REVENUE FOR INCREASED ARMY AND NAVY APPROPRIATIONS

HEARINGS AND BRIEFS

BEFORE THE

SUBCOMMITTEES OF THE COMMITTEE ON FINANCE UNITED STATES SENATE

SIXTY-FOURTH CONGRESS
SECOND SESSION

ON

H. R. 20573

AN ACT TO PROVIDE INCREASED REVENUE TO DEFRAY THE EXPENSES OF THE INCREASED APPROPRIATIONS FOR THE ARMY AND NAVY AND THE EXTENSIONS OF FORTIFICATIONS, AND FOR OTHER PURPOSES

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CONTENTS.

	Page.
Munitions, hearings of subcommittee on	5
Statement of—	
Quinn, John	5, 41
Chapin, Frederick E	37
Bright, Frank S	38
Bosworth, Charles C	42
Insurance, hearings of subcommittee on	43
Statement of—	
Rhodes, Edward E	47
Barnes, John	55
Lunger, John B	64
Milliken, R. C	68
McIntosh, James H	74, 96
Cox, Robert L	78
Blackburn, Thomas W	81
Powell, Henry J	87
Hoey, James J	91

Page.

Excess-profits tax, hearings of subcommittee on 99
Statement of—
Marsh, Benjamin C 106
Butler, Charles H 122
Joslyn, C. D 125
Motley, Warren 132
Emery, James A 139
Garcelon, William A 148
Armitage, Paul 150
Douglas, Archibald 159
Landis, Charles B 159

Oleomargarine tax, hearings of subcommittee 165
Statements of—
Creasy, William T 165
Farrell, John J 172
Black, B. John 185
Lincoln, Burr B 188
Hampton, George P 198

REVENUE FOR INCREASED ARMY AND NAVY APPROPRIATIONS.

MUNITIONS.

TUESDAY, FEBRUARY 6, 1917.

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

The subcommittee met, pursuant to call, at 10 o'clock a. m. in the room of the Committee on Education and Labor, Capitol, Senator Hoke Smith presiding.

Present: Senators Smith of Georgia (chairman), Thomas, and James.

Also present: Mr. John Quinn, Mr. Frederick E. Chapin, and Mr. Frank S. Bright.

The committee proceeded to consider certain provisions of the bill (H. R. 20573) "To provide increased revenue to defray the expenses of the increased appropriations for the Army and Navy and the extensions of fortifications, and for other purposes."

The chairman stated that the subcommittee would hear the representatives of the munitions manufacturers first and would postpone the hearing of the insurance representatives until 2 o'clock in the afternoon

The CHAIRMAN. Gentlemen, will you let us know who is here, for whom you appear, and what your plan is for presenting your statements? Mr. Quinn, have you any suggestions?

STATEMENT OF JOHN QUINN, ESQ., OF NEW YORK CITY.

Mr. QUINN. Gentlemen of the subcommittee: Last Saturday Senator Simmons, the chairman of the Senate Finance Committee, in response to numerous telegrams of protest that were sent by various firms and corporations engaged in the munition business requested that the persons who desired to be heard should avoid as much as possible repetition in the presentation of their facts and arguments, and if possible confine the presentation of their case to one statement or at the most to two or three. That was the substance of a letter that the clerk of the Senate Finance Committee at the request of its chairman sent to me.

Senator THOMAS. You can save a good deal of time by doing that.

Mr. QUINN. I agree, Senator Thomas, with that fully. I came here Saturday morning and spoke to Senator Simmons about the hearing. Senator Simmons said that was the wish of the committee. I thereupon telephoned to one of my associates in New York to telegraph to

the various firms and corporations interested to that effect. The result is that the committee will not be burdened with many speeches here this morning.

I presume it is in order first to note who are represented here and by whom represented, and to save reading it I have a typewritten list which I will hand to the stenographer of those who are personally here and what firms and corporations are represented here and join in the protest.

(The list referred to is here printed in full, as follows:)

APPEARANCES.

Smith & Wesson, of Springfield, Mass., by Mr. F. H. Wesson and Mr. Bosworth, chairman of its board.

American Steel Foundries Co., by Mr. R. P. Lamont, president, desires to join in this protest.

New London Ship & Engine Co., by Mr. Henry R. Bond, jr., treasurer of that company, who desires to join in the protest to be presented here.

Westinghouse Electric & Manufacturing Co., of East Pittsburgh, Pa., on behalf of The New England Westinghouse Co., by Mr. John J. Jackson, general counsel.

General Ordnance Co., of Derby, Conn., represented by Earl W. Chafee.

Hercules Powder Co., of Wilmington, Del., are represented and desire to join in the protest by Mr. Russell H. Dunham and by Mr. Robert H. Richards, its counsel.

E. I. du Pont de Nemours & Co., of Wilmington, Del., represented here and desire to join by Mr. Irene du Pont, vice president, in the protest.

Colt's Patent Fire Arms Manufacturing Co., of Hartford, Conn., desire to join in the protest.

Burton-Richards Co., of Pittsburgh and New York, desire to join in the protest.

American High Explosives Co., of Pittsburgh, have telegraphed desiring to join in the protest.

Savage Arms Co., of Utica, have telegraphed desiring to join in the protest.

Driggs-Seabury Ordnance Co., of Sharon, Pa., and New York, have telegraphed desiring to join in the protest.

E. W. Bliss Co., of New York, have telegraphed desiring to join in the protest.

Minneapolis Steel and Machine Co., of Minneapolis, Minn., have telegraphed that they desire to join in this protest.

United States Cartridge Co., of New York City, desire to join in this protest and have telegraphed to that effect.

Federal Pressed Steel Co. desires to join in the protest and have telegraphed.

Pollock Steel Co. of New York City desire to join in the protest.

Mississippi Valley Ordnance Co. of St. Louis, Mo., desire to join in the protest.

American Brake Shoe & Foundry Co., 30 Church St., New York City, desire to join in the protest.

Yale and Towne Manufacturing Co. desire to join in the protest.

Frederick E. Chapin, Esq., representing The Washington Steel & Ordnance Co.

Frank S. Bright, Esq., representing The Winchester Repeating Arms Co.

Mr. QUINN: A large number of munitions manufacturers were unable to be present here to-day. Among others those above enumerated telegraphed to me in response to my telegram of Saturday stating their inability to be here and asking that they be noted as joining in the statements made here and in the protest submitted to this honorable committee. I will take as a type of those telegrams the following telegram to me from the Federal Pressed Steel Co. [reading]:

In view of wire received from your Mr. Sheffield, also from Mr. Simmons, Chairman Senate subcommittee, desiring to make hearing as short as possible to avoid repetition, we have considered it unadvisable to seek personal hearing before committee but authorize you to use our name amongst those seeking to protest against the proposed excess profits tax just as though our personal representatives were there in person.

GEO. F. MARKHAM,
President Federal Pressed Steel Co.

Mr. QUINN: I did not intend to make a speech here. I notified all those with whom I could get in touch—and they are very generally scattered through the country, some in the Middle West and some in New England and other parts of the country—that time was pressing and that it was the desire of the Finance Committee to limit the hearings as much as possible. My experience has been that oftentimes business men repeat their arguments at hearings of this kind. Therefore I arranged for a brief conference here in Washington last evening, at which I explained the desire of the committee. Those present thereupon asked me to present, in a general way, their facts and argument. With the permission of the committee, that I shall now do.

I believe that Mr. Chapin, of the Washington Steel & Ordnance Co., desires to follow me with a few brief remarks, and Mr. Bright, representing the Winchester Repeating Arms Co., desires to refer very briefly to a separate point.

Senator THOMAS. Do I understand you are going to present a statement of all these gentlemen, or will there be more than one?

Mr. QUINN. No; my remarks will be substantially all the hearing. This hearing will be the whole thing, just to shorten the matter and save the time of the committee.

The CHAIRMAN. And only two of you desire to present your views?

Mr. QUINN. Mr. Bright also desires to say a word regarding a possible amendment to the bill, which is not duplicated or covered in my remarks at all. There will be no duplication in any of our remarks. So between myself dealing with the general features of the proposed bill, Mr. Chapin dealing with another suggestion that I do not deal with, and Mr. Bright briefly with another, there will be no repetition whatever. I will try to be as brief as I can.

In the first place, gentlemen of the subcommittee, I want to thank the committee for the courtesy of this hearing. The notice was a little short, and some of the representatives of the munitions manufacturers who wanted to be here could not be here.

Senator THOMAS. We assume that they are all protesting.

Mr. QUINN. I want to do the best I can, considering the very short time we have had to prepare, because the conference I refer to was held only last night. I may ask at the conclusion of the hearing a day or maybe two days to file a memorandum, or to prepare a short brief for the subcommittee, as well as for the entire Finance Committee.

Senator THOMAS. I doubt if it would do you any good, because it is the purpose of the committee to report this bill to the Senate as quickly as possible, and probably day after to-morrow.

Mr. QUINN. I will get what I can in the shape of a memorandum by to-morrow noon. I will stay here and finish it But it has been a very short time to do it all.

(The memorandum was subsequently submitted and is here printed in full, as follows:)

[Senate of the United States—Committee on Finance.]

IN THE MATTER OF THE PROTEST OF MUNITION MAKERS AGAINST THE 8 PER CENT EXCESS PROFIT TAX IN SO FAR AS IT TAXES PROFITS ON WHICH THEY ALREADY BY LAW PAY THE 12½ PER CENT PROFIT MUNITIONS TAX.

I. BRIEF SKETCH OF THE PRESENT MUNITIONS PROFITS TAX.

No hearing was given by the House Ways and Means Committee while it was framing the present bill. The hearing accorded by the subcommittee of the Finance Committee of the Senate has been the only opportunity given to present the arguments and facts of the munitions makers. In this respect there has been a repetition of the history of the revenue act of September, 1916. In that act, as it passed the House, a tax was imposed upon the gross receipts from the manufacture of munitions. The House bill exempted subcontractors. It also proposed a graduated tax upon gross receipts. It was an unfair and unjust method of taxation as it passed the House. The munitions manufacturers appealed to the Senate Finance Committee. The Senate amended the House bill so as to impose a tax of 10 per cent upon the net profits of the munitions business. In the conference that 10 per cent net profits tax was increased to the 12½ per cent net profits tax which is now the law.

II. FEDERAL TAXES THAT WILL BE PAID BY MAKERS OF MUNITIONS IF THE HOUSE BILL BE ENACTED INTO LAW.

We will assume for the purpose of our argument the case of a munitions manufacturing corporation having actual capital invested of $10,000,000, and that it has earned net profits, over its State and local taxes, of $2,000,000 during the calendar year ending December 31, 1917. Such a corporation would pay, under existing laws and under the proposed House bill if it be enacted into law, the following Federal taxes:

Income tax of 2 per cent on $2,000,000 under the act of Sept. 8, 1916	$40,000
Munitions manufacturers net profits tax of 12½ per cent on $2,000,000 under the act of Sept. 8, 1916	250,000
Capital stock tax for the first half of the year 1917, after allowing the exemption of $99,000 provided by the act of Sept. 8, 1916, amounting to	2,475
Total Federal taxes now imposed	292,475

Said sum of $292,475, the total amount of Federal taxes now imposed upon the munitions business, deducted from the assumed total net income of $2,000,000, leaves $1,707,525.

Tax under the proposed law: Eight per cent of the assumed capital invested of $10,000,000 amounts to $800,000; the proposed bill allows an arbitrary deduction of $5,000; total deduction allowed by the proposed bill, $805,000.

Deducting the sum of $805,000 from the net income of $1,707,525, after paying all Federal taxes now imposed, leaves an excess net income, over $5,000 plus the 8 per cent proposed to be allowed upon the actual capital invested, of $902,525. That would be the basis, in the case assumed, of the proposed excess profits tax. Eight per cent on that excess profits tax would amount to $72,202.

The figure estimated for the capital stock tax of the first half of the year 1917 is arrived at by allowing the exemption of $99,000 as provided by the act of September 8, 1916. That act provided, section 407, that corporations, joint stock companies, or associations actually paying the munitions tax imposed by section 301 of Title III of that act should be entitled to a credit on their corporation tax of 50 cents per $1,000 of the fair value of the capital stock of "the amount of the 12½ per cent munitions tax so actually paid."

In the case of the corporation that we have assumed, that credit would wipe out, after the first half of this year 1917, the capital stock tax, because the net profit tax of 12½ per cent would exceed the amount of the capital stock tax. The Government will get that tax for the first six months of this year, because the companies will not have paid any munition tax at the end of the first six months of this year.

The total amount of Federal taxes which a munitions manufacturing corporation, having the assumed capital invested of $10,000,000 and earning the assumed net profits of $2,000,000, after paying State corporation and franchise taxes and local taxes during the calendar year 1917, will have to pay to the Federal Government for the year 1917 will be $364,677.

In short, if the proposed House bill be enacted into law, the munitions manufacturing corporation whose case we have assumed would pay in Federal taxes alone $\frac{364,677}{2,000,000}$, or over 18 per cent of the net income.

While we have assumed, for the purpose of our illustration, the round figure of capital invested as $10,000,000, and have assumed a net profit of $2,000,000 for the year 1917, after the corporation shall have paid its State corporation and State franchise and local taxes, we do not mean to be understood as saying that this is the normal profit. There is no such thing as a normal or average profit in the munitions business. The munitions business, like other kinds of business, varies as to its profits. Some corporations make large profits, some small profits, and some make no profits at all.

III. DEDUCTIONS ALLOWED BY THE PRESENT 12½ PER CENT NET PROFIT TAX.

Section 302 of the munitions manufacturers tax, Title 3 of the act of September 8, 1916, has six subdivisions relating to the deductions to be made in computing net profits. The first five of those subdivisions, *a*, *b*, *c*, *d*, and *e*, are substantially similar to the deductions allowed in the income tax. The sixth subdivision allows a deduction as follows:

"Subdivision *f*. A reasonable allowance, according to the conditions peculiar to each concern, for amortization of the values of buildings and machinery, account being taken of the exceptional depreciation of said plants."

The construction of this provision is in the discretion of the department. There is nothing in the act of September 8, 1916, allowing for losses on plant or depreciation that would ensue from the sudden termination of the munitions business. If the war stopped presently, the munitions makers could not claim for the year 1917 as a depreciation or deduction the money that they might have sunk in plants and equipment. They would be entitled only to a reasonable allowance, "account being taken of the exceptional depreciation of said plants."

There is no normal standard of profits in the munitions business. It was at the outbreak of the war an entirely new business to almost all of the concerns now engaged in it. They were not equipped for munitions manufacture. At the outbreak of the war there were but perhaps six or seven corporations whose specialty was the manufacture of munitions. All of the other corporations in the country now engaged in the business had to learn the business. Obviously in pioneering work of that kind there is no rule or standard of profit.

IV. STATE TAXES PAID BY MUNITIONS MANUFACTURERS.

In addition to the Federal taxes that we have assumed, these corporations have to pay State franchise and State corporation taxes and real estate and local taxes. We think it fair to assume that the State franchise and corporation taxes and real estate and local taxes amount to 3 per cent. In making the assumption of a net profit of $2,000,000 upon $10,000,000 of capital actually invested, we had previously allowed for the State franchise and State corporation taxes and the local taxes. That gives the Government the full benefit of the assumption. What we desire to impress upon the committee is the great burden of taxation in dollars, both Federal, State, and local, that the munitions business is called upon to bear.

Assuming the State corporation and State franchise taxes and local and real estate taxes to amount to 3 per cent, the corporation with $10,000,000 of capital invested that we have assumed for purpose of illustration will have paid $300,000 for State corporation and State franchise and local taxes. That would make, together with the $364,677 total Federal taxes that would be imposed if the House bill should be enacted into law, a total burden upon the business of the corporation assumed of $664,677.

V. NO ALLOWANCE FOR UNPROFITABLE YEARS.

The proposed excess profits tax is likely to prove a tax not merely upon normal profits but upon what we may call subnormal profits. The House bill ignores the practical and varying risk of business which necessarily relies upon larger returns for successful years to meet the probably lessened returns of more unsuccessful or leaner years. A corporation, for example, may earn net profits for this year, 1917, of 12 per cent. On 4 per cent of that net profit, the proposed House bill would impose an excess profits tax for this year. But for last year the same corporation's profit might be only 8 per cent; for the preceding year but 6 per cent; and for the year before that, 4 per cent. Thus we have four years in which the earnings were 12, 8, 6, and 4 per cent, respectively, making a total of 30 per cent for four years, which is only an average of 7½ per cent profit a year. That does not leave any margin of safety. It is a burden upon this year's

income, without reference to last year or to the year before or to what may be next year's profits or next year's losses. While this argument goes to the percentage, it still follows that the larger the tax burden the less the margin of safety is.

VI. THE INJUSTICE AND INEQUITY OF IMPOSING AN ADDITIONAL BURDEN OF THE PROPOSED EXCESS PROFITS TAX UPON THE MUNITION BUSINESS.

There is no reason in justice and equity why manufacturers of munitions should be singled out from all other kinds and varieties of our business and corporate enterprises and be subjected to this onerous and excessive tax. We are not attacking the proposed excess profits tax law generally. While we do not think that it is the best method of taxation, we feel that in existing circumstances it is one of the permissible means of raising revenue until our revenue laws are generally revised and until the close of the war at least. We might summarize our objections to this bill in one word—"injustice." There is no reason why the munitions business should be put in the same class as, for example, the liquor business, as a business that is hurtful in itself, or as a business on which the police power of the Government should be exercised. Instead of being overtaxed, as the proposed bill would overtax us, we think that we should be encouraged. No valid reason can be given why the manufacturers of munitions should be singled out from all other kinds of business and be subjected to this special and onerous and unjust tax. If it be argued that they make large profits, the answer is that so do other large corporations make large profits and yet they are not included in the special 12½ per cent net profits tax.

VII. THE AMENDMENT ASKED FOR.

To put our case briefly, our plea is that the munitions manufacturers now contribute 12½ per cent of their net profits to the Government, and for that reason they should be exempted to that extent from this additional 8 per cent excess profits tax. We ask that the bill be amended so as to exclude from the excess profits tax the manufacturers of munitions who now pay, and to the extent that they shall pay or shall be required by law to pay, and only to that extent, and only so long as they shall so pay, the 12½ per cent on the net profits of the munition business, leaving them, however, taxable the same as other corporations on their other business.

We have drawn a proposed amendment to House bill 20573. The proposed amendment is: On page 3, line 20, after the words "fiscal year," add the following:

"The partnerships, corporations, and associations required to pay the munitions manufacturers tax imposed by title three of the act of September eighth, nineteen hundred and sixteen, entitled 'An act to increase the revenue, and for other purposes,' shall, to the extent of their net income as defined in this act, upon which they shall have paid or are required by law to pay the munitions manufacturers tax imposed by said act, be exempt from the payment of the excess profits tax herein provided to be paid; but nothing in this section or in this act shall be held or deemed to exclude partnerships, corporations, and associations from the payment of the excess profits tax imposed by this act upon and in respect of their net income derived from their respective businesses other than the business of manufacturing and selling munitions, which under said act of September eighth, nineteen hundred and sixteen, subjects them to the twelve and one-half per centum net profits munitions tax."

That amendment would exempt the munitions makers from the operation of the proposed bill so far and only so far, and only to the extent, that they pay the present 12½ per cent munitions tax.

Many of the companies concerned do a large volume of other business. They are of course willing to pay the proposed 8 per cent excess profits tax on their other business.

VII. THE MARGIN OF SAFETY IN FEDERAL REVENUES WILL NOT BE SERIOUSLY IMPAIRED IF THE AMENDMENT TO THE HOUSE BILL ASKED FOR BY THE MUNITIONS MAKERS SHALL BE ADOPTED.

The majority report of the House Ways and Means Committee estimated that the excess profits tax proposed by the House bill would yield, during the 12 month's period of this year, $226,000,000.

They divided that sum as follows:

From corporations	$170,000,000
From partnerships	56,000,000
Thus making the total excess profits taxes	226,000,000

The report of the majority of the Ways and Means Committee of the House estimated that the revenues derived from the bill now under consideration, together with the other revenues to be raised by the proposed act, would leave a margin of $41,000,000 between receipts and expenditures. That $41,000,000 they regarded as a "margin of safety," in order to be on the safe side.

The question arises as to how much of the $170,000,000 to be paid under the proposed excess-profits tax will come from munitions makers. We think it is a fair estimate that of the large corporations or firms in the country about 1 in 10 does munitions work. In other words, there are probably 9 large corporations in the country that do no munitions business to 1 that does. If we are correct in this assumption—and we believe that it is a fair estimate—of the $170,000,000 that would come from corporations from the proposed excess-profits tax, $17,000,000 would come from munitions manufacturers. Therefore, if the amendment to the bill that we ask—and we are not attacking the bill generally—should be passed, it would mean merely that the margin of safety of $41,000,000 would be reduced somewhat; that is, that $17,000,000 would be deducted from the $41,000,000, leaving what we believe to be the entirely safe margin of $24,000,000. The estimated $41,000,000 margin of safety will not be seriously trenched upon if the proposed 8 per cent excess-profits tax be not imposed upon munitions makers. But if it be felt that the estimated $17,000,000 should be made up from some other source, we submit that the committee could with justice and propriety increase the present capital-stock tax of 50 cents per $1,000 to $1 per $1,000, thus doubling the revenues to be derived from corporations by that tax. That special stock tax is not an onerous tax. It is applicable to all corporations after allowing an exemption of $99,000. It is a fair basis of taxation. It applies to all corporations and not to any one class of corporations, like the munitions makers. Its rate is moderate and its imposition uniform, and hence it is just. To increase it from 50 cents to $1 a thousand would impose no great burden. That is one source of additional revenue, if the Senate thinks that the margin of safety requires something to take the place of the estimated $17,000,000 that would be taken out of the House bill by the amendment that we ask for. Such an increase would be just and equitable, would be uniform in its application, and would yield a certain and steady revenue.

Then there has been offered, we understand, an amendment to the bill taxing oleomargarine that would, we believe, bring an added revenue of about six millions the first year and eight or possibly ten millions the second and succeeding years.

IX. IT IS NOT WISE PUBLIC POLICY TO IMPOSE AN ADDITIONAL BURDEN UPON MUNITIONS MAKERS AT THIS TIME.

The crisis in which the country finds itself is likely to produce a great change in the relations of the Government of the United States to the makers of munitions. There ought to be a change in the policy of the Government toward munitions manufacturers. At the beginning of the war, aside from the six or seven concerns that specialized in the business, all of the other concerns that went into the business had to train their men. They had to secure their experts. They were compelled to estimate upon a new kind of business. There were heavy penalties involved. There was rigid inspection and rejection, and it was a very risky business. There were often large profits, but always large risks.

We may spend weeks and months of work and thought and many thousands of dollars on a new gun or a new projectile or a submarine or an aerial battleship that turns out just a hair's breadth wrong after all. That work must then be scrapped and the time and money is lost. If we venture our money in what is to most of us a pioneering business, we should not be punished for it, for it is a business of which we are not ashamed. It is closely bound up with the welfare of our country. And if in some cases the profits are large, the risks taken are great. To make a large profit is not yet a crime in this country. It is a crying injustice to make profits the sole criterion of taxation. We have the highest authority in this country for the doctrine that mere bigness, either of business or of profits, is not in itself an offense.

In addition to this, the foreign munitions business has largely fallen off. A great deal of it, by far the most of it, will be ended by the months of April and May of this year, 1917. One of two things will then happen. Either the new concerns that now do a foreign munitions business will go out of the munitions business entirely and will revert to industrial business only, or else they will remain in the munitions business. We submit that it is in the best interests of our Government that they stay in the munitions business. It is a sound economic principle that the more concerns there are in the business, the more bids will be submitted for Government work, the wider the field of competition will be, and the more favorable prices the Government will receive.

The Government is not, as it is sometimes said, at the mercy of the munitions makers. Rather, we are at the mercy of the Government. The Government, for example, has by law compelled the powder manufacturers to supply powder at 53 cents a pound at the very time when they were getting almost double that price abroad.

To show the enormous extent to which the manufacture of munitions has to be carried to meet the requirements of modern warfare, we desire to call the attention of the committee to the fact that, according to our information, at the outbreak of the present war there were in the whole of Great Britain but 172 firms or corporations engaged in whole or in part in the manufacture of munitions. Whereas on the 1st of July, 1916, there were in Great Britain alone more than 4,000 of such manufacturers.

Again, taking the production of the 1st of June, 1915, at 100 per cent, on the 1st of July, 1916, that production had risen from 500 to 9,000 per cent in the manufacture of many forms of munitions. And on the 25th of November, 1916, it had risen from 500 to 32,000 per cent.

And again, in many classes of munitions manufacture in England the entire product of one year, that is the annual product as of the 1st of June, 1915, is now made in Great Britain, by the thousands of factories engaged in the work, in a single day. The entire product formerly of a year is now made in one day. This shows how the English were compelled to readjust their ideas and their practice to the demands of modern warfare.

Finally, in many other classes of English munitions manufacture, the entire year's product on the 1st of June, 1915, is now made in eight days.

It is fair to assume that a corresponding increase has also taken place in France.

This will give the committee some idea of the requirements of modern warfare.

This war has taught many lessons. It has brought many tragedies. Its tragedies have not been merely personal. They have been national and international. Perhaps the greatest of these tragedies was due to the lack of foresight on the part of those in control of the allied governments. They failed to realize, what they have now learned at bitter cost, that the problems of this war were largely engineering and transportation problems. Perhaps the greatest tragedy of the great war has been the lack of ability on the part of those in power to grasp the great, broad, and fundamental needs of the war. They failed to realize that the decisive factor in modern warfare is engineering and transportation more than men. Even experts high in armies and navies, at the beginning of the war at least, failed fully to comprehend the magnitude of the problem. It is earnestly to be hoped that Congress and the executive departments of our Government, as well as the high officials of our Army and Navy, will profit by the dearly bought experience of the allied countries in this respect. If that lesson be not taken to heart this country may be shocked by a tragedy the magnitude of which it is appalling to imagine. The lesson that our people should draw from the European war is that while we have the men and the courage, we should avoid repeating the colossal mistake of the allied governments in underestimating the problem of munitions, which is an engineering and scientific and transportation problem.

On the subject of the vital relation of munitions to modern warfare we beg to call the attention of the committee to a letter by the well-known English publicist, Mr. Sydney Brooks. It was dated January 30, 1917, and appeared in the New York Tribune of Monday of this week, February 5. Mr. Brooks is doubtless known, if not personally, at least by reputation, to all the members of the committee as a man of wide experience in public and international affairs, as a writer of authority, and as a man of high standing in the councils and affairs of his own country, England. We take the liberty of quoting such parts of his letter as have a direct bearing upon the problems that now confront our people. The words of Mr. Brooks are not those of a casual observer. He speaks with full knowledge and authority. We hope that his warning, based upon the bitter and tragic experience of his own country, will be taken to heart by every member of the committee and by Congress and by the officials in whose hands our country's welfare now lies. Mr. Brooks said:

"Almost all the signs that history has taught one to recognize as the forerunners of a great national crisis are present to-day in the United States and in her relations with the outer world. Next to a victory for the allies, an Englishman like myself, who has known the United States for 20 years, can have no dearer wish than that Americans may face this crisis, when it comes, fully prepared.

"But great numbers of them still do not seem to have learned one of the most patent lessons of this war. They still persist in thinking of armies in terms of men. The great war should have taught them to think of armies in terms of munitions. The men you can always get, but it is a much lengthier and infinitely more difficult business to arm and equip them.

"Victory nowadays is not to the big battalions. It is to the big battalions backed by the big guns; and you will find when your turn comes, as we found in England, that unless you look ahead the men will be trained and ready long before there are

weapons to put in their hands. A few months ago, when I was at the front, a general crystallized the whole problem: 'When I am ordered,' he said, 'to undertake an attack I don't ask how many men are going to be given me, but how many guns.'

"Guns, shells, material—these are the foundation of all real preparedness. Your first line of defense in the United States is not your millions of men. It is your plants and factories and steel works, your chemists and engineers and metallurgists, your lathes and tools and machinery, your manufacturing industries and the men they have trained, the organizations they have built up, and the experience they have amassed. Take away firms like Bethlehem and Du Ponts and the Midvale Steel Co. and the Winchester Arms Co. and Remington's, and for all military purposes you would be infinitely worse off even though you doubled your population. Halve your population and double the capacity of these and similar firms, and for all military purposes your strength would be immeasurably increased, so curiously have modern conditions of warfare shifted the relative importance of men and material.

"With this lesson branded on his brain by a somewhat bitter experience, it almost appals an Englishman who to-day revisits the United States to find that the relations between the American Government and the leading American munition makers leave apparently so much to be desired. We in England have learned in the costliest of all schools, at the price of thousands of lives lost and months of precious time wasted, the vital importance of encouraging during the years of peace as many private manufacturers as possible to engage in the production of war material. * * *

"There are certain broad principles which the war has shown that a nation can neglect only at its peril.

"First, it has shown the folly of depending upon other and possibly hostile countries for essential items in the national equipment for war. The habit of placing orders abroad is the most ruinous form of economy that any government can adopt. If the domestic manufacturers are unable to produce what is required and there is no question of immediate urgency, the proper and in the end infinitely the cheapest course is for the naval and military authorities to cooperate with the private firms in solving the problem. * * *

"Second, the war has shown the absurdity of regarding the question of industrial preparedness from the standpoint of cost. * * *

"If they" (the English companies) "have earned large and liberal profits on their Government contracts, what of it? Every Englishman is well content that they should, because every Englishman knows that by merely remaining in existence and in a condition to fill the war office and Admiralty orders they are rendering the nation a supreme service. This war has taught us that there is no imaginable profit which it would not have been well worth our while to pay over to the private manufacturers of war material simply to keep them in being and that no saving to the treasury could ever have compensated us for having driven even one of them out of business.

"As a matter of fact, we have always found the situation in England entirely manageable. People talk of the Government being at the mercy of the manufacturers; but the manufacturers are equally at the mercy of the Government. It is by far their largest and in some cases it is virtually their only customer. It is in just as good a position to dictate the terms as they are. It depends on them, but not a bit more than they depend on it. With the merest modicum of honesty and business intelligence and diplomacy their relations can always be made harmonious and helpful. * * *

"Third, the war has shown that no government plants, however huge, can meet the requirements of modern war. Victory nowadays goes to the country that is able to turn to immediate account the greatest number of firms that know the armament business from top to bottom and that have been encouraged by a wise public policy to keep themselves in a state of instant efficiency and responsiveness. Government plants are useful and necessary as supplements and regulators. But the main reliance must always be placed on the private manufacturer.

"There is much that disquiets an Englishman who, in the light of the present war, endeavors to take stock of American readiness to face such a crisis as burst upon us in August, 1914. But there is nothing more disquieting than the lack of unity and concord that seems to exist between the Government departments at Washington and the great industrial corporations that must always, in America as elsewhere, be the real backbone of national preparedness.

"SYDNEY BROOKS."

We respectfully submit that this is the time for our Government to wait before imposing additional burdens upon the munitions business. We do not know what the next few months will bring forth. We are not certain what our Government's attitude may be toward the foreign countries who are now purchasers of munitions. We do not know what its attitude will be with regard to its own purchases of munitions. We earnestly submit that this is not the time to impose an additional burden upon the

munitions manufacturers of the United States. We urge the Senate to wait and see what the next six months or the next year will bring forth. The Government will then know definitely what its relations to the munitions business are and should be. We will then know more definitely than we do now what our country's future is to be. We will then know whether we are to go on in peace, or whether we are to be confronted with the dread fact of war. We will know all these things then. We do not think it is wise statesmanship or sound public policy at this acute crisis in our affairs to put additional tax burdens on munitions manufacturers.

We do not object to the 8 per cent excess profits tax so far as it applies to our business other than the manufacture of munitions.

We do not object to the 8 per cent excess prolts tat so far as it applies to our business other than the manufacturer of munitions.

This is no time for further experiment in taxing munitions makers. If the House bill be enacted into law and the double burden of taxation be placed upon munitions manufacturers, we as a nation may speedily regret it. The regret may be a double regret. First, we may regret that this excessive burden has been placed upon the foreign purchasers of munitions. Secondly, we may regret that the excessive burden has been put upon the Government of the United States itself as a purchaser of munitions. We submit that it is the part of wisdom and enlightened statesmanship, for the time being at least, to exclude munitions manufacturers from the excess profits tax, leaving upon them the 12½ per cent net profit tax that they are now required to pay. We believe it to be wise statesmanship to wait and see what the course of the next few months will bring forth. It is not only the course of wise and prudent statesmanship, but it would be just and equitable and would involve no strain on the Government finances.

X. THE ARGUMENT THAT FOREIGN COMPANIES PAY AN EXCESS-PROFITS TAX DOES NOT APPLY.

If it be said that munitions manufacturers abroad pay a larger excess-profits tax than that proposed to be placed upon them by this bill, the answer is complete and it is unanswerable: That answer is that the excess-profits tax imposed in England applies to all corporations and not to munitions manufacturers alone. That is why the English excess-profits tax, though very high, is equitable. For the same reason the excess-profits tax in the proposed bill upon munitions manufacturers alone, added to the 12½ per cent net-profits tax now imposed upon them, is grossly unfair. We feel that we are already bearing a heavy burden of taxation. An exception was made against us in the revenue bill of September 8, 1916. But the crisis that now confronts our country, the vital and fundamental change in the relations between our Government and the manufacturers of munitions that is bound to follow, impel us to assert with confidence that not only is it the part of wise statesmanship and sound public policy not to impose this additional burden upon the munitions manufacturers, but we feel that it is an unjust and inequitable thing to single them out from all the other business enterprises of the country and to place this double burden upon them.

Just and equitable treatment is what we ask. In fairness and justice, that is what we should receive. This is peculiarly a case, owing to the crisis now confronting our country, where justice and equity coincide with wise statesmanship and sound public policy.

Respectfully submitted.

Smith & Wesson, Springfield, Mass.; American Steel Foundries Co., Chicago; New London Ship & Engine Co.; Westinghouse Electric & Manufacturing Co. of East Pittsburg, Pa., on behalf of the New England Westinghouse Co.; Hercules Powder Co., of Wilmington, Del.; General Ordnance Co., of Derby, Conn ; E. I. du Pont de Nemours & Co., of Wilmington, Del.; Colt's Patent Fire Arms Manufacturing Co., of Hartford, Conn.; Burton-Richards Co., of Pittsburg, Pa., and New York; American High Explosives Co., of Pittsburg; Savage Arms Co., of Utica, N. Y.; Driggs-Seabury Ordnance Co., of Sharon, Pa., and New York; E. W. Bliss Co., of New York; Minneapolis Steel & Machine Co., of Minneaspolis, Minn.; United States Cartridge Co., of New York; Federal Pressed Steel Co.; Pollock Steel Co., of New York; Mississippi Valley Ordnance Co., of St. Louis, Mo.; American Brake Shoe & Foundry Co., of New York; Yale and Towne Manufacturing Co.

By JOHN QUINN, *Counsel.*

The Winchester Repeating Arms Co., by Frank S. Bright, its counsel, and the Washington Steel & Ordnance Co., by Frederick E. Chapin, its counsel, join in this brief.

Mr. Quinn: Of course, the committee knows that there was no opportunity for a hearing given by the House Ways and Means Committee. We do not complain of that. But this, therefore, is our first and only chance to present our views at any hearing. In that respect this is a repetition of the history of the revenue act of September 8, 1916. In regard to that bill the House, as the members of this subcommittee will recall, imposed a tax upon the gross receipts from the manufacture of munitions. The House bill exempted subcontractors, and made the tax a graduated tax. That was, with all respect to the learned House committee, a demonstrably unfair method of taxation. It was passed by the House, and the manufacturers of munitions came to the Senate Finance Committee for their only hearing and for relief. They stated frankly that they wished to meet their fair burden of taxation, and they pointed out the unfairness of the House bill. They were met in a spirit of perfect open-mindedness and fairness on the part of the subcommittee, and the Finance Committee reported to the Senate a munitions bill which is now the law.

I happened to be in the gallery of the Senate when the munitions sections of the revenue bill of September 1916, were under discussion. I recall that Senator Thomas stated, in the course of the debate, that of all the persons, firms, and corporations who appeared before the Finance Committee during the hearings on the entire revenue bill the munitions people were the fairest and most reasonable in the presentation of their claims, and the frankest in the presentation of their arguments, and the most open-minded and fair in expressing their willingness to be taxed, if the tax was fair.

That is the attitude of the munitions manufacturers now. All they want is fair and just treatment. They ask mere equity which is equality, taking into consideration all the tax burdens of themselves and the other corporations of the country.

As the revenue bill of 1916 passed the Senate, as amended by the Senate, it imposed a net profit tax of 10 per cent. In the conference as the committee knows, that was changed to 12½ per cent of the net profits, so that the munitions manufacturers now pay to the Government a tax of 12½ per cent of their net profits.

Under the House bill now before you, if it is enacted into law, corporations and partnerships engaged in the manufacture of munitions will pay, in whole or in part, the following taxes.

Senator Thomas. In this bill the munitions people are embraced generally?

Mr. Quinn. Yes; generally, with all other corporations.

Senator Thomas. In other words, there is no distinctive munitions tax in this bill?

Mr. Quinn. None whatever.

To show what munitions manufacturers will pay, if the House bill be enacted into law, I have taken a typical company, with a $10,000,000 capital investment, and capital investment is the basis of this act, as well as of the capital stock tax law. I assume the capital invested to be $10,000,000. I am not speaking of market value, or anything of that sort.

The Chairman. Actual money?

Mr. Quinn. Actual money invested or property or surplus. I am assuming a $2,000,000 profit, annually, after paying State and local taxes, and I am taking that as an illustrative case to show how

this new tax, if imposed upon, if added to, the tax imposed by the revenue act of 1916, will result in dollars as a burden of payment by the company whose case I assume. What is the result?

They pay an income tax of 2 per cent on $2,000,000 under the act of September 8, 1916, that is, $40,000.

Next, they pay the munitions manufacturers tax of 12½ per cent on my assumed $2,000,000 of net profit under the act of September 8, 1916, that is, $250,000.

Senator THOMAS. Do you not deduct the income tax of $40,000?

Mr. QUINN. Yes; I think that that tax should be deducted. That is, the income tax of 2 per cent, under the act of September 8, 1916, amounting to $40,000.

The munitions manufacturers' tax of 12½ per cent on my assumed net profit of $2,000,000 amounts to $250,000.

Then comes the capital stock tax. That should also be deducted.

For the first half of the year 1917, after allowing the exemption of $99,000, as provided by the act of September 8, 1916, it amounts to, in the case I have assumed, $2,475.

There is an exemption there. It was provided in the act of September 8, 1916, section 407, that corporations, joint-stock companies, or associations actually paying the munitions tax imposed by section 301 of Title III of that act should be entitled to a credit on their corporation tax of 50 cents per $1,000 of the fair value of the capital stock of "the amount of the 12½ per cent munitions tax so actually paid."

Senator THOMAS. That is wiped out in your supposed case?

Mr. QUINN. That will be wiped out for the second half of this year in my supposed case, because the net profit tax of 12½ per cent will exceed the amount of the capital-stock tax. But the Government gets it the first six months, because the companies will not have paid any munitions tax at the end of the first six months of this year. That capital stock tax will amount to $2,475.

Then we come to the excess profit tax under the proposed House bill of 8 per cent of the amount by which the net income exceeds the sum of (A) $5,000; (B) 8 per cent of the actual capital invested. Those three taxes, namely (*a*), the income tax at 2 per cent on $2,000,000 under the act of September 8, 1916, amounting to $40,000; (*b*) the munitions manufacturers' tax of 12½ per cent on $2,000,000 under the act of September 8, 1916, amounting to $250,000; and (*c*) the capital-stock tax for the first half of the year 1917, after allowing the exemption of $99,000 provided by the act of September 8, 1916, amounting to $2,475, make a total of $292,475. Deducting this from the assumed total net income of $2,000,000 after paying State taxes, State franchise taxes, and local taxes leaves a balance of $1,707,525.

Now, if the House bill be enacted into law there will be further deducted 8 per cent of $10,000,000, which is $800,000, and $5,000 arbitrarily allowed. Add to the $800,000 the $5,000 deduction allowed and you have $805,000. Deducting from the total net income of $1,707,525 that sum of $805,000 leaves an excess of net income over $5,000 plus 8 per cent of the actual capital invested, in the sum of $902,525, which is the basis of the proposed excess profit tax. Eight per cent on that net amount of $902,525 will yield an excess

profits tax from the munition manufacturer, whose case I have assumed, of $72,202.

The total amount of Federal taxes which a munitions manufacturing corporation having a capital invested of $10,000,000 and earning assumed net profits of $2,000,000, after paying State taxes, State franchise taxes, local corporation taxes and local real estate taxes, and other local taxes during the calendar year 1917, must pay to the Federal Government for the year 1917 will be, if the House bill be enacted into law, the sum of $364,677.

In other words, if the House bill be enacted into law, the munitions manufacturing corporation, whose case I have assumed, will pay in Federal taxes alone $\frac{364677}{2000000}$, or over 18 per cent of its net income.

In making this estimate, I have assumed that the corporation whose actual capital invested and whose assumed net profits I have made the basis of my illustration, will be allowed to deduct from the assumed net profits of $2,000,000 the 12½ per cent of the present munitions tax, amounting in the case I have assumed to $250,000. But as the House bill now reads that deduction could not be allowed, and without question the department would so rule. The House bill allows only (*a*) $5,000 and (*b*) 8 per cent "of the actual capital invested." So that the corporation that I have assumed would have to pay the excess-profits tax on the $250,000 of tax now paid under the 12½ per cent munitions tax.

In other words, unless the House bill be amended so as to exclude the amount paid under the 12½ per cent munitions tax law from the amount to be taken as the basis of the proposed net-profits tax law, the corporation will not be allowed the $250,000 deduction, but on the contrary will have to pay 8 per cent on $1,152,525, or $92,000, instead of $72,202. That would make the fraction $\frac{384675}{2000000}$, or nearly 20 per cent to be paid in total Federal taxes. Under the House bill as drawn the 12½ per cent munitions tax can not be deducted. The bill should in simple justice be at least amended, if the real exclusion that we ask for be denied, so as to allow the amount of the present munitions tax to be deducted in arriving at the basis of the excess-profits tax.

Senator JAMES. But you make these deductions for the purpose of getting at the effect of the bill?

Mr. QUINN. Yes, I do.

Senator JAMES. For instance, you would not be required to pay in this excess tax a tax upon that which you have already paid to the Government. You deduct that. You take out all the taxes you have paid.

Mr. QUINN. I understand that perfectly. I mean to be perfectly fair in order to show the tax burdens on an assumed net business profit of $2,000,000.

Senator THOMAS. I may have misunderstood you in your statement, and I want to be set right. I understood you to say that this bill, if it became a law, would impose a tax, after these deductions, of 8 per cent upon that $10,000,000 of capital invested. Is that right?

Mr. QUINN. No, I did not mean $10,000,000. I say as the basis in arriving at the first 8 per cent net profit allowed by the proposed law you take the capital invested. The House bill allows 8 per cent on the capital invested.

Senator THOMAS. I thought I must have misapprehended you. As you seemed to state it, it was an astounding proposition to me.

Mr. QUINN. In order to arrive at the 8 per cent profits which the proposed bill allows, you take the actual capital invested, which here I assume to be $10,000,000.

The CHAIRMAN. So you allow the $800,000?

Mr. QUINN. The $800,000 and take that from the $2,000,000 and the $5,000, as well as the other Federal taxes paid.

The CHAIRMAN. Eight per cent is fixed upon the excess profits.

Mr. QUINN. That is it; 8 per cent on the excess profits—over and above the 8 per cent allowed in the first instance.

Senator JAMES. Did you hear any arguments made on this bill in the House that assumed any other position?

Mr. QUINN. Senator, there was practically no argument in the House on the munitions section of the bill. I have read the Record carefully. There was some general debate. The Republicans talked about other kinds of taxation and about the unfairness of the proposed excess profits tax. But the munitions sections of the bill practically went undiscussed and unconsidered and unattacked and undefended.

Senator JAMES. I do not see how anyone could say you could fix an excess profit tax without deducting all of the outlay before you arrived at the excess profits.

Mr. QUINN. I think you are right.

If the House bill be enacted into law, the munitions manufacturers' tax, on the computation I have made here, will be something over 18 per cent of the assumed net profits of $2,000,000.

I assume, for the purpose of my illustration, the round figures of the capital investment at $10,000,000. I assume a net profit of $2,000,000. Of course, I do not mean to say that is a normal profit. That is not a normal condition. The munitions business, like any other business, varies. Some corporations make large profits, and some make small profits and some make no profits.

The CHAIRMAN. I would just like to ask you this question: In estimating the net profits of these munitions companies, is there a substantial deduction made each year upon the theory that their investment, say, of $10,000,000 in this case, is not a permanent, good investment, as in an ordinary business, but is dependent upon war, and therefore the deduction from their capital larger than a normal business would make would be made each year to ascertain a fair estimate of their actual net profits?

Mr. JACKSON. The amount taken off for depreciation, I think, is fixed by the Commissioner of Internal Revenue.

The CHAIRMAN. Is there not a much larger sum written off for depreciation each year upon the theory that your investment does not continue permanently good, like the investment in a bank or the investment in a cotton manufactory?

Mr. RICHARDS. Yes; that is true.

The CHAIRMAN. That would be fair in ascertaining your genuine profits, your real profits.

Mr. QUINN. I think that would be fair. But here is the law, Senator, and the law as construed by the department is found in subdivision F of section 302 of the revenue act of September 8, 1916,

where Congress fixed the method of computing net profits. That subdivision provides as follows [reading]:

Subdivision F. A reasonable allowance, according to conditions peculiar to each concern, for amortization of the values of buildings and machinery, account being taken of the exceptional depreciation of special plants.

There is nothing there about depreciation being dependent on the ending of the war. If the foreign war stopped to-morrow and peace came over the world, we could not claim for the year 1917, or these concerns could not claim, as a depreciation or deduction, the money that they had put in their plants. They would be entitled only to a reasonable allowance, "account being taken of exceptional depreciation of special plants."

Of course, munitions plants require heavy machinery, and being specially constructed, can not be changed all at once into plants for other kinds of business. There is a heavy depreciation in business of that kind. It requires larger structural steel, and so forth, larger elevators, and all the appliances and machinery to be specially designed. I do not believe they could charge all that as a deduction if the war should end soon. It seems to me that if a company had put $10,000,000 in a munitions plant and peace should come soon and their business should end in three months, as a great many of these contracts will, they could not deduct the whole $10,000,000 from their profits. They would be entitled to only fair and reasonable depreciation.

The CHAIRMAN. And it would not be fair to deduct the whole $10,000,000, because it is worth something.

Mr. QUINN. That seems to me to be quite correct. Now, as I have said, there is no normal standard of profits. Some munitions concerns are really having a very hard time of it. This was a new business to many concerns that were not especially equipped for munition manufacturing. At the beginning of the war there were only six or seven corporations, whose names are familiar to the committee, whose business, in whole or in part, was especially that of manufacturing munitions. Most of the others had to learn the business, and naturally in pioneering work of that kind there is no rule or standard of profit.

In addition to the taxes I have assumed, these corporations have to pay real estate taxes. They also have to pay State taxes, State franchise taxes or State corporation taxes. I think it is fair to assume that the local taxes, the State franchise taxes, and the State corporation taxes amount to 3 per cent.

Senator JAMES. But all of that goes back to this original proposition, that it is hardly fair to argue that, when you eliminate that from this excess profit tax.

Mr. QUINN. I do not claim that. I desire to show what, on the ledgers of these companies, they will have to take out for State and local taxes before they get my assumed net profit. Upon my assumed capitalization of $10,000,000, that is a burden of State and local taxes of $300,000. I assumed in my net profit of $2,000,000 that the State and local taxes had already been deducted. So I give the Government the full benefit of taking out that deduction. But what I desire to impress upon the committee is the gross actual burden of taxation in dollars, both Federal and State and local, that these munitions companies will be called upon to pay.

The CHAIRMAN. Their normal taxes, outside of these special taxes.

Senator THOMAS. I wish you would give us the percentage left to the companies after all these things are paid. On your assumption. Take your illustration.

Mr. QUINN. The percentage of profit, you mean?

Senator THOMAS. $10,000,000, making $2,000,000 a year. Let us know how much is left to the stockholders.

Mr. QUINN. I will do that.

Senator THOMAS. Of course, you can not do it except upon your assumed case.

Mr. QUINN. I will show just how much is left to the stockholders after that.

On my assumed case of $300,000 for State franchise taxes and for the local taxes there is a total tax burden of $664,677.

Senator THOMAS. Out of your $2,000,000?

Mr. QUINN. Out of the $2,000,000 net profits after paying State taxes, State franchise taxes, and other local taxes.

Senator THOMAS. That illustrates the truth of old Sidney Smith's remark about a century ago, that taxes were the inevitable consequence of being too fond of glory.

Mr. QUINN. I submit, gentlemen of the subcommittee, that that is too heavy a burden for these corporations to bear.

The CHAIRMAN. It would leave this particular company with which you illustrate about 15 per cent net profit.

Mr. QUINN. On the $10,000,000?

The CHAIRMAN. Yes.

Mr. QUINN. I will work that out, Senator.

The CHAIRMAN. Roughly I have calculated that, and it seems to be about 15 per cent.

Mr. QUINN. Senators have in mind—and I have made the percentages, I think, correct—that there is first the 2 per cent income tax, then 50 cents per thousand tax on the corporation's capital invested above $99,000, then the tax of 12½ per cent on the net profits of the munitions business, and now they propose to add an excess profit tax of 8 per cent on the net income above 8 per cent, all in addition to the burden of State and local taxes.

I recapitulate for the sake of clearness [reading]:

Income tax of 2 per cent on $2,000,000 under the act of Sept. 8, 1916		$40,000
Munition manufacturers' tax of 12½ per cent on $2,000,000 under the act of Sept. 8, 1916		250,000
Capital stock tax for the first half of the year 1917 after allowing the exemption of $99,000 provided by the act of Sept. 8, 1916, anounting to		2,475
Total Federal taxes now imposed		292,475
Deducting the above amount of total Federal taxes now imposed of $292,475 from the assumed total net income of $2,000,000 leaves		1,707,525
8 per cent of the assumed capital invested of $10,000,000 amounts to	$800,000	
The proposed bill allows an arbitrary deduction of	5,000	
Total deduction allowed by the proposed bill		805,000
Deducting the said sum of $805,000 from the assumed net income of $1,707,525 after paying all Federal taxes now imposed, leaves an excess net income over $5,000 plus 8 per cent of allowed income upon the actual capital invested as the basis of the proposed excess profits tax of		902,525
8 per cent on that excess profits tax amounts to		72,202

As I have shown above, if the bill be not amended, the corporation will pay $92,000 excess-profits tax, instead of $72,202, and the percentage will be nearly 20 per cent. From the remarks of the committee it appears that that is not the intention. Obviously, in mere justice the bill should be amended in this respect.

Now I come to the computation suggested by Senator Thomas a few moments ago, and that is the percentage of profit to the stockholders after paying all these taxes. The total Federal taxes would amount to $364,677. That is exclusive, on the assumption that I have made, of the estimated $300,000 paid for State corporation taxes, State franchise taxes, and local taxes. Deducting the total Federal taxes of $364,677 from my assumed net profits of $2,000,000 leaves a $1,635,323, or upon the assumed actual capital investment of $10,000,000 a return of a little over 16 per cent on the par of stock. Where the investment is more than the stock, the rate of course would be lower.

There is another fact that I should like to call to the attention of the committee, and that is this: The proposed excess profits tax is likely to prove a tax not merely upon normal profits, but upon what I may call subnormal profits. The House bill seems to me to ignore the practical and varying risk of business which necessarily relies upon larger returns for successful years to meet the probably lessened returns of more unsuccessful or leaner years. That was impressed upon me last night by two or three of the gentlemen who are here to-day. It would not be fair to name them, but they are making more now than they did last year, or the year before, and the way business men compute it is: A corporation may show profits, we will say, this year of 12 per cent. On 4 per cent of that the House bill will impose an excess profit tax for this year. But for last year that same corporation's profit might be only 8 per cent, and for the preceding year 6 per cent, and for the year before that 4 per cent. Then we have four years of 12, 8, 6, and 4 per cent profits, respectively, making 30 per cent, which is only an average profit of 7½ per cent a year. That is not leaving any margin of safety. It is a burden upon this year's income without reference to last year, or the year before, or what may be next year's profit or next year's loss.

Senator THOMAS. Is not that true of all taxes? Taxes are a constant quantity.

Mr. QUINN. In a sense it is true, Senator, but at the same time I think that in fixing taxes some consideration should be paid to the way business is conducted, and the corporation that has three or four lean years should be given some consideration.

Senator THOMAS. That argument goes to the percentage.

Mr. QUINN. Yes; but the larger the tax burden the less the margin of safety.

Now I come to a practical thing. I want to be as frank with the committee as I always am to a court. I never will make an argument, and never have, to a court that I would not want to listen to if I were a member of that court. I will deal in the same way with this committee. I know the Senate Finance Committee is confronted with the practical problem of raising revenue, and I want to deal very frankly with that question.

The majority report of the House Ways and Means Committee estimated that the excess profits tax proposed by the House bill would yield, during the 12 months' period of this year, $226,000,000. They divided it as follows:

On corporations, $170,000,000.

Upon partnerships, $56,000,000.

Thus making a total excess profit tax of $226,000,000.

The report of the majority of the committee to the House estimated that the revenues derived from the bill now under consideration, together with the other revenues to be raised by the proposed act, would leave a margin of $41,000,000 between receipts and expenditures. That $41,000,000 they regarded as "a margin of safety," in order to be on the safe side. They thought a substantial margin would be advisable.

After talking with several of the men practically engaged in this business, I think it is a fair estimate that of the large corporations or firms in the country about 1 in 10 does munitions work; that is to say, I think there are probably 9 large corporations that do not do munitions business to 1 that does. If I am correct in that—and I believe that is a fair estimate of the $170,000,000 that would come from corporations from the proposed excess profit—$17,000,000 would come from munitions manufacturers. Therefore, if the amendment to the bill that we ask—and I am not attacking the bill generally—should be passed, it would simply mean that from the House margin of safety of $41,000,000 would be deducted $17,000,000, leaving still a safe margin of $24,000,000.

The CHAIRMAN. What is the amendment you ask?

Mr. QUINN. The amendment is this: We ask that the bill be amended so as to exclude from the excess profit tax the manufacturers of munitions who now pay, and to the extent that they pay, and only to the extent that they pay, and so long as they shall pay, the 12½ per cent on net profits from their munitions business, leaving them taxable on all their other kinds of business.

For the sake of completeness I desire here to set forth the amendment I have in mind to accomplish what we think is just and equitable. On page 3, line 20, after the words "fiscal year," add the following [reading]:

The partnerships, corporations, and associations required to pay the munitions manufacturer's tax imposed by title 3 of the act of September 8, 1916, entitled "An Act to increase the revenue and for other purposes," shall, *to the extent of their ne income as defined in this act upon which they shall have paid or are required by law to pay the munitions manufacturer's tax imposed by said act*, be exempt from the payment of the excess profits tax herein provided to be paid, but nothing in this section or in this act shall be held or deemed to exclude said partnerships, corporations, and associations from the payment of the excess profits tax imposed by this act upon and in respect of their net income derived from their respective businesses other than the business of manufacturing and selling munitions, which under said act of September 8, 1916, subjects them to the 12½ per cent net profit munitions tax.

Senator THOMAS. You would exempt the munitions makers from the operation of the new bill?

Mr. QUINN. So far as, and to the extent that they pay the present munitions tax. Many of these companies are to-day doing a very large volume of other business. Of course, they are quite willing to pay the 8 per cent excess profit tax on their other business.

The CHAIRMAN. On the branch of the business that consists of munitions, upon which they now pay 12½ per cent of their net profits, you wish them to be exempted from the 8 per cent on the excess profits?

Mr. QUINN. That is the whole point, as a matter of justice and fairness.

Senator JAMES. In the working of this profit, of course, I imagine you assumed the value of the property at this time?

Mr. QUINN. Yes, Senator, I do.

Senator THOMAS. No. I understood you to assume that you had actually invested $10,000,000?

Mr. QUINN. Yes. But Senator James means generally.

Senator JAMES. Yes. Of course, I imagine the stock of many of these companies has gone up to a considerable extent?

Mr. QUINN. Yes; in some cases it has, but by no means in all.

Senator JAMES. And of course to that extent the men who have been interested in them have profited, and in reckoning that profit you take the greater value to which it has gone by reason of the war?

Mr. QUINN. No, Senator. I think I can answer that very clearly.

The CHAIRMAN. They propose to allow 8 per cent on their actual investment.

Mr. QUINN. Under the stock tax law—it is a little technical, but I happen to be able to answer that, because I have been passing upon reports of various companies—under the capital stock tax law imposing the 50-cent tax upon a thousand, there are three methods of arriving at that value. Methods known in the Treasury forms as 1, 2, and 3.

Senator THOMAS. I have been told that the Treasury Department has up to this time been unable to definitely formulate a plan of procedure under our last law.

Mr. QUINN. They have, Senator, in some recent rulings, which construe the law. There are three ways of arriving at that value under that law.

The CHAIRMAN. The 50 cents a thousand is based upon the present market value of the plant. This 8 per cent is on your investment, an entirely different proposition, and based upon an entirely different estimate. One is present market value; the other is actual investment.

Mr. QUINN. Yes, Senator, that is the difference.

The CHAIRMAN. You are allowed to pay 8 per cent on your actual investment, then you pay this excess profit tax?

Mr. QUINN. That is what the House bill proposes.

Senator SMITH. While the 50 cents a thousand is on actual market value?

Mr. QUINN. Yes. My point is this, under the tax that Senator Smith has just been referring to, they take into consideration the market value of the stock. Under the present House bill they do not do anything of the kind. It will not be permissible, and they go back to the method No. 3, where there is no stock quotation and no sales of stock, and that is, take the actual money invested.

The CHAIRMAN. It is better for you.

Mr. QUINN. It is fairer to the Government.

Senator JAMES. You take someone who holds this stock, for instance, based on the real money invested, and it has probably gone

up to ten times as much as it was, in many instances, before the war commenced.

Senator THOMAS. It seems to me there are only two certain bases or reliable methods or procedure. One is its value based on the capitalization, the other the actual capital invested. You take market value, and you are at once in a sea of speculation and uncertainty.

Mr. QUINN. The bill that Senator Smith has in mind, levying the capital stock tax, does take market value, sales for 12 months, and takes the average of those sales. But if there have been no sales and there is no such average they go back to the method that is substantially what is in the House bill now.

Senator JAMES. The purpose of my inquiry was not wholly on the question of the tax, but the question that you raised before, that of allowing you for the depreciation of the property. I thought it would be well to carry in mind that that stock had gone up to such a great extent and was now worth more, and these men had profited to that extent, and they profited by reason of this unnatural condition, this world war, and while they say we are taxing them they ought also to take into consideration how many times greater it has made their holdings by reason of the very condition that forced the tax.

Mr. QUINN. Senator, without pretending to be a financier, I think there are two answers to that. That profit is measured by the dividends the companies may have paid.

Senator THOMAS. No; not if the stock is on the market.

Mr. QUINN. A man who buys and sells can take his profit or his loss and goes away. I am talking of actual conditions of business. I think it is a fair answer to the Senator that, after all, irrespective of what the market may be for that stock trying to control it or corner it, or what not, it is what those companies pay in dividends and what they earn and what they have is back of that stock. That is the essential thing. I must look at it from the point of view of the president and the treasurer and the managers of those companies—what they earn and what they can pay—and that comes back to this question of the tax. I admit that a man may have owned a certain number of the shares of a company that were selling at $50 or $75 or $100 a share, and they may have gone up three or four or five hundred dollars. That has nothing to do with the question of taxation. It is fair to take into consideration profits, and there are some munitions concerns that make very high profits, some that make very moderate profits, and some that make no profits.

The CHAIRMAN. If that speculative value of stock is brought to the benefit of the holder, then he gives it up and we are taxing some other holder.

Mr. BRIGHT. You are taxing him for the profit he has made.

Mr. JACKSON. Should you not differentiate there, Senator James, between the corporation itself and the individual? The individual, the man who has made the money on this enormous rise in values of the stock, pays the tax as an individual when he pays his income tax.

Senator JAMES. I do not think the corporation would hold on to the property if it did not believe it was worth its market value. I think it would sell it. I do not know of any disinterested parties of that sort in this country.

Senator THOMAS. It is unfortunate that every business now that amounts to anything is capitalized and then made the plaything of gamblers, and that interferes with all our calculations when we come to levying taxes.

Mr. QUINN. I think it is fair to look at it from the point of view of the president of the company and not from the point of view of the individual stockholder. As Mr. Jackson said, you have to differentiate between the company itself and the stockholders and their sales. The market price of the stock does not always represent the actual worth of the company.

Senator JAMES. You would not want the Government to allow you an exemption on property that depreciated by reason of a failure of continuance of conditions that had made that boom in value?

Mr. QUINN. No; and we are not entitled to it under this bill. I believe that the day of big profits has passed in this country, for the time being at least.

Senator THOMAS. Not if we should become involved with Germany. War breeds big profits.

Mr. QUINN. It breeds, I believe, good wages to workingmen.

Senator THOMAS. It does.

Mr. QUINN. But it is not the experience of England and France that it means big profits to people of wealth or large corporations.

Senator THOMAS. It was our experience in the Civil War, when Mr. Seward assured the business men of the country that there was no customer like a great nation engaged in an offensive war. You will have abnormal profits, if we are unfortunate enough to become actively involved in the present world-wide conflict.

Mr. QUINN. I think we will, but we will also have abnormal taxes.

Senator THOMAS. I think you will. You will have them anyhow. This is only a starter.

The CHAIRMAN. If one country is involved in war probably all the profits anybody makes anywhere and all the income anybody makes will be needed by the Government. We will all just work for the Government, and nobody will work for himself, if we get into the war.

Mr. QUINN. The amendment I have suggested, in answer to Senator Smith, is the only amendment we ask. We are not attacking the excess profit tax generally.

Senator THOMAS. There are plenty of manufacturers who are.

Mr. QUINN. I imagine there are. But we are not attacking the proposed law generally. I believe that has come to stay until our revenue laws are generally revised and until the close of the war at least. I do not think that it is the best method of taxation. But with the short time left at this session of Congress, and with the problem before the committees of the House and Senate to provide revenues, I would not argue to this committee in favor of revising the entire scheme. It would be useless; a mere waste of time on our part, and a waste of the time of the committee. I think the only alternative would be a bond issue. I think that would be the wiser course at this time.

In the revenue bill of 1916, as I said a moment ago, by section 407, corporations, joint-stock companies, and associations actually paying the munitions tax imposed by section 301 of that bill were entitled to a credit of 50 cents per $1,000 on the fair value of the capital stock, to the extent of the 12½ per cent munition tax actually paid. That, of

course, is not binding upon this committee. Committees can reverse themselves, the same as courts can.

Senator THOMAS. And do.

Mr. QUINN. And do. But that was a recognition by Congress of the principle that to the extent that they pay the munition tax, they are exempted from the 50 cents per $1,000 corporation tax. That is the same principle that we ask to be applied here.

Senator JAMES. Do you believe it would be a just proportion between what I might call ordinary business, the business of peace, and the business made great by war, to tax one 8 per cent and the other 12½ per cent? Is that a just proportion, in your mind?

Mr. QUINN. If I understand you, Senator, that is just our contention.

