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The United States Senate 74th C.

Report of Proceedings

Hearing held before

SUBCOMMITTEE of the COMMITTEE on

FINANCE

H. R. 5539

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H. R. 5529

Tuesday, August 13, 1935.

United States Senate,

Subcommittee of the
Committee on Finance.

Washington, D. C.

The Subcommittee met in executive session, pursuant to call, in the Committee Room of the Committee on Finance, Senate Office Building, Senator Tom Connally (presiding).

Present: Senators Connally (presiding), Bailey, Guffey and LaFollette.

Also present, Senators Nye and Clark.

P R O C E E D I N G S

Senator Connally: The Subcommittee will please come to order. Senator Guffey, if it is agreeable to you, I thought we would start off with Mr. Brown, who is representing the Treasury.

Senator Guffey: That is perfectly agreeable.

Senator Connally: And get the governmental views of these matters first, and if we have any time left we will hear Mr. Flynn.

Is Mr. Brown here?

STATEMENT OF HERMAN OLIPHANT
REPRESENTING THE DEPARTMENT OF THE TREASURY.

Mr. Oliphant: I would like to say that I am Mr. Oliphant and that on behalf of the Treasury in introducing Mr. Brown that, as you know, the tax provisions of this bill extend to some 190 pages, and the taxing problems raised are both numerous and complicated.

The Treasury has been working on them during the past sixty days or more, and real progress has been made. However, it is only fair to say that with the press of other things that has been upon the Treasury, this part of the Treasury staff having to do with the work of the Congress, it has not been possible for the Treasury to complete its work on the bill.

In general, I would say that it is in such shape that this question of policy may well be before the Subcommittee; namely, that it was thought wise the bill could be enacted -- I am speaking now only of the tax provisions in its present form -- with the thought that the tax experts of the Congress and the Treasury staff would continue their work on the bill and submit to the next session of Congress such perfecting amendments as might be necessary.

Senator Connally: It is your thought, then, as it is mine, for that matter, that it is impracticable to enact this legislation at this session unless we are to have a prolonged session, and that in the meantime, between now and the next session, the Treasury and our own experts here might give the

matter intensive consideration and be better prepared to act next session than we are now?

Mr. Oliphant: I certainly would echo that sentiment; that is, if the Treasury could do just as it pleases, and the convenience of the Treasury only had to be considered, it would be perfectly agreeable to us to have a lot more time to put on the bill.

Senator Connally: That would be particularly true with us, because in the meantime we will supposedly have this other general tax bill out of the way.

Mr. Oliphant: Yes.

Senator Connally: And our experts could devote their whole attention to this particular matter between now and the next session of Congress.

What do you think about it, Senator Guffey?

Senator Guffey: I agree with you. I am sorry to see it put off. I am in sympathy with the purposes of the bill and the legislation entirely, but I do not think we have it sufficiently complete, and obviously if the Treasury Department can not give us the figures I do not see how we could enact it at this time.

Senator Connally: Of course this is an executive session, and we do not intend to publish what happens in this session. And if it is agreeable, Senator Guffey, we will go

ahead with Mr. Brown and let us get what temporary views the Treasury has.

Senator Guffey: I would like to hear Mr. Brown and I would like to hear Mr. Flynn.

Senator Connally: We will now hear from you, Mr. Brown.

STATEMENT OF RALPH W. BROWN

SPECIAL ASSISTANT TO THE GENERAL COUNSEL OF THE DEPARTMENT OF THE TREASURY.

Senator Connally: You are of the General Counsel's office?

Mr. Brown: Yes, special assistant to the General Counsel. I am one of Mr. Oliphant's assistants.

Senator Connally: Mr. Brown, this is H. R. 5529, the so-called "Take-the-profits-out-of-war bill." It was reported by the Munitions Committee first, and then referred to the Committee on Military Affairs for consideration of the military aspects of the legislation, and it is now before the Finance Committee for consideration of the taxing features. So those are the matters that we would like to have you discuss as to what study the Treasury has been able to make and such other general observations as you care to submit.

Mr. Brown: As Mr. Oliphant said a few minutes ago, this is a long bill. The present draft covers 191 pages and it is intended to operate as a substitute for existing revenue laws in the event of war. It therefore must cover in its features practically all the provisions of existing law.

The incident of the tax and the burden of the tax is heavy, and for that reason any inequalities and any opportunities for evasion which at present exist in the law are brought into relief in this act, and necessarily so.

