STATEMENT ON H. R. 4473, REVENUE ACT OF 1951
BY
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ON THE FLOOR OF THE SENATE
September 20, 1951

The pending tax bill, H. R. 4473, which the Finance Committee has reported to the Senate, is one of the most important pieces of legislation to come before the Congress during this eventful year. The bill is of crucial importance to the defense effort and to the welfare of this country, and it is therefore essential that the soundest possible consideration be given its provisions.

What are the economic facts? Congressional appropriations will amount to about $94/or $95 billion. Not all of this sum will be spent this year. For the current fiscal year which ends June 30, 1952, expenditures will be roughly $70 billion. In the next fiscal year, expenditures will be between $80 billion and $90 billion.

These are not theoretical expenditure figures. These are facts -- the result of deliberate and mature action by the Congress for which we cannot escape responsibility. The major appropriation bills have passed both houses and the huge sums decided upon underwent serious study and debate before we acted. We have voted large sums for our military defenses, for new weapons, to strengthen the free world, to run our government efficiently -- and we have done so by our own votes. We must now as responsible members of Congress seek to raise the money to pay the bills which we have incurred.

In deciding on the amount of our national bill, I believe the American people agreed with us that the expenditures are necessary.

The citizens of this country are aware of the dangers that beset us. Communist aggression continues to threaten our security and the security of the free world. It can be halted in one of two ways. The first way is to stop the aggressor when he ventures to attack, as he was stopped in Korea. The second way is to arm ourselves and help build up the strength of our allies so that the aggressor will know that he cannot succeed. We must show our determination to protect freedom all over the world wherever it may be attacked.

The production program which is necessary to build the free world's defenses against Communism is a large undertaking. It is expensive. It requires the diversion of a large proportion of our human and physical resources from production of peacetime goods to the production of arms and munitions. It means that we will temporarily have fewer automobiles, refrigerators and television sets, and that our wage earners and farmers will have to work longer hours. Above all, it needs all the courage and foresight which is characteristic of the American people.

The genius of the American people to produce more in times of great stress is always under-rated, but it has been proved many times. I believe we can achieve the production goals required to complete the military program and also to lay the groundwork for increasing living standards, not only in this country but also in the rest of the free world. We need only to harness some of the tremendous potentials which are still untapped here and abroad to realize these objectives.

The cold war is not a temporary phenomenon. It is one of the practical political facts of our generation. In the present armistice talks in Korea, we are dealing with only one thrust of Communism. Even though one thrust may be stopped, there is no telling when a second will strike in another corner of the globe. We will not cope with Communism unless we face the cold, hard fact that we must build up our strength for a long pull. We cannot arm quickly to meet one threat and then disarm as soon as it has been averted. Such a course of action is wasteful and inefficient. More important, if we relax our guard even once, we are likely to lose the fight against the enemies of freedom.

The fact that the cold war is likely to last a long time makes it imperative that we plan ahead. Our economic system must be based on a strong foundation if we are to succeed in our resolve to stop Communism. Part of this foundation must be a strong and equitable tax system which will be adequate to pay the cost of rearmament.

Now that the Congressional action on appropriations is completed, it is clear that we must add substantially to our revenues. The citizens of this country are willing to undertake to pay for their defense so long as the tax burden is distributed fairly and in accordance with ability to pay. The tax structure is a complicated mechanism of necessity. Most of the technical provisions of the tax laws are not understood by the average citizen. The task before the Congress in distributing the burden fairly among individuals and corporations is therefore especially important. It is our obligation to our constituents to design tax legislation in the fairest manner possible.

We should approach the problems of taxation on the basis of a simple principle: our tax system should be strong enough to meet our commitments and it should distribute the burden fairly among the people.

The legislation which is now before the Senate does not meet the specifications in this simple test. It will not raise enough revenue to balance the budget and will therefore invite inflation through deficit financing. Moreover, the money that the tax bill does raise is distributed unfairly. The tax burden on corporations whose profits have soared to the $50 billion level has been cut by almost $800 million below the House bill. Taxes of individuals with incomes above $5,000 have been cut by $351 million below the House bill. Furthermore, some of the most important loophole-closing provisions adopted by the House have been stricken from the bill and a number of new loopholes have been added. The many excess profits tax amendments which we are asked to adopt to "relieve hardship" give $120 million of relief, in most cases where it is unwarranted.

Few people can comprehend the broad scope of the loophole-opening provisions included in the bill. Nonetheless, I believe that it is the duty of the Senate to scrutinize these provisions carefully and to understand their implications. My objective in bringing these matters to your attention is to familiarize the members of the Senate with details which they might overlook in the rush to complete action on this one remaining piece of major legislation during this session. When the tax system already calls for over $60 billion a year and when we are asking the taxpayers to pay $5 to $7 billion more, we must in good conscience examine carefully the make-up of the additional burden.

An analysis of the bill before the Senate will demonstrate that it is defective in three respects:

> First, the reductions made below the House bill will go largely to corporations whose swollen profits are ample proof that they are able to pay the additional taxes imposed by the House.
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> Second, the bill does not close enough loopholes in the present laws.
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> Third, it extends unwarranted tax privileges and opens up new loopholes which will be available to relatively few people at the expense of many.

I. <u>Comparison of House and Senate bills</u>

According to the report by the Finance Committee on H. R. 4473, the House bill would collect in a full year of operation about $7.2 billion of additional revenue. This amount would be obtained from the following sources: $2.8 billion from changes in the individual income tax; $2.9 billion from changes in the corporation income and excess profits taxes; $1.3 billion from increases and revisions in the excise taxes; and a net increase of $245 million from structural changes.

As revised and amended by theFinance Committee, the bill would raise only $5.5 billion. Of this amount less than $2.4 billion would be raised from the individual income tax, or almost $1/2 billion less than the House bill; $2.1 billion from corporation taxes, or almost $800 million less than the House bill; and $1.3 billion from excise taxes, or approximately the same increase that the House bill provides in this area. Finally, the so-called "structural changes" in the Finance Committee's bill will actually reduce revenues by $390 million whereas the House bill raised $245 million, making a difference of $635 million.

I should like to repeat these differences: almost one-half billion dollars of the reduction in the yield below the House bill will go to individuals; almost $800 million will go to corporations and $635 million will be lost because of the failure to close loopholes recommended by the House and because of the addition of new loopholes in the tax laws. I wonder whether the members of the Senate realize that of the total reduction of $1.7 billion below the House bill, $128 million will go to families with incomes below $5,000. The remaining $1,565 million will go to corporations and to individuals in the high-income brackets who can take advantage of the existing loopholes and the new loopholes that were added.

In view of the one-sided nature of the reductions made in the House bill, I believe it is worthwhile to review them carefully.

A. Corporation Income Tax

The reduction of $800 million dollars in the increased corporation taxes passed by the House comes at a time when corporation profits are at the highest point in history. The story is the same whether profits are taken before or after taxes. In the period 1946 through 1949 which is the base period for the excess profits taxes, corporation profits averaged $29 billion before taxes and $17.6 billion after taxes. In the first half of this year, corporation profits averaged $50 billion at an annual rate before taxes and almost $23 billion after taxes. Even if the increased taxes imposed by the House were to be adopted, corporation profits this year would be about $20 billion after taxes. This is higher than profits after taxes in any year of the base period except the boom year 1948, and it is just about double the highest profits made by corporations during World War II.

There is every indication that corporations have the ability to pay the taxes proposed by the House. Markets for corporations are virtually assured by the defense expenditures. Five year amortization has been allowed on $6 billion of future plant expansion, even though a high proportion of these facilities will be useful to their owners after the current emergency is over. The excess profits tax provides generous relief provisions for all corporations. It is not surprising under these circumstances, to find that the stock market has this year reached the highest levels in the past two decades. To ask corporations to bear $2.9 billion of additional taxes, as provided in the House bill, is only fair in times like these since it will still leave them with record profits after taxes.

The major part of the $800 million dollar reduction in the corporation tax increase made by the Finance Committee is due to the elimination of the increase in the excess profits tax proposed by the House and the reduction of the ceiling rate from 70 to 69 percent. These two changes, which cost about $600 million, will benefit the largest and most profitable corporations. By contrast the purpose of the House provision was to reduce the impact of the higher taxes on corporations whose profits have fallen substantially below their average profits in the base period.

The bill before us deviates in one other important respect from the House bill. The House made the corporation tax increases effective January 1, 1951. As reported to the Senate, these increases are made effective April 1, 1951, or one quarter later. In this manner, liabilities of corporations for calendar year 1951 will be reduced by over one-half billion dollars. The difference in effective dates was reported by the WALL STREET JOURNAL of September 11, 1951, to mean a reduction in the tax of United States Steel by $23 million. On the basis of its reported financial statement for the first half of the year, General Motors will save at least as much by the change in the effective date.

Corporations have been forewarned from the beginning of this year that they would be subject to additional taxes on all this year's profits. Except for the special situation created by Korea last year, changes in corporation tax rates -- whether up or down -- have always been made effective beginning the the first of the year during which the legislation was enacted. This is necessary because corporations are not on a current tax payment basis. If corporation tax increases were to be prospective only, the lag in collections would postpone actual payments of increased liabilities by as much as two years in some cases. The argument that increased corporation taxes made effective the first of this year are retroactive and thus undesirable is merely a pretense to enable corporations to escape their fair share of this year's tax burden. I am certain that corporations would insist that tax reductions be made effective beginning the first of the year if profits fell and they would not call it a retroactive tax reduction. There is no valid reason for postponing the effective date of the increase in taxes on corporations to a date later than January 1 of this year. In the first quarter of this year corporation profits were the highest in history. By delaying the effective date to April 1, 1951, the Senate Committee has exempted from increased taxes the very profits that should bear the heaviest load.

