common knowledge that these small stockholders vote by proxy, if they vote at all. They have nothing whatever to do with shaping the policies of these large corporations, either with reference to dividends or anything else. Perhaps not once in ten thousand times do these small stockholders even know the names of the controlling groups manipulating the corporate profits. As the corporate system actually works in this country, these small stockholders, who are chiefly in the lower income-tax brackets, most frequently have their rights to dividends passed on by those stockholders who are in the higher income-tax brackets, who have working control of the corporation, and who are prompted by the strongest motives to manipulate these corporate profits so that they will not have to pay individual income taxes on them.

By this simple device of retaining corporate profits unnecessarily, there has evolved the most stupendous tax avoidance in our history. It is proper to state, however, that it is practically impossible to prove that this retention was not within the law. According to the report of the Treasury Department made after careful study, the United States Government will lose more than 600 million dollars during the taxable year of 1937, if Congress permits this unfair and unjust system to continue.

In other words, by amending the law in such way as to require men in the higher income-tax brackets to pay their taxes on the same square and honest basis as men who do not draw profits from

corporations, these particularly favored persons will be required to pay 600 million dollars in additional taxes on individual income.

EFFECT OF COMMITTEE BILL

Since the majority report recommends an increase of a flat tax of 3 percent on corporations, it is proper to consider the effect it will have on this situation. The committee bill providing for an increased flat corporate rate does not lessen the unjust result of this evil practice. On the contrary, it exaggerates the injustice. It strikes a wholly unnecessary and deadly blow at many of the 90 percent of small corporate structures now struggling to compete with the larger corporations so well financed with funds often selfishly withheld from their small stockholders. This increased flat corporate rate of the committee bill adds to the actual tax laid upon the corporate profits and thus is an additional tax burden of 3 percent on the gains of the hundreds of thousands of small corporation stockholders in the lower individual brackets. Thus we find the small stockholders, who are in the 4-percent income-tax bracket, whose corporate profits are taxed 18 percent by the committee bill instead of 15 percent, as under the present existing law. We are opposed to adding this heavy tax burden to more than 200,000 small corporations, and thus, also, increasing the burden of tax upon thousands of individuals—small stockholders, and taxpayers, in general—until we first attempt by legislation to collect the more than 600 million dollars of individual income taxes which those in the higher individual income-tax brackets now escape.

We believe that the small income-tax payer and the small corporations are unjustly treated by the present tax law and would be more unjustly treated by the committee proposal. Recent history has shown that many who enjoy the largest incomes, and who make the most profits, do not, in many instances, pay the most income taxes because they are able to avoid them under our present corporate tax system.

This was illustrated recently when the country was astonished to know that one of its wealthiest citizens had not paid a dollar of income tax in a year. The corporate device so frequently used for tax avoidance, which we have heretofore outlined, aided materially in bringing about this indefensible situation. The committee's bill which would increase the flat corporate rate 3 percent upon all corporations, and which would impose a 7-percent flat rate upon undistributed profits and 4-percent increase upon dividends received by stockholders, will result in unnecessarily accentuating and aggravating existing tax injustices. A graphic picture of the law as it operates under the present method, as it would operate under the committee's bill, and as it would operate if corporate profits were distributed in line with the President's suggestion, is shown below. In this illustration it is assumed that two individuals own stock in the same corporation, and that their part of the corporate earnings for the year is $1,000, each. The individual numbered (1) falls in the 4-percent individual income-tax bracket, and number (2) in each instance falls in the 75-percent income-tax bracket. These illustrations would produce a similar result, if other figures had been selected, although the differences would not be so great.

Corporate profit of individual	Corporate tax on this profit at present rate if undistributed and tax paid by the corporation	Income tax for individual if dividends distributed and tax paid by the individual
Under existing law:		
(1) $1,000	$150.00	$40
(2) $1,000	150.00	750
Under Senate committee's bill:		
(1) $1,000	237.40	40
(2) $1,000	237.40	750

It will be observed from the above illustration that under the Senate committee's bill the stockholder in the individual 4-percent tax bracket has an additional tax placed upon his part of the retained corporate earnings of $87.40 on each $1,000 of corporate profits. It is also noted that under the committee's bill the stockholder in the 75-percent income-tax bracket would still avoid the payment of more than $500 of individual income taxes if his $1,000 profit should be retained in the corporate treasury instead of being distributed to him in dividends. It is clearly seen from this illustration that the committee's bill would aggravate the existing injustice to the small stockholders and small taxpayers.

As a matter of fact, we believe that the Treasury experts are correct in their conclusion that the committee's bill will not provide any effective incentive for the reasonable distribution of dividends. While the corporation would be subjected to an increased tax of 7 percent on undistributed profits, it is also true that the committee's bill adds 4 percent on the normal tax of the individual where these dividends are distributed to the individual stockholders. This means that if all the corporate profits should be distributed the corporation would not pay the 7-percent penalty but the individual would pay a 4-percent tax on the dividends. The net incentive, therefore, is a 3-percent tax on undistributed profits. Such a penalty will not cause the controlling group in the higher income-tax brackets to declare dividends, because it is too much to expect that men will deliberately take action that increases their own individual income tax up as much as 500 percent. As a matter of fact, the net result of the passage of the committee's bill will be an ostensible increase of tax upon corporations, but in reality it amounts to an indefensible increase in the tax on thousands of small corporations and small corporate stockholders, while at the same time the committee's bill perpetuates the evils of a tax system under which the largest income beneficiaries in America avoid their fair proportion of tax.