I might summarize my objections to this bill in one word—"injustice." There is no reason why the munition business should be put on the same basis as the liquor business, for example, as a thing that is hurtful in itself, as a thing on which the police power of government should be exercised. Instead of being overtaxed, I think that the munition business should be encouraged. But I will come to that in a moment.

Senator THOMAS. Is not this true, that the general conditions engendered by the war have powerfully promoted pursuits which are not directly classifiable as munitions products?

Mr. QUINN. They have, indeed, such as the automobile and rubber business, and trucks——

Senator THOMAS. For example, I understand the farmers are very much embarrassed because they can not secure the implements of agriculture so necessary, due to the fact that the best grades of steel are exhausted by the demands in other directions, in consequence of which there is a great advance in the prices of agricultural implements, and of course that is only one of a thousand illustrations that might be used.

Mr. QUINN. Gentlemen, I submit that there is no reason in justice and equity why the manufacturers of munitions should be singled out from all other kinds and varieties of corporations of our vast country and be subjected to this special, and what I can not help thinking is, an onerous and an unfair tax. If they are included in the excess profit tax, if the amendment I advocate is not added to the bill, then they are subjected to a burden that no other corporation in the country is subjected to.

The CHAIRMAN. Your argument is really this, that the munitions manufacturers now contribute 12½ per cent, and for that reason they should be exempted from this 8 per cent tax?

Mr. QUINN. Precisely, Senator.

Mr. JACKSON. That is all there is to it.

Senator THOMAS. You have done your bit.

Mr. QUINN. I want to broaden my argument just a little, if I may. I think the evidence of the last few days ought to lead to a broader view from the standpoint of a wise public policy in considering the question whether the munitions business should be specially taxed.

The CHAIRMAN. We have already specially taxed you, and we are not considering repealing that at all. What we are considering now is whether you should be exempted from this 8 per cent excess profit tax because we have specially taxed you.

Mr. QUINN. That is it. Under the present law foreign Governments, to the extent that contracts with them were made after the revenue act of 1916 became a law, may pay part of that tax. It is very unfair to the companies that made contracts before that law, because that was sprung in the summer of 1916. I do not think that it would be good policy for us to put an additional burden upon munition manufacturers now to the extent that they do business abroad. That is one argument of public policy. It may become a very cogent argument indeed. I need not enlarge upon that here.

The CHAIRMAN. Your thought is that if we go into the fight, we do not want to take anything from our friends?

Mr. QUINN. That is it, Senator.

Senator THOMAS. We may take your entire plants away from you before we get through.

Mr. QUINN. That is the point. We may regret this tax very much if two months from now we should unhappily be in war with Germany.

The CHAIRMAN. We will have to tax you heavily then.

Senator THOMAS. What we would take away from Great Britain we would have ourselves.

Mr. QUINN. But the great change in our situation is likely to be that from now on the Government of the United States is likely to be the largest purchaser of munitions. I think that ought to lead to a change in the policy of the Government toward munition manufacturers.

As I said at the outset, to a great many concerns this was a new business outside of the few companies whose specialty was this. It took courage to go into this business; it took initiative.

Senator THOMAS. Do you know of anybody who hesitated to go into it if he thought he could get a good contract?

Mr. QUINN. I know a good many who hesitated, and I know some who regret that they went into it.

Senator THOMAS. Of course. I am not talking about vain regrets. I am talking about promises.

Mr. QUINN. They risked their millions. They had to train their men; they had to get their experts; they were compelled to figure and estimate upon a new kind of business. There were heavy penalties imposed. There were inspections and rejections, and so on, and it really was a risky business. There were often large profits, but always very large risks. They are not complaining of that. But the foreign business has largely fallen off. A great deal of it will be ended in the months of March and April of this year, 1917. One of two things will happen. Either those new concerns that now do the foreign business will go out of the munition business entirely, will scrap their plants, or change them into industrial plants pure and simple; or else they will stay in the munition business. I think it is to the interest of our Government that they stay in the munition business.

Senator THOMAS. All of them?

Mr. QUINN. Yes, Senator; all of them.

The CHAIRMAN. While the war is going on, and while we may be called on?

Mr. QUINN. No. I will come to that. I think it is to the vital interest of this country that they stay in the munition business.

The CHAIRMAN. Permanently?

Mr. QUINN. Yes, sir.

The CHAIRMAN. All of them?

Mr. QUINN. Yes, sir.

Senator THOMAS. That would be to the despair of civilization.

Mr. QUINN. I think it is an economic principle that the more people, the more concerns, you have bidding in a certain business the more competition you have and the more favorable prices the Government will get.

Senator THOMAS. And the absolute certainty of combination.

Mr. QUINN. No, Senator. These munition people are in your power. You can prevent combination.

Senator THOMAS. The Government would compel them to combine?

Mr. QUINN. No; the Government can compel them to shut down.

Senator THOMAS. The Government can make them, provided the Government is in a position to make them.

Mr. QUINN. Do you know what the Government has done with the powder people? It has compelled them to supply powder at 53 cents a pound by law, at the time when they were getting a dollar a pound abroad.

Senator THOMAS. But there is no competition in powder making to speak of.

Mr. QUINN. But the Government has fixed prices here by law.

Mr. BOSWORTH. I take exception to that statement, Senator Thomas, because there is competition.

Senator THOMAS. I know there is ostensible competition.

Mr. QUINN. There is actual competition.

Senator THOMAS. The only difference between the Hercules and the Du Pont people is a separate organization.

Mr. QUINN. That is probably true. But I want to say that the cry that the munition people have the Government in their power is quite contrary to the fact. The Government has absolutely the power over the munition people. There is no question about that.

It may seem a little startling at first to argue, as I have done, that it is to the interest of this Government, from the standpoint of broad public policy, not to discourage munition manufacturers generally. But to show the enormous extent to which the manufacture of munitions has to be carried to meet the requirements of modern warfare, I wish to call the attention of the committee to the fact that, according to my information, at the outbreak of the present war there were in the whole of Great Britain but 172 firms or corporations engaged in whole or in part in the manufacture of munitions; whereas on the 1st of July, 1916, there were in Great Britain alone more than 4,000 of such manufacturers.

Senator THOMAS. Of course, that is due to the tremendous crisis that is confronting the empire.

Mr. QUINN. I know that. Again taking production the 1st of June, 1915, at 100 per cent, on the 1st of July, 1916, that production had risen from 500 to 9,000 per cent in the manufacture of many forms of munitions; and on the 25th of November, 1916, it had risen from 500 to 2,000 per cent.

Senator THOMAS. If your logic is good, after the war ends that condition should continue.

Mr. QUINN. I will break right in here and deal with that point. I do not want to anticipate Mr. Bright's argument, but those concerns

over there will have to have a market for their products. They are not going out of business entirely.

Senator THOMAS. How will they get it if we do not continue the war, or have another one somewhere? That would lead to the conclusion that wars were made for manufacturers, and not manufacturers for war.

Mr. QUINN. I do not believe this war is to be followed by general disarmament. I do not want to be a prophet, but I believe that we are going to be made into a more or less military people. This may be a shock to some of the members of this committee. I believe that as profound a change may come over this country in the next few months as came over our ideas after the Spanish War. The Spanish War made us a world people. It took us out into the world, and I think the events that are before us are likely as profoundly to change our habits of thought and our lives.

Senator THOMAS. I think our dream of universal peace will be badly shattered after the war, and I think disturbances are going to occur. I do not believe the people engaged in the war will ever attempt to pay their enormous fixed obligations. That is where the trouble is coming from over there, and of course it will be contagious.

Mr. QUINN. There may be something in that.

But, to resume my argument, in many classes of manufacture in England the entire product of one year, that is, the annual product, as of the first of June, 1915, is now made in Great Britain by the thousands of factories engaged in the work in one day. The entire product formerly for a year is now made in one day, showing how the English had to readjust themselves to the conditions of modern warfare.

Senator THOMAS. The English Government takes 50 per cent of the profit, does it not?

Mr. QUINN. Yes, Senator; 60 per cent, I am told; but not from the munition factories alone—of all business. They do not single them out.

Senator THOMAS. That is precisely what we are proposing to do here.

The CHAIRMAN. You are referring to the 8 per cent on everything except munitions?

Mr. QUINN. Yes.

Continuing, however, with my illustration about England, and I am very nearly through, in many other classes the entire year's product, on the 1st of June, 1915, is now made in eight days. This will give the committee a good idea of the requirements of modern warfare.

Senator THOMAS. Does not that also give us an idea of what you gentlemen will be doing right here in the event of hostilities with Germany?

Mr. QUINN. Yes, we will. But we will be doing it for Uncle Sam, and he will get his 12½ per cent of all the net profits.

The CHAIRMAN. We will want half the profits of everything if we go to war with Germany.

Mr. QUINN. In so far as you make governmental profit sharing uniform, and do not single out one business rather than another, these manufacturers who are here objecting can not specially then complain.

Senator THOMAS. That sounds fair.

Mr. QUINN. Now I desire to refer to what I think is the sound public policy in regard to this tax.

This war is likely to leave the world different from what is was for evermore. It has taught and will continue to teach many lessons, as it has brought many tragedies. Its tragedies have not merely been personal. They have been national and continental. Perhaps the greatest of these tragedies was due to the lack of vision and foresight on the part of those in control of the allied governments. They failed to recognize, what they have now learned at bitter cost, that the problems of this war were largely engineering problems. I embrace transportation in the definition of engineering problems. Some one defined genius as the infinite capacity for taking pains. But genius can no more be defined than art can be defined or than life can be defined. All we can do is to note certain aspects of its ever varying manifestation. But though we can not define genius, I think we may say that one of its attributes is vision, the trained, imaginative grasp of all the factors involved in a situation or likely to be involved. To put it more bluntly, the ability to get scared in time often amounts nearly to genius. When one looks out over the world and sees how in individual life and in business life and in the affairs of the State and of the Nation lack of vision and of foresight often leads to all but irreparable disaster, one is tempted to advocate that in all our schools and colleges and military and naval academies there should be a course of lectures on "The Idea of the Expert." A very profitable volume could be written on that theme. In a few words, that means bringing a trained intelligence to the consideration of new problems, together with imagination and the faculty of vision. Or, as I have said, "to be able to get scared in time." That is the difference between hindsight and foresight, between safety and disaster.

Perhaps the greatest tragedy of this great war was the lack of ability on the part of those in high places to grasp the great, broad, and fundamental factors of the war. They failed to realize that the essence of modern warfare is engineering and transportation, more than men. The civilians in council and cabinet might be pardoned for not bringing a trained, technical intelligence to the problems that confronted them; but even the experts, even those highest in the Army and Navy, at the beginning of the war at least failed fully to comprehend the magnitude of the problem. I hope that Congress and the executive departments of our Government, as well as the officials of our Army and Navy, will profit by the bitter experience of the allied countries in this respect. If that lesson shall be taken to heart, if the problems now confronting our country and demanding prompt solution shall be considered in the light of the tragic experiences of the allied countries in the last two years, and with an opened mind and an imaginative grasp of the fundamental conditions of real preparedness, this country may be spared a tragedy which would shock its people more profoundly than they have been shocked since we became a nation.

The tragedy of the allies, France apart, was not that they lacked courage, for they did not; not that they were without means, for they had money and securities; but they were without trained scientific knowledge, without an imaginative grasp of the problems suddenly thrust upon them, without adequate knowledge of the engineering and transportation problems involved; in short, without skill and,

apparently, apart from courage and money, without anything real except tradition and hidebound precedent. That is the real tragedy of this great war. As one of the men now high in power has said: "Too late; too late." The lesson we should draw from it is that while we may have enough nerve or courage or luck to muddle through a little war like the Spanish-American War, or the invasion of a country like Mexico, nothing but tragedy is sure to confront us if we do not at once profit by the colossal mistakes of the allied countries in the early months of the war.

Peace and the ideals of peace are glorious things. But facts are facts. All of the demonstrations of the pacifists, the moralists, the sentimentalists, the economists, the jurists, and legislators that war was wicked and foolish and soon to disappear, or impossible, have been falsified by fact. And so to-day we should be wary of the theorists, the economists, the moralists, the sentimentalists, and the pacifists whose arguments tend to induce us still to live in the fool's paradise of perpetual peace and security. If we refuse to face facts, if we rely only upon ideals of abstract justice and honor, tragedy is certain to overwhelm us.

Ideals and ideality are fine things, appeals to patriotism and for humanity are good things, but without hard-headed experience and insight into the facts and problems of the nation, the crisis before us may make our ideals and our appeals and our patriotism vain things.

On the subject of the vital relation of munitions to modern warfare I earnestly desire to call the attention of the committee to a letter by the well-known English publicist, Mr. Sydney Brooks. This letter, dated January 30, 1917, appeared in the New York Tribune of Monday of this week, February 5. Mr. Brooks is doubtless known, if not personally at least by reputation, to all of the members of the committee as a man of wide experience in public and international affairs, as a writer of authority, and as a gentleman of high standing in the councils and affairs of his own country, England. While I do not agree with all of the expressions contained in his letter, I will take the liberty of quoting the parts of it which I think have a direct and strong bearing upon the problems that now confront our Government and people. The testimony of Mr. Brooks is not that of a casual observer. He speaks with full knowledge and authority, and I hope his warning, based upon the bitter and tragic experience of his own country, will be taken to heart by every member of the committee and by Congress and by the officials in whose hands our welfare now lies. Mr. Brooks said [reading]:

Almost all the signs that history has taught one to recognize as the forerunners of a great national crisis are present to-day in the United States and in her relations with the outer world. Next to a victory for the allies, an Englishman like myself, who has known the United States for 20 years, can have no dearer wish than that Americans may face this crisis when it comes fully prepared.

But great numbers of them still do not seem to have learned one of the most patent lessons of this war. They still persist in thinking of armies in terms of men. The great war should have taught them to think of armies in terms of munitions. The men you can always get. But it is a much lengthier and an infinitely more difficult business to arm and equip them.

Victory nowadays is not to the big battalions. It is to the big battalions backed by the big guns, and you will find when your turn comes, as we found in England, that unless you look ahead the men will be trained and ready long before there are weapons to put in their hands. A few months ago, when I was at the front, a general crystallized the whole problem: "When I am ordered," he said, "to undertake an attack I don't ask how many men are going to be given me, but how many guns."

Mr. QUINN. If I may digress: I was told by one of the prominent Frenchmen over here on a commission that when Gen. Foch was asked to make the advance on the Somme last summer he said, "How many big guns can you let me have?" They said, so many, and he replied, "Then I can and will go so far," and that is what he did.

Senator SMITH. And plenty of ammunition to fire from those guns.

Mr. QUINN. Yes. And he stated almost to the mile the length and the depth to which he could go, and he went practically where he said he would go. It is really a question of big guns, which corroborates Mr. Brooks. [Continuing reading:]

To resume with Mr. Brooks' letter: Guns, shells, material—these are the foundation of all real preparedness. Your first line of defense in the United States is not your millions of men. It is your plants and factories and steel works, your chemists and engineers and metallurgists, your lathes and tools and machinery, your manufacturing industries and the men they have trained, the organizations they have built up and the experience they have amassed. Take away firms like Bethlehem and Du Ponts and the Midvale Steel Co. and the Winchester Arms Co. and Remington's, and for all military purposes you would be infinitely worse off even though you doubled your population. Halve your population and double the capacity of these and similar firms, and for all military purposes your strength would be immeasurably increased, so curiously have modern conditions of warfare shifted the relative importance of men and material.

With this lesson branded on his brain by a somewhat bitter experience, it almost appalls an Englishman who to-day revisits the United States to find that the relations between the American Government and the leading American munition makers leave apparently so much to be desired. We in England have learned in the costliest of all schools, at the price of thousands of lives lost and months of precious time wasted, the vital importance of encouraging during the years of peace as many private manufacturers as possible to engage in the production of war material. * * *

There are certain broad principles which the war has shown that a nation can neglect only at its peril.

First, it has shown the folly of depending upon other and possibly hostile countries for essential items in the national equipment for war. The habit of placing orders abroad is the most ruinous form of economy that any government can adopt. If the domestic manufacturers are unable to produce what is required and there is no question of immediate urgency the proper and in the end infinitely the cheapest course is for the naval and military authorities to cooperate with the private firms in solving the problem. * * *

Second, the war has shown the absurdity of regarding the question of industrial preparedness from the standpoint of cost. * * *

If they (the English companies) have earned large and liberal profits on their Government contracts, what of it? Every Englishman is well content that they should, because every Englishman knows that by merely remaining in existence and in a condition to fill the War Office and Admiralty orders they are rendering the nation a supreme service. This war has taught us that there is no imaginable profit which it would not have been well worth our while to pay over to the private manufacturers of war material simply to keep them in being, and that no saving to the Treasury could ever have compensated us for having driven even one of them out of business.

As a matter of fact, we have always found the situation in England entirely manageable. People talk of the Government being at the mercy of the manufacturers; but the manufacturers are equally at the mercy of the Government It is by far their largest, and in some cases, it is virtually their only customer. It is in just as good a position to dictate the terms as they are. It depends on them, but not a bit more than they depend on it. With the merest modicum of honesty and business intelligence and diplomacy their relations can always be made harmonious and helpful. * * *

Third. The war has shown that no government plants, however huge, can meet the requirements of modern war. Victory nowadays goes to the country that is able to turn to immediate account the greatest number of firms that know the armament business from top to bottom and that have been encouraged by a wise public policy to keep themselves in a state of instant efficiency and responsiveness. Government plants are useful and necessary as supplements and regulators. But the main reliance must always be placed on the private manufacturer.

There is much that disquiets an Englishman who, in the light of the present war, endeavors to take stock of American readiness to face such a crisis as burst upon us:

in August, 1914. But there is nothing more disquieting than the lack of unity and concord that seems to exist between the Government departments at Washington and the great industrial corporations that must always, in America as elsewhere, be the real backbone of national preparedness.

Mr. QUINN. I think, gentlemen of the committee, that this is a very impressive document.

I dealt with the point that the munition makers now in the business, aside from concerns that were in it before the war, will soon go out of business if their business is singled out and made onerous and burdensome with taxes. They ought to be encouraged. I think the principle I announced is a sound one—that the larger the number of concerns in the field, the larger the number of bidders, and the lower the bids the Government will get, and that is one reason why munition manufacturers should not be singled out from all other concerns for this additional tax.

I think that this is the time for the Government to wait. We do not know what the next few months or even days may bring forth. We are not certain what the Government attitude should be or will be toward foreign purchases. We do not know what its attitude will be toward our own Government's purchases. If we have war, we will probably have an extra session of Congress.

Senator THOMAS. We will have it long before the autumn whether we have war or not.

Mr. QUINN. At any rate, now, during the next three weeks, I earnestly submit, gentlemen of this committee, is not the time to fix this additional burden upon these munitions manufacturers. Let us wait and see what the next six months or the next year brings forth. We will then know definitely what they pay under their 12½ per cent profits tax. We will then know definitely what the Government relations to that business are and should be. We will then know definitely what our future is to be. We will then know whether we are to go on in peace or whether we are to be confronted with the dread uncertainty and expense of war. We will know all these things then. I do not think it is good statemanship, I do not think it is wise public policy now, at this acute crisis, to say "Let us put an additional tax on munition manufacturers."

I know there is a feeling here that because of the war crisis this bill should be rushed through just as it passed the House, unamended; just as it is. It is a natural feeling, I admit. But it is a hazardous thing to do. The wise thing is to wait.

As to the 8 per cent excess profits tax, I say that it should be uniform. No one in this room would then object to that. But, notwithstanding the desire on the part of this committee—and it is a proper one and a natural one—to report this bill out early and to get this tax, notwithstanding the fact that the Government needs the revenue, I submit that now is not the time, that it is not wise now and in this crisis, to put that additional tax upon munition manufacturers.

This is no time for experiments in taxation. If the House bill be enacted into law and the double burden of taxation be placed upon munitions manufacturers, we may soon regret it. That regret may be a double one. First, we may regret that a double burden has been placed upon the foreign purchasers of munitions. Secondly, we may regret that an excessive burden has been put upon the Government of the United States as a purchaser of munitions itself

It will, I submit, be the part of wisdom, and enlightened statesmanship for the time being at least, to exclude munitions manufacturers from the excess profits tax, leaving upon them the 12½ per cent net profit tax that they are now required by law to pay; and to watch and wait and see what the course of the next few months will bring forth.

This wise course will, I earnestly submit, be as wise and as prudent as it will be just and equitable, and it will involve no danger to the Government finances.

If it be said that munitions manufacturers abroad pay a larger excess profits tax than that proposed to be imposed upon them by this bill, the answer is complete and unanswerable: That answer is that the excess profits tax imposed in England applies to all corporations and not to munitions manufacturers alone. That is why that English excess profits tax is fair, though very high. For the same reason the excess profits tax in the proposed bill upon munitions manufacturers, added to the 12½ per cent net profits tax now borne by them, is grossly unfair.

These manufacturers feel that they are now bearing more than their just burden of taxation. They feel that it is unjust and inequitable to single them out from all the other business enterprises of the country and to place this double burden upon them. Just and equitable treatment is what they ask. And in fairness and justice that is what they should receive.

Senator THOMAS. I have an amendment before the committee that would relieve you people of that tax very largely, and yet there is not a man in this room who would support it.

Mr. QUINN. I heard it offered last Saturday.

Senator SMITH. I am opposed to it. I do not think noninterest-bearing notes under any circumstances should be used as currency.

Senator THOMAS. I am offering a remedy that you reject.

Mr. QUINN. I heard it offered last Saturday, and I do not believe that $500,000,000 of noninterest-bearing notes redeemable on or about 1935 would dangerously impair our gold reserve. If you doubled that, you might get to the point where it would make our gold reserve dangerous.

Senator THOMAS. I call attention to the fact that I am doing all I can to relieve you, and the keystone is being rejected.

Mr. QUINN. Well, gentlemen of the committee, I have finished. The committee has been very patient and very fair to me, and very generous as to time. On behalf of all those who are here I thank the committee for the open-minded and fair hearing you have given us.

Senator THOMAS. Before you take your seat, I want to ask you a question. I am in receipt of a telegram this morning from Mr. K. R. Babbitt, a member of the New York bar, formerly a member of the bar of my own State.

Mr. QUINN. I know him well.

Senator THOMAS. He wanted to be here, but he could not come. I will read it [reading]:

NEW YORK, *February 5, 1917.*

Hon. CHARLES S. THOMAS,
United States Senate, Washington, D. C.

On returning this afternoon from week's absence find notification that committee will have hearing to-morrow. Absolutely impossible me to be present—stop. The points which seem to be unjust as to taxation of profits are: First, purely holding com-

panies should be exempt or result is clearly double taxation; second, amount of capital invested should be determined by present fair valuation of properties, not what they originally cost, et cetera. Provision as it now stands may result in simply transferring properties to new corporations—stop. We should pay on a basis of present valuation and be permitted to deduct income on such valuation before tax would apply. It seems unnecessary and unfair to force such a position upon any company. We are all willing to bear our fair proportion of burden of taxation, but do not think basis in bill is fair.

K. R. BABBITT.

What have you to say about that?

The CHAIRMAN. Purely holding companies are not munition manufacturers?

Mr. QUINN. He means, Senator, under the general 8 per cent excess profits provision. That is not germane to this munition question, but what Judge Babbitt has in mind is generally the 8 per cent excess profits tax. I say frankly that a holding company that merely owns stocks in other companies and does no business but receive and declare dividends to its stockholders will be hard hit by this bill. It is double taxation pure and simple.

The CHAIRMAN. Purely holding companies are organized on the theory that such holdings bring profits.

Mr. QUINN. Not always. Sometimes they are organized for convenience or merely for control.

The CHAIRMAN. That control brings profits.

Mr. QUINN. There are various motives for organizing holding companies. I can think now of holding companies that it would be very unfair to tax that way.

Senator THOMAS. I do not think any railroad companies will be affected very materially by this law.

Mr. QUINN. They will not come within the excess, you mean?

Senator THOMAS. Unless we are able to fix a tax upon their actual capital invested.

Mr. QUINN. I can imagine cases where it would be a real hardship to tax holding companies, and yet it is very difficult to draw the line and to separate some holding companies, where it would be a real hardship from some where it would not.

Senator THOMAS. That feature of the law did not occur to me until I got that telegram.

Mr. QUINN. Just offhand, under the old corporation tax law holding companies were excluded, but I believe that under a recent ruling of the 1916 revenue law, holding companies are required to pay the tax. That was the ruling of the department made only a very few days ago.

Just one word more: That is that I must say this subcommittee has considered our case with an open mind. I ask that in reporting to the full committee, if you agree with me that the exclusion we ask is not taking away too largely from that forty-one millions margin of safety, now is not the time to leap in the dark. As far as this munitions business is concerned, you have it all in your own hands. The skies may clear or we may be plunged into war. But now is not the time, above all other times, to put an additional burden upon the munitions manufacturers.

I have alluded to the excess profits tax in England, but they do not single out munitions manufacturers. All companies pay it. England is fighting for her very existence, for her very life, and they pay in high income taxes, they pay in high estate taxes, and they pay

in excess profits corporation taxes. But they do not single out munitions. The tax is high for all.

The CHAIRMAN. We tried to find a way to extend it beyond the munitions a year ago, but we found we were running into conflict with the tax on exports.

Mr. QUINN. I remember that Senator Thomas, in the course of the hearing last summer, when I pointed out that, so far as the Government was a purchaser the Government was paying the tax, and you were no better off—what you got on the one hand you paid out on the other—said that, so far as the munitions were supplied to the Government of the United States, the profits from those munitions should not be taxed, but if you had done that you would probably have made the law unconstitutional.

Senator THOMAS. There was a difference of opinion with regard to the constitutionality of such a law. Some of us thought that it was perfectly feasible. Others thought that it was not. But it was not reported.

I want to say, before you take your seat, that what has impressed me more than anything else since I have been connected with this Finance Committee is the fact that the taxpayers of this country never appear here except when we are about to levy a tax. The tax eaters of the country are organized here at all times, and every one of them that designs a raid upon the Treasury is backed with organizations, with local influence, and everything else. We are the most profligate country in the world, in my judgment, in times of peace, and if the taxpayers of this country would only be as insistent that the money which they are compelled to pay is properly and economically appropriated we would not have to raise these enormous amounts of money. But they do not do it. I sent a letter to that effect to the National Chamber of Commerce which met here the other day, and as far as I have been able to watch their proceedings they have not even noticed it. Everybody who wants rivers and harbors appropriations, flood control, public buildings, pensions, and everything of that kind appears here, but you men never come until the time arrives to make you pay for what those people get from the Treasury. In one respect I think it serves you right.

Mr. QUINN. I think that is true. But, Senator, you know after all the average American business man is a modest man, you can say about them what you like. They are busy and modest as a rule.

Senator THOMAS. I would prefer to say he was a man of intermittent modesty.

Mr. QUINN. Many of them are. I am making this speech to-day which I have inflicted upon the members of this subcommittee because these men, who know infinitely more about the business than I do, are too modest to get up here and say what they know.

Senator THOMAS. A few of us have tried to effect some economies here, and the only thing we have succeeded in doing is to incur enmities among our associates.

Mr. QUINN. We love you for the enemies you have made.

Senator THOMAS. And, at the same time, incur the condemnation of our own constituents. In a letter some time ago from one of my constituents he wanted to know how I could expect to get anything from Colorado when I was fighting everything in it.

Mr. QUINN. That is not the report I get from Colorado.

Mr. Chapin wishes to say a word, as does also Mr. Bright.

I am very grateful to the committee for the courteous hearing you have given me.

The CHAIRMAN. Mr. Chapin, we will hear you now, and then Mr. Bright.

STATEMENT OF MR. FREDERICK E. CHAPIN, REPRESENTING THE WASHINGTON STEEL & ORDNANCE CO.

Mr. CHAPIN. Gentlemen, I appear on behalf of the Washington Steel & Ordnance Co., which is located here in the District of Columbia and I am going to say one or two things a little away from what Mr. Quinn has presented.

This company of ours practically had its organization in Pittsburgh. It came to Washington some 10 years ago. It is strictly a projectile factory. It has manufactured nothing else but projectiles, and the Government had been our only customer up to some time in 1914, the latter part of 1914. Then we became interested in the foreign contracts. Up to that time we had manufactured the armor-piercing shell, and met with great success. But when these orders came from abroad we took up other features of manufacturing. Those contracts are nearly concluded. No new ones have been taken over. We will probably finish these existing contracts within a very short time. In the meantime, we have taken over contracts from the Navy and from the War Departments. We want to take over more. We are quite ready and willing to do so. We have been the lowest bidder on the various proposals issued by the Navy and the War Departments, and that is the reason we have gotten our contracts.

With the conclusion of our foreign business our principal customer, and our only customer, will be the United States Government. If this tax of 12½ per cent continues, that is a tax that naturally goes, you might say, into the price of the projectile furnished the United States Government. We do not object to paying 8 per cent on our net profits. We do not object to that at all. But we do think that the 12½ per cent tax should be remitted, or that feature of the bill of 1916 should be repealed. That is about all I have to say. Of course, it is within the wisdom of the committee.

The CHAIRMAN. What you want, then, is not to be spared this 8 per cent excess profits, but to be relieved of the old 12½ per cent tax?

Mr. CHAPIN. We are quite ready and willing, as we announced last summer when we appeared before the committee, to pay anything of that kind in the wisdom of Congress, and we made no opposition to the payment of the tax. We made no opposition to the payment of the 10 per cent or the 12½ per cent. But when you add 12½ per cent, and in addition to that the 8 per cent, we think we are being discriminated against at a time when really the Government will be our only customer, and will be the sufferer. That is about all I have to say.

Mr. QUINN. Mr. Chapin and I talked about that, and the way that is translated into dollars is this: In my case, $250,000 is the amount of the 12½ per cent on the net profit of $2,000,000, and $72,182 the tax he wants to pay. So he is asking much more than I am asking.

The CHAIRMAN. That is what I meant.

Mr. QUINN. I am asking only a small thing compared to that.

Senator THOMAS. That gives us a margin of compromise.

Senator JAMES. He is probably following that statement in the Bible, "Ask much that your joy may be full."

Mr. CHAPIN. No, that is not the idea entirely. This 12½ per cent will go into the projectiles we manufacture for the Government. I will very frankly state this, however, that in our bids we made no reference to excluding that tax. Some of our competitors excluded the tax from the contract price. We did not do that, and still we were the lowest bidders. We are particularly well qualified to manufacture projectiles. That is our business, and we are ready and willing to do that and offer our works to the Government for that purpose.

The CHAIRMAN. Now you can go ahead, Mr. Bright.

STATEMENT OF MR. FRANK S. BRIGHT, OF WASHINGTON, D. C., REPRESENTING THE WINCHESTER REPEATING ARMS CO.

Mr. BRIGHT. I represent the Winchester Repeating Arms Co., and I hold in my hand a telegram from the president of the Western Cartridge Co., on the same lines that Mr. Quinn has been talking on. I would like to offer that.

(The telegram referred to is here printed in full, as follows:)

Am advised that United States Senate Finance Committee has to-morrow (to-day) a hearing of the munition manufacturers reference to proposed excess profits tax. This matter reached us too late to have representative in Washington. Do you expect to be present? If so, respectfully suggest we insist our business be placed in same class as all other manufacturers. If suggested tax is agreed to the former Federal munition tax should be eliminated. Would much prefer proposed measure to present law. Have written chairman Finance Committee along above lines suggesting if further conference is desired to set the date for hearing all munition manufacturers. Please wire if you expect to be in Washington to-morrow, and if so can we be of any assistance? Wire us.

Mr. BRIGHT. I have lived in Washington 38 years, and 7 of that I spent in the service of the Senate, when I was a young man, and that happened to be during the days of the Spanish War. I remember hearing of the sinking of the *Maine*, and I remember all the things that went on. I have never known, in those 38 years, any such wave of patriotism as this country has seen in the last three or four days, and in the last 48 hours I have been spending most of my time with munition makers and representatives of munition makers, and I think you would be surprised, perhaps, at the intense patriotism that these men have evinced. I was at the Navy Department yesterday, and at the War Department, with one of my clients, a representative of the Winchester Co., and there were quite a number of representatives of munition manufacturers there, such as these men here. They will not have to be coerced, if we come to war, into manufacturing without substantial profits. They are ready right now. I have never been quite as much gratified by anything as by the spirit of the munition manufacturers toward their own Government.

Perhaps what I am about to suggest to you is a matter of supererogation, but I wanted to call your attention to a provision in the act of the 8th of September. My many years of observation have told me that in minor matters of this kind about the only way to have them properly cared for is to find the vehicle that is going through Congress and get a place for them on that bill.

Senator THOMAS. We call it the omnibus bill.

Mr. BRIGHT. I have seen a good deal of the omnibus claims bill, but we have not seen much of it in the last few years, and if there is an omnibus coming I want to get on.

A matter that peculiarly interests my own clients is the second paragraph of that bill. Section 301 of Title III of the act of the 8th of September, 1916, reads as follows [reading]:

This section shall cease to be of effect at the end of one year after the termination of the present European war, which shall be evidenced by the proclamation of the President of the United States declaring such war to have ended.

I have given some attention to that, and I can not find that the President of the United States has ever proclaimed the end of a European war. The courts of the United States took something like 27 years to determine when the Civil War ended. They finally settled on the 13th of April.

Senator THOMAS. Do you think that under that the President would have power?

Mr. BRIGHT. The President would have power, but there is nothing that would require him to do it.

The CHAIRMAN. Of course he would do it.

Mr. BRIGHT. I want to suggest, instead of an indefinite thing of that kind, a definite thing, and I would suggest that the section be amended to read [reading]:

This section shall cease to be of effect on the 1st day of January, 1918.

I know that will surprise you. I am suggesting that for this reason: The tax is not payable until June, 1918, for the year 1917. You will be back here on the first Monday in December, 1917, and this whole thing will be in your hands.

Senator THOMAS. That implies that we are going to leave.

The CHAIRMAN. If it is important to pass such legislation, we can do it then. It is always easier to repeal a piece of legislation than it is to enact a new piece of legislation.

Mr. BRIGHT. Senator, you and I disagree on that point. I am getting ready to take the vehicle that it was said a few moments ago is going through Congress now. The chances are very strong that if we do not get into the war there will be no such vehicle.

The CHAIRMAN. Instead of that, we might provide that with the close of the war the President be required to issue the proclamation, if you do not think he is required to do it. We can provide that as soon as the war is closed he must, within 30 days, issue his proclamation.

Mr. BRIGHT. That would be better than this.

Senator JAMES. Suppose we put in the proposition you suggest, and the war does not close in 1918. You have been around the Senate, you say, and you know how easy it is to get a bill through that body taxing people.

Senator THOMAS. Especially under our present rules.

Mr. BRIGHT. Before you are through this summer you will have a great many bills that will be vehicles for things of that kind.

Senator JAMES. You do not seriously contend that the President would fail to follow that declaration in that act, that if the war be over, when treaties had been declared and hostilities stopped, he would issue such a proclamation?

Mr. BRIGHT. I do not think he would fail to do it; but it is a very indefinite piece of legislation.

Senator JAMES. It is very definite, to my mind. It states he shall proclaim it.

Senator THOMAS. It is as definite as the conditions permit. We do not know when the war is going to end. No man knows.

The CHAIRMAN. Does it not require him to issue the proclamation?

Mr. BRIGHT. No, sir.

The CHAIRMAN. "Which proclamation shall be made within thirty days after the time has arrived."

Senator THOMAS. That is what we lawyers call certainty to a certain extent in general.

Mr. BRIGHT. That is just what it is. But I have not yet come to the burden of what I have to say.

Mr. Quinn has pointed out to you the fact that there are 4,000 munition factories in Great Britain to-day. Not all of those, of course, can continue. I sympathize with my friend from Colorado. I hope we are going to have world peace instead of world war, and that all these munition factories will not need to go on. But when the fighting ceases it will be many days, if not weeks, and probably months, before the treaties will be signed and the war is really at an end. This act contemplates that this tax shall prevail for one year after the war is ended. The war will be ended when the treaties are really signed.

Senator THOMAS. The war expense will go on and get higher and higher for years to come. Mr. Garfield demonstrated that when he was in Congress right after our rebellion as something that is almost a natural law.

Mr. BRIGHT. The munition manufacturers in the foreign countries in the time elapsing before the signing of the treaty, after the peace parleys, will be the most serious competitors of commercial manufacturers of sporting goods, rifles and ammunition, that they have ever had, and the law as it stands to-day will leave those people subject to a tax at home of 12½ per cent as the basis of their competition with the foreigner, who would turn immediately to this market as the most profitable market for his product, and the law as it stands leaves this tax imposed for an entire year after the termination of the war. That is my concern, and I am not going to press this matter at any length if it does not meet with the interest of the committee.

Senator JAMES. Do you not believe it would be just as easy, if you thought the President would fail in his duty of proclaiming the war as having ceased, for you gentlemen to get a bill through Congress to relieve you of these taxes as it would be for us to put one through, if we put the exemption of 1918 there, and the war was still going on?

Mr. BRIGHT. No, sir. I have tried many years to get bills through Congress with very little success, but of course Congress will appropriate money when the Government is at stake.

Senator JAMES. It is easier to relieve people of taxation than it is to impose it.

Mr. BRIGHT. I have been a very unsuccessful advocate of clients if I could believe that. The Government looks after itself.

I thank you gentlemen very much.

STATEMENT OF MR. JOHN QUINN—Resumed.

Senator THOMAS. I want to call your attention, and the attention of the gentlemen present, to the fact that the Senate retained in the bill last year the tax upon the transfers of shares in corporations; in other words, a tax on speculation, a tax which produces a very considerable revenue, and that was stricken out by the House. I can only speak for myself, but my own view is that we ought to reimpose that tax here. I do not know whether the House will retain it or not. But it seems to me to be one of the most equitable of all taxes. The men who are making and have been making money in prodigious quantities are the men who gamble in the exchanges, and a small transfer tax upon those transactions seems to me to be one of the most equitable and desirable of taxes.

Mr. QUINN. Just on that line, if it will not be presumptuous, I think that the present corporation tax will produce more than they estimated, and I will tell you why. In the big industrial corporations they have expert accountants, and they set aside large sums for amortization and depreciation. A small business corporation seldom does that. My opinion is that the one hundred and seventy millions will be exceeded instead of falling below.

Senator THOMAS. I hope not.

Mr. QUINN. The House's estimated forty-one million margin of safety is not going to be trenched upon if you leave out this 8 per cent excess profits tax on munitions. But if you do not, I think one of the possible taxes is to take that 50 cents a thousand and make it $1 a thousand. I pass upon a good many reports, and it is not an onerous tax. One place to get some additional tax, and an equitable place, would be to make that special stock tax $1 a thousand instead of 50 cents, if the committee thinks that the margin of safety requires that. Then there has been offered an amendment taxing oleomargarine that would, I believe, bring in added revenue of from six to ten millions dollars.

The CHAIRMAN. What did you say the amount of our loss would be if we let the munition makers out?

Mr. QUINN. I estimate about seventeen millions of dollars out of the forty-one million of surplus.

Senator THOMAS. I hope we will not have a surplus. If there is anything Congress abhors, it is a surplus.

Mr. QUINN. In the House bill they estimate that the tax will produce from corporations one hundred and seventy millions, and taking one in ten out of that, would be seventeen million. I believe that is fair and equitable. I have talked to some of these men, and their profits in proportion to the amounts invested and the risks involved are not large. At a later day, a brief from the Hercules Powder Co. will be mailed the chairman.

The CHAIRMAN. When it is received the clerk will insert it with these proceedings.

(The brief referred to was subsequently received and is here printed in full, as follows:)

The FINANCE COMMITTEE OF THE SENATE OF THE UNITED STATES:

The purpose of the Hercules Powder Co., of Wilmington, Del., in appearing before your subcommittee on Monday, the 5th instant, was not to escape its proper share of the burden of national taxation or primarily to save money, but in the advocacy of

what it believes to be a sound principal, namely, that there is no just or logical reason for discriminating against munition manufacturing companies in the matter of taxation or for singling them out as objects of special taxation.

This contention was made by this company last summer, as by other munition manufacturers, with respect to the revenue act of September 8, 1916. The contention did not then prevail, we believe, for reasons of expediency rather than because of any unsoundness in the contention itself. We renew the contention now because we believe that, in legislation extending the "tax on profits" to all corporations and copartnerships, the discriminatory character which was given it under the act of September 8, last, should, in justice, be eliminated.

The manufacture of munitions has never heretofore in any nation been an object of governmental disfavor. If universal permanent peace can be established in the world, which all right-thinking men hope for, the business will disappear. If our country should become involved in war, which we sincerely hope may not happen, her munition manufacturers will be one of her greatest assets.

The logic of our contention would require us to ask for the repeal, in the pending revenue bill, of the special tax of 12½ per cent upon the manufacture of munitions imposed by the act of September 8, 1916. We have not asked this and do not ask it now, solely, however, because to ask it would put us in the position of appearing to be trying mainly to escape a part of a burden already imposed and not to establish a principle which we believe to be correct, the proposed new tax being only 8 per cent on profits in excess of 8 per cent, while the tax of last year is 12½ per cent on all the net profits. We, therefore, are asking that the discrimination be removed only in part, by exempting us from the 8 per cent tax as to that part of our profits only which are subject to the 12½ per cent tax, namely, the profits from the war munitions branch of our business.

If the proposed new tax were 12½ per cent, we should then unhesitatingly ask for the repeal of the special munitions tax of 1916. Indeed, with that special tax repealed, if the Congress shall deem the exigencies of the Government to require a 20 per cent excess profits tax, we make no protest if it is imposed on all alike. We fully realize that if the misfortune of war shall visit our country it will be necessary to impose profits taxes of even much larger amount, and we shall then be ready to respond cheerfully to the full extent of our ability so long as the burden is placed upon all in equal degree.

We know that many other manufacturers of munitions are in full accord with the views above expressed.

Respectfully submitted.

HERCULES POWDER CO.

The CHAIRMAN. Now, Mr. Bosworth, we will listen to you.

STATEMENT OF MR. CHARLES U. BOSWORTH, REPRESENTING THE SMITH & WESSON CO.

Mr. BOSWORTH. Senators, that tax on munitions was because, I suppose, of world-war conditions. Smith & Wesson, as they made pistols, had a large foreign business which had not anything to do with the war. The war shut that off, so that their normal business was decreased in a way that the war conditions have not made up for. So, instead of the world-wide war helping them, the world-wide war has hurt them.

Senator THOMAS. That is not a universal fact, is it? It does not apply to all munition makers?

Mr. BOSWORTH. It applies to Smith & Wesson, and I think you will find that this war-munition bill, being drawn so broadly, just because of that export clause in the Constitution, is really a tax on a corporation's regular business which has not anything to do with war conditions in a great many instances, and working out that way is extremely unfair and unjust.

(Thereupon, at 11.45 o'clock a. m., the subcommittee adjourned to meet at 2 o'clock p. m. to-day, Tuesday, February 6, 1917.)

HEARINGS

BEFORE THE

SUBCOMMITTEE ON FINANCE

IN REGARD TO

REVENUE ON INSURANCE

REVENUE FOR INCREASED ARMY AND NAVY APPROPRIATIONS.

INSURANCE.

TUESDAY, FEBRUARY 6, 1917.

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

The subcommittee, pursuant to adjournment, met at 2 o'clock p. m., in the room of the Committee on Education and Labor, Capitol, Senator Hoke Smith presiding.

Present: Senators Smith (chairman), Thomas, and James.

Also present: Edward E. Rhodes, vice president Mutual Benefit Life Insurance Co., Newark, N. J.; John Barnes, counsel for the Northwestern Mutual Life Insurance Co., Milwaukee, Wis.; John B. Lunger, vice president Equitable Life Insurance Society, New York City; James H. McIntosh, counsel for the New York Life Insuraanc Co., New York City; Robert Lynn Cox, vice president Metropolitan Life Insurance Co., New York City; Thomas W. Blackburn, secretary and counsel of the American Life Convention, Omaha, Nebr.; Henry J. Powell, representing the National Association of Insurance Agents; and R. C. Milliken, soliciting agent for the Northwestern Mutual Life Insurance Co., of Milwaukee, Wis.

The subcommittee proceeded to consider certain provisions of the bill (H. R. 20573) an act to provide increased revenue to defray the expenses of the increased appropriations for the Army and Navy and the extensions of fortifications and for other purposes.

(By direction of the chairman the following letter was subsequently ordered inserted in the record and is here printed in full, as follows:)

THE PENN MUTUAL LIFE INSURANCE CO.,
Philadelphia, February 5, 1917.

Hon. F. McL. SIMMONS,
Chairman Senate Committee on Finance,
Washington, D. C.

MY DEAR SENATOR: When the present income-tax act was pending, this company sent to you a protest against the proposed increase, which appears as a portion of the memorial of the Massachusetts Mutual Life Insurance Co. in the Congressional Record of January 31, 1917, pages 2629 and 2630, and we direct your attention thereto in view of the contemplated increase of 8 per cent under the provisions of House bill No. 20573. A strong appeal was made for the exemption of mutual life insurance companies, which was denied by the Ways and Means Committee, and several motions intended to accomplish this purpose were defeated on Thursday last in the House of Representatives. We therefore turn to the Senate for the measure of relief which it is believed should be accorded to the members of such organizations who are endeavoring through life insurance to protect their dependents.

Mutual life insurance companies have been organized with no thought of profit, but solely for the distribution of losses which would be crushing if borne individually.

They are composed of members, conducted by members, and solely in the interest of members, who alone share in any lessened cost due to favorable mortality and economy of administration.

All mutual companies, with the exception of life insurance companies, are exempt under the provisions of the income-tax act of September 8, 1916, and thus under this bill, mutual fire insurance companies, mutual marine, casualty, and other similar companies, including all fraternal associations, are, as we believe, properly exempt, and we respectfully submit that similar exemptions should be accorded mutual life insurance companies which are equally conducted in the interest of members.

Life insurance is an economic necessity which we believe should not be discouraged by taxation. The burden to the various States for dependents would be tremendously increased if no life insurance existed. The Federal Government should therefore encourage citizens to insure instead of imposing a tax which increases the cost or diminishes the benefits to policyholders, for in the last analysis all taxes imposed on mutual companies are borne by members.

England, which is conceded to be the parent of income legislation, exempts one-sixth of an individual's income if devoted to life insurance protection.

The taxes levied by the various States are already approximately ten times the cost of supervision, which is the only valid reason for any such imposition, the amount collected having been approximately $14,000,000 last year and the cost of conducting the departments $1,400,000. The Federal Government imposed an income tax of 1 per cent upon the net income of mutual life insurance companies which has been increased to 2 per cent, and now an additional 8 per cent is proposed; a total in all of 10 per cent, which is almost confiscatory. This proposal is embodied under Title II, referring to excess profits, which are unknown to mutual life insurance companies.

Ordinary businesses may adjust the prices to include the proposed tax. Many other companies may also increase the rates to cover, but the premiums on life insurance policies now outstanding can not be changed and taxes uncontemplated when the premium rates were established should not now be levied.

We therefore trust that an exemption of this kind may receive the favorable consideration of your committee; that the discrimination against this form of mutual insurance may not be permitted to continue; and that the mutual life insurance companies may be granted a hearing.

Very truly, yours,

GEO. K. JOHNSON, *President.*

Senator THOMAS. Mr. Chairman, before we proceed with the matter that we have for discussion this afternoon, I want to add to the hearings of this morning a short statement. During our hearings of this morning I made the statement that the Du Pont and Hercules powder companies were virtually identical. The representative of those companies during the recess made the statement to me, and I promised to put it in the record, that the two companies were not identical; and, among other things, the Du Pont company was required by the courts to observe certain contracts and conditions which operated to prevent that identity which is common to corporations largely controlled by the same interests.

Senator SMITH. Now, gentlemen, what is your desire as to the way in which you should present your case? Have you any spokesman or how many of you desire to be heard?

Mr. RHODES. I have been asked, Mr. Chairman, to introduce the subject.

Senator JAMES. Who else is to be heard besides yourself, so we can allot the time?

Mr. RHODES. I shall not take over 15 minutes of your time, I think, and who shall take part after that will depend somewhat upon what arises during the discussion. I anticipate that Mr. Barnes, who represents the Northwestern Mutual Life Insurance Co. of America will have something to say. Aside from that, I think there will be nothing more than perhaps a few brief remarks from other gentlemen.

Senator SMITH. You may proceed first, Mr. Rhodes.

STATEMENT OF MR. EDWARD E. RHODES, VICE PRESIDENT OF THE MUTUAL BENEFIT LIFE INSURANCE CO. OF NEWARK, N. J.

Mr. RHODES. Mr. Chairman and gentlemen, I want to speak for all insurance that is conducted on the mutual plan. This bill by its terms covers all insurance companies. We are, of course, concerned with title 2, and only title 2, which imposes an excess-profits tax upon the capital invested and used in the business.

Now, these mutual insurance companies are peculiar and the bill is not in any sense applicable to the business which they transact. They have not a dollar of capital stock. They have no capital invested in the business.

Take the company with which I am connected. It was organized some 72 years ago by a few men getting together and agreeing to insure their lives. They put up out of their own pockets the money which was required to obtain their charter. They were men who recognized that the old practice of insuring people's lives by which they passed around the hat when one of their members died was unsatisfactory, and they recognized that that very plan of mutual insurance which was then largely in vogue, that of each member paying a premium determined according to his age at the time, was unsatisfactory; that it was all right as long as the members were young, but that when they grew old the cost would become prohibitive, and that their insurance would be lost at that time in life when they most needed it. So to overcome that difficulty and to make insurance sure these mutual companies were organized precisely upon the plan that was followed by the original assessment companies and later by what was known as the step-rate premium companies—the steps going up all the time—but on the same basis and with the same idea in mind, that of insuring the lives of their members at cost.

If we had been unfortunate enough to have had a loss, if one of the members of the company had died in the first year, there would not have been money on hand to pay the claim. They would have had to go outside to borrow it. That is not true to-day. The companies have grown and they have become big institutions. The company with which I am connected is not as big as some and it is not as small as some. It is, perhaps, bigger than the average. Its funds now amount to a little over $200,000,000, and that looks like a big sum, and it might look as if it ought to be taxed, but it is big, gentlemen, only because for 72 years past it has been growing. It ought to be big by this time. It has, perhaps, 285,000 members.

Senator THOMAS. You mean policyholders?

Mr. RHODES. No; I am not speaking of policyholders. We have over 342,000 policies, but some of those policyholders have more than one policy, and I am reducing it to be perfectly accurate to the actual number of members that we have; some 285,000.

Senator SMITH. That number of men own all the policies issued by your company?

Mr. RHODES. Absolutely; they own that $205,000,000 we have accumulated to pay their claims, and on the average each member's share of that fund is only $697. It is big not because of any plan of growing big. It is not an aggregation of wealth except as it is made

up by these 285,000 men and women who are insured in it. Their average amount of insurance in our company is under $2,500, and in general it is still less than that. Those men pay on the average a contribution of only about $90 a year, and, knowing as you do the persistency of the average life insurance agent, I think you can be pretty well assured that they have gotten out of those 285,000 members all that they can afford to pay for life insurance.

I am well within the facts when I say that over 90 per cent of those people who are insured with us have not sufficient incomes to be taxed under the income-tax law.

Senator JAMES. Could you not make it greater than that?

Mr. RHODES. I think we could, sir. I am trying to be conservative in my statements. Now, this bill says what? We do not know precisely what, except that insurance companies are to be taxed under it the same as a commercial business; but we are not taxed the same as a commercial business. A commercial business can deduct from its taxable net income, as shown in its income-tax return, 8 per cent of its actual capital invested, and it need pay no tax on that 8 per cent. But what can a mutual life insurance company deduct from its taxable net income? It has no actual cash paid in such as is referred to in section 202. It has no actual cash value at the time of payment of assets other than cash paid in. If, as I assume, that means the actual cash value of property other than cash represented by shares of stock, has it any paid-in or earned surplus and undivided profits which are used or employed in the business? We might possibly get 8 per cent of the amount that we are holding as a contingency reserve aside from this specific exemption of $5,000, and that is all that we could get if we could get that.

Senator THOMAS. In your annual statements, do you not give figures showing what you call your surplus and also what you call your profits?

Mr. RHODES. Not what we call our profits. We have no profits, sir. I would like to come to that question of profits a little later.

Senator THOMAS. I beg pardon for interrupting, then.

Mr. RHODES. That question of profits has a very essential bearing upon this matter. We have a contingency reserve or surplus—that is, over and above our required liabilities, the liabilities that the insurance departments of several States require us to put up—of $9,682,000.

Senator THOMAS. That is your surplus?

Mr. RHODES. That is what you might call surplus. It is held to meet contingencies. There was a time when life insurance companies held large surpluses and those large surpluses were at times subjected to abuse. That has been done away with with the reforms that have been instituted in life insurance. Their surpluses to-day are limited by law. They can not hold them. That $9,682,000, gentlemen, of surplus that we hold is just about 1 per cent of our contingent liabilities. It is there to meet any contingency that arises. Every dollar of our income over and above that and what is used to pay our running expenses is returned to the policyholders.

Now, let me speak, please, of this question of profits.

Senator SMITH. Before you take up that subject could you give me the way in which you classify your assets?

Mr. ROHDES. Certainly. I would be very glad to do so.

Senator SMITH. I would like to know that and I can then appreciate better your discussion of the profits.

Mr. RHODES. We aim to carry about 50 per cent of our assets invested in loans on real estate.

Senator SMITH. I did not mean that. What do you call your assets other than this $9,682,000?

Mr. RHODES. The larger part of it, sir—practically all of it—is held under the laws of the several States as a reserve to meet death claims as they accrue. Of our $205,000, $186,000 is found in that required reserve. Then, we have about $900,000 that we are holding to meet death claims. I am always speaking of policy claims when I use the word "claims."

Senator SMITH. You would have no claims against you except your policy claims?

Mr. RHODES. That is all, except for current bills.

Senator SMITH. Yes; but you settle them right along?

Mr. RHODES. Yes; we settle them right along, but in our statement we have to include anything that is current at the time. We have about $900,000 of claims that are awaiting settlement for which the papers are not complete. We have set aside in adjustment of the cost of the insurance to policyholders $6,300,000.

Senator SMITH. What do you call that?

Mr. RHODES. We have set aside $6,300,000. We will use that this year to adjust the premiums that the policyholders paid last year. They paid us, in other words, last year $6,300,000 more than we actually required, and this year that will be refunded to them.

Senator SMITH. It will be returned as premiums? You collected that much more out of them than was necessary as you found to be the facts from the result of your year's business?

Mr. RHODES. Precisely.

Senator SMITH. So you just hold that temporarily as a guaranty fund that goes back to them?

Mr. RHODES. Yes; that is all it was. I may put it in this way: What we estimated, conservatively estimated, their insurance would cost during the year. That estimate was conservative; it was too large. We knew it was too large, but we had to be on the safe side.

Senator SMITH. You made it conservative in connection with the fact that it was absolutely necessary that you should have enough to meet your liabilities?

Mr. RHODES. Precisely.

Senator THOMAS. Your error was on the side of safety?

Mr. RHODES. It must be; we have not any capital stock to fall back upon.

Senator SMITH. You fix it at the lowest amount that you are assured will cover your liabilities?

Mr. RHODES. Yes.

Senator SMITH. And it covers that $6,300,000 in excess of your liabilities, and you distribute that back to the policy holders?

Mr. RHODES. Yes; that will be refunded to them this year. Now. let me take up the question of profits. We got away from this old pass-around-the-hat plan. We got away from the old step-rate plan. There was only one way in which we could do that, and that was by leveling these step-rate premiums, so that in the early years

of a man's insurance he would pay us more than we actually needed to provide for the insurance of those early years. It was easier, of course, for him to pay that excess in the productive years of his life than it was in his later years, and he paid it; but we did this: We did not spend that excess; we accumulated it in this reserve which every company is required by law to hold. It is a sinking fund, gentlemen, without which no company can do business to-day.

That reserve is necessarily accumulated at interest. The life insurance business could not be done except as the interest factor is brought into it. But that interest earning is not a profit to the company. The law says that we shall compute our premiums according to a certain table of mortality; and they say that we shall not use in the computations a higher rate of interest than 3½ per cent. It used to be 4 per cent. That means this: That on every dollar of interest that we earn we must take it at the rate of 3½ per cent and add that to our sinking fund. Every dollar over and above that 3½ per cent is refunded back to the policy holders.

Senator JAMES. If that is true, how would you be taxable under this provision?

Mr. RHODES. Because under the income tax law, sir, we show a taxable net income. It is not our true income in any sense of the word. It is an arbitrary amount reached under the provisions of the income tax law, and this bill taxes us again on the basis of what we show in income tax return.

Senator SMITH. Would you object to stating what your company shows its tax income to be in its income-tax statement?

Mr. RHODES. Not at all. The year 1915 I shall have to use because the figures for 1916 are not compiled. We showed a net taxable income for the year 1915 of $1,530,000, roughly, on which we paid, of course, a 1 per cent tax, or $15,000. Now, that was not our true net income. It could not be. As a matter of fact, we had no net income judged by the standards that you apply to any commercial business. Our members do this: They put in our hands at the beginning of each year a sum which we estimate to be sufficient to cover their insurance. Out of that we pay the running expenses, pay the death claims, and hand back to them what is left. It is purely a cooperative business.

Senator SMITH. You pay your death claims in part out of this reserve?

Mr. RHODES. Yes, sir; and there is nothing left in our hands to use. That $205,000,000 of funds earned last year less than 5 per cent—to be exact, 4.9 per cent. It was all we could get.

Senator SMITH. You say that you would have to pay under this bill upon the theory that your net income was $1,530,000?

Mr. RHODES. Yes, sir.

Senator SMITH. Now, what would you turn to, then, to say that the deduction of 8 per cent would be figured on?

Mr. RHODES. There is not a thing in your bill that would enable us to take 8 per cent off unless it is that surplus of $9,000,000; and whether the internal-revenue department would allow that or not I do not know, but assuming that we could get 8 per cent of that out of our net taxable income, and that we were taxed 8 per cent upon the difference, you would collect from our members under this bill $66,000.

Senator JAMES. Under the income-tax law, as I understand it, while you receive those several millions of dollars, you would be entitled to deduct the amount of money that you used in operating the business—that is, in payment of the death claims?

Mr. RHODES. Yes, sir.

Senator JAMES. Then, if I understand you, you have nothing left except what is used in payment of the current running expenses?

Mr. RHODES. Yes; but the law bases that net income arbitrarily.

Senator JAMES. I do not quite understand how they do that.

Senator THOMAS. What would be your total income for that year?

Mr. RHODES. We received in premiums and interest and rents about $38,500,000, roughly.

Senator THOMAS. In giving $1,530,000 as your net income upon which you paid income tax, did you give identical figures, or merely an approximation in round figures?

Mr. RHODES. It was $1,553,000 exactly. I stated it approximately at $1,530,000.

Senator THOMAS. I assumed that.

Mr. RHODES. Now, out of that, what we really did was to pay back to our policyholders some $21,000,000.

Senator SMITH. Out of that $38,000,000 you paid back $21,000,000?

Mr. RHODES. We paid back $21,000,000 to the policyholders directly. We set aside for the necessary increase in our liabilities to meet the growth in our business the difference between that and our expenses and taxes.

Senator SMITH. Do you recall what your expenses and taxes were?

Mr. RHODES. Yes; I can give them to you. We paid for taxes last year $702,000, and our expenses outside of taxes were about $4,200,000.

Senator SMITH. Then, the difference between the sum of those three figures and your $38,000,000 you estimated as your increased liability upon policies?

Mr. RHODES. Precisely.

Senator SMITH. Leaving your net of $1,530,000.

Mr. RHODES. No; that would not give you $1,530,000. It would balance.

Senator SMITH. Yes; you returned to your policyholders the difference between your running expenses, your losses, and your increased liabilities?

Mr. RHODES. Yes; every dollar of the income is accounted for, but the income-tax law does not take that view of it. Out of that $38,000,000 it permits us to make only certain deductions, and when we have complied with the law we have a million and a half left upon which we are taxed, although it was not free income.

Senator JAMES. Do they do that by saying that you set aside too great an amount to meet your outstanding liabilities?

Mr. RHODES. No; the law requires it. The revenue department is fair toward us. They are enforcing the law.

Senator THOMAS. Of course, that rule applies to all mutual companies, does it not?

Mr. RHODES. Yes; it does. It applies to mutual fire companies and to mutual marine companies; any insurance company that is conducted on the mutual plan.

So that when you get down to this bill we are up against this situation: Taking the funds that we have to meet the claims of policyholders invested as they are in only safe securities, we can not earn 5 per cent interest on them, and yet you will permit an ordinary business concern to earn 8 per cent before you tax it a bit.

Senator THOMAS. I confess that I can not see how, if that statement is correct, and I have no doubt it is, you are affected by this bill at all, because the exemption of 8 per cent is essential to the levying of the tax.

Mr. RHODES. If this bill should be amended, sir, so as to provide that before we were taxed we should deduct 8 per cent of our invested reserve, we would be on a par.

Senator SMITH. What is the language of the bill that you think reaches you?

Mr. RHODES. That section 200, "That when used in this title—the term 'corporation' includes joint stock companies or associations, and insurance companies." Not stock insurance companies; all insurance companies.

Senator SMITH. I understand. Now, how does the language reach you even then? How does it describe a net profit that you make?

Mr. RHODES. Under section 201 we have this language [reading]:

> That in addition to the taxes under existing laws there shall be levied, assessed, collected, and paid for each taxable year upon the net income of every corporation and partnership organized, authorized, or existing under the laws of the United States, or of any State, Territory, or district thereof, * * * a tax of eight per centum of the amount by which such net income exceeds the sum of (a) $5,000 and (b) eight per centum of the actual capital invested.

Section 202 further provides: "That for the purpose of this title, actual capital invested means (1) actual cash paid in," of which we have none; "(2) the actual cash value, at the time of payment, of assets other than cash paid in," of which we have none, if that means property represented by shares; "and (3) paid in or earned surplus and undivided profits used or employed in the business."

There is your definition of actual capital invested, which does not apply to a mutual insurance company.

Section 203 provides [reading]:

> That the tax herein imposed upon corporations and partnerships shall be computed upon the basis of the net income shown by their income tax returns.

Senator JAMES. That would have to hold in order to tax you under this section. It seems to me that your notes and securities are not assets.

Mr. RHODES. They are not assets represented by shares of stock. They are not capital.

Senator JAMES. But as investments made by your company.

Mr. RHODES. Yes.

Senator JAMES. But you have made that with assets or with money paid in.

Mr. RHODES. And we have been to the internal-revenue department, Senator, and they say that under that bill they could not regard anything that we have as capital invested unless it were our contingency reserve. They say that they would have to place that interpretation upon it.

Senator JAMES. I do not think that theory is well grounded, myself. It might be.

Senator THOMAS. Is there any reason from an insurance man's standpoint for this exemption of companies combining the business of life, health, and accident?

Mr. RHODES. I was curious to know how that got in there.

Senator JAMES. I imagine that was placed in there to give an exemption to the insurance that is generally used by the poorer class of people.

Mr. RHODES. No; that is not so. It seems that there are a few companies recently organized upon a stock plan which are transacting that kind of business, and it was represented that if those young companies struggling for a foothold were taxed it would put them out of business.

Senator THOMAS. I was told that one of those young struggling companies made a profit last year of some $800,000. Personally, I do not know anything about it; but that strikes me as a remarkable exemption.

Mr. RHODES. I am simply giving you the explanation that was given to me.

Senator SMITH. Therefore your conclusion is that under the bill you would be subjected to taxation and the taxation would be 8 per cent on your $1,535,000 as the entire sum would be treated in the excess of the profits of 8 per cent on your capital?