The only reason I mention that is because we who must administer the law naturally are concerned with the opportunities for evasion, and those of us who are interested in the social and economic effects of legislation naturally are interested in how this bill will operate and burden the various classes of our citizens.

Now this tax, with those general views in mind, in its framework is, so far as corporations are concerned, erected on the basis of Section 701 of the Revenue Act of 1934, the capital stock tax.

Under that section, corporations are permitted to declare their own value of the capital stock.

Coupled with that is an excess profits tax in Section 702, the primary purpose of which was to insure that corporations put a fair value on their capital stock, or to pay the penalty in the form of excess profits if they did not. The capital stock tax is not comparatively such a heavy tax.

Senator Connally: You are aware, of course, that the pending revenue bill, which we expect to enact in a few days, revises this?

Mr. Brown: I was going to mention that, Senator.

Senator Connally: All right.

Mr. Brown: It imposes a tax of \$1 per \$1,000 declared value.

Now, probably from the point of view of a capital stock tax that, while far from being perfect, is about the best basis that has yet been worked out by your tax experts. But it is rather different in its purposes from the proposed tax. The proposed tax is to use that adjusted or declared value as the basis for imposing a tax on profits, not excess profits exactly, but almost all profits, and the first problem that it would seem to me that it presented for your consideration is whether that is in fact a sound basis upon which to erect the structure of this tax. Whether it is or not is perhaps a question of fact rather than of law, from which the Committee's experts, particularly the experts on Senator Nye's committee, are better prepared to say than we are.

There is some reason to believe that many taxpayers, many corporation taxpayers, in fixing the value of their corporate stock, did so on this theory: You recall that the tax imposed is a 5 per cent tax over 12-1/2 per cent of corporate earnings.

Senator Connally: That is the old present law?

Mr. Brown: That is the present law. Many corporations merely multiply that by eight in fixing their value of their corporate stock. Now whether they were encouraged to do that

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or not is a matter of debate. But the fact is a great many of them did. And a great many of them in the depression in determining the value of their capital stock used various methods. If they anticipated good times they may have done one thing. If they anticipated the continuance of hard times they may have done something else.

Senator Connally: You may go right ahead and proceed with your testimony, but I have to leave at this moment, although I will be back in about two minutes.

Mr. Brown: As I say, those are some of the points which no doubt have been considered, and which seem to me deserve your careful thought.

Now as I said in the beginning, when you impose a tax which has the weight and burden that this tax purports to have, inequalities and inequities that exist in our present legislation, particularly the Revenue Act of 1934, are brought into relief. Also, there are many more times the incentive for evasion where the only way a man may have a substantial amount of money left is by exercising his ingenuity to avoid the tax, if he may. And if he is unsympathetic with the tax, or is the kind of person who will evade, if he can, to evade the tax, that is entirely apart from the objectives of the bill, which I may assume that all of us here are generally in sympathy with.

The purpose in mentioning it again is merely to see that it requires the utmost care in draftsmanship and consideration of many problems which in the past we have been unable to let slide or postpone for future consideration.

I think many of those probabilities have been given the earnest thought of Mr. Nye's committee, and no doubt of this committee, and some of them have been tackled in one way or the other, but because of the great possibilities and the incentive for evasion, it seems to me that this bill needs to be considered with greater care and to be subjected to the analysis of more people and more points of view than perhaps any other piece of legislation that has come before this Committee in recent times.

The bill in some of its provisions increases enormously the administrative burden placed upon the Bureau of Internal Revenue. It imposes certain positive duties that the Commission of Internal Revenue has not had before. And in other cases it merely increases them, but increases them enormously.

Mr. Flynn: Would you indicate those, Mr. Brown?

Mr. Brown: Pardon me?

Mr. Flynn: Could you indicate some of those?

Mr. Brown: Yes; I would be very glad to.

For example, on page 20 of the bill, in sub-paragraph (1) that provision is a provision which imposes on the tax -- let

me say first that the bill contemplates the taxpayers instead of paying annually, shall for war purposes in order that the revenue may become immediately available, pay the tax on a quarterly basis. They are required to estimate the tax for each of the first three quarters, and to estimate it as accurately as may be, and in good faith. This provision imposes a penalty of 10 per cent. of the amount by which such a tax due and payable for the fourth quarter of any year, pursuant to the return filed with the provisions of this Title exceeds one-fourth of the total amount of such tax for the entire taxable year.

Then it goes on to say, "unless it shall appear to the satisfaction of Commissioner that such excess is not due to the withholding of amounts properly apportionable to the first three quarters of the taxable year."