OUR PROPOSAL

We are in full accord with the objective of the House bill to stop the tax avoidance through the corporate device. We believe, however, that the rate schedules provided in the House bill are too complex and too complicated. We suggest, therefore, as a substitute for the House rates on undistributed profits, and as a substitute for the proposal of the Senate committee, a simple and easily understandable

schedule of corporate tax rates. Since we believe there is no justification at the present time for an arbitrary flat increase of 3 percent on corporation taxes when such an increase will fall heavily on thousands of small struggling corporations, we propose to retain the present flat graduated corporation rates of 12½ to 15 percent. We propose a plan in line with the President's suggestion, which, according to Treasury estimates, will obtain substantially the same revenue as the increased flat corporation rate proposed by the committee with its 7 percent surplus tax. While our proposal, according to Treasury estimates, will raise 502 million dollars while the corporate tax plan of the committee, according to Treasury estimates, will raise 522 million dollars, our proposal will not, as does the committee bill, fall with crushing force upon the small corporations and the small taxpayers. It will place a fairer burden of taxes upon the higher income group who have been heretofore escaping from their just burden, and who will continue to escape if the bill reported by the committee is adopted. Our proposal is as follows:

1. Exempt the first $15,000 of adjusted net income from the undistributed-profits tax. Our proposal will therefore permit 90 percent of all of the corporations of the country making $15,000 or less to retain all of their profits free from the undistributed-profits tax.

2. In addition to the present corporation tax, impose no additional tax upon the first 20 percent of corporate adjusted net income.

3. Impose 20-percent tax on that part of the undistributed adjusted net income in excess of 20 percent and less than 40 percent of such income.

4. Impose 30-percent tax on the remainder of the undistributed net income.

5. Enact the same provision as appears in the House bill for permitting the corporation to comply with outstanding written agreements which prevent a distribution of dividends.

6. Specifically provide that there shall be no undistributed-profits tax on stock dividends which are taxable income for the individual recipient because the stock "gives the stockholder an interest different from that which his former stockholdings represented."

Under the opinion of the Supreme Court in *Koshland* v. *Helvering*, decided May 18, 1936, the Supreme Court decided that stock dividends represented taxable income where they give "the stockholder an interest different from that which his former stockholdings represented." It is, therefore, beyond any question of doubt, that under our proposal, corporations would be able to retain all money profits needed for carrying on their business without any additional corporate tax. If the exemption of the first 20 percent of profits, and the exemption as to outstanding dividend contracts, were not sufficient to protect the interest of the corporation, it could declare stock dividends of such a nature as to be taxable income in the hands of the individual stockholders without paying additional corporate tax. It cannot be argued that under our proposal corporations would be unable to discharge their obligations or meet business conditions and requirements for expansion.

Under our proposal the Government of the United States would be able to collect a large part of the more than $600,000,000 in taxes which the most prosperous financial group in the Nation will inev-

itably escape and avoid if the corporate tax law remains unchanged or if the Senate committee's bill becomes the law. Our proposal therefore would simply require this group so greatly favored at present to bear their proper proportion of taxes as a result of benefits accruing to them from their share of corporate profits. Our proposal would advance toward the goal of equalizing tax burdens and of requiring an individual to pay a similar rate of tax upon profits accrued from corporation investments as other individuals are now compelled to pay on profits accrued from noncorporate investments.

We do not here consider at any length the uses to which the higher income groups who control large corporate surpluses have employed these surpluses for their own advantage and to the distinct disadvantage of the small stockholders and the public in general. It is well known that these closely controlled surpluses have been availed of for stock-market manipulation to the advantage of the same group that avoided individual taxes by withholding dividends. It is common knowledge that at the height of the stock-market boom the gambling funds of the Street were replenished from these closely controlled corporate surpluses.

It is clear that if we will tax the income, in the form of corporate profits, of this higher income-tax group which is now avoiding the higher individual income taxes, we need not impose further burdens in this bill on small corporations and upon individuals who are now paying their just share of taxes. We cannot follow the recommendations of the majority, which impose additional tax burdens on those individuals now paying their fair share of taxes until we first make a conscientious effort to place a just tax burden on those who today are escaping their share of taxes by retaining more than $600,000,000 annually which in all equity they owe to the Government in taxes.

Just one example of many possible illustrations will show the enormity and injustice of this tax avoidance. A certain corporation made more than $6,000,000 net income in 1 year. This corporation paid Federal taxes that were approximately $700,000. If the profits had been declared out in dividends so as to be taxable in the hands of stockholders, one stockholder of this corporation would have paid the Government more than three and a half million dollars in additional income taxes. In other words, the graduated individual income-tax brackets for this individual and numerous others are but "paper brackets", and unless and until these "paper brackets" for the favored few become taxes of those who now pay their full share of taxes.