For these reasons, I will join with a number of my colleagues in urging the Senate to restore the increase in excess profits tax made in the House bill and also to make these changes effective beginning January 1, 1951.

B. Individual income tax

The most equitable feature of the bill as passed by the House was the defense tax which increased everybody's taxes by 12½ per cent, with an adjustment in the highest brackets to limit the topmost rate to a maximum of 94.5 per cent. This method of increasing taxes for lower and middle-bracket taxpayers has been retained in the amended bill before you, but the increase is reduced from 12½ to 11 per cent. In the higher brackets, however, the tax increase was limited to 8 per cent after present taxes. The effect of these changes at different levels of income for a married person with two dependents is shown in the following table:

*Net Income	Tax increase: House bill	Tax increase: Finance Committee bill	Reduction: Amount (1) - (2)	Reduction: Percent (3)/(1)
	(1)	(2)	(3)	(4)
$ 3,000	$ 15	$ 13	$ 2	13%
5,000	65	57	8	12
10,000	199	174	25	13
25,000	784	688	96	12
50,000	2,361	2,080	281	12
100,000	6,489	3,680	2,809	43
500,000	29,571	7,787	21,784	74
1,000,000	42,544	11,287	31,257	74

* Net income after deductions but before exemptions.

The revisions made by the Finance Committee reduced the House tax increase by 12 or 13 per cent for all levels of income up to $50,000. However, the reduction was 43 per cent at the $100,000 level and 74 per cent above the $500,000 level. Stated in other terms, the tax bill was reduced for the 36 million taxpayers with adjusted gross incomes of less than $5,000 by a total of $128 million; but for the 8 million taxpayers with incomes above $5,000 the reduction was $351 million.

These figures demonstrate the real purpose behind the revisions made in the tax increases for individuals. They were designed to soften the impact of the tax bill on low-income recipients by a few dollars in order to make more palatable the very large reductions made in the taxes of the wealthy. The 8 per cent limitation will benefit only single persons with taxable incomes above $27,000 and married persons with taxable incomes above $54,000. Those with lower incomes will not save a single cent from this limitation.

The staff of the Joint Committee on the Economic Report recently published the latest study of the distribution of total Federal, State, and local taxes by income levels. These figures are no less than startling and it is unfortunate that they have not been given more widespread publicity. The facts are that in 1948, individuals and families with incomes under $1,000 paid 23.6 per cent of their income in taxes to all levels of government. This compares with 20.3 per cent between $1,000 and $2,000; almost 22 per cent between $2,000 and $5,000; 23.1 per cent between $5,000 and $7,500; and 31.7 in the classes above $7,500. Thus, the people with incomes below $1,000 actually bear a heavier tax load, when all taxes are taken into account, than any group up to the $7,500 level.

The need for revenue is urgent and we must impose higher taxes even on those in the lower income groups who are already heavily burdened. But we cannot give away a half-billion of taxes at this time, especially when the major share goes to the wealthy. I, therefore, urge my colleagues to reconsider the reductions made by the Finance Committee in the House bill and to restore the original individual income tax increases passed by the House.

C. Capital gains

The capital gains rate is now limited to a maximum of 25 per cent and profits from the sale of assets held for six months or more are given this preferential treatment. So far as I have been able to determine, the six-month holding period accomplishes nothing except to reduce the taxes of speculators who will be able in one way or another to hold their gains for at least 6 months in order to obtain preferential the rate on long-term capital gains.

The low rate of tax on capital gains singles out for special treatment incomes which have no less ability to pay than other types of incomes. Indeed at one time, earned income was considered to be entitled to a special credit for tax purposes. Apparently, speculating and coupon-clipping have attained a more preferential status than income earned by wage earners and even salaried executives. Capital gains are heavily concentrated in the high-income brackets and the preferential treatment accorded them will be especially favorable to the wealthy.

At the $3,000 level, capital gains amounted to less than one-half of one per cent of total income in 1948; but they amounted to 25 per cent at the $500,000 level. Preferential treatment for capital gains is, therefore, nothing less than class legislation--legislation which reduces the tax burden of the wealthy classes.

The Secretary of the Treasury urged that the capital gains tax be increased. He pointed out that the starting rate on ordinary incomes and the rate on long-term capital gains for individuals not subject to the alternative tax were increased substantially under the Revenue Act of 1950 and will also be increased again under this bill. His recommendation was that the alternative tax rate be increased from 25 to 37½ per cent. I would suggest a 35 per cent rate to accord approximately with the rate increase in the Revenue Act of 1950 and in this bill.

The House bill increased the capital gains rate to 28 per cent for corporations and individuals, or by only one-fifth of the increase proposed by the Secretary. The bill before you does not contain even this small increase.

Why does the Finance Committee not believe in increasing tax burdens of of recipients of capital gains even in the slightest degree? The reason given is that an increase of 3 percentage points will discourage the realization of gains and presumably would reduce rather than increase revenue. On Pages 62 and 63 of the report of the Ways and Means Committee, you will find, however, that $87 million will be lost as a result of the elimination of the capital gains tax increase provided by the House. Apparently, those who made the estimates for the House do not agree with the Finance Committee in its analysis of the effects of the capital gains tax.

The fact of the matter is that the yield from capital gains has not depended on the capital gains rate. Capital gains reported on tax returns have increased and decreased as the stock market has gone up and down. Large capital gains were reported when the rates were high and low; and conversely, varying amounts of capital gains were reported when the rate has remained unchanged for a number of years. The basic forces of the market are more controlling than the tax rate, and it is erroneous to suppose that a relatively small change in the capital gains tax can upset the market.

According to the record of the open hearings before the Finance Committee, pages 119 and 334, a report in capital gains taxation was submitted by the Treasury Department. I should like to ask the Chairman, or any other member of the Committee, whether this report substantiates the conclusion that a 3 per cent increase in the capital gains will discourage realization. Will the Chairman make this report available to the Senate today so that we can all give this matter the careful study it deserves?

The failure of both the House and the Finance Committee to lengthen the holding period from six months to one year is also unwarranted. The holding period was originally designed to prevent taxation of capital gains which accrue over many years from being taxed as a lump sum in the year when the gains are realized. The holding period was originally two years, but it was gradually whittled down until, in 1942, it was reduced to six months.

There is no justification for taxing a profit from an asset held for less than one year at a preferential rate, any more than to give such treatment to a jeweler or some other merchant who turns over his stock of goods only twice a year. Our income tax is on an annual basis and there is no hardship imposed on profits if assets are held for less than a year. The six months holding period benefits mainly the speculator; the genuine investor who holds his stock for long periods for investment purposes derives no benefit from a short holding period.

An increase in the capital gains tax is required not only on the ground that all other incomes have been subject to higher tax rates since Korea, but also on the ground that it is needed to protect the basic equity of the individual income tax. When tax rates are high and one type of income is subject to a low rate, it is natural that individuals will try to convert ordinary income into the type of income which is given preferential treatment. The courts have for years wrestled with this problem but the cases of tax avoidance keep increasing. What is more important, ordinary incomes are converted into capital gains by legislative action. This bill is one of the best examples. While the taxes on ordinary incomes of individuals and corporations are increased by almost $4.5 billion, the unjustified capital gains treatment for profits from the sales of depreciable property has been extended to other ordinary incomes in this bill. I shall have more to say about these new loopholes later. It is sufficient to note at this point that, when we fail to move up the capital gains tax as the tax on ordinary incomes increases, we run the risk of undermining the individual income tax.

I should like to ask the distinguished Chairman of the Finance Committee whether he is not concerned about the gradual process by which the income tax base is being whittled away through the conversion of ordinary income into capital gains and by legislating capital gains treatment for the ordinary incomes of special groups.

Lengthening the holding period to six months and increasing the capital gains rate for individuals and corporations to 35 per cent would produce $300 million of revenue. In times like these, we cannot afford to give up this much revenue when the case for the tax increase is so strong.

II. Suggested loophole-closing provisions

The changes in the bill which I have suggested this far would raise a total of almost $1.4 billion, and would increase the yield of the bill to $6.9 billion. This still falls far short of the amount of revenue needed to balance the budget. I submit that billions more could be raised by a determined effort to close loopholes.

I believe you will agree with me that the man in the street, however unsophisticated he may be, endorses a pay-as-we-go policy. He is willing to be taxed to pay for his own defense. But he insists that taxes be levied fairly, that everybody shoulder the burden according to his ability to pay.

I want to emphasize this point because I believe it is important. When we increase the tax burden of a married man with two children and with an income of $60 a week by $1 a week, we are denying him the use of a dollar which would otherwise go for food, clothing, or lodging. There is little room for anything else in his budget. This sacrifice can and will be borne by our wage earners and farmers if they are assured that others are paying their fair share.

We cannot in good faith ask the rank and file to make a substantially larger tax contribution for the defense effort when a chosen few can take advantage of glaring loopholes in the tax laws. It would violate every test of equal sacrifice to ask the man in the street to pay higher excise and income taxes when the rich become richer through our failure to close loopholes.

What are the most important loopholes?

First, the unbelievably generous depletion provisions hand the oil and mining interests about three quarters of a billion dollars each year. Last year, the President called this loophole the most glaring in the tax laws. Congress did nothing about it. This year with tax rates going still higher, this loophole becomes more intolerable.