Mr. RHODES. Yes, sir. In other words, we would pay an income tax of 10 per cent.

Senator JAMES. It would be taxed on profits you did not have.

Mr. RHODES. Precisely. We have not a dollar of net profit. I do not think that question has been better stated than it is in a brief by one of the judges in the English House of Lords, which I am going to leave with you. I would like to read that. It is as follows [reading]:

With regard to life insurance the facts have been most clearly and convincingly stated in the opinion of Lord McNaghten in the case of New York Life Insurance Co. *v.* Styles (L. R., 14 App. Cas., 381), as follows:

"Certain persons agree to insure their lives among themselves, on the principle of mutual insurance. They take care to admit none but healthy lives. They contribute according to rates fixed by the approved tables, and they invite other persons to come in and join them by insuring their lives on similar terms. The rates fixed by the tables are taken as being sufficient to provide for expenses, to meet liabilities, and to leave a margin for contingencies. What is to become of the surplus if everything goes right? The practice is to take an account every year of assets and liabilities, and to give the insured the benefit of the surplus, either by way of reduction of premium or by way of addition to the sum insured. It can make no difference in principle whether the surplus is so applied, or paid back in hard cash. In either case, it is nothing but the return of so much of the amount contributed as may be in excess of the amount really required. I do not understand how this excess can be regarded from any point of view, or for any purpose, as gain or profit earned by the contributors. I do not understand how persons contributing to a common fund in pursuance of a scheme for their mutual benefit—having no dealings or relations with any outside body—can be said to have made a profit when they find that they have overcharged themselves, and that some portions of their contributions may be safely refunded. If a profit can be made in that way, there is a field for profitable enterprise, capable, I suppose, of indefinite expansion."

Senator SMITH. I understand that one company pays about one-half of the income tax that we now collect under the existing law from insurance companies. Do you know what company that is?

Mr. RHODES. I think that company is probably the New York Life Insurance Co., whose counsel is here this afternoon. We are paying a small income tax under the law, but we are paying a small income tax, Senator, because we are returning more to our policyholders every year.

Senator SMITH. Do you feel that these large insurance companies like yours ought to make no substantial contribution toward the general policy of national expense, especially under the existing circumstances?

Mr. RHODES. I know of no reason why they should not, if you will tax in like manner the uninsured public. How are they different from the man whose life is uninsured and who is in precisely the same circumstances in life as the man who is insured, pursuing, perhaps, the same work and having the same income, the same living expenses to meet.

Senator SMITH. Your point is that we ought not to regard it as a company; we ought to regard it as taxation upon the policyholders, and that the insured are in a better position as citizens than the uninsured, and that it would be better for the entire country that all should be insured?

Mr. RHODES. It was the policy, Senator, in every income-tax law that was passed up to that of 1913. It is the policy of the law in England and in every European country. Even premiums that a man pays for life insurance in England are exempted from his income. Now, why?

Senator SMITH. To stimulate the investment to relieve the Government from any responsibility for poverty and dependence.

Mr. RHODES. Just because they have chosen to insure their lives in a company which by reason of its age and size and its consequent ability to furnish cheaper insurance attracts them to its membership, why should they be taxed more than the man on the street who is in the same circumstance in life? We do not object to your taxing our members. We personally who are officers of the company have no interest in it. All that we have to do is to manage the affairs of the company and distribute these costs upon an equitable basis so that each man pays his proper share. There is no magic in the thing. We can not pay out any more than we get in, and if we have to pay out more than we are paying out to-day we have to go back to the members for it.

Senator SMITH. And charge them more?

Mr. RHODES. That is all there is to it; there is no magic in it.

Senator SMITH. This tax would come out of the amount that you otherwise would return to your policyholders each year?

Mr. RHODES. It must; there is no other fund for it to come out of.

Senator SMITH. You must preserve your reserve fund and increase your reserve fund to increase your liabilities growing out of your increased policies, which if kept up will finally be a charge against you?

Mr. RHODES. Precisely.

Senator SMITH. And if you pay this additional tax you then must take that out of this amount that you otherwise would have as a surplus each year to return to policyholders?

Mr. RHODES. That is all that it can come from.

Senator SMITH. You mean that that is an increased charge for the insurance that your policyholders get?

Mr. RHODES. That is all there is to it.

Senator JAMES. If they reckoned this as an excess of 8 per cent profits, it would be falling back on thousands of people who practically make no profits at all.

Mr. RHODES. Even in their corporate capacity they are not making a profit of 8 per cent.

Senator JAMES. I am speaking of the people who are insured in your company. You would return to them the amount of money in excess of that which was necessary to run the business and put the reserve aside for your future insurance?

Mr. RHODES. Yes.

Senator JAMES. Of course, there are thousands of those people who practically have no 8 per cent or 6 per cent or any excess profit at all.

Mr. RHODES. They are scraping the bottoms of their pockets every day to pay the present cost of living and keep up their insurance.

I would like to have you listen to Mr. Barnes, and I would like to leave with you a brief that we have prepared.

Senator SMITH. We will next hear Mr. Barnes.

STATEMENT OF MR. JOHN BARNES, COUNSEL FOR THE NORTHWESTERN MUTUAL LIFE INSURANCE CO., MILWAUKEE, WIS.

Mr. BARNES. Mr. Chairman and gentlemen, I will occupy your time for but a very few moments. There are many men here, who, perhaps, want to say a few words. Before leaving I jotted down a few ideas I have, and, perhaps, by confining myself to my manuscript pretty closely, I will save your time and say about everything that I want to say.

By way of introduction I want to say to you that I have studied the features of this emergency revenue bill, and as I read it and understand it, it amounts in substance and fact, to raising the rate of tax on mutual life insurance companies from 2 to 10 per cent on all of their taxable income except $5,000. Now, I may be mistaken about that construction, but that is what I think the bill means. Being an emergency revenue bill the question is whether the contributors to the tax that will be raised in that way are a class of people on whom the burden of such an extraordinary tax should be cast.

I would say, in the first place, that our company or any other mutual life insurance company makes no profit. That feature of the matter has been discussed by Mr. Rhodes, and I pass it with his discussion. We furnish insurance at cost. Mutual life insurance on whatever plan a company is organized is insurance at cost if it is mutual insurance. We charge a level premium, and because we do we must make our rate of premium higher than the ordinary cost of carrying business in order that we may meet unforeseen contingencies. If we did not do that, when the unforeseen contingency came upon us we would become insolvent and unable to meet our obligations.

Senator THOMAS. I think that is a pretty well understood fact in life insurance business nowadays.

Mr. BARNES. I am not going to discuss the question that dividends or anything more or less than a return of excess premiums that have

been returned by policyholders because of the necessity of meeting that contingency. That question has been before the courts——

Senator SMITH. I do not think you need discuss it.

Mr. BARNES. Of course, we have no stockholders; our funds belong to our policyholders; and whatever we collect in the way of surplus is returned to the policyholders, at one time or another.

Let me refer for a moment to this item of surplus. There is only one excuse, in my judgment, for mutual life insurance carrying a surplus account at all. We all do it and we do it, I think, for just one reason, and that is to take care of the fluctuations in the value of securities from time to time so that there will no time come when we have not enough property on hand to keep our reserve unimpaired. For instance, our company has an investment of $100,000 in bonds and this goes up and down. There are times when the fluctuations were quite remarkable. We may meet losses from time to time, and so we carry a surplus which we think is large enough to cover those fluctuations and to cover any unusual losses that we may meet. It is an insurance fund to insure the stability and continuity of the reserve fund which we must carry for the benefit of our policyholders.

We have in round numbers about 575,000 policies outstanding, and they average about $2,600 apiece. I do not know the number of our policyholders; I have not had that computation made, but, of course, it would be less than the number of policies, because some of them carry more than one policy; but the average is about $2,600 apiece, and I understand that in the country at large there are in the aggregate about 7,000,000 policyholders—I mean in mutual life insurance companies—which indicates the very, very wide distribution there is of insurance among all classes of people.

It may be something of a surprise to you to learn that the largest individual class of policyholders that we have are farmers. We have a larger percentage of farmers insured in our company than we have of any other class of individuals.

Senator THOMAS. You have larger loans on farms than you have on city real estate, have you not?

Senator SMITH. There are more farmers than any other class of individuals.

Mr. BARNES. I mentioned that fact to show the very general distribution of policyholders. If the purpose and the intent of this law is to make the rich man pay the tax and to tax corporations that are making profits—perhaps many of them unusual profits—in some instances unreasonable profits—the reason in no sense extends to a mutual life insurance company.

Senator SMITH. I would not put it "makes the rich man pay the tax." I would put it "makes the wealth pay the tax."

Senator THOMAS. Some years ago, Mr. Barnes, one of the eastern mutual insurance companies made some pretty heavy political contributions. Did that money belong to the stockholders?

Mr. BARNES. That money belonged to the policyholders of the company, and any practice of that kind ought to, I think, meet the condemnation of anyone who has the interest of life insurance at heart.

Senator SMITH. And should also have the attention of grand juries?

Mr. BARNES. Yes.

Senator THOMAS. I quite agree with you.

Mr. BARNES. I want to say this: I think it can be honestly said of the company that I represent that not a dollar ever went out of its treasury for political contributions.

Senator THOMAS. I think you will recall that I limited my statement to one eastern company in particular, so I would not even seem to include any others.

Senator JAMES. He is partial to the West, anyhow.

Senator THOMAS. Yes; I am.

Mr. BARNES. If that were so, of course, it would not be a fair thing to assume that it was representative of a class.

Senator THOMAS. Not at all.

Mr. BARNES. I think the investigation that was carried on in New York and some other places was very healthy and it has resulted beneficially for the policyholders and the life-insurance companies. They have a little keener appreciation now than they had before of what the life-insurance business is.

Senator THOMAS. I think it was the salvation of the business.

Mr. BARNES. I would be inclined to agree with you in that. Now, I say in reference to these policyholders—and I will give you the percentages in a moment of the different classes of policyholders that we have—they are very often scraping together a little fund to pay their premiums at the end of each year for the purpose of making some provision for their family when the breadwinner passes away, and that with very few exceptions they are not policies that are taken as an investment; they are policies that are taken as an insurance against want in the future and in order that the wife and children will be left a little something in time of stress and in time of need. If I am right about that, it seems to me to be illogical from any standpoint, economical or otherwise, to impose a burden on people who are of that class, as has been stated here, where comparatively few of them have enough in the way of income to come anywhere near being required to pay income tax on their individual incomes, because as a corporation we receive no income; every dollar we have belongs to our policyholders; and we have got to keep it in such a way that we would be obliged to settle with them. For instance, we might be called upon within 90 days to pay every policy that we have outstanding; to pay the value of it. The reserve is being built up against the policy. Any man has a right to come in and demand the amount that is coming to him on his reserve, and we are obliged, both as a matter of law and contract, to pay it to him.

I can not help thinking that this institution of life insurance, from the standpoint of the State, ought to be encouraged rather than discouraged, and I am sorry to see a sort of disposition among the States to impose tax burdens on this class of companies. That seems to me to be unfair. Our company last year, excluding its real estate taxes, paid in the United States in taxes eleven hundred thousand dollars.

Senator THOMAS. That is for 1916 or 1915?

Mr. BARNES. For 1915. It was paid in 1916. Aside from that, of course, we paid our taxes on our real estate, our office building, and some other real estate that we have taken in one way or another. But it is a substantial tax and a substantial drain on the income and revenues of life insurance companies with their interest rates decreasing from year to year.

Senator SMITH. Would all of that money have gone back to your policyholders in returned premiums?

Mr. BARNES. Every dollar of it.

Senator SMITH. Every dollar of that would have been distributed pro rata to the policyholders at the end of the year?

Mr. BARNES. It would have been distributed pro rata to the policyholders; if not this year, then at some time or another. I can furnish you gentlemen with our annual statement.

Senator THOMAS. If there were a death of a policyholder in your company, would the representatives of the insured receive, in addition to the policy, a proportion of the fund which is held in trust?

Mr. BARNES. The man receives the face of the policy and any dividend that stands to his credit; and we do not wait to the end of the year in case of a death to make a distribution of dividends.

Senator THOMAS. Perhaps I did not make myself clear. You declare a dividend, we will say, or make your divisions on the 1st of January and John Smith dies on the 1st of March. Your next time for accounting or settlement is the 1st of July. Does he get the part or fraction of the term in addition to what is credited to the policyholder at the time you make your annual division?

Mr. BARNES. Speaking for our company, I would say that he gets credit for that dividend in 60 days and it is paid to him.

Senator THOMAS. My question relates entirely to your company.

Mr. BARNES. I am told that that is so with respect to all companies. I want to say a word here in reference to fraternal insurance. This income tax law exempts fraternal insurance companies or societies from the operation of the act altogether, and I think that is very proper, because it is encouraging the idea of people laying aside a little to take care of themselves and their families in their old age. I think from an economical point of view the law is all right in that respect and Congress took the right view of it. But, now, what is the difference between the fraternal and the mutual insurance companies? Some classes of people insure in both companies. We may have a few more wealthy men in our companies than the fraternal insurance companies have.

Senator THOMAS. You have not as many voters.

Mr. BARNES. Well, I would not say that. We have not our voters, organized. I think we have more of them than the other fellows, but the companies, the best they can, have been endeavoring to explain those things to the legislators and they have not drawn on their policyholders to any extent for help, while the fraternal companies have; but leaving aside the question of having the votes and having the organization there is still the economic question, and you will find in most classes of insurance companies the farmer, the laborer, the doctor, the lawyer, the merchant, the school-teacher, and so all along down the line; and if you are dividing on the question of health the number of wealthy policyholders we would have in excess of what the fraternal has is merely negligible when you take into account the whole amount of insurance which we carry. So I say that while I think Congress took the right theory in exempting the fraternals altogether——

Senator THOMAS. It did not go far enough?

Mr. BARNES. It did not go far enough; that is my idea. For instance, there is one fraternal insurance company that has eighty mil-

lion more insurance than our company. I think if you come to make up their income on the basis that the law requires us to make up our income account, they would have a substantial income tax to pay; but, be that as it may, there is no chance of getting income tax from that company or any kindred company, because they are specially exempt from the provisions of the law.

There is another of those companies that has an insurance of over a billion dollars. The average amount of other certificates is about $1,600. It is not very much lower than the average certificate in the old-line life insurance companies. It is lower than ours. I think our average is about $2,600 apiece.

Senator THOMAS. Your statement in regard to the expense of that fraternal insurance is astonishing to me.

Mr. BARNES. The fraternal companies have a lot of insurance.

Senator THOMAS. I had one or two personal experiences with some a few years ago.

Mr. BARNES. They are very large and they are built on the same general theory that the old-line life insurance company is with this exception; they say, "We will furnish insurance at cost"; the old-line company says, "We will furnish insurance at cost, but we start in by charging a man a premium that would insure the performance of his contract when we are called upon to perform." Unfortunately, some of the fraternal insurance companies have not done that, and, of course, a great many of them have fallen by the wayside. I do not mean to speak disrespectful of the fraternals.

Senator THOMAS. No; I spoke very mournful of the one I referred to a few moments ago.

Mr. BARNES. But really the difference between the two classes of companies is the difference in the fundamental idea as to the rates of charge that should be made initially.

Senator THOMAS. So I learned. They say there is a class of people that learn only by experience.

Mr. BARNES. Sometimes you can console yourself upon the theory that you take that kind of insurance just the same as you take fire insurance. Of course, that does not give the protection that a good many men aim to get.

There is another provision of the income-tax law that I desire to invite your attention to, and that is the one which exempts mutual savings banks not having a capital stock represented by shares. That is in the second subdivision of section 11 of the 1916 income-tax law.

Now, the idea, of course, of that is to encourage thrift.

Savings banks are built up by a large number of people getting together and putting in their savings and getting out of it all the profits that there is in the business. They do not have any stock and they put their money in there and invest it as best they may.

If it is logical to exempt those institutions from taxation, wherein do they differ from the ordinary mutual life insurance companies? One class of men are putting away a little sum where they can draw it at any time they want to by presenting their pass book at the bank. The idea is to encourage thrift. The other goes to an insurance company and pays in a certain amount from year to year, which to be sure they can draw also on presentation of the policy, but if they are persistent when they die they get the face of their policy. It seems to me that if this whole question were thoroughly understood there

would be no differentiation between the old-line life insurance company and the fraternal insurance company or the mutual savings bank. The trouble seems to be I think that, fortunately or unfortunately, so far as the question of taxation is concerned, we have great aggregations of capital.

Senator THOMAS. That is it precisely, that and the methods which some of them used a few years ago have created, I think, a theory that has overcome what otherwise would be a general knowledge concerning the mutuality of insurance investment. I do not mean to justify the fact, but I think that is one of the causes.

Mr. BARNES. I think there was a good deal of prejudice originated against insurance companies at that time. Some was justifiable; a great deal I think was a result of muckraking.

Senator THOMAS. And consequent misunderstanding.

Mr. BARNES. Probably some of the insurance companies did things which they should not have done and things which should have been called to public attention, but when the pendulum got to swinging that way, of course, the usual result followed, and they were damned for things that they did do and just as well for things that they did not do. But what I wanted to say in reference to this accumulation of wealth is this: I never understood that a corporation or an individual was very well to do if he owed as much as he had in property. If I have $100,000 worth of clean property and I owe $100,000, I do not think I am wealthy. I am not a bit better off than the man on the street who has not a dollar. Now, we necessarily must have large aggregations of capital if we continue insuring people, because we have to build up a reserve to take care of our contracts.

Senator THOMAS. You have to keep going?

Mr. BARNES. We have to keep going. The result is capital accumulates; but, as I mentioned a few moments ago, there is not a policyholder of ours who can not come in and demand the reserve that is built upon his policy. We have $340,000,000, approximately, in reserve now, and it belongs to our policyholders. Each one is entitled to a share of it and he is entitled to a share of it on demand. So we are in the position of a big company or a fairly large company. We are not as big in comparison as one of the New York companies, but we are a fairly large company with a large amount of money on deposit and own a large amount of securities, but money which we must distribute at some time or other to our policyholders, and we may be called upon to distribute a large amount or all of it within 90 days.

Senator SMITH. I could not conceive a reason for your being called upon to distribute it within 90 days.

Mr. BARNES. That would be true if they demanded the reserve on their policies. If all our reserves went out all our money would be gone. We would need this little surplus to take care of our reserves.

Senator SMITH. Does your reserve fund not exceed the amount for which each policyholder could call on you for at once?

Mr. BARNES. No, sir; I think the reserve represents just what the policyholder could call on us for at once, if I am correctly informed.

Now, a word more and I am through. I want to refer to the way in which this tax operates. We will suppose that I have an income of $24,000 and I have a family to support, so I have a $4,000

exemption. Under the operation of the income-tax law of 1916 I would be obliged to pay a 2 per cent tax on $20,000, or $400. If I place the right construction on this act, and I think I do, if our company had $24,000 of taxable income it would have to pay a tax five times as much, or $2,000. In other words, we would have to pay 10 per cent on all of it in excess of $5,000, and, of course, 2 per cent on the $5,000. In other words, it makes the small policyholders in the aggregate contribute five times as much toward that income tax as I as an individual with $24,000.

Senator THOMAS. You get that 10 per cent by adding the 8 per cent to the 2 per cent tax?

Mr. BARNES. Yes, sir.

Senator SMITH. What does your company's return show as its net income tax?

Mr. BARNES. I came away rather hurriedly, Senator; I did not know this matter was coming up when I started, and I did not bring the figures along.

Senator THOMAS. Do you know whether or not they paid any?

Mr. BARNES. I think so. I think we pay an income tax every year. I know I have been over the record for 1909 and 1910, because we had some suits in reference to them, and for those years we must have paid $300,000 a year.

Senator THOMAS. Income tax to the Government?

Mr. BARNES. Actual tax. I am saying that we paid $300,000 a year tax to the National Government in 1909 and 1910, but we are sure to recover some of it, because we think they charged us too much. That is corporation tax.

Senator THOMAS. I am talking about the corporation tax under the Underwood Act.

Mr. BARNES. I can not give you our figures on that.

Senator SMITH. We collected only about $300,000 altogether.

Mr. BARNES. Of course, what you imposed under the income-tax law of 1913 may not mean what we would pay under the income-tax law of 1916.

Senator THOMAS. That is not operative yet; at least, no payments have been made under that yet.

Mr. BARNES. No; but what I want to call your attention to is that the amount of deductions which are allowable under the 1916 tax law are fewer.

Senator THOMAS. Senator Smith's question was in reference to what you actually paid as an income tax for 1915, as I understood it.

Mr. BARNES. I can not give you the figures, Senator, because I do not know. I do know this, because this was called to my attention, that the Government is demanding of us a tax in addition to what we have paid heretofore, claiming that we did not pay on all of our taxable income.

Senator THOMAS. Three of the great companies paid no tax whatever.

Mr. BARNES. It is my judgment that under the 1916 income-tax law a good many of the companies will be compelled to pay a substantial income tax. Of course, if they are not liable to any income tax under the 1916 law, then there is no object in putting an 8 per cent tax on them. If they are not subject to the 2 per cent there is nothing to be gained by raising it to 8, and we certainly think we

are liable to be called upon to pay a very substantial amount under that 1916 tax law, or we would not be here.

Senator THOMAS. My remarks had reference to the 1915 tax law.

Mr. BARNES. I will say that I can not give you the figures; I do not have them. I can send them to you, and if we did not pay any tax in 1915 I will say so.

Now, there is just one word more that I want to say. We have certain statistics that we make periodically in dealing with the classes of our people who are insured. I got this information from our figures in the first nine months of 1916. I have not taken the first nine months in 1916 because it would be different from that of any other period, but we have just had it made up for that. I have 1911 also complete. Those statistics show that of the insured in our company for the first nine months of 1916, 14.4 per cent of all our policyholders were farmers; and 9 per cent, merchants; 6 per cent, office employees; 5.3 per cent, clerks in stores; 3.4 per cent, doctors; 2.9 per cent, lawyers; and 3 per cent, manufacturers. Teachers, students, salesmen, carpenters, railway employees, stationary engineers, and plumbers, architects and draftsmen, telephone and telegraph operators, and clergymen make up the bulk of the remainder of the 36,407 persons insured during this period.

The idea that I wanted to convey was one that I alluded to here before, that if it is the purpose of this law to impose a tax on those who are able to bear the burden, the people who will have to pay this tax are people who can ill afford to bear any extraordinary burden.

My own theory is that everybody ought to pay an income tax that has any income, if it is $500 or not more than 25 cents. That would be my idea, because I think they ought to feel that they have some interest in the Government. I do not care what amount they pay, but I would like to see them pay something.

Senator THOMAS. You and I do not disagree a particle on that subject.

Mr. BARNES. But what I object to here is selecting, as it seems to me, a whole lot of comparatively poor people and imposing an extraordinary tax, because a 10 per cent tax is an unusual and an extraordinary tax in this country anyhow, and I hope will be for some time to come. If you have to raise an extraordinary tax I think there should be a more general distribution of it than to just place it on people who are contributing in the manner that the policyholders in life insurance companies are contributing. I want to thank you gentlemen, for your attention. Permit me to file this brief with the committee.

Senator SMITH. The clerk will print the brief in the record.

(The brief referred to is here printed in full, as follows:)

PROTEST AGAINST IMPOSING AN EMERGENCY TAX ON MUTUAL LIFE INSURANCE COMPANIES (SEC. 201, H. R. 20573), SUBMITTED BY THE NORTHWESTERN MUTUAL LIFE INSURANCE CO.

[This section proposes to increase our tax from 2 per cent to 10 per cent on all net income over $5,000.]

Our company makes no profits. It furnishes insurance at cost. Because it charges a level premium, such premium must be high enough to provide for unusual contingencies. Otherwise, when they were met, we would become insolvent. Our stipulated premium is in excess of normal requirements, but such excess is returned as so-called dividends. Dividends in life insurance parlance mean the return of excess premium collected.

Mutual Benefit *v.* Herold, 198 Fed. 199.
S. C. in Court of Appeals, 201 Fed. 918.
S. C. in U. S. Sup. Ct., 231 U. S. 755.
Conn. Mutual Life Ins. Co. *v.* Eaton, 218 Fed. 206.
Conn. General Life Ins. Co. *v.* Eaton, 218 Fed. 188.
S. C. in Court of Appeals, 223 Fed. 1022.
Commonwealth *v.* Penn. Mutual, 97 Atl. 677.
Commonwealth *v.* Metropolitan, 98 Atl. 1072.
New York Life *v.* Chaves, 153 Pac. 303.
Mutual Benefit *v.* Commonwealth, 107 S. W. 802.
Huebner on Life Insurance, 314–316.
Gephart on "Principles of Insurance," p. 195.

We have no stockholders. Our funds belong to our policyholders. We collect from them from year to year a sum which, with interest additions, enables us to fulfill our contracts. We carry a comparatively small surplus to take care of the fluctuations in the market value of our securities, and to make good losses in investments. Aside from this surplus all other income is returned to the policyholders at one time or another.

We have over 575,000 policies outstanding, averaging about $2,600. Our largest class of policyholders is composed of farmers. Then come clerks and moderate salaried employees who are endeavoring to lay something aside for their families in the event of their death. Life insurance is about all many of them leave. Then we have the professional and small business men, teachers, mechanics, and laborers who, for the most part, are not men of means. While we have wealthy men among our policyholders, their number is comparatively small. It is the man who is making an endeavor to provide for his family who will have to pay the greater part of this excess tax. These people have denied themselves many little luxuries and sometimes necessaries to keep their insurance in force. It often stands between the family and the poorhouse. From an economic standpoint life insurance should be encouraged instead of penalized by the State. It lightens the burden that the State would otherwise have to carry. Very properly the tate practically exempts fraternal insurance companies from taxation. Why should it make a pariah of the old-line life insurance company? Both are advertising to carry life insurance at cost, and the level premium mutuals do so. The ultimate expense, considering relative benefits, is as great in one as in the other. It is only when the fraternal tries to do the impossible—that is, to carry insurance below cost—that it comes to grief, if otherwise efficiently managed. One of these fraternal organizations had about $80,000,000 more insurance in force December 31, 1915, than did the Northwestern. Its certificates averaged about $1,600. Still another had over a billion of insurance on the same date. The fraternal organizations are not called upon to pay any tax, State or national, except on real estate. They are exempt from a Federal income tax under subdivision 3 of section 11 of the income-tax act.

The Northwestern during the year 1916 paid on account of taxes, excluding real estate, $1,100,000. The farmer, the lawyer, the doctor, the mechanic, the merchant, the laborer, and the capitalist insure in both classes of companies. Many of the fraternals are on a legal reserve basis, as well as the old line companies. The principal difference is that one class of policyholders prefer to pay a larger premium to begin with and to buy something which they believe to be safe, while the other class prefers to take a cheaper article of insurance to begin with, and take chances on the future. It is safe to say that as to 95 per cent of the policyholders in both classes of companies, insurance is taken for family protection, and that in the majority of cases, it is essential that it should be taken for such protection. This is just as true as to mutual insurance as it is to fraternal insurance.

By the second subdivision of section 11 of the 1916 income-tax law, mutual savings banks not having a capital stock represented by shares are exempt from taxation. I venture the assertion that not one valid reason can be advanced for this exemption which does not apply with equal or greater force to mutual life insurance companies. This proposed increase in taxes is largely a tax on the widows and orphans of the future.

It has been stated in the press that it was the purpose to tax those business institutions which were making large sums of money to pay for the military protection which the Government proposed to afford to the whole people. Without conceding the justice or propriety of the law as a whole, the reasons given have no application whatever to a mutual life insurance company. Wealth will be called upon to pay only a negligible share of this extraordinary tax. The individual who is entitled to a $4,000 exexemption may clip coupons to the extent of $24,000, and is called upon to pay an income tax of $400. A like amount of net income coming to our company for the benefit of its policyholders would be taxable to the extent of $2,000. Our policyholders, rich and poor, would be called upon to pay five times as much as the indvidual of independent means. It may be conceded that it is difficult to impose a tax that will not result in some inequity, but a studied attempt to make a tax unfair could hardly work greater injustice than this bill does to life insurance companies. This bill has not the merit of being a good measure from a socialistic standpoint, because it imposes a burden on thrift and on those who are least able to bear it. There are, in round numbers, 7,000,000 policyholders in old-line mutual life insurance companies in this country, It ought not to be necessary for them in order to secure fair play to be compelled to imitate the example of other classes and organize for their protection.

It is asserted that these companies control large aggregations of capital. This in itself is no reason why they should be subject to excessive taxation. I never supposed that an individual who had $100,000 in property and owed a like amount was well off financially, and this is the situation as to life insurance companies. Both by contract and by law, practically all of the $330,000,000 of reserve which we carry can be demanded of us in 90 days. Savings banks and other institutions are not taxed because they happen to owe enormous sums of money. No more should we be.

Figures for the first nine months of 1916 show that of those taking policies of insurance in our company 14.4 per cent were farmers, 9 per cent merchants, 6 per cent office employees, 5.3 per cent clerks in stores, 3.4 per cent doctors, 2.9 per cent lawyers, and 3 per cent manufacturers. Teachers, students, salesmen, carpenters, railway employees, stationary engineers and plumbers, architects and draftsmen, telephone and telegraph operators, and clergymen make up the bulk of the remainder of the 36,407 persons insured during this period. The average for a period of years would not differ materially from the figures above given. The idea which I wish to convey is that these are the persons who must pay this emergency tax, and that they are not plutocrats or beneficiaries of the present war, and that there is no reason why they should be singled out and compelled to bear an excessive portion of the burden of taxation for whatever purpose a tax may be imposed.

Respectfully submitted.

John Barnes,
Counsel for The Northwestern Mutual Life Insurance Co.

Senator Smith. The committee will now hear Mr. Lunger.

STATEMENT OF MR. JOHN B. LUNGER, VICE PRESIDENT OF THE EQUITABLE LIFE INSURANCE SOCIETY OF NEW YORK CITY.

Mr. Lunger. First of all, gentlemen, I want to say that Senator Thomas must not take those figures for 1915 too seriously.

Senator Thomas. I took them quite seriously. I found that your company paid two-thirds of all the tax.

Mr. Lunger. Not so much as that. We paid our fair share. But the figures for 1915 were based on the 1 per cent tax. If I mistake not, in that year two of these large companies were mutualized and it took several million dollars to buy out their capital stock. But they will come in for the 1916 statement and then we shall have to pay 2 per cent instead of 1, and our $200,000 is likely to become very nearly a million.

The preceding speakers have presented the case of mutual insurance so carefully that I have not anything to add to what they have said. It all relates to my society, but there is this distinction to which I wish to call your attention: The Equitable is one of a class of companies doing business on the mutual plan that has a capital stock. The Equitable was organized in 1858. In 1853 a law was passed in the State of New York to the effect that a company organizing on and after the passage of that law should have a capital stock of at least $100,000, which should be deposited at Albany. The reason for that was that so many companies had organized on the mutual plan previous to 1853 and had gone into the hands of receivers that they felt there ought to be a reasonable guarantee. We do our business exclusively on the mutual plan. I simply draw attention to that distinction to show that any phraseology about mutual life insurance would not affect the companies that have that nominal capital. The expression ought to be, "doing business on the mutual plan."

The chairman spoke about contributions toward preparedness. Gentlemen, we are preparing to make the biggest contribution toward whatever may eventuate out of this present situation of any corporations in this land.

Senator THOMAS. Do you mean waiving the exemption for the soldier?

Senator SMITH. No; he means if they go into the field and are killed.

Senator THOMAS. That is the point I make.

Mr. LUNGER. There are two things that we are preparing to do. I think at least 5,000,000 men carry policies averaging about $2,000. If you take into consideration the companies doing a business in small policies we would represent about 25,000,000 people, say of that number 20,000,000 men. Now, there is not a single company that in the case of war would charge a single dollar for extra premiums to any one who enlists. They can go cheerfully with free permits, and we will afford them every reasonable extension under their premium and we will pay the claim.

Two weeks ago I was in the city of Toronto. They were raising there a fund of two and a half million dollars that they called a patriotic fund. Every firm in the city was contributing to it. It was for the purpose of taking care of the wives and the children of those killed on the other side and the wives and children of those remaining on this side. But they do not insure in Canada as they do in the United States.

Senator SMITH. Do your insurance policies contain no exempton in case the policyholder enters the military service?

Mr. LUNGER. All policies issued in recent years, I should say practically for the last 15 or 20 years, in the American companies have been free from restrictions as regards military or naval service in the United States. Some of the companies have retained the privilege of charging an extra premium on the European business which they have issued, but not for the United States.

Senator SMITH. Those who go out of the United States?

Mr. LUNGER. Those who go out of the United States and enlist; for instance, those who have gone out of the United States and enlisted in this present war in France and England.

Senator THOMAS. I had the impression that a man enlisting or going to war without the consent of the insurance company forfeited his policy.

Mr. LUNGER. No; that was years ago. By degree we extended these benefits to all old policy holders.

Senator SMITH. All of your policyholders if called upon to serve in the United States would have the right under their policies to have their beneficiaries recover, even though the policyholder were killed in line of duty in the United States?

Mr. LUNGER. Yes, sir.

Senator JAMES. What would be the effect if a soldier of the United States had to go over to Europe?

Mr. LUNGER. This applies to all the people who are residents of the United States. It does not limit the place of death.

Senator THOMAS. There is no distinction as to where a man is killed?

Mr. LUNGER. No.

Senator JAMES. Senator Smith's question had reference to those who were soldiers in the United States and who were killed here.

Mr. LUNGER. I take it as meaning residents of the United States killed in service. So long as the insured is a resident of the United States he may serve anywhere in the interests of the United States, but not of any other country.

Now, the second point I wish to make is this: We are the most patriotic of institutions. We mobilized a great deal of money. We are creating preparedness in that way, not of our own money, but the savings of our policyholders. You gentlemen will probably recall that the life insurance companies saved an embarrassing situation here in Washington. You will recall the first $50,000,000 loan that was put out to build up the gold reserve in President Cleveland's administration. Then the second loan came along and it was made a public offering by reason of that criticism and it was practically underwritten.

Senator THOMAS. I suppose that appeals to Senator Smith; it does not appeal to me.

Mr. LUNGER. It was a patriotic move, gentlemen.

Senator SMITH. I think it was splendid, myself.

Mr. LUNGER. The life insurance companies underwrote that loan practically before it was offered.

Senator THOMAS. I have a communication here, Mr. Chairman, from R. C. Milliken, of this city, representing the Northwestern Mutual Life Insurance Co., which contains some statistics and some very good arguments on this subject. With your permission I will put it in the record.

(The communication and argument referred to is here printed in full, as follows:)

THE NORTHWESTERN MUTUAL LIFE INSURANCE CO.,
Washington, D. C., February 3, 1917.

Senator F. M. SIMMONS, *Senate Office Building.*

DEAR SIR: I hand herewith an argument which I hurriedly prepared against the imposition of a tax on the "net income" above $5,000 on mutual life insurance companies, and I would esteem it a favor if you could grant me an opportunity to appear before your committee and present the question more fully in an oral argument.

I was born and raised in Texas and my father was insured in two southern life insurance companies which failed. In the last 10 years the South has organized a number of companies, and I believe that this tax would injure them much worse than it would the Northern companies, which are well established.

Sincerely, yours,

R. C. MILLIKEN, *Agent.*

AN ARGUMENT AGAINST THAT PART OF SECTION 201 OF H. R. 20573 IMPOSING A TAX OF 8 PER CENT OF THE "NET INCOME" OF MUTUAL INSURANCE COMPANIES.

[By R. C. Milliken, 515 Union Trust Building, Soliciting Agent for the Northwestern Mutual Life Insurance Co., of Milwaukee, Wis.]

As my company was organized on the mutual plan in 1857, and has never had any capital stock, that part of this section of the bill which imposes a tax of 8 per cent on the "actual capital invested" does not apply to it, and therefore I shall confine my argument to that portion imposing a tax of 8 per cent on the "net income" above $5,000.

I must confess that I do not comprehend the meaning of the phrase "net income" when applied to a mutual insurance company, as it is never used in this business. Ordinarily, we understand that to mean the difference between the gross income and gross disbursements. But that could not apply to a mutual life insurance company, because all the States require it to maintain a reserve and other liabilities to meet the increasing cost due to advancing age, and the only means of doing so is by using a portion of the difference between its gross income and gross disbursements.

To illustrate this I shall give the gross income and gross disbursements of the Northwestern Mutual for the year 1915, the latest available figures on file with the Insurance Department of the District of Columbia. This data is compiled from the Pocket Index by the Spectator Company, which may be found in the Congressional Library.

Income and disbursements of the Northwestern Mutual for 1915.

Income:	
Premiums received	$49,461,752
Interest and other receipts	17,370,376
Total income	66,832,128
Disbursements:	
Death claims	13,845,764
Matured endowments and annuities	4,742,586
Surrendered and ceased policies	10,598,674
Dividends paid policyholders	13,271,992
Taxes	1,236,152
Expenses of management	6,994,549
Total disbursements	51,257,418
Excess of income over disbursements	15,574,710

During 1915 the Northwestern's liabilities increased from $305,720,914 to $320,375,889 or $14,654,975. The only possible source from which the company can meet such increase in liabilities is from the excess of income over disbursements. Clearly, then, the phrase "net income" does not mean what the term ordinarily implies, i. e., the difference between the gross income and gross disbursements.

Therefore we will deduct the increase in liabilities ($14,654,975) from the excess income over disbursements ($15,574,710), which would leave $919,735 of increase in unassigned funds, which the uninformed often term surplus. I surmise it was this last-mentioned sum which the author of the phrase "net income" sought to tax. But is it fair to the policyholders to tax such a fund, a fund provided for the protection of the company's liabilities? Let come what may and the company must meet its liabilities or go into the hands of a receiver. And a mutual company has no stock to sell to an investor as an inducement for him to come to the rescue of the company in time of need.

Let us see the purpose of the unassigned or surplus fund of a mutual life insurance company. The principal purpose of such fund is to meet the fluctuation in the securities which it invests to meet its liabilities. These are troublous times through which we are passing. The security market at the present time is subject to violent fluctuations. Taken by itself, that $919,735 seems a large increase to be made in such fund during a single year, but when it is considered that the company had more than $320,000,000 of liabilities to be protected by it, it is small. The total unassigned funds of the company at the time that report was made amounted to less than 2 per cent of its liabilities. Nothing but a life insurance company would think of operating on such a small surplus, but it is based on such a stable law—the law of mortality—that it is regarded as perfectly safe.

THE PRINCIPLE OF THIS TAX IS UNSOUND.

We should not forget the multitude of life-insurance failures during the seventies. All the Southern companies failed, and only four companies west of the Alleghenies survived that period. They failed because their net income was insufficient to meet their reserve liabilities. Therefore to adopt the principle of taxing the surplus will surely tend to weaken the companies, for in order to escape such unjust burden the companies will pay policyholders excessive dividends. No State has ever invoked this unjust principle of taxation, but if Congress sets a precedent, it might be followed by them, for the people look on that body as possessing more wisdom than their State legislative bodies. And it is much easier to have a vicious law repealed by the State legislatures than it is by Congress, for the members of the former spend but little of their time at legislating, the balance of which is spent in attending to their duties of earning a livelihood, and in doing so come in constant and intimate contact with their constituents, who recognize that few of them are philosophers. But Congress has so much legislation to attend to that the Members have to give up their duties of earning a livelihood and devote their whole time to legislation. That is, they are professional legislators, and are therefore supposed to be masters of the science of government and legislation.

BURDENS OF STATE TAXES ON INSURANCE AT PRESENT.

The insurance taxes now imposed by the States are a great burden to this business. To illustrate this I direct attention to the fact that in 1915 our taxes exceeded by 35.8 per cent the salaries paid its officials and home office employees, a burden not born by any other company in the world. The British Government, instead of taxing their life insurance companies, exempt one-sixth of each citizen's income from taxation if it be used in paying life insurance premiums. In many other ways they have encouraged their citizens to insure their lives for the protection of their dependents, for that is the only way to capitalize human life, the greatest wealth of any lands. Germany and other European States have made life insurance compulsory and ex, empted it from taxation. While all that has been done in other countries, we in this country have twice as much life insurance in force as all the world combined, and it has all come about by private initiative. The most unselfish financial act any man ever did is to insure his life, for he must die to win. Our life insurance statistics is the greatest encomium ever paid to the fathers and husbands of any land.

WHY LIFE INSURANCE SHOULD NOT BE TAXED.

A life insurance company is not a producer, but only a distributor of wealth. Therefore a tax imposed on it means double taxation on the contributors of its premiums. To illustrate this, I call attention to the fact that this company had loaned on the farms in Missouri in 1915 the sum of $20,814,461.19. Our mortgage policy is to encourage tenants to become small landed proprietors, in the pursuit of which we make better farmers, for the small landed proprietor who actually tills his own soil does not rob it of its fertility for immediate profit, but improves his land for future profit. Those farmers we lent to paid the taxes on those farms, and our mortgages are only titles to equities in them. In doing that my company did not create any wealth, but only enabled the poor man to acquire the legal title. No one would think of taxing a farmer's land and deed, too. That would be double taxation. The same thing is true when you tax the title papērs to the equity.

I make this argument of my own volition and without any suggestion from the home office officials. I make my living by soliciting insurance for this company. I believe in the institution of life insurance, and I would greatly appreciate it if the Finance Committee would accord me an opportunity to appear and personally present thi question to them.

Senator SMITH. Now, Mr. Milliken, you may proceed.

STATEMENT OF MR. R. C. MILLIKEN, SOLICITING AGENT FOR THE NORTHWESTERN MUTUAL LIFE INSURANCE CO. OF MILWAUKEE, WIS.

Mr. MILLIKEN. Mr. Chairman and gentlemen of the committee, I represent myself as local agent of the Northwestern Mutual Life Insurance Co. in the District of Columbia. Speaking of the tax on

the capital of the companies, there are but three companies virtually that this tax would reach, and those are the Aetna, whose dividends are 12 per cent; the Union Central, whose dividends are 10 per cent; and the Travelers, whose dividends are 16 per cent.

Senator JAMES. How much tax would be derived under this bill from the three companies you have mentioned?

Mr. MILLIKEN. The capital of the Aetna is $5,000,000, with dividends of 12 per cent, which is $600,000.

Senator THOMAS. Where is that company located?

Mr. MILLIKEN. In Hartford. Here is the Travelers of Hartford.

Senator THOMAS. Is that a fire insurance company?

Mr. MILLIKEN. That is a life and accident insurance company. The Travelers have their $5,000,000 of capital and $800,000 of dividends. The Union Central of Cincinnati has half a million dollars in stock and a 10 per cent dividend.

Senator THOMAS. A previous speaker spoke of a company in Omaha that paid 10 per cent.

Mr. MILLIKEN. That is the Bankers' Reserve. I could furnish you with a list showing the dividends paid by every company. The Bankers' Reserve of Omaha with a capital of $100,000 pays 10 per cent.

Mr. LUNGER. You have quoted the dividends of the Aetna and the Travelers and you perhaps have given the committee the impression that that entire dividend is paid out of their life business. Now, will you kindly subdivide that dividend into the amount that is paid out of life business and the amount paid out of their casualty business?

Mr. FLEMING. Both of those companies have general liability. It is largely out of that branch of the business that these dividends are earned.

Mr. MILLIKEN. Here are 81 new companies that have never paid dividends. They have over $17,000,000 in capital.

Senator THOMAS. What are they afraid of?

Mr. MILLIKEN. There are four in your State, at Denver, that never paid a dividend.

As I say, they have been in the business several years and have never earned a dividend on their capital.

Senator THOMAS. They are as badly frightened as though they were paying 25 per cent.

Mr. MILLIKEN. I have here a list showing the business done by the British companies as over $300,000,000 a year. The New York Life does $240,000,000 of business and the Metropolitan's total business is over half a billion.

Senator JAMES. What does all that go to show?

Mr. MILLIKEN. It shows that Great Britain exempts one-sixth of a man's income from an income tax if it is invested in insurance. They have done everything to encourage men to take insurance, exempting not only the companies from taxation, but exempting the individual from paying the income tax if it is invested in insurance. Notwithstanding that encouragement which the British companies receive, the Prudential and the Metropolitan each do nearly twice as much as practically all the British ordinary companies.

I wish to leave with the committee a statement containing an argument against that part of section 201 of H. R. 2573 imposing a tax of 8 per cent on the net income of mutual insurance companies,

and also these tables of comparison between the new business done by all the British and only 24 of the United States life insurance companies.

Senator SMITH. Leave it with the stenographer and it will be printed in the record.

(The argument and tables referred to are here printed in full, as follows:)

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I make this argument of my own volition and without any suggestion from the home office officials. I make my living by soliciting insurance for this company. I believe in the institution of life insurance, and would greatly appreciate it if the Finance Committee would accord me an opportunity of appearing and personally presenting this question to them in an oral argument where I may be questioned by the members of that committee.

The year of the British is indicated below and the new business of our own companies was for the year 1915. These statistics are compiled from the 1916 Life Insurance Yearbook.

Comparison between the new (ordinary) business done by all the British and only 24 of the United States life insurance companies.

BRITISH COMPANIES.

Name of company.	Year.	Amount.	Name of company.	Year.	Amount.
		Pounds.			*Pounds.*
Abstainers	1914	286,437	N. B. & Mercantile		2,259,061
Alliance	1914	1,140,424	Norwich Union		4,643,525
Atlas		598,583	Phoenix		1,266,743
Britannic		403,042	Profit & Income		38,998
British Equitable	1915	162,382	Provident Clerks		423,846
British Legal		27,305	Refuge		2,513,140
British Life	1914	11,505	Royal Exchange		808,512
Caledonian		702,980	Salvation Army	1915	163,226
Century		357,033	Scottish	1914	150,568
City Life		178,748	Scottish Equitable	1915	634,929
Clergy Mutual	1915	253,303	Scottish Province	1914	1,654,664
Clerical Medical		672,732	Scottish U. & N		783,794
Commercial Union	1914	2,433,948	Standard		1,713,646
Consolidated		152,179	Sun		2,692,862
Customs Annuity Fund		32,780	University	1915	107,557
Eagle		421,471	Yorkshire		603,843
Edinburgh		384,257	London Life	1914	814,958
English and Scottish Law		395,481	Marine & General		258,046
Equitable		406,054	National Benefit		108,060
Equity & Law		443,052	National Standard		13,380
Friends' Provident		224,022	Northern		377,307
General Accident		133,036	Pearl		1,891,318
General Life		505,755	Pioneer	1915	43,925
Government (post office)		34,287	Prov. Association	1914	201,788
Gresham		1,763,407	Prudential		6,318,843
Hearts of Oak		30,597	Royal		1,572,346
Law Integrity	1915	67,115	Royal London Auxiliary		743,441
Law Union & Rock	1914	1,239,370	Sceptre		100,365
Legal & General		2,660,492	Scottish Amicable		763,886
Life Association of Scotland		487,408	Scottish Life		420,300
L. & L. & G		538,654	Scottish Temperance		555,890
London Assurance		494,238	Scottish Widows		2,090,861
London & Lancashire		767,733	Star		1,086,574
London & Manchester	1915	275,525	U. K. Temp. & General		1,080,551
Metropolitan	1914	226,563	Wesleyan & General		459,465
National Mutual		388,090			

UNITED STATES COMPANIES.

Name of company.	Amount.	Name of company.	Amount.
Aetna	$52,167,847	Northwestern	$137,816,644
Connecticut Mutual	23,237,353	Pacific Mutual	23,758,191
Equitable of New York	147,819,198	Penn Mutual	75,611,313
Fidelity Mutual	18,026,596	Phoenix Mutual	20,091,081
Germania	20,203,221	Pittsburgh Life & Trust	19,082,134
Home Life	13,932,882	Provident Life & Trust	47,231,636
Massachusetts Mutual	40,458,133	State Mutual of Massachusetts	19,998,129
Mutual Benefit	77,747,292	Travelers	56,958,755
Mutual of New York	164,010,785	Union Central	51,041,722
National of Vermont	21,911,618	John Hancock	45,930,999
Northeastern Mutual	33,085,058	Metropolitan	230,521,376
New York Life	240,823,083	Prudential	157,813,411

Stock companies which have never paid a dividend to stockholders.

Name of company and habitat	Date of the organization.	Amount of capital.
American National, St. Louis, Mo	1912	$200,000
Atlantic Life, Richmond, Va	1900	200,000
Bankers International, Denver, Colo	1910	100,000
Bank Savings, Topeka, Kans	1909	200,000
California State, Sacramento, Cal	1912	500,000
Capitol Life, Denver, Colo	1905	100,000
Central States, St. Louis, Mo	1910	390,000
Cherokee Life, Rome, Ga	1910	100,000
Cleveland Life, Cleveland, Ohio	1906	250,000
Colonial Life, Jersey City, N. J	1897	250,000
Columbia Life, Cincinnati, Ohio	1902	181,800
Commonwealth, Omaha, Nebr	1909	100,000
Conservative Life, South Bend, Ind	1912	145,050
Conservative Life, Wheeling, W. Va	1907	295,390
Cotton States Life, Tupelo, Miss	1911	103,190
Dakota Western, Sioux Falls, S. Dak	1910	100,000
Farmers and Bankers, Wichita, Kans	1911	275,000
Farmers and Traders, Syracuse, N. Y	1912	200,000
Farmers Life, Denver, Colo	1911	254,756
Farmers National, Chicago, Ill	1913	252,380
Forest City, Rockford, Ill	1909	100,000
Gem City Life, Dayton, Ohio	1912	100,000
German-American, Denver, Colo	1911	186,035
Gibralta Life, Paris, Tex	1912	145,500
Great Northern, Grand Forks, N. Dak	1910	141,000
Great Republic, Los Angeles, Cal	1911	500,000
Great Southern, Houston, Tex	1909	500,000
Guardian Life, Madison, Wis	1909	108,660
Gulf Coast Life, Gulfport, Miss	1911	168,020
Idaho Life, Boise, Idaho	1909	200,000
Inter-Mountain Life, Salt Lake City, Utah	1911	124,510
Iowa Life, Waterloo, Iowa	1908	100,000
Kansas Life, Topeka, Kans	1913	216,190
Louisiana State, Shreveport, La	1911	250,000
Mid-Continent, Muskogee, Okla	1910	100,584
Midland, St. Paul, Minn	1910	171,439
Midland, Kansas City, Mo	1909	100,000
Midwest Life, Lincoln, Nebr	1906	150,000
Montana Life, Helena, Mont	1910	250,000
National, Butte, Mont	1910	203,805
New World, Spokane, Wash	1910	1,129,480
North State Life, Kinston, N. C	1906	50,000
Occidental Life, Los Angeles, Cal	1906	250,000
Ohio National, Cincinnati, Ohio	1909	446,730
Oklahoma National, Oklahoma, Okla	1909	200,000
Old Colony, Chicago, Ill	1907	116,302
Our Home Life, Jacksonville, Fla	1910	110,157
Pan-American, New Orleans, La	1912	1,000,000
Peninsula Life, Detroit, Mich	1911	113,550
Pension Mutual, Pittsburgh, Pa	1912	849,825
Pioneer Life, Kansas City, Mo	1907	100,000
Pioneer Life, Fargo, N. Dak	1907	100,000
Prairie Life, Omaha, Nebr	1913	133,867
Preferred Life, Grand Rapids, Mich	1909	100,000
Protective League, Decatur, Ill	1914	100,000
Protective Life, Birmingham, Ala	1907	141,680
Provident Life, Des Moines, Iowa	1913	100,000
Prudential, San Antonio, Tex	1911	140,800
Public Savings, Indianapolis, Ind	1909	289,010
Puritan, Providence, R. I	1907	151,000
Reliance, Pittsburgh, Pa	1903	1,000,000
Reserve Loan Life, Indianapolis, Ind	1897	100,000
Rockford Life, Rockford, Ill	1909	100,000
St. Joseph Life, St. Joseph, Mo	1913	100,000
San Jacinto Life, San Antonio, Tex	1914	100,000
Shenandoah Life, Roanoke, Va	1915	121,920
Southeastern, Greenville, S. C	1905	100,000
Southern Union, Waco, Tex	1909	190,880
Southland, Dallas, Tex	1908	295,735
State Life, Great Falls, Mont	1913	103,853
Toledo Travelers, Toledo, Ohio	1912	100,000
Twin City Life, Minneapolis, Minn	1912	100,000
Two Republics, El Paso, Tex	1909	150,000
West Coast, San Francisco, Cal	1915	250,000
Western Life, Des Moines, Iowa	1907	100,000
Western Reserve, Muncie, Ind	1910	100,635
Western States, San Francisco, Cal	1910	1,000,000
Wichita Southern, Wichita Falls, Tex	1911	153,050
Wisconsin National, Oshkosh, Wis	1008	400,000
Wyoming Life, Cheyenne, Wyo	1911	300,000

Senator SMITH. Mr. McIntosh, you may proceed now.

STATEMENT OF MR. JAMES H. McINTOSH, COUNSEL OF THE NEW YORK LIFE INSURANCE CO., NEW YORK CITY.

Mr. MCINTOSH. I want to concur in all that has been said by the gentlemen who have preceded me. And I want to remind the committee especially of this thing, that an insurance company because it is large does not differ one whit from an insurance company that is small. The small company must have precisely the same relative assets proportionate to its insurance risk that a large company must have, and a large company must have large assets because it has large insurance risks. The proportion between its risks and its assets is exactly the same as the proportion between the risks and the assets of the small company. That is inherent in the nature of the business, and it is imposed upon our company equally by the laws of every State, which require each company to have a reserve back of every policy which is mathematically the same in every case, differing only whether the reserve is held upon an assumed interest earning of 3 per cent, 3½ per cent, or 4 per cent. So, that because a company is big is no reason why it should be taxed. If it is big, that means that it has big insurance risks.

There is another thing which I hesitate to speak of, but I am going to because Senator Thomas made reference to it, and that is the incident of one or more of these large companies contributing to campaign funds. I want to concede, in the first place, that that was a wrong thing, and then remind you that it was a very regrettable and dreadful thing with respect to those persons who took part in it. One of them paid as the price of that thing with his life. Another who took part in that same thing in my company underwent the humiliation of prosecution and voluntarily paid back to the company with 6 per cent interest the entire contribution in which he was concerned.

The insurance world learned a lesson from that—a lesson which legislators would do well to remember; a lesson which stood in large letters at the head of the columns of many newspapers and created a great impression over this country. That lesson was that this money which was taken for campaign purposes was the money of the widows and orphans who were the beneficiaries of the funds so diverted. And when a State taxes these funds the State would better remember that same thing too. It seemed to me when that result was so forcibly impressed upon the public mind that we would not after that have much trouble with tax legislation and, indeed, we have not had a great deal in the States. The States have not very much increased their taxes from that day to this. It is only the Federal Government. The Federal Government has imposed its income tax on mutual life insurance companies under what I feel sure is a mistaken understanding of the nature of this business. If all the members of this Congress had understood the business of life insurance as you gentlemen have indicated here in this discussion that you understand it, the life insurance on the mutual plan would have been placed in the income tax right where the savings banks without a capital stock were placed, and that is where they ought to have been placed.

Now, whatever the Congress takes from these companies comes no part of it out of its officers, out of the men responsible for the management of these companies, except as they are policy holders of the companies. Last year my company paid an income tax.

Senator THOMAS. Do you mean in 1915?

Mr. McINTOSH. In 1916 on the business of 1915. My company paid an income tax of $113,000. We have to-day been at the Revenue Department to meet an additional claim of the department on an objection to our return. If the Revenue Department's claim of what our return should be is right—and I do not think it is—it will more than double the tax we paid last year. Under the present law which refuses to allow any deduction on account of depreciation in securities our tax will be very much increased, because the old law allowed us to make deductions from our gross income on account of depreciation in securities. This law only allowed a deduction in case the securities have been charged off. So that with the doubling of the tax rate and the changing of that item of deduction I feel satisfied that under the present income tax law taxes of my company this year will be about $300,000.

Senator SMITH. Then, it is your company and not the Equitable that pays?

Mr. McINTOSH. I do not know what the taxes of any other company is. I never looked that up.

Senator SMITH. What is the capital stock of your company?

Mr. McINTOSH. My dear sir, we have not a sou of capital stock. Every dollar of the assets of my company belongs to the policyholders. If we were liquidated to-day and all our property divided among our policyholders, each would get something like $700 or $800.

Senator THOMAS. Yours is the largest of all of them?

Mr. McINTOSH. The largest in assets; yes, sir. If we were liquidated to-day and all our assets divided among our policyholders each would get $700 or $800.

Senator SMITH. What are your assets now?

Mr. McINTOSH. Something like $800,000,000, but we have about 1,200,000 policyholders insured, and our policies average twenty-one hundred and some odd dollars. So that the average policyholder of our company is a man who pays a premium of from $60 to $70; the farmer, the laborer, the mechanic, the man to whom $60 or $70 means something, and who saves his money to pay that quarterly, semiannually, or yearly. Every dollar of tax that we have to pay increases the sum that that man is saving against the calamity of his death.

Senator SMITH. Do you distribute back each year the surplus on your return premiums?

Mr. McINTOSH. Yes, sir; we keep our account exactly as Mr. Rhodes explained to you that they keep theirs. All companies keep their accounts alike.

Senator THOMAS. Has your company always been a mutual company?

Mr. McINTOSH. It has always been a mutual company. It never has had a dollar of stock and it is exactly on a par with the mutual benefit in every way; in its accounts and in its methods of doing business.

Senator SMITH. Did you have a dispute at one time with your policyholders about excessive accumulations?

Mr. McINTOSH. No, sir.

Senator SMITH. A number of companies did some 10 years ago in New York.

Mr. McINTOSH. I think you have in mind the laws of New York. The Armstrong laws were directed against excessive accumulation of surplus.

Senator THOMAS. I recall a suit in connection with the Equitable on behalf of some of its stockholders in which I was asked to join, but I do not remember the details now.

Mr. McINTOSH. One of the reform laws was that the contingent reserve of the company shall never be allowed to exceed 7½ per cent of its legal reserve. So that when we take up our account at the end of the year and find what our business has been we pass to the reserve fund the sum the law requires to go into that, and we pass to the contingent reserve the sum that the law allows us to pass to that. Then every dollar outside of that goes back to our policyholders to reduce the cost of their insurance. This is simply different from the assessment insurance in that it is paid for in advance and accounted for and the excess returned rather than waiting until a loss occurs and trying to collect it then from the members of the association.

Now, this is an excess profit tax. Unless the corporation has excess profits it ought not to come within the classes that are taxed under that law. You say so. You say, "We will let you earn 8 per cent. That we will look upon as a normal profit. Now, all in excess of 8 per cent on your invested capital you must pay a tax on of 8 per cent." But how can a life insurance company have excess profits under the conditions that give rise to this law—war and the conditions of war? My company has policyholders in every country that is now and has been at war. Why, its experience is not excess profits; it is excess losses. And so if the worst should come to the worst here, which we are all praying may not happen, in the case of every American that holds a policy in my company and dies his beneficiary will get the proceeds of his insurance as soon as the mails can carry it to him; no questions will be asked. That is true with respect to every company that is represented here.

Senator SMITH. Your reserve is how much?

Mr. McINTOSH. About $600,000,000.

Senator SMITH. Your face policyholders are how much?

Mr. McINTOSH. About $2,500,000,000.

Senator JAMES. Instead of this war situation increasing what might be said to be profits, you think it would decrease them?

Mr. McINTOSH. There is not any question about it.

Senator SMITH. If we are really at war.

Senator JAMES. He says many of his policyholders are already in the armies.

Mr. McINTOSH. We have insured in Siberia, Russia, France, Germany, England, and elsewhere, and I just want to call your attention to it; it is proper that I should; in spite of that, all this stress and financial strain in these warring countries there never has yet been one suggestion of imposing any tax upon life insurance in Germany or in France or in Serbia or in Turkey or in any other country except in Russia, and there is some discussion in England.

Senator JAMES. But up to this time there has been no tax imposed?

Mr. McINTOSH. There has been no tax imposed and there has been none suggested.

Senator THOMAS. Except in England?

Mr. McINTOSH. Except in England. I am not sure that it has been passed in Russia.

Senator SMITH. How could the English insurance companies, if they continued carrying their risks on these men in the trenches, pay their taxation?

Mr. McINTOSH. It would be a terrible strain on them.

Senator SMITH. Is it not all they can do to live?

Mr. McINTOSH. I should think it would be.

Senator THOMAS. Can you give us an approximation of your company's losses incident to this war?

Mr. McINTOSH. No; I can not.

Senator SMITH. The great majority of policyholders are in the United States; I suppose there is only a small percentage abroad.

Mr. McINTOSH. We have about $500,000,000 insurance in foreign countries, excluding Canada.

Senator SMITH. About 20 per cent of your policyholders are in Europe?

Mr. McINTOSH. Yes.

Mr. JONES. Mr. Kingsley made a statement about that recently.

Mr. McINTOSH. In no European country have they ever taxed life insurance, except in Spain, and we have had a controversy with the Russian Government. They claimed that we came under a taxing law, but we have not paid any tax there. I except, of course, their stamp taxes on receipts and things of that kind that come in in some of the detailed taxes that they have, but the governing officers of those companies—now, I do not mean to reflect on anybody—but they really understand the theory of insurance and they encourage it. Of course, they were the first to pass compulsory insurance laws and things of that kind.

I want to just suggest where I think you can amend this law to meet the situation we have. The difficulty with the law is that it does not define any capital at all when it refers to the business of life insurance. If life insurance makes excess profits, why then the bill should be so worded that it should tax them, but unless they do it ought not to tax them. It ought not to select them out and put them at worse places. I suggest that in section 202 you insert after the word "business," in line 21, the words "in case of insurance companies."

Senator JAMES. You would say life insurance companies, would you not?

Mr. McINTOSH. If you wish. They ought to go all alike. In the case of insurance companies the invested reserve required by law is held by them to meet their obligations to policyholders. Now, that is a fair basis for actual capitalization.

Senator SMITH. There is not one that gets 8 per cent on its invested reserve. It would indicate ignorance on our part to put such a thing in the legislation. I do not suppose there is an insurance company that makes 6 per cent in its invested reserve, is there?

Mr. McINTOSH. No; I do not think so. But what is the capital of the company that has no capital?

Senator SMITH. If we are going to put in what you suggest, would it not be more intelligent to strike insurance companies out? We are striking them out, are we not?

Mr. McINTOSH. Yes; I agree with you, and that can be done by putting them in that section——

Senator SMITH. You might say we are taking an easy way to slip through with insurance companies without saying we had left them out.

Mr. McINTOSH. I suggest inserting in section 201, line 16, page 3, after the word "business," the words "of insurance transacted on the mutual plan and the business."

Senator THOMAS. Right there, what reason can you advance, if any, for the exemption of life, health, and accident insurance combined in one policy that would not apply to mutual insurance?

Mr. McINTOSH. Well, Senator, I do not know. I did not know that there was any such policy written myself, and I did not know any companies writing them. I do not know anything about that at all.

I thank you, gentlemen, very much.

Senator SMITH. The committee will now hear Mr. Cox.

STATEMENT OF MR. ROBERT LYNN COX, VICE PRESIDENT OF THE METROPOLITAN LIFE INSURANCE CO. OF NEW YORK.