Now that, it seems to me, is an illustration of an affirmative duty on the Commissioner to do something. In other words, if perchance the tax for the fourth quarter is out of line with the estimates of the one quarter of the entire taxable amount this tax penalty applies, unless the Commissioner does something.

Is that not so, Mr. Flynn?

Mr. Flynn: Yes. I think the Commissioner has the right to impose the penalty and to make the estimate.

Mr. Brown: But it seems to me that the set-up of this

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provision --

Senator Guffey: (Interposing): Is it mandatory?

Mr. Brown (continuing): -- is such that he must do something, the tax does apply unless the Commissioner makes this finding, which means of course that the Commissioner must, of course, do something about it.

Mr. Flynn: I seriously doubt that, Mr. Brown.

Mr. Brown: Now, there are other --

Mr. Flynn (interposing): It says that "unless it shall appear to the satisfaction of Commissioner that such excess" shall be due to the withholding of amounts properly apportionable. In other words, the Commissioner has the duty first to examine these things, and, unless he expresses his dissatisfaction, the tax would stand.

Mr. Brown: Even if that is not so -- if you will allow me to go on -- I will refer you to some other concrete instances.

Senator Nye: Mr. Brown, from the standpoint of creating more work, on that ground alone, it is quite anticipated, is it not, in the event of war, there is going to be more work on all of the Departments?

Mr. Brown: I think that is reasonable.

Senator Nye: It is to be anticipated?

Mr. Brown: Surely.

Senator Nye: You were not meaning that some of these

burdens were impossible of accomplishment?

Mr. Brown: Oh, no. What I mean is this: As an illustration, for the matter of these details of draftsmanship I think we all agree, even in war time, we do not want to create unnecessary work, and possibly through further careful consideration of many of the provisions of this bill we may arrive at more economic and more artistic ways of doing things than perhaps has been possible to date.

Mr. Oliphant: I would like to make it clear, Senator Nye, that as I understand it Mr. Brown is not urging any of these things for not passing the bill at this time.

Senator Nye: I understand that.

Mr. Oliphant: I think that is the position of the Treasury on that. He is proceeding with the discussion on the theory that what you wanted was a discussion of further details that needed policy.

Mr. Brown: Now, I do not believe the Committee wishes this morning to take time to go into the matters of details of draftsmanship.

There are throughout the bill in various spots provisions which seem to us not to be entirely clear, either through inadvertence or pressure of time of getting out the draft and it does not seem to us the bill has clearly stated what the thought was.

For example, on page 28, they are talking about the losses, or deductions from gross income at the bottom of the page.

Senator Connally: What page?

Mr. Brown: Page 28, Senator, line 19.

This is just illustrative. It does not seem to us that the following ten or twelve lines really say anything. I think the thought is clear, but it just illustrates the need for polishing up. No doubt if that was all we had to consider that could be disposed of very readily. I only offer that as an illustration of what is inevitable in a bill of such magnitude where we do not have a chance, all of us, to sit down and work on it.

There are other matters which would seem to us to deserve consideration which are not clear; at least, they are not clear to me. For example, on page 30, under the heading of "Depreciation."

Senator Connally: You mean there is no standard set, just leaving it up to administrative officers?

Mr. Brown: Pardon me?

Senator Connally: I say on the ground there is no standard set, just leaving it to the discretion of the administrative officers?

Mr. Brown: That is one thought. But here is what I was going to mention particularly -- I am referring to the language starting on line 15 -- "In the case of property held

by one person for life with remainder to another person, the deduction shall be computed as if the life tenant were the absolute owner of the property."

Mr. Flynn: What page is that?

Mr. Brown: Page 30. (Continuing) -- the absolute owner of the property, and shall be allowed to the life tenant."

Mr. Flynn: That does not correspond with my bill.

Mr. Brown: The draft I am working from is one of the calendar day June 14th. Is there a later one?

Senator Connally : Here, Mr. Flynn, is the bill.

Senator Guffey: It is page 30.

Mr. Brown: Now, I suppose the purpose of that is to make sure that the depreciation that may be taken shall not exceed 100 per cent. But in attempting to arrive at that result it seems to me that the life tenant is given a rather unusually favorable consideration.