Second, the income-splitting provisions enacted by the 80th Congress confer unwarranted tax benefits on the well-to-do. People in the lowest tax bracket gained nothing from this provision. At the $500,000 level, it reduced taxes of a married person by $25,000. We cannot afford to give such large tax reductions to the higher income classes in times like these.

Third, at the same time that wage earners are paying every last cent of their taxes because it is withheld from their pay envelopes, billions of dollars of interest and dividends are evading taxes. This critical evasion must be stopped. The best way to do this is to withhold the tax from interest and dividends just like we do on wages and salaries.

Fourth, the estate and gift taxes are in a pitiful state. It is unbelievable that, in a country as wealthy as ours, these taxes raise little more than three-quarters of a billion dollars. The Secretary of the Treasury presented a plan to the Congress last year for tightening up these taxes but nothing was done. The estate and gift taxes should be made to contribute substantially more than they do now. A tax bill of the size being considered here would be deficient without a thorough revision of these taxes.

These four items alone add up to almost $4 billion. I have not mentioned others, such as the loopholes in the capital gains provisions, the weak tax provisions for life insurance companies, and the tax hand-outs to the large corporations through the accelerated amortization provisions. A determined effort to close all the loopholes could therefore be made to yield billions more. I realize that the need for speed will preclude the adoption of all of these loophole-closing provisions. Nonetheless, there is more than enough to choose from to raise the yield in the bill now before you substantially, and I expect to offer some of them as amendments to the bill before you.

Again, I should like to ask the distinguished Chairman of the Finance Committee why it is that the Committee has not seen fit to raise revenue by closing some or all of these loopholes, and how much money has been raised since the invasion of Korea by a loophole closing program?

A. Percentage depletion

The first and most important loophole which should be corrected is percentage depletion. At present rates and income levels, percentage depletion saves oil and mining interests at least $750 million a year and 85¢ out of every $1 goes to an oil company. Such tax relief cannot be justified either on equity grounds or on economic grounds. It is no wonder that the profits of the oil industry are expected to exceed $2 billion this year and that the stocks of oil companies have been in the lead of this year's bull stock market.

Real depletion to an oil well or mine is simply what depreciation is to machinery or buildings used in a business. The theory is that oil wells are exhausted in the process of working them and producing income. Consequently part of every dollar received is not taxed because it is only a return of the money originally invested. This kind of depletion, however, is already fully covered by Section 23 of the Internal Revenue Code.

Percentage depletion of oil and gas wells was first allowed in 1925. The Treasury has been pointing out the inequity and pointlessness of this subsidy to the oil industry for at least thirteen years.

Percentage depletion, as applied to oil and gas, simply means an income tax deduction of $27\frac{1}{2}$ percent -- over one-fourth -- of the gross income from the property, or one-half of the net income, whichever is smaller.

This bonus has nothing to do with the cost the owner is entitled to recover, and continues as long as the oil or gas well is in operation. The owner may recover the cost of his investment a hundredfold, through these so-called depletion allowances.

Still more taxes are lost through excessive depletion deductions of individual oil well owners. The Treasury recently cited a number of cases where wealthy individuals, with annual incomes averaging over a million dollars a year, paid an average income tax of only 22½ percent. (See page 59 of hearings before Committee on Ways and Means, Revenue Revision 1950.)

Again the Treasury has shown that in 1947 the oil companies worth over a $100 million dollars claimed percentage depletion of more than 13 times actual depletion on an original cost basis. In plain language, that is practically equivalent to allowing a businessman to recover the cost of his plant 13 times through tax-free "depletion" or depreciation deductions. As long as we are going to play that game I suppose it is only fair to allow taxicab drivers to deduct the cost of their cab 13 times for income tax purposes. The cab drivers certainly need it and probably deserve it just as much as the oil companies.

Percentage depletion doesn't end there. Special provisions allow oil companies to deduct development costs, costs of a kind that can't currently be deducted by other businesses for tax purposes. Their percentage depletion is allowed on the same expenses in the same year. As the Secretary of the Treasury has said, this is "a double deduction for the same costs, once when they are incurred, and again under percentage depletion."

The following statement of President Truman is of interest here. In his 1950 tax message, he said, "I know of no loophole in the tax laws so inequitable as the excessive depletion exemptions now enjoyed by oil and mining interests." And the President documented his charges as follows:

"For example, during the five years 1943-47, during which it was necessary to collect an income tax from people earning less than $20 a week, one oil operator was able, because of these loopholes, to develop properties yielding nearly $5,000,000 in a single year without payment of any income tax. In addition to escaping the payment of tax on his large income from oil operations, he was also able through the use of his oil-tax exemptions to escape payment of tax on most of his income from other sources. For the 5 years his income taxes totaled less than $100,000 although his income from non-oil sources alone averaged almost $1,000,000 each year.

"This is a shocking example of how present tax loopholes permit a few to gain enormous wealth without paying their fair share of taxes.

"I am well aware that these tax privileges are sometimes defended on the ground that they encourage the production of strategic minerals. It is true that we wish to encourage such production. But the tax bounties distributed under the present law bear only a haphazard relationship to our real need for proper incentives to encourage the exploration, development, and conservation of our mineral resources. A forward-looking resources program does not require that we give hundreds of millions of dollars annually in the tax exemptions to a favored few at the expense of the many."

The examples given above could and have been repeated and expanded indefinitely. Presidents, Secretaries of the Treasury, General Counsels of the Treasury, and dozens of others have given you the real facts time and time again. Unchallengeable statements against percentage depletion in the printed reports of many hearings before the House and Senate would fill volumes.

All the arguments for percentage depletion have been refuted again and again, while the arguments against it remain almost unanswered and unanswerable.

A dean of tax experts and former Counsel of the Treasury has well summed up the case against percentage depletion and oil and gas: "(subsidies) are inexcusable when they serve no public purpose and indiscriminately favor entire industries which are in an established financial position far beyond need of special government help. For then their effect is to shift part of the tax burden to the shoulders of others who are less able to bear that burden. A sound tax system will permit no one segment of business to ride roughshod over others." 1/

1/ Randolph Paul - Taxation for Prosperity (1947) p. 307

I sincerely and devoutly hope that this Chamber will find the conscience -- and the courage -- to dispense equal justice to the oil company and the taxicab driver.

The Secretary of the Treasury outlines, during the hearings on the Revenue Act of 1950, the adjustments which can be made as a first step toward eliminating this loophole. His proposal was to reduce percentage depletion for oil, gas, and sulfur to 15 percent of gross income and for non-metallic minerals to 5 percent. He also proposed that oil and gas operators who elect to expense intangible drilling and development costs be required to reduce income from the property by the amount of such expensed costs in computing their depletion allowance. These changes would increase revenues by $350 million, and I intend to offer them as amendments to this bill.

B. Income-splitting

The income-splitting provision which was adopted in 1948 was intended to equalize the tax burdens of married persons throughout the Nation, but it gave very substantial tax reductions to wealthy taxpayers. A married man with two children receiving wages of $4,000 gains absolutely nothing from this provision. If he receives $5,000, he gains all of $2. If he receives $10,000, he gains $168. However, a married taxpayer receiving a salary of $500,000 gains $25,000.

To put it another way, 97% of the tax relief from this provision went to people under $5,000. No wonder President Truman so successfully stumped the country in 1948 with the Republican rich-relief tax bill as his theme. And I predict that he will go to the country with equal success in 1952 with this tax bill as his text unless it is substantially amended before final passage.

This discriminatory provision was adopted because residents of community-property States were enjoying the privilege of splitting their incomes by virtue of local property laws. The tax advantages of these laws were so great that a number of States adopted them to obtainthe benefits for their citizens. The solution devised by the 80th Congress was to universalize income splitting for the residents of non-community property States. More equitable solutions were considered for many years by the Congress, but they were never adopted because of the determined opposition of representatives and Senators from community-property States. It is noteworthy that all of the States that had adopted community-property laws to get their tax advantages repealed them soon after the Revenue Act of 1948 was enacted.

Aside from the fact that income-splitting benefits only high-income people, it can be criticized on the ground that it discriminates against all single people. The Bill before you will actually raise the taxes of some single people in the upper brackets above World War II levels, but married couples in these brackets will pay substantially lower taxes because of the advantage of income splitting. H. R. 4473 not only does not remove this inequality but actually increases the tax differential between single persons and married persons.

The House was well aware of these inequalities. In order to relieve hardship for widows and widowers who are denied income splitting after the death of the husbands or wives, it extended half of the advantage of income splitting to single persons who are "heads of households". "Heads of households" are defined in the bill as single persons who maintain in their household children or their descendents whether or not they can support themselves, or who maintain any relative for whom they claim an exemption under present law. The Finance Committee adopted the principle of head-of-household, but gave them only one-quarter rather than one-half the benefit of income splitting.

Extending a small part of the benefits of income splitting to heads of households does not cure the disease. It merely adds another group of favored taxpayers precisely at a time when the burdens of all other taxpayers are being increased in the interest of the defense effort. It is my conviction that the differential in tax liabilities between married persons and single persons should be reduced not by extending the regressive feature of income splitting to a new category of taxpayers but on the contrary by eliminating this privilege for all the high-bracket taxpayers.

The splitting of income in community and non-community property States now costs about $2.5 billion. All of this revenue could be raised by adjusting the rates for married couples. If the Senate had the courage to adopt this suggestion, it could eliminate all of the individual income tax rate increases from the bill and still raise some $200 million more than the bill as it is now written.

I should like to submit for the record a table which compares the House bill, the Finance Committee bill and my proposal to eliminate the benefits of income splitting.