Mr. COX. I want to say just a word on behalf of the situation which the Metropolitan Life Insurance Co. of New York finds itself in, just merely by way of adding a little bit of emphasis to the fact that these assets which seem to be large are split up. The Metropolitan Life is one of the few companies doing a large industrial business that is insuring working people. They have in the aggregate a large amount of assets, but the average amount of interest of the policyholders in the assets of that company is something less than $40. In other words, the company has nearly 17,000,000 policies issued and outstanding—to be exact, 16,952,000. That is the extent to which its policies have been issued. Its assets represent a large amount in that they are $608,000,000, but dividing that company's assets in that way you see how the figures run down much below the figures that have been given you by the other gentlemen. The average amount of premiums paid on those policies to that company is only about $9 a year. The average amount of insurance that it has under these policies that it has outstanding is about $205 per policy. That only shows how the business multiplies by getting in a very large number of people.

This company is in the class of the other companies that have been referred to in that it is a mutual company to-day without a dollar of capital stock, and, therefore, without any stockholder to reap profits. The burden will therefore fall upon that company as it falls on the other companies that have been described. Of course, I am not going into the question of arguing as has been argued here, because that would be only adding to what has been already said, but I thought those figures would interest you a little bit when you come to that question.

Senator THOMAS. Your insurance is largely industrial?

Mr. Cox. To a great extent. It also writes a large amount of ordinary insurance, but I am including both to get the average that I have stated. The industrial pulls down to those averages. If I were giving you the figures of the industrial alone they would go very much below the averages that I gave here.

I want to just add a word of emphasis on this question of the situation in which insurance companies generally will find themselves shortly after the Nation goes to the extent which it seems to be contemplating now.

Senator SMITH. Oh, no; no.

Mr. Cox. I do not know whether it will or not.

Senator SMITH. Let me express my dissent from the idea that it is going to.

Mr. Cox. I am delighted, sir, and I think every American will be delighted if we could keep out of this turmoil.

Senator JAMES. He is expressing his hope.

Mr. Cox. Well, I am expressing more than a hope.

Senator THOMAS. I wish I could join you.

Mr. Cox. You can not go too far for this audience, and I will say this: Not only will we join as American citizens in that hope, but we certainly will join as business men engaged in life insurance, in that hope, because it was to that point that I wanted to give emphasis, that this burden if it does fall will fall upon these companies. And I would go a step further, if I may, because I want to speak in another capacity. I am a member of the executive committee which is managing the affairs of the Association of Life Insurance Presidents. That organization represents stock and mutual companies. It represents also what we are accustomed to call the mixed companies. All of these companies, if this blow should fall, are very much in the same position. When you consider the amount of life insurance there is outstanding in this country, when you consider that the American life insurance companies lead the world in the volume of their business, that it is one of the great businesses of this country, it seems to me they ought to be taken absolutely out of this bill, mutual, stock, and all other kinds, and treated separately in order that they may be treated fairly and intelligently. That would be my suggestion if I had to deal with it as I would like. Then you would be able to take up, perhaps, and balance the equities between life insurance companies. If some ought to pay something you could determine that fact. I do not believe you can determine it in the turmoil here and the pressure that has been upon you at this time. You know that this great business has over $5,000,000,000 assets. It ought to be treated separately.

The great fundamental mistake was made when we were drawn into this income-tax law by phraseology and bookkeeping calculations that were not intended, and probably it would not have been done had it been known what was being done. Is not this the time and is not this the place to take out this business and treat it separately as it ought to be treated? You gentlemen are convinced that there is no such thing as 8 per cent profit in this business, and we tell you that we are drawn in here for a tremendous amount of money and to a tremendous expense?

Senator JAMES. You would agree to a compromise if we would strike it out of this bill without going into the other laws?

Mr. Cox. I think we would wait until you sent for us, Senator.

Senator SMITH. The only trouble about this law is that it reaches after 10 per cent of your profits, while you have not an 8 per cent basis for your reduction.

Mr. Cox. That is all. I have no doubt but what you would send for us some day, basing our present experience on the past. We have been here several times within the past two years. We were here first to pay a 1 per cent tax. Then we came back and you proposed we should pay a 2 per cent tax. Then, in addition to that, so far as stock companies are concerned, you also saw to it that they were to pay a tax upon their capital stock, and that has to be paid now as an additional tax by the stock companies.

Senator SMITH. That does not amount to anything.

Mr. Cox. That is a comparatively small tax that should not be unduly magnified for purposes of this discussion. It would be important in some instances when it amounts to $5,000 were it not for the fact that we are not so enormously taxed in other ways that it makes $5,000 look like a bagatelle. So, as I say, that would be the logical and proper thing if you could do it, to simply say this business is in a class by itself; its risks are different; and it could be taken out as a whole. The arguments for the mutual companies stand an a different basis.

Senator JAMES. We have to deal in this matter with the House. It has already passed this bill, including this objectionable increased tax, from your standpoint. If we were to go the length you suggest, do you not think we would have trouble with the House?

Mr. Cox. My judgment is you would not have much trouble with the House. We have discussed this matter somewhat with members of the House, and I know that there are many members of the House, and they are leaders in the House, who think it was a most serious mistake to have included insurance companies in this bill.

Senator SMITH. Do you know what number of life insurance companies have capital stock?

Mr. Cox. A majority of the companies have capital stock, but it should be said at the same time that that majority is among the smaller companies where any kind of a tax burden falls, as a rule, heaviest. A very considerable majority of the outstanding life insurance of this country is on the mutual plan. I should say, Senator, if I recollect correctly the figures, eighty-six and a fraction per cent of the outstanding life insurance of this country to-day is on the mutual plan, ordinarily called the participating plan.

Senator SMITH. To what extent have these life insurance companies limitations as to dividends that they can pay on their capital stock, as the Equitable has?

Mr. Cox. I could not say.

Senator SMITH. Beyond the 7 per cent on its capital stock, I understood that the Equitable was purely mutual as the others are.

Mr. Cox. It is limited to 7 per cent in that instance. I would like to make this point on behalf of those companies, that while many of them perhaps are not limited by law, they are decidedly limited in their competition with mutual companies. You must not forget that this business is on a competitive basis. There are about 250 life insurance companies doing business in this country and every stock company competes with the mutual companies, and these

mutual companies are doing business at cost. You can imagine the chances for excessive profits under those circumstances.

If they are doing a participating business, as many of them do, they must practically declare dividends as the mutual companies do in order to compete. If they are doing a nonparticipating or stock business they must make a rate so low that it practically in the end competes with a nonprofit-making concern. Their opportunities in many instances may be sky-high, but they do not work out that way in practice.

Senator THOMAS. You gentlemen are giving us a great deal of information, but I must right here remark that if you would only exhibit the same interest in the way we spend your money that you do in the way we raise it, I think we would run a more economical Government and do away with the necessity of raising so much money.

Mr. COX. I am glad to have that suggestion. If there is any way we can make our swearing heard at long distance we would be glad to do it, because we have heard a lot of it.

Senator THOMAS. Everything here is organized except the taxpayer. The interests and the people concerned who want money out of the Treasury are here with both feet. The men who pay the bills are only here when we have revenue to consider.

Senator SMITH. What Senator Thomas means is that there is no organization back of us that desires to check appropriations.

Senator THOMAS. Precisely so; and you can not get it.

Senator SMITH. That we have to stand alone against tremendous organizations.

Senator THOMAS. We can not find the place to begin economizing. Every time an attempt is made we are told that that is not the place.

Senator SMITH. I do not agree exactly with the Senator. We can not find anybody here in Washington that is willing to help us begin the economy. We can find the place.

Senator THOMAS. I must stick to my statement, that we have not been able to find the place.

Senator SMITH. Mr. Cox, you stated that the average policy in your company was how much?

Mr. COX. Two hundred and five dollars. The average premium paid was $9 a year and the average policy $205.

Senator SMITH. That grows out of the fact that your industrial insurance is so cheap.

Mr. COX. In such small amount; yes, sir.

Senator SMITH. Now, Mr. Blackburn, we will hear you.

STATEMENT OF MR. THOMAS W. BLACKBURN, SECRETARY AND COUNSEL OF THE AMERICAN LIFE CONVENTION, OMAHA, NEBR.

Mr. BLACKBURN. Mr. Chairman and gentlemen of the committee, I presume I have come a little farther for this hearing than anybody else who is here, having left Omaha Sunday night to be here this morning. I represent an organization known as the American Life Convention. It is made up of 100 life insurance companies domiciled in 33 States of the American Union, all west of New York State. The Southern States Life of Atlanta, the Inter Southern and the

commonwealth of Louisville, and the Capital Life of Denver are members of the organization which I am here to represent, and you gentlemen, knowing those companies, can form some conception of the general character of the organization. It is designated as the organization of the smaller companies as distinguished from the Presidents' Association, which is represented by my friend Mr. Cox here.

Senator THOMAS. Do they include both mutual and capital stock?

Mr. BLACKBURN. They represent about 84 capital stock companies and 16 mutual companies, but the majority of capital stock companies write participating under mutual insurance. I think that distinction perhaps is more a matter of mind than anything else. The capital stock simply adds the additional capital stock to the regular legal reserve that is provided by law, and the reason for the organization of the capital stock companies is because it is necessary to have money enough on hand to start your company to pay your losses. The capital stock is put up as an additional reserve to guarantee back the regular reserve which the law requires. So that the capital stock companies have that much more in proportion to the amount necessary to meet their obligations than the mutual companies. Both do business on exactly the same plan because the policyholder pays the premium and the policyholder conducts the company. The capital stock company which is operating on the participating plan pays exactly the same dividends, as a rule, as a matter of competition, as was stated here by Mr. Cox. They must pay practically the same dividends as their competitors who are purely mutual.

Some years ago when we were discussing the income tax I had occasion to compare the dividends paid by the Equitable of Iowa, which is the oldest stock company doing a mutual business, and the Mutual Life of the city of New York, the oldest mutual company in this country. The difference between the two was trifling, the Equitable of Iowa paying a little larger dividend than the Mutual of New York, and that chiefly because the Equitable of Iowa made larger interest earnings than the Mutual of New York.

So we object to a separation in the minds of this committee of life insurance into the two groups of stock and mutual because they are practically on the same basis and are entitled to the same consideration excepting that the profits that are earned and paid to stockholders, of course, should be taxed.

Senator SMITH. Have you no stock companies which pay over 8 per cent on their capital stock?

Mr. BLACKBURN. Yes, sir; there are several stock companies that pay more than 8 per cent on their capital stock.

Senator SMITH. Divided in dividends to their stockholders?

Mr. BLACKBURN. Dividea in dividends to their stockholders; yes, sir. There are some of the young companies that pay more than 8 per cent. One in Omaha has paid 10 per cent since it was organized.

Senator SMITH. How can we distinguish a company of that kind which is distributing over 8 per cent to its stockholders as dividends from other corporations? How can we distinguish from other corporations an insurance company that has stock and is paying to its stockholders over 8 per cent, not turning it back to its stockholders, but giving it to them on their investments?

Mr. BLACKBURN. Probably you can not, but there are so few of them that the amount of tax would be a pure bagatelle. Many of the stock companies that I represent here have never paid any dividends. Some of them have paid 5 per cent, some 6 per cent, some limit their payments to 7 per cent, and others to 10 per cent.

Senator THOMAS. I should not think they would be concerned in this law at all if that is the case.

Mr. BLACKBURN. They are concerned in this law because, as the Treasury Department has interpreted the income tax, the income is figured for the stock company in addition to its capital stock, about which we have no fault to find, exactly as it is figured for the mutual company. Mr. Cox made a suggestion that I was going to make, and that is that this matter of life insurance—and I limit it to life insurance, although I think he said insurance generally—is a distinct form of contract, so different and so unique in many of its particulars that it ought to be a matter of separate legislation so far as taxation is concerned.

I wanted to suggest this with reference to the difference between the mutual rate of premium where the premium is paid back at the end of the year and the nonparticipating rate. The nonparticipating company simply invests the amount that would be paid back and takes it out at the beginning of the year instead of at the end of of the year, and its capital stock is back of its guarantee that it will carry the insurance on that basis.

It seems to me that here is one proposition that ought to be considered, so far as life insurance is concerned, and I have no brief for any other form of insurance. Life insurance costs exactly the same to the premium payer now that it did 10 years ago. Any other commodity that is offered by corporations is higher in price.

Senator THOMAS. Except Ford machines.

Mr. BLACKBURN. Except Ford machines, possibly.

Senator JAMES. Well, gasoline has gone up.

Mr. BLACKBURN. So that the Ford machine is expensive. But life insurance continues at the same price right through. Our contracts have been made, some of them as long ago as 72 years, policies that were carried all through that period, and we are still carrying them. We can not possibly raise the rate on life insurance policies that were issued prior to this act. We have to make that contract good. The high cost of living has hit the life insurance companies themselves. The high cost of living has hit the agents of the life insurance companies, and in every particular, so far as my information goes, the cost of doing business has been increased, and yet we pay the same benefits, we charge the same premiums, and on top of that it seems to me that it would be an imposition upon institutions that do not have the power to correct the evil by charging more next year to put upon them this excess 8 per cent profits tax. If you put an excess profits tax on gasoline or on munitions or anything of that kind, that firm or corporation can protect itself by raising the price of the commodity it is selling so that the consumer has to bear it. But our contracts are made. These five million policyholders have contracts that we can not change in any iota.

Senator THOMAS. That might be an argument against you, because we are looking for something that can not be transferred to the consumer.

Mr. BLACKBURN. The only place where you get the policyholder is in cutting down the dividends, but I am speaking from the company point of view, and I think the company point of view has been perhaps overlooked here. These companies are bound by their contracts to pay these losses and these endowments as they mature. They can not reduce them; they can not cut the payment.

Senator JAMES. Would not all that argument go to show that there would be no excess profit above 8 per cent, the increased cost of the agents in the field and the increased cost of living?

Mr. BLACKBURN. Unfortunately for us this matter of the income tax is a matter of bookkeeping, is it not, Mr. Rhodes?

Senator JAMES. I agree with you that that is generally true, but I am referring to a stock company that had as you say over 8 per cent dividends per year. If the increased cost of this insurance world had grown greater by reason of the high cost of living, it would tend to decrease that dividend.

Mr. BLACKBURN. The usual tax upon a life insurance company is based upon the premiums in the State, and the tax as represented by the income tax does not take that into account at all, but we are taxed by an arbitrary method that is not affected by the increased cost of living or the increased expense that we are put to for these various matters to which I have referred.

I feel, gentlemen, that so far as the hundred companies I represent are concerned, having a volume of business about equal to the total volume of the New York Life, two and a half billion, that we are already taxed as much as we should be taxed, not only by the States, but by the National Government. Our tax, of course, is doubled this year, and, if my information from the companies I represent is correct, the tax would be doubled on the present 2 per cent basis. Mr. Randell, of the Minnesota Mutual at St. Paul, made the calculation that they would pay just double the tax under this 8 per cent excess tax provision.

Another thing I forgot a moment ago with reference to the maturing of these contracts is the fact that since the beginning of the war interest rates have very materially fallen all through the West and I think through the East.

Senator JAMES. What, in your judgment, would be the amount of tax that we would get under this bill, applying it to the stock companies where the amount of dividends would exceed 8 per cent?

Mr. BLACKBURN. Well, I hate to make a guess at that, but I would think it would be within the hundreds of thousands somewhere. It would be a comparatively small amount.

Senator JAMES. $100,000?

Mr. BLACKBURN. It might run up as high as $900,000, but I should place it at about that. There are only three companies in the United States, I think, that would pay any very large tax. Those are the Travelers, the Aetna, and the Union Central. Those are the only large stock companies in the United States now that would be affected.

Senator SMITH. And the Travelers and the Aetna make substantially over 8 per cent?

Mr. BLACKBURN. On their capital stock. Just what they make I would not be able to say. Take the companies in your city, for instance, Senator James. Neither one of those companies would

have much tax to pay on the basis of the capital stock. There is no objection on the part of stock companies to paying their proportion of what is required for this preparedness issue. There is no disposition on the part of any company to avoid their public duty in this particular, but we feel that we ought to be put on a basis that is equitable as compared with the other corporations that are doing business in this country. That is why I contend with Mr. Cox that as a matter of fact the equitable and proper basis to determine what tax should be levied against life insurance companies is one that ought to be worked out by itself.

Senator THOMAS. Are you familiar with any companies doing a combined business of life, health, and accident in one policy?

Mr. BLACKBURN. No; most of those companies are new companies, and most of them are in the South. I do not know why that is put in the bill unless it is to help some of those young companies down there. There is one at Nashville and one at Atlanta and another in Florida.

Senator THOMAS. Can you think of any reason that would make it desirable to help them unless it be this exemption?

Mr. BLACKBURN. I do not know of any unless there are weekly payments made and they are paid by poor people.

Senator THOMAS. That is equally true of the industrial companies?

Mr. BLACKBURN. It is.

Senator JAMES. Do you not see a vast difference between a man who has his money invested in a stock insurance company and those who have insurance in these mutual organizations, in a matter of taxation?

Mr. BLACKBURN. No; I do not.

Senator JAMES. For instance, a man who owns railroad stock has to pay a tax. Why should not a man who has insurance stock do the same thing?

Mr. BLACKBURN. He should. We are perfectly willing to pay it on that basis, but what we are trying to avoid is having the excess earnings charged against us on these reserves and other items of assets that we are holding for the benefit of our policyholders just as the mutual companies are.

Senator THOMAS. You do not like the Government's method of bookkeeping?

Mr. BLACKBURN. That is putting it pretty broadly.

Senator JAMES. In these mutual companies there are thousands of people who do not make this excessive profit, and they will be taxed under this bill, but the stock insurance holder would be really escaping a tax that would fall upon him if he had his money invested in any other sort of corporation that would exceed 8 per cent.

Senator THOMAS. In other words, if Senator James had $10,000 invested in an industrial corporation making more than 8 per cent, he would have to pay a tax, but if you had the same amount of money invested in one of these insurance companies making 10 per cent you would not have to pay a tax?

Mr. BLACKBURN. Let me make myself clear on that. These stock companies, many of them, are writing the mutual policies.

Senator THOMAS. I think I understand you. Your position is that these excess earnings are not profits, that they go back to the stockholder insured whether your company is a mutual or a capital stock company?

Mr. BLACKBURN. Yes; they go back in one way or the other.

Senator THOMAS. Then where do you make your profit?

Mr. BLACKBURN. We make it in savings in mortality, in increased interest.

Senator THOMAS. But in a mutual company that goes to the insured?

Mr. BLACKBURN. Yes; except this continued reserve which is being added to all the time, and in lieu of that we have our capital stock back of it.

Senator SMITH. They do not take the contingent reserve and distribute it among the stockholders?

Mr. BLACKBURN. No; neither do we.

Senator SMITH. They give them the reduced price of the policy?

Mr. BLACKBURN. Yes; just as the stock company does. There is no essential difference between these two forms of organization in the management of the business.

Senator THOMAS. Except one is operated for a profit and the other is not?

Mr. BLACKBURN. One is for certain people who have put up a fund to guarantee the contracts that that company has made.

Senator SMITH. If you limit that to a cumulative 8 per cent dividend you would not have any trouble about that.

Mr. BLACKBURN. It is limited in a considerable number of instances, but frankness compels me to tell you that some of the companies do not limit it. There is another thing I want to say on that subject. Suppose you were to take the attitude that mutual life insurance companies should be exempted from this tax. There are more stock companies in the United States than mutual companies, and as a matter of competition you would place the stock companies at a disadvantage to the mutual companies. You would hurt us there also.

Senator THOMAS. I do not see how that can follow if you make more than 8 per cent on your stock. I may be obtuse.

Senator JAMES. These mutual insurance companies do not make any profit.

Mr. BLACKBURN. But they are our competitors in this field, and by reason of what they are doing we are obliged to furnish insurance at the same rate they do, and all we can possibly make out of it is by better management and the interest on our capital. If we can earn 8 per cent on our paid-up capital it is perfectly proper that the contributors of that capital should have it, because it is merely their guarantee to carry out the terms of the contracts made by the mutual company.

Senator THOMAS. But is not your surplus made up of a fund which in a mutual company would be redistributed to the policyholders?

Mr. BLACKBURN. Yes, sir; and if we are writing strictly nonparticipating, that goes to our stockholders; but the majority of these companies write participating business, which is mutual business. So that a general proposition in the law that limits this tax to mutual companies would hit companies like the Equitable, and the Home Life until recently. The Home Life was a stock company writing mutual business. Now, the Equitable of Iowa is a stock company with $300,000 of capital, writing participating business, and, as I stated before, the results to the policyholders were a little better in the Equitable than they were in the Mutual of New York for the period that I took up of 10 years when discussing this income tax before. But may I make my distinction clear there? If you in this bill provide that mutual life insurance companies shall be exempted

from this tax, you hit the stock company which is writing a mutual business and prevent it to that extent from competing with the mutual company.

Senator SMITH. If we freed the mutual from the tax, we would have to free all that business of the stock company from the tax. We would have to limit our tax upon the stock companies to their excess dividends above 8 per cent on their capital stock, treating their capital stock as their capital.

Mr. BLACKBURN. That is exactly the way. I thank you, gentlemen.

Senator SMITH. Now, Mr. Powell, you may proceed.

STATEMENT OF MR. HENRY J. POWELL, REPRESENTING THE NATIONAL ASSOCIATION OF INSURANCE AGENTS.

Mr. POWELL. Everyone who has spoken so far has been an officer of a company. I represent the agents and managers who are going all over the country selling life insurance. Our association is made up of these agents and we perhaps more than anyone else realize just what it means to have life insurance taxation. We are the ones who have to defend any extra tax in dealing with our policy holders. Many a man who has to pay a premium would be unable to do so were it not for that refund, because he rakes up everything that he can find to pay a premium, and any tax falls heavily upon the policy holders throughout the country districts. It will fall heavier there than anywhere else because their surplus will be reduced. We represent the agents, and we want to concur in everything that these gentlemen have said here.

Mr. COX. For the purpose of the record may I add a word? You asked Mr. Blackburn what he thought this tax on stock companies might amount to. On the figures that have just been given you I have made a calculation roughly here as to what the Government would get on the excess tax paid by the Aetna, the Travelers, and the Union Central. If I have figured it correctly, the entire excess tax on their earnings as measured by their stock dividends paid would be $50,000 a year—sixteen on the Aetna, thirty-two on the Travelers, and two on the Union Central.

Senator THOMAS. That is enough to build a post office at Sun Dance.

Senator SMITH. Can anyone present tell us anything about the fire insurance companies? Are they, as a rule, stock companies or mutual companies?

Mr. RHODES. I think we might say that they are both. In England there are a great many mutual fire insurance companies which have been very successful. The mill owners in England have organized mutual insurance companies and have insured their mills at a very low cost. In the income-tax law you recognize that they are not subject to the ordinary rules of that law. That is true also of mutual marine companies, and scattered all over the country you will find mutual cyclone companies and hail insurance companies furnishing insurance to their community members at cost.

Senator THOMAS. I think the mutual companies insuring against hail are exempted under the act of 1916.

Mr. RHODES. Those are. The mutual fire companies you have not, but they should be treated just the same as any life insurance company that is conducted on the mutual plan.

Senator THOMAS. Mr. Chairman, I have a letter here consisting of three pages from the president of the Penn Mutual Life Insurance Co.

Senator SMITH. So have I.

Senator JAMES. Do you not think a distinction should be made between a fire insurance company and a life insurance company?

Mr. RHODES. Not if they are both on the mutual plan.

Senator JAMES. It seems to me there should be a distinction. Here is a class of insurance by means of which a man tries to leave something to his wife and children. There ought to be a distinction between that and the fire insurance.

Mr. RHODES. One is a human risk and the other is a mercantile risk.

Senator SMITH. One is to carry a responsibility incident to dependency growing out of his death, as a rule, and the other is to take care of his property while he is alive.

Mr. MILLIKEN. The Southern Mutual of Athens has paid an average annual dividend in the last 42 years of 62½ per cent on its premiums.

Senator SMITH. Yes; it starts with a higher premium.

Mr. MILLIKEN. Now it has the same premium as the other companies.

Senator SMITH. Then it does not pay the dividends you are speaking of. It has quit the dividends if it has quit the higher premiums. It is a very select company.

Senator THOMAS. You say that is a mutual company?

Mr. MILLIKEN. It is a mutual company.

Senator THOMAS. We have just been told that mutual companies paid no dividends.

Senator SMITH. When he says "dividends" he means returned premiums. I do not like the term "dividend."

Senator JAMES. When you are giving a fellow back something you have taken from him you are not giving him a dividend.

Senator THOMAS. But you are doing a very unusual thing.

Senator SMITH. I am sorry that there are no representatives of the fire insurance companies here. I suppose that means that they are satisfied to pay.

Mr. DUNHAM. One reason is, Mr. Chairman, that these fire insurance companies do not have the accumulation of assets which render life companies susceptible to this tax under the law as laid down and the rules in the departments.

Mr. RHODES. They probably knew nothing of the hearing. We were in Washington on another purpose and learned of it.

Senator SMITH. Notice of the hearing was given to the press last Friday afternoon.

Mr. RHODES. I left my home on Sunday to come here on another matter not knowing that the hearing was to be held.

Mr. JONES. I can say that they did not know about it. One of them was in Chicago, another was in Columbia, S. C., and still another was in Springfield as respresenting the National Board of Fire Underwriters, and neither of them had a chance to get here. I know that from my personal knowledge of the situation.

Senator THOMAS. I guess they will be here by the time the bill reaches the Senate.

(Thereupon, at 4.55 o'clock p. m., the subcommittee adjourned to meet at 12.30 o'clock to-morrow, Wednesday, February 7, 1917.)

HEARINGS

BEFORE THE

SUBCOMMITTEE ON FINANCE

IN REGARD TO

INSURANCE

REVENUE FOR INCREASED ARMY AND NAVY APPROPRIATIONS.

INSURANCE.

WEDNESDAY, FEBRUARY 7, 1917.

UNITED STATES SENATE,
SUBCOMMITTEE ON FINANCE.

The subcommittee met pursuant to adjournment, at 12.30 o'clock p. m. in the room of the Committee on Education and Labor, Capitol, Senator Hoke Smith, presiding.

Present: Senators Smith (chairman), Thomas, and James.

Also present: Mr. James J. Hoey, representing the Continental Fire Insurance Co.; Mr. Robert L. Cox, vice president of the Metropolitan Life Insurance Co. of New York; and others.

The subcommittee resumed the consideration of certain provisions of the bill (H. R. 20573) to provide increased revenue to defray the expenses of the increased appropriations for the Army and Navy and the extensions of fortifications, and for other purposes.

Senator SMITH. The subcommittee will come to order. We will first hear Mr. James J. Hoey.

STATEMENT OF MR. JAMES J. HOEY, REPRESENTING THE CONTINENTAL FIRE INSURANCE CO. OF ———.

Mr. HOEY. I represent the Continental Fire Insurance Co., and, incidentally, the National Board of Fire Underwriters, just unofficially. I have been asked to speak a word for them while I was here representing my own company. My views, or the views of my company, are in accord with the views of the National Board.

I am here to urge an amendment to this bill exempting the reserves. The reserves are not moneys belonging to the company. They are moneys belonging to the policyholders.

Senator THOMAS. You are representing mutual companies also?

Mr. HOEY. No, sir. I am representing stock companies only. They are moneys belonging to the policyholders, held for the purpose of paying losses, and we think that they should be tax exempt. I might call your attention to the fact that if we have a war, the fire insurance companies, as well as the other insurance companies, are going to be subject to much heavier losses than we are paying at the present time. We have already paid out $50,000,000 of losses occasioned by the manufacture of munitions, at Kingsland, in New Jersey, and at Black Tom, and if we have war, these hazards will be increased.

Senator THOMAS. Your percentages for the insurance of material of that kind are very large, are they not?

Mr. HOEY. The rates are regulated by law. We can not charge in excess of the rates fixed.

Senator THOMAS. The rate regulated by law would be a very liberal rate for that sort of commodity, would it not?

Mr. HOEY. It is not so. It is unlawful in many States to do business at all.

Senator THOMAS. How much is it?

Mr. HOEY. The underwriting profit?

Senator THOMAS. Yes, on munitions of war, the rate.

Senator SMITH. On munition plants.

Mr. HOEY. The rate has been about 1½ to 2 per cent, but since these disasters the rates have gone up somewhat. We did not have any experience in that class of risks before, and we did not know what the risk was.

Senator SMITH. Is not that an incorrect statement, that the rates are fixed by law? Are they not fixed by the insurance boards themselves, based upon their experience from losses?

Mr. HOEY. In some States, Senator, the rates are absolutely fixed by law.

Senator SMITH. What States?

Mr. HOEY. The State of North Carolina is one. The companies have had to withdraw from the State because they were unable to do business under the rates fixed by the State, and we have State regulation.

Senator SMITH. You have no State law in New Jersey, New York, Pennsylvania, and Delaware.

Mr. HOEY. We have an antidiscrimination law, which has the same effect as the State rate-making body. We can not charge a rate higher for any particular risk than we do for a risk of the same kind of hazard.

Senator SMITH. I should think if Senator James had a munitions plant in New Jersey and I had a house and lot the rate would be very much higher on his than mine.

Mr. HOEY. On risks of the same character.

Senator SMITH. You can not charge a munitions plant a rate higher than what you charge another munitions plant, if the relative risks of the two is the same. That is your limitation by law as to your charges, is it not?

Mr. HOEY. Yes. The point I am making is that these reserves, if conditions are changed, may be inadequate. I am speaking here for all of the insurance companies, because the conditions are practically the same. You take the casualty companies, and the writing of workmen's compensation insurance. We have compensation laws now in about 30 States or more. The reserves in New York State were 54 per cent. The loss ratio last year and the year before equaled 65 per cent. We did not know what a proper and adequate rate was. Now, with conditions as at present existing, and perhaps to be still more marked if we have a war, casualties are going to be still more frequent than they are at the present time, so that the solvency of the companies will be threatened.

Senator SMITH. You say that you do not think your reserves should be taxed. How would they be taxed? Your reserve is not

a profit. Your reserve is a sum which you carry to cover the losses. That is not treated as a profit, is it?

Mr. HOEY. Under the present language of the law it is the opinion of our attorneys that we would be taxed. If you do not intend to tax us, we are quite willing to have an amendment clearing up that proposition so that it would be understood.

Senator SMITH. What dividends do your companies pay, as a rule, on their stock?

Mr. HOEY. The Continental up to last year paid 10 per cent.

Senator THOMAS. These reserves, I take it, are invested, so that they are interest bearing?

Mr. HOEY. Yes, sir.

Senator THOMAS. Does the interest go to the stockholders as profits in that reserve fund?

Mr. HOEY. I think they do.

Senator THOMAS. Why should they not go to the policyholders if the funds belong to the policyholders?

Mr. HOEY. The law requires us to put up these reserves, and they are held for the payment of losses, and we are trustees of that fund. They do not belong to us.

Senator THOMAS. You ought to be trustees, then, for the interest or for the earnings of the fund, instead of dividing it among your stockholders.

Senator SMITH. In point of fact, is it not true that the liability of that company grows out of its capital stock, and the existing reserve grows out of legislation which compels you to keep that amount in addition on hand to make perfectly safe your fire losses?

Mr. HOEY. Yes, sir. Out of our capital stock we could not pay our losses, and these reserves are put up in excess so that there will be an absolute security behind our contracts.

Senator SMITH. They are not a trust fund, though, held by your stock companies for your policyholders, except as a consequence of legislative enactments, where your corporations exist, compelling you to accumulate that fund to make your policyholders safer?

Mr. HOEY. Exactly.

Senator SMITH. There is no right on the part of your policyholders to cancel policies and take down this reserve fund as a fund belonging to them? It is a fund that only guarantees them against loss in case of fire?

Mr. HOEY. They can, of course, cancel their policies. They could have their policies canceled and take down a portion of that unearned premium. They could withdraw.

Senator SMITH. That is a part of the contract of insurance, that you can cancel a policy and get a portion of the unearned premium?

Mr. HOEY. Yes, sir. I think that the insurance companies which are going to bear a tremendous burden in the event of war should be strengthened rather than penalized.

Senator SMITH. But if the insurance companies make for their stockholders an amount in excess of 8 per cent, which would be subject to distribution among their stockholders as dividends on their stock, why should they not pay on that excess profit, which otherwise would go to their stockholders, just as other corporations would pay?

Mr. HOEY. That might be all right if you were viewing it just from that standpoint. Let me call your attention to another fact. We

have treaties with a half a dozen foreign companies. We take a large risk and we reinsure a portion of it with these foreign insurance companies. At the present moment our treaties are threatened. They threaten to cancel our treaties; abrogate them. We do not know whether they would make good the portion of the risk which they have if we had a loss.

Senator THOMAS. Are not those treaties mutual? Do they not distribute a part of their business to you in return?

Mr. HOEY. No, sir.

Senator SMITH. You refer to them as "treaties"?

Mr. HOEY. Yes, sir.

Senator SMITH. Do you mean treaties between our Nation and other nations?

Mr. HOEY. No; treaties between insurance companies.

Senator SMITH. Agreements?

Mr. HOEY. Yes, sir. In the insurance field we call them treaties. At the present moment these treaties are threatened. If we have war all of those treaties may be abrogated. Therefore, if we fail to make good on these losses, the direct writing company would have to make good.

Senator SMITH. That, then, would lessen the profits you would have to distribute among your stockholders and save you the payment of any tax on excess profits?

Mr. HOEY. We do not want to be saved to that extent. Our burden would be that much heavier. It is absolutely necessary for the people of this country, the business people, that we have sound insurance, and if we had losses, or such a condition, I have no doubt at all that the fire insurance companies would meet those losses to the extent of their ability. But in these times, where we are having explosions and unusual fires, we think that the insurance companies ought to be exempt, because it is necessary that the business people of this country have insurance, and we do not think the Government ought to add further to our burden.

Senator SMITH. If we exempt you up to 8 per cent dividends to your stockholders, are you not left where your stockholders are reasonably well taken care of?

Mr. HOEY. We think if you will include our unearned premium reserve, and exempt all of our taxes, you are doing something for the protection of the policyholders.

Senator SMITH. Are your unearned premium reserves treated as profits?

Mr. HOEY. I think under the interpretation that our attorney has given to this law, the earnings from those would be treated as profits, and would be subject to tax under this law.

Senator THOMAS. If your profits from your reserve were added to the fund for the benefit of the stockholders, it would appeal to me very strongly. But the fact that you do not so devote them robs your statement of the trusteeship character that it would otherwise possibly possess. A trustee can not use a trust fund for his own purposes. If he does, then he is required, by every principle of equity, to account as well for the profit as for the principal. Inasmuch as you do not do that, it can not be considered legally a trust fund.

Mr. HOEY. I do not think technically it is a trust fund, but it is in the nature of a trust. It is mutual. The underlying principle

of insurance is the distribution, and this fund is mutual in character and held for the purpose of paying losses.

Senator SMITH. A policy is taken out in your company for 12 months. The policy expires on February 1 and there has been no fire. You take in a certain amount of premiums during the 12 months. You pay out a certain amount of losses during the 12 months. Your premiums received in excess of your losses are net profits, are they not?

Mr. HOEY. Yes.

Senator SMITH. And that would be treated, then, as a net profit of the company for the year?

Mr. HOEY. But a majority of the business is written for a term, three years or five years, and we are not in a position to determine at the end of a year what our profits are. We have to put aside that until the policy does expire, and, as I say, most of the business is written for three and five years.

Senator JAMES. You could pro rate the premium, could you not?

Mr. HOEY. We can not pro rate the losses. We can not anticipate the losses. Suppose we had a disaster such as we had in Kingsland, N. J., the other day, when we had a twenty million dollar loss, or the one down at Black Tom, where we had another one. You can not calculate the losses.

Senator SMITH. How often do you take from this reserve that you set aside funds and distribute them among your stockholders?

Mr. HOEY. I do not think the reserves are taken down as such. I think the earnings, if I am informed rightly, are invested.

Senator SMITH. Your reserves being maintained, your additional premiums become profits for distribution?

Mr. HOEY. No; the earnings on the reserves.

Senator SMITH. The earnings on the reserves?

Mr. HOEY. Yes.

Senator Smith. And your surplus premiums.

Mr. HOEY. Yes, sir. I want to emphasize again, gentlemen, without intending to bore you, that this not a time when the insurance companies of this country, whether they are life, fire, or casualty companies, should be taxed, because their burdens are going to be greater in the event of war, and at the present moment the fire companies and the casualty companies are being strained to the point of solvency in order to pay their losses.

Senator THOMAS. Of course it is no pleasure to us to tax anybody.

Mr. HOEY. I know that, Senator.

Senator THOMAS. But we are face to face with a financial crisis consequent very largely upon the compliance by Congress with the evidently general large demand for increased preparedness, and every interest that is affected by this bill is before us making arguments analogous to yours. So you can understand the embarrassments under which we labor.

Mr. HOEY. Take the marine companies. You have to search the markets of the world to get sufficient insurance to cover our shipping. With a war on the other side, the opportunity for getting insurance is very limited.

Senator JAMES. The Government insures cargoes, does it not?

Mr. HOEY. Yes. They have a bureau, and they do insure. But I am again saying that you are restricting them by taxing them. The

rates now are tremendous, and adding the tax on those companies is going to make the burden still greater.

Senator THOMAS. I wish you gentlemen could frame some kind of revenue measure that would be popular, so that we could adopt it.

Senator JAMES. Are you familiar with the marine insurance that has been issued by the Government?

Mr. HOEY. Yes. Mr. Delano is the head of that bureau. He is a very prominent insurance man in New York.

Senator JAMES. What has been the result of the losses?

Mr. HOEY. I am not familiar with the experience of the national bureau. But I do know that because of the fact of the war on the other side, we have not been able to get insurance for our shipping to the extent we would like. Gold and other shipments to South America are going down there without insurance. We can not get coverage at the present moment.

Senator JAMES. That is what caused the passage of this insurance law.

Mr. HOEY. Still, it has not been helped very materially by that. I will be glad if you would consider the amendment which I suggested.

Senator THOMAS. We will certainly do that.

Senator SMITH. Mr. Cox, do you wish to say anything?

Mr. COX. Just a little statement.

STATEMENT OF MR. ROBERT L. COX, VICE PRESIDENT OF THE METROPOLITAN LIFE INSURANCE CO., OF NEW YORK.

Mr. COX. Senators, I hold no brief for the fire insurance companies, and really have no right to speak on this subject, but I do want to make the point that they are somewhat in our situation with reference to these extra hazards, that if they chance to make a profit over and above the 8 per cent, they are taxed, but the Government does not step in in the other years when they make enormous losses.

Senator THOMAS. On the other hand, the Government does not take anything at that time.

Mr. COX. No; it just simply keeps its hands off. But it only becomes a partnership in half, and the companies do suffer at times tremendous losses.

Senator THOMAS. That is true of the income tax, also.

(Thereupon, at 12.50 o'clock p. m., the subcommittee adjourned to meet at the call of the chairman.)

HEARING

BEFORE THE

SUBCOMMITTEE ON FINANCE

IN REGARD TO

EXCESS-PROFITS TAX

80136—17——7

REVENUE FOR INCREASED ARMY AND NAVY APPROPRIATIONS.

EXCESS-PROFITS TAX.

TUESDAY, FEBRUARY 6, 1917.

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

The subcommittee met, pursuant to call, at 10 o'clock a. m., in the committee room, Capitol, Senator John Sharp Williams presiding.

Present: Senators John Sharp Williams (chairman), Charles F. Johnson, William Hughes, John W. Kern, and F. M. Simmons.

The committee resumed the consideration of certain provisions of the bill (H. R. 20573), "An act to provide increased revenue to defray the expenses of the increased appropriations for the Army and Navy and the extensions of fortifications, and for other purposes."

Also present: Benj. C. Marsh, secretary of Association for an Equitable Federal Income Tax, 320 Broadway, New York City; Chas. H. Butler, lawyer, Washington, D. C.; C. D. Joslyn, New York City; Warren Motley, lawyer, Boston, Mass., representing Stone & Webster; James A. Emery, counsel for the National Association of Manufacturers, Washington, D. C.; William P. Garcelon, representing the Associated Industries of Massachusetts, 608 Sears Building, Boston, Mass.; Charles Henry Butler, lawyer, Washington, D. C.; Paul Armitage, lawyer, representing the United Verde Extension Mining Co., 233 Broadway, New York City; Archibald Douglas, lawyer, representing the United Verde Mining Co., 233 Broadway, New York City; Walter S. Penfield, lawyer, Colorado Building, Washington; and Charles B. Landis, representing the E. I. du Pont de Nemours & Co., Wilmington, Del.

The Chairman. Gentlemen, I want to say something for your own guidance. The committee has determined to give to-day, and only to-day, to hearings; so you must arrange matters so that you may get in everything that you can. Of course, if you permit anyone present to take too much time, the others will have no opportunity. It would be better, I think, if you divide your work amongst yourselves and arrange so that each one can be heard who is going to address the committee upon any particular aspect or phase of the case. But you can order the matter as you choose, and I think you had better have a little informal conference now and tell us whom you desire us to hear first, and as chairman of the subcommittee I will be guided by your wishes.

Senator Hughes. All of them can file anything they want to in the way of briefs.

The CHAIRMAN. Senator Hughes suggests that the committee will be very glad to have you, in addition to what you say before the committee, file written briefs covering any questions you choose, and the committee will have the clerk read those briefs to them and and consider them, and print them with the hearings, of course.

(In accordance with the foregoing statement the chairman subsequently directed certain briefs to be inserted in the record, which are here printed in full, as follows:)

PHILADELPHIA CHAMBER OF COMMERCE,
February 3, 1917.

Hon. F. M. SIMMONS,
Chairman Finance Committee,
United States Senate, Washington, D. C.

DEAR SIR: The executive committee of the Philadelphia Chamber of Commerce desires to place before you the following resolution:

Whereas the provision entitled "Estate tax" in the new proposed revenue bill now under consideration in the Senate intends to raise revenue by means of collection from sources on which the individual States rely for their own income, and

Whereas it is believed that the Federal inheritance tax will prove a serious menace to the revenue of the States, and

Whereas it is believed entirely possible for the Federal Government to secure adequate funds for its legitimate needs through the judicious system of indirect taxes to cover current expenses, including bond issue, stamp dues, and higher rates of tariff; therefore be it

Resolved, That the Philadelphia Chamber of Commerce emphatically disapproves of the Federal inheritance tax, and strongly protests against the exactment of said tax.

Will you kindly record our opposition to this measure and use your influence toward the defeat of same?

Very truly, yours,

N. B. KELLY, *General Secretary.*

NEW BERN, N. C., *February 3, 1917.*

Hon. F. M. SIMMONS,
United States Senate, Washington, D. C.

DEAR SENATOR: I am inclosing herewith copy of resolutions adopted last night at a meeting of the members of the chamber of commerce.

With best wishes, I am,

Very truly, yours,

ROBERT C. W. RAMSPECK,
Secretary-Manager.

RESOLUTIONS.

Whereas the Ways and Means Committee has reported to the House of Representatives a revenue bill proposing to tax the profits of corporations and partnerships "in excess of the sum of $5,000, and 8 per centum of the actual capital invested"; and

Whereas prima facie it is a penalization of success, efficiency, energy, and enterprise, and a discrimination against business; and

Whereas the proposed tax to raise two hundred million dollars ($200,000,000) to meet the increased appropriations of the Army and Navy are of a permanent nature: Be it

Resolved, By the New Bern Chamber of Commerce.—First. That the proposed tax will place a premium on the evil of overcapitalization. (This very thing gave Congress considerable worry a few years ago.) It almost invites ingenuity in evasion by voting large salaries or otherwise padding expenses. It emphasizes further the drift to class legislation; will require further undesirable, inquisitorial methods, and tend to drive capital into hiding.

Second. That taxing excess profits will be an unstable tax, as Government revenue will show a wide fluctuation with the ebb and flow of industrial prosperity. On the business interest of the country largely falls the burden of the income tax, as less than one-third of 1 per cent of the American people pay the income tax, and to further directly tax the business of the country, is making an invidious distinction.

Third. That when the present tariff bill was passed, there was reason to believe it would produce sufficient revenue to meet normal conditions. The European war upset all precedent, and if the present tariff does not produce sufficient revenue to meet current expenses, there should be a temporary increase on such dutiable articles as will not be a burden on any class, but on those articles that will reach the largest proportion of population.

Fourth. That the revenue needed by unusual increase in Navy and Army appropriations are more of a permanent nature, and to meet same bonds should be issued, that the burden may be equitably distributed, and be paid by future generations as well as the present.

Therefore, because of the above facts and reasons, we respectfully petition our Representatives in Congress to oppose that portion of the proposed revenue measure taxing profits.

NEW BERN CHAMBER OF COMMERCE,
ROBERT C. W. RAMSPECK,
Secretary-Manager.

NEW BERN, N. C., *February 2, 1917.*

CHAMBER OF COMMERCE OF THE UNITED STATES OF AMERICA,
WASHINGTON, D. C., *February 6, 1917.*

HON. WILLIAM J. STONE,
United States Senate, Washington, D. C.

DEAR SIR: As a bill, H. R. 20573, is pending before the Committee on Finance, of which you are a member, with proposals for a tax on excess profits, I beg to inclose a copy of a letter I have addressed to the chairman of the committee, together with copies of the resolutions mentioned therein.

Very truly, yours,

ELLIOT F. JORDAN, *Secretary,*

CHAMBER OF COMMERCE OF THE UNITED STATES OF AMERICA,
Washington, D. C., February 6, 1917.

Hon. F. M. SIMMONS,
Chairman Committee on Finance, United States Senate, Washington, D. C.

DEAR MR. CHAIRMAN: In accordance with action taken at the annual meeting of the Chamber of Commerce of the United States, on February 3, 1917, I beg to inclose a resolution upon the subject of excess-profits tax as proposed in H. R. 20573, now pending before your committee, together with a second resolution which expresses the unanimous sentiment of the delegates at our annual meeting in view of recent events, and possibilities of the future.

Very sincerely, yours,

ELLIOT H. GOODWIN, *Secretary.*

TAX ON EXCESS PROFITS OF CORPORATIONS AND COPARTNERSHIPS.

Resolved, That the Chamber of Commerce of the United States of America reaffirms its devotion to the program of preparedness which it has approved by vote of its constitutent members through referendum No. 15 and through resolutions adopted in annual meeting and further pledges the support of this body to any just and reasonable measures of taxation which the Government may see fit to adopt under such a program; but while reaffirming its devotion to this policy, it feels compelled to protest against the inequitable and discriminatory methods of taxation proposed in the bill known as H. R. 20573 providing for a tax on excess profits of corporations and copartnerships; and, be it further

Resolved, That while fully recognizing the necessity of providing increased revenues to carry out wise and patriotic measures for the adequate defense of our country, we would respectfully suggest that any bill passed by Congress to accomplish these purposes should be along lines of fairness to all interests in the country, so that every citizen may pay his just share of the tax.

SUPPORT OF THE PRESIDENT.

Resolved, That the Chamber of Commerce of the United States of America in convention assembled, voicing the sentiment of the business men of every State in the Union, expresses to the President of the United States its profound appreciation of the gravity of the international difficulties which now confront the Nation and solemnly pledges them to stand as one behind him in patriotic purpose, whatever the eventuality.

WASHINGTON, D. C., *February 7, 1917.*

Hon. F. M. SIMMONS,
United States Senate, Washington, D. C.

SIR: Referring to H. R. 20573, amending the revenue act of September 8, 1916, I venture to bring to your attention certain provisions of the House bill affecting railroads and which I think may be fairly urged upon at such a time as this.

It would seem from sections 200 and 203 of the bill that this is not a special tax within the meaning of section 3237 of the Revised Statutes, providing that all special taxes shall become due on the 1st day of July, but that it is an income tax and the tax will be payable at the same time as the income tax imposed by the act of September 8, 1916.

I assume that in the last line of section 201, if the bill should pass, a verbal change will be made in (*b*) so that it will be 8 per cent upon the actual capital invested.

In section 202 actual capital is defined as (1) actual cash paid in, and (2) the value of the assets other than cash at the time it is contributed to the capital, and (3) "paid in or earned surplus and undivided profits used or employed in the business," but does not include money or property borrowed. It is not clear what is meant by "paid in or earned surplus and undivided profits." If this expression means everything except original contributions to capital and money borrowed or property borrowed, the definition would be good; but if it means only such surplus and profits as may be considered to be invested and does not include income or earnings of a railroad which have been used in making betterments, such as straightening track and other matters of a like kind, it would not seem to be fair that the railroad company should not be allowed to calculate the 8 per cent upon earnings so used or invested. It also does not seem to be a fair proposition that the company should not be entitled, so far as this bill is concerned, to earn more than the interest it pays upon money and property borrowed, and property capital valued as at time contributed.

Section 203 provides that the tax "shall be computed upon the basis of the net income shown by their income-tax returns under Title I of the act of September 6, 1916." I assume this means that there shall be but one income-tax return filed by a corporation, and that under such return a corporation shall be assessed and shall pay the normal tax under the act of September 8, 1916, and shall also be assessed and shall pay an additional tax of 8 per cent upon so much of its net income as is in excess of 8 per cent upon its actual capital invested plus $5,000. While it can not be hoped to avoid the payment of what is known as the excess profits tax, it does seem that it might be fairly urged that a company ought to be entitled to a net earning of 10 per cent upon all its invested and borrowed capital before there should be any tax upon its excess profits.

In section 205 a company is required to set forth in its return "a detailed statement of the actual capital invested." If this means that the return is to contain a statement not only of what was paid in, but also of all the various items of profit and loss or undivided profits that have gone into the construction, maintenance, and betterment of the road, the amount of clerical work required from a company and the amount of useless information given to the Government would be so great that it would seem such a detailed statement should not be required.

Section 402, which adds a new section (sec. 26) to part 111 of the act of September 8, 1916, providing that the corporation "shall render a correct return, duly verified under oath, of its payment of dividends, and whether made in cash or its equivalent or in stock, including the names and addresses of the stockholders, and the number of shares owned by each, in such form and manner as may be prescribed by the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury," impose a burden upon such a corporation as the Pennsylvania Railroad Co., which should hardly have been within the contemplation of the framers of the act. This company has about 90,000 stockholders. The number of clerks it would take to do the mere mechanical work of transcribing the names of such a number of stockholders—a return with 50 names on a page would necessitate 1,800 pages—with the number of transfers during the period of a year; the amount of time it would require to do the work; and interference with the regular routine of corporate work; and the expense which the making of such detailed information will necessitate, are so great as to amount to a hardship upon a corporation which would seem not to be justified by the amount of benefit such a return would be to the Government. This new section is added not because of the excess profits tax, but because of the income tax. The Government is not interested in knowing who receive dividends, except in the case of an income taxpayer whose income exceeds $20,000, and the only purpose of requiring a list of stockholders is to learn whether a stockholder subject to the additional tax has made a proper return. The information required by this amendment to the act of September 8, 1916, if furnished to the Government, would be of very little avail to it; would be entirely useless as to the information conveyed with respect to most of the

stockholders; would be a burden to the Government files; and would be an excessive burden upon the corporation.

I realize fully that a stockholder might receive only $500 in dividends from a single corporation, but that he might receive that amount in dividends from 40 or more corporations, and thus make his income from dividends alone amount to $20,000 or more, but even this possibility would not seem to require so drastic a provision as this amendment provides for.

The Pennsylvania Railroad Co. pays its dividends four times a year, and there is a substantial difference in what might be called the personnel of the stockholders at each dividend period, and if the company is required to give the names of all the parties to whom it paid dividends at any time during the year, with their addresses and the amounts paid them, the labor will be something enormous. Some dividends are paid in the company's office and addresses need not necessarily be given. The company would not refuse to pay the dividends simply because it did not know the address of a stockholder.

The Pennsylvania Railroad Co. makes every effort to comply with the Government's requirements, but in view of the number of reports and returns that have to be made to State taxing authorities and to the National Government, it feels justified in making as strong a protest as it possibly can against any additional burdens in the form of returns being placed upon it.

If the committee desires, either myself or some member of the legal department o the Pennsylvania Railroad will appear before the committee and elaborate the views which I have presented to you in this letter. I am, sir,

Your obedient servant,

S. C. NEALE,
Attorney Pennsylvania Railroad Co.

THE MERCHANTS' ASSOCIATION OF NEW YORK,
233 Broadway, New York, February 3, 1917.

Hon. F. M. SIMMONS,
United States Senate, Washington, D. C.

DEAR SIR: We respectfully request your careful consideration to the inclosed resolutions adopted by this association and the statement of reasons therein why the proposed tax of 8 per cent on the excess profits of corporations and copartnerships should not be adopted.

We believe that the business interests throughout the entire United States will join us in protesting against a form of taxation so unjust, unequally distributed, and discriminatory.

Respectfully, yours,

THE MERCHANTS' ASSOCIATION OF NEW YORK,
By S. C. MEAD, *Secretary.*

THE MERCHANTS' ASSOCIATION OF NEW YORK,
New York, February 2, 1917.

RESOLUTIONS ADOPTED BY THE MERCHANTS' ASSOCIATION OF NEW YORK IN OPPOSITION TO THE PROPOSED TAX OF 8 PER CENT ON THE EXCESS PROFITS OF CORPORATIONS AND COPARTNERSHIPS.

Whereas unequal taxation is unjust taxation; and

Whereas all who share in the benefits arising from the activities of government should contribute to the cost of maintaining the Government with due regard to their ability to pay; and

Whereas, unless taxation be widely and equitably distributed, those exempted from its burdens feel no personal responsibility for promoting economy in governmental outlays, which indifference of a large part of the electorate is a principal cause of governmental waste and extravagance; and

Whereas a proposition is now pending before Congress to impose upon the net income of corporations and copartnerships a tax of 8 per cent of the amount by which such net income exceeds the sum of (*a*) $5,000 and (*b*) 8 per cent of the actual capital invested; and

Whereas such tax, unprcedented as to rate and the extent of the burden thereby imposed upon those affected, is open to the following, among other, objections: (*a*) It is discriminatory and unjust in that it imposes upon a relatively small class

a very heavy burden of taxation and exempts by far the greater part of the community from any share in that burden; it is directed solely against the profits arising from business enterprises and exempts profits arising from other sources, particularly those arising from the capital invested in agricultural pursuits; it exempts the profits of individuals arising either from business or other sources, thereby discriminating against corporations and copartnerships; it discriminates against copartnerships in favor of corporations by reason of the fact that the net profits of the latter are reduced by salaries, which is not the case as to copartnerships; (*b*) it is cumulative in that the entire body of capital upon which this tax will fall is already subjected to heavy taxation under the income-tax law and supplies a large, and probably the greater, part of the revenue derived from that source, thus placing a double burden of taxation upon specific accumulations of capital while permitting the great body of accumulated capital to remain free from Federal taxation; (*c*) it is unwise in that it relieves the greater part of the electorate of its due share of the cost of government and thereby tends to make the major part of the people indifferent to the waste of funds to which they do not contribute; (*d*) it is class legislation in that its manifest purpose is to impose upon business undertakings the greater part of the expenses of government, and almost wholly to exempt other classes from bearing any considerable part of the cost of carrying on the Government; and

Whereas the revenues necessary for the conduct of government can be obtained from other sources, among which are the following: (*a*) By lowering the exemptions in the present Federal income-tax law, which will very greatly increase the number of persons subject to the operation of that law, increase the revenues derivable therefrom by manyfold, and cause a very large part of the people to directly contribute to the revenues of the Government, thereby causing them to feel a direct and personal interest in governmental economy; (*b*) by the imposition of stamp taxes which do not bear heavily upon individuals, distribute themselves over the entire community, and from which large revenues can be obtained; (*c*) by taxes on sugar, coffee, tea, and similar commodities almost universally deemed proper subjects of equitable and widely distributed taxation; (*d*) by taxes on the capital employed in farming and upon other forms of capital now exempt from Federal taxation: Now, therefore, be it

Resolved, That the Merchants' Association of New York protests, for the reasons set forth in the foregoing preamble, against the adoption by Congress of the excess-profits tax provided for by H. R. 20573 and recommends that Congress consider, as a substitute for the taxation of excess profits, the sources of revenue indicated above, from which sources revenue sufficient for the present needs of Government can probably be obtained.

THE MERCHANTS' ASSOCIATION OF NEW YORK.
WILLIAM FELLOWES MORGAN, *President.*
S. C. MEAD, *Secretary.*

To the COMMITTEE ON FINANCE OF THE UNITED STATES SENATE,
Washington, D. C.

In the matter of H. R. 20573, known as the excess profits tax act.

The request is respectfully made that section 202 of the above act be amended with the object, first, of making its provisions definite; second, of making the basis of the taxation correspond with other tax acts of the United States; third, by providing the machinery to determine the property value upon which deductions shall be allowed.

POINT I.

SECTION 202 SHOULD BE MADE CLEAR.

At present it is indefinite in that "the time of payment of assets" in subsection 2, should read at the time of making the return, inasmuch as apparently the section refers to the time when the assets were originally paid in to the corporation. The section ends "but does not include money or other property borrowed by the corporation or partnership." This language is not clear, since it does not appear whether the proceeds of money borrowed should be deducted from the actual capital invested in order to arrive at the value upon which the 8 per cent income deduction is to be allowed. Apparently the meaning of this clause is to deduct from the actual capital invested all moneys borrowed. If such is the case, it reduces the 8 per cent deduction to a minimum in many cases, and would operate with great hardship on borrowing corporations.

POINT II.

THE BASIS OF VALUATION SHOULD BE UNIFORM WITH OTHER TAX LAWS OF THE UNITED STATES.

The Government has recently passed the excise tax law calling for a determination on the basis of "fair value." It is respectfully submitted that the basis of "fair value" is the only basis which can be equitably worked out in a tax deduction of the character proposed in this act. The systems of bookkeeping and the methods of accounting of different corporations are such that it will be impossible to determine what is and what is not "actual cash value at the time of making payment, of assets other than cash paid in" and matters of that kind. It will be most confusing to corporations to have to render two tax lists of this character. The conservative corporations which have not charged in expenses against capital will be penalized, while loose financial methods which have capitalized all items possible will be benefited. If it is intended as a tax upon the so-called unearned increment, it will operate unequally, for the reason that a large proportion of the corporate property of the United States has been purchased after the so-called unearned increment has accrued and such corporations will be justified in claiming a deduction of 8 per cent upon the actual cash value paid by them, while corporations which have developed properties in the country and have retained them over a period of many years will be penalized for having done so.

POINT III.

MACHINERY SHOULD BE PROVIDED FOR DETERMINING THE VALUE OF THE PROPERTY UPON WHICH DEDUCTION OF 8 PER CENT IS TO BE ALLOWED.

If this section is not to be amended so as to make it definite, then a section should be added providing for the principles and facts upon which the auditors may prepare their report to the Government.

POINT IV.

SECTION 202 SHOULD BE AMENDED.

We respectfully suggest that section 202 subsection 2 should be amended by striking out the present words of subsection 2 and substituting therefor the words "the fair value at the time of making the return." This amendment will give uniformity to the tax legislation of the country, will give clearness and distinctness to the law and will permit the corporations of the country to know in advance the exact basis upon which their taxes are to be levied.

Respectfully submitted.

WM. CHURCH OSBORN,
Counsel for Phelps Dodge & Co., of New York, and the Mill Iron Cattle Co., of Embar, Wyo.

Dated February 6, 1917.

EXCESS-PROFITS TAX AS APPLICABLE TO THE MANUFACTURERS OF MUNITIONS—STATEMENT OF THE BARTLETT-HAYWARD CO. (BALTIMORE, MD.).

COMMITTEE ON FINANCE, SENATE OF THE UNITED STATES.

GENTLEMEN: I desire to submit the following statement relative to Title I, revenue bill, known as H. R. 20573, now under consideration by you:

We earnestly request that the bill be so amended as to exclude from the excess-profits tax the earnings which are now subject to the 12½ per cent net-profits tax on munitions manufacturers so long as the 12½ per cent munitions tax is applicable.

On July 24, 1916, we appeared before the subcommittee of your committee and stated that we were in accord with a proposition that taxes should be so levied that those who were making profits out of the then abnormal conditions should bear their portion of the burden of meeting the Government's need of new revenue. Although the conditions have radically changed since that date in that the foreign purchases of munitions have greatly decreased and the United States purchases of such materials have greatly increased, and consequently munitions manufacture has become an industry of negligible value to foreign purchasers and of great value to the United

States Government, we still would offer no protest at bearing our just portion of any special tax.

The proposed tax of 8 per cent on excess profits will mean in our particular case that we must pay over to the Federal Government during the current year, in addition to any State taxes, approximately 20 per cent of the net profits derived during that period from the manufacture of munitions. We would not protest at this tax, nor would we protest if the amount were doubled or trebled so long as need existed, and so long as all corporations and partnerships were equally taxed regardless of the nature of their product. We do not now offer objection to this excess-profits tax as applied to our manufacture other than munitions, although it does seem that the revenue in the main is to be derived from a small section of the country.

We do, however, protest against what appears to us to be the injustice of selecting a small group of manufacturers who have embarked in the munitions business at great risk, and who are to-day the largest element of industrial preparedness, and placing upon them a tax upon net income that is double or treble the tax that will be paid by other manufacturers who have not embarked in new industries, have taken less risk, and who have derived and are deriving during these abnormal times vastly greater profits than the average munitions manufacturer.

As the object of this special increase in revenue is that it may be expended in the interest of preparedness, and as foreign purchases of finished ammunition have practically ceased, it naturally follows that this special tax, as applied to munitions manufacturers, will, from the date of its passage, be added to the cost estimates of munitions manufacturers bidding for the United States Government supplies, with the result that the tax will not be generally distributed, but find itself brought back to the United States Government. This company has, within the past 10 days, as the lowest bidder, secured in competition open to the entire country, a contract of from four to five million dollars for artillery ammunition from the United States Government. The special tax will in this case be a special penalty to this company, as in our estimating and bid prices we did not include this excess tax.

It appears to us as if ever in the history of this country there was a time when it was to the interest of the country as a whole to encourage, and not penalize, munitions manufacturers, now is that particular time. We often hear of a nation at arms, but in modern war what is more needed and vastly more difficult to secure is a nation manufacturing arms. If we undertook to argue at length the advisability of encouraging private enterprises in the manufacture of munitions we could quote from the messages of practically every President who touched upon the subject of national defense.

As the whole question of increased revenue revolves about the problem of preparedness, it seems to us appropriate, in assessing the tax, to bear in mind the fact that munitions manufacturers, by their mere existence, are contributing a large factor toward a national state of preparedness, and consequently should, if any exceptions are made, bear a smaller percentage of tax than other manufacturers, rather than a larger one.

Respectfully submitted.

HOWARD BRUCE,
Vice President and General Manager.

BALTIMORE, MD., *February 10, 1917.*

Mr. BENJAMIN C. MARSH. Mr. Chairman, I might say I do not know the other gentlemen, at all, and I am ready to go ahead at this time.

The CHAIRMAN. Very well. You may proceed.

STATEMENT OF MR. BENJAMIN C. MARSH, OF NEW YORK CITY, EXECUTIVE SECRETARY OF THE ASSOCIATION FOR AN EQUITABLE FEDERAL INCOME TAX.

Mr. MARSH. I am executive secretary of the association for an equitable Federal income tax. I am going to put before you what I said in a private conference with the President two or three weeks ago. I can not say what he said, as it is understood you do not repeat what the President says. But it seems to us the revenue bill which has passed the House is as much an act of perfidity as the tariff act of 1893. It violates all principles of just taxation, the fun-

damental principle of which is that we should tax privilege instead of industry. This Association for an Equitable Federal Income Tax prepared a little pamphlet last year, which I will be glad to leave with the committee. Of course, the figures given here were for last year. I have subsequent figures.

The CHAIRMAN. Just hand the pamphlet to the stenographer.