You take a case of this sort: Suppose the value of the estate was \$100,000, and suppose the life beneficiary was rather well along in life, and according to the actuarial basis did not have a very great life expectancy; assume, for example, his life estate was valued at \$20,000. Suppose the fair, annual depreciation for the property was 5 per cent. In that case the life tenant would be entitled to take a depreciation allowance of \$5,000 a year, which in four years

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would amount to \$20,000, or the total value of the life estate. Now it would seem to me fairer perhaps in a case of that sort, if instead of allowing the life tenant the entire \$5,000 if he should be allowed only that proportion which the value of his life estate bore to the value of the total estate, or in the illustration I gave, if you allowed a depreciation allowance say of \$1,000.

Senator Connally: In other words, the depreciation would affect the residuary holder of the property just as well as it would the income of the life estate?

Mr. Brown: Certainly. Now I do not raise that because I imagine for a moment you have time to consider this morning all these details, but I just raised that as an illustration of some of the problems that with more time at your disposal you would be glad to consider and would want to consider.

Of course the rates to be imposed would seem to be almost entirely a question of policy for the committee and for the Congress, but we have to deal with realities, and I suppose that even in war time we must face the fact that the people have been living according to fair standards of living, they have incurred various permanent obligations that are hard to unload at any particular time - perhaps "unload" is not the proper phrase, but to arrange and adjust, and there are widows and there are people dependent upon fixed

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incomes to a considerable extent, and an attempt has been made to deal with those problems. But if you take the case, for example, of a widow whose income is derived largely say from preferred stock of corporations; suppose there was also mixed in that some common stock. I think it is fairly clear that the corporation, if it paid any common stock at all under the provisions of this bill, would be an unusual corporation, and under the rates imposed there is at least reason to believe that they might have difficulty in paying the preferred stock dividend, but that, as I say, is purely a matter of policy which I do not pretend to go into.

But we all know that our tax laws do have social and economic effects, and we may not entirely close our eyes to that fact. And so I suggest in a field where perhaps, which is not controversial, the desire to look after one's wife after death and minor children and so forth, that from the point of view of trusts estates and matters of that sort we might wish to give some consideration to features of that nature.

Beyond that I think in a general summary that I do not know that the Treasury can add very much which would be helpful.

Of course there are some provisions of the bill, which because of their severity it may be claimed by some that they go to the point of confiscation. I think one answer to that

possibly is that in addition to the taxing powers we have the war powers to fall back upon, and what might possibly be considered confiscatory taxation on an unreasonable classification in time of peace when coupled with the war powers we may find some comfort there. But, nevertheless, it seems to me that your experts would have to consider some of the provisions from the point of view whether we may go so far.

Senator Connally: In other words, whether we should go so far as to probably cripple our power to make war, is that the idea?

Mr. Brown: Senator, I am not really attempting to pass on that because I do not feel qualified, because that obviously suggests -

Senator Connally: (Interposing) There is that question, of course?

Mr. Brown: There is of course that question. And that is a matter for economists, industrialists and other people to pass upon. I would not feel qualified.

Senator Connally: In other words, you take a munition plant, whatever may be said about the munitions, if you had war you would have to have them, and if there was no substantial inducement for them to make a profit out of making the munitions they might not engage in it to the extent or with the industry and urge that they would otherwise? Is that the suggestion?

Mr. Brown: That was not the thought I really had in mind. Of course, I appreciate -

Senator Connally: (Interposing) I used that merely as an illustration.

Mr. Brown: Yes. That problem does present itself. And I know that Mr. Flynn and Senator Nye and members of his committee have views upon that subject.

How far we may assume that the profit motive is necessary in time of war as a basis for speeding up production and bringing to a successful conclusion war, is a matter of psychology and debate that I again do not wish to go into.

What I was thinking of was from the point of view of how far under the powers granted to the Federal Government we may go in certain provisions, and those questions are raised because of the possibility that they might/^{be}claimed to be confiscatory. Now that arises in two ways, both from the point of view of the rates involved, and from the point of view of classification of certain kinds of taxpayers, and that I judge is a matter for legal discussion and for debate among lawyers, rather than on the economic basis of the bill.

As Mr. Oliphant said, the Treasury does not wish in any way to suggest opposition to the bill. The bill is undoubtedly meritorious. All forward-looking people probably would be sympathetic with its purposes. It is only that we desire that the bill shall be administratively feasible and that its bur-

dens may be as fairly distributed as possible that we are here and wish to suggest if there be time the work could be improved upon. And that does not mean any reflection upon those who have worked so hard on the bill to date, because it is a large job which required considerable time, money and much hard work.

Senator Connally: Any questions?

Senator Nye: Mr. Chairman, might I inquire of Mr. Brown

Senator Connally: (Interposing) Yes, Senator Nye.