The table shows that for everybody with incomes up to about $10,000, my proposal would require a smaller contribution in increased taxes than the bill before you. Stated differently, eliminating the benefits of income splitting will raise more revenue than the Finance Committee bill and yet would require practically no increase on the families with incomes below $5,000, and would be much less of a burden on families with incomes between $5,000 and $10,000.

Comparison of the Tax Increases If Income Splitting Were Eliminated With the Tax Increases Under the House Bill and the Finance Committee Bill

MARRIED PERSON - TWO DEPENDENTS

Adjusted Gross Income 1/	Present Law Tax	Increase Over Present Law Tax: House Bill	Increase Over Present Law Tax: Finance Committee Bill	Present Tax Rates With Income Splitting Eliminated
$ 5,000	$ 420	$ 53	$ 46	$ 2
6,500	690	86	76	29
7,500	877	110	96	54
8,500	1,075	134	118	90
10,000	1,372	172	150	168
15,000	2,486	311	277	572
25,000	5,318	665	583	1,998
50,000	15,976	1,997	1,780	5,558
100,000	44,724	5,591	3,563	11,880
500,000	356,956	27,821	7,437	25,180

1/ Income before deductions and before exemptions

NOTE: In computing the tax, a deduction of 10 percent of gross income was allowed at all income levels.

C. WITHHOLDING ON DIVIDENDS AND CORPORATE BOND INTEREST

When tax rates are high and burdens on all groups of taxpayers must be increased, it is necessary to provide the Bureau of Internal Revenue with the means to enforce the tax laws in the best possible manner. It is acknowledged that in many areas of tax enforcement the cost of collecting all of the additional taxes due from recalcitrant taxpayers would be exorbitant. For this reason the Treasury Department has been recommending for the past two years that a withholding system be adopted on dividends in order to assist the Bureau of Internal Revenue in its tax enforcement efforts.

Last year, the House adopted a dividend withholding provision which was eliminated in the Senate primarily on the ground that it would have created substantial compliance problems for corporations, since it would have required corporations to submit to every stockholder a statement showing the amount of dividends paid and the tax withheld. This year the provision adopted by the House is much simpler and it is my understanding that it would involve relatively little additional work on the part of corporations. All the corporations would be required to do is to withhold 20% from each dividend payment and to pay this total amount quarterly to the Bureau of Internal Revenue. No statement would be required to be submitted to the stockholder. The stockholder would be able to take credit for the tax withheld on his tax return as in the cases of wages and salaries.

I cannot understand why a simple provision like this one, which involves very little additional paper work on the part of the corporations and which is estimated to raise over $300 million in revenue, can be objectionable. As I pointed out to the Senate last year, the amount of underreporting of dividends on individual income tax returns is substantial. For the calendar year 1951, underreporting of dividends will amount to over $1 billion. In view of these facts, it is clear that evasion is widespread whether it is due to inadvertence or carelessness or willful failure on the part of the taxpayer to evade taxes.

It is, of course, argued that the dividend withholding system is not needed. It is said that the Bureau of Internal Revenue should use the information returns supplied by corporations on dividends paid to stockholders to check the individual income tax returns. However, the Treasury Department last year stated that the cost of collecting the additional revenue from dividends without a withholding system would be prohibitive.

Another argument that is often leveled against a dividend withholding system is that there would be over-withholding on nontaxable individuals. Tears are shed for those who would be eligible for refunds for taxes withheld on dividends but nothing is said about the present over-withholding on wages. In 1948, nontaxable income recipients received tax refunds amounting to over $500 million. Wage earners have considered this as necessary and they have not complained. There is no reason why there should be any more complaints from dividend recipients.

Experience with the wage withholding system indicates conclusively that individuals prefer to have their taxes collected currently. Familiarity with withholding on wages will make the transition to the new dividend withholding system relatively simple. I should like to ask the distinguished Chairman of the Finance Committee the following question: Would not the majority of the people who receive dividends prefer to have a withholding system than to allow the minority who escape their fair share of taxes to continue to get away with it? When income tax rates are increased, must we not make every effort to collect the taxes which are due at a minimum of cost?

The reasons for adopting a withholding system on dividends apply also to corporate bond interest. The withholding system devised by the House can be applied in this area as well as in the area of dividends without any additional complications. I will, therefore, join with a number of my colleagues in proposing an amendment to the bill which would restore withholding on dividends and corporate bond interest.

D. ESTATE AND GIFT TAXES

Except for the estate and gift splitting provisions which were enacted in 1948, the estate and gift taxes have remained untouched since 1942. The opportunities to avoid high transfer taxes by placing property in trust or making gifts still remain open for those who have skilled legal counsel. The 1948 provisions, moreover, undercut substantially the effectiveness of the already weakened rate structures of these taxes. In their present state, the estate and gift taxes are no more than a mere appendage of the tax system -- they raise less than a billion dollars out of a total of $61 billion this year during a period when income taxes have increased 18 fold since 1939.

The weakness of the present estate taxes is due to the fact that, while all other taxes were increased very substantially in the 1940's, the estate and gift tax rates and exemptions remained the same. The exemption for estates remains $60,000 and the lifetime exemption for gifts remains $30,000. In addition, the 1948 amendments permitted married persons to exclude one-half of their gifts from the tax base and the estates of decedents who were married at death are allowed deductions for one-half of the total estate if it is transferred to a spouse, thus in effect doubling the exemption. These splitting provisions gutted whatever effectiveness the estate tax may have had even at the low rates that applied at that time. Their effect was to decrease the total estate tax yield by a third. Before the 1948 amendments a $10-million estate of a decedent who was married at death paid an estate tax of $5 million. As a result of the 1948 amendments that tax was reduced to $2 million if one-half the estate was transferred to the spouse, a reduction of 60 percent.

Keeping the estate and gift taxes ineffective at a time when we must increase the burdens on low and fixed income groups who are barely able to make ends meet is unconscionable. The primary objective of the gift and death taxes is to prevent accumulation of vast estates and to reduce the tremendous inequality of wealth. Although we have had an estate tax since 1916 and a gift tax since 1932, there has been little apparent reduction in the vast fortunes and in the concentration of control of private wealth in the United States. This demonstrates how ineffective a tax can be when loopholes are provided to escape from it.

It is disappointing that the Finance Committee did not see fit to look into the estate and gift taxes as a means of raising revenue at this time. I believe that we should not allow a tax bill to go through without an adjustment in this area. I intend to introduce amendments which would (a) repeal amendments of the Revenue Act of 1948; (b) increase the tax on estates and gifts by 15 percent; and (c) cut the exemptions in one half. In total these amendments would raise $600 million which are vitally needed at this time to pay for defense commitments.

This figure is about half of the reserve which the Committee has recommended be raised by excise taxes-- burdens which fall mainly on low and moderate income groups. Closing these loopholes would more than make up for the $488 million to be raised through manufacturer excise taxes.

I ask that a table fund on page 96 of Senate Finance Committee Report No. 781 be incorporated at this point in the record. It describes the effect of the manufacturers excise tax in specifics. I likewise bring to the attention of Senate that included in the consumer items on which additional excise taxes are to be levied under the Committee bill are the following 18 items:

1. Electric vacuum cleaners.
2. Electric washing machines.
3. Electric garbage disposal units.
4. Exhaust blowers
5. Electric belt-driven fans.
6. Electric or gas clothes driers.
7. Electric door-chimes.
8. Electric dehumidifiers.
9. Electric dishwashers.
10. Electric floor polishers and waxers.
11. Electric food choppers and grinders.
12. Electric hedge trimmers.
13. Electric ice cream freezers.
14. Electric mangles.
15. Electric motion- or still-picture projectors.
16. Electric pants pressers.
17. Power lawn mowers.
18. Electric sheets and spreads.

I again repeat, Mr. President, that at a time when the American Congress is placing heavier tax burdens on the American consumer through heavy excise taxes and on the American working man, farmer and small business man, the bill before us would grant special tax privileges to the few in the form of estate and gift tax loopholes. I see no justice in this.

E. MULTIPLE EXEMPTIONS FOR MULTIPLE CORPORATIONS

In order to tax individuals and corporations on the basis of their ability to pay, the income tax laws have always made some exemptions for people and corporations with very small or relatively small incomes. Each individual is exempt from tax on the first $600 of his income. Thus, a person whose income is only $600 pays no tax. This is simple equity.

The same principle of alleviating the tax on the very small corporation from tax has always been followed under the income tax laws. All corporations are subject to a normal tax of 25 percent, but those with profits of less than $25,000 are exempt from the surtax of 22 percent. The purpose is to avoid making small and new corporations pay the general rate of 47 percent which is applicable to large corporations. In addition, a minimum of $25,000 of the income of each corporation is exempt from the excess profits tax.

Suppose, however, that a corporation earning $250,000 wants to escape the income and excess profits tax. If the corporation's business can be subdivided into ten components, the corporation can divide like an amoeba, into ten new corporations. Each of the new corporations than has an income of only $25,000. None of the complex of corporations pays any surtax or excess profits tax.

To take an example, I imagine that the Atlantic and Pacific Tea Company has 5,000 different stores throughout the country. Under existing law, A & P might be able to incorporate into separate subsidiaries each of its stores. After all, a grocery store is a separate entity in a sense. Many individual grocery stores are separate corporations. A & P might be able to make a good case for the proposition that it was entitled to incorporate each of the 5,000 stores. And thereby A & P could multiply the $25,000 exemption 5,000 times and theoretically at least exempt income of $125,000,000 from the surtax and excess profits tax.