(The pamphlet referred to is here printed in full, as follows:)

WHY THE FEDERAL GOVERNMENT SHOULD SECURE AT LEAST $300,000,000 BY A RAPIDLY PROGRESSIVE INDIVIDUAL INCOME TAX.

[By the Association for an Equitable Federal Income Tax, 320 Broadway, New York City.]

Officers.—John J. Hopper, president; E. Vail Stebbins, secretary; Benjamin C. Marsh, executive secretary.

Executive committee.—Frederick L. Cranford, Prof. John Dewey, Jonah J. Goldstein, Rev. Percy S. Grant, Sen. Charles O'Connor Hennessy, Byron W. Holt, Hon. Frederic C. Howe, Charles H. Ingersoll, Frederic C. Leubuscher, Rev. J. Howard Melish, Hon. John J. Murphy, Edmund B. Osborne, Amos R. E. Pinchot, Hon. Edward Polak, George L. Record, Charles T. Root, Hon. Calvin Tomkins, F. S. Tomlin.

Memorial to the President and the Committee on Ways and Means of Congress.

GENTLEMEN: The rapid increase in local, State, and national budgets, especially the plan for extraordinary expenditures for defense, and the deficit in the customs revenue, emphasize the inadequacy of existing methods of raising revenue.

Most of the revenue for the National Government is secured from internal-revenue and customs taxes.

Most of the revenue for local and State purposes is secured from general property taxes, business taxes, fees, and licenses.

Much the major part of these revenues comes from the workers of the country. The smaller the income, the larger is the proportionate contribution under our tax system, which, directly or indirectly, costs many workmen nearly a fifth of their earnings. Earned incomes are taxed much more heavily, in effect, than unearned incomes, for nearly every great income is chiefly derived from secure investment or from privilege and monopoly.

The war taxes proposed would increase these burdens.

The deplorable conditions of millions of tenant farmers and workers in industrial centers, fully described by the United States Commission on Industrial Relations, demand that we should lighten the present heavy burden of taxes upon these millions and millions of other workers.

The most fundamental measure of preparedness which our Nation can adopt is the establishment of better economic and industrial conditions.

A rapidly-progressive income tax is a proper source of revenue for the Federal Government, because nearly every person receiving a large earned income does so for services throughout a large area, and nearly every person receiving a large unearned income derives it from the entire country.

The individual income tax yielded during the fiscal year ended June 30 last only $41,046,000, although in 1914 there were 2,348 persons receiving an income of $100,000 or more, of whom 174 received an income of $500,000 or more.

We believe that at least $300,000,000 should be secured by the individual income tax and that the rates should be very rapidly progressive and intensive.

We urge that those receiving an income of over $1,000,000 be taxed a third to a fifth of their total incomes. To take such a proportion of these incomes would more nearly approximate that equality in taxation which it is the purpose of the Constitution to insure and the duty of statesmanship to secure.

This sum of $300,000,000 would meet any reasonable expenditures for preparedness and permit the reduction of customs duties upon the necessaries of life and of internal-revenue duties upon the cheaper grades of commodities now classified as luxuries.

Additional revenue for local and State purposes can be secured by heavier taxation of land values, which are an adequate, appropriate subject of taxation for these purposes.

We therefore ask that Congress at once enact legislation to secure $300,000,000 from an individual income tax and that the President approve such legislation.

THE PRESENT BURDEN OF TAXATION.

The total current cost of Federal, State, county, and local governments is approximately $2,850,000,000, exclusive of long-term debts and the postal deficit.

This amounts to approximately $130, on the average, for each of the 23,000,000 families in the country. The value of manufactured goods consumed in the country is approximately $14,000,000,000. On the average we pay about 8 per cent more for these goods annually because of the existing tariff, or $1,300,000,000, an average of nearly $50 per family.

The annual cost of our present tax system is, therefore, about $180 per family. This bears most heavily upon the poorer families. A small homeowner, for example, with a house and lot assessed for $4,000 and a tax rate of 2 per cent pays directly $80 for local government in addition to indirect taxes for city, county, State, and Federal governments. The smaller the family income the larger the proportion taken by taxation.

THR PRESENT FORMS OF TAXATION FOR THE FEDERAL GOVERNMENT, LOCALITIES, AND STATES.

The Federal Government.—Of the total ordinary receipts of the Federal Government for the fiscal year ended June 30, 1915, amounting to $697,910,827, approximately $615,000,000 was secured by consumption and other indirect taxes, the chief items being: Customs, $209,786,672; internal revenue (ordinary), $283,398,760; the emergency revenue act (of Oct. 22, 1914), $52,069,126; and miscellaneous, $70,287,372.

Last year the total excess of disbursements of the Federal Government over receipts into the general fund—i. e., the deficit—was $57,442,509.75.

States, counties, and localities.—Of the total revenue receipts for 1913 of States, counties, and incorporated places having a population of 2,500 and over, amounting to $1,845,001,128, the chief items were: General property taxes, $1,082,971,468; special property taxes, $83,960,118; special assessments and charges for outlays, $113,218,693; poll taxes, $12,412,477; business taxes, $57,024,897; liquor licenses and other imposts, $79,516,989; other business licenses, $22,328,805; nonbusiness license taxes, $12,945,902; highway privileges, $13,685,951; interest and rents, $62,393,830; subventions and grants, $78,372,386; earnings of general departments and miscellaneous, $87,391,576; earnings of public-service enterprises, $122,311,560.

The Federal Government.

The total current Federal ordinary disbursements for the fiscal year ended June 30, 1915 (exclusive of the postal deficit and debt incurred) were		$731, 399, 759. 11
The chief revenue receipts were:		
Customs	$209, 786, 672. 21	
Internal revenue ordinary	283, 398, 760. 85	
Emergency revenue act, Oct. 22, 1914	52, 069, 126. 29	
Corporation income tax	39, 155, 596. 77	
Individual income tax	41, 046, 162. 09	
Sales of public lands	2, 167, 136. 47	
Miscellaneous	70, 287, 372. 90	
Total ordinary receipts	697, 910, 827. 58	

States.

The total current (cost) expenditures of States in 1913 were		382, 551, 199
The chief revenue receipts were:		
General property taxes	$139, 750, 303	
Special property taxes	67, 675, 933	
Poll and occupation taxes	2, 965, 069	
Special assessments, etc	6, 454, 807	
Business taxes	53, 642, 322	
Liquor and other business and nonbusiness licenses	36, 032, 997	
Interest and rents	21, 300, 430	
Earnings of general departments and miscellaneous	32, 994, 761	
Inheritance transfer tax	26, 470, 964	

The total current (cost) expenditures of incorporated places in 1913 were		$1, 246, 659, 000
The chief revenue receipts were:		
General property taxes	$661, 144, 096	
Special property taxes	15, 478, 766	
Poll taxes	3, 629, 553	
Special assessments, etc	97, 440, 808	
Business taxes and nonbusiness license taxes, etc	67, 501, 627	
Fines, escheats, and forfeits	6, 717, 873	
Highway privileges	13, 521, 183	
Interest and rents	35, 561, 915	
Subventions and grants	51, 498, 823	
Earnings of general departments and miscellaneous	25, 832, 348	
Earnings of public service enterprises	120, 182, 809	
The total current (cost) expenditures of counties in 1913 were	(a)385,181, 760	
The chief revenue receipts were	282, 077, 068	
Poll taxes	5, 817, 855	
Special assessments, etc	9, 323, 078	
Liquor licenses and other imposts	6, 557, 556	
Fines, forfeits, etc	3, 531, 537	
Interest and rents	5, 531, 485	
Subventions and grants	23, 682, 813	
Earnings of general departments and miscellaneous	28, 564, 467	

(*a*) The current (cost) expenditures of unincorporated places with a total population of at least 2,000,000 is estimated at $20,000,000, $10 per capita, as against $27.29, the per capita governmental cost payment of all incorporated places having a population of 2,500 and over. While statistics are not available regarding the revenue receipts, the major part was secured from the general property tax.

(These figures are given in the Report of the Secretary of the Treasury for 1915, and the Census report on wealth, debt, and taxation for 1913.)

Three-quarters of the cost of Government in the country—Federal, State, county, and local—is secured by indirect, shiftable taxes, chiefly borne by the workers regardless of benefit conferred by governmental expenditures, or ability to pay.

Names assigned to taxes do not affect the established fact, that under ordinary circumstances, such as exist in this country now, there are only three taxes which can not be shifted—taxes on land values, on inheritances, and on incomes.

There are only two sources of revenue: Ground rents, created and maintained by the presence and industry of population and governmental expenditures; and earnings or income, currently earned, or secured, or accumulated.

The tax bearers, not the taxpayers, are the sufferers under our unjust method of raising revenue.

Of the total governmental expenditures, amounting last year (1915) to about $2,850,000,000, approximately $650,000,000 was secured by taxing land values; i. e., taking ground rents, although the ground rent of the country calculated at 6 per cent was at least $3,720,000,000, and the increase in land values was at least $2,400,000,000. Less than 3 per cent of the population own nearly all the value of the land and the major part of the acreage of land.

Only $41,046,162 was secured by the Federal income tax on individuals, although 7,509 people had an income of at least $850,000,000, and probably $1,000,000,000, or about one-twentieth of the national income. (See tables later.)

Only $39,155,596 was secured from the Federal corporation income and $26,470,864 from the inheritance tax in 1913, although every year about a billion dollars is devised or bequeathed.

Part, at least, of the income tax on corporations was shifted, so that $2,000,100,000 was secured from consumption or other indirect and shiftable taxes, most of which were paid by the working classes, who have no exemption, as do those now subject to an income tax. As is universally agreed, indirect taxes are most expensiveto collect and cost the tax bearer more than direct taxes, because the taxpayer collects not only tne taxes which he advances, but a profit for advancing them.

JUST FORMS OF TAXATION FOR THE FEDERAL GOVERNMENT, STATES, AND LOCALITIES.

Fully as apparent as the injustice of the present system of raising revenue is the fact that all units of government from village to national must spend more, despite any practical economics in administration. This is due chiefly to three facts:

1. Increasing social demands.
2. Increasing cost of living.
3. The enormous governmental debt incurred chiefly during the past quarter of a century, which involves very heavy carrying charges.

THE GOVERNMENTAL DEBT OF THE COUNTRY IS APPROXIMATELY FIVE BILLIONS.

Interest-bearing Federal debt (June 30, 1913)	$969, 759, 090
Funded and floated debts of States (1913)	422, 796, 625
Net debt of cities, villages, and other civil divisions (1913)	2, 985, 555, 485
Net debt of counties (1913)	371, 582, 268

Estimating the interest to average only 4 per cent, the annual charge on the governmental debt is nearly $200,000,000, an average of about $9 per family.

Obviously in seeking to determine proper objects of taxation for various governmental units, the effects of taxation must be considered as well as what classes of citizens and property have been benefited financially by governmental expenditures and by governmental action.

LAND, INCOMES, AND INHERITANCES SHOULD BEAR BULK OF PERMANENT TAXES.

Dr. Thomas N. Carver, professor of political economy in Harvard University, in his Essays in Social Justice (p. 429), says: "As permanent taxes should be levied in such a way as to avoid as much as possible the shifting of the burdens, it follows that they should be levied mainly upon the land, incomes, and inheritances."

LAND AND INHERITANCES ARE PROPER OBJECTS OF TAXATION FOR LOCAL AND STATE GOVERNMENTS.

It is agreed by practically every one that municipal and all local expenditures for transit lines, water supply, sewerage, streets and roads, police and fire protection, education, health, charities, recreation, etc., attract population and so maintain and increase land values. These expenditures benefit financially only one class of property—land—and only one class of people—land owners.

In nearly every American city and town and, to only a lesser degree, in villages, a very small per cent of the population owns most of the value of land, and are hence the chief financial beneficiaries of local governmental expenditures.

New York City.—One hundred families (out of about 1,100,000 families in the city) are the owners of record of about one-ninth of the assessed value of land in the city, while 3,000 families and real estate corporations which they control own about two-fifths of the total value of land in the city.

Chicago.—The assessed value of the sites of nine well-known buildings in or near the "loop district" is about one thirty-fourth of the total assessed value of land of the city.

Washington, D. C.—Seven families, companies, and estates recently owned 7 per cent of the land in the city.

Boston.—The assessed value of land fronting on Winter Street, one block, including that on the Tremont and Washington Streets corners, is about 1½ per cent of the total assessed land value of the city.

The present selling price, i. e., net untaxed price of land of the cities, towns, and villages of the country is at least $22,000,000,000. The selling price of land in New York and Chicago alone is nearly $5,850,000,000—with a total population of about 7,525,000.

The selling price of farm land in the United States was in 1910, $28,476,000,000. Assuming a total increase during the past five years of only 40 per cent, although the increase in the preceding decade was 118 per cent, the present selling price of farm land is nearly $40,000,000,000.

The average annual increase in land values of the country is sufficient to meet all increases in local budgets, and to permit the gradual untaxing of improvements as urged by the majority report of the United States Commission on Industrial Relations, by State granges and labor organizations and by civic organizations throughout the country.

Although the total revenue from the inheritance tax was (1913) only a little over $26,460,000, the revenue from this source can be increased very materially—sufficiently to meet all reasonable and necessary increases in the cost of State governments

in most States, while a small part of the tax upon land values would meet any deficit in every State.

The ground rent of the urban and agricultural land of the country, calculated at only 6 per cent, is at least $3,720,000,000. The total current cost of State, county, and local governments is about $2,120,000,000, and will probably not exceed $2,500,000,000 for years to come, by which time the annual ground rent of the country will have increased by many hundreds of millions.

The inheritance tax can, obviously, without any injustice, yield several times as much as at present.

These two sources will readily yield all additional revenue that can ever be legitimately expended by State and local governments. There is not the slightest foundation in equity or necessity for an income tax for either State or local purposes in the United States, while a heavy land value tax is necessary to prevent speculative increases in land values, which are placing annually a dead weight burden upon industry and workers of billions of dollars.

THE INCOME TAX THE PROPER MAJOR SOURCE OF REVENUE FOR THE FEDERAL GOVERNMENT.

Concentration of income in the United States.—Income from Federal, State, and municipal bonds are not taxable under the Federal income tax, and deductions are allowed for State, local, and municipal taxes paid, so that the figures of the incomes subject to Federal income tax do not in any way represent the total income of those taxed. The wage earner, the small business man and the farmer do not enjoy any deduction before they pay taxes, direct or indirect, for local, State, or Federal governments.

The figures given by the Commissioner of Internal Revenue are striking, but incomplete, for in addition to the rebate allowed those in receipt of an income of $3,000 ($4,000, if married) or over, noted above, no distinction is made between incomes currently earned and incomes derived from secure investments, between what Gladstone designated as "industrious" and "lazy" incomes.

The commissioner in his 1915 report states:

"The information to be obtained from individual returns as now required by law in conjunction with the withholding features of the law, is so incomplete as to the gross incomes received by individuals that it would be difficult to make a statistical report that would be of practical value to those concerned in problems of taxation or other economic questions."

SEVENTY-FIVE HUNDRED PEOPLE IN THE UNITED STATES HAVE A MINIMUM AGGREGATE NET INCOME OF $850,000,000.

The following table gives the net taxable range of incomes and total incomes of those who received, in 1914, a taxable income of $20,000 or more. The aggregate for those receiving over $1,000,000 and those receiving between $500,000 and $1,000,000 was courteously furnished by the Internal Revenue Bureau. The mean of the other classes is taken as the average which, in view of the exemptions, is very conservative; and the minimum net income is also given, assuming each to receive only the minimum of the range of income in his class.

Range of income.	Number of taxpayers.	Probable aggregate net taxable income.	Minimum aggregate net taxable income.
Over $1,000,000	60	$127,643,766	$127,643,766
$500,000 to $1,000,000	114	76,041,104	76,041,104
$400,000 to $500,000	69	31,150,000	27,600,000
$300,000 to $400,000	147	51,450,000	44,100,000
$250,000 to $300,000	130	33,750.000	32,500,000
$200,000 to $250,000	233	52,425,000	46,600,000
$150,000 to $200,000	406	71,050,000	60,900,000
$100,000 to $150,000	1,189	148,625,000	118,900,000
$75,000 to $100,000	1,501	131,337,500	112,575,000
$50,000 to $75,000	3,660	228,750,000	183,000,000
	7,509	954,222,370	829,859,970
$40,000 to $50,000	3,185	143,325,000	127,400,000
$30,000 to $40,000	6,008	210,280,000	180,240,000
$25,000 to $30,000	5,483	150,782.500	137,075,000
$20,000 to $25,000	8,672	195,420,000	173,540,000
	23,348	699,807.500	618,285,000
Grand total	30,857	1,654,029,870	1,448,144,970

The most striking facts brought out by this table are that the minimum aggregate net income, subject to the Federal income tax, of 7,509 people in the United States was, in 1914, $829,859,970. They probably received nearly $1,000,000,000 total income, if their income is reckoned as is that of the ordinary workingman, or approximately one-twentieth of the total income of the country, which is about $20,000,000,000.

Twenty-three thousand three hundred and forty-eight other persons, each receiving a net taxable income of at least $20,000 received in the same year (1914) an aggregate minimum income subject to the Federal income tax of $613,285,000 and their real income was probably about $800,000,000.

In other words, counting three dependents to every person included above, 123,428 persons received in 1914 a net taxable income of from $1,448,144,970 to $1,800,000,000, while 100,000,000 persons received a gross income of about $18,300,000,000.

The average minimum taxable income per person in one case was $11,733; in the other $183. The average minimum net income of the 60 persons receiving over $1,000,000 was $2,127,396; the same average for the 114 receiving $500,000 to $1,000,000 was $667,018.

DUTIES ON CHEAPER GRADES OF NECESSITIES AND INTERNAL-REVENUE RATES ON CHEAPER "LUXURIES" SHOULD BE REDUCED.

Within a few years at most even if no large expenditures are made for preparedness or defense, the national expenditures will probably be about $900,000,000.

There is every indication that the fictitious "prosperity" of this country, due to the European war and the purchase of American agricultural and manufactured products (paid for by the allies on borrowed capital), will not long survive the termination of that conflict.

At least $200,000,000 more revenue than the Federal Government received in 1915—$697,910,827—must be secured; and if the most conservative plan of "preparedness" be put through this additional sum must come, either from the consuming public through indirect taxes, the most expensive method, bearing most heavily on those least able to bear it, or through the income tax, unless the objects of taxation now reserved for States and localities, be taken by the Federal Government—which would in most States result in further tax burdens upon the workers. The per capita receipts from ordinary internal revenue were, in 1915, $2.80; the per capita custom receipts about $2.07. Almost every family in the country contributed to both these funds, while every family contributed to the nearly $40,000,000 duty collected on sugar—and to the same amount contributed as an indirect subsidy to sugar refiners.

INTERNAL-REVENUE RECEIPTS WILL DECREASE UNLESS RATES BE INCREASED.

The Commissioner of Internal Revenue, in his report for 1915, says of the decrease of nearly $2,250,000 from the tax on spirits and fermented liquors: "This in the main can probably be attributed to the prohibition laws." Since the first of the year seven more States, with a population of over 5,000,000, have "gone dry."

SECRETARY OF THE TREASURY'S ESTIMATE FOR 1916 AND 1917 EXPENDITURES AND RECEIPTS.

The Secretary of the Treasury, in his 1915 report, estimates:

Total ordinary disbursements for the fiscal year 1916	$741,891,000
Total receipts based on existing laws	670,365,500
Excess of total disbursements over total receipts based on existing laws, Panama Canal disbursements from the general fund included	71,525,500
Total disbursements for the fiscal year 1917	857,951,000
Total receipts based on existing law	603,500,000
Excess of total disbursements over total receipts	254,451,000

The excess of ordinary disbursements over ordinary receipts for 1917 based on existing law he estimates at $252,701,000.

SUGGESTED METHODS OF RAISING ADDITIONAL REVENUE REQUIRED.

Among the methods suggested to raise additional revenue are the continuation of the emergency revenue act of October 22, 1914, the tax on sugar, a tax on gasoline. horsepower of automobiles, etc. Were the country actually at war these as well as the usual taxes on consumption might be endurable, even if not defensible.

It is not, however, within the range of probability that the country will be at war; so that ordinary consumption taxes, as well as the extraordinary measures now in force, are indefensible.

The principle of one suggestion made by the Secretary of the Treasury is the only feasible and just method immediately available. He says: "It is respectfully suggested that consideration may well be given to an increase in the rates of taxation on individual and corporate incomes as a means of raising in whole or in part the additional revenues required to meet the new expenditures. In addition to the increased rates the present exemption of $3,000 for single and $4,000 for married persons could be reduced to $2,000 and $3,000, respectively, without any hardship. The surtax could begin at $10,000 or $15,000 instead of $20,000, as provided by the present law.'

The following table shows the number of taxpayers receiving, in 1914, a net taxable income of less than $20,000 and therefore not liable to the additional income tax, their minimum aggregate taxable income, and their probable aggregate net taxable income, as in the preceding tables for other income taxpayers:

Range of income.	Number.	Probable aggregate net taxable income.	Minimum aggregate net taxable income.
$15,000 to $20,000	15,790	$276,325,000	$236,850,000
$10,000 to $15,000	34,141	426,762,500	341,410,000
$5,000 to $10,000	127,448	955,860,000	637,240,000
$4,000 to $5,000	66,525	299,362,500	266,100,000
$3,000 to $4,000	82,754	289,639,000	248,262,000
Total	326,658	2,246,949,000	1,729,862,000

Combining this table with the figures given previously, we get the minimum aggregate net taxable income in 1914 of the 357,515 persons subject to the Federal income tax and their probable similar income as explained in the preceding tables:

Range of incomes.	Number of taxpayers.	Probable aggregate net taxable income.	Minimum aggregate net taxable income.
A.—*Subject to the additional income tax.*			
$50,000 to $1,000,000	7,509	$954,222,370	$829,859,970
$20,000 to $50,000	23,348	699,807,500	618,285,000
B.—*Subject only to normal income tax.*			
$3,000 to $20,000	326,658	2,246,949,000	1,729,862,000
Total	357,515	3,900.978,870	3,170,006.970

No figures are available showing the number of persons receiving, in 1914, an income of from $2,000 to $3,000, but it may conservatively be estimated at 300,000, whose minimum aggregate income was $600,000,000—whose probable income was nearly $750,000,000, and whose taxable income, if the exemption were reduced to $2,000, was $150,000,000. Less than one-half of 1 per cent of the population receives about one-fifth of the total national income.

The minimum net taxable income of those liable last year to pay the Federal income tax, $3,170,006,970, could readily yield $300,000,000 with a rapidly progressive rate. Their probable income, about $4,000,000,000, would yield this amount with rates far below those of the war rates in several nations at war, and not much higher than the rates in some of those countries in peace.

In 1866, although the national income was only a fraction of what it is to-day, the Federal income tax yielded nearly $73,000,000.

If it were deemed equitable, a tax rate of one-half of 1 per cent might be levied upon net incomes between $2,000 and $3,000.

The Bureau of Internal Revenue has the net taxable income of all taxpayers, under the Federal income tax, and can compile the net taxable incomes. By determining the amount to be raised through the income tax the exact rates on different ranges of incomes can readily be ascertained.

PRESENT DISTRIBUTION OF INCOME TAX INEQUITABLE.

The following table is from the report of the Commissioner of Internal Revenue for 1915 (p. 24):

Income tax, normal	$16,559,492.93
Income tax, additional—Net incomes—	
$20,000 to $50,000	4,106,673.36
$50,000 to $75,000	2,500,890.33
$75,000 to $100,000	2,102,927.01
$100,000 to $250,000	5,945,104.55
$250,000 to $500,000	3,328,423.78
Exceeding $500,000	6,439,004.54
Total	40,982,516.50
Accepted offers in compromise	63,645.59

Obviously, since the minimum aggregate net taxable incomes of the 30,857 persons receiving a net income of from $20,000 to over $1,000,000 was $1,448,144.970, the additional income tax of $24,423,024, and the normal income tax of $6,171,400—these persons paid a total of $30,594,424—was entirely disproportionate to their ability to pay. The average tax rate was only 2.1 per cent on their minimum net taxable income, and about 1.7 per cent on their probable net taxable income.

The most flagrant injustice of the present income tax rates is, however, the result on the receivers of the largest incomes.

The net aggregate taxable income of the 174 persons receiving a net taxable income of over $500,000 was $208,684,870. Their total aggregate income in excess of $500,000 apiece, was $116,684,870, while their total tax on this sum was only $6,439,004. The average additional tax rate on the excess of a net taxable income of $500,000 was, for these 174 wealthiest people of this country, only 5.5 per cent.

In order, even to approximate justice, those in receipt of a net taxable income of over $1,000,000 should pay an income tax of at least 20 per cent to 33⅓ per cent, which would not represent a sacrifice in any way commensurate with that involved in paying an income tax of one-half of 1 per cent on the excess of $2,000 and less than $3,000.

GEOGRAPHICAL DISTRIBUTION OF RECIPIENTS OF LARGE INCOMES.

The following table from the Commissioner of Internal Revenue's report for 1915 shows that most of the wealthiest persons in the country live in the four States, New York, Pennsylvania, Illinois, and Massachusetts:

	Total individual income tax paid in 1915.	Per cent.	Number of persons having given range of income (pp. 116, 117).						
			$500,000 and over.	$400,000 to $500,000.	$300,000 to $400,000.	$250,000 to $300,000.	$200,000 to $250,000.	$100,000 to $200,000.	Total number of taxpayers.
United States	$41,046,162	100.0	174	69	147	130	233	1,593	357,515
New York	17,417,537	42.4	102	27	66	65	99	584	83,405
Pennsylvania	4,642,557	11.3	20	3	15	15	30	193	33,789
Illinois	2,670,630	6.5	14	7	15	13	17	126	33,768
Massachusetts	2,683,084	6.5	3	6	11	6	18	170	21,963
Total	27,413,808	66.7	139	43	107	99	164	1,073	172,925

New York State (including Porto Rico) paid nearly half (42.4 per cent) of the total Federal income tax in 1915, and nearly two-thirds of the persons receiving an income of $500,000 and over resided in that State.

The "big four" industrial States paid just over two-thirds of the Federal income tax in 1915, while more than three-quarters of the persons receiving an income of $500,000 and over resided in these four States, and nearly one-half of the persons subject to the Federal income tax.

RESIDENCE IS NO INDICATION OF SOURCE OF REVENUE.

Very few, if any, receivers of a net income (in 1914) of over $500,000 secured that income from the city or even from the State in which they lived. Practically no large income is derived from the locality in which the recipient thereof resides. If this income is from secure investment it is usually derived from investments affecting, not only the people of the city and State, but the entire country if not foreign countries.

This is generally also true of large salaries paid and income derived from business.

To the extent that income is derived from land ownership, that income can be effectively and appropriately reached by the locality and State by heavier taxation of land values and franchises.

THE MENACE TO THE NATION OF A LOCAL AND STATE INCOME TAX.

An effort is being made by beneficiaries and servants of privilege to inaugurate an income tax for local and State purposes in New York State, the most popular abiding place of the multimillionaires of the country.

It is urged by land speculators as a "relief" to the landowners of New York City, who, as such, get on the average an annual net profit of about $300,000,000 from ownership of land there.

STATE AND LOCAL INCOME TAXES ARE DESIGNED TO EMBARRASS THE FEDERAL ADMINISTRATION.

State Senator Ogden L. Mills, chairman of the joint legislative committee of New York, says cities and States should tax incomes before the Federal Government "dries up" this source of revenue.

Prof. E. R. A. Seligman, of Columbia University, also an advocate of a proportional—not a progressive—income tax for cities and States, admits that if this is done the Federal Government must tax the wage earners and people with small incomes more heavily. He says (1914) in his book, The Income Tax:"

"We do not often stop to think what an immense potential resource is afforded by the excise system. In a country of the prodigious wealth of the United States it is no exaggeration to say that the entire expense of the National Government could be easily met by a system of internal excises which would even then be moderate in both rate and extent. Instead of reckoning our internal revenue by the few hundreds of millions, we could, without great difficulty, reckon it almost by the thousands of millions.

"A tax on expenditures necessarily becomes an increasingly heavy burden on the least wealthy classes.

"If wages are sufficient only for a bare minimum of subsistence, then to encroach upon this minimum by taxation is to require the minimum to be maintained in some other way. If the laborer can no longer live on his wages, he must be supported by a system of poor relief, if he is to live at all.

"The English income tax has thus become a mighty fiscal and social engine. Nearly $200,000,000 a year are now raised in a way that gives perhaps as little trouble as any form of taxation."

Even an advocate of the income tax for States and localities like Prof. Seligman has to admit that it is impracticable. In his book, referred to, he says:

"If any one lesson is to be learned from Swiss experience, it is that a system of income taxes, resting, as do the general property taxes, upon methods of local assessments, even when modified by a central State control, is bound to fail. It is a conclusive proof of the fact that the way out of American difficulties is not to be sought in the direction of any kind of local or State income tax * * *.

"So that even at the very best a State income tax would not be apt to succeed unless it was controlled and regulated by the Federal Government, either in the formulation of the principles to be adopted or in the choice of the administrative methods to be employed; for in no other way can the incomes from interstate business be reached."

A chief purpose of most advocates of the income tax for State and local purposes seems to be to give the receivers of great incomes a seemingly plausible but actually specious argument against a rapidly progressive Federal income tax.

Bankers and many other wealthy people in New York City urge a low rate proportional, not progressive, local income tax on almost all incomes, to insure privilege against an equitable rapidly progressive Federal income tax.

ECONOMISTS INDORSE A RAPIDLY PROGRESSIVE FEDERAL INCOME TAX ON INDIVIDUALS

Dr. Henry R. Seager of Columbia University, says:

"From the time the income tax was imposed I have felt that it was defective in two respects: First, that it did not apply to smaller incomes, beginning, say, with an income of $2,000 and a tax rate on such incomes of one-half of 1 per cent, and with the rate progressing on higher incomes. Second, that the higher rate on large incomes was too low to make the tax a really proportional tax from the point of view of the ability of the recipients to pay, or of the sacrifice which the tax would impose on them. The only objection to a high tax on large incomes that appeals to my judgment is administrative; that is, that if the tax is too high it fosters evasion and may even cause the recipients of very large incomes to withdraw from the country. I believe that European experience justifies the expectation that a tax of 20 per cent on incomes of a million or more will not have either effect to an appreciable extent. If this high rate is imposed, as I believe it should be, the rates on intermediate incomes should be graduated down by easy steps, so that there will be no sudden or abrupt change.

"I should not be disposed to advocate a higher rate than 20 per cent on incomes of $1,000,000 or more until the new system has been tried out."

Dr. Franklin H. Giddings, also of Columbia:

"I am heartily in sympathy with all efforts to make our Federal taxation more just than, in my opinion, it is to-day. I can see no way to achieve this end, but through a frank adoption of the system of a progressive income tax. A uniform rate on small and large incomes is a bit of pure arithmetic fairness that has no relation to the facts of life. I do, however, feel that the detail of a tax program is a serious matter that calls for most careful expert consideration."

Among other well-known economists who indorse taxing large incomes very heavily are Profs. Charles A. Beard and Henry Mussey, of Columbia University; E. A. Ross and John R. Commons, of Wisconsin University; H. J. Davenport, University of Missouri; Carl Kelsey and James T. Young, of the University of Pennsylvania, and Charles H. Cooley, of Michigan University.

Secretary of the Treasury Fessenden, in his annual report for 1864, stated:

"Taxation upon incomes as they rise in amount, although unequal in one sense, can not be considered as oppressive, inasmuch as the ability to pay increases in much more than arithmetical proportion as the amount of increase exceeds the limit of reasonable necessity."

Senator John Sherman, debating the Federal income tax law in 1864, said:

"If I had my way I would retain the income tax at 5 per cent on all incomes above $1,000, make such modifications as would afford the proper exemptions, and then throw off these taxes upon consumption that oppress the poor, and take the coppers out of dollars of the people who earn them by their daily work."

No such rate as Senator Sherman suggested would be necessary or equitable now; the maximum rate on incomes of $2,000 to $3,000 should not exceed one-half of 1 per cent.

THE NATIONAL INCOME TAX IN SOME FOREIGN COUNTRIES.

England.—In 1914, out of a total revenue from taxes of $818,275,000, $236,205,000 was raised by the income tax.

The principal feature of the new revenue bill is a 40 per cent increase in the rates on incomes, and while the exemption is lowered, so that those receiving $700 a year will pay an income tax of $12 a year, the tax upon those receiving an income of $500,000 is a little over one third, so that a person with an income of $500,000 will pay an income tax of $170,000.

The tax rates on incomes of $2,000 to $5,000 is approximately 10 per cent; on incomes of $25,000 about 20 per cent. It is estimated that the new rates will produce about $235,000 more than the old rates, or a total of $470,000,000 from a population of approximately 47,000,000, or a per capita of about $10.

With the same per capita yield, our Federal Government would secure over $1,000,000,000 from an income tax.

Germany.—In 1914 Germany secured from the State and local income tax about $177,076,750, a per capita of approximately $2.70. The exemption is very low.

Switzerland.—Switzerland is levying this year an income tax of $10,000,000, which will involve a per capita contribution of nearly $2.

Austria and France also are increasing income tax rates very rapidly.

FURTHER SUGGESTIONS REGARDING THE INCOME TAX LAW.

1. There should be more classes of incomes, with different rates, since the jump from $500,000 to $1,000,000 is disproportionate to the other ranges.
2. Income from investments should be taxed at a higher rate than currently earned income. A person receiving $3,000 net taxable income from mortgages can much better afford to pay a higher rate of taxation than a person receiving the same income for professional services or from business enterprise.
3. Recipients of salaries from Federal, State, or local Governments should not be exempt from payment of a Federal income tax.
4. Income from Federal, State, county, municipal, and special improvements bonds should not be exempted from the income tax.
5. As long as taxes paid States, cities, and localities are deducted in computing the net taxable income, equivalent deduction should be made at least for rent paid, so that the tax bearer may be put on the same basis as the tax collector, and the tenant on the same basis as the owner of a mansion on Fifth Avenue, Euclid Avenue, Beacon Street, Walnut Street, or Michigan Boulevard.

CONCLUSION.

The imposition of a rapidly progressive income tax is denounced as confiscatory. It is pertinent, therefore, to recall that fact that there is hardly a person in the United States receiving a net taxable income in excess of $100.000 who earns that sum by his own exertions and brains alone. Were it not for some privilege, even fewer than the present number would receive such income.

Every great fortune in the country was secured through some privilege—tariff, freight rebates, patent rights, control of credit—or the fundamental privilege—monopoly of land and natural resources therein and thereon.

Even were it true that heavy taxation of land values would abolish all unearned incomes, this is not feasible for many years because of provisions in State constitutions and in the Federal Constitution, which it would require years to amend.

The country is confronted with a crisis not due primarily to the European war.

Although the income tax is the fairest test of ability to pay for the Federal Government, under existing constitutional restrictions, we secured only about one twenty-fifth of Federal expenditures from the individual income tax in 1914 and one-eighteenth in 1915.

Congress must determine whether to "take the coppers out of the dollars of the people who earn them by their daily work" to meet Federal expenditures, and so violate every canon of taxation and every sanction of justice, or to approximate justice by securing at least $300,000,000—only about one-third of the probable Federal expenditures in 1917—by a rapidly progressive income tax upon individual incomes.

We respectfully submit that a Congress representing the country should not hesitate in determining which policy to adopt.

Mr. MARSH. We believe that every dollar of revenue needed by the Federal Government should be secured by a rapidly progressive tax on large incomes.

The CHAIRMAN. Would you mind confining your remarks to this present bill. Of course your idea of what taxation should be is just taking up time for nothing. Tell us your objections to the present bill, so that we may consider them.

Mr. MARSH. Mr. Chairman, I am doing that in my own way, if you will permit me, because our reasons——

The CHAIRMAN. Your own way will take up the time of the other gentlemen.

Mr. MARSH. We oppose this whole bill; we are opposed to most of the features of the bill. It proposes a flat rate upon all excess profits, whether the excess profits amount to $1,000 or $5,000, or a few million dollars. It is utterly inequitable, because it fails to recognize the principle of progressiveness which should be recognized.

Now, in the first place, it is inconceivable that the Democratic Party should keep a tax upon sugar. I am sure every member of

this committee knows that the poorest man in New York City, in the State, in the city, and in the country is paying nearly twice as much money in proportion as the richest man, twice as large a proportion of his income—even with the supertax upon the large incomes, and while you retain the tax upon sugar of course we know that is paid by the consumer.

Then, this bill is faulty again in that you simply say to a man, "If you are thrifty, if you conduct your business thriftily, we are going to tax you upon it," while a man utterly negligent, unbusinesslike, and inefficient in his methods of business is taxed heavily. The fundamental provision of the bill is that you are going after taxing industry, as such. As I said to the President—I can not say what he said—it is a bad principle to tax industry. We should raise the most of our revenue by the natural source, taxing the ground rents of the country and putting that into the public treasury. I recognize that is a theoretical question, and do not urge it now, at all. But a tax upon excess profit is a tax specifically upon industry. What this Government ought to do, because the Democratic Party has not dared to touch the fringe of limiting privilege, is to impose, instead of any taxes which you propose on excess profits, to put a tax of at least a third upon incomes in excess of $1,000,000. There are 120 people in this country each of whom have a net taxable income——

The CHAIRMAN. To which particular part of this bill do you desire to address yourself?

Mr. MARSH. To the tax on excess profits and to the tax on sugar, and to say that instead of those we sincerely hope this committee will recommend a very rapidly progressive tax on large incomes, and I will give our reasons for suggesting the substitutes.

Senator HUGHES. You are opposed to the bill?

Mr. MARSH. I am absolutely opposed. It is an undemocratic bill, a bill dictated by privilege, it seems to us.

The CHAIRMAN. Whom do you mean by "us"?

Mr. MARSH. The Association for an Equitable Federal Income Tax. I was informed by the ranking member of the Ways and Means Committee that there are several men in the United States each of whom had a net income of $5,000,000 and over. Not one of those men earned that income, and instead of taxing this unearned income obtained from privilege you are proceeding to tax the working people of this country, and the tax on excess profits will lead to inefficiency. We are talking about preparedness, and you are putting a premium on inefficiency in business. That could easily be covered up. A very able lawyer in New York told me the other day how he would show his clients how to evade this tax on excess profits by simply voting themselves a good salary, and there are no excess profits, and most of them will get away from it.

Another objection to this proposal is this, that it is going to discourage people from going into business when they know they can make a large profit and they are going to be disproportionately taxed upon that profit as compared with the men who have a large income. I should like to go into a few figures as to the income tax in this country. These are taken from the official report of the Commissioner of Internal Revenue. It is thoroughly inappropriate to raise any of the revenue for alleged military and naval preparedness by postponed

payments. It should be raised by current taxation, so that we may know just what we are doing.

For the fiscal year ending June 30, 1915, each of 3,704 individuals received a net taxable income of at least $100,000, and their gross income was approximately $1,050,000,000. In other words, one-tenth of 1 per cent of the population (including the dependents of these taxpayers) received one-twentieth of the total national income.

Now, this bill, of course, is purely designed to reach those who are making exorbitant profits on account of the war in Europe, but that is a mistake, because the profits of the people who received those huge incomes before the war have nothing whatever to do with the war; those who have monopolized and secured legislation giving them oil resources and timber land—men like young Vincent Astor, of New York, who gets $1,000,000 a year and never does a stroke of work. Those men are getting their revenue exactly as immorally as any man who is manufacturing munitions of war and soaking the allies.

Mr. Chairman, that is a thoroughly unfair bill to the working people of this country. It absolutely goes back on the pledges of the Democratic Party to lighten the burden of taxation on the working people, and it increases it, and we earnestly plead that, just as you changed the revenue bill as passed in the House two years ago as to the rates and income tax, if you gentlemen will respect the recommendation of the President, who, I understand, has a great deal to do with making these suggestions—and I regret I can not give his statement to me—I hope you will increase the tax on large incomes to at least 33⅓ per cent, on incomes of at least $1,000,000 and over, and a proportionate rate on all incomes in excess of $50,000, and if those people shall force us into this savage war with Germany there ought to be at least a 50 per cent tax on large incomes.

Senator HUGHES. Suppose we take it at that, how much money would we get?

Mr. MARSH. For the year ending June 30, 1914, 60 people received a taxable income of over $1,000,000 each, an aggregate of $127,000,000. I think it is very fair to assume, of course, that this item is an estimate. I have asked the Treasury Department to give me these exact figures and have not yet received them. They said they had not been able to compile them yet. Probably the number of people who received a taxable income of $1,000,000 is 120. At the most conservative estimate they are getting $250,000,000, and we propose half of the whole income of those who receive an income of $1,000,000, but that will be less of a burden upon Rockefeller and all the other men who have these huge incomes, absolutely, than the burden of taxation upon the poorest man in the country in the United States to-day. You get, at 33⅓ per cent, at least $80,000,000 from that little group of 120 men who are exclusively the beneficiaries of privilege accorded them by Congress and the legislatures, and if you do that the chances are that there would be no holler for a war with Germany. You could easily raise $300,000,000 to $400,000,000 by such a tax, and it would not injure any business.

Here is what Prof. E. R. A. Seligman, of Columbia University, says of an income tax [reading]:

A tax on expenditures necessarily becomes an increasingly heavy burden on the least wealthy classes.

If wages are sufficient only for a bare minimum of subsistence, then to encroach upon this minimum by taxation is to require the minimum to be maintained in some other way. If the laborer can no longer live on his wages, he must be supported by a system of poor relief, if he is to live at all.

As you gentlemen know, there are scores and hundreds of thousands if not millions of families in this country trying to live on from $100 to $300 a year less than they need to maintain a reasonable standard, and you are retaining taxes upon them and you are letting these wealthy beneficiaries of Government privilege get away with $5,000,000—I quote Mr. Rainey—net income, while you tax a worker. You say every man ought to contribute to the cause of Government. Every man is paying to-day an indirect income tax, and that indirect income tax provided for in this measure is vicious. It is a tax on consumption. Our tax system costs on the average every workingman in the country about $180, directly and indirectly, and instead of increasing that burden it seems to us, now that there is an appeal to the patriotism of the working people, that it is incumbent upon this Congress, instead of hitting them with such a measure as this, to say, "No; we believe in the sort of patriotism that is at least honestly fair, in a fair system of taxation, and we are going to tax privilege instead of the workers and make privilege pay something like approximately a fair proportion of the cost of the Government." You remember there were 357,000 persons subject to the income tax in 1914, and a slightly smaller number for 1 15. But in both years an insignificant fraction of 1 per cent of the population of the United States—one-half of 1 per cent of the population, approximately, of the United States—received approximately one-fifth of the total national income. You can not change the State systems of taxation, but the Federal system of taxation is the only way, with the inheritance tax and the income tax, in which you can make the people pay a fair proportion.

I want to say that this association does not believe in the principle of an inheritance tax for the Federal Government for current expenditures. An inheritance tax is a tax on capital. You know that a business man who would take his capital to pay wages would go broke. He ought not to do it, and that is what we are doing when we take an inheritance tax for current expenditures. It is a bad policy.

There is another point which should be emphasized, that not only should this inheritance tax be used only for permanent improvements, because it is a taking of capital, but the States need the inheritance tax, and they need it badly. I recognize that the inheritance tax should be levied by the States, but could be collected better by the Federal Government so that there would be no evasion of an income tax rate, but it should, most of it at least, be returned to the States We object also to this feature of the bill which provides that the cost of preparedness shall be paid by issuing one or two year bonds. If we are going to have war—and if we had a referendum of the United States it would be three to one against the proposal to fight Germany—but if we are going to have war we are going to have

continuing expenditures, and we might face the facts and pay accordingly and make privilege instead of the victims of our present industrial and economic conditions, make the beneficiaries, the few people who are getting one-fifth of the national income, pay for preparedness if we are going to have it. The rest of us have no stake, practically, in this country.

Those are the chief suggestions we have to make. If there are any questions I will be glad to answer them, and then I want to thank you.

Last year I stumped from here to St. Louis with this exact proposal. The proposal has been indorsed by the leading federations of the country, by the Chicago Federation of Labor, the American Federation of Labor, and by numerous others, as the only equitable method which can be adopted.

Senator HUGHES. By everybody who does not have to pay?

Mr. MARSH. I beg your pardon, Senator. Prof. Charles A. Beard and Henry Mussey, E. A. Ross, and many others indorse it, and they will be called upon to pay. They are willing to pay; it is not because they do not want to pay. They are willing to pay proportionately, but when you take $180 a year out of the wages, or even $75 a year, or $100 a year out of the wages of a man who has got only $750 with a family to support, you are taking the wages of a man, and you are taking these proposed taxes from those who are not earning their money. I challenge my friend the Senator as to whether Vincent Astor or the Weyerhausers earn their money. They came down and got land grants for which they never paid a sou, and it is time to equalize. I submit herewith a brief which we have prepared and which was sent to members of the Committee on Ways and Means of the House of Representatives.

The CHAIRMAN. It will be printed in the record.

(The brief referred to is here printed in full, as follows:)

BRIEF ON THE PENDING REVENUE BILL BY THE ASSOCIATION FOR AN EQUITABLE FEDERAL INCOME TAX.

The proposals of the leaders of the House to raise revenue are undemocratic and evasive. Fortunately the suggestion that taxes on imports should be increased has apparently been abandoned, but the obvious and equitable method of securing revenue has not been adopted, to wit, a rapid increase in the rates of taxation upon large incomes, especially those from secure investment. The proposal to sell all authorized Panama Canal bonds, approximately $231,000,000, to aid in financing the military preparedness campaign is unjustified from any point of view. The cost of preparedness should be met out of current taxation, and not by postponed payments, which would not only place the actual outlay for military preparedness chiefly upon the working people of the country, but would afford profits to money lenders, most of whom should be compelled to pay a larger share of the cost of military preparedness, instead of being made financial beneficiaries thereof.

The inheritance tax is properly and logically chiefly a source of revenue for State governments, although it may appropriately be collected by the Federal Government to prevent evasions, and distributed among the States with whom it is shared. No such device is contemplated. A tax upon inheritances is, moreover, taking capital and such capital should be used for permanent improvements only.

The urging of a special revenue tax on excess profits is similarly illogical and disproportionate, since 5 to 8 per cent on amounts in excess of 8 per cent profit, suggested, would be a much heavier proportion of the whole profit if small than such a rate upon such an excess if the profits were very large. A flat rate of profits from industry is always unfair.

Obviously, the only practical and just method of securing increased revenue is that urged by this association—very rapid increase in the rates of taxation on large incomes. The proposal has an additional fiscal advantage in that the machinery is already provided by law and the method is in operation. To inaugurate and operate a new

system of collecting revenue would involve heavy expense and duplication, which is unnecessary and wasteful.

Congress should not abandon the direct and logical method of raising revenue to which it committed itself in the adoption of a progressive income tax, to which method the people of the country have given their assent and approval.

THE CONCENTRATION OF INCOME IN THE UNITED STATES.

For the fiscal year ending June 30, 1915, each of 3,704 individuals received a net taxable income of at least $100,000, and their gross income was approximately $1,050,000,000. In other words, one-tenth of 1 per cent of the population (including dependents of these taxpayers) received one-twentieth of the total national income. Every one of these wealthy tax receivers enjoyed some privilege, and all should be made to pay much more heavily to meet increased Federal expenditures.

The CHAIRMAN. This bill provides an exemption of $5,000 and it provides a deduction of 8 per cent. I am going to ask gentlemen to confine themselves to the subject and not to indulge in general observations upon taxation systems. We have only twenty-odd days left in this Congress to provide a revenue for this country, and we want to get this bill out to the Senate so that it may pass, and it is vitally necessary that we should provide the revenue. You are all business men, or most of you are, and you realize the value of time to yourself and to others.

The CHAIRMAN. We will hear you now, Mr. Butler.

STATEMENT OF MR. CHARLES H. BUTLER, WASHINGTON, D. C.

The CHAIRMAN. Please state your occupation.

Mr. BUTLER. I am a lawyer.

The CHAIRMAN. Your residence?

Mr. BUTLER. Washington. I simply have been asked to ascertain how long the committee will allow for the various suggestions to be received by filing briefs. There are one or two specific points in this bill that my clients outside of Washington desire to submit a memorandum on.

The CHAIRMAN. We shall hope to report this bill to the Senate day after to-morrow morning, and we want the briefs in to-morrow morning or to-morrow by noon.

Mr. BUTLER. I will prepare and submit my suggestions by that time.

Mr. BUTLER. I only wish to say that in asking this information I was requested over the telephone by a very large mining interest and by one or two large corporate interests to say that there were suggestions in regard to page 4, line 21. That is section 202. There are suggestions as to estimating the capital, and also in regard to estimating the depreciation on mines. I was asked to say that suggestions will be made on those and at the same time to say that those interests understood that this bill was to provide the revenue which the country needs and they do not in anyway wish to be regarded as opposing the payment of revenue on a profit basis if the country needed it.

Senator HUGHES. That depreciation is provided for under the present law, and this is just an addition.

Mr. BUTLER. They simply asked if I could find out how long they would have to submit suggestions.

(The suggestions referred to by Mr. Butler were subsequently submitted and are here printed in full, as follows:)

[H. R. 20573, Sixty-fourth Congress, Second Session.]

IN THE SENATE OF THE UNITED STATES.

SUGGESTIONS RESPECTFULLY SUBMITTED ON BEHALF OF CERTAIN INTERESTS SERIOUSLY AFFECTED BY BILL H. R. 20573 TO INCREASE THE REVENUE.

In submitting these suggestions, neither the undersigned nor those whom they represent desire to obstruct legislation for proper and equal taxation, realizing that in this critical period of our nation's history increased taxation is necessary for its maintenance and protection, and appreciating that everyone who is under obligation to do so should cheerfully contribute his fair and equal proportion thereto.

The undersigned therefore asks the members of the Finance Committee of the Senate before favorably reporting the bill as it passed the House to consider the following questions:

First. Is not the definition of invested capital in section 202 ambiguous?

Second. If the value of assets other than cash is to be taken for computing the normal tax at the time of purchase of those assets and not at the time of making the return—

(*a*) Will the surtax be fair and equitable to the Government?

(*b*) Or to the taxpayer?

(*c*) Will it affect the legality of the bill?

Third. If invested capital is to be fairly estimated, will the bill be effective in producing the revenue estimated, and should not other methods be adopted which could fairly and efficiently produce the desired result?

The particular amendment suggested is as follows:

For the purpose of computing the excess profit tax of 8 per centum of the amount by which the net income exceeds 8 per centum of the actual capital invested levied by section 201 (p. 3, lines 18 and 19) of the revenue law, such actual capital assets other than cash should not as now provided in section 202 be "the actual cash value at the time of payment" (p. 4, lines 18 and 19), but "the actual cash value at the time of making the return provided by the act."

1. The words "actual cash value at the time of payment" are ambiguous and indefinite.

If they refer to the time of when the assets were paid for they should be "time of payment therefor," and in the absence of the word "therefor" it is uncertain whether the time of payment means that or payment of the tax.

Ambiguous and indefinite expressions in a tax statute give rise to much litigation and to friction between the tax officials and the taxpayers, delay in the collection of tax, and expense to both the Government and the taxpayer.

The words, however, should be interpreted to mean at time of payment of the tax, or of making the return and it would be therefore better to change them so as to definitely refer to the time of making the return as the value stated must be sworn to and the only ascertainable value which present officers of a corporation or present partners can actually swear to are present values.

Some of the corporations which will be taxable under this statute have owned their assets other than cash for many years prior to the election of their present officers, and the nature and condition of the property has so changed that it would be impossible for any officer to make oath or even to guess at its actual value at time of purchase. Taxpayers or officers of taxpaying corporations should not be required to make oath as to matters not within their knowledge.

II. Would making the value of assets other cash at the time of their purchase be fair to the Government or to the taxpayers?

A. *To the Government.*—If a greater price had been paid for the property than it is now actually worth but which was its fair cash value at the time of purchase, as the act does not provide for depreciation, the 8 per cent excess would not begin until after 8 per cent normal had been earned on an amount which might be far in excess of value when the return was made.

A careful examination of the assets of those who are to be subject to this tax might disclose the fact that in the majority of cases assets other than cash are actually worth less than the price paid but which price must have well been regarded as their actual value at the time when purchased.

B. *To the taxpayer.*—On the other hand the same construction would be unfair to the taxpayer whose property has increased in value, because such increase having

already transpired before the passage of the act now actually represents invested capital. Congress has virtually declared not only this increase in value but also good-will to be part of the capital of a corporation by requiring it return present market value of its stock in determining the capital employed and present market value necessarily reflects increased value of assets as well as good will.

If A's property purchased in 1900 for $100,000, which was considered to be its then actual cash value, now has an actual cash value of $1,000,000, which he can realize and invest in other business, is it not exactly as much invested capital while remaining in the same business as though he converted it into cash and reinvested $1,000,000 in another business, in which event there would be no doubt that he could claim exemption from the surtax up to 8 per cent on the $1,000,000.

(C) *Will the legality of the bill be affected?*—Whatever the utopian ownership of property may be, the so-called unearned increment of value of privately owned property is not now illegal, nor can present owners be compelled to donate to the State any part of their property simply because it has increased in value without effort on their part. Would not this be the effect of construing the time of payment back to the date of purchase? Let us take a concrete example and see if the result would not be unequal taxation.

Twenty years ago A purchased property for $100,000, its then actual cash value, but which to-day is worth $1,000,000, which amount he can realize and reinvest in another business, and B has recently purchased similar property for $1,000,000, the same present cash value as A's property and each property produces the same cash income, $100,000.

A (or his successors in interest if stockholders in a corporation) must pay a surtax on all over $13,000, i. e., 8 per cent on $87,000—$6,960. B, however, is allowed to deduct $85,000, or $72,000 more than A and pays therefore only 8 per cent on $15,000—$1,200, or $5,760 less than A pays on the same income from exactly similar property of the same value.

Under these circumstances is not A's property to that extent actually taken without due process of law, and to that extent might it not be an unconstitutional exercise of power by Congress and not within the purview of the sixteenth amendment? (See Gast. Realty Co. *v.* Schneider Granite Co., 240 U. S., 55.)

III. If invested capital is to be fairly valued will the bill produce the estimated revenue? The bill has been framed on the idea that a vast amout of capital is producing a return of more than 8 per cent per annum. This may be so but as a matter of fact, have not the calculations been based on antecedent, and not present value, of actual capital invested? And the moment this bill is passed will not the present actual value of assets necessarily become the basis of capitalization and thus of the normal tax?

The entire efficiency of the bill as a revenue producer depends upon the ability of the Government to require the owner of property to pay a surtax on what his property produces over 8 per cent on a value of an antecedent date far less than that for what he can to-day regard it as invested capital and which he can not avail of for purposes of taxation where he has to declare the value for purposes of state, municipal, or national taxation. The bill practically says to the taxpayer:

"Although the municipality, State, or nation may assess this property at 10 times what you paid for it because to-day you can sell it for that amount and obtain the current rate of income from the proceeds, and you can not therefore object to such valuation, still you can not consider it to-day as invested capital for the purpose of this bill beyond the amount which you originally paid for it."

To disregard the so-called unearned increment amounts to taking a part of what has become principal might be regarded as confiscation and unconstitutional as not taxing income and so might jeopardize the bill.

To construe the words as relating to the time of purchase would therefore probably result in a vast number of new corporations based on repurchase at the actual present cash value of assets, now held by original owners and which would be a perfectly legitimate method of establishing an actual cash value of assets forming the capital invested.

If all corporations and partnerships should avail of this method and convey to new corporations at fair and actual values—say values based on the values yielding 6 or even 7 per centum, and certainly no objection could be raised to the bona fides of such transfers and valuation—would not the result of this particular tax fall far below the Treasury's estimate? Ought not the Senate therefore to carefully consider this whole scheme of taxation before enacting the bill into a statute?

These suggestions are made principally on behalf of corporations owning mines purchased many years ago for what was then considered actual value, but which to-day have established values far in excess of hire and which represent to-day—and are traded in by purchasers of stock and interests—as invested capital of present market

value, but they apply equally to all owners of properties which have similarly advanced in value.

There are other objections that can be raised to the bill as it now stands.

Should it not provide that manufacturers of munitions are to be credited on the surtax paid by them under the munition tax provisions of the act of September 8 1916? This is simply fair treatment.

Other briefs have been submitted in support of this proposition so it will not be enlarged upon here. The tax on munitions is manifestly discriminatory but if allowed as credit on the surtax might not that objection be oversome to some extent?

There is great indefiniteness in the exemption of income derived from agriculture and personal services and will not much litigation result if those terms are not more accurately defined?

At the suggestion of the chairman of the subcommittee of the Finance Committee of the Senate we file herewith copies of the excess profits tax laws of Great Britain, France, and Italy, but in regard thereto wish to submit that the tax and method of computation as provided in sections 201 and 202 are as, if not more, drastic than the excess profits taxes of European countries.

Excess profits taxes have been levied in Great Britain, France, and Italy during the last two years to provide for the extraordinary expenses of the most exhaustive war in history—and as a dernier resort.

The papers inform us that the exchequer officers of Great Britain have stated as a justification for these heavy taxes that the expenses of their Government amount to over $20,000,000 a day, i. e., over $7,200,000,000 per annum.

Surely Congress does not intend to levy upon American industries taxes equal, if not in excess, of those required to meet such expenditures, heretofore unheard of in any country, and we trust never to be heard of in our own.

A cursory examination of these foreign statutes will show that the term "excess profits" does not so much relate to an excess over a fixed amount considered to be a fair return on invested capital, but an excess over what the same invested capital produced prior to passage of the act or of the commencement of the war.

The statutes are replete with references to "prewar" profits, and the basis of the surtax is the fact that those who have made abnormal profits by reason of the war should contribute a share of such excess over prewar profits toward the expenses of the very war which resulted in the excess itself.

The undersigned therefore respectfully suggest that the bill be amended as in the manner above stated, and also that parties in interest may be heard in regard to other and more equitable methods of raising the increased revenue required by present exigencies.

CHARLES HENRY BUTLER,
JOHN A. KRATZ,
Attorneys for Interests Seriously Affected by H. R. Bill 20573,
1537 I Street, Washington, D. C.

FEBRUARY 7, 1917.

The CHAIRMAN. We will next hear Mr. Joslyn.

STATEMENT OF MR. C. D. JOSLYN, OF NEW YORK CITY, REPRESENTING THE BIG CREEK DEVELOPMENT CO. OF WEST VIRGINIA.

The CHAIRMAN. What is your occupation?

Mr. JOSLYN. I was a lawyer; I have retired from active practice.

The CHAIRMAN. Whom are you representing?

Mr. JOSLYN. I represent specifically the Big Creek Development Co., of West Virginia, of which I am a stockholder, and which is engaged in the pumping or production of oil from an oil field which we have leased.

I have no suggestions to make to this committee as to what it ought to do as a general policy with reference to taxation. It is of no consequence whether I agree with your policy or disagree. The responsibility of raising money that is absolutely needed is upon you and you must select the method which seems most advisable to you, and I have no theories to offer on this subject, but I want to call the committee's attention to one specific thing, and that only. I want to call the committee's attention to section 202 of this bill, page 4.

Senator HUGHES. I suppose you are referring to "But does not include money or other property borrowed by the corporation or partnership"?

Mr. JOSLYN. Yes, that is in there, and I have suggested this amendment which I will read. I called your attention to the original provision that you might see the drift of my amendment. "That for the purpose of this title, actual capital invested shall be the fair average value for the preceding year of the capital assets of the corporation or partnership, and in estimating the value of such actual capital invested the surplus and undivided profits shall be included," and the rest of paragraph 2 as in this bill. This amendment is suggested by a concrete case, that of our own. When the project first started of exploring and drilling for an oil field we organized the corporation with a capital stock of $5,000, shares of $10 each, par. We discovered oil after a while—I presume you gentlemen are familiar with the general terms of oil matters so that you know in a general way what the conditions are. When we discovered oil we had to make expenditures to a large amount, probably between three and four millions. When we came to make a return for the stock taxes which you have recently enacted, or did last September, we were in a quandary. We could not comply exactly with the terms of the case, one, two, or three of that act, but we said, "We have a property here which is valuable and our capital stock necessarily must be worth what the property is worth," and so after the best judgment we could give to it we returned the value of our stock, which was valued for $5,000, at $4,000,000. Now, we conceived that section 202 as passed by the House, when they came to apply it to this excess profits tax, might cut our valuation to $5,000 instead of its true value, and then when you commenced to make out 8 per cent on $5,000 and assess us for the rest of the receipts from the oil it would be an injustice, not only to us but to thousands of others who are in a similar line of business, in iron ore, coal, oil, etc., and the various things which you gentlemen are familiar with, and so I thought——

Senator KERN (interposing). Your corporation will suffer by being undercapitalized?

Mr. JOSLYN. Yes, sir, that is exactly it. Your question, Senator Kern, reminds me that the first objection that will occur to your mind to my amendment will be that the overcapitalized concern will take advantage of it, but a moment's reflection will show you they can not do it because the assessing officer when he is called upon to put the valuation at a fair value of the assets and not think about capital stock, will just say, "What is this property worth," just as they value your house and lot and home, and they will come to the Big Creek Development Co. and say, "What is your property worth?" "We think it is worth a million dollars." "Upon what do you base that judgment," and so the assessing officer himself may say you have valued this too high or too low. He may come around under the new stock tax and say you ought to put it at $6,000,000. We have got to accept that; as long as he is fair about it we have got to stand for it.

We do not object to the excess profits tax; if the men who are in charge of the Government think we have got to have one, all right; we will pay our tax and pay it willingly and gladly if you can only

put it on a fair basis. As I was about to suggest, if you put our 8 per cent profit on $5,000 instead of $4,000,000 which we have actually got, it is a rank injustice, and I say this, that directly or indirectly neither Congress nor the assessing officer has a moral right to value our property up for the purpose of collecting a stock tax and then value it down for the purpose of lowering the 8 per cent profit which we are entitled to make. That is the point of what I have to say, and it does not seem to me I ought to take your time further, except to elaborate just a word, that if the corporations are allowed to be valued at their true actual, honest basis, what they are actually worth, neither the Government can be harmed, and neither can we. I want to suggest this, although I am not particularly anxious about the form of words. You all now grasp the idea of what I am after by this amendment, instead of limiting it to cash paid in, or property paid in, just say the average value of the capital assets, and I have put in "for the preceding year" as being the best way to avoid the company's juggling its assessment up or down at the immediate time.

The CHAIRMAN. Mr. Joslyn, subclause 2 under section 202 says, "The actual cash value, at the time of payment, of assets other than cash paid in." You noticed that, did you not?

Mr. JOSLYN. I did. I understand that to mean this, and some disagree with me about that. I understand the first clause refers to the actual cash paid in. This clause 2 was intended to cover where you put in the amount of property in connection with cash to make your entire capital. That is my understanding of that subsection 2, and if I am correct about it we are not provided for because you will readily see in the first instance——

The CHAIRMAN (interposing). This third clause, you remember, reads, "paid in or earned surplus and undivided profits used or employed in the business."

Mr. JOSLYN. Yes.

The CHAIRMAN. In your case, is it not true that your operating capital is largely composed of the earned surplus and undivided profits which have been used in the business?

Mr. JOSLYN. The secretary of the company can tell us exactly what it is.

Senator HUGHES. You have had to use those profits?

Mr. JOSLYN. I have not had to. I will tell what we have done.

The CHAIRMAN. I am asking purely for information, you understand, because if you have a plant worth four million and you have stock outstanding of only a few thousand evidently you must have built up the plant in some way with undivided profits, or something else.