Senator Nye: (Continuing) - would the time between now ^{and} ~~the~~ middle of December be sufficient so that at the very beginning of the next Congress there could be laid before this committee a draft that would be in keeping with the thought, that is that of the Treasury Department and the drafting authorities of the Congress?

Mr. Brown: I should think so. I would like to suggest though that if that is what you have in mind that experts should be immediately put to work and that they should so far as may be possible ~~to~~ devote all of the time between now and then to that job.

Senator Nye: The set-up that occasions my question, Mr. Chairman, follows what has been a year of large insistence for action.

The President last December insisted we ought to do that this session of Congress.

In January, members of the committee, which were having to pass upon the availability of money for a continuation of the work of the Munitions Committee, were very insistent that if action was not taken at this Congress we could not anticipate that there would be any action during a Congress in an election year.

So I am asking now if we cannot get action at this Congress to accomplish it as quickly as we know how when the new Congress convenes, and before it becomes, what it assuredly will, a political Congress.

Do you think, Senator Connally, we might hope to get somewhere very early in the next Congress on this?

Senator Connally: I do not know how early, but ^{it} seems to me before this session is over we might.

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Senator Guffey: If we had the bill drafted early from the Treasury --

Senator Connally (interposing): Of course, I do not suppose we could expect the Treasury to draft the bill. We would probably like to have their services, but we would probably have the drafting experts of the Committee do that.

Senator Guffey: Yes.

Senator Connally: Is not that right?

Senator Clark: The tax features of the bill have already been prepared by the drafting experts of the Finance Committee, that is, Mr. Parker, who was in consultation with the Munitions Committee in the drafting of the bill.

Senator Connally: Of course he may have drafted it, yes.

Mr. Flynn: No; Mr. Parker did not draft it. It may be a good idea, Senator, if a little brief history of that were made to this Committee so you will understand what has been done on this bill.

Senator Connally: We will give you a chance to do that a little later.

Mr. Flynn: Yes.

Senator Connally: Are there any other questions? (no response). All right. Now let us see what is the pleasure of the Committee about Mr. Parker. He has gone downstairs, but we can get him back.

Mr. Oliphant, is there anybody else from the Treasury you think we ought to hear?

Mr. Oliphant: No, there is nobody here.

I would be glad to answer, if I may, Senator Nye's question on behalf of the Treasury.

Senator Connally: Very well.

Mr. Oliphant: I shall undertake, Senator, on behalf of the Treasury, to provide the man-power necessary between now and the first of the year to make all the contributions that the Treasury can make to the drafting of the tax bill, that is, all the contribution or the assistance that we can give Mr. Parker and his staff. I am willing to undertake to do that.

And I again want to repeat what I said at the outset. The suggestions which Mr. Brown made have not been interposed as a reason for not enacting the bill at this time. It would be perfectly feasible, if in the judgment of the Committee it was desirable, to leave this perfecting of the tax provisions so far as they could not be taken care of now, we will say, to some sort of omnibus tax bill that you might have later on.

I also want to repeat that if you had only the Treasury's convenience to consider, why it would be perfectly agreeable to us to have a lot more time to put on the bill, as we want

all the time we can get, because we have been crowded with a lot of work this session, as you probably know.

Senator Connally: Suppose you phone Mr. Parker, Mr. Chesteen.

Mr. Chesteen: Mr. Parker will be here in just a few minutes.

Senator Connally: While he is coming, we would be glad to hear from you, Mr. Chesteen. Give your name.

STATEMENT OF G. D. CHESTEEN.

Mr. Chesteen: G. D. Chesteen. I am not authorized to speak before the Committee.

We did some work on this bill with Mr. Flynn; that is, he brought his bill to the office and we assisted him in doing some detail work on the bill. As far as the policy is concerned, and the general structure of the bill, it was all by Mr. Flynn and his committee.

Senator Connally: In other words, you just assisted us to the mechanics of the bill?

Mr. Chesteen: That is right.

Senator Connally: And they took what they wanted to?

Mr. Chesteen: That is correct.

Senator Connally: And advised with you as to how to draw it to accomplish those results?

Mr. Chesteen: That is right.

Senator Connally: And all matters of policy came from the Munitions Committee?

Mr. Chesteen: That is right. I might say I participated in the auditing of the war returns of the war manufacturers altogether for a number of years.

Senator Connally: In the World War?

Mr. Chesteen: Yes. That was from a section that I happened to be in.