I know that under existing law, passed in 1944 (Section 129 of the Internal Revenue Code), the Congress has authorized the Commissioner to disallow exemptions where corporations are spawned purely for tax avoidance purposes. However, where the business can show even some minor business purpose or reasonable justification for splitting its business into several corporations, the Tax Court has stopped the Commissioner from disallowing these exemptions. /Alcorn Wholesale Company et al. v. Commissioner, 16 T.C. No. 10 (1951); (grocery chain operating in five different towns in Mississippi split into five different corporations); Berland's Inc. of South Bend, 16 T.C. No. 24 (1951), (chain of retail shoe stores consisting of 51 existing branches; twenty-two of the branches were separately incorporated and twenty-two separate exemptions were thereby obtained.)/

I understand that a number of these multiple corporations were created for good business reasons, and have existed in divided form for a long time. Long before there was any tax advantage in dividing a business into a vast network of separate corporations, I know that we have had the problem of giant chains and giant interlocking corporations. I do not say that the tax laws should be invoked to prohibit such corporations from spawning new corporations. All I say is that the tax laws should be corrected to the extent that they/do not encourage or give enormous tax advantage to these multiple, multi-headed giants. Among the principal beneficiaries of this practice will be the tax lawyer who can split corporations at the drop of a fee.

The House has recommended and adopted a provision whereby only one exemption would be allowed to a chain of corporations where they were all controlled to the extent of 95 percent by the same parent company, or the same individuals.

The House bill does not prevent the multiplication of corporations. It merely makes the tax system neutral as to whether the corporation should or should not split up. As a matter of fact, as the law exists now, I don't see how a business can resist the temptation to multiply itself into as many separate corporations as there is any basis for forming, in terms of business functions. I recommend that the Senate approve the House provision. I do not think that we should sanction the existing loophole, and I believe particularly in the context of this bill which contains so many statutory loopholes anyway, that we should endeavor at least to close this one.

F. CAPITAL GAINS ON SALES TO RELATED TAXPAYERS

Section 310 of the House bill was directed against an abuse of the capital gains rules which has gained considerable popularity during the past decade of rising prices. This is the realization of a capital gain on a technical transfer of depreciable properties in order to enjoy increased depreciation allowances against ordinary income. The House proposed to prevent the continuation of this practice. The Committee on Finance voted to ignore it, and struck this section from the bill.

Let me state an example of the type of thing which the Finance Committee action condones. Suppose John Smith constructed an apartment house in 1931 at the cost of $1,000,000. We will say that this building is subject to depreciation over a forty year period, so that in the intervening 20 years, half the cost has been written off against Smith's income and half remains to be deducted in the next twenty years. But this system of amortization for tax purposes doesn't reflect what has actually happened to the value of that building. Rather than having been reduced in half, its actual value is now double the original cost -- or $2,000,000. So John Smith, after seeing a tax lawyer, decides that he will sell the building to his wife. She borrows most of the purchase price, and the deal is consummated.

The result: first, the Smiths still have the apartment house; second, even considering them separately, neither Mr. Smith nor Mrs. Smith is any richer or poorer than before the transfer -- the sale was at current market value; third, Mr. Smith must pay a capital gains tax at a 25 percent rate, and this would amount to $375,000; fourth, Mrs. Smith has a $2,000,000 basis to deduct over the next twenty years instead of a $500,000 basis, which means a $75,000 a year greater deduction against ordinary income -- this means (in the Smith's tax bracket) income tax savings of $50,000 a year for twenty years, or $1,000,000; and, finally, at the end of the twenty years, they can sell the property with its stepped-up basis at much less tax cost than if the transfer to Mrs. Smith had not occurred.

This sort of thing is possible for two reasons. One is that a husband can sell to his wife, or to his wholly-owned corporation without parting with his investment in a practical sense. This reason was recognized by the Congress as far back as 1934, when it denied deductions for losses on such sales. Conditions have changed somewhat since the early thirties, and fortunately we are now called on to legislate with respect to gains rather than losses, but we should be no less realistic in our assumptions than were our brethren 17 years ago.

The other reason is that capital gains tax rates have been allowed to continue at a level so far out of line with the rates applicable to ordinary income. This is the root of the evil. If it is not to be dealt with directly, the least we can do would be to accept the House measure which cures one of its worst manifestations.

G. LOOPHOLES CLOSED BY THE BILL

I would be remiss if I did not call attention to the fact that this bill does close two important loopholes in the tax bill.

The most important of these is the elimination of the so-called "two-for-one" effset of short-term capital losses against long-term capital gains. In non-technical terms, the problem is this: If an individual makes a loss on an asset held for less than six months, he is given a full deduction for that loss; on the other hand, if he makes a gain on an asset held for more than six months, that gain is cut in half before it is taken into account for tax purposes. The result is that an individual with a $1,000 short-term capital loss can offset completely a long-term capital gain of $2,000. Thus, even though he makes $1,000 in a given year, he would not be subject under present law to any tax.

The closing of this loophole will be especially important in keeping speculators from avoiding their fair share of the tax and I should like to congratulate the Senate Finance Committee for the courage it has displayed in closing this loophole.

Another avenue of tax avoidance that the Finance Committee closed was the loophole by which dealers in securities shift securities from their own account to their business account and vice versa in order to obtain the maximum tax benefits. If the dealer makes a capital gain on the investment, he reports it as his own income and gets the preferential capital gains treatment, which means that he is subject to a maximum rate of 25 percent.

If he makes a loss on the investment, he reports it as his business loss and gets full deduction for it, the value of which may be as high as 91 percent if he is in the top most surtax bracket. To forestall this practice, the bill provides that in the case of a dealer in sureties, capital gains treatment will be available only under certain restricted conditions which will prevent them from shifting their assets from their own accounts to business accounts.

In total these two items will not raise a great deal of revenue. However, even though it is a small amount, it is nonetheless a good start. Unfortunately the Committee has more than made up for this revenue gain by including in the bill a large number of new loopholes which cost much more than the revenue raised by these new provisions.

I should like to turn now to an examination of these new loophole-opening provisions.

III. NEW LOOPHOLES ADDED BY THE BILL WHICH SHOULD BE ELIMINATED

The bill before you is 349 pages long and contains 131 different sections. Of these, 52 sections relate to the changes in rates of individual, corporation and excise taxes. The remaining 79 sections are technically worded provisions which cannot be understood without diligent and intensive study. I do not claim to understand all of them, nor do I intend to bore you with all of the minutiae. I do want to state, however, that behind the facade of legal language, a number of important loopholes have been opened. These new loopholes cannot be tolerated and I propose to join my colleagues in offering amendments to eliminate them from the bill

The loophole-opening provisions are of two kinds. First, there are several which expand the scope of two important loopholes already in the present tax laws -- the capital gains provisions and percentage depletion. As I have already indicated, these provisions are not of the "peanut" variety -- they cost the taxpayer hundreds of millions of dollars. Unless they are eliminated, taxpayers who do not now benefit from them can argue on the basis of equity that they are being discriminated against or are put in a bad competitive position relative to those who do benefit. The danger of extending these loopholes is that the structure of the income and excess profits taxes becomes punched full of holes through which the chosen few can avoid the high tax rates while the many who work on the farms or in the factories will have to pay for the cost of running the government.

The second type of provision which is objectionable is the variety which are obviously designed to give relief to individual taxpayers. In the 2600 pages of testimony taken by the Senate Finance Committee on this bill, you will find hundreds of requests that these taxes be reduced. Everybody's taxes are high and the load is admittedly burdensome. But there is no justification for pinpointing relief tailored to one taxpayer. The relief accorded to individual firms in this bill under the excess profits tax bill exempt many corporations from taxes on profits which this Congress, at the insistence of the people, defined as excess profits. The fact that a firm is required to pay a large excess profits tax is usually evidence that that firm is earning exorbitant profits, not that the law is defective. The relief provisions in the original law are overly generous and we should be now engaged in tightening them rather than extending them.

The provisions which are objectionable can be spotted easily in the bill even by the layman. Where a section refers to capital gains, percentage depletion or exemptions, the likelihood is that one taxpayer or a small group of taxpayers is being allowed to convert ordinary income into capital gains, or is being permitted a double deduction for depletion, or is being exempt from his fair share of the tax load. We cannot afford to indulge in this practice. Experience in foreign countries provides ample evidence that a tax system will quickly become discredited and wholesale non-compliance and tax evasion will be invited. This is the road to inflation and national bankruptcy.

A. CAPITAL GAINS FOR COAL ROYALTIES

One example of the special relief provisions is section 325 of the bill. The demands of the private owners of one of the country's natural resources was made in the name of the divine right of capital gains, and this combination, of course, was irresistible -- even in the House of Representatives. The result was a provision which would somewhat lighten the tax burden of some of our people -- not of wage earners, to be sure; not even of those who direct the development of the resource in question. In this case the beneficiaries would be the recipients of royalties. The provision is one to tax at capital gains rates royalties received on coal production.

In recommending this provision, the Ways and Means Committee offered the explanation that timber owners now have capital gain treatment on their cutting contracts, and have had since 1943. How could one justify denying to coal what is accepted in the case of timber?

This, of course, is always the argument made on behalf of one special interest from a privilege granted to another. Instead of demanding that the hole be closed, the cry is to open it a little wider so we can get through too. It was opened for timber partly because timber gets no percentage depletion. Now that is forgotten, and the only thought is not to discriminate in favor of timber and against coal. If this measure passes, next year we will be asked to do the same for other mineral interest, particularly oil and gas, and then our defenses against the in-oil payment provisions, thrown out in conference last year, will be down, and an entire major segment of our economy will have squeezed itself into the capital gain area. One year ago, my colleagues and I stood on the Senate floor exposing a similar provision with regard to "in-oil" payments with the result that it was rejected in Conference. In truth, if this measure is to pass for coal, how can any of the other minerals -- oil, gas, iron, or limestone -- be denied it, and how can writers, composers, and inventors any longer be taxed at ordinary rates?