Mr. JOSLYN. I will tell you what we did, and then you gentlemen can draw your own conclusions and call it what you like. When we first found a well of paying quantities, we then had to devise ways and means to see how we could develop that oil field, and it cost from five to seven thousand dollars in our field to put down a well. One of the people who originally associated with us furnished the money to keep on drilling wells and get it where in could produce an income. Of course, you will not hold me to exactness, but my recollection is that this man got in before a dollar was paid to anybody about $850,000. Then, of course, as these wells began to produce the company began to pay back this man his money. After we took out what we call

"distributions" and what you gentlemen may call "dividends"—distributions of capital—we took enough each year to go on drilling the wells. It makes very little difference, it seems to me, whether you call them "dividends" or whether you call them "capital." It was our money that went into the construction or drilling the wells. The amount that has gone into the drilling of the wells—I can not give any exact figures, but it was between three and four million; four millions and a half.

The CHAIRMAN. The profits of the business paid for your property?

Senator HUGHES. Do you not think that those are assets for cash paid in?

Mr. JOSLYN. I am afraid they will not hold it that way.

The CHAIRMAN. I should.

Senator HUGHES. This certainly is paid-in undivided profits used in the business.

Mr. JOSLYN. My own construction would be that way; but in talking with some of the officers of the revenue department, they are in doubt about it.

Senator HUGHES. Have you read the language of your amendment yet?

Mr. JOSLYN. Yes. I will read it again: "For the purpose of this title, actual capital invested shall be the fair average value for the preceding year of the capital assets of the corporation." Now, you are going to calculate the 8 per cent profit which we are going to have without a tax and then you are going to calculate profits on the actual capital. What I want is to shut off calculating that on the $5,000. We are not here objecting to your method of taxation or raising any question as to whether it is the right method or the wrong method.

I only want to say one word, which may not be absolutely material to this question, but if you can adopt a uniform system of valuing these properties you will eventually reach a situation where we will get out of the difficulties that we tax-payers are now having with the revenue department as to how these incomes should be computed.

The CHAIRMAN. What was your original capitalization?

Mr. JOSLYN. $5,000.

The CHAIRMAN. I think that all of us agree that if it were possible to value these things as 160 acres of land is valued, an actual physical market valuation, I think it would be fairer and better. The difficulties are practical in their character.

Mr. JOSLYN. Yes.

The CHAIRMAN. And when we come to corporations we have got to fix some guiding rule, or else we would have to spend two or three years ascertaining the physical valuation of the plants, just as we have been spending some two or three years already trying to ascertain the physical valuation of the railroads, and we are not through yet. So that your general principle, I think, nobody disputes; the only question is we want to find some rule which is fixed upon something certain and prescribed and which will incidently come as nearly as possible to the real valuation of the thing; and with the corporations we are bound to go more or less by the capital stock and assets that have been put in, instead of cash, and by so much of the undivided profits and things as have been used and employed in the business in lieu of capital and have thereby become operating capital, but the committee will consider the amendment very carefully.

Mr. JOSLYN. Thank you, Senator, but I would like to have you consider this. If you will not embark upon the policy of valuing these properties undoubtedly you gentlemen are all familiar with the fact that the revenue department has a great deal of difficulty in calculating, and I think that is evident by your amending in 1913 the excise law, and then you amended it again in 1916. I think eventually as a basis of calculating income you have got to get to a valuation of the properties themselves before you can get anything like a fair taxation.

The CHAIRMAN. I think probably that is true, but we can not do it now.

Senator HUGHES. The actual cash paid in, in your case, and the actual cash valuation at the time of payment; there may not have been any.

Mr. JOSLYN. There was not any. All we put in was $5,000 in cash and property, except as I have told you how we have made the distributions.

Senator HUGHES. Clause 2 provides that you shall be credited with what you paid in, with the exception that it does not mean to take care of this particular phase of your business which you describe as borrowing something like $800,000.

Mr. JOSLYN. $850,000.

Senator HUGHES. From some individual, for the purpose of developing the property; but that was paid back?

Mr. JOSLYN. Out of the earnings of the property. He got his money back.

Senator HUGHES. If that language is construed as I would construe it, for instance, you would be credited with that actual cash paid in, the actual cash value of the property, but you were also credited with all the money put into the property, that came out of the property in the shape of dividends or earnings, which, put back into the property, was treated as cash capital. That would meet your objection, would it not?

Mr. JOSLYN. Not quite, because we have got other than the capital paid in, or by that earning, or other method. We have got a property, the oil in the ground, which the courts of West Virginia say we have a vested right in. The moment we find oil in paying quantities the character of the lease changes from a mere license to giving to the lessee a vested right to the oil in the ground. When we made out our stock tax we took into consideration the oil in the ground as part of our capital assets, and this leads up to that question of what you are going to allow. I admit that, I do not want to cover up any design, but is it not fair that in some way or other we should get a valuation of what our capiral assets are so that when you come to make out your 8 per cent, 2 per cent, whatever per cent you tell us to pay, we have got a fairly good way to ascertain what that payment amounts to.

Senator HUGHES. In other words, you want the oil in the ground to be treated as capital rather than as profit.

Mr. JOSLYN. As I construe the Supreme Court's decision, the Supreme Court says we can not accept the doctrine that what you receive for iron ore is all capital.

The CHAIRMAN. The original bill to which this is a supplement makes an allowance for depreciation and things of that sort.

Senator HUGHES. Is that allowance for depreciation fair, that has been made in the other bill?

Mr. JOSLYN. I do not think so and I do not think it is practicable in that case. That bill was evidently drawn by a man who had in his head a vision of an oil field where the oil gushes out of the ground. We never had any flow of oil, within the proper definition of that term; we have had to go down 2,500 to 2,700 feet and pump it up, every barrel by the operation of a pump, and not a drop by flow.

Senator HUGHES. Suppose you submit to us what you think would be proper in the way of an amendment of the last act, which provided for an allowance.

The CHAIRMAN. You understand, everybody can submit briefs.

Mr. JOSLYN. I shall avail myself of the privilege, Senator.

(The brief referred to was subsequently submitted and is here printed in full, as follows:)

The following substitute is suggested for H. R. 20573, section 202:

"That for the purpose of this title actual capital invested shall be the fair average value for the preceding year of the capital assets of the corporation or partnership, and in estimating the value of such actual capital invested the surplus and undivided profits shall be included, but moneys or other property borrowed by the corporation or partnership shall not be included."

This amendment is suggested by a concrete case in which the parties suggesting the amendment are interested.

The Big Creek Development Co. is a West Virginia corporation operating an oil field in West Virginia, and has a normal capital stock of $5,000 divided into shares of par value $10 each. It is operating under what are known as oil leases. It has found oil in paying quantities in 454 wells. The boundaries of its oil field are thoroughly defined. Under the laws of West Virginia, having found oil in paying quantities, its right to the oil in the ground has become a vested right. That vested right is, of course, an asset of the corporation of large value.

In making its return under the stock tax law recently enacted, it valued its capital stock at $4,000,000 based upon the value of its vested rights and proceeds of the oil field reinvested. The company regards this valuation as a fair one upon which it should pay the stock tax.

The company conceives that section 202 of the act under consideration tends to estimate its profits on a capital basis of $5,000 instead of its true basis, and the purpose of the proposed amendment is to give the company an opportunity to put its capital assets upon their true basis upon which it should have a right to estimate its true profits. The stock tax will be imposed on the fair value of the capital stock. This means that if the assets of the corporation are worth more than the par value of the stock the assessment will not be limited to the par value, but to the fair value. It would seem just that in calculating profits for purposes of taxation it should also be on the fair value of the assets. The Government should not value the stock up for the purpose of taxation on its stock and down for the purpose of taxing profits.

To state it more clearly: We have a capital stock of the par value of $5,000, but of an actual value of $4,000,000. The assessing officer, as we understand the law, has the power to raise even that valuation if in his judgment such a raise is warranted by the facts, and of this increased valuation the company could have no legal cause for complaint if such increase is fairly made, but surely the same officer should have no right to turn around and value the same property at $5,000 for the purpose of increasing the assessment of a tax on profits. No one can doubt the injustice of such a proceeding. The purpose of the proposed amendment is to render such a result impossible.

It will be at once obvious to the committee that the case of this company is by no means the only one. There are a large number of oil fields throughout the country situated as is this company. Likewise there are many coal properties heretofore developed, now in the process of development, and to be hereafter developed which we think ought to be protected by this amendment.

All these enterprises are subject to the income tax as well as these other special taxations. It seems to us that sooner or later there must be a method of valuation adopted by which these various enterprises can be called upon to pay a fair income tax and no more upon the profits received, and it may be that this or some like system of valuation will solve the vexing questions which have arisen in the taxation of mines and oil fields and like wasting properties.

It should be noted that in suggesting this amendment we have followed substantially the language of the stock tax act adopted September 8, 1916, thus establishing as near as may be a uniform rule for valuing capital assets.

While we fully appreciate that Congress must so frame its laws as to meet actual conditions in the matter of special taxation, and also realize that Congress, very properly, is desirous of avoiding a necessity for valuing these properties and getting itself into the same difficulties which now confront it with reference to railroad valuations, we think that there is no practical danger with respect to the valuation of corporate assets for this purpose.

We are aware that such valuation in many instances must be more or less arbitrary, and in all probability the owners of these properties will have to submit to such valuation. We also recognize that the question of determining the portion of receipts from mines and oil fields which is a return of capital and the portion which is profit probably never can be determined with any degree of accuracy. But Congress is not to be blamed for these conditions, nor is it required to try to require a yardstick valuation. It must simply do the best it can. And, following the direction of Congress, the administrative officers must do the best they can. And having done that, it is not likely that any court can be found to upset either the law which Congress shall make in this direction or the efforts of the administrative officers on the ground that such taxation is not based on accurate calculation.

Now, under the stock tax companies are required to return under oath their estimate of the fair value of their stock. The administrative officers may accept or reject this valuation, according to their judgment in the premises. The assessing officer undoubtedly in cases of doubt will ask the companies to state their reasons for the valuation given. They will examine those reasons, they will examine the books of the company, and from these examinations make up their judgment as to the fair value of that stock. When so made up, in the absence of wantonly arbitrary measures, the courts will unquestionably sustain the judgment of the administrative officers.

It will undoubtedly follow that once having put a value upon this property the administrative officers, in computing either the income tax or the excess-profits tax, will have to take their own valuation as the basis of such computation. As a matter of justice, why should they not?

It has been suggested that this might give some corporations an opportunity to so value the capital stock of their organizations that as a result it could be made to appear that they were getting little or no profit. We do not think that such valuation would or could be successfully done; because, first, if such corporations should raise their valuation on account of a supposed low stock taxation, it is wholly within the power of Congress to meet that by immediately levying a much higher stock tax. The matter would be wholly within the control of Congress. And, second, whatever valuation any corporation puts upon its capital stock, it is subject to the review of the administrative officers, and the judgment, fairly exercised, of those officers would be final and would have to be accepted by the corporation.

We think there is no difference between putting a proper valuation upon the properties we have under consideration and putting a valuation upon 160 acres of land. Although much more difficult, still the principle would be exactly the same. But whatever difficulties there may be in the way of the valuation of these properties, that method has already been provided in the stock-tax law, and whatever difficulties arise out of the question of valuation will arise under that tax.

Now, if companies make a fair valuation of their stock on a basis acceptable to the Government, both parties ought to be bound by it until there is a change in conditions. At all events, it temporarily solves the difficulties under which the owners of property like this under consideration and the administrative officers are now laboring under these various acts.

The stock-tax act having used language and devised a method which seems to us likely to work out fairly between the Government and the taxpayer, we think the bill now under consideration should make no departure therefrom.

It was suggested at the hearing that the language in section 202 is in accord with our claim of what it ought to be. We are afraid it may be construed otherwise. If the committee or any members of it disagree with our view of the construction of this section, is it not the part of wisdom to so frame it that there shall be no doubt upon the subject, and if our substitute is accepted we think there can be none.

To summarize our position, it is apparent from the remarks of the committee at the hearing that all agree that the fair value of the capital assets should be the basis for this tax, the only difficulty being to define a practical working method of fixing such value. A similar valuation is necessary, however, as a basis for the stock-tax law, and a method for determining such value is defined therein, and the difficulties

arising therefrom have been largely overcome by the Treasury Department. While not perfect, the method there given is perhaps as good as can at present be devised. Why embarrass the department and the taxpayer by now declaring a new rule for accomplishing the same result by a method not in harmony with the rule already established? Each corporation has or will make a return under that law showing its capital assets, and the department has or will pass upon its correctness. Why make the taxpayer or the department do this over again under a new method?

The act in question already provides that the income thereunder shall be computed on the return under the income-tax law. What we propose is that the value of capital assets be based upon the return under the stock-tax law. Then, without additional problems for the department or extra labor for the corporation, the Government will have a complete basis for this tax—the income under the income-tax law, the capital under the stock-tax law; and fixing the amount of the tax will be largely a mathematical problem. Uniformity should prevail as far as possible through this class of legislation, and wherever a rule already adopted and put into practice can be followed in new legislation the perplexing problems incident to taxation of this character and the difficulties of the department arising thereunder will be correspondingly diminished, and this in time will result in a practical workable system for the levy and collection of all such taxes.

Big Creek Development Co.,
C. D. Joslyn, *Counsel.*,

The Chairman. We will hear you next, Mr. Motley.

STATEMENT OF MR. WARREN MOTLEY, OF BOSTON, MASS., REPRESENTING THE FIRM OF STONE & WEBSTER.

The Chairman. Whom do you represent?

Mr. Motley. I represent the firm of Stone & Webster.

The Chairman. They are construction engineers, are they not?

Mr. Motley. Construction engineers and managers of public utilities and financers of public utilities. I am here to call specific attention to the second clause of the law and particularly to two suggested amendments which I believe were offered in the Senate by Senator Lodge yesterday, although I have not the record of that. I was informed as to that.

I want the committee's attention first to section 204, at the bottom of page 5, "and the tax imposed by this title shall not attach to incomes of partnerships derived from agriculture or from agricultural services." The principle, I take it, of that clause is that the act is to tax the excess profits derived from invested capital rather than any profits derived from personal or professional services. There are in this country a large number of engineering concerns which, starting from individual engineers who were working among themselves or in partnership, have for one reason or another formed a corporation under which they are conducting their engineering and similar business, just as, we will suppose, half a dozen lawyers, instead of forming a firm form a corporation as a convenient method of dividing their profits and handling their business. There are a large number of those concerns. My particular clients, Stone & Webster, are a firm, and for convenience in handling their business which is very extensive, they have formed two corporations, one a general management association which acts as general manager of public utilities, and the other as an engineering corporation.

The firm of Stone & Webster owns all the capital stock of each of those companies. Each of them has a small capital which is nominal compared to the amount of business they do. All they own is to pay for the office furniture and to carry things along from month

to month until their pay comes in. I was in conference on Saturday in New York with representatives who came together rather hastily of about a half a dozen engineers, concerns which are in a similar situation. They had formed corporations which had small or no capital and all of whose profits were derived from the personal services of those who own the capital stock. In the case of our particular corporations it has not been the habit to pay salaries to the officers who are the owners of the stock. This provision here is to the effect "that there shall be no tax upon incomes of partnerships derived from personal services or from agriculture."

The CHAIRMAN. What you want to suggest is that that ought to apply to corporations whose income is derived from the personal services of the members?

Mr. MOTLEY. Just so. The language suggested is this: "And the taxes imposed by this title shall not attach to such parts of the income of any partnership or corporation." We have changed "incomes" to "income." "Derived from agriculture or from personal or professional services."

Senator HUGHES. The proposition is to put in the words, "or corporations or partnerships"?

Mr. MOTLEY. I have also changed the word "incomes" to read "such part of the income." In other words, a corporation or a partnership might derive a portion of its income from invested capital.

Senator HUGHES. "Such part of the income of any partnership or corporation."

The CHAIRMAN. That would bring us into endless entanglements, trying to make discriminations. This is intended for cases where the income is exclusively derived from personal services, and if we had to go into a corporation's books and find how much was derived from personal services, and how much from invested capital, and how much from other things, we would never be through. It would not be practicable of administration. If you want to get your idea in at all it would be to insert the words "or corporations" after "partnerships."

Senator HUGHES. They might have a very small income derived from something besides personal services.

Mr. MOTLEY. The idea is this: Suppose you have a small corporation with a capital stock of $10,000, which is all they need for their office furniture and for paying their bills as they come along. Suppose three or four engineers, or other professional men, who are giving their time to that corporation, may have an income of $100,000 or $200,000. It might be argued that inasmuch as they have a capital of $10,000 they perhaps do derive some return; that they were not deriving it exclusively from professional services. The same thing would apply to a partnership. A partnership which was primarily devoting its time to personal services might have a small capital upon which they were deriving some return.

Senator HUGHES. In the case which you have just cited, how could they derive—in what way would they derive—any income from the $5,000 or $10,000 capital?

Mr. MOTLEY. Only as it is a necessary part of their business. It is necessary to have some capital. Suppose it is invested in a building. In fact, in the case of one of those very corporations it has

capital invested in a building which they occupy almost entirely. They do derive some earnings from the use of the building.

Senator HUGHES. The other corporations must pay rent to the original incorporation?

Mr. MOTLEY. Just so.

Senator HUGHES. It would be easy enough to arrive at that.

Mr. MOTLEY. I concede the difficulties that may arise in determining what portion——

The CHAIRMAN. Your suggestion is directed to your particular case. How much of the Bethlehem Steel Co.'s income has been derived from Schwab, from his management and his genius and personal service? You can not ascertain that. It might be possible to do so in a corporation or partnership where the income is exclusively derived from personal services, but you could never tell how much a corporation has derived from the genius of its management, and how much from other things.

Mr. MOTLEY. The amendment might be modified to this extent, of course.

The CHAIRMAN. The subcommittee will consider the amendment.

Senator HUGHES. As I get it, these men earn almost all of this money as a recompense for personal services?

Mr. MOTLEY. They sell nothing, but go out and make plans for projects and do construction work, etc.

The CHAIRMAN. Is not that exclusively personal service?

Senator HUGHES. Except for the fact that this original corporation which owns the building must take some rent from the other corporations which occupy the building, and technically, I suppose, they would be deriving some profit.

Mr. MOTLEY. That happens to be so in the case of the engineering corporations I spoke of, and in the other case it so happens that they had several thousand dollars capital which they did not actually need and they loaned it to a bank. In other words there are incidental earnings, which come in from the small capital, but they are infinitesimal compared with the whole income, which is derived from other services; and I imagine other concerns similarly situated would have similar situations. A corporation to be a corporation has to have some capital, but a firm would have none at all.

Senator HUGHES. Would not they escape taxation on all the money they derived from these other corporations and pay the ordinary tax upon the income that came to the original corporation?

Mr. MOTLEY. I do not know that I quite got that.

Senator HUGHES. They would not be taxed on any income derived from these other two corporations they have formed.

Mr. MOTLEY. I was talking about taxation against the subsidiary companies, against the two companies which are formed for the engineering and management business.

Senator HUGHES. They would not be affected by the profit making of the original company.

Mr. MOTLEY. Here is a firm which owns the stock of two subsidiary companies. Those two subsidiary companies are doing the professional work and the profits are going into those companies, and therefore they would be subject to a tax of 8 per cent on practically all of their earnings. After paying that tax any profits they have left would go to the firm in the form of dividends. That happens to be

that particular case. I imagine there are many others where the case would be simpler. They would get together and form a corporation and own all the capital stock between them. One man takes the office of president, one vice president, one secretary, and so forth, a better way than having a firm and more convenient, and they presumably would have some small capital which might bring in some earnings which would be very small compared to the earnings derived from the personal services, and it was with that in mind that we suggested the amendment. Really the essential thing is that a corporation which is formed for those purposes should not be subjected to a severe tax which does not fall on a partnership which is formed for precisely the same purposes.

Senator HUGHES. This partnership owns two subsidiary engineering corporations, we will say.

Mr. MOTLEY. Yes, sir.

Senator HUGHES. And they take all the profit those two corporations earn in the shape of dividends?

Mr. MOTLEY. Yes, sir.

Senator HUGHES. So far they would not be taxed under this law.

Mr. MOTLEY. They would not be taxed under this law. The corporations——

Senator HUGHES (interposing). No; each partner would not be taxed under this law.

Mr. MOTLEY. On their dividends?

Senator HUGHES. Yes.

Mr. MOTLEY. They would be as the law stands possibly but they ought not to be. But that is not the particular point I am discussing—if you will pardon me. The point I am discussing now is the taxation which will fall upon those subsidiary companies—upon those engineering corporations. They will be taxed 8 per cent on all their earnings as the law stands here.

The CHAIRMAN. On their earnings above 8 per cent and after exempting $5,000.

Mr. MOTLEY. Exactly.

The CHAIRMAN. And the 8 per cent is derived from benefits?

Mr. MOTLEY. It is, if you have that capital invested, but if your capital invested is nothing but your office furniture and your building you do business in, it is not, where all your earnings are really derived from your personal services and your professional work. It would be just the same thing as taxing all lawyers 8 per cent on their earnings, although they have no capital invested.

Senator HUGHES. If those men did not form any corporations they would not be taxed, but they are penalized because they have found it convenient, as though they were a great industrial corporation.

Mr. MOTLEY. Precisely, and they can avoid paying this tax by dissolving all those corporations and doing business in the old way, which will lessen the convenience and facility and effectiveness of their work, and can do nobody any good.

Senator HUGHES. They would be undoubtedly driven to do that.

Mr. MOTLEY. Undoubtedly they would be driven to do that.

Senator HUGHES. You have provided for what you think will cure his criticism?

Mr. MOTLEY. Yes, sir. I should like if the committee will bear with me one moment longer to refer to section 203 at the bottom of

page 4, and I am going to refer to the point which the Senator recently mentioned, that is, as to whether a partnership would have to pay the tax of 8 per cent upon the dividends which they receive from corporations. Now, the committee will no doubt remember that under the old income-tax law of 1913, as it was construed by the Bureau of Internal Revenue, was held to provide that where a partnership derived part of its earnings from dividends of corporations that the individual members of the partnership were obliged to pay the normal tax upon those dividends although the corporation had already paid it. That was the defect in the construction of the original law as construed by the department. That was corrected in the recent income-tax law of 1916, wherein it is specifically provided that members of partnerships should have a credit for their proportionate shares of dividends received by the firm, the corporations having already paid the normal tax.

Senator HUGHES. For partners as individuals.

Mr. MOTLEY. Just like individuals, partnerships having been penalized inadvertently in the original law. Section 203 provides that "The tax herein imposed upon corporations and partnerships shall be computed upon the basis of the net income shown by their income-tax returns." A study of the income-tax law and of the recent forms of return shows that "net income" as therein defined is income after making certain deductions, so-called, for expenses, depreciation, and so on, but before deducting the so-called credits which are for dividends which have already been subjected to the tax. Our suggestion is simply that that principle which is recognized in the new income-tax law ought to be recognized here, that those words, "net income," should be changed so as to read, "upon the basis of the income subject to the normal tax," which is the net income after certain credits have been deducted. It would be manifestly unfair where a corporation has paid 8 per cent on its excess profits and what is left of the profits are distributed by way of dividends, that the partnership which receives those dividends should be subjected to an 8 per cent tax over again, whereas an individual receiving them would not be subject to this law at all and therefore would not have to pay.

Senator HUGHES. But a corporation would.

Mr. MOTLEY. A corporation would under the income-tax law.

Senator HUGHES. It was designed that they should.

Mr. MOTLEY. It is designed that they should under the income tax law. That was to penalize to the extent of the one or two per cent tax the privilege of having holding companies. Whether this committee wishes to extend that to the extent of penalizing holding corporations 8 per cent in addition to the 2 per cent they have already been penalized is a question I wanted to bring out.

Senator HUGHES. First you are interested in whether or not you are going to penalize partnerships.

Mr. MOTLEY. We are not penalized under the income tax law and I do not believe the draftsman of this law really intended to penalize us.

Senator HUGHES. You want, in other words, to make the complaint in section 203 that partnerships are treated as corporations rather than as individuals.

Mr. MOTLEY. Just so.

The CHAIRMAN. What is your amendment specifically?

Mr. MOTLEY. To change the words "net income" at the bottom of page 4, last line, to the words, "income subject to the normal tax as;" the word "as" is necessary to make it grammatical. I take it that would clear that situation, so far as partnerships are concerned. The amendment which I have here goes a little further and adds, in addition to the provision on the next page, where you see the word, "provided," in line 7, these words, "That for the purpose of computing said tax corporations and partnerships shall be allowed a credit as provided by section 5 subdivision.

I will submit a brief to the committee explaining my amendments.

The CHAIRMAN. The clerk will have it printed.

(The brief referred to was subsequently submitted and is here printed in full, as follows:)

BEFORE THE COMMITTEE ON FINANCE, UNITED STATES SENATE.

In the matter of H. R. 20573. "A bill to provide increased revenue to defray the expenses of the increased appropriations for the Army and Navy and the extensions of fortifications, and for other purposes."

MEMORANDUM SUPPORTING SUGGESTED AMENDMENTS.

I. Amend the first part of section 203 by striking out lines 23, 24, and 25 on page 4, and lines 1, 2, and 3 and the words "this title" on line 4, page 5, and substituting the words—

"That the tax herein imposed upon corporations and partnerships shall be computed upon the basis of the income subject to the normal tax as shown by their income tax returns under Title I of the act entitled 'An act to increase the revenue and for other purposes approved September 8, 1916,' or under this title, and that for the purpose of computing said tax corporations and partnerships shall be allowed a credit as provided by section 5, subdivision (*b*) of said Title I for their profits derived from dividends."

The section, as it stands, provides that the tax imposed upon corporations and partnerships shall be computed upon the basis of the net income shown by their income-tax returns. Reference to the income-tax law of September 8, 1916, discloses that the term "net income" in the case of individuals means gross income less the eight deductions allowed in section 5 (*a*), but before deducting the credits allowed in section 5 (*b*) and (*c*). Subdivision (*b*) allows, for the purpose of the normal tax, a credit for dividends received by the individual from corporations which are themselves subject to the normal tax. The original income-tax law of 1913 was so construed by the Treasury Department that members of a partnership were deprived of any credit for dividends received by the partnership. This injustice was cured in the law of 1916, by an express provision contained in section 8 (*e*), allowing individual partners a credit for their proportionate share of the profits derived from such dividends. We have no reason to think that Congress intends, or desires, to reject this principle in the case of the excess profits tax and we therefore ask that the words "net income," above quoted, be amended to read "income subject to the normal tax as." The effect of this would be to allow partnerships for the purposes of this act the same credit for dividends that they are allowed under the income-tax law. If such amendment is made, it may then become necessary to further amend section 205, page 6, lines 19 and 20, by inserting after the word "deductions" the words "and credits," and after the words "5 (*a*)" the words "and 5 (*b*)" and after the words "6 (*a*)" the words "and 6 (*b*)," so that the same shall read, "like deductions and credits as are allowed to individuals in sections 5 (*a*) and 5 (*b*) and 6 (*a*) and 6 (*b*) of said act of September 8, 1916."

The amendment suggested at the beginning of this memorandum goes somewhat further, in that it also proposes the insertion at page 5, line 4, after the words "this title," of the following: "And that for the purpose of computing said tax corporations and partnerships shall be allowed a credit as provided by section 5, subdivision (*b*) of said Title I for their profits derived from dividends." This further amendment would have the effect of allowing corporations, as well as partnerships, a credit for dividends received. This, we submit, is just in principle as it would be an undue hardship upon so-called "holding corporations" to impose an excess profits tax of 8 per cent upon earnings which have already been subjected to that tax, in the hands

of the subsidiary corporations. We recognize, however, that the income-tax law purposely imposes such double taxation upon holding corporations as distinguished from partnerships holding stock in corporations, and we merely ask the committee to give due consideration to the question whether holding corporations should be subjected to this additional burden.

II.

Amend section 204 by striking out the words commencing with "and the tax imposed" on line 25, page 5, and lines 1 and 2, page 6, and substituting therefor the words "and the tax imposed by this title shall not attach to such part of the income of any partnership or corporation as is derived from agriculture or from personal or professional services."

The clause in question, as it now stands in the bill, exempts from the excess profits tax "incomes of partnerships derived from agriculture or from personal services." We represent one of the numerous groups of individuals engaged in professional work who, for the more convenient and efficient conduct of their professions, have chosen to organize themselves and conduct their business in the form of corporations, rather than partnerships. These corporations are, for the most part, organized with a capital so small as to be practically nominal compared to the volume of professional work which they carry on. The earnings are derived either entirely, or almost entirely, from the personal or professional services of those who own the stock and give their time and labor to the work of the corporations. If the bill is enacted in its present form, these persons will be obliged, as a practical matter, to dissolve their corporations and continue the practice of their professions as partnerships or individuals. Such enforced discarding of the corporate form of organization tends to diminish their efficiency and usefulness, without producing any benefit to the Government or the community.

Respectfully submitted.

WARREN MOTLEY,
GASTON, SNOW & SALTONSTALL,
BRITTON & GRAY,
Attorneys for Stone & Webster.

Senator HUGHES. That is to take care of holding corporations?

Mr. MOTLEY. That is to take care of holding corporations, as to which, it seems to me, the principle is really the same as partnerships, but it was not recognized in the income tax law for the reason that it was designed to penalize them.

The CHAIRMAN. Understand those excess profits do not attach until after not only the ordinary deductions are made of all sorts, but also the deduction of the normal and the other taxes paid by the parties affected by this new proposition. All Federal taxes are deducted in arriving at the net excess profits.

Mr. MOTLEY. Yes, sir; I take it that is so.

The CHAIRMAN. Including the tax on the profits. That is all deducted, so that the net excess profit is the profit over and above 8 per cent after there has been deducted the State, county, Federal, all taxes, and every other possible expense of the business.

Mr. MOTLEY. The only other question is that the corporation, having paid that excess tax, then distributes what is left by putting that 8 per cent out among the stockholders. The individual stockholder then has to pay no tax upon that except his additional income tax.

The CHAIRMAN. Undoubtedly, because the first thing was the income of the corporation, and when the dividend comes to him it is his income.

Senator HUGHES. He is not complaining about that.

The CHAIRMAN. All that we thrashed out pretty carefully before.

Senator HUGHES. You are anxious to have the first part of section 203 treated as individual?

Mr. MOTLEY. Just so.

Senator HUGHES. And the next inquiry is as to whether or not it is the purpose of this act to tax holding companies over again.

Mr. MOTLEY. Just so.

Senator HUGHES. If they come within the clause, if they make a certain amount of profits.

Mr. MOTLEY. I am confident that in the matter of partnership that is really an inadvertence. Of course, in the case of corporations, it is simply a matter of policy whether Congress intends to impose that additional tax. I simply wanted to call attention to that so that it would not get by unnoticed.

Senator SIMMONS. I think everything was very thoroughly thrashed out when the question was raised as to holding companies.

Senator HUGHES. That they should be taxed over again?

The CHAIRMAN. Mr. Emery, you may begin now.

STATEMENT OF MR. JAMES A. EMERY, COUNSEL OF THE NATIONAL ASSOCIATION OF MANUFACTURERS, WASHINGTON, D. C.

Mr. EMERY. The National Association is composed substantially of 4,000 firms and corporations engaged in general manufacture in 28 States of the Union, and I have received some 700 telegrams from certain members of the association and nonmembers, some of which are included upon the list that you read, and in so far as the objections are general to certain terms of the bill they may be said to be applicable to their objections, and I am compelled to ask the indulgence of the committee to make some general objections because of the fact that as an association it can not recite the specific objections of individuals but rather is compelled to present to the committee certain considerations they believe apply to the manufacturing industry. In that connection I am compelled to make an inquiry at the outset in order that I may understand the meaning, and the objection falls if there is a possibility of a definition which would relieve an objection to the bill. I should like to ask the committee if in section 202 where actual capital is defined, whether the term "the actual cash value, at the time of payment, of assets other than cash," applies to physical assets, or will include any allowance, as, for instance, good will?

The CHAIRMAN. My own individual opinion is it would not include good will.

Mr. EMERY. In any form? Of course the chairman will realize that with a manufacturing corporation the good will is a very valuable asset.

Senator HUGHES. Do you mean trade-marks, etc.?

Mr. EMERY. Trade-marks, and manufacturers of standard articles where there is a very wide market for a trade name, these are often disposed of apart from the physical assets of the corporation.

Senator HUGHES. I know of some I would like to get for nothing.

Mr. EMERY. You can see, Senator, they can not be included by this definition in capital invested, unless the committee will in some way by some definition provide for an allowance for that.

The CHAIRMAN. I do not see how you could commercially capitalize good will. If that could be done then you could capitalize a man's individual character.

Mr. EMERY. It is not definable in certain instances. On the other hand, publishing corporations have substantially nothing in addition to good will, except a plant and a list of subscribers, and the other day a publishing house was sold for $1,000,000 which did not have $100,000 physical assets.

The CHAIRMAN. Of course this has to be construed by the Treasury Department and the legal advisors, and any opinion given you here as to what its construction will be amounts to nothing more than when you ask me for my individual opinion.

Mr. EMERY. In undertaking to interpret, as I have, for manufacturers, we have had to wrestle with 125 opinions of the Treasury Department relating to these subjects, some of which have conflicted with the decisions of the courts, and others of which have come in later, and it has left us wandering around in a very dubious state of uncertainty.

The CHAIRMAN. That is always the case owing to the insufficiency of human language. There is no new law that does not admit of various constructions. It can not be avoided; we have to do the best we can.

Mr. EMERY. I wanted to call that to the attention of the committee because we believe it is a matter of sound public policy to provide for some allowance for good will. That increases just as in the case of undivided profits, and you allow them to deduct for undivided profits.

The CHAIRMAN. How would you fix the value of good will?

Mr. EMERY. I think the committee might make some allowance for it.

The CHAIRMAN. How, upon what basis?

Mr. EMERY. If they would allow any capitalization of it in accordance with the actual returns of the company and the actual capital——

Senator HUGHES. If the concern was worth only $100,000 and earned $100,000 on the investment it would be easy to determine what the good will would be.

Mr. EMERY. You could get it appraised.

Senator HUGHES. Under this language the actual cash value would seem to preclude any idea of making an allowance for a trade name, or a trade mark, or good will. You could hardly put it in at the time of the formation of the corporation.

The CHAIRMAN. If you could ascertain the value of good will it would be taken into consideration right there, but I confess I do not see how you can do it. There is only one way of doing it and that is by putting the property up for sale without the good will and then putting it up for sale with the good will and figure out what the difference was, and it would have to be a real bona fide sale then.

Mr. EMERY. Of course you have cases where they have bought the good will and paid for it.

The CHAIRMAN. It would be difficult to determine how much of the extra value paid was for good will and how much for the purpose of monopolizing the other concern's business. However, give the committee the benefit of your opinion about it.

Mr. EMERY. The second proposition is with respect to the term "income derived from agriculture." If the term "agriculture" is to be strictly construed I assume that would mean income from the result of tilling the soil and the sale of crops.

Senator HUGHES. Where is that?

Mr. EMERY. The top of page 6, section 204, "incomes of partnerships derived from agriculture." Of course, if that is strictly to be income derived from the sale of the products of the soil, resulting from its cultivation, it might not be particularly objectionable. If it can be extended at all to general farming so that it would include stock raising as a part of the assets of the farm——

The CHAIRMAN. Undoubtedly, stock raising is agriculture.

Mr. EMERY. If it includes stock raising, I will venture a suggestion. One of the objections we desire to offer as manufacturers rests upon what appears to be an arbitrary distinction in the laying of the burden of taxes between income derived from business based on industry, finance, or a commercial source in corporate form or by partnership and income derived from exactly such sources of income as the Senator suggests. I have in mind the well-known firm of Miller & Lux, who are farming and raising stock on between 300,000 and 400,000 acres of land. I presume their income is far more than that of thousands of industrial corporations in this country.

The CHAIRMAN. Do you know what their income is?

Mr. EMERY. No, sir.

The CHAIRMAN. What are their net profits?

Mr. EMERY. I could not tell you.

The CHAIRMAN. Of course, they must get a large amount of income; but how much of it is net profits, I do not know. I never heard of any farmer making exorbitant profits.

Mr. EMERY. I am only saying that that income under the terms of the bill, whether it be great or small, if it comes within the 8 per cent profit feature of the bill, is improperly distinguished from the income derived from the manufacturing corporation. The one pays the tax and the other does not. They stand in exactly the same relation to the Government, receive the same protection from it, are as much citizens of the State in their corporate capacity, and the one may derive a considerably larger income than the other. The one is asked to bear this burden and the other is not; and I beg to say that so far as this association is concerned its objection is not to the amount of the tax but to the form of the tax, and it offers cooperation in this crisis and stands ready to cooperate in industrial preparedness, but it seems that this is an arbitrary discrimination without reason for the distinction.

Senator HUGHES. General agriculture?

Mr. EMERY. General agriculture within the meaning that the chairman has added to the phrase, that it would probably include stock raising. I can not see why a man who derives an income of ten or fifteen or twenty thousand dollars from agriculture, which may represent 8 or 10 or 15 per cent profit upon his investment, should be exempted while the manufacturer in the town within 10 miles of him pays the tax under precisely the same conditions as to his income.

The CHAIRMAN. The majority of people engaged in agriculture do not keep books from which can be ascertained with anything like a degree of certainty what their excess profits were. The difference between what it would cost to pasture and feed a cow and what the cow costs in the market is always unascertainable. That is the excuse for it. Now, I am not saying it is not to some extent obnoxious to

the objections which you make. That is one of those things which could hardly be helped.

Mr. EMERY. I referred only to agricultural income which would come within the terms of this bill, where there was a $5,000 cash exemption and an 8 per cent profit allowed, and I say with 130 agricultural colleges in the land and agriculture becoming more and more a science there are larger and better farms in the Western States. I have personal knowledge of many farmers getting incomes comparable with those of manufacturing establishments.

The CHAIRMAN. Your proposition is to strike out the word "agriculture"?

Mr. EMERY. Or define it so that it exempts only those who should not come within the limit of this bill.

The CHAIRMAN. What is the specific amendment which you propose?

Senator HUGHES. Have you prepared a definition of "agriculture"?

Mr. EMERY. I would be very glad to offer it.

The CHAIRMAN. You can hand it to the stenographer and it will be printed.

(The matter referred to was subsequently submitted and is here printed in full, as follows:)

FEBRUARY 6, 1917.

To the honorable the SUBCOMMITTEE OF THE FINANCE COMMITTEE OF THE SENATE.

GENTLEMEN: By your leave, I beg to submit herewith a brief summary of the criticism and suggestions made by the National Association of Manufacturers of the United States, through counsel, with respect to the "excess profit tax" feature of the pending revenue bill, H. R. 20573.

The National Association of Manufacturers is composed of some 4,000 individuals, firms, and corporations engaged in industrial production in some 30 States of the Union. The membership of the association is ready to bear its proportion of any necessary public expense essential to preparation for national defense, but it respectfully suggests that the form of the proposal is open to serious objection. These objections presented in detail in oral argument are briefly summarized, and certain amendments invited by the committee are suggested.

The provisions of the pending measure to which we direct your attention are contained in Title II, including sections 200 to 207, inclusive. They substantially provide that there shall be levied, beginning with the calendar year 1917, and for each year thereafter, an additional tax upon the income of every corporation and partnership organized and existing under the laws of the United States—

"excepting income derived from the business of life, health, and accident insurance combined in one policy issued on the weekly premium payment plan, a tax of 8 per cent of the amount by which such net income exceeds the sum of (*a*) $5,000 and (*b*) 8 per cent of the actual capital invested."

"Actual capital invested" is defined in section 202 to mean: (1) "Actual cash paid in," (2) "the actual cash value, at the time of payment, of assets other than cash paid in," and (3) "paid in or earned surplus and undivided profits used or employed in the business; and does not include money or other property borrowed by the corporation or partnership." "Net income" is to be ascertained in the manner provided in the act of September 8, 1916.

Respecting these provisions, we venture to suggest that the term "assets other than cash paid in," constituting the second element of "actual capital invested," in section 202, appears to include only "physical" assets. We know, as a matter of experience, that in many forms the manufacture of standard articles "good will" is a most valuable property right, which is sometimes sold, together with trade-marks, separate and apart from the business to which it attaches. It can not, under the proposed definition, be included in the "actual capital" of the corporation, but where the value is definitely ascertainable it is an element that in justice ought to be considered, both because it is "property" and it is sound public policy to encourage by appropriate legislative recognition the growth in national life of those elements which constitute the good will of a going business, the honesty, integrity, and skill of management, and the superior quality and worth of the product of established reputation. It is not suggested that good will should be capable of indefinite or vague appraise-

ment, but that it should be included as an element in the "actual value" of capital invested only when it is definitely determinable. We venture to suggest, therefore, that section 202 be amended by inserting in (2), line 20, after the words "paid in," the following:

"In which may be included a reasonable allowance for the fair value of good will when definitely ascertainable."

Such an amendment is in keeping with the spirit and substance of the proposal contained in the second paragraph of section 207 of the act of September 8, 1916, providing a stock tax on each $1,000 "of the fair value of its capital stock." Such an amendment would relieve the collectors of internal revenue of all indefinite claims for good will and place the burden of establishing its value upon the corporate taxpayer and afford a measure of justice where justice is due.

We venture to object that—

1. An "excess profit tax," within the terms proposed, will in actual practice be a tax upon the maintenance of average profits. It must be obvious that sound management maintains the average return essential to secure the use of capital by creating in more successful years a surplus to meet the actual or probable deficits of poorer years. A profit in excess of 8 per cent in a single year can not, in terms of continuous business, be called "excess profit" when it is essential to maintain the average return upon capital invested at 5 per cent or 6 per cent over a period of years. We submit that sound public policy requires the assurance of an unpenalized fair return to secure the continuous capital investment required for the development of industry.

2. An "excess profit tax," within the terms proposed, displays no consideration for the higher risks of novel or pioneer enterprise. Investment is presently demanded for shipping, foreign trade development, and the many novel demands of a still new country. Usually speaking, profit is proportionate to risk. The safest business yields the lowest return. The greater the risk involved in a novel enterprise—the flotation of patents, the preliminary development of mines, or bold commercial undertakings—the greater must be the ultimate profit which justifies the risk and actual expenditure involved. The pending proposal practically penalizes undertakings of the character described, the encouragement of which is obviously sound public policy.

3. The proposal arbitrarily discriminates between income derived from business done in corporate as distinguished from individual capacity.

Referring now to other provisions of the proposal, I beg to direct the committee's attention especially to the exemptions provided. These include the income of all corporations, presently exempted under section 11, of Title I, of the act of September 8, 1916. It is here proposed that the "excess profit tax" shall not attach "to incomes of partnerships, derived from agriculture or from personal service." If, in the term "agriculture" was merely included the great body of small farmers, we should say nothing of the exemption, but in the absence of more specific definition, it may include not merely the income of partnerships derived from the sale of products of the soil, but likewise of live stock, citrus fruits, berries, and the products of the vine.

We submit that under institutions like ours no sound reason can be given for exempting from taxation an income derived from agriculture when the same amount of income derived by a financial, mercantile, or industrial corporation subjects it to taxation. Within the terms of the bill, the proposed tax should be equalized that the duty of support, like that of service to the Government, be made proportionately universal. We therefore suggest the following amendment to section 204, to be a new sentence immediately after line 2, page 6:

"The above exemption shall not apply to the income of any partnership derived from the sale of products of the soil, the vine, citrus fruits, live stock, or dairy products, where said income upon actual capital invested, within the terms of section 202, exceeds the sum of (*a*) $5,000. and (*b*) 8 per cent of the actual capital invested."

All of which is respectfully submitted.

Very truly, yours,

National Association of Manufacturers,
James A. Emery, *Counsel.*

Senator Hughes. You know that most of the European countries, in fact all of them, have specifically exempted agriculturalists from these taxes.

Mr. Emery. I find a conflict of opinion on that and I am not able to assure myself. I find statements both ways and assertions that large landed proprietors, especially where income is largely derived from agriculture taxes while the small farmer exempted, and I would not suggest such a tax should lie upon him. But I am referring to

the farmers who stand, so far as their income is concerned, on a level with the manufacturers as to income and exemption. I can not see any reason for saying to one "Pay the tax" and to another "Do not pay it," especially at a time when the whole world is learning the necessity of universal service. If the Government is in need of revenue it seems fair to broaden the burden of taxation.

The next point is that in providing for an excess profit tax it does not take practical cognizance of the actual condition of the industry to which the tax is applied, and while it gets an excess profit tax in a successful year it does not take the notice which it practically should of the fact that in every well-managed business provision is necessarily made in the more profitable years to devote a surplus to meeting the actual and contemplated deficit of the leaner years. It must be obvious that management which did not take note of the rise and fall of profits for any reasonable period of years would be unsound management, and we trust the taxing authority will take notice of the necessity of providing in good years for the leaner years.

The CHAIRMAN. The language of this bill in section 202 is, "undivided profits used or employed in the business."

Mr. EMERY. Yes, sir.

The CHAIRMAN. Now, if a part of the profits was put to the surplus for the purpose of taking care of a possible lean year, that could hardly be said to be used or employed in the business.

Senator JOHNSON. How could you calculate what the lean years might be?

Mr. EMERY. It does not take due regard for the actual condition. If you take a three-year period, say 1914, 1915, 1916, and if you will take that period and assume, which I do not think is doubted by the figures of the internal revenue collector nor by the findings of the Federal Trade Commission, but simply assume for 1914 a profit on a corporation is 3 per cent, and for 1915, it goes to 6, and for 1916 it goes up to 10. Now, the profit is 10 and 6 and 3, 19; you have had three years during which the corporation has produced this amount.

The CHAIRMAN. You desire that this act should be changed so that when a man got 10 per cent that excess could be carried back to make up for what they failed to get in the previous year?

Mr. EMERY. No, I say the 8 per cent margin does not represent the profit for a number of years.

The CHAIRMAN. You think it might be very wise to take 2 per cent and put it in surplus for a lean year in the future?

Mr. EMERY. It must be done out of its profits. A corporation can not put in what it does not earn.

The CHAIRMAN. It would not put in any more than it earned. If it did not earn 8 per cent it would not pay anything.

Mr. EMERY. No, sir; it has either to put up a surplus which is required by sound management, or else it has no opportunity to pay deferred dividends.

The CHAIRMAN. Do you not think that would open up a very wide opportunity to some day cut a melon?

Mr. EMERY. Those are cases that are exceptional. I am referring to the general line of business in which for a period of four or five years you must take the aggregate earnings of the corporation to determine whether or not it is on a sound basis. You can not take one year's earnings to determine whether or not a business is earning an

excess profit. In levying a tax upon an 8 per cent profit you are specifically assuming that 8 per cent represents an excess profit, when for any term of two years 8 per cent would probably not balance the three or four year period.

The CHAIRMAN. We are assuming the 8 per cent profit for that year and taxing the excess for that year and no further.

Mr. EMERY. I am speaking of actual conditions.

The CHAIRMAN. The beauty about this tax is this, that in so far as these great profits are being made from the war we were bothered a good deal about putting a tax upon the things, and if the war stopped and the profits went down the tax would continue, and then we came to the idea that the excess profits tax would work automatically. If the war ends and the excess profits cease the tax ceases automatically, and we could not make it much fairer unless we proceeded with some totally different method of taxation.

Senator HUGHES. Your idea was to raise the exemption?

Mr. EMERY. To raise the amount that you determine to be excess profits tax, because for any period of three years it will only be four or five or six per cent.

(Senator Kern took the chair.)

Senator KERN. Proceed.

Mr. EMERY. I wanted to make clear the objection I was making that an excess profit tax within the standard fixed in this measure is in effect measured by the practical earnings of the corporation for a reasonable period of years, which alone can determine whether or not it can earn a fair return on the capital and it results in laying on the earnings of the corporation a tax which in one year will amount to more than for a period of three or four years.

Senator HUGHES. I do not quite get your idea there, Mr. Emery. You do not mean we ought to reduce this exemption?

Mr. EMERY. No.

Senator HUGHES. So as to get the normal income. This is an abnormal income we are dealing with.

Mr. EMERY. I assume when you say abnormal income within the standards of the bill you mean a corporation which earns more than 8 per cent?

Senator HUGHES. I mean the incomes of corporations generally are abnormal. Are they not abnormal?

Mr. EMERY. I am taking the figures of the Federal Trade Commission. Here is what I refer to particularly. I say the corporation that earned 2 per cent for 1914, which earned 6 per cent in 1915, which earned 12 per cent in 1916; 12 and 6 are 18, and 2 are 20. If you take those three years, the corporation would earn nothing like 8 per cent; it has earned about 6½ per cent for that period, and yet it pays an excess-profits tax as though it were earning more than 8 per cent.

(Thereupon at 11.50 o'clock a. m. the committee took a recess for 10 minutes.)

AFTER RECESS.

(At 12 o'clock m. the committee reassembled, pursuant to the taking of the recess, Senator John Sharp Williams presiding.)

The CHAIRMAN. We will go ahead now.

Senator HUGHES. Your idea is that any corporation making 8 per cent in a single year does not mean that it has had that 8 per cent in past years or that it will have in future years?

Mr. EMERY. As a basis of taxation it is unfair, because of the necessary business arrangement by which a corporation must provide for preceding years and operate in order to maintain its capacity to earn a reasonable return on its capital invested. In reenforcement of that objection I desire to say to the committee that we respectfully submit that a tax within the standard established in this bill appears to operate directly to the discouragement of what may be termed pioneer or novel enterprises. Profits, it may be said, are almost directly in proportion to risks, so that high profit is accompanied by high business risk. I am speaking of normal business conditions. While the smaller returns are accompanied by a very conservative condition with regard to risk at a time when we desire, if the peace we hope for is maintained, to enlarge our foreign trade and to establish novel forms of industry, and the laying of an 8 per cent profit tax is a discouragement to the embarkation in such enterprises, because the risk of entering into them and the preliminary expenditures are such that they can be assumed by the bolder industrial spirits and the more enterprising leaders of business only where a high profit is assured that can alone compensate for the higher risk assumed and for the preliminary expenditure. This is true in the development of patents particularly; it is equally true in all forms of what may be termed pioneer or novel adventure in any department of commerce, where unusual risks are taken in order to secure sales resulting in private profits.

I would like to call the committee's attention to a matter which appears to be quite germane to this, but which is indirectly related to it, and I desire in doing so to say that I am not complaining on behalf of the industries that I represent of the tax burden, except in so far as we object to the imposition of this burden arbitrarily as an invidious discrimination which makes the industrial corporation pay while the agricultural partnership to which we have called your attention does not pay it under precisely similar conditions. In that connection I would like to suggest to the chairman that all the small farmers, whom no one wishes to include here, are individuals, and it is only when they rise to unusual size that they develop into partnerships of the type that, no matter how great their earnings, are exempted from this act.

Senator HUGHES. It is your idea that the partnerships are exempted from the act?

Mr. EMERY. That is, agricultural partnerships. What I desire to call the committee's attention to now in this connection is that industrial corporations are paying a very large tax at the present time to the States, and that the form of direct taxation in which Congress has indulged in the last six months is likely to create a very considerable friction between the State and Federal jurisdiction and has

a very serious effect on corporations. Perhaps the most notable instance of this is New York, which has endeavored during the period from 1890 to 1915 to raise a considerable amount of its revenue by indirect taxation, for which it has peculiar facilities, and the report of the State Tax Commission of the State of New York, made in the year 1915, practically shows a failure of the State to derive its income from indirect taxation, and it is compelled to resort again to direct taxation in all but five years of that period. Meantime the cost of State Government has risen very greatly from about $11,000,000 which it cost the State of New York to operate its government in 1890, to the budget which is now suggested by the State Legislature, of approximately $80,000,000 for 1917.

The CHAIRMAN. The committee will now take a recess for 15 minutes.

(Thereupon at 12.10 o'clock the committee took a recess for 15 minutes.)

AFTER RECESS.

(At 12.25 o'clock p. m. the committee reassembled, pursuant to the taking of the recess, Senator John Sharp Williams presiding.)

The CHAIRMAN. Have you anything there for the information of the committee?

STATEMENT OF MR. CHARLES H. BUTLER—Resumed.

Mr. BUTLER. Yes. I want to say again that there is a suggestion here about some amendment to make the act more definite and certain as to certain points which might raise a question between the corporations paying the revenue officer, which we hope the committee will make certain so as to save time and money not only to the Government, but to the corporations. Messrs. Douglas and Armitage are in accord and represent substantially similar interests to mine, and what suggestions they may make will cover my views, but I will ask to put in a memorandum. I will also take great pleasure in finding those foreign acts.

The CHAIRMAN. I would like to get the British and French acts. If you will get them I will be very much obliged.

Mr. BUTLER. I will see that that is done, Mr. Chairman.

The CHAIRMAN. You may continue with your argument now, Mr. Emery.

STATEMENT OF JAMES A. EMERY, COUNSEL OF THE NATIONAL ASSOCIATION OF MANUFACTURERS, WASHINGTON, D. C.—Resumed.

Mr. EMERY. An outline of the State tax rate which corporate business is paying is readily obtained by an examination of the valuation of property and the amount and rates of levies for the years 1860 to 1912, published by the Department of Commerce through the Bureau of the Census. On page 41 it is noted that the tax rates of States for 1912 range from $1.02 in Kansas, per $100, to $4.73 in New Mexico, and the most authoritative tax reports express the general opinion that the present rates for 1916 in the States are

substantially 25 per cent in excess of those rates generally. It is so that the taxes now paid by industrial corporations to the State are substantially on an average of 2½ per cent upon the appraised value of their properties. While it may be suggested the tax is not paid on the real value of property I think it is historically true that the increase of rates is general and that it is the actual experience in most of the States that the appraised value of property tends constantly to approach more nearly its true value for taxation purposes.

I make this statement to the committee in order that it may very properly take into consideration the inroad which it will make upon the State income. It has become so marked that the Legislature of California has proposed by its State tax commission that there shall be called a conference to undertake to separate the field of taxation for the State and Nation and prevent the present conflict of jurisdiction and interest which are most unfortunate. These taxes to which I refer are of course exclusive of the State organization and operation taxes and franchise taxes now laid on various forms of corporate industry.

I want it clearly undrestood that those whom I represent make no protest in paying their proportionate share of any revenue which is necessary.

We wish to call these matters to the attention of the committee, because we think you will see that it is necessary to promote sound beneficial business organization, and that it is necessary to secure cooperative industry and distribution in all forms of commerce, and that our chief objection is not to the amount of this tax but to its form which we believe at this period in our country's history is an arbitrary discrimination against a portion of the tax-paying community, and that it is an unwise policy at this time when universal service is a keynote to let any portion of our population believe they do not or ought not to pay their proportionate part.

The CHAIRMAN. We will now hear Mr. William F. Garcelon.

STATEMENT OF MR. WILLIAM F. GARCELON, OF BOSTON, MASS., REPRESENTING THE ASSOCIATED INDUSTRIES OF MASSACHUSETTS.

Mr. GARCELON. I represent the Associated Industries of Massachusetts, which consists of miscellaneous manufacturing corporations and some partnerships, and I also represent the Arkwright Club, which includes cotton mills in Maine, New Hampshire, Masschusetts, Connecticut, and Rhode Island.

I shall speak very briefly and generally in protest against the enactment of an excess profits tax. First, I'may say that so far as I have heard, all New England is behind the President in the present crisis, and New England expects and wants to pay her share of the taxes. First, speaking of corporations: Corporations have been looked upon as wealthy organizations. We consider when we talk about corporations the wealthy organizations that have made great profits. Now, we need the aggregations of capital in order to build up big business, in order to build up the industries of the country, and this may be defeated specially and specifically by their losing their usefulness. That has happened in railroad corporations. Railroad stocks were splendid investments 20 years ago, and to-day they

are not looked upon as good investments, and my impression is that the tax upon corporations will become so great that corporations are bound to lose their investment value and we shall lose the value of aggregations of capital put up by a great many stockholders.

The CHAIRMAN. Is there that objection where there is $5,000 exemption?

Mr. GARCELON. That is added to the others. The corporation in Maine, for instance, with an office in Boston, pays a local tax in the State, a Maine State franchise tax, a small tax in the city of Boston, a franchise tax, a Federal income tax, and a Federal capital stock tax. I would like to call the attention of the committee to one other thing.

The CHAIRMAN. You understand that all these taxes are deducted before we ascertain this net profit above 8 per cent?

Mr. GARCELON. I understand, but it makes an additional tax upon the corporation just the same. I may be wrong in my understanding of this particular phase of this bill. Two men become partners with $100,000 capital in the manufacturing business. Next door is an individual with $100,000 capital. They both make the same amount of money. I understand under this bill the partnership will be taxed under this excess profits tax and the individual will not be taxed. I see no reason for the discrimination between the individual and the two individuals joining their money in the same line of business. It seems to me that this is discriminatory and puts an unfair burden on the two men who have not $100,000, paying, when this man who has does not pay.

The CHAIRMAN. The reason for that was a good many corporations were attempting to escape the corporation tax by forming partnerships, limited and otherwise.

Mr. GARCELON. Next, the burden of taxation in the States has steadily grown. The expenditures in Massachusetts have grown about as they have in the Nation. New taxes are being continually added. It has come about that the States have directly taxed the corporations. They will without any question lay new direct taxes, and the corporations will be taxed in such a way that they will lose their value as investments.

One of the features about this that will cause a great deal of difficulty and cause a great deal of unfairness, and has caused a great deal of difficulty and is not remedied in the old income tax, is the question of the valuation of the depreciation that may be allowed. We have had a great deal of difficulty in Massachusetts in the cotton industry in fixing valuation. Many of them started years and years ago. Under the old method of bookkeeping they would carry a building worth $300,000 on their books at $100,000. Then the question came up as to how, when the income tax came along, they could determine their valuation for the purpose of making their depreciation, and an inspector from the Treasury Department would come along and say they must change their bookkeeping. Another year another inspector would come along and he would say they were all wrong and we would have to go to another method. Several of the New Bedford cotton mills are now before the Treasury Department at work upon some definite form of valuation. You can easily see that there may be a new mill with its capital just paid in, with nothing charged for building depreciation, making the same line of goods as an old company next to it, which had charged in, which would be in

a very difficult position. In my opinion that would make a very strong discrimination between certain of the corporations, not only among the cotton mills, but among other corporations.

It is believed by the manufacturers of New England, by the men interested in the corporations of New England, which I represent, that this is a tax upon initiative and enterprise. It would seem to me—I have not any definite proposition to make in the way of amendments—that it might be that a tax upon the dividends above a certain amount might be a satisfactory tax, and the money that was not paid out in dividends would have to go back into the organization and would increase the value of industries in the community.

I think that perhaps I ought not to take any more of the time of the committee, because a good many of the points I would bring out have been already brought forward and I know the committee is tired, but we desire very earnestly to protest against this additional tax as being discriminatory and unfair to the organizations I represent.

The CHAIRMAN. The subcommittee thanks you.

Senator HUGHES. Do you suggest any change to be made along that line?

Mr. GARCELON. Personally I am a believer in the income tax. I doubt whether that could be satisfactorily added to. I have not any proposition to make along that line.

The CHAIRMAN. The committee will now listen to Mr. Armitage.

STATEMENT OF MR. PAUL ARMITAGE, NEW YORK CITY.

The CHAIRMAN. What is your occupation?

Mr. ARMITAGE. Lawyer. I may say that we do not object to the tax or the form of the tax but we object to certain clauses in the bill which we think are ambiguous and would lead to all sorts of complications and litigation, and if this committee or the Senate will clarify those it will remove most of our objections. The first objection that we have is on the question of ascertaining the income, the net income of a corporation. The act says in section 205, the last sentence on page 6, "In computing net income of a partnership for the purposes of this title there shall be allowed like deductions as allowed to individuals in sections 5–A and 6–A of said act of September 8 1916." We think a like clause should be put in as to corporations so that there should be no dispute that the corporations should be entitled to the same deductions in computing their net incomes. That would be a clause reading substantially as follows: "In computing there shall be allowed like deductions as are allowed to corporations in section 12 subdivisions A and B of said act of September 8 1916."

Senator HUGHES. What are those deductions?

Mr. ARMITAGE. General deductions allowed by the act. "In the case of a corporation or joint-stock company all ordinary or necessary expenses for maintenance or loss actually sustained in the case of oil and gas wells."

The CHAIRMAN. None of that act is repealed.

Mr. ARMITAGE. But we say it is not clear that those deductions are allowed. It has stated specifically in regard to partnerships——

Senator HUGHES (interposing). That was to cure the defect in the law that partnerships were named specifically.

The CHAIRMAN. He is talking about those provisions for depreciation, etc., for corporations. They are in no case repealed.

Senator HUGHES. Why was this language put in here with reference to partnerships, beginning on line 17, page 6, "In computing net income of a partnership for the purposes of this title," etc.

The CHAIRMAN. That is because the corporation tax has never been applied to partnerships before, and the tax on excess profits, which is a corporation tax, is applied to the partnerships.

Senator HUGHES. I do not think there is any cause for alarm on that?

Mr. ARMITAGE. I have no doubt your intention is to permit us to make those deductions, but I think the act should be clarified by saying so.

The CHAIRMAN. If we undertake to repeat certain parts of the old act in connection with corporations then, expressio unius est exclusio alterius would apply, and we would have to repeat all of it. The old law is not repealed. Every provision of the old law is in full force and standing, except in so far as we introduce as, for example, in this partnership business, when we add special partnerships to the corporation tax. Then, of course, we have got to show they shall be subject to this, that, and the other provisions of the old law.

Mr. ARMITAGE. The point I would like to make is this, that corporations are taxed under the income tax. They are going to be taxed under this law. You say under this law that partnerships shall be entitled to some deductions. The argument may be made that the law does not permit corporations to deduct.

The CHAIRMAN. That is because partnerships hitherto had not been taxed in that way.

Senator HUGHES. There is no machinery for allowing the partnerships to deduct if we do not have this language.

The CHAIRMAN. The machinery already exists for exemption of corporations where you begin to compute the excess tax, and it says there——

Mr. ARMITAGE. The tax herein——

The CHAIRMAN. That all taxes of every description shall be deducted before, and that the provisions of the law in the old act apply.

Mr. ARMITAGE. It says, "The tax herein shall be computed upon the basis of the net income tax;" it says both corporations and partnerships there. Then it comes to the special provision allowing partnerships to make a special deduction.

Senator SIMMONS. Under the old law the partners did not put in their income tax, the individual members did, and that is one of the reasons why it was necessary.

Mr. ARMITAGE. If you gentlemen are satisfied that that is perfectly clear and there is no possibility of a doubt——

Senator HUGHES (interposing). The Treasury Department is satisfied.

Mr. ARMITAGE. Our second objection is based upon section 202. It says this: "That for the purpose of this title actual capital invested means (1) actual cash paid in." That is clear. Then "(2) to the actual cash value at the time of payment of assets other than cash paid in." The words "at the time of payment" we think

ambiguous. What time does that refer to—the time of the payment of the assets, or does it refer to the time of the payment of the tax?

The CHAIRMAN. The time of the payment of the tax.

Senator HUGHES. Read it with the word left out.

Senator JOHNSON. That means when the stock is taken out and something besides cash is taken.

Senator SIMMONS. That is a little ambiguous.

Senator HUGHES. The actual cash value of assets other than cash paid in. I do not think the words "at the time of payment" lend anything to the clarity of the provision at all.

The CHAIRMAN. We have got to fix some time.

Mr. ARMITAGE. There has been a great diversity of opinion, I may say.