And of course I have gained certain experience from the auditing of the large manufacturers; for instance all the steel companies, all the powder companies, and practically all the large manufacturers.

The tax laws that we had during that period operated in very queer ways. In some instances the company was worse off after the war than if we had never had a war. In other instances, of course, they tremendously benefitted by the war. And there is a wealth of experience in those returns in the Bureau's files of our experience during the war and how those tax returns operated. That, I think, would form a good background for any further study of this bill.

Senator Connally: Mr. Parker has arrived. We will hear from you, Mr. Parker.

STATEMENT OF L. H. PARKER.

Senator Connally: Mr. Parker, as you know, this is a

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Munitions Committee bill, and was referred to the Military Affairs Committee, and is now before the Finance Committee for action on the tax features of the bill.

The Committee is considering the matter of postponing any definite action until the next session of Congress in view of the probabilities of an early adjournment, and the rather large and complex scope of this particular measure, and we would be glad to hear anything you care to submit about the tax features of this bill, both as to policy and as to its mechanics. This is an executive meeting.

Mr. Parker: Mr. Chairman, I gave some study to the bill, two or three weeks, some months ago. Of course, since the President's tax message I have put no further time on this bill. In fact I have not read the bill in its present form since reported out from the Military Affairs Committee.

In the original bill we found some defects, mostly minor defects, which I think, or I understand, have been cured in this bill.

There are, of course, many major questions of policy which if you want a bill that meets with the views of the Committee would require a long discussion.

As far as the Joint Committee staff is concerned, of course we are still involved on the tax bill. We will be required more or less on the floor of the Senate. It will

be more or less impossible for us to give our usual study to the bill for the benefit of the members of the Committee on the general policies of the bill.

Of course, I think it is very wise that we have a bill enacted which will automatically come into effect upon the declaration of war. That has been considered advisable, I think, for a long time. We certainly know that it would have been very advantageous if we had had such a bill in the World War. It was very unfair and very unsatisfactory for instance when our real War Revenue Act of 1918 was enacted. You will recall in that Act that although it was started in June, 1918, during the War, it was not passed until February 1919, several months after the date of the Armistice. And it was made retroactive. And on all those profits of 1918, nobody knew how they were going to be ~~taxed~~ until February of 1919. That is not fair to the taxpayer, and it is not fair to the Government, and the revenues do not come in fast enough the way they should come in. Of course, you had a War Revenue Act of 1917 that went part of the way, but it was not nearly as heavy in the tax as the 1918 Act. The 1918 Act was really a well-considered war-revenue bill. The 1917 Act was very hastily put together.

Senator Connally: The Act of 1918 did bring in a lot of money, though, did it not?

Mr. Parker: Oh, yes, it did bring in a lot of money after the war, but not during the war.

Senator Connally: Yes. But it was on the war profits?

Mr. Parker: That is correct.

Senator Nye: You are not meaning that the Act of 1918 dealt with severally all war time income?

Mr. Parker: It was intended to do so. It does not go of course as far as this bill.

Senator Clark: The distinctive feature about this bill, Mr. Parker, is that you intend not only to tax war profits, but all profits and every other great income during war on the theory of pay for war as you go, and not creating a tremendous inflation by the skyrocketing prices due to war, and with its consequent depression. The distinctive feature of this is not its intent to tax war profits, but all profits of all incomes.

Mr. Parker, I have nothing to say against that policy, Senator Clark.

Senator Clark: I was just pointing that out as being entirely distinctive of the theory of the 1918 Act.

Senator Connally: The 1918 Act taxed all profits, of course.

Mr. Parker: The taxes in the 1918 Act were rather heavy. The normal rate on individuals was 6 per cent and 12 per cent.

the two normal rates.

The excess profits tax went to 65 per cent.

And then there was a war profits tax on war industries going to 80 per cent.

The taxes did bring in considerable money.

Senator Nye: Mr. Parker, Mr. Flynn and those who assisted in drafting the bill have estimated that had this bill been law during 1917 and 1918 --

Mr. Flynn (interposing): The Treasury officials.

Senator Nye: Oh, the Treasury officials estimated this, that had this bill the law in 1917 and 1918 the income of the Government during those two war years would have been greater than was the outgo of the Government during those years.

Have you given any thought or afforded any check on that finding at all?

Mr. Parker: No, I have not. In the aggregate, though, it does not look unreasonable. That is, if you take the two years together, take the whole war period for 1917 and 1918 together. 1918 expenditures, as I recall it, were about 18 billion, whereas 1917 expenditures were only about 7 billion, just talking from memory. If you add those together it is 25 billion. It is possible we would get the 25 billion. Whether we would get 18 billion in 1918 alone or not I do not know.