I wish I could say that our own Finance Committee had alerted us to this problem. On the contrary, it not only approved the House action; it extended it. So that no royalty owners will be denied the benefit, it virtually knocked out the six-months holding period requirement by permitting the holding period to be computed by reference to the date the timber or mineral is cut or mined, rather than to the date of the cutting or mining contract.

This is an example of the type of relief provision which cannot be tolerated in these times.

B. MINE DEVELOPMENT AND EXPLORATION EXPENDITURES

Existing law permits mining companies to capitalize expenditures for development and exploration purposes, and write them off against income as the mineral is produced and sold. After the development stage is passed, further development expenditures are similarly "spread" and charged against subsequent, benefitted production, but these latter expenditures are not deemed to be capitalized, and therefore are not charged to the cost depletion account. Therefore, they can be deducted even if the company elects to use percentage instead of cost depletion. Now, the companies want to treat pre-production development and exploration expenditures in the same way, so that for them, as for the later expenditures, percentage depletion becomes not a substitute allowance, but substantially a free and clear subsidy on top of most of the cost deductions for which cost depletion is traditionally allowable.

The House agreed that this should be permitted for development expenditures and the Finance Committee has both approved this proposal (Section 309) and a further proposal to give an option as to when the deduction for development expenditures should be taken. It also added a deduction for exploration expenditures up to $75,000 (Section 341).

These actions raise two questions. One is provoked by the fact that the ordinary business concern is strictly supervised as to the year in which its depreciation deductions and its expense deductions may be taken. Perhaps this supervision is more strict than it should be, but if it did not exist to some extent, taxpayers would acquire a great control over the degree to which increases in tax rates would be effective against them on the date enacted. But it is hard to see why a company which puts its money into plants and machinery should be subjected to a more rigid tax amortization system than mining companies.

But even if this discrimination in favor of the mining companies is justified, the double deduction is not. The importance of the proposal really lies in the "expensing" of costs as a means of enhancing the value of the percentage depletion allowance.

It is true that the deduction for development costs would give to mining companies only what was long ago given to oil and gas concerns. But that criterion would justify amendments which would leave little in the way of an income base for the tax rates to apply to.

It may be argued that these provisions are necessary to give the little fellow a break and to provide him with additional incentives to explore and develop mines. However, no limitation on the double deduction for development expenses was placed in the bill. The double deduction for exploration expenses is limited to $75,000. If these provisions are not entirely eliminated, I shall move to place the $75,000 limitation on development expenses as well as exploration expenses.

C. EXTENSION OF PERCENTAGE DEPLETION

Over and over again both President Roosevelt and President Truman have directed attention at percentage depletion as the most costly and most unjustifiable tax subsidy in the Revenue Code. Over and over again the Congress has responded by enlarging the privilege, making it more costly and less justifiable than it was before. Once percentage depletion was the prerogative of oil and gas, supposedly an allowance to cope with the hazards of exploration and drilling. Before the war it was extended to coal, sulphur, and the metallic minerals. During the war it was extended to many non-metallics. In Section 319 of the present bill, besides raising the rate of several minerals already in the law, it is proposed to add about 25 new minerals. If there is any substance found in a natural state which has been omitted from this most recent list, I cannot think of it. If there is one, I cannot conceive of why it should be denied a privilege which is to be granted sand, gravel, stone, clay, oyster and clam shell, and salt.

Let me read a list of the new minerals to which percentage depletion is applicable. Both Section 319 of the committee's bill and section 304 of the House bill set up a new group of minerals to which percentage depletion is available at the rate of 5 percent. Both bills extend this rate to sand, gravel, slate, stone (including pumice and scoria), brick and tile clay, shale, oyster shell, clam shell, granite, and marble.

In addition, the committee added to this category entitled to the 5-percent rate: sodium chloride, and, if from brine wells, calcium chloride, magnesium chloride, potassium chloride, and bromine.

The House bill also included asbestos at the new 5-percent rate. The Senate committee allowed asbestos a 10-percent rate. Both bills increase coal from its present 5-percent rate to 10 percent.

The House bill added to the list of nonmetallic minerals, to which percentage depletion is available at a 15-percent rate, borax, fuller's earth, tripoli, refractory and fire clay, quartzite, perlite, diatomaceous earth, and metallurgical and chemical grade limestones. The committee's bill, on the other hand, provides that these items added by the House are to receive percentage depletion at the same 10-percent rate accorded coal and asbestos. In addition to these items, the committee added a 10-percent rate for wollastonite, which is important as an insulating and fireproofing material and thus competitive with other items presently accorded similar treatment, and the magnesium compounds magnesite, dolomite, and brucite.

The committee's bill adds to the nonmetallic minerals presently receiving 15-percent depletion, aplite. This material is closely related to feldspar, which already receives a 15-percent depletion.

Again, as before, the contention is that these new minerals are all competitive with some already enjoying the privilege. I am not prepared to confirm or deny this assertion. I do know that it is a contention which must eventually lead, if accepted, to percentage depletion for every element and compound known to the chemical laboratory.

As I have indicated, the annual revenue cost of percentage depletion for oil and gas alone has been estimated at three-quarters of a billion. The increases and additions in this bill would cost another $77 million each year.

Those figures do not account for the cost as to sulphur, coal, the metals, and the non-metallics which are already in the law. The changes recommended by the Finance Committee altered the result of the House action but little. Another half-dozen minerals, more or less, would be added, but the rates on a few added by the House would be somewhat reduced.

Again and again, various excuses are made for percentage depletion, and as soon as one is run down and exposed, another has been prepared. If this debate could lead to a full understanding of the percentage depletion issue, this body would be amply rewarded for the entire time devoted to the bill, but I will assure you that much time would be required.

The latest excuse is the necessity of stimulating exploration for and development of minerals of strategic importance. This sounds fine for oil and gas. What it means for sand, gravel, stone, and oyster shells, I do not know. For coal, everybody knows that it is nonsense, so the argument is turned upside down and coal is said to be a depressed industry, and requires the stimulus of the depletion subsidy. If subsidization is the real justification of the privilege, we could not only eliminate half of those minerals entitled to it -- we could take the program entirely out of the tax laws and put it where an administrator could handle it so as to get the maximum results for the cost to the government. I am sure that it won't be difficult to find an administrator who could stimulate a great deal of exploration with a fund of three-quarters of a billion to a billion a year.

Percentage depletion is already overdone in present law. It should not be extended.

D. FAMILY PARTNERSHIPS

A special provision for family partnerships was adopted by the Senate last year with a clause which made it retroactive back to 1939 but it fell by the wayside in the conference.

It is back again in this bill in Section 339. The House bill includes the provision, but makes it effective only for the future; the bill as reported to the Senate was amended to include last year's retroactive feature.

The bill allows a father who runs a business to reduce his taxes by making gifts to each of his children of an interest in his business. The children need not work. An infant 6 months or 6 days old can be a partner. If the father wants to be technical, he can create a trust for his children, make himself trustee, and in that capacity become his own partner.

Ordinarily a man would not seriously consider making his infant children partners in his business or becoming an imaginary partner with himself as trustee. For the past ten years, however, our country has lived in mortal peril. To meet that peril Congress has reluctantly felt obliged to raise everybody's taxes. We have tried generally to impose those increased taxes on the principal of each income producer's ability to pay. Persons making a larger amount of money have been called upon to pay taxes at higher rates than those who make less.

I believe that many of the family partnerships formed during World War II were motivated and used primarily, if not entirely, by high bracket taxpayers — many of whose incomes are directly or indirectly multiplied by war-connected inflation — to escape paying what the Congress has decided is a fair share of the tax burden to be borne by people receiving a certain amount of income. Most of the family partnerships which would be sanctioned by the bill would be motivated in the same way.

If a man's business earns a net income of $100,000, he should pay the tax at the rates the Congress has prescribed for $100,000 incomes. If he wants to give some of his money to his children, or set it aside in trust for their benefit, that is fine. That is what a man should do. But first he ought to pay his taxes on money that he earns and continues to control. He should not be allowed to take his two children into partnership with him, and pay a reduced tax on part of his income as if the children or the children's capital earned a half or a third of his income.

Without income splitting a married man with two children earning $100,000 net would pay an income tax of $65,232. As the law is now his tax is $51,912. By the fiction of income splitting, he saves in taxes $13,320 — almost the amount of a Senator's entire salary.

Now let our $100,000 income man take advantage of the new bill and form a partnership with his two babies. Let us assume that he keeps one-half of the income himself because he does all the work, and that he gives each of his children a one-quarter interest in his business. Then the taxable income of the husband and wife is artificially reduced to $50,000. The income of the child partners is assumed to be $25,000. The family tax bill is reduced still further. The husband-father files a joint return with his wife and pays a tax of $19,592. Each baby has a tax paid for him of $9,796. The family tax bill on exactly the same income of $100,000 earned in exactly the same way as before is $39,184. Our generosity by first giving split income in 1948 and now by legalizing family partnerships would save our $100,000 businessman $26,048 in taxes.