The CHAIRMAN. That is somewhat ambiguous, but I think the object of the law was to cover a point that was made this morning, where the money had been taken and instead of being distributed as dividends had been used for the enlargement of the plan. For example, there is in my town a little company that had an original capital of $10,000. It has now a plant worth about $40,000 because every year, instead of declaring the larger dividends they could, they declared a uniform dividend of about 8 per cent and took the balance to enlarge the plant. Up to the time of the payment of the tax they have put into it some $25,000—I do not know how much—$25,000 or $30,000, and that would be necessarily taken into consideration when you came to estimate the valuation of the business and of the plant.

Senator HUGHES. That comes under clause 3.

Senator SIMMONS. Would not that trouble be removed by simply striking out the comma after the word "payment"?

Mr. ARMITAGE. I agree it would ordinarily be at the time the capital would be contributed. We say that is not a fair and a just tax. If it means at the time of the payment of the tax, we would have no objection to that. The actual cash value at the time of the payment, the cash paid in, would be fair.

The CHAIRMAN. We all think with you that that is somewhat indefinite, and we will have to make that more specific.

Senator HUGHES. You think an allowance should be made for deterioration?

Mr. ARMITAGE. Also for the increase of value. I think the deterioration comes in under the deductions allowed under the income tax.

Senator JOHNSON. You would never get any tax assessed if you went into all those matters.

Senator SIMMONS. Do you mean deterioration in plant?

Mr. ARMITAGE. No, sir; increase in value; on the actual value of the corporation at the time the tax is made; at the time the assessment is made.

Senator HUGHES. Rather than the time when the property is turned over to the corporation?

Mr. ARMITAGE. Senator Williams has suggested that would require an appraisement of all the properties of all these corporations and would lead the Government into innumerable difficulties. It would be a difficult thing to appraise, but we do not avoid it under the present act because it says we must appraise the actual cash value of the assets. When? At the time they were paid in—a far more diffi-

cult thing to do than on the assets to-day. They are here; we can see them. The assets 10 or 15 years ago are impossible of appraisement. Under this act the Government has to appraise those assets.

Senator HUGHES. Except at the time the cash assets were turned in. They were turned in at a cash value.

Mr. ARMITAGE. Not necessarily. It does not say the value at which they were turned in. It says the actual cash value. You have got to go back into the past. Take a corporation organized 10 years ago that had a mining property and issued 10,000 shares of stock. You have got to determine the value of that 10 years ago, or take the case of a plant that is destroyed, an almost insuperable task is imposed.

Senator HUGHES. Suppose it was not in existence at the time of the return, but had been in existence at one time and was destroyed by fire?

Mr. ARMITAGE. It is the actual cash value at the time of the assessment or the return.

Senator HUGHES. Whereas at one time they did have a cash value.

Mr. ARMITAGE. That would be true; if the Government had to determine the cash value of the assets at the time of payment in the past, it would be almost impossible to determine; but if it makes a tax upon the value of the assets at the time of the return, they are in existence and could be easily returned.

Senator HUGHES. It does not matter what has become of it. Under this act you would have to do it whether it had been distributed or not.

Mr. ARMITAGE. We have got to appraise them and appraise them when many of them are not in existence.

The CHAIRMAN. Now go on to the next point.

Mr. ARMITAGE. Our own corporation was organized some time ago at $1,000,000. We bought this land for $1,000,000 of stock. It was then reorganized, feeling that that was not a fair valuation, at $75,000, in 1910, and it has gone up now, and the actual value is unquestionably about $3,000,000. What is this income tax to be based upon, upon the $1,000,000 ten years ago? It says actual cash value. Or is it when we were reorganized at $750,000, or the actual value to-day? We say the actual value to-day is a fair tax. You may go down and see the land and know how much property is there and you can estimate its value and deduct a payment of 8 per cent, which would be fair, and then pay a tax upon the excess.

Another objection is this, that the bill makes two different methods of taxation. In the first place, we have the Federal income tax based upon the net income. Then we have the excise tax upon corporations upon which that tax is based. I read the act, "shall pay annually a special excise tax with respect to the carrying on or doing business by such corporations, joint stock company or association, or insurance company, equivalent to 50 cents for each $1,000 of the fair value of its capital stock, and in estimating the value of capital stock the surplus and undivided profits shall be included." We have got to estimate for that tax a fair value of the capital stock either as determined by the sales in the market, or, if no sales are made, by the assets of the corporation less the deductions. Now, here is another tax which makes us estimate our tax on the capital invested not at the time, to-day, when we make the return, but at the time it was paid in, at

some remote period of the past. There would be two different methods of taxing.

Senator HUGHES. That goes to the same objection.

Mr. ARMITAGE. It is another objection on the same ground, unifying the law. If you made the law on the fair value of its capital stock, and in estimating the value of the capital stock the surplus of the undivided profits should be included, that would be fair and would not require two methods of bookkeeping. It would be uniform. That is another answer to Senator Williams's objection. He says we can not appraise the capital stock of all the corporations.

The CHAIRMAN. I did not say you could not appraise the capital stock; you can not appraise the value of the plant.

Mr. ARMITAGE. Under the excise tax you have to, unless you have sales in the market.

Senator HUGHES. Have you paid that excise tax?

Mr. ARMITAGE. Yes.

Senator HUGHES. How did it operate?

Mr. DOUGLAS. We valued it under the Treasury decisions on the average sales of our stock on the stock market, beginning July 1, 1915, and ending June 30, 1916, and we also gave all of the other statements that the bill calls for, and we went into a pretty close valuation. We had our expert accountant determine what our excess surplus was, what our earnings had been, and the average of our sales of our stock in the market, and, as I recollect, we paid on the average sales and stated our surplus and undivided profits, and sent a check to the Treasury Department.

Senator HUGHES. That was easier than with a corporation whose stock was unlisted?

Mr. DOUGLAS. We had to answer the question, to make a full appraisal. My contention is that we have to make an appraisal of our properties, and if we do it conscientiously we have to do it fairly and very carefully. It is an additional burden that the moment we have reported on the act as of December 31 under the excise act, to turn us around and appraise the property in another way and draw different conclusions, and in one act under the theory that we would be appraising up, and on this theory appraising down; we have to work on two different theories, and it would save the mining companies and all the companies of the country a great deal of bookkeeping if we could combine them.

Senator HUGHES. Did you submit your objections to this language to the House Committee?

Mr. DOUGLAS. No. We represented quite a number of mining interests who would have been here to-day, but they only heard of this yesterday and this is the first hearing we have had an opportunity to attend.

Mr. ARMITAGE. I merely thought this second clause should be amended to read: "The fair value at the time of the assessment of the tax or at the time of the return of the assets other than cash paid in." That would meet our objection. We have such a thing in New York.

Senator HUGHES. You said, "the fair value." Did you mean to import those words in, or are you willing to take the words already in, "the actual cash value?"

Mr. ARMITAGE. No, sir.

Senator HUGHES. What do you say to that?

Mr. ARMITAGE. "The actual cash value at the time of the assessment."

Senator HUGHES. Or the return?

Mr. ARMITAGE. Either one of those. The time of the return would be a more definite period.

Senator JOHNSON. Would that include good will?

Mr. ARMITAGE. I am frank to say I do not think it would include good will, and I agree that good will is impracticable to appraise.

Senator HUGHES. That does not occur in your case?

Mr. ARMITAGE. No; it does not, with us.

Senator SIMMONS. Do you not think that would not only include good will but unearned increment?

Mr. ARMITAGE. In the sense of increase in value, and I think that should be included. The personnel of the stockholders charges, and while I may have bought the stock for 50 cents a share 10 years ago you gentlemen may pay $50 to-day, and to disregard that unearned increment is unfair to present stockholders. In accordance with the suggestion of the chairman of the committee, I will later submit a brief relating to this matter.

The CHAIRMAN. It will be printed in the record.

(The brief referred to was subsequently submitted and is here printed in full as follows:)

WASHINGTON, D. C., *February 6, 1917.*

Hon. JOHN SHARP WILLIAMS,
Chairman Subcommittee of Committee on Finance
of the United States Senate, in Charge of Hearings:

On "Title I, excess profits tax," of H. R. 20575, being a bill "to provide increased revenue to defray the expense of the increased appropriations for the Army and Navy and the extension of fortifications, and for other purposes," passed by the House of Representatives and introduced in the Senate of the United States on February 2, 1917, and referred to the Committee on Finance.

THE ONLY AMENDMENT WE PROPOSE IS TO SECTION 202 OF THE BILL AS FOLLOWS:

Section 202, page 4, line 19, strike out the word "payment" and add "the making of the return for the tax."

Section 202 will then read as follows:

"SEC. 202. That for the purpose of this title, actual capital invested means (1) actual cash paid in, (2) the actual cash value, at the time of the making of the return for the tax, of assets other than cash paid in, and (3) paid in or earned surplus and undivided profits used or employed in the business; but does not include money or other property borrowed by the corporation or partnership."

ARGUMENT.

The tax proposed is on excess profits. It is on the theory that there is an excess profit due to the extraordinary conditfons arising out of the war, which should bear a greater proportion of the expense imposed on the Government by such conditions. The standard or normal profits are defined to be "(*a*) $5,000.00" and "(*b*) 8 per cent of the actual capital invested." All over that is deemed excess profits and a tax of 8 per cent is imposed.

Our objections are to the definition of "actual capital invested."

Section 202, which defines this, is either ambiguous or it imposes an unfair and unjust tax. This section defines the actual capital invested as (1) "actual cash paid in," (2) "the actual cash value, at the time of payment, of assets other than cash paid in," and (3) "paid-in or earned surplus and undivided profits used or employed in the business."

SECTION 202 IS AMBIGUOUS.

Subdivisions 1 and 3, in our opinion, are clear, but subdivision 2 is ambiguous. The question is, At what time the valuation of the assets is to be taken, at the time they were originally contributed as capital to the company, or "at the time of the payment" of the tax? The ambiguity arises out of the use of the words "at the time of payment." Does this refer to the time the assets were contributed as capital to the corporation or partnership, or does it refer to the time of the payment of the tax? This has been variously construed, the New York Sun recently having an editorial on the bill assuming that the time of payment referred to the time of the payment of the tax. (See editorial, "Actual cash paid in," New York Sun, Jan. 31, 1917.)

If the proposed bill means that the assets are to be appraised at the time of the payment of the tax or at the time of the making of the return, then we will not interpose an objection, but we submit that this is not the normal meaning of the English employed, and that the bill, fairly read, means that the value of the assets shall be taken as of the time when they were contributed as capital to the company or partnership, whenever that time may be. Thus construed—and we submit that this is the grammatical meaning of the language employed—the bill, in our opinion, is unfair and unjust.

THE TAX UNFAIR.

First, it bases the tax upon the value of the assets at some period in the past that, in many cases, may be exceedingly remote, as in the case of a corporation organized 10 or 15 years ago. The tax has no reference to the actual value of the property at the time the tax is levied.

The result will be that the property of corporations and partnerships subject to the tax will be appraised arbitrarily at different times. This will not be by any fixed rule or method, but purely adventitiously, depending upon the chance date of their organization or the contribution of capital. For example, in the case of a corporation organized in 1893, a time of great financial depression, its property would be valued as of that date, whereas, a corporation organized in 1916, a period of prosperity, would be appraised as of that date.

This would impose various and conflicting standards on different corporations, according to the date that the capital happened to be contributed. At these various times property and money values would be entirely different, owing to the different financial conditions, whether of depression or inflation, and the different population and different standards existing at the time.

Again, the tax does not necessarily exclude the profit on the unearned increment. Whether or not a profit on such increment would be allowed depends upon the date that the property was contributed to the corporation or partnership in relation to the date when the increment was added.

PROPOSED METHOD OF FIXING TAX DISCRIMINATES AGAINST CONSERVATIVE BUSINESS AS AGAINST "WILD CAT" CAPITALIZATION.

Again, the proposed method of valuation places a higher tax or penalty on conservative business methods. Corporations which have taken over property at a conservative basis and have issued capital stock at par at a fair valuation therefor would be taxed far in excess of the "wild cat" companies, and it would be almost impossible at this time to show the overcapitalization of the "wild cat" company, as the capitalization as originally taken would prima facie stand as the original value of its assets, while an original conservative valuation would likewise be now argued by the Government to be the real value then of the conservative corporation. Those corporations which have indulged in the methods of high finance, charging to principal every available item, adding into the surplus the development work on the property, increasing the capital account by all known fictitious devices will relatively escape from excess taxation.

The tax would also impose a severe burden both on the corporations and on the Government. It requires them to appraise "at its actual cash value" all assets, not at the present date, but at the time they were contributed. This would require the taxing officers not to find the value of existing tangible property in being, but the value of property much of which might be no longer in existence or which had so changed or altered that it was unrecognizable.

For example, a manufacturing establishment would have to be appraised, not at the value of its factories to-day, but at the value of its factories probably many years ago, as originally constructed. Many of the buildings might be torn down, destroyed by fire, or so changed as to be unrecognizable.

In the case of companies long in existence the taxing officers and the corporation would have to depend upon the vague testimony of old employees.

Take the case of our mine owners; how is the value of their proerty, which consists of a mine, to be appraised? The mine was originally sold to the company in 1910 for an issue of $1,000,000 capital stock. Thereafter, in 1913, a reorganization was had and the capital was reduced to $75,000. Since that date large findings of ore are made, and the stock is selling at the present time on the market on the basis of about $2,000,000 and the values developed in the mine more than justify that appraisement. It would be clearly unjust to this corporation to tax it on capital invested and based upon $75,000. It would result in taking practically 8 per cent of all of the income of the corporation.

What value should be taken for this mine? Is it the value placed upon it by the original promoters, of $1,000,000, or the value placed upon it by the second set of promoters, of $75,000, or the actual value of the mine shown to-day? The property is the same; the mine is the same. There is no unearned increment here—merely the ore has been discovered. The ore has always been there. It is submitted that the only fair basis on which to fix its capital would be at the time of the return of the tax.

BURDEN FALLS ON SUBSEQUENT STOCHKOLDERS.

It may be argued that the owners of the mine who purchased it or obtained it for $75,000 are not entitled to the excess value or unearned increment, because they have done nothing to earn it. This argument is fallacious, for two reasons. In the first place, it assumes that the owners of the mine to-day are the original owners. This is not true of any large corporation. The personnel of the stockholders changes from year to year, and the new stockholders pay for the properrty the full market value at this time as represented in purchase of stock in the market. A tax based on the value of the mine originally would be a burden on those of the stockholders who have purchased the stock on the basis of the actual value at the present time.

The second reason is that the owners have fully earned the increased increment by their industry, their skill, their knowledge, their work and perseverance in exploiting the mine and the actual money spent and invested in discovering the ore and the risk attendant thereto.

DIFFICULTIES OF APPRAISAL OF ORIGINAL CAPITAL INSUPERABLE.

It may be argued that if the capital invested is to be determined by appraising the assets of the corporations at their value at the time of the tax or return, this will require the Government to value the assets of all corporations in the country—an insuperable task.

The answer to this is that the burden is already placed upon the Government of doing this by the very act in question. On our present assumption of the act's meaning it requires it to determine the actual cash capital invested to be "the actual cash value of the assets at the time of payment of assets other than cash paid in." This necessitates the appraisement of the assets of every corporation in the United States subject to this tax at the time those assets were taken over, invested as capital in the business. This is far more difficult than appraising the assets of the corporations as they exist to-day.

Furthermore, all corporations have been compelled to appraise the actual value of their property for the purpose of income or excise tax returns under the recent federal tax law requirements; and this is undoubtedly true of all partnerships as well, due to the fact that the partners must make a separate income tax return. These figures and reports could be used to get at the value of the present assets for the purpose of making the return under the new proposed excess tax law. These figures and data are all in the possession of the Government at this time.

ENGLISH EXCESS PROFITS TAX.

The English act imposes a tax of one-half of all the excess profits made over and above a "pre-war standard." This standard is determined by taking "the amount of profits arising from the trade or business on the average of any two of the three last pre-war trade years to be selected by the taxpayer."

It will be readily seen that this act gives to the corporation, or taxpayer, the full benefit of the unearned increment and value of its property, at the time the act was passed, including good will, etc., before taxing any excess profits.

THE BILL IS UNSCIENTIFIC, UNLESS BASED UPON PRESENT FAIR VALUE OF ASSETS.

Considering the present bill as a scientific tax measure, its terms are subject to severe criticism and should lead to the rejection of the bill unless substantially modified after careful consideration. The Federal Government now has an income tax system based on net income. It also has a stock franchise tax entitled "Excise tax on corporations approved September 8th, 1916." This tax is "50 cents for each $1,000 of the fair value of the capital stock." It is now proposed to prepare an excess profits tax entitled "Special Preparedness Fund" based on "actual capital invested," defined in section 202 2B" (1) actual cash paid in, (2) the actual cash value at the time of payment of assets other than cash paid in, and (3) paid-in or earned surplus and undivided profits used or employed in the business, but does not include money or other property borrowed by the corporation or partnership."

It is thus proposed to establish three separate bases of valuation for corporation properties in the United States, viz, income, the fair value and cash paid in. There should be but one basis of value for tax purposes, and corporations dealing with the Government should be entitled to simplicity and directness of the law by having but one basis of taxation so that they can at any time know where they stand and what the charges against them are to be. The deduction allowed in the excess profits tax of 8 per cent upon the actual cash paid in should be changed to be a deduction of 8 per cent upon the fair value being the same term as required in the stock franchise tax above mentioned.

IT IS SUBMITTED THAT ASSETS SHOULD BE FIXED AS OF TIME OF TAX.

We therefore submit that the bill should be clarified so as to make the "capital invested" mean the actual value of the assets at the time of the payment of the tax. This amendment could easily be accomplished by a slight substitute in section 202, as follows:

Section 202, page 4, line 19, strike out the word "payment" and add "the making of the return for the tax." Section 202 will then read as follows:

"SEC. 202. That for the purpose of this title, actual capital invested means (1) actual cash paid in, (2) the actual cash value, at the time of the making of the return for the tax, of assets other than cash paid in, and (3) paid in or earned surplus and undivided profits used or employed in the business; but does not include money or other property borrowed by the corporation or partnership."

Respectfully submitted.

DOUGLAS, ARMITAGE & MCCANN,
Attorneys for United Verde Extension Mining Co.,
233 Broadway, New York.

By PAUL ARMITAGE
Archibald Douglas, of Counsel.

WALTER S. PENFIELD,
Local Counsel, Colorado Building, Washington, D. C.

The CHAIRMAN. What have you there, Mr. Butler?

STATEMENT OF MR. CHARLES H. BUTLER—Resumed.

Mr. BUTLER. I have here from the Library the excess profits bills of Italy, France, and Great Britain. From the cursory glance which I have made of them they all make the excess-profit tax for the purposes of calculation based upon the pre-war normal profits as the basis of what those corporations earn. I would like to call attention to the excess-profits tax in France which is found in revue de science at de legislation financieres, 1916, pages 454–462, and to the taxation of war profits in Italy found in the decrees of November 21, 1915 (No. 1543), and December 23, 1915 (No. 1893), also to the excess profits duty of Great Britain contained in the financial act of 1915, being chapter 89 of 5 and 6, George 5, 1915.

The CHAIRMAN. Please proceed, Mr. Douglas.

STATEMENT OF MR. ARCHIBALD DOUGLAS, OF NEW YORK CITY.

Mr. DOUGLAS. We represent some lumber and some mining interests and some cattle companies, and in regard to this unearned increment, if we go back and we do not tax them at their present value we will have a very heavy tax on those companies, because those companies were originally capitalized at a very small capitalization, and in the case of all those companies their present value is much greater—the growth of their timber and, in some cases, the increase in the number of their cattle—and they are in a good deal the same situation as the mining companies, and all of those increases in value have been brought about by energy and at the great risk of capital, because the mining business and all of those industries are hazardous industries. We feel we should not be placed on the basis of a small capital when we originally went into them conservatively, and not be given the advantage of what has come through industry and ability, and we should be taxed on the present fair value, as suggested by Mr. Armitage.

The CHAIRMAN. We will now hear Mr. Charles B. Landis.

STATEMENT OF MR. CHARLES B. LANDIS, WILMINGTON, DEL.

Mr. LANDIS. I had no thought, gentlemen, of appearing before this committee until a few moments ago. We had a short hearing this morning before the Subcommittee on Munitions, and while sitting here I recalled an amendment to this bill introduced by Senator Saulsbury that I would like to briefly call your attention to.

I have not seen the amendment proposed by Senator Saulsbury, but I understand that it provides that the manufacturers of munitions, now being taxed on their net profits, 12½ per cent under the munitions law, should be exempted in this bill. If this bill passes as it is written, the munitions manufacturers will not only be compelled to pay a tax of 12½ per cent on the net profits as provided in the munitions bill but, in addition, will be forced to pay a tax of 8 per cent on their excess profits.

The CHAIRMAN. On the excess profits.

Mr. LANDIS. On excess profits, thereby taxing them practically 20½ per cent, while the ordinary manufacturers will be taxed only 8 per cent on their profits.

The CHAIRMAN. Of course this excess profit tax does not begin until the 12½ per cent tax has been deducted.

Mr. LANDIS. Until the 12½ per cent has been deducted from the profits.

The CHAIRMAN. This is a tax merely upon the profits in excess of 8 per cent after having deducted the 12½ per cent sales, all other taxes and all other expenses. There would be a clear profit of 8 per cent after deducting 12½ per cent before this tax attached at all.

Mr. LANDIS. Yes, but before we pay this tax we pay 12½ per cent tax on all net profits of the business.

Senator HUGHES. You do not make so much money that you are going to pay this tax, do you?

Mr. LANDIS. Yes, we do.

The CHAIRMAN. If after paying the 12½ per cent, notwithstanding the fact you did not earn as much as 8 per cent, you would have nothing to pay under this law.

Mr. LANDIS. We feel that the munitions manufacturers should not be singled out and forced to pay a double tax, even though they may have made enough money to come under the provisions of both laws. I was impressed with the statement made by the gentleman who has just spoken, Mr. Armitage, of the increase in value of the United Verde Copper Corporation; $750,000 capitalized value before this war has advanced to $30,000,000 actual value. The big profit, gentlemen, that has been made in this country since this war began has been made by the munitions manufacturers as a class. Some of us have made great profits. That is true of the Du Pont Powder Co.; that is true of the Bethlehem Steel Co.; that is true of one or two other companies that I might mention. But I will venture the statement that if you take these munitions manufacturers as a whole, the profits they have made will not exceed 10 per cent on the capital actually invested. Take the Remington Arms people. Their stock was quoted at $2,800 at one time. It is now down to one-fourth of that. It is generally known that they have made no money out of this war. Take the U. M. C. Cartridge Co. Their notes are at a discount of about 20 per cent. The Du Pont Powder Co., having sold powder to many of these people, is in a position to realize what losses they have suffered and we know that there is a wrong impression prevailing relative to the alleged exorbitant profits that have been made by munitions manufacturers, as a class, and we feel that munitions manufacturers should not originally have been discriminated against.

Much more money has been made indirectly out of this war than directly, as I have instanced; as is instanced in the oil business, gasoline having been more than doubled in price; as is instanced in the advance of stock of motor-truck manufacturers; as has been instanced in the advertised profits of the great steel companies. The money that has been made by those individuals and corporations indirectly profiting has been the big money. Look what this war has done for cotton, corn, wheat, and the pork packers and the canners. Now, the munitions tax of 12½ per cent was quite an unfair tax if you take into consideration the risk that was run and the general profits that have been made. To put this tax on top of that will appear as though you are discriminating against and in a way attempting to penalize men for having gone into the manufacture of munitions. I want to ask you, gentlemen, what would be your condition of comfort to-day, with this foreign threat hanging over us, if these men had not gone into the manufacture of munitions of war. The company that I represent invested in the neighborhood of $60,000,000 in this expansion. We have multiplied by 30, as a result of that, our capacity for the manufacture of smokeless powder. Our capacity at the outbreak of the European war was 10,000,000 of smokeless powder a year; we are making to-day 300,000,000 pounds a year, and, as one of the Army officers said to me yesterday, the one feature concerning which they do not have to worry is the powder feature. And another thing: At the outbreak of this war it required six weeks to manufacture smokeless powder. We have perfected a method by which we now make it in six days.

Now, had we not had the courage and the money and the initiative to thus expand you would be in a very embarrassing situation to-day. I use that simply as an example. If these other men had not had the courage, the initiative, and the money to embark in the manufacture of munitions you would be in a very embarrassing situation to-day.

I do not know that I have anything in addition to say except this: The manufacturers of munitions who have made money have made their money off of their customers abroad. The other people who have made such great money have made it for the most part off the people at home. The steel people, the oil people, the copper people, the zinc people, the manufacturers of acids and alcohol and motor trucks, and automobiles risked no money abroad. They simply raised the price of what they had and sold their product at home. The manufacturers of munitions had to have courage and take a chance. They took the chance, and invested their millions. Some of them have made great money. Many of them have made no money. Some of them have gone into actual bankruptcy. Speaking for my own company, I want to say to you, too, that we have not taken advantage of our domestic customers in this crisis. We started out selling powder abroad at $1 a pound. Our own Government came to us for smokeless powder and for high explosives. We contracted for 53 cents a pound with our own Government and furnished the powder when we could have sold the same powder abroad—they were clamoring for it—for $1 a pound. The high explosive known as "T. N. T." we were selling abroad for from $1 to $1.25 a pound. They were clamoring for it at that price. At one time we sold 400,000 pounds of that to our own Government at 40 cents a pound. I figured out, at the time, that we made a present to the Government of over $600,000 in these two sales.

The manufacturers of munitions did not increase their price to anyone except to the foreign customer. These men who indirectly profited were in a position to increase their prices, and they did increase their prices to the home customer, the home consumer. You know how cotton advanced, you know how lead advanced, you know how copper advanced, you know how steel advanced. Everything at home went up, and these men have made enormous profits, and yet you exempted them in the munitions bill. You confined the munitions tax to manufacturers of powder and other instrumentalities actually used in combat, and now propose to add this 8 per cent tax to that burden. I do not think it is fair. I think it is a reflection on the manufacturers of munitions. I think it will discourage initiative along that line and I think that you should incorporate in this bill Senator Saulsbury's amendment. Even then the manufacturers of munitions will be paying 4½ per cent more than other manufacturers.

That is all I have to say, gentlemen, except in conclusion I want you to understand that we are not objecting to paying any tax you may deem necessary for the support of the Government at this time. What the manufacturers of munitions object to is discrimination, double taxation. You may make war taxes 8 per cent, you may make them 15 per cent, you may make them 25 per cent, you may make them 50 per cent on excess profits, as they have made them,

I understand, in Great Britain; but I insist that, as in Great Britain, you should treat all manufacturers alike and not have your taxation scheme apply in a discriminatory way to those men upon whom the nation may depend for its very existence when the crisis comes. The objections to this bill by the manufacturers of munitions will be entirely met if you amend the measure in accordance with Senator Saulsbury's proposal.

The CHAIRMAN. Is there anyone who wishes to be heard? My list is exhausted.

(Thereupon, at 1.30 o'clock p. m., the committee took a recess until 2.30 o'clock p. m.)

AFTER RECESS.

(At 2.30 o'clock p. m. the commitee reassembled, pursuant to the taking of the recess, Senator John Sharp Williams presiding.)

The CHAIRMAN. The committee will come to order. There does not seem to be anyone here who wishes to be heard, so the committee will stand adjourned.

(Thereupon at 2.32 o'clock p. m. the committee adjourned to meet at the call of the chairman.)

HEARINGS

BEFORE THE

SUBCOMMITTEE ON FINANCE

IN REGARD TO

OLEOMARGARINE

REVENUE FOR INCREASED ARMY AND NAVY APPROPRIATIONS.

OLEOMARGARINE.

FRIDAY, FEBRUARY 9, 1917.

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

The subcommittee met, pursuant to call, at 10.30 o'clock a. m. in the committee room, Capitol, Senator Furnifold McL. Simmons presiding.

Present: Senators Simmons (chairman), James, Thomas, Johnson, Hughes, and Williams.

Also present: Mr. John J. Farrell, representing the National Creamery Butter Makers' Association; Mr. William T. Creasy, secretary of the National Dairy Union of Pennsylvania; Mr. George P. Hampton, editor of the Farmers' Open Forum, Washington, D. C.; Mr. B. John Black, master of the Maryland State Grange, vice chairman of the legislative committee of the National Grange; Mr. Burr B. Lincoln, member, executive committee, Michigan State Grange, and deputy Dairy and Food Commissioner of Michigan.

The CHAIRMAN. The committee will come to order. The committee is prepared to hear Mr. Creasy.

STATEMENT OF MR. WILLIAM T. CREASY, SECRETARY OF THE NATIONAL DAIRY UNION, OF PENNSYLVANIA.

Mr. CREASY. This is a protest against the intended oleomargarine amendment to the revenue bill submitted to the Finance Committee of the United States Senate on behalf of the dairy interests of the United States.

(The paper submitted by Mr. Creasy is here printed, in full, as follows:)

Gentlemen of the committee, we, the representatives of the dairy industry of this country, appear before you on short notice, having less than one day's time in which to prepare an adequate presentation of the farmers' opposition to the Underwood amendment to the revenue bill (H. R. 20573). We regret that we were not granted further time, which would have enabled us to summon dairymen of the various States to present to you in person their objections to this proposed legislation.

In behalf of the 4,500,000 dairy farmers of this country, we most emphatically object to any legislation affecting this great billion-dollar industry at this time in the manner in which it is being taken up. The farmers of the country had no intimation that legislation so detrimental to the dairy industry would be attempted at this time. We oppose this amendment for the following reasons:

That the legislation proposed is destructive of the great dairy industry and in favor of the interests seeking to foist on the public oleomargarine colored in imitation of butter.

That the purpose of the amendment, as expressed in the title, namely, "To provide increased revenue to defray expenses of the increased appropriations for the Army and Navy, and the extension of fortifications, and for other purposes," is incorrectly stated. A title fittingly expressing the effect of such a law would be "To destroy the great dairy industry of this country in favor of the oleomargarine interests, and, incidentally give the Federal Government $1,000,000 of revenue for every $10,000,000 taken by the oleo—the Beef Trust—interests above a legitimate profit."

That if it is true that oleomargarine is the poor man's substitute for butter, it is a crime in these days of increase in the high cost of living to increase the tax thereon 700 per cent, and the actual price to the consumer a considerable increase above this tax.

That the evidence is conclusive that the oleomargarine frauds are due entirely to the law permitting it to be colored in imitation of butter, and that the Underwood amendment, if enacted into law would restore the intolerable conditions that prevailed when the 2-cent oleomargarine law was in effect.

That if the real intent of this amendment is to raise revenue regardless of the unjust burden such tax would place on people in proportion to their poverty, then the Government could raise as much honest revenue—if increasing the tax on the poor man's substitute for butter 700 per cent can be called honest—by inserting a clause in the amendment absolutely prohibiting the coloring of oleomargarine by any shade of yellow whatever.

That the Underwood amendment, if enacted, would be so injurious to the dairy industry that thousands of farmers would be compelled to go out of the dairy business. The result would be a reduction in the production of all dairy products, a further shortage of the meat supply, and many other attendant evils, all of which would inevitably increase the cost of living.

That a bill was prepared and introduced nearly a year ago which was carefully drawn after several hearings before the Agricultural Committee of the House, known as H. R. 13825. This bill has a scientific plan of color measurement worked out by the Bureau of Standards and approved by the Treasury Department. It prohibits the coloring of oleomargarine and provides for a flat tax of 1 cent a pound. The amount of tax, however, is immaterial, as far as the dairymen are concerned, but should be enough to properly enforce the law.

We oppose this legislation as a part of an emergency revenue bill, because whatever revenue may be received therefrom imposes a grossly unjust burden on the poor, and the amount of possible revenue to be derived therefrom is insignificant compared to the injury it does to the great dairy industry and the dangerous monopoly it fosters. Such legislation, if attempted at all, should be considered in a separate bill and fought out on its merits after the most exhaustive hearings and public discussion.

We oppose this legislation further, because it has been sprung suddenly on Congress as an eleventh-hour amendment to an emergency revenue bill. It is new legislation and the public has been given to understand that no new legislation other than the appropriation and administration bills would be considered or passed at this short session of Congress.

Congress placed the tax on oleomargarine to protect the consuming public from fraud and deception in the purchasing of butter or oleomargarine. The present law in the United States places a tax of 10 cents a pound on oleomargarine when it is colored to imitate butter. It is taxed only a fourth of a cent a pound when it is put up and sold in its natural color, which is white. This fourth of a cent a pound tax was placed on oleomargarine so as to bring it under the Internal Revenue Department, as this department of the Federal Government has police facilities for enforcing the law and protecting the public against fraud.

Every country where oleomargarine is sold or manufactured has certain restrictive measures controlling its sale and manufacture. Fraud and deception seem to have followed in the wake of this product. France, where the product originated during the Franco-Prussian war, has had to amend its laws twice to protect the public against fraud in the sale of oleomargarine. The laws in many of the European countries are different from ours from the fact that they do not place a direct tax on oleomargarine but do prohibit it from being colored yellow in imitation of butter, and also require that it be sold in separate stores where butter can not be handled. Heavy penalties are assessed for violation of the law. If such a law were enacted by our Government the tax would not be necessary. Germany, France, and Belgium require oleomargarine to be sold in separate stores. Germany and France prohibit the coloring of the product in imitation of butter. More oleomargarine is sold per capita in Denmark than in any other country, and Denmark prohibits the coloring in imitation of butter, but permits it to be sold in the regular stores the same as we do in our country. It is sold, however, in a different-shaped package, the package being oblong.

Some of the European countries prohibit the mixing of butter with margarin in the manufacture of oleomargarine. Others restrict the percentage of butter that can be used. Writers of late have been giving the impression to the public that the manufacturers of oleomargarine are paying 10 cents a pound tax on the same. The late report put out by the Internal Revenue Commissioner shows that over 97¾ per cent of the oleomargarine in this country last year only paid a fourth of a cent a pound tax.

The first law in this country placing a tax on oleomargarine was passed in 1886 during President Cleveland's administration. The law placed a 2-cent tax on oleomargarine and permitted it to be colored in imitation of butter. During the time that this law was in effect the fraudulent sale of oleomargarine for butter became appalling. The mixing of butter and oleomargarine was practiced quite extensively. Thus the consuming public had no protection against fraud.

We quote the following from President Cleveland's message to Congress concerning the proposed tax:

"I am convinced that the taxes which it creates can not possibly destroy the open and legitimate manufacture and sale of the thing on which it is levied. If the article has the merit which its friends claim for it, and if the people of the land with full knowledge of its real character desire to purchase and use it, the taxes exacted by this bill will permit a fair profit to both manufacturer and dealer. If the existence of the commodity taxed, and the profits of its manufacture and sale depend upon disposing of it to the people for something which it deceitfully imitates, the entire enterprise is a fraud and not an industry.

"Not the least important incident related to this legislation is the defense afforded to the consumer against the fraudulent substitution and sale of an imitation for a genuine article of food of a very general household use. Notwithstanding the immense quantity of the article described in the bill, and notwithstanding the claims made that its manufacture supplies the chief substitute for butter, I venture to say that hardly a pound ever entered a poor man's house under its real name and in its true character. Having entered upon this legislation it is manifestly a duty to render it as effective as possible in the accomplishment of all the good which should legitimately follow in its train."

There was more oleomargarine manufactured last year then ever before in the history of the industry in this country. There were manufactured 152,509,912 pounds according to the report of the Commissioner of Internal Revenue. Of this amount 2,587,689 pounds were exported, and consequently were relieved from paying this tax; 748,531 pounds were withdrawn free for use of the Government during the fiscal year ending June 30, 1916.

During the same year there were manufactured 145,760,973 pounds of uncolored oleomargarine, which paid a tax of only one-fourth cent a pound, as against 138,241,907 pounds the previous year. This shows a net increase of 7,546,066 pounds in the production.

Of the enormous amount of oleomargarine produced during the fiscal year only 3,403,287 pounds were taxed at 10 cents a pound, or a little less than 2¼ per cent of the total manufacture.

Out of the total number of pounds of oleomargarine (152,509,912) made in 1916, the Underwood amendment would increase the tax from one-fourth cent to 2 cents on 145,760,973 pounds, as against a reduction from 10 cents to 2 cents on only 3,403,287 pounds of the colored oleomargarine, which paid the 10-cent tax. This is an increase to the consumer on the uncolored product of $2,550,817.03 annually in taxes alone, provided the output remains the same. This, instead of reducing the high cost of living, as has been alleged, would increase the already heavy burden on the poorest classes of our people.

We admit that the present law is not perfect. It not only permits oleomargarine manufacturers to use the cheaper fats, such as intestinal fats and vegetable oil, but also permits them to use milk, cream, or butter in making their product. They are only taxed one-fourth of a cent a pound on the same when sold in its natural color. There is no limit as to the amount of water that may be incorporated in oleomargarine. In addition to this, such terms as butterine, Jersey brand, Holstein brand, Guernsey brand, and other such names imply that it is made from milk. On the other hand, if the dairyman incorporates the smallest fraction of a per cent of foreign fats in connection with his butter he is required to pay a tax of 10 cents a pound and a license of $600 a year, and to brand it adulterated butter. There should be a line of demarcation that would prohibit the mixing of butter and oleomargarine unless same was branded adulterated butter. This, together with a clause in the law positively prohibiting the coloring of oleomargarine in imitation of butter, would prevent oleomargarine from masquerading as butter.

We have thus hurriedly given a few reasons why the Underwood amendment should not be made a part of this revenue bill. If, however, you insist upon reporting the bill to the Senate with the Underwood amendment incorporated therein, we respectfully submit that it should be amended as follows:

Add to end of Section 400 of the following:

"*Provided further*, No margarine shall be manufactured in imitation or semblance of butter of any shade of yellow—for the purpose of this act margarine shall be deemed to be in such imitation or semblance of butter of any shade of yellow, if the diffuse reflecting power for light of wave length four hundred and thirty-six micromillimeters is less than seventy per centum of the diffuse reflecting power for light of wave length five hundred and seventy-eight micromillimeters the temperature of sample being seventy to eighty degrees Fahrenheit; no margarine shall be manufactured by mixing butter or milk fat with the same."

The method of measuring color in the above was worked out by the Bureau of Standards and is approved by the Treasury Department.

Submitted on behalf of the dairy interests of the United States.

WM. T. CREASY,
Secretary National Dairy Union.

J. J. FARRELL,
President American Dairy, Food, and Drug Officials' Association;
President National Creamery Buttermakers' Association;
Dairy and Food Commissioner of Minnesota.

GEO. P. HAMPTON,
Editor The Farmers' Open Forum.

Mr. CREASY. I would like to file, in addition to that, an editorial written by Dr. H. E. Stockbridge, president of the Farmers' National Congress, and editor of the Southern Ruralist, published at Atlanta, Ga., and I call particular attention to six lines there, which read [reading]:

The cottonseed-oil interests of the South have joined hands with the packers' trust for our undoing. Their servility is easily explained. Cottonseed oil is used in several packing-house products—soap, and hogless lard.

The real interest of these oil-mill men has never been with the farmer.

Senator THOMAS. Are not some of the 4,000,000 farmers of whom you speak farmers in the South?

Mr. CREASY. I would like to finish this before I answer any questions.

(The editorial referred to is here printed in full, as follows:)

TAKE NOTICE.

We recently mentioned the official recommendation of Secretary McAdoo that Congress prohibit the coloring of oleomargarine in imitation of butter, and levy a tax of 1 cent per pound on the uncolored product. A single subscriber objects to this course in the supposed interest of the consumer.

This reminds us that it is just six years since the last organized assault of manufacturers was made upon the present law. Had this contributor been a reader of the Ruralist at that time he would realize the inherent weakness of his argument. Every point he raises was fully discussed at that time and every assertion refuted. The course of the Ruralist was one of the recognized important factors in preventing contemplated congressional action at that time.

There are other new readers—or old ones with short memories—in whose interest we shall present a few of the old and some of the new facts.

The poor consumer.—We are asked: "Why tax a thousand families that one dairy farmer may make money?" Dairying is a fundamental industry. Butter is only one of its products. Its existence is essential to our national life. Without it cows would disappear, and without cows our economic life would be jeopardized.

There is no more injustice in a revenue tax on oleo than upon any other manufactured article in general use. As a matter of fact, however, the oleo tax is not a revenue measure, but a police measure for the express purpose of protecting the public against fraud. Its chief purpose is to control an industry which has been conclusively proved to be a menace to the public wherever it has been allowed to exist without this control.

Color in oleo is wholly artificial. Its only purpose is to deceive, and the direct object of this deception is to increase sales or raise prices. To-day dairy butter sells at perhaps 40 cents, and oleo without color at about 20 cents. Remove the restrictions upon color and the immediate tendency would be for the difference in price between the genuine and the imitation butter to disappear. The much commiserated poor consumer would then pay about double the present price for an article no better, but merely so colored that only the expert chemist can distinguish the real from the spurious.

We are told that the Southern consumer of oleo can buy in large quantities, and therefore at wholesale prices, while he must buy his butter in small quantities because of its poorer keeping qualities. If this be true, it is merely another reason why the Southerner could encourage Southern dairying by encouraging home-made butter by means of a tax on the spurious competitor.

Our reader insists that if oleo be taxed to protect the farmer, creamery butter should be taxed for the same purpose, "for farmers do not run creameries." Many farmers do run creameries, but all creameries use cream and that means cows. Farmers own the cows and produce the cream from which the butter is made. That would seem to give them a pretty direct interest in protecting creamery butter against fraudulent imitation.

The stake of the South.—We are constantly told that the real interest of the southern farmer is with the oleo manufacturer, because the latter uses our cottonseed oil in his product.

Here are the actual facts: Cottonseed oil is used in only one of the three standard grades of oleo—the lowest. The best oleo contains no cottonseed oil whatever. The other contains only 1.8 per cent of this oil. The actual total consumption of our oil in oleo manufacture is from $30,000 to $35,000 in value per year.

For this paltry sum southern farmers are asked to demand that their Representatives in Congress make defrauding of the public easy and kill a fundamental growing industry. We are coolly asked to jeopardize the new agriculture of the South, annul all efforts at diversification, prevent soil conservation, and risk our prosperity.

The cottonseed-oil interests of the South have joined hands with the packers' trust for our undoing. Their servility is easily explained. Cottonseed oil is used in several packing-house products—soap and hogless lard.

The real interest of these oil-mill men has never been with the farmer. Last spring when the whole real South was striving for diversification and reduction of cotton acreage the president of the Interstate Seed Crushers' Association delivered public addresses to farmers' organizations against crop reduction. He argued that the larger the cotton crop the greater the export, and that large export would discourage production of foreign cotton to compete with our own product.

Few farmers were misled. They knew that the real object of the oil men was cheap seed.

In this issue the interests of North and South are identical—protection to a vital agricultural industry and protection of the consuming public against corporate fraud.

Congressmen, take notice!

Mr. CREASY. I would like to file the statement of Hon. James H. Maurer, president of the Pennsylvania State Federation of Labor, who, in writing to Samuel Gompers, explained why oleomargarine should not be colored. I would like to call attention to one paragraph in that. While the statement incloses the whole argument, there is one paragraph that I would like to call your particular attention to from the labor man's standpoint, because in Pennsylvania we have large labor interests, and I believe that there is as much oleomargarine sold in Pennsylvania as there is in any State in the Union. This is what he says [reading]:

The imitation article, therefore, like any other imitation which closely resembles the genuine, comes in direct competition with it. Once we allow it to be colored, its price will begin to soar dangerously close to the real article and, as a consequence, the consumer who is now buying oleomargarine, or butterine, for 20 cents a pound, will pay the advanced price.

(The paper referred to is here printed in full, as follows:)

WHY OLEOMARGARINE SHOULD NOT BE COLORED.

The laws of Pennsylvania do not allow manufacturers or dealers to color imitation butter. The consumer may, however, color it. But once colored it shall not be sold again.

For the past six years, or the three last legislative sessions of Pennsylvania, I opposed all proposed legislation which aimed to legalize the coloring of imitation butter by manufacturers or dealers. My objections are not based on any thought that coloring matter is unhealthful or that imitation butter is not fit for human consumption. My objection is solely an economic one. At present imitation butter in its natural state sells for from 18 to 22 cents a pound in Pennsylvania, while the genuine dairy product costs 36 cents a pound. The purer the imitation is the whiter it is. If the manufacturers and dealers in the imitation article were permitted to color their product, the imitation would be complete, so much so that nothing short of an analysis would reveal its component parts. This is, at least, true of the great majority of consumers.

The imitation article, therefore, like any other imitation which closely resembles the genuine, comes in direct competition with it. Once we allow it to be colored, its price will begin to soar dangerously close to the real article and, as a consequence, the consumer who is now buying oleomargarine or butterine for 20 cents a pound will pay the advanced price.

Inclosed find copy of an advertisement which will verify this contention. The River Creamery and Elgin brands, mentioned on advertisement, are colored in imitation of dairy butter and the price is 10 cents a pound higher than the uncolored. The result of this kind of competition would mean ruin to the dairy farmer. The imitation being so perfect, deception would be easy and the market for the dairy product would weaken.

One thing sure, the farmer never could hope to compete with the manufacturers of the imitation article. As a result many of the dairy farmers would be compelled to go out of the dairy business and turn their farms to raising something else. And just as fast as this happened the price of the imitation article will rise until finally the great packing companies will have a monopoly; then the consumer will pay more for the imitation article than we are now paying for the genuine. Besides, the imitation will, most likely, not be as pure as it is now, if colored, because the purer the whiter, and the consumers know this. When colored, a certain amount of impure, foreign matter may be used and can not be detected by sight because of the coloring.

On the other hand, if the farmers can not find a profitable market for their milk and turn their farms to other products, it means the starving of their land. As fertilizers, cattle are the life of soil.

Therefore, looking at the question from every angle possible, I can see but two reasons why some dealers and manufacturers want a law giving them the right to color in imitation of butter their product—one is to charge more for their product and the other to give them a monopoly of the butter market.

Let oleomargarine and butterine and all other substitutes stand on their own feet and sell for what they are and not for what their manufacturers can make people believe they are.

JAMES H. MAURER.

Mr. CREASY. I would also like to file a letter in reply to the statement which was made yesterday by the committee that the adding of the amendment had no particular weight. This is from Senator Tillman, of South Carolina. In reply to a letter he says [reading]:

UNITED STATES SENATE,
COMMITTEE ON NAVAL AFFAIRS,
Washington, D. C., February 8, 1917.

Mr. WM. T. CREASY,
Secretary the National Dairy Union, Washington, D. C.

DEAR SIR: I have your circular letter of February 7, and in reply thereto will say that it is impossible for me to investigate every bill of this kind and that I am inclined to accept the bill as it is reported out by the committee which has it in charge.

Very truly, yours,

B. R. TILLMAN.

Senator JAMES. What the committee meant by that statement that you construed as intimating that it would affect the result was that the action of the committee did not bind the other Senators.

Mr. CREASY. Is it necessary to give the amendment we desire in separate form?

Senator THOMAS. It would be a little more convenient, but it is not necessary.

(The amendment submitted by Mr. Creasy is here printed in full, as follows:)

Add to end of section 400 the following:

"*Provided further*, No margarine shall be manufactured in imitation or semblance of butter of any shade of yellow—for the purpose of this act margarine shall be deemed to be in such imitation or semblance of butter of any shade of yellow, if the diffuse reflecting power for light of wave length four hundred and thrity-six micromillimeters is less than seventy per centum of the diffuse reflecting power for light of wave length five hundred and seventy-eight micromillimeters the temperature of sample being seventy to eighty degrees Fahrenheit; no margarine shall be manufactured by mixing butter or milk fat with the same.

Senator JAMES. Is there any contention by the dairy people that oleomargarine is not a pure food product; in other words, that it is deleterious to health?

Mr. CREASY. The thing has been worked out scientifically at the University of Wisconsin, at Harvard, and at the State Agricultural Experiment Station, and while that particular point has not been gone into, I suppose it is healthy; that is when it is manufactured in a cleanly manner. It has heat and energy, but lacks the quality that makes for growth, which butter contains. Butter and milk practically are the only two animal products that contain growth. That is, if you want to feed children or pigs or anything, you want to give them milk or some substitute.

Senator JAMES. It was thought by a considerable number of people for a long time that olemargarine was not a pure food product; that is, that it was deleterious to health.

Mr. CREASY. We do not contend that. The only thing, getting outside this argument, is to tell you this, that when I was master of the Pennsylvania State Grange we framed an agreement with a fertilizer concern, and I asked the head of that concern about the raw bone. He said, "The dead cattle are not treated any more like they used to be. They are put in caldrons, the steam is turned on, and the fats are taken out in that way, and then they are graded according to their specific gravity." I said, "What kind of oil do you get?" He mentioned a lot, and among others, oleo. I said, "Where does that go?" He said, "To the general market, and is exported." If that is true, that it leaves the place of its production without being properly stamped, while it is chemically pure, it still has that characteristic that those oils may come from anywhere. The making of it I think is all right.

Senator JAMES. Senator Underwood had statements of several celebrated chemists, I think, that it was pure. They contend that the heating necessary to make oleomargarine killed all impurities.

Mr. CREASY. I say it is chemically pure; that is, there will be no bacteria or microbes.

The CHAIRMAN. The committee will next hear Mr. John J. Farrell.

STATEMENT OF MR. JOHN J. FARRELL, REPRESENTING THE NATIONAL CREAMERY BUTTER MAKERS' ASSOCIATION.

Mr. FARRELL. Mr. Chairman, I am with the three who signed the brief, and we have gone over the subject as briefly as possible; but I would like to call your attention to the tax feature of this oleo proposition, that we have been accused in the past of demanding this high tax. When it was taxed 10 cents a pound, as far as the dairymen were concerned, it was presumed by them that by that act the colored oleomargarine would be driven out of the market by taxing it 10 cents a pound. But through the advent of science and chemistry and the selection of fats and oils it has brought about a situation that has colored oleomargarine without artificially coloring it, and the word "artificially" in the present law is really what we term now a "joker" in the law, because they have got all around it through their science of chemistry and conscious selection of oils and fats. Therefore 2½ per cent of what is now really artificially colored of the entire market is all that is paying the Government 10 cents a pound, and that has been handed out as a great barrier to the consumers of butter, that were it not for the fact that oleomargarine was taxed 10 cents a pound butter would be 10 cents a pound cheaper to the consumer, when the great bulk of it, 145,000,000 pounds, is in fact only paying a quarter of a cent a pound tax. So that we, as dairymen, do not want unduly to tax oleomargarine, but we do want to cut the emblem of fraud out of it and tax that as oleomargarine. During the last three and a half years of the Internal Revenue Commissioner's duties he has collected $27,000,000 in fines for illegitimate uses of the colored product.

Senator HUGHES. Most of that, though, under the law as it is administered, sells for a higher rate, does it not?

Mr. FARRELL. It is because of the color.

Senator HUGHES. I mean the consumer does not get any benefit out of it?

Mr. FARRELL. None at all.

Senator HUGHES. That is sold for butter?

Mr. FARRELL. Sold for butter, because of the fact that it is colored.

Senator HUGHES. It is sold at a very high price, is it not?

Mr. FARRELL. In some places. For instance, in Massachusetts a short time ago, because it was colored, it sold for 45 cents. In our State the colored only sells for 2 or 3 cents higher than the white.

Senator THOMAS. That was sold for butter?

Mr. FARRELL. Yes. It was colored oleomargarine sold as butter. So that you will see the color is the emblem of fraud in this product, and it has continued to be so, and this is because of all the States enacting what are known as white laws.

The CHAIRMAN. What States have enacted them?

Mr. FARRELL. Minnesota, Iowa, Wisconsin, Michigan, Pennsylvania, and I expect numerous others.

Mr. CREASY. I think about 30 States.

The CHAIRMAN. They have enacted laws prohibiting the coloring of oleomargarine?

Mr. FARRELL. Prohibiting the sale of oleomargarine in the semblance of butter, or any shade of yellow. That is about the wording of all of the laws. Senator Thomas asked the question as to the

number of dairy farmers, if the South was not included. They certainly are.

Senator THOMAS. My question was prompted by the article which Mr. Creasy offered, and which went into the record, which charges this legislation as either being in the interest of or as producing the merger or combination between the cottonseed oil producers of the South and the Beef Trust. My question was to ascertain whether or not some of the men you represent did not live in the South?

Mr. FARRELL. Yes, sir.

Senator HUGHES. Have any of the States passed legislation compelling restaurants and hotels using oleomargarine to explain that they do?

Mr. FARRELL. Yes, sir.

Senator HUGHES. Does not that protect the public?

Mr. FARRELL. It is up to the local police of the States to see that that is carried out, although in a great many districts it is not. Take, for instance, St. Loius, and a great many places where the fight is continually on. I do not believe, while there are many phases of this we could touch on, we want to take up your time further entering into the evidence.

Senator JAMES. As to the argument made here that this would be hurtful to the farmers—that is, to reduce this tax on colored oleomargarine—what have you to say about the benefit, if any, that would be derived by the farmers who sell the beef and produce the cotton that makes the oil that goes into the making of oleomargarine? Would that tend to balance the injuries with the benefits that would accrue to those who are likewise farmers, in the production of cattle and cotton?

Mr. FARRELL. No, sir. The live-stock breeders of this country do not sell their cattle as grease. This is a by-product. The price is fixed when they sell the animal. They sell the whole carcass, and the greases are collected afterwards. When it comes to the amount of cottonseed oil, it amounts to only $35,000 that goes into the oleomargarine from the South. In other words, it would amount to only one and three-quarters an acre of the real value of the number of acres in the South raising cotton.

Senator THOMAS. Then I take it you do not subscribe to this charge which the editorial introduced contained?

Mr. FARRELL. That is the amount of oil that enters into it.

Senator THOMAS. But if that is all the oil that enters into oleomargarine, it would hardly be sufficient to justify the alleged combination between the cottonseed oil producers of the South and the Beef Trust.

Mr. FARRELL. But it goes into hogless lard in large quantities.

Senator THOMAS. I can not recall an item of legislation of this character since I have been here but that sooner or later it assumes in some of its aspects a sectional basis, either as affecting the South, the West, or the North.

Mr. FARRELL. It has been brought into it, and I really think what is good for the northern farmer is good for the southern farmer.

Senator THOMAS. I merely mention it because it is not a new thing with us.

Mr. FARRELL. I think it is a wrong idea, that a great many of the southern farmers and cotton growers have been educated to believe

that this cotton was the only thing they could grow. The 10 cotton States that are raising cotton pay only $10,000,000 a year for commercial fertilizer, whereas if they diversified their crops they could fertilize that land.

Senator JAMES. If you make the southern farmer prosperous, of course he is enabled, in the production of cotton, to pay a better price for corn and beef and the other products of the western farmer. So I do not take kindly to this argument that would array the farmers of one section of our country against those of another section.

Mr. FARRELL. We do not, either. We are not entering into that arraignment. In fact, what is known as the Farmers' Union of the South are with us in this.

Senator THOMAS. It must have been introduced.

Mr. FARRELL. In the past there have been people who are not dairymen who have tried to array us against one another, to keep us apart. That has been done.

Senator THOMAS. I received a long telegram from the cattle growers of my State approving this measure.

Senator JAMES. Is it your idea that the by-product does not enter into the price paid to the farmer for his stock?

Mr. FARRELL. It has certain influence, using all the by-products. But when the animal is sold to the packers, these by-products are not entering into the price they shall pay, because the market price of cattle controls what they pay the producer, the shipper of the cattle.

Senator SMITH. But if the carcass were made more valuable to the buyer, would not that naturally become an element in the price per pound he paid for the carcass?

Mr. FARRELL. Yes, in this way—that it enables the packers, through the power to use these by-products in imitations, to sell that carcass for actually what he pays for it, and the by-products are his profits, thereby driving out the local butchers throughout the country, and the local abattoirs. That is what is done. In fact, in the East you have not to-day abattoirs that are butchering as they used to. The packers are supplying the whole country.

Senator JAMES. So that your argument along that line applied to beef, as you have made it, would also apply to cotton, would it not, and the farmer in the South, then, according to your judgment, would not be benefited any more by reason of the fact that the oil used in the making of oleomargarine came from the cotton?

Mr. FARRELL. The amount of oil that is used in oleomargarine the cotton grower of the South reaps no benefit from, but he sells his oil to these people who buy that oil. Of course, if he stipulated on a market price, and a great deal of it goes into hogless lard, that is what is known as the substitution for hog lard.

Senator SMITH. What appeals to me just at this time about this measure is the claim that the product sold as oleomargarine, and used as oleomargaiRne by consumers, is a valuable food, and that a great many people are not financially in condition to furnish themselves the butter that they would like, when they could at this much cheaper price obtain the oleomargarine, and that it would help furnish a cheaper food to a great many people whose financial condition calls on us to see if we can do anything to furnish them a cheaper food.

Mr. FARRELL. The 145,000,000 pounds manufactured now by these people are paying one one-quarter of a cent a pound tax, and that is the great bulk of the entire output. Only 3,000,000 pounds are paying the 10-cent tax. We are not standing out for that tax. We only had that tax originally put on there to drive the imitation, the colored product, out of the market.

The CHAIRMAN. Does not a large part of the oleomargarine, although it does not pay the 10-cent tax, when it goes on the market carry that tax in the price?

Mr. FARRELL. A large part carries the quarter of a cent, but not the 10 cents.

The CHAIRMAN. Is it not a fact that there is a 10-cent tax imposed upon colored oleomargarine, a circumstance that enters into the market price of colored oleomargarine?

Mr. FARRELL. That would enter into the market price of colored oleomargazrine, that portion of it.

The CHAIRMAN. Is not a large part of the oleomargarine that is sold actually colored in violation of the law, without paying the tax?

Mr. FARRELL. Not any more since this last commissioner came in. He has enforced the oleomargarine laws pretty rigidly.

Senator THOMAS. He has unearthed a great many violations of the law, and punished them?

Mr. FARRELL. Yes, sir.

The CHAIRMAN. By reason of his scrutiny, and these various prosecutions that he has inaugurated the frauds are not so rampant as they were before?

Mr. FARRELL. No, sir.

The CHAIRMAN. But, nevertheless, frauds upon this law are still perpetrated to a very considerable extent, are they not?

Mr. FARRELL. They always will be, while the emblem of fraud is in the commodity.

The CHAIRMAN. Where the fraud is perpetrated, and without paying the tax the oleomargarine is colored, does not that go upon the market with the 10 cents added, just as if it had been paid?

Mr. FARRELL. Yes, as in the case I cited in Boston, where the product went on the market not only as oleomargarine, but went on as butter because it was colored just like butter.

The CHAIRMAN. So that at present, under the present law, without the Government getting the benefit of this 10 cents in revenue, the people are actually paying the 10 cents, to a large extent?

Mr. FARRELL. On that 3,000,000 only.

Senator SMITH. This bill proposes that it should be put up in packages, marked as margarine, and to be sold to the ultimate consumer in the unbroken package marked margarine. Would not that prevent the possibility of fraud, and compel the man who buys it to know that he is buying oleomargarine and not butter?

Mr. FARRELL. That is the result, of course, of the color being there. That is what prompted these men in the trade now in Leavenworth prison, who were forced to pay this $27,000,000 of their fraud profit back to the Government. They were the moonshiners of that trade. When they bought it they would continue to put the yellow in there, and then here are the 10,000,000 people in this country who lunch and take meals at hotels and restaurants.

When they go in to buy bread and butter they buy it and get oleo, because that is colored to resemble butter.

Senator THOMAS. There is a great deal of butter that is also colored.

Mr. FARRELL. Yes, sir. The law has defined butter.

Senator SMITH. Would you be willing to have butter that was colored at all taxed 10 cents a pound?

Mr. FARRELL. If Congress would see fit to put a tax of 10 cents a pound upon the genuine article——

Senator SMITH. No; upon the colored product.

Mr. FARRELL. Then how could you tell when butter was colored and when it was not, because the natural color of butter is yellow?

Senator SMITH. What would you think of taxing 10 cents a pound all butter that was colored?

Mr. FARRELL. Then we would not color it.

Senator SMITH. You have not answered me. Would you approve that tax?

Mr. FARRELL. To tax all that was colored?

Senator SMITH. All colored butter 10 cents a pound.

Mr. FARRELL. If Congress saw fit to tax it, I would.

Senator THOMAS. Would you advocate or oppose it?

Mr. FARRELL. No; because when we color butter we do not color it to resemble anything but butter. Therefore we are within our original bounds in doing so. We do not try to imitate another product, but these other imitations try to imitate another product.

Senator SMITH. When you color oleomargarine you color it to imitate another product.

Mr. FARRELL. Not always, because nine months in the year butter is yellow; in fact, in May, June, and July it is too yellow.

Senator SMITH. When the grass is green it colors itself.

Mr. FARRELL. Yes. We feed silage in the winter.

Senator SMITH. You color it in winter, when you have a silo, to make the people think they are eating as good butter as they have in the summer?

Mr. FARRELL. It has nothing to do with the quality.

The CHAIRMAN. Do you think coloring oleo has anything to do with the quality of the oleo?

Mr. FARRELL. In this way, that they can use and do use it, if you will permit us to present testimony of oleo—that they use cheaper materials in the colored product, oleomargarine; cheaper materials go into the colored than in the white.

The CHAIRMAN. Do you use a different material for coloring white butter from that used for coloring oleomargarine?

Mr. FARRELL. As I stated a moment ago, there are only 3,000,000 pounds of what is called artificially colored, but by conscious selection of fats and oils they give this yellow color to the oleomargarine, without using that artificial coloring. That is brought about by a combination of palm oil, cottonseed oil, etc.

Senator HUGHES. The Senator asked you if you used the same material to color white butter as to color oleomargarine?

Mr. FARRELL. No; we use a vegetable oil to color butter.

The CHAIRMAN. When white oleomargarine is colored, do they not use chemically as pure a coloring matter as you do when you color white butter?

Mr. FARRELL. I presume so; yes, sir. But they are coloring it to imitate this butter, and when they are using color they use the cheaper grades of grease.

The CHAIRMAN. I understand you to say now, without using any coloring matter at all—from the natural elements and the character of the constituent elements of oleomargarine—it is now produced yellow?

Mr. FARRELL. A great deal of it; yes, sir; and especially that sold in States where they have no laws barring yellow oleomargarine.

The CHAIRMAN. So that there is a yellow oleomargarine that is not artificially colored at all, just as there is yellow butter that is not artificially colored?

Mr. FARRELL. It is a selection. For instance, 3 or 4 per cent of the beef animals; that is, old stags and steers and we will say a Guernsey cow occasionally that has gone to slaughter, are used.

Senator SMITH. Is that taxed, too?

Mr. FARRELL. No; it is only the artificially colored, and then they use June butter, those who have formed butter with this oleomargarine to give it color without artificially coloring it. These are the things they resort to, and that is the reason we are asking for that color law to be retained.

The CHAIRMAN. In other words, they are making a colored oleomargarine without any artificial coloring, because that is inherent in the elements that go into the manufacture and color of oleomargarine?

Mr. FARRELL. They used to, but these last few years, since this present commissioner has been doing business, they have not done so much of that.

Senator THOMAS. If my memory serves me right, I think the present commissioner is in favor of this amendment.

The CHAIRMAN. I know he is very much in favor of it.

Mr. FARRELL. Yes; he is in favor of the taxation feature of it, but I do not know whether he is in favor of that color, because he has told us dairymen that the color is what is giving him all of the trouble, and it enables the moonshiners in oleomargarine to continue. I am quite positive he has told me at several visits to his office that he is not in favor of that color.

The CHAIRMAN. We were not speaking in reference to that; but he is in favor of a flat tax.