Senator Clark: That included loans.

Senator Nye: That included loans, did it not, to our allies?

Mr. Parker: The 18 billion?

Senator Nye: Yes.

Mr. Parker: I think it did. I think that is just what we showed on those expenditures, 18 billion.

Senator LaFollette: I suppose it is already in the record, but if it is not I would like to direct attention to a thing that is pretty obvious, but I have discussed it before with Mr. Parker, and that is the fact that after we got into the last war it took us so long to get a real War Revenue Bill worked out, and on the statute books. We had permitted a tremendous amount of profits to go over the dam, so to speak, before our war taxation ever began to bite in.

Mr. Parker: Exactly.

Senator LaFollette: And while those rates were ridiculously low -- perhaps I am a little prejudiced on that fact, in view of the fight my father made to make them high -- nevertheless, it is one of the real justifications, as I see it, for the enactment of this legislation in time of peace, because the experience in the last war has clearly demonstrated that if we wait for the war to come on, by the time we get around to re-writing a tax bill commensurate with the necessities and expediencies of a war crisis the big bulk of our profits may have passed without taxation, and be in the hands

of war profiteers.

Senator Connally: Mr. Parker just touched on those points.

Mr. Parker: I just pointed out, Senator, the 1918 Act, which was the highest war revenue act, although started in June, 1918, it was not passed until February, 1919, three months after the Armistice.

Senator Connally: Although it carried retroactive rates on 1918.

Mr. Parker: Yes.

Senator LaFollette: Yes.

Senator Connally: Now, then, Mr. Parker, as I understand you, then you feel like your staff is so engrossed now with the pending revenue bill, and will be during the debates, that you could not give this particular measure much study during this session?

Mr. Parker: It is just physically impossible, Senator.

Senator Connally: Is there any other matter that anyone wants to ask Mr. Parker about?

Senator Nye: Mr. Parker, we asked Mr. Brown and Mr. Oliphant, and had assurances from them that the time between now and January 1st would be ample to whip this legislation into that shape that you and the Treasury Department would like to have it in before action was taken by the Committee. Do

you think that is possible?

Mr. Parker: I think so. I do not have any doubt but what the Chairman of the Committee will authorize the staff to properly cooperate with the Treasury Department, and that we could in that time work out something.

Senator LaFollette: Mr. Chairman, in order to facilitate that action, I move that this Subcommittee report to the full Committee a recommendation that the Joint Committee staff be instructed to cooperate with the Treasury Department.

Senator Connally: Mr. Parker, was there something else you wanted to say?

Mr. Parker: I was just going to point out if work is immediately started on this bill by the Treasury Department, and perhaps my own staff going through it -- there is a great deal of work that has been done here, and many meritorious general policies have been set forth -- in the event of war none of this work would be lost; that is, if war is declared in October, no doubt the Congress would be immediately called and the bill would be in much better shape, and be very near almost ready to introduce right away, and we would not find ourselves in the situation we were in 1917.

Senator LaFollette: No; that is true.

Senator Guffey: How about Senator LaFollette's motion?

The Chairman: Yes. All in favor of the motion say "aye."

Opposed "no."

(The motion was duly carried.)

Senator Connally: And the substance of your motion was --

Senator LaFollette (interposing): That we recommend to the Chairman of the full Committee that proper instructions be given to the Joint Committee staff to cooperate with the Treasury.

Senator Connally: Did you want Mr. Flynn to say anything?

Senator Nye: I think we should hear Mr. Flynn.

STATEMENT OF JOHN T. FLYNN

Mr. Flynn: ~~I~~^{do not} want to go into a discussion of the bill, in view of the action taken, because that would seem to be unnecessary.

Senator Connally: I was going to say in view of the action taken it is not necessary to go back into all of the policies.

Mr. Flynn: No, it is not necessary. I simply want to call the attention of the Sub-committee to a fact about the bill.

The bill looks like it is very formidable, a very large, formidable bill, but as a matter of fact the tax sections of the bill take about 190 to 195 pages, and that ~~bulk~~ is largely the existing tax bill. In other words, what the Munitions Committee did in drafting this bill was to try not to disturb the existing tax machinery at all, but merely to change the

rates, and that is the first thing which is done, change the rates of taxes, making them very drastic, not penalizing anybody or punishing anybody, but providing such revenue, if that is possible, to pay the expenses of war if we can for the purpose of avoiding inflation.