Instances like this could be multiplied. It is typical of the tax avoidances of those who are the most prosperous. The corporate device is now being used to a large extent as nothing more nor less than a scheme through which the higher individual income-tax brackets are avoided. The committee bill would permit many persons to continue to escape the payment of just taxes as did the individual in the above case. Evidence before the committee shows that other individuals will escape taxes in this manner at a cost to the Government and an enrichment to themselves of more than $600,000,000. We cannot recommend a bill which provides for legalized continuation of such an unjust system. The existing law and the committee bill are unfair to the small corporations and to the men and women who now pay their fair share of income taxes without the

benefit of this device which brings about such widespread and wholesale avoidance of higher individual taxes. Our proposal if adopted would collect the 600 million dollars of taxes now being avoided by this privileged group.

HUGO L. BLACK.
ROBERT M. LA FOLLETTE, Jr.

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REVENUE BILL OF 1936

JUNE 1 (calendar day, JUNE 2), 1936.—Ordered to be printed

Mr. HASTINGS, from the Committee on Finance, submitted the following

MINORITY VIEWS

[To accompany H. R. 12395]

The President has recommended the present revenue bill to the Congress upon the ground that it is necessary in order that the permanent expenses of the Government may not exceed the revenue received by the Government. He makes no recommendation with respect to raising revenue for what he calls "emergency expenditures."

Reference to his last Budget message shows that the expected revenue for the next fiscal year amounts to $5,654,000,000 and the permanent expenses to $5,649,000,000, thus showing a surplus of $5,000,000. It will also be noted that in that Budget message the President deliberately placed the money to be paid to the farmers, amounting to $499,054,985, in the category of permanent expenses and $246,000,000 of the expenses of the Civilian Conservation Corps in the same category.

Both of these in the previous Budget message had been treated as emergency expenditures, and it is perfectly clear that they were transferred to the permanent expenses only because the President believed the increased revenue from present sources would permit it to be done without showing a deficit of receipts over permanent Government expenses. His only excuse for his present recommendation is that the Supreme Court decision invalidating the processing tax, and the passage of the Veterans' Adjusted Compensation Act over his veto, destroyed his effort to balance permanent expenses with existing revenues. In other words, this bill is forced upon the Congress merely to maintain the President's pride in his own mental process. So far as the taxpayer is concerned, and so far as concerns those who are practically forced to purchase the securities of the Government, the shifting of one expense from the President's emergency Budget to his permanent Budget is immaterial. It is about as unimportant to the taxpayer as a request of a creditor of his debtor to divide his obligations into two promissory notes and at the same time instead of including the whole sum in one note.

I am opposed to any increase in taxes until there be shown some affirmative evidence upon the part of the President and the majority of the Congress of a real appreciation of their respective responsibilities to the taxpayers of this and future generations. I do not believe in the theory that it is wise at this time to levy heavier taxes upon all the people of the Nation in order that they may better appreciate the extent of the present extravagance in the Federal Government. Such a plan would simply mean a greater distribution to a larger group of the voters of the Nation, and does not make more secure the credit of the Nation. It would not assure the balancing of the Budget because the power to put the Budget out of balance is without limit so long as the credit of the Government exists.

I have agreed upon the bill presented to the Senate only because I believe it to be so much better than the House bill. I am opposed to either of them.

The House bill is framed upon a theory that might well have been expected from this administration. In theory it looks fair enough to compel a corporation to distribute all of its profits, tax the persons receiving the dividend just as other individuals are taxed, and thus put them all on the same basis. The evidence submitted to the Committee on Finance showed conclusively that this would not work out in actual practice without destroying the framework of corporate business itself.

The bill presented to the Senate does great injustice to the millions of stockholders of corporations. The existing tax on corporations is high enough to impose a real penalty upon those who adopt the corporate form to do business. The advantage of the corporate form has been sufficient to warrant the investor in adopting it. We must not overlook the fact, however, that there must be a limit to the penalty we impose. Under the present law the small investor, as well as the large one, is paying a normal tax of about 15 percent upon the earnings of his investment in a corporation. This compares with 4 percent upon his income from sources that are not incorporated. The bill presented to the Senate increases that tax to 18 percent if all the income is distributed, an additional 7-percent tax upon that portion which is not distributed.

The House bill undertakes to put all on an equality. The Finance Committee very properly found this was not a practical thing to do. Instead of that it has increased the normal tax from approximately 15 to 18 percent and added an additional 4 percent upon the amount distributed, making a certain increase of nearly 7 percent, and if the corporate income is not distributed, an additional 7 percent. This is a sure increase directly or indirectly upon the stockholder of about 46 percent, and in many cases it will mean an increase of about 93 percent.

The hope for the unemployed depends largely upon the revival of business. Most of the business is conducted through corporations. Corporations dare not spend more than they find necessary when they know the administration is endeavoring to punish them. There should be no tax bill at this time. The Congress should agree to no tax bill until there appears some evidence of economy When a tax bill is proposed it should be submitted to careful study in order that reasonable justice could be done to all who are called upon to bear the burden.

DANIEL O. HASTINGS.

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