Mr. FARRELL. Yes; well, gentlemen, we are too. This tax question is not entering into it with us. We are accused, of course, of holding this 10-cent tax on to make our butter higher; but when you see the figures you will find there are only 3,000,000 pounds a year artificially colored.

The CHAIRMAN. I understand you now to take the position that you are opposed to allowing oleomargarine to be colored?

Mr. FARRELL. Yes, sir.

The CHAIRMAN. That is what you want?

Mr. FARRELL. Yes, sir; we are opposed to the coloring.

The CHAIRMAN. You do not care anything about the rate of tax, but you want a law that prohibits oleomargarine from being colored.

Mr. FARRELL. Not colored, Senator—to be made in semblance of yellow butter, because they have got away with this word "coloring."

The CHAIRMAN. Then, if they are manufacturing from natural products oleomargarine that is yellow, you want the manufacture prohibited?

Mr. FARRELL. The general run of olein oil is not yellow. It is about 70 per cent white.

The CHAIRMAN. Do you mean to say that in those instances where oleomargarine is being manufactured from natural products, and is yellow, you want that prohibited?

Mr. FARRELL. Any natural products they are using, making it yellow, we want prohibited.

The CHAIRMAN. If they are using a yellow fat, instead of a white fat, that makes it yellow, you want them to be prohibited from using that yellow fat and compelled to use white fat, although the yellow fat may be just as pure as the white fat?

Mr. FARRELL. Yes, sir; because when they do that, it is such a small percentage of it——

The CHAIRMAN. Do you think the Government ought to confiscate the yellow fat, or this beneficial use of the yellow fat?

Mr. FARRELL. No, sir; not at all.

The CHAIRMAN. Would not that do it, if that is the most profitable way in which that yellow fat can be used? Would you deny the owner of that yellow fat, or the producer of that yellow fat, the right to use it in the way which is most to his advantage, when that use does not injure the American citizen in his health or in any other particular?

Mr. FARRELL. But it does injure a large portion of American citizens, both consumers and producers of the genuine article.

The CHAIRMAN. Simply because the product happens to be in competition with yours. That is the only way.

Mr. FARRELL. But if this was not selected, and was let run through the whole line of olein oil, it would be 70 per cent white.

Senator THOMAS. Naturally yellow oleomargarine is not affected by the present law at all?

Mr. FARRELL. No.

Senator THOMAS. Then your position, with such a law as you want, would be worse on the oleomargarine owner or producer than the present law?

Mr. FARRELL. It would stop the selection of these yellow materials to make a yellow oleomargarine.

Senator THOMAS. Suppose the law requires, under heavy penalties, that this product be labeled and sold as oleomargarine and not as butter?

Mr. FARRELL. We have that now.

The CHAIRMAN. What per cent of oleomargarine that is being made now is yellow as a result of the use of these yellow fats?

Mr. FARRELL. About the difference between the total and 3,000,000 that are using the artificial coloring, according to the Commissioner of Internal Revenue; the difference would be about 4,000,000 pounds, as 7,000,000 altogether are made yellow.

The CHAIRMAN. Three artificially and four naturally?

Mr. FARRELL. Three pay the artificial-coloring tax, and he does not state whether that went abroad or was withdrawn for the Government's use. He does not state whether it was artificially colored or not. But there are 145,000,000 pounds that are made white that pay the quarter of a cent.

The CHAIRMAN. Then, you think there is more oleomargarine that is naturally yellow as a result of the use of the yellow fats than is artificially colored?

Mr. FARRELL. No, Senator.

Senator THOMAS. Upon which the Government collects a tax?

The CHAIRMAN. Yes; I will modify it to that extent.

Senator JAMES. Is there any oleomargarine that is yellow that is sold on the market?

Mr. FARRELL. Yes; there is some that is about 55 or 60 per cent yellow that is sold.

Senator JAMES. Just naturally yellow without anything being added to it to make it yellow?

Mr. FARRELL. That was just naturally yellow. But in our State we make them put on the ingredients, and we see they have added 14 per cent of yellow June butter to make it yellow.

Senator JAMES. The question I was directing your attention to was, Is there any production of oleomargarine, aside from the addition of things already referred to, that is yellow?

Mr. FARRELL. Not that I know of, unless there is the selection of some yellow oil to make them a shade of yellow like butter.

Senator HUGHES. Does the Government still buy it for soldiers?

Mr. FARRELL. They buy butter for the Government, but I do not know what the term is, but they use it largely for cooking, in the camps and naval vessels.

Senator HUGHES. For soldiers' rations it was oleomargarine.

Mr. FARRELL. As I understand it, in the commissary they do not supply butter to anybody. I believe there is no butter ration, and therefore some of them get oleomargarine. Whether they use it entirely for cooking or as a spread for bread I do not know.

Senator HUGHES. We wonder why we can not get soldiers, and we have not any butter ration.

Mr. FARRELL. I think it would be a poor ration for soldiers.

Mr. CREASY. I would like to ask a question, Senator. Senator Thomas spoke about the cottonseed-oil interests and the packing interests being combined. Is it not a fact that the Beef Trust was driven out of the State of Texas because they had a monopoly of the cottonseed-oil interests?

Senator THOMAS. If you say that is a fact, I will accept it, because, candidly, I do not know. I want to assure you that I am no friend of the Beef Trust. The cattle growers of my State have had ample cause to complain of them, and they complained very bitterly.

Mr. CREASY. I would like to answer that one question in regard to the effect on the price of oleomargarine when it is not colored. In Pennsylvania we have a law to prohibit the coloring of oleomargarine. It was opposed by some of the labor people. We got some very bitter letters. But we put it through the legislature and it became a law, and those people who opposed it have written us since that they were wrong, because they were buying oleomargarine now at a great deal less money than they did formerly. When it was colored it always followed the price of butter, within a few cents. That is the statement that is made here, that I have filed with you, from the president of the Pennsylvania State Federation of Labor.

Senator THOMAS. Let me ask you, Mr. Creasy, a question in turn. The New York World, I think, stated last December, in a column

article on the front page of one of its issues, that the price of butter to the consumers of the United States was fixed, I think, every day, at Elgin, by the edict of three men. I would like to know whether that is so.

Mr. CREASY. I have heard that story. I have been at the produce exchanges, and the price of butter is fixed exactly as the price of wheat. It is bid up and bid down according to the supply and demand. That is what fixes it, the supply and demand.

Senator THOMAS. Then, it is fixed by speculation very largely.

Mr. CREASY. It may be possible that if it gets into the hands of big warehouses——

Senator THOMAS. That is the way the price of wheat is fixed very largely in this country.

Mr. FARRELL. You realize that the large packers of this country are the largest buyers of butter. They store this in June, as I stated before, and it is held until winter, and as the price of this butter goes up or down, as the market demands it, this oleomargarine follows it. You never see a quotation for oleo. As to the Elgin market, 25 years ago Elgin went out of business. It is still quoted. Somebody quotes the market there. In Minnesota we are making 130,000,000 pounds of butter, and 90,000,000 pounds of it goes to New York, Philadelphia, and Pittsburgh.

Senator THOMAS. The article to which I refer gave the names of the three men, one of whom, I think, lives in the city of Chicago.

Senator HUGHES. They sell three or four tubs of butter at a certain price, and that fixes the price. That is the story as printed.

Senator THOMAS. It is supported by what seem to be the statements of a great many men.

Mr. FARRELL. The Assistant United States Attorney General investigated all that.

Senator SMITH. Is not a large quantity of butter that is used made by individual farmers all over the country?

Mr. FARRELL. Not now any more, although we will say half and half. There is about 1,600,000,000 pounds of butter. I would not say that is absolutely correct, but it is approximately that, and about half of that is made in our creameries, and the rest is made by individual dairymen all over the country.

Senator SMITH. At the small creameries, too, all over the country, that contribute to this creamery production?

Mr. FARRELL. Yes, sir.

Senator SMITH. I know there are a number in my State, small creameries.

Mr. FARRELL. What State are you from, Senator?

Senator SMITH. Georgia.

Mr. FARRELL. Yes; you are having a few started.

Senator SMITH. And a great deal of butter made by the individual farmers and sent in.

Mr. FARRELL. Yes, sir; in the Southern States more so. The creamery industry is now getting a good start in the South.

Senator SMITH. The creamery industry is growing?

Mr. FARRELL. Yes.

Senator SMITH. Would you say that in that section half of the butter they use comes from the big creameries?

Mr. FARRELL. Not in our section.

Senator SMITH. I mean in a State like Georgia.

Mr. FARRELL. There is more butter shipped from the East and North to the South than they produce in the whole 10 States, which I classify as the 10 Southern States.

Senator SMITH. I can hardly believe that.

Mr. FARRELL. I can show you the figures, if you wish me to.

Senator SMITH. I do not believe they have a correct statement, then, of what is produced. Have they statistical reports of what each farmer produces, and what is locally used in the immediate locality?

Mr. FARRELL. Oh, no. The only statistics we have as to what the farmer produces and churns for his own use is an estimate. That is the only statistics you can get of that.

Senator SMITH. It is a guess.

Mr. FARRELL. What they consume we figure out. We have 22,000,000 pounds——

Senator THOMAS. It is all consumed, is it not?

Mr. FARRELL. Yes. A large portion of the farm butter goes into the renovating plants for process butter. It is sold at the country store; the balance he does not consume; it is collected to the central points, and is renovated and sold as process butter.

Senator SMITH. In the State of Georgia you go to nearly any farmer's home and eat a meal and you will find nice butter. In the summer it is yellow, and in the winter it is white—clean, nice butter that is made on the farm.

Mr. FARRELL. Yes, sir.

Senator SMITH. You find it everywhere.

Mr. FARRELL. In the East, too.

Senator JAMES. White butter always tasted as good to me as yellow.

Mr. FARRELL. It does, and lots of white butter is superior to the yellow. Color has nothing to do with the quality.

The CHAIRMAN. You made a statement a little while ago which I did not quite catch, and I am going to ask you to repeat it, whatever it was—as to the amount of cottonseed oil that was consumed in the manufacture of oleomargarine.

Mr. FARRELL. I was taking the editor of the Southern Ruralist for that. He said $35,000 annually of cottonseed oil. Is not that correct, Mr. Creasy?

Mr. CREASY. I think so.

Mr. FARRELL. We have figures on that, but we haven't them with us. When I came to Washington, I did not know I would appear before this committee.

The CHAIRMAN. I find that most of the cottonseed oil mills in my State are opposed to this oleomargarine law. If all the cottonseed oil that enters into the production or oleomargarine amounts to only $35,000, why should any cottonseed oil mill man be concerned about a bagatelle of that kind?

Mr. FARRELL. That is what we do not understand. The growers themselves do not understand why they are concerned, and in talking with them personally, as I meet southern farmers occasioanlly, when they see it the way we dairymen look at it, they are not concerned about that small bagatelle.

The CHAIRMAN. Is it not inconceivable that the manufacturers of cottonseed oil should not have some accurate knowledge about the amount of their product that is consumed in this way?

Mr. FARRELL. I presume they have.

The CHAIRMAN. They are undoubtedly under the impression that the amount of their product that enters into this product is sufficient to make it a matter of pecuniary consideration and importance to them.

Mr. FARRELL. I think so; yes, sir.

The CHAIRMAN. Then they must be wholly mistaken about the uses of their own product.

Mr. FARRELL. I think they are mistaken about the portion of it that goes into oleo. A great many of them are lead to believe that this cotton oil goes into oleo, while the great bulk of it goes into this hogless lard, put up by the same people, the packers.

The CHAIRMAN. They probably know that some of it is used in hogless lard, and they know this law does not apply to the hog lard.

Mr. FARRELL. And the southern farmer is opposed to the 10-cent tax, as I understand it.

The CHAIRMAN. I was not speaking about the farmer. I was speaking about the cottonseed-oil manufacturer.

Mr. FARRELL. Yes.

Senator WILLIAMS. I would like to ask the witness one question. Do you contend that oleomargine is deleterious to health?

Mr. FARRELL. No, sir.

Senator WILLIAMS. What is your objection, then, to this amendment? Is it the objection that you are afraid the oleomargarine will be sold as butter?

Mr. FARRELL. The objection to it is the color line, permitting it to be colored to resemble butter.

Senator WILLIAMS. You are afraid that the colored oleomargarine will be sold as butter?

Mr. FARRELL. It is sold as butter.

Senator WILLIAMS. I know it is now, but you are afraid it will be under this amendment if adopted?

Mr. FARRELL. More so than at present; yes, sir.

Senator WILLIAMS. What makes you think so, when this amendment carefully guards it and provides, under Treasury regulations, that it shall be wrapped in paper and sold with a sign around it as oleomargarine?

Mr. FARRELL. Yes, sir.

Senator WILLIAMS. Have you examined this amendment thoroughly?

Mr. FARRELL. Yes, sir.

Senator WILLIAMS. In my opinion it is very much more efficacious in preventing the sale of oleomargarine as butter than the present law.

Mr. FARRELL. Senator, it can be taken out of this package, and, as I stated to the gentleman a while ago, a great deal of the fraud, according to the Commissioner of Internal Revenue, is because they allow a lot of these packages to become empty, and they continue to sell out of that one package. These are the moonshiners in oleomargarine, and these are the 10,000,000 people who eat every day.

Senator WILLIAMS. You mean putting something fresh into the package marked "oleomargarine?"

Mr. FARRELL. Some more yellow oleomargarine goes into this package before it is empty. They have paid the 10 cents tax on the original, possibly, and before they let it get entirely empty, they keep putting in more.

Senator WILLIAMS. That is under the present law?

Mr. FARRELL. Yes.

Senator WILLIAMS. If this amendment is defeated, the present law will stay on the statute books and that fraud will continue.

Mr. FARRELL. The commissioner has done away with a great deal of the fraud.

Senator WILLIAMS. Then, if the commissioner has done away with it, what makes you think that fraud could be any more resorted to under that amendment than now?

Mr. FARRELL. Because the emblem of fraud still remains in the product, and, so long as that emblem of fraud still is in the product, there will be fraud perpetrated on the people.

Senator WILLIAMS. Under the present law?

Mr. FARRELL. Under any law.

Senator WILLIAMS. So that the objection you are making to the amendment upon that score is also an objection to the present law?

Mr. FARRELL. The coloring.

Senator WILLIAMS. Is there an objection to the present law and to any coloring of oleomargarine, whether with or without a tax?

Mr. FARRELL. Yes, sir.

Senator WILLIAMS. But you do not contend that there is any greater opportunity for committing fraud under this amendment than there is now under the present law?

Mr. FARRELL. Yes; because it will allow them to color all of it, whereas now they are only coloring about 7,000,000 pounds annually, and there are 145,000,000 now not colored, and paying this quarter of a cent, where, if they color all of it, there will be some tendency to fraud.

Senator WILLIAMS. But this amendment makes them sell it as oleomargarine in a package marked "oleomargarine"?

Mr. FARRELL. Yes; the present law does, too.

Senator WILLIAMS. And subjects them to a very heavy penalty?

Mr. FARRELL. Yes, sir.

Senator WILLIAMS. So that your sole objection to the amendment is that somebody might violate it?

Mr. FARRELL. The coloring.

Senator WILLIAMS. Somebody might break the law?

Mr. FARRELL. No; they are always doing that.

Senator HUGHES. He says he is against allowing them to sell it colored, whether it is a violation of the law or not.

Senator WILLIAMS. I understand that.

Mr. FARRELL. It is an imitation product.

Senator WILLIAMS. The objection is that they violate the law, and the objection is that under the amendment some of them might continue the violation of the law, but he does not contend there would be any greater violation then than now.

Mr. FARRELL. Yes, sir; I do; because I think there would be a larger amount colored.

Senator JAMES. The incentive to fraud would be greater when the tax was 10 cents than when it is 2 cents, would it not?

Mr. FARRELL. It is possible; yes.

Senator JAMES. The man could make 8 cents a pound by his fraud if the tax were 10, and would only make 2 cents by his fraud if the tax were lower than 2 cents.

Mr. FARRELL. Yes, sir.

Senator SMITH. There is one question I want to ask following the question I asked before. Taking Georgia as an illustration, you stated that half the butter used there was made in the creameries and shipped in?

Mr. FARRELL. Oh, no, sir. I did not mean Georgia. I meant the whole South; the 10 States. I could not select one State, because I have not got their figures and their statistics of shipments of butter going to the South. I am informed that there is more butter shipped South than they produce in the South.

Senator WILLIAMS. Than they send out?

Senator SMITH. No; than they produce for home consumption.

Mr. FARRELL. That enters into the market.

Senator SMITH. You mean that it is sold on the market?

Mr. FARRELL. Yes, sir.

Senator SMITH. You do not mean there is more shipped in than the farmers produce and use than the farmers produce and sell?

Mr. FARRELL. No. I have not the figures as to that.

Senator SMITH. Let me give you Georgia as an illustration. The production in Georgia in 1909 was $27,350,000.

Mr. FARRELL. Yes, sir. I knew Georgia was coming.

Senator SMITH. If you take an average of 15 pounds per person, which I believe is considered quite a liberal estimate——

Mr. FARRELL. It is a light one.

Senator SMITH. A good deal more than two-thirds would be produced in the State.

Mr. FARRELL. Yes. That is probably the heaviest producing State in the South.

Senator SMITH. Except Texas.

Senator JAMES. The fact remains that Georgia is not self-sustaining in the production of butter, does it not?

Mr. FARRELL. Yes.

Senator SMITH. We contribute a good deal to the balance of the agricultural interests in the country, buying from them, just as they buy our products.

Mr. FARRELL. It is growing rapidly. North Carolina and Tennessee are getting into the creamery and butter business.

Senator SMITH. Tennessee produces all of the butter she uses, and ships a large amount of it, does she not?

Mr. FARRELL. Some, so I am told. Some of their good makes are shipped out. In Minnesota our finest butter is shipped to the large markets. We make 130,000,000, and 90,000,000 of it goes to New York, Philadelphia, and Pittsburgh markets.

Senator SMITH. I am very sure you are mistaken about there being produced not more than half of the consumption in the Southern States.

Senator THOMAS. He did not make that statement.

Mr. FARRELL. I am willing to stand corrected, Senator.

Senator SMITH. What you said was that that which entered into the trade——

Mr. FARRELL. Yes, sir; that we shipped more South than is shipped out.

Senator WILLIAMS. There are no statistics of the butter produced and consumed on the farm.

Mr. FARRELL. Only an estimate, as near as we can figure it out.

Senator JAMES. How about the State of Kentucky?

Mr. FARRELL. If Gov. Stanley were here, I could tell you very well. I have a very high opinion of the State of Kentucky, and they are producing a very high product of butter—and some other goods.

Mr. CREASY. I would like to make this one statement about when it is put in packages, that they think they will stop the fraud. That is going to bring to the front another class of perpetrators of fraud who are of a lower degree than what we have now, because when it is in these packages and stamped, these bootleggers, or whatever you will call them, can take this "Jersey Brand" package marked "butter" and take all out of the package and sell it for butter.

Senator THOMAS. Did you ever hear of a revenue law that was not subject to evasion, and was not evaded?

Mr. CREASY. Certainly they are evaded.

Senator THOMAS. By the ingenuity of the taxpayers?

Mr. CREASY. Sure.

Senator JAMES. The very moment they do that, however, the Government inspector could slip up on that fraud, because he could detect the difference between oleomargarine and butter. That is the way they get at the fellows who refill stamped bottles of whisky. They go in and can tell by the test of the whisky, and you will find there will be very little of that, in my judgment, because that would be such an open avenue of ascertainment of fraud that they would not resort to it.

Mr. CREASY. It would be done on rather a smaller scale by more people. I would like to introduce now as the next speaker Mr. Black, the vice chairman of the legislative committee of the National Grange.

The CHAIRMAN. Now, we will hear Mr. B. John Black.

STATEMENT OF MR. B. JOHN BLACK, MASTER OF THE MARYLAND STATE GRANGE, AND VICE CHAIRMAN OF THE LEGISLATIVE COMMITTEE OF THE NATIONAL GRANGE.

Mr. BLACK. Mr. Chairman, I have not gone into this question thoroughly, hardly enough to be familiar with just the question that is before you. The position the National Grange takes on the oleomargarine question, as I understand it, is this: The natural color of butter is yellow. The natural color of oleomargarine, as we understand it, is white. If oleomargarine is manufactured and put on the market, we want that it shall be its natural color.

Senator WILLIAMS. If the natural color of butter is yellow, why do they color it yellow?

Mr. BLACK. During the winter months, when cattle are fed dry food——

Senator WILLIAMS. That is just what I want to get at. They color the winter butter yellow in order to be able to sell it as June butter,

as summer butter, which is itself a fraud upon the consumer. Is there any other object in coloring winter butter except to make it look like summer butter?

Mr. BLACK. The natural color of butter is yellow, and the natural color of oleomargarine is white. If oleomargarine is to be sold and put on the market, we want it to be known that it is oleomargarine. This has been brought out in this hearing, that oleomargarine may be sold in lunch rooms and hotels, and the hotel man may know that he is buying oleomargarine, but not his customers.

The CHAIRMAN. I thought the natural color of oleomargarine was white until this morning. Mr. Farrell has told us, however, that a part of the oleomargarine that is manufactured of beef fat is yellow without any artificial coloring being added to it.

Mr. FARRELL. With the addition, Senator, of the selection of oils of butter to make it yellow.

The CHAIRMAN. Do you mean you can not make that yellow oleomargarine without putting yellow in?

Mr. FARRELL. There is not any on the market.

The CHAIRMAN. I misunderstood you, then. I understood you to say you could make it by the use of yellow beef fat.

Mr. FARRELL. If that were selected.

The CHAIRMAN. And that they were doing that to a very large extent now, something like one-half of the yellow oleomargarine on the market.

Senator WILLIAMS. Would you gentlemen be willing that winter butter should be taxed 10 cents if it were colored?

Mr. CREASY. We had that up a while ago. The point I was just going to make was that you said, or somebody said, if butter was colored it was a fraud. Then it follows that if oleomargarine is colored it is a fraud, and two wrongs never make a right.

Senator WILLIAMS. I am following it up to see if it is a fraud. Do you consider it a fraud to color winter butter yellow?

Mr. BLACK. To imitate the natural butter?

Senator WILLIAMS. To imitate the natural color of summer butter; yes.

Mr. BLACK. That is the natural color of butter.

Senator WILLIAMS. Of summer butter.

Mr. BLACK. That can be done in different ways. It can be done by feeding different foods that will color it.

Senator WILLIAMS. I am not talking about coloring it by feeding. I am talking about coloring it artificially. Do you regard it as a fraud to color white butter yellow?

Mr. BLACK. It is then the natural color of butter.

Senator WILLIAMS. No. Do you regard it as a fraud to color white butter yellow; yes or no?

Mr. BLACK. Not if it is known that the color is put in there to produce the natural color.

Senator WILLIAMS. Would you mind just answering the question? Do you regard it as a fraud to color white butter yellow?

Mr. BLACK. I do not think so, when that is the natural color.

Senator WILLIAMS. Then, if it is not a fraud to color white butter yellow, why is it a fraud to color white oleomargarine yellow?

Mr. BLACK. Because that is not the natural color of oleomargarine.

Senator WILLIAMS. The natural color of winter butter is not yellow, is it? The natural color of white butter is not yellow, is it?

Mr. BLACK. No; the natural color of white butter is white.

Senator WILLIAMS. Then, to color a butter yellow whose natural color is white, you say is not a fraud?

Mr. BLACK. Not when the butter as butter is known to be yellow.

Senator WILLIAMS. That particular butter as butter is not known to be yellow, is it, or it would not be white?

Mr. BLACK. True; it is.

Senator WILLIAMS. Then, if it is not a fraud to color white butter yellow in order that the consumer may buy it as yellow butter, and there is no law to keep you from defrauding him, why is it a fraud to color white oleomargarine yellow? Do you think the coloring matter that goes into it is deleterious?

Mr. BLACK. Because the natural color of it is not yellow. When you start out with oleomargarine, unless you go into some manipulation, the natural color of it is white.

Senator WILLIAMS. Let us take for granted that the natural color of oleomargarine is white.

Mr. BLACK. That is right.

Senator WILLIAMS. And let us also take for granted, please, if you can, that the natural color of white butter is also white.

Mr. BLACK. That is, white butter.

Senator WILLIAMS. Then you say it is not a fraud to color the white butter yellow?

Mr. BLACK. But is not that an unnatural condition, that that butter shall be white?

Senator WILLIAMS. Of course it is, to color white butter yellow, very unnatural, because you change the color.

Mr. BLACK. How about in June?

Senator WILLIAMS. In June your butter is yellow anyhow. Mine is.

Mr. BLACK. Then is it not naturally yellow?

Senator WILLIAMS. That is naturally yellow and you do not color it, either.

Mr. BLACK. How about the oleomargarine that you make in June?

Senator WILLIAMS. All right. We will pass that by. Then I would like to have an answer to this question: Would you consider it right to put a tax of 10 cents a pound upon every pound of white butter which had been colored yellow?

Mr. BLACK. The position we take in this whole matter——

Senator WILLIAMS. Now, would you people be willing to stand a law which put a tax of 10 cents a pound upon every pound of white butter which was colored yellow? You can just answer no. Of course I know you would not.

Mr. FARRELL. I would be willing to stand it.

Senator WILLIAMS. You would not, would you?

Mr. BLACK. I do not know that I am in a position to answer that, because I have not thought enough about it to answer it. I do not think we ought to do it.

Senator WILLIAMS. That is what I thought.

Mr. BLACK. But this is the situation, that the natural color of butter is yellow and the natural color of oleomargarine is white.

Senator WILLIAMS. Not the natural color of all butter.

Mr. BLACK. Except in winter time, when the cattle are eating dry food.

Senator WILLIAMS. And except that in times of long drouth, especially in the South and the southwest, when the cattle do not get good, nutritious grass, the butter is white. It is not so much a case of color.

Mr. BLACK. It is this, that people shall know when they are getting it that they are eating oleomargarine. If they want to eat oleomargarine and know it, all right; but if they are buying butter and getting oleomargarine, that is what we object to.

Mr. CREASY. We want to proceed as quickly as possible, and we have Mr. Lincoln, representing the State Grange of Michigan.

The CHAIRMAN. Very well, we will hear Mr. Lincoln.

STATEMENT OF MR. BURR B. LINCOLN, DEPUTY DAIRY AND FOOD COMMISSIONER OF THE STATE OF MICHIGAN.

Mr. LINCOLN. Mr. Chairman, I am on the legislative committee of the Michigan State Grange—the executive committee. For the past four years I have been deputy dairy and food commissioner of Michigan, and directly in charge of the inspectors.

I will state that the reason our State Grange is exercised over any change in the oleo laws is because we are a State of farms—40, 80, and 160 acres—and nearly all our farmers—probably 95 per cent—do a general farming. They keep a few cows and a few hands, and raise some sugar beets and some beans, and the cows form part of their regular income, and anything that would come in competition and reduce the price of butter would naturally drive them to some other line of raising farm products, and it would stop the keeping of dairy cattle and the raising of beef cattle.

Senator THOMAS. Do you not think a reduction in the present price of butter would be very beneficial to 100,000,000 consumers in the United States?

Mr. LINCOLN. It might, Senator; but our experience there is that our wages are high in Michigan.

Senator THOMAS. Do you think that wages have increased in proportion to the increase of butter since the outbreak of this war?

Mr. LINCOLN. I will say this, that in my own individual neighborhood every farm is for sale, for the purpose of allowing the farmer to go to the city to work out. I say every farm—I will say nine out of ten.

Senator THOMAS. That is natural, too; but is it not a fact that these enormous prices for butter do not go to your farmer clientage at all, or a very small part?

Mr. LINCOLN. A very large percentage. Our creameries there are cooperative creameries, owned directly by the farmers.

Senator THOMAS. If the farmers get it, I would be reconciled to it a great deal more.

Mr. FARRELL. We pay 47 cents a pound for butter in Minnesota.

Senator THOMAS. To whom do you pay that?

Mr. FARRELL. The farmers.

Mr. LINCOLN. Probably 50 per cent of the creameries in Michigan are run by the farmers, and all the money gotten for the butter goes

back to the farmers, because the creameries are run on a cooperative basis.

Senator THOMAS. I have been paying 60 cents for butter in this city, but if most of it goes to the farmers, I am reconciled to the fact. I thought I was paying these middle men.

Mr. LINCOLN. There is a certain proportion of that that goes to the middlemen. I could furnish you as good butter as is made in the United States cheaper than that.

Senator JAMES. What would you say would be the average price for butter paid to the farmer when it is selling for 60 cents a pound in the market here to the consumer? What would be the price the farmer gets?

Mr. LINCOLN. We run this winter along about 40, 41, or 42 cents, so you see about two-thirds is paid to the farmer.

Senator WILLIAMS. Thirty-three and a third per cent profit?

Mr. LINCOLN. Thirty-three and a third per cent profit. It is generally reversed. The farmer gets 33⅓ per cent of what it costs the consumer. That is about the average.

Senator THOMAS. That is a higher average than for the fruit growers of my State.

Mr. LINCOLN. Thirty-three and a third per cent?

Senator THOMAS. Yes.

Mr. LINCOLN. It probably is.

The CHAIRMAN. You mean the middle man gets 66⅔ per cent?

Mr. LINCOLN. Not in butter. In many of the big butter-producing States the farmers are beginning to own their own creameries. It does not take a very costly equipment to produce butter.

The CHAIRMAN. Still, it requires a middle man before the consumer gets it, and the middle men, even in your State, where you have these cooperative creameries, would get 33½ per cent of the price, would they not, of the ultimate price?

Mr. LINCOLN. Hardly there. Right close to these creameries in the city of Detroit it will run about 5 to 10 cents a pound above the creamery price.

Senator WILLIAMS. Do not your creameries up there as a rule sell directly to the consumer?

Mr. LINCOLN. Not as a rule, but a great many of them do sell through parcel post directly to the consumer.

Senator WILLIAMS. And they have daily deliveries where they are near the large cities?

Mr. LINCOLN. Yes. There are some of the big central creameries that deliver to the restaurants and hotels, and so on. So that helps keep down the price of butter. I imagine one of the reasons your butter is so high here in Washington is that you are a considerable ways from the big butter-producing States.

Senator WILLIAMS. I ask that because I know that in the western part of Mississippi we sometimes buy butter from a creamery over in the eastern part, and get it at stated periods by mail.

Mr. LINCOLN. Yes.

Senator JAMES. What per cent of the retail price of butter would you say the farmer receives where hs is not in this cooperative creamery region?

Mr. LINCOLN. I think in Iowa, if I remember correctly, one section has a great many cooperative creameries and the other section has

not. The price of butter fat is about 3 cents a pound more in the section that has the cooperative creameries than in the section that does not have them. I think those are the statistics, or something like that.

Senator WILLIAMS. You mean the selling price, the price they pay the farmer?

Mr. LINCOLN. About 3 cents a pound more.

Senator WILLIAMS. That is, they pay him according to the butter fat?

Mr. LINCOLN. Yes; according to the butter fat. You see, the competition of the cooperative creameries is very keen. They are getting those on a very fine systematic business scale. I think I have described to you the condition of the Michigan farmer. He is a small farmer, and has a few cows as one of his sources of income, and he does not like to see this enter into competition with him.

I would like to tell you some of my experiences as a food inspector, as I was in the field in direct charge of the inspectors for four years, and it was not hearsay, office experience, as I went right into the field, worked with the inspectors, did inspection work myself, and directed the inspectors. We have a law in Michigan against the selling of colored oleo, and we were enabled to enforce that law in every place in Michigan, but in the city of Detroit they had 17 licensed colored oleo stores. We got a list of those, of course, and kept watch of them, and we worked in with the National Government, and they raided, I guess, the majority of those, and found they were perpetrating frauds in regard to taxes. But we found out that all of those stores were selling that as butter. We arrested them repeatedly, and I remember one individual raid that I planned on those stores on Saturday afternoon. I had one of our women inspectors and a man inspector go together, and put some phony packages under their arm and go into each store and ask for 2 pounds of butter. They managed to visit 12 of these stores that afternoon. In 10 stores they got colored oleo; in 1 store they got renovated butter, which under our law is required to be stamped as renovated butter, and it is was not stamped; and in 1 store they got what they asked for out of 12. All of these stores came in direct competition with stores that were doing a legitimate business, and they were cutting the price from 2 to 4 cents a pound below butter. The stores that came in competition with them were always complaining to us because they put out in a window some false signs. They did not state exactly it was butter, nor did they state it was oleo, but it led people to believe it was butter.

Senator JAMES. How would they fix that sign? How would it read?

Mr. LINCOLN. Somewhere near the sign they would have a butter carton, and they would say "Try our 32-cent," or say "Visit our butter department and try our 32-cent."

Senator THOMAS. There is not any doubt that a host of frauds and crimes have been committed under the present law. It offers a premium to the commission of crime. If we inspect the records of the office of the Commissioner of Internal Revenue we find it. I know it to be so in my State.

Mr. LINCOLN. Under this bill, as drawn, there is just one place where I see that fraud can be perpetrated more than any other place, and that is in the restaurants and hotels.

Senator WILLIAMS. You say under this law as drawn. Do you mean under the law on the statute books?

Mr. LINCOLN. I mean under the amendment. Our force of food inspectors in Michigan is so small in number that we get in a store and restaurant about an average of once a year.

Senator THOMAS. Do you not get cooperation from the department inspectors?

Mr. LINCOLN. Of the national department?

Senator THOMAS. Yes.

Mr. LINCOLN. They do not go into the restaurants. They go into the stores. Under our law we had a sign "Oleomargarine used here." That had to be placed in the restaurant, and in about nine out of ten of those restaurants something would happen to that sign. It would get down behind the table, or something of that kind, and they always had about the same excuse, they were just cleaning the wall, and the sign fell down, and they were going to paste it up. But it was there. They would say at once where it was. I used to ask the restaurant keeper to invent a new story. I told them to invent something that was new, and if we would take them into court it would seem to convince the jury that they were cleaning the wall, or the sign had fallen down, or something like that.

The CHAIRMAN. That would look as though the juries were with them.

Senator WILLIAMS. Why did not the fellow put under the sign "Also butter."

Mr. LINCOLN. One fellow tacked the letters inside; that is, he tacked it up so that the letters were inside.

Senator WILLIAMS. Do you not think that every law in the world that attempts to embargo an innocent and nutritive article of human food would be violated?

Mr. LINCOLN. To quite an extent. There is no question of it. But my experience as a food inspector has convinced me that all of the foods have to be guarded against substitutes. We will take maple sirup for illustration. While corn sirup probably has as much food value as maple sirup, the person who buys maple sirup wants maple sirup, and you put a very small percentage of maple sirup with corn sirup and it takes an expert to tell the difference.

Senator THOMAS. The temptation to adulterate foodstuff is too great to resist.

Mr. LINCOLN. Yes. There is a man selling a pure article. He is up against a competition he can not beat. There is a storekeeper right along the street, and here is one fellow who cuts the price, and he puts it on his window, and the other fellows have to adulterate their article or lose the trade. That is the situation with any substitution for a food article.

Senator THOMAS. Why does he not buy some of the colored oleomargarine and put up a sign saying "Colored oleomargarine for sale at such and such a price. It is the same thing as advertised as butter at so-and-so's"?

Mr. LINCOLN. Senator, the fellows who handle colored oleo in our State do not care anything about being arrested. They are the type of fellows who would just as soon be arrested as anything else. In fact, we have them in court all the time.

Senator HUGHES. This would do away with the moonshining aspect of it. In other words, it would not be profitable for them to attempt to evade the paying of the tax.

Mr. LINCOLN. They are putting it in packages.

Senator HUGHES. I mean the fact that we take off the 10-cent tax and reduce both to 2 cents. That would eliminate the profitable feature so far as the moonshiner was concerned. In other words, there would not be that margin of 8 cents.

Mr. LINCOLN. That would be as far as the National Government is concerned, but, you see with us, where our trouble comes in is that they are selling it as butter. The restaurants and storekeepers would all be handling it as butter.

Senator HUGHES. A law of this kind would not affect a restaurant or storekeeper at all, or a hotel keeper. So far as the individual is concerned, it is a much better law than the old law. Do you not think so?

Senator WILLIAMS. When you say it would not affect the storekeeper or the restaurant keeper, you mean it would not affect him any more than the existing law?

Senator HUGHES. No.

Mr. LINCOLN. It would force the colored oleo on the butter interests. I have found a great many amusing instances in regard to buying oleo. Some lady would come in and buy a package of oleo and ask for this little color capsule, and just as one illustration, I was standing in a store in Lansing, and the wife of an alderman came in and asked for the color capsule. She says, "Do you know my husband has been a farmer, and he will not eat anything else as butter, but I am coloring this, and he has been thinking for the last three or four years he has been eating butter."

Senator WILLIAMS: Did you ever hear about the time that Joe Sibley, who was very enthusiastic about the oleomargarine bill, was a judge of an exhibition, and they were giving a prize for the finest butter? Armour quietly put in some oleomargarine and got it on the butter table, and Joe Sibley and his committee gave the prize to the Armour olemargarine.

Mr. LINCOLN. I have heard stories like that. It takes the very best of experts to tell the difference between the taste of butter and oleo.

Senator HUGHES. I just had a request from a representative of one of the largest oleomargarine manufacturers in this country who desires his appearance to be entered here, and asking that he be permitted to file a brief with the committee against this amendment.

The CHAIRMAN. Who is he?

Senator HUGHES. A large oleomargarine man.

Mr. CREASY. In Pennsylvania they do not allow it to be colored. We are enforcing that law, and we have no trouble. Besides that, we are charging the retailer $100 a year to sell it. It has got up in the hands of respectable dealers, and, of course, if this law passes he can not color his oleomargarine and send it into Pennsylvania as long as we have that law, and he is just paying that 700 per cent increased tax.

Senator HUGHES. I will say that this man represented an oleomargarine firm of the State of Ohio, and the statement he made to me—which I presume he will make in his brief—was that these oleo-

margarine manufacturers have conformed very largely to the law as administered by the present Commissioner of Internal Revenue. They put their business on an honest basis. They are selling oleomargarine not colored, and they do not want to pay the additional tax.

Mr. CREASY. That is right. That we have in our brief.

Senator THOMAS. I do not see any objection, Mr. Chairman, if he could get his brief in to-day.

The CHAIRMAN. Let the brief be filed.

Mr. LINCOLN. I will just finish by saying this, that the last four years with us have been a very aggressive and progressive development of the food laws of Michigan, and we have received more criticism that really hurt us in regard to our troubles with this color law than any other one thing, and we fight everybody, from the largest packer down, to enforce the law, and we are uniformly successful in our administration of the food laws. But it seems to me as if in this administration of that color law we have had more trouble in the enforcement of that law, and we receive more criticism, than as to any other law we had on the statute books.

Senator HUGHES. I want to get back to that point I was trying to get at awhile ago. The reason there has been so much difficulty in enforcing this law is that there is a large financial inducement offered for the violation of the law, is there not? In other words, they have made it profitable by law to evade this law. The law in itself makes it profitable to bring about its own evasion.

Mr. LINCOLN. Let me ask you a question, so that I will thoroughly understand what you mean, Senator. A violation of the Federal law?

Senator HUGHES. I mean the Federal law.

Mr. LINCOLN. Or a violation of our food laws, selling it for butter?

Senator HUGHES. I mean a violation of the Federal law, because under the law as it stands now a man can ostensibly be in both businesses.

Mr. LINCOLN. There is certainly an incentive to refill those packages.

Senator HUGHES. Because of the 9¾ cents difference in the tax?

Mr. LINCOLN. Yes.

Senator. HUGHES. That is a strong inducement to a man to refill those packages.

Mr. LINCOLN. It certainly is.

Senator HUGHES. And that has been the basis of all the moonshining frauds that have been uncovered?

Mr. LINCOLN. I think it is, from a Federal standpoint.

Senator HUGHES. I will ask you, from your experience as a man administering the laws, whether the fact that we wiped out that difference would not have a tremendous effect in doing away with the moonshining industry?

Mr. LINCOLN. It would have a tendency to do away with the violation of the moonshine law, but I think it would increase the tendency for the restaurants and hotel keepers and family homes, etc., to use oleo on their tables.

Senator THOMAS. As butter?

Mr. LINCOLN. As butter.

Senator HUGHES. Yes; that may be so. I do not dispute that.

Mr. LINCOLN. I will say in answer to your question that I think you are right.

Senator HUGHES. You know, as well as I do, that there is a floating population of these margarine handlers, as you said, fellows who do not care whether they are arrested or not, who come and go, who drop on a town sometimes like a lot of locusts and set up their stores, and disturb conditions and grab some money, and then get out. All that is predicated upon this difference between the tax on the white and colored oleomargarine?

Mr. LINCOLN. Yes; I think you are right. I found that in 17 stores, almost without exception, oleo was all they handled. They called them coffee and tea stores, but oleo was that they handled.

The CHAIRMAN. Mr. Lincoln, do you not think that the privilege oleomargarine will add more than 2 cents to the market value of that product?

Mr. LINCOLN. Of that oleo?

The CHAIRMAN. Yes.

Mr. LINCOLN. Sure, I think it would.

The CHAIRMAN. If that be true, upon the passage of this law would not practically all the oleomargarine that is put on the market for sale be colored?

Mr. LINCOLN. I think it would, except in the States where they have an anticoloring law.

The CHAIRMAN. So that if all the oleomargarine put on the market by reason of this small tax is colored, you would have no objection to that competition, provided you could be protected against the fraud of selling the oleomargarine as butter?

Mr. LINCOLN. We would not have any objection if we could be protected.

The CHAIRMAN. If that were possible?

Mr. LINCOLN. If that were possible. But I doubt if it is possible, from my experience.

The CHAIRMAN. You would have no objection to the competition with colored oleomargarine if it were sold as oleomargarine? Your objection is that after the tax is paid and it is colored it will not be sold as oleomargarine, but will be sold as butter?

Mr. LINCOLN. I have found that the average family, in talking to them over the oleo situation, do not like it to be known that they are using oleomargarine.

Senator HUGHES. That is the point.

The CHAIRMAN. That is what I am getting at. That is really the gravamen of your objection.

Mr. LINCOLN. When we compel those signs to be hung up in a restaurant, that "oleomargarine is being used here," immediately they take out the oleo.

Senator THOMAS. Do you mean take it out of the sign or out of the restaurant?

Mr. LINCOLN. Out of the restaurant, because they say it is a sign of a cheap restaurant.

Senator HUGHES. If we had a provision in this law which compelled every restaurant and hotel keeper who used oleomargarine to display that sign upon his premises, and that law were enforced, would not that meet most of the objections the butter manufacturers have, I think you must admit that, as far as the wife is concerned, if the

proposed legislation makes it impossible for her to be deceived, she will not be able to get a package of oleomargarine without knowing it, any more than you can get a package of cigarettes or a box of cigars without a revenue stamp on it. I want to find out, for information, if we can do anything to bring these two factions together. I can see the difficulties of administering the law in the case of hotels and restaurant keepers. But there are no difficulties in the way of administering the proposed law so far as private individuals are concerned, as I see it, because under the provisions of this Act, if a woman goes into a store to purchase butter, she can not be given oleomargarine instead of butter, because the oleomargarine must be wrapped in a distinctive package, and bear a stamp affixed under the supervision of the Federal Government. That would preclude the possibility of any individual buying oleomargarine in the guise of butter. Would you not say that was true?

Mr. LINCOLN. Yes; it might be true.

Senator HUGHES. Let us go that far. Is that true or not? I just want to get your opinion.

Mr. LINCOLN. That is, that the housekeeper who is buying it would know it is oleomargarine?

Senator HUGHES. Yes.

Mr. LINCOLN. I think she would.

Senator HUGHES. And that meets all your objections, so far as those individuals are concerned, does it not?

Mr. CREASY. No. The law does not say how the package is to be marked. It says it has to have "oleomargarine" on it, but nothing about the size of the letters, or anything of that kind.

Senator HUGHES. I mean meeting all those objections so that there is no question in the mind of the purchaser of the oleomargarine, or the purchaser of butter, that he is getting what he asks for. That is what you gentlemen want, is it not? That is all you want, is it not?

Mr. CREASY. No, sir; we do not want it to have the same color as butter, because it will follow the price of butter more closely when it is colored like butter.

Senator HUGHES. I just want to find out what you think about it. I assumed from what you said that all you were interested in was keeping this oleomargarine from being substituted for butter.

The CHAIRMAN. No; they go farther than that, and they are opposed to anything that allows oleomargarine to be colored.

Mr. CREASY. That is it.

Mr. LINCOLN. Here are two or three things that enter into that, briefly. You will find families who serve oleo, possibly, who will keep a small platter of butter around so that when they have company they can put the butter on. In regard to these restaurant signs, I have found it is a matter of constant inspection. A man might have his sign up and have it back in the corner, right in a corner where there is only a small portion of that room where you can see what is on that sign, and still he would be sort of complying with the law.

Senator THOMAS. Why do you not make them put it on their bills of fare?

Senator HUGHES. There are a thousand ways of having it done. Suppose the law provided that a public institution like a hotel or a restaurant could not at the same time use oleomargarine and butter?

Mr. LINCOLN. There is the real nub of the question. If you color it so that it represents butter, it makes a competitor in the market of butter, a strong competitor of butter, and naturally the price of oleo will go up toward butter, and the price of butter will go down toward oleo, so that there will not be much distinction in price.

Senator HUGHES. There is no element of fraud in that. If a man wants to buy oleomargarine and wants the colored, is there any reason why he should not have his oleomargarine colored, if he wants it and chooses it, either on account of its quality or price? Is there any reason why he should not have it colored, so long as the element of substitution is altogether removed?

Senator WILLIAMS. Yes, there is a reason. It would decrease the profits of the dairymen.

Mr. LINCOLN. Yes, and consequently they would go out of dairying. The Senator said it would lower the cost to the consumer. It might lower the cost to the consumer, but in the long run it would not lower the cost, because the dairymen would get rid of their cows.

Senator THOMAS. Every interest and every industry that has been subject to a tax since I have been here has presented that argument, that they would be ruined if they were taxed. I confess I am not able to go back in my experience and put my finger on any industry that has been ruined, and very few that have been hurt. Candidly, I do not think, gentlemen, there is a thing in that argument. I may be mistaken.

Mr. LINCOLN. I am not referring to the tax so much as I am to allowing them to sell it as colored oleo.

Senator HUGHES. Of course, this is going to happen. I can see now from the information I have heretofore gotten and the information you gentlemen have given us, that the enforcement of this law is having an effect right at this time—an effect that will be progressive and develop as time goes on—of compelling these market men to make the public take a light-colored oleomargarine, and when that is done, the effect on the butter producers will be just what you say, will it not; that is, uncolored margarine will come into active competition with butter?

Mr. LINCOLN. Yes, sir.

Senator WILLIAMS. I remember when the Waldorf Astoria would not put anything on the table but white butter.

Senator HUGHES. I had breakfast at the Shoreham this morning, and I noticed I had absolutely uncolored fresh butter.

Mr. LINCOLN. Certain parts of the country now demand light-colored butter. Mr. Farrell, who is a butter maker himself, will tell you that certain sections of the country demand light-colored butter and others highly colored butter.

Senator HUGHES. It is a matter, after all, largely of education. In Germany, for instance, now they are subsisting almost entirely on oleomargarine.

Mr. FARRELL. Mr. Jelke has made that statement, that the mistake he made in entering into the business was that he commenced with yellow oleomargarine.

Senator THOMAS. If we should enact a law requiring all oleomargarine sold to be white in color, would it not exclude the use of vegetable oils, or some of them, in the manufacture of oleomargarine?

Mr. LINCOLN. I think it might exclude one or two.

Senator THOMAS. What ones would be excluded?

Mr. LINCOLN. The palm oil.

Mr. FARRELL. The court has ruled against us.

Senator THOMAS. What other oils?

Mr. LINCOLN. I am not so familiar with that end of it as Mr. Farrell would be, who has made a study of it. As I understand it, the greatest element of color that they put in that that they do not put in others is butter—June butter.

Senator THOMAS. You mentioned palm oil. Are there not other vegetable oils perfectly pure?

Senator HUGHES. I will say to the Senator that there is a big industry in this country to produce a substance which will come within the law and will color oleomargarine. That is a separate industry.

Senator THOMAS. What I had in mind was this, that should we require all oleomargarine on the market to be white, we might, by that means, prevent the use of very wholesome vegetable oils now used in the production of pure oleomargarine from being so used, since it will give a color other than white to the composite product.

Senator WILLIAMS. And we would also prevent the use of yellow fats.

Mr. FARRELL. We have now in some formulas in our State 33 per cent of cottonseed oil, which is still about 70 per cent white, much whiter than any butter.

Senator THOMAS. Cottonseed oil leaves the product white?

Mr. FARRELL. Yes, sir.

Mr. LINCOLN. Senator, I have noticed these oleos colored, as he states, by the natural product, and they are not colored as highly as butter is. They have to have an artificial color to get the color of butter.

Senator THOMAS. You disagree in that respect to some extent with what has been said here by other witnesses, and that is that there is some of this oleomargarine that is naturally yellow.

Mr. LINCOLN. Yes; it is naturally yellow, but it is not as highly colored as the butter.

Senator THOMAS. There are different shades of yellow in butter.

Mr. LINCOLN. Yes.

The CHAIRMAN. What these gentlemen want is a prohibition, not only against artificial coloring, but a prohibition against the use in the manufacture of oleomargarine of any element that would give it a yellow color. That is what you want?

Mr. LINCOLN. Yes.

The CHAIRMAN. Which means that you are opposed to the manufacture, and you want the manufacture prohibited, of oleomargarine except it be white oleomargarine?

Mr. CREASY. When we talk about white, it is about like the Churngold oleomargarine. That is the standard we have taken in our bill. There is no oleomargarine absolutely white, but it is as white as paper.

The CHAIRMAN. It is white as we use that term?

Mr. CREASY. We have that all here. It is a light shade, very light, straw color.

Mr. LINCOLN. Before another speaker is introduced, Mr. Chairman, may I add a word in regard to the difference in the price of these

commodities? Oleomargarine can be put on the market for from 8 to 16 cents a pound, while the first cost of producing butter fat is 18 cents; while, with the cost of mill stuff, it costs from $40 to $50 a year to keep a cow in this food, and it is worth at least $30 to sit down and milk her 365 days a year. So there is a wide difference in the cost.

Senator WILLIAMS. Your argument is based upon the idea that it is proper and right to have a protection in favor of an industry in the United States against another industry in the United States.

Mr. LINCOLN. No, sir· only protection against the direct imitation of another commodity.

Mr. CREASY. We have one more witness, Mr. George P. Hampton.

The CHAIRMAN. Mr. Hampton will be heard.

STATEMENT OF MR. GEORGE P. HAMPTON, OF WASHINGTON, D. C., EDITOR OF THE FARMERS' OPEN FORUM.

Mr. HAMPTON. Mr. Chairman, I am one of the committee of three hastily called together by the secretary of the National Dairy Union when he heard that this Underwood amendment would be considered by this committee. As you know, we asked for an opportunity for a hearing next Monday or Tuesday, in order to give time for the representatives of the dairy interests to assemble here and present their case personally. The situation confronting your committee determined you that we would have to have a hearing to-day, and so we hastily prepared our brief, and I am one of the committee of three who prepared that brief, and I respectfully submit to every member of the committee that we want them to consider the points made in that brief as the stand upon which we oppose the Underwood amendment.

We have supplemented that by the presentation of two exhibits which also ought to be carefully considered by this committee, one by one of the most eminent southern men in the agricultural world, the editor of the Southern Ruralist and president of the Farmers' National Congress. The other by the president of the Pennsylvania State Federation of Labor, a carefully prepared document which was prepared for the special purpose of presenting it to the president of the American Federation of Labor and the consideration of the officers of that great labor organization. These documents cover very substantially the important points as to why we oppose this Underwood amendment.

The discussion that I have listened to in the two hours and more that I have been in this room shows conclusively the wisdom of one of the objections that we made to the hasty consideration of such important legislation as an amendment to this emergency revenue bill, and I want to call your attention to that. We said in this brief [reading]:

> We oppose this legislation as a part of an emergency revenue bill because whatever revenue may be received therefrom imposes a grossly unjust urden on the poor, and the amount of possible revenue to be derived therefrom is insignificant compared to the injury it does to the great dairy industry and the dangerous monopoly it fosters. Such legislation, if attempted at all, should be considered in a separate bill and fought out on its merits after the most exhaustive hearings and public discussion.

I submit, Mr. Chairman and gentlemen of the Finance Committee of the United States Senate, that the discussion in this room during the last two or three hours is conclusive proof of the wisdom of having legislation of this tremendous import considered in a separate bill and considered absolutely on its merits.

Senator THOMAS. I agree with you thoroughly as to that proposition, but the activities of the National Congress have become so great, through the extension of its jurisdiction and through the demands made upon it for all kinds of legislative relief, that we have gotten to the point where we can not consider a separate bill upon anything. Nearly every bill we consider at all is a composite bill covering a large number of subjects. We have 31,000 bills, I think, introduced up to this time, in round numbers, in both Houses. It would take one man, I think, 20 years to even read those, and as a consequence what you say, while absolutely true, is becoming a virtual impossibility in national legislation. Hence the omnibus bill, which has no basis to recommend it except the time and the necessity.

Mr. HAMPTON. Mr. Chairman, I have too much respect for the members of this committee and for the United States Senate itself—and I have a growing admiration of the increasing quality of statesmanship I have seen in the Members thereof—to feel for one moment that they want to be parties to hasty, snap legislation on important measures vitally affecting one of the greatest industries of this country.

Senator THOMAS. Or upon any legislation, for that matter.

Mr. HAMPTON. We do say, as the representatives of the dairy industry, that this legislation if enacted is a vital blow to its prosperity, and we ask you to consider the arguments as we have presented them, not in the hasty off-hand statements that any witness may make in answer to rapid cross-fire questioning, but as we have stated in our carefully prepared brief—we admit it is hasty. It has not been prepared with that careful consideration we would like to give to a subject when we present it to you gentlemen, but we have had, as you know, less than 24 hours in which to prepare it, and yet we submit that it presents the proposition in such a light that I do not believe you gentlemen, if you consider what we have said to you, will indorse the enactment of legislation in such a way.

Senator WILLIAMS. You do not mean by that that you did not know that the Underwood amendment to this bill was pending in the Senate only 24 hours ago?

Mr. HAMPTON. Senator Underwood, if my memory is correct, gave notice that he would move this amendment on last Friday.

Mr. CREASY. Not this amendment, but an amendment.

Mr. HAMPTON. This was the amendment, I believe.

The CHAIRMAN. This was introduced on the 2d.

Mr. HAMPTON. There have been lots of bills. There is a bill corresponding to this amendment that has been pending in the House, and an investigation and inquiry among the Members of the House has been very satisfying to us that there was no prospect of it being taken up and considered at this short session of Congress. We have concurred in the wisdom of this, knowing the limitations of the closing session of a Congress, with the great appropriation bills to be considered. With the tremendous emergency confronting the administration and the Congress, in the peace or war situation, we appreciated that it was not an opportune or a wise time to force the consideration

of great measures of this character. That has been the stand we have taken, and we did not know we would have to meet this situation until, as we say, within the last few days.

The CHAIRMAN. I want to say that I think you gentlemen are presenting your case with as much clearness and force and completeness as you could have done if you had had a very much longer time for preparing it.

Mr. LINCOLN. I may say, Senator, that I left home on Monday morning, from Michigan, and we had a meeting on the Friday before of the executive committee, and we knew nothing about this measure. I came down on another measure.

Senator WILLIAMS. In connection with the question I asked a moment ago, I want this fact to go into the record. The Underwood amendment was introduced into the Senate the 2d day of February.

Senator THOMAS. He offered a similar amendment to the act of September 8, 1916.

Mr. HAMPTON. I do not want to take up your time unnecessarily. I know how busy you are, and how things are crowding you. I simply want to say more particularly, in answer to Senator Williams, that we do stand—and I believe you will find, on a careful study of the situation, that the dairy farmers from the Atlantic to the Pacific stand—on the position that the fraud in this measure is wholly due—probably modifying "wholly" very slightly—to allowing oleomargarine to be colored in imitation of butter. It is a fraud on the public, and if this legislation should pass with a color clause in it it will make the Federal Government a party to the fraud. I stand on that position, and will fight it out to a finish on that ground.

No one ever colored butter with intent to defraud. It was to be sold as butter, and anyone knows that butter produced in January under certain conditions is white, and that it is artificially colored. There is hardly a boy or a girl, except probably in the poverty stricken districts of the larger cities, but what knows that color is used, and that in a great many instances butter is white in the winter months. It is colored simply because the demand of commerce is for a uniform product.

Senator WILLIAMS. In obedience to that demand of commerce you do not regard coloring white butter so as to resemble June butter as a fraud?

Mr. HAMPTON. No, I do not; most emphatically no. It is not intended to be colored in imitation of June butter.

Senator WILLIAMS. It is intended, though, to be colored in imitation of something which it itself is not.

Mr. HAMPTON. It is colored on purpose to meet the conditions of the market for butter.

Senator WILLIAMS. And in order to meet those conditions, it is colored to resemble something which it itself is not?

Mr. HAMPTON. It is colored to resemble butter. Of course if you want to make a discrimination between June butter and winter butter and make an implication that one is inferior to the other, or that the coloring of winter butter to imitate June butter is a fraud and can demonstrate that position——

Senator WILLIAMS. I do not say it is a fraud. On the contrary, I do not think it is.

Mr. HAMPTON. If it is imposing on the public, it would be perfectly legitimate and proper and good, sound public welfare legislation to protect the public from the fraud.

Senator WILLIAMS. Then, if it be not a fraud to color white butter so as to resemble yellow butter, I can not see, for the life of me, why it is a fraud to color white oleomargarine. That is a mere argumentative observation, so that you need not answer it.

Mr. HAMPTON. I have too much respect for the Senator from Mississippi, whose career in Congress I have watched for many years, to believe that he is unable to make a distinction between coloring butter and coloring oleomargarine.

Senator WILLIAMS. I do not see any distinction between them.

Mr. HAMPTON. Oleomargarine is colored to imitate butter. It is colored to imitate butter for the express purpose of perpetrating a fraud on the public, in getting a higher price than it is entitled to.

Senator WILLIAMS. It is colored for the same reasons that white butter is colored, namely, first, to meet a commercial demand of public taste; and, secondly, to get a higher price than would be gotten if it was not colored, which is the case with the white butter colored, as well as with the oleomargarine colored.

Mr. HAMTON. Well, gentlemen, I have been looking into this matter for many years.

Senator WILLIAMS. The same as candy is colored. Some people want it colored.

Mr. HAMPTON. Yes. If you want to color oleomargarine a beautiful sea green, go ahead and do it. If you want to color it a beautiful pink, go ahead and do it.

Senator WILLIAMS. Of course, you know, as a matter of fact, nobody would eat green oleomargarine, any more than they would eat green butter. You would not think of coloring your butter green. I would not touch a piece of green butter or of green oleomargarine, either. Neither would you, no matter how innocent the coloring was.

Mr. HAMPTON. Nevertheless, Senator, we maintain, and that is the position we take, that the coloring of butter is not a fraud. It is not a fraud on the public. It does nobody an injury, and it does not increase the price of the product that is colored.

Senator WILLIAMS. I do not think so, either. I agree with you perfectly, and I also say that coloring oleomargarine is not a fraud upon the public, unless the colored oleomargarine is sold for butter. There is nothing in the Underwood amendment that enables that to be done, any more than the present law enables it to be done. Both of them try to prevent it.

Mr. HAMPTON. Senator Williams, you unfortunately were not in the room when our brief was read.

Senator WILLIAMS. I heard all this 10 years ago, when the bill was passing through the House.

Mr. HAMPTON. Then I am not casting any reflection upon your knowledge of the subject, but permit me to say that we did make a brief review of the conditions prevailing throughout the world in regard to legislation affecting oleomargarine. The evidence can be supplemented ad libitum to the showing that the permitting the coloring of oleomargarine does mean fraud. Every country that has had anything to do with oleomargarine testifies to that fact. You can not find anybody who has been connected with the great dairy

industry of this country anywhere in the world, whether it is in the east or the west, the north or the south, but universally testifies that the coloring of oleomargarine is a fraud and an injury. You can go further, and you will find out that even among the oleomargarine people themselves, some of the more honest among them do admit that the coloring of oleomargarine is intended to be a fraud on the public; they can get more money. The uncolored oleo has to meet its own level of price. The colored oleo follows the price of butter.

I do not want to take up any more of your time. Those are the points we wish to make. There are a great many other great questions in this controversy between butter and oleomargarine that are not properly covered in this bill. It will have to come up again. If you permit color in oleo, you have the whole fraudulent conditions to contend with. It is a situation you can not meet by special laws here and other laws there. You can absolutely adjust the thing on a good, common-sense level, by striking at the very root of the evil and absolutely forbidding the coloring of oleomargarine in imitation of butter, and all the other superstructure of laws you would have to have if you do allow it can be wiped off the statute books.

Senator WILLIAMS. How would it be to permit the coloring of any food product any other color than the natural color, its own color, whatever it happens to be?

Mr. HAMPTON. If coloring is not injurious, if the purpose of the coloring is not to perpetrate a fraud, there can be nothing against the public welfare in permitting it.

Senator WILLIAMS. Is not the purpose of coloring every white butter to make it sell at the same price as yellow butter? I do not call that a fraud, but is not that the purpose?

Mr. FARRELL. In Philadelphia, in the markets, there are brands of white butter, as white as oleo, that are selling for the same price as yellow butter. It depends altogether on the customer. Butter was shown to me just as white as oleo.

Senator WILLIAMS. Just a moment ago I mentioned the fact that it was a fad amongst rich people, especially the smart set, for a while, to eat nothing but white butter, and they bought it from certain well-known creameries, that did not adulterate their butter even with coloring matter. I think there is a good deal of sense in it. I think white butter is apt to be purer than butter colored to resemble June butter.

Mr. FARRELL. Just now, when butter is white, it is selling wholesale for 43 cents a pound, while last June's butter is selling for 35, 36, and 37 cents a pound, depending on the grade of it.

Senator WILLIAMS. Yes; if it is last June's butter.

Mr. FARRELL. And that is colored.

Senator WILLIAMS. That is because it is old butter.

Mr. FARRELL. Storage butter.

Senator WILLIAMS. That is a different proposition.

Mr. FARRELL. All this butter that is made and comes in competition with their white butter must be storage butter when it is yellow.

Mr. HAMPTON. I wish to say that the point raised by Senator Williams in regard to the possible fraud in the coloring of butter raises the question on which gentlemen can legitimately dispute, but the point I would make right here is, it is not germane to the

matter before this committee at this time. I do believe that if anybody believes it is fraud in the coloring of butter, it is a perfectly legitimate thing to be brought up and considered on its merits by the United States Congress, and have it properly regulated. That is not a question that is germane to the purposes for which we are here to-day. The question here is on the Underwood amendment being put in this bill; in the form in which it has been presented, we oppose, and we ask you gentlemen, and we ask the Senate of the United States, and we ask the House of Representatives of the United States, to strike it out, or if in their good judgment they do not see fit to do that, to modify the amendment by an additional amendment that we have presented to this committee, which will put in the absolute prohibition of the imitation of butter by coloring oleomargarine.

That is all I wish to say, Mr. Chairman.

Mr. Creasy. We thank the committee for the courtesy you have extended to us in our hearing.

The Chairman. Gentlemen, we have been very glad to have had an opportunity to hear you about this matter, and I want to say that I think you have covered the ground pretty effectually from your point of view.

(Thereupon, at 1.10 o'clock p. m., the subcommittee adjourned to meet at the call of the chairman.)

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