And we added one other thing, namely, for collection of the tax in the year in which the tax was imposed quarterly, and not in the following year. In other words, if we go to war in 1936 the tax would be collected on earnings during 1936, rather than during the year 1937, when perhaps the war is over.

Now a few other provisions were made, based almost entirely upon this matter Mr. Brown called attention to, namely, in as much as you have imposed very drastic revenues, the necessity of closing off evasions is all the greater, because while you make the tax more, the more eager will be the tax evader in his operations, and therefore additional loopholes in tax evasion have been closed up, or at least the effort has been made to close them up.

That is chiefly what this bulky bill amounts to. Therefore it seems to me that the work of checking it over, and of considering it, will not be such a gigantic task, because it will not be a task of considering a completely new bill.

In this draft the new portions of the bill are in italics, and they comprise perhaps not one-twentieth. They could all

perhaps be put in about ten pages of the whole 195 pages. And they merely have been woven into the existing bill.

Senator Connally: You would be better prepared to do this after we pass this new tax bill, because we can build on that structure, rather than the existing one.

Mr. Flynn: I think they have put very little in the new tax bill that is not in this. Some things already put in the tax bill we have put in here. I think after the new tax bill is passed it will be wise that we have in this the administrative and mechanical provisions of the new tax bill.

But I just wanted to call the attention of this Sub-committee to this fact, namely, that this bill was not a bill cooked up very rapidly. I hope I may not be thought guilty of any invidious comparisons, but I believe that this bill up to now had an enormously ^{greater} amount of consideration than the tax bill which you are about to pass. First of all, it was prepared over three or four months by a staff of economists, tax experts, and statisticians organized by the Munitions Committee.

Senator Connally: And you were a member?

Mr. Flynn: I organized that staff and superintended the drawing of that bill. After the bill was drafted it was submitted to the experts of the Treasury and the experts of the Joint Committee. They went over it, and I sat in conference

with them, representing the Munitions Committee, for several days, and Mr. Parker and his staff pointed out a very large number of defects in the bill. Most of them were mechanical defects. He also made some suggestions of policy. I might say that practically all those defects were corrected in this bill.

The bill was submitted to tax experts in different parts of the country.

The Treasury Department made some suggestions. And we ourselves found large numbers of defects in the bill and those were corrected, and the bill has had at least six or eight different printings, progressively effected as it went along.

Now this draft which Mr. Brown held in his hand was a draft made by the Military Affairs Committee, a comparative draft, and in the printing of it quite a number of typographical errors have gotten into it, and one or two other things left out through hasty preparation of the comparative draft, all of which I have corrected, or rather my assistants have corrected, and I was prepared to suggest correcting them here today.

But I just want to make this statement so the Committee may not suppose what they have is a very large, extensive and elaborate new tax measure which was hastily gotten up. It is the existing tax measure, the existing tax machinery,

with the new rates and a few evasions closed up, and that is all it is. So there would certainly be no difficulty in having this bill in shape by the time Congress assembles again if the Joint Committee will furnish a portion of its staff and the Treasury will assign a man or two to the job, and I believe you could have, I won't say a perfect tax bill, because such a tax bill has not yet been passed, but you could have a really good war tax profits bill.

Senator Connally: All right. Thank you, Mr. Flynn. Are there any questions?

Is there any other matter before the Committee?

Senator Bailey, since you have just come in, the Committee met to consider this whole matter, and it seems to be now the consensus of opinion that on account of the probably early adjournment of Congress and the rather complicated and great scope of this legislation that we would not have an opportunity to adequately consider it properly at this session, and that we will recess with the understanding that in the meantime a study should be made by the Treasury and the staff of the Joint Committee on Taxation, so that when we meet back again in January the Finance Committee will be enabled at an early time in the session to take it up. It was also thought advisable to consider this measure alone on its own legs, rather than to involve it with legislation of other character.

We have heard the witnesses, and that seems to be the notion.

Senator Bailey: I am sorry that I was late.

Senator Nye: Mr. Chairman, I hope you would expect in this work by the Treasury and the Joint Committee representatives that they would be willing to confer with Mr. Flynn and those who knew what policies were being sought in shaping this legislation. There would not be any objection to that, of course?

Mr. Parker: Absolutely not.

Senator Guffey: I move we adjourn.

Senator Connally (after consulting): I see no occasion at this time for printing this hearing. We will adjourn.

(Whereupon, at 11:20 o'clock a. m. the hearing was closed.)