If the increased rates become law, the tax saving from split income and family partnerships will be even greater — in dollars and percentage-wise. I don't see how anybody running a business as an individual could afford not to take advantage of the loophole here proposed. I wish that the times were such that we could reduce everybody's taxes that much. I see no reason why a man in a position to take his children into his partnership should be singled out for specially privileged treatment.

That is what the House bill does. That is bad enough if only for the future. But there are a lot of people who tried this tax avoidance scheme during World War II when taxes were also pretty high for the same reason they are now — because we were trying to pay for our defense by taxing people according to their ability to pay. This bill would fix those World War II cases. The bill goes back to 1939.

During all that time many businessmen and high-bracket taxpayers succumbed to the suggestion of smart lawyers and accountants, or figured out for themselves, that they might avoid a lot of taxes by taking their wives and children into so-called partnership. To get the tax advantage under the law as it is now and was then, they had to claim that the wives and children were real partners in the legal sense that they intended to work together and invest their money together as bona fide partners.

Those who formed valid partnerships in a bona fide way have been allowed to split their incomes by the Bureau of Internal Revenue and the Courts. Many had a little, but not enough, evidence that their wives or children contributed money of their own which didn't come straight from papa, or who could prove that they did some work for the income they claimed was theirs for tax purposes. They have generally settled their cases and gotten some tax advantage - not all they claimed.

But there are obviously many cases in which nothing happened except that the husband purported to make a gift to his wife and children. These cases the Government refused to settle. The people involved in these classes of cases are trying to make the new loophole which the House has opened for the future retroactive to minor cases all the way back to 1939.

There was a time when the Congress was making a studious effort to close loopholes -- to make people pay taxes on their real income at the rates the Congress purported to fix.

An alarming tendency is developing to open loopholes for the future principally by letting people split incomes and enlarging and extending the privilege of paying capital gain rates on half of the income a person gets from certain kinds of transactions. It is bad enough to create a loophole by act of Congress. This partnership provision reaches a new high - or low. It opens a loophole -- of dubious merit -- for the future, retroactively extending that loophole back thirteen years into the past.

I recommend that the Senate delete the family partnership provision. The Treasury estimates that it will cost $100 million annually in the future and $200 million for past refunds. We cannot afford to give tax handouts like these. I strenuously urge that the Senate refuse to enact a bill for the private and unwarranted relief of unnamed and unnumbered individuals who formed family partnerships in the past thirteen years for tax avoidance purposes.

If the Bureau of Internal Revenue has taken tax money from some of the people -- for example, where soldiers were made partners and then went away to war -- perhaps a private bill for their relief might be in order. Even if some of these people have lost their cases in court, they can be helped by a private bill. I suspect that some of the most deserving cases involve people who believed in the bona fide nature of their partnership, took their cases to court and lost. This bill would give them no relief. The measure before the Senate is a comprehensive revenue bill -- it is a war measure. The procedures and safeguards which we have established for private bills have not been followed where we have focused on the complex and difficult fiscal and legal problems involved in a revenue measure.

Let us not enact private relief measures for high bracket taxpayers in a bill like this.

On this provision I should like to obtain some information from the distinguished members of the Committee.

(1) Would it be of any benefit to taxpayers under $5,000? If so, how much?

(2) Is it true that the principal support for this provision comes from tax lawyers who gave bad advice to clients that they could set up tax avoidance schemes to duck the higher income tax rates during World War II and then had them upset by the Courts?

(3) Does it appear reasonable that at a time when we are raising taxes for the many to meet the costs of an emergency, we should enact a provision which loses revenue for the benefit of a few?

E. Tax-free redemption of stock to pay estate tax

In the Revenue Act of 1950 the House proposed to permit the tax-free redemption of the stock of a closely held corporation where the proceeds of the redemption were needed to pay the estate tax of a stockholder. The House bill limited the privilege of tax-free redemption to cases where stock of the closely-held corporation constituted 70 percent of the decedent's taxable estate.

The Finance Committee amended the House bill to delete the 70 percent limitation therein. We debated the provision on the floor last year. Thereafter the conference committee limited the provision to those cases where stock of a closely-held corporation constituted 50 percent of a decedent's estate.

The Finance Committee has now come forward with a proposal in Section 339 of the bill to reduce the 50 percent limitation to a 25 percent limitation.

As we pointed out in last year's debate, the problem for which the tax-free redemption feature was enacted would not arise in cases where a closely held corporation regularly distributed its profits in dividends, instead of constantly accumulating those profits. The reason these closely held corporations accumulated the profits was usually in order to protect the stockholders from the ordinary income tax imposed on dividends.

This purposeful failure to declare dividends means that when theprincipal owner of a closely held corporation dies, he has no cash outside of his corporation with which his estate can pay the estate tax. The only way the estate can withdraw the cash necessary to pay the estate tax is by liquidating a portion of the stockholders' interest in his corporation. And a partial liquidation of a stockholder's interest is taxed as it should be, asa dividend at ordinary income tax rates.

Stockholders of closed corporations having put themselves into this jam, came to Congress last year, andare back this year, to get relief from it.

There may be some justification for tax-free redemption where an individual stockholder has all of his property tied up in a single corporation. There is some, but less, justification for allowing tax-free redemption where the stockholder of a closely held corporation has half of his property tied up in a closed corporation. We see no justification for giving tax-free redemption relief to those estates of those who have only one-fourth of their property tied up in a closely held corporation. If they have to pay an income tax on the distributions necessary to pay the estate tax, that is only because they have escaped the tax on dividends by cutting close to the corner of section 102 of the Internal Revenue Code.

The Senate should reject the Senate Finance Committee's request and leave the qualifying percentage at 50.

F. Section 117(j)

The bill contains another chapter in the old story about conferring capital gains treatment on property used in a business.

The story started in 1942- the first year that capital gains on this type of property was ever allowed - with the enactment of section 117(j) of the Code. Section 117(j) was not only unprecedented in that it allowed capital gain treatment on the sale of land, buildings, and other properties used in a business. It was also the first provision of law ever to declare as to certain properties that if sold at a gain would be capital gain, but if sold at a loss would be ordinary loss. In other words, heads I win, tails you lose. No wonder Uncle Sam comes out on the short end and doesn't have enough left to pay his bills.

How many members of this body have ever thought of the fantastic consequences of this provision? Take the case of two firms operating fleets of delivery trucks which have been fully depreciated against ordinary business income, but which are still in use. They sell their trucks to each other. Each pays a capital gain, but each also acquires a new cost basis to write off against ordinary business income, once more. This is merely one illustration of the result of making capital gains treatment available for ordinary business properties, whose cost is of course charged against ordinary income as long as they are in use.

The livestock problem was inevitable, once this irrational section 117(j) system was adopted. The question whether taxpayers who owned draft, breeding, or dairy animals, and who from time to time make sales from the herd, were disposing of property used in the business, or rather of property held for sale, which was not entitled to section 117(j) treatment, was a difficult one in many cases. After contesting many of these cases with no success, the Bureau of Internal Revenue earlier this year issued a ruling that section 117(j) treatment would be accorded such animals where sold after their full period of usefulness for draft, breeding or dairy purposes. The House hasproposed to substitute for the Bureau's rule merely the requirement that the animals sold shall have been held for 12 months or more in order to come within section 117(j). In section 324 of the bill, the Committee on Finance approved this proposal, recommended that it be made retroactive to January 1, 1942, and included turkeys along with draft, breeding and dairy animals.

Our basic problem in taxation is equality of treatment of those similarly situated. The farmer who disposes of property used in his business should not be taxed differently from the manufacturer or the merchant who does the same thing. There is no doubt that draft, breeding, and dairy animals are property used in the business of the farmer.

But this does not justify the retention of section 117(j) as a whole. Special capital gains treatment, if proper at all, is proper for investment properties and investment properties only. Properties used in the business must regularly be acquired, regularly used, and regularly sold or junked in order for the business to continue. There is not the same problem of the "bunching" of income, nor the same problem of discouraging the conversion of investments, which arise in connection with investment properties.

Unless the rate structure for ordinary income is to be junked by making capital gains rates of universal application, section 117(j) should be repealed and we are offering an amendment to that effect.

G. Corporate Spin-offs

Section 317 of the bill deals with the tax free distribution of common stock in connection with a reorganization. This is commonly referred to as the "spin-off" provision. Its general effect is to allow the business conducted by one corporation to be conducted by two. And unless strictly safeguarded it can result in a loophole which will enable a corporation to distribute earnings and profits to stockholders without payment of the usual income taxes. This provision was in last year's bill, but was eliminated in conference.

As I indicated in my statement last year, if corporation A conducts a lock and key business it may, under this provision, transfer the key business to new corporation X in exchange for X's common stock and then distribute to the Corporation A stockholders all the stock of X, free of tax. At present the Treasury would attempt to impose a tax upon the stockholders of A based upon the receipt of X stock. The value of the X stock would ordinarily be taxed as dividend.

If the A stockholders merely wish to divide the two businesses for good business reasons and operate them by means of two corporations, the provisions of section 317 allowing the tax free distribution of the X stock do not result in tax avoidance; the stockholders merely continue to operate the same business through two rather than one entity.

Clauses (A) and (B) of Section 317 provide very important safeguards against the tax avoidance which would be possible if Section 317 were adopted without Clauses (A) and (B). To illustrate — assume that Corporation A has a factory and a very large amount of cash and government bonds which it does not particularly require in its business. If the corporation declares a dividend of the cash and bonds, the shareholders are taxable on the full value of the cash and bonds at ordinary surtax rates. However, if the protection afforded the revenue by paragraphs A and B were removed, the stockholders might obtain the cash and bonds at low capital gain rates in the following manner. Corporation A, claiming some trumped-up business purpose, would transfer the cash and bonds to new Corporation X in exchange of X's stock and distribute X's stock to the stockholders of Corporation A. After permitting a decent interval to elapse, Corporation X would be liquidated. The stockholders would receive the cash and bonds in liquidation -- which transaction gives rise to capital gain rather than ordinary income -- or the stockholders could merely sell their stock and "cash in" on their dividend at capital gain rates.

Paragraphs (A) and (B) prevent this type of avoidance by requiring that in order for the distribution of stock in Corporation X to be tax free, both Corporations A and X are intended to carry on active business after the reorganization and by providing that Corporation X was not used as a device to distribute the earnings and profits of either corporation.

There is one type of tax avoidance possible under the spin-off which is not prevented by paragraphs (A) and (B), namely, a corporate tax on appreciated assets and a tax upon the proceeds of a sale of these assets. Going back to the lock and key business owned by Corporation A, let us assume that Corporation A wants to get out of the lock business and receives a very advantageous offer for the lock assets. If Corporation A sells the lock assets the profit will be taxable income to Corporation A and then when the profit is distributed as dividends to the stockholders, the dividend is taxable to them as ordinary income. Under Section 317 as it now stands it might be possible for Corporation A to transfer the lock assets to Corporation X in exchange for X's stock and then distribute X's stock to the A stockholders. (In all these corporate exchanges no gain or loss is recognized or taxed under the reorganization sections.)

The stockholders would then sell the stock of X Corporation and would receive the proceeds as capital gain. Accordingly, both the corporate tax and the tax upon the distribution as a dividend could be avoided if the transaction were properly handled.

If the section is to remain -- and the provision is not without merit in effectuating bona fide business adjustments -- a further safeguard should be added to meet the last example. This safeguard might be a provision to the effect that the distribution of X Corporation stock (in the example) would be tax free only if there were no intention to sell the stock at the time of its distribution and if there were in fact no sale for a period of three years thereafter. Without this safeguard, I believe the provision is undesirable and should be eliminated.

Now, I ask the distinguished Chairman of the Finance Committee, if the purpose of this amendment isnot to afford capital gain treatment for an otherwise taxable dividend, what objection can there be to the safeguard I propose?

H. Other Income Tax Loopholes

Let us turn now to the minor loophole provisions. Overall, they are much too involved, and too numerous, to warrant a detailed analysis here. It is important, however, that we be able to identify some of these sections and know what in general they do. You will recall the earlier simple tests I mentioned. The most favorable result that can be attained by a taxpayer is to have his income exempted from tax - and sections 302 and 303 do that - for those taxpayers lucky enough to fit the specifications. The next best thing tax-wise is to turn ordinary income into capital gains, taxable at a maximum rate of 25 percent, and sections 323, 324, 328 and 330 do that - again, not for you, or for me, or for the factory worker, but for a particular taxpayer, or a narrow group of taxpayers. Another desirable achievement is to cut down the amounts of certain penalty taxes, and sections 315 and 316 do that - again, not for you or the man next door, but for those corporations improperly accumulating surpluses and for taxpayers owning personal holding companies.

All these special provisions should be considered in their proper context. This bill is not the Internal Revenue Code - to understand the full effect of loopholes you need to look not only at this bill, but at the Internal Revenue Code, as it has been amended in the past few years. A host of loopholes in this bill, others added last year, several the year before that - together, they mean that in a few short years perhaps, the only person who will be affected by the general provisions without a special relief gadget will be the wage earner. For the wage earner, this bill raises his taxes - with the only generous gadget one which will let him agree with his employer to withhold more taxes from his pay envelope. It must be possible to reverse this trend, to resist the pleas for special treatment to subject one and all to taxes which are really equal, not just deceptively so in a rate schedule.

Take, for example, section 323. That section provides that where land is sold with an unharvested crop, the gain attributable to the crops is to be treated as a capital gain and that expenses attributable to raising the crop are to be added to basis. Now you might suppose that a working farmer selling his crops, with a profit of $5,000, would be taxed the same as a fruit grower selling his orchard for a profit of $5,000. Not so, if this provision is enacted, for whatever part of that $5,000 profit of the working farmer is taxed to him as ordinary income - while the same type of profit attributable to growing crops is taxable as capital gains. This is directly contrary to present law, which properly says that growing crops are produced for sale to customers in the ordinary course of business and so are not capital assets or assets used in the trade or business. Moreover, many fancy schemes might be rigged up and attempted under this provision. There would be many sales in name only, for example, a "traveling" fruit grower might sell land and a crop each year to a willing canner, with a purchase back of land on the other side of town. The Bureau cannot possibly catch up with all the schemes.

Or take section 328. That provision would provide capital gains treatment for amounts received by an employee upon termination of employment in exchange for his release of a right to receive a percentage of future profits, if -- the taxpayer had been an employee for more than 20 years and has held the rights to future profits for 12 years. Now, this is a patently discriminatory and unjustifiable provision. The particular conditions of 20 and 12 years attached to the section obviously have no relation to any general principle -- except the facts of a particular case undoubtedly in the mind of the U. S. Chamber of Commerce representative, Mr. Alvord, who suggested it on page 1478 of the hearings, along with a number of other suggestions found in the bill. The amounts to be received are of course sums paid in lieu of compensation taxable at ordinary rates. This is not a profit on the sale of a capital asset, because the taxpayer here had no asset -- merely a contractual right to future income. The provisions of section 165(b) of the Code are far from a precedent, since that section deals with a broad group of exempt pension plans which must be nondiscriminatory and cover a high percentage of all employees. This proposal in the bill has neither restriction. How many persons can possibly benefit from this provision -- how many can there be who today fit its particular limitations? I know of none -- but there must be at least one, or Mr. Alvord would not have suggested it. I wonder if the committee can tell us how many taxpayers are affected by this and how many taxpayers under $25,000 would be affected by it? Averaging of income for all persons might in theory be desirable, but its cost would be prohibitive. There is no special merit for this one exception.

Then there is section 330. This provision would, for the purpose of determining whether a particular stock option met the requirements for receiving the special capital gains treatment provided in the 1950 Act, treat the option as granted when approved by the Board of Directors even though a later ratification by stockholders is required.

The provisions of the 1950 Act provided a loophole whereby corporate executives might receive compensation at capital gains rates. The amendment, while not highly important by itself, illustrates how loopholes grow by treating for tax purposes as being legally granted that which cannot be lawfully granted without stockholders approval. My predictions of last year are coming true when I opposed the stock option proposal. One loophole leads to another and this one is being enlarged. Furthermore, as I warned, it hasproved inflationary, as evidenced by recent action of the Salary Stabilization Board.

It would be possible to spend hours analyzing the language of these technical provisions and showing how each of them grants special relief in narrow instances for the benefit of a special few. However, it is necessary to pass on -- but in passing I must comment on one other, which in the bill's technical language is at best confusing.

Notice section 315 on page 148 of the bill. Its heading reads "Surtax on corporations not properly accumulating surplus" -- and the rest of the section relates to long-term capital gains. Now you might suppose that this provision possibly has some effect in tightening up on corporations which accumulate surplus in order to avoid paying dividends to their stockholders, which would be subject to the ordinary personal income tax rates. Just the opposite -- as we might guess from the fact that this is another U. S. Chamber of Commerce suggestion appearing on page 1477 of the hearings. This provision of the bill would exempt -- I repeat -- exempt capital gains for income subject to the penalty tax on unreasonable corporate accumulations.

There is a provision in the Internal Revenue Code (Section 102) which is designed to penalize the failure to distribute business profits to the shareholders. The nature of a corporation's income is immaterial insofar as avoidance of surtax on its shareholders is concerned -- its character is lost in its dividends which are taxable at ordinary rates. Moreover, capital gains of business corporations are usually from sales of property used in the business and thus are closely akin to its regular business profits. Thus, an accumulation of capital gains has the same effect of avoiding a shareholder's dividend tax as any other accumulation of business profits.

These provisions and others should be eliminated from the bill, and I will so move.

I. Estate and Gift Tax loopholes

The bill contains eight amendments to the estate and gift taxes. One of these, section 603, closes a loophole by taxing United States Government bonds held by non-resident aliens if situated within the United States. Three others, sections 602, 604, and 605 have apparent merit, providing a credit against the estate tax for foreign estate taxes, exempting works of art loaned to American museum by non-resident aliens and exempting from tax estates of armed force members dying in service.

The other four sections, 606 through 609, inclusive, seem objectionable enbloc. Without analyzing each in detail, they all deal with the problem of transfers intended to take effect at death, including life insurance, which in general have been always includible in the gross estate. And each section attempts to get its particular bit of such transfers out of the gross estate, thus freeing it from the estate tax, each section apparently for a particular case. To the extent that the estate tax has any merit, these amendments are without merit.

I ask the Finance Committee: How many individuals will benefit from this provision? Will it raise revenue at a time when we need revenue? What right do we have to give special rebates to the few, while we increase the load on the bulk of the American people???

J. Excess Profits Tax Relief

The bill contains 20-some provisions amending the excess profits tax, enacted less than a year ago. The cost of these provisions is $120 million. It was generally agreed last year that amendments would have to be made after sufficient actual experience had shown the problems. Here, nine months after enactment of the basic law, before most of the regulations have become final, before most of the returns have been filed and before any sizeable collections under the tax have been made, amendments are to go into effect which in the main are designed to relieve payments under the tax and to benefit particular taxpayers.

Here, again, we find techniques for arranging to relieve particular taxpayers from excess profits tax. Since that tax is applied only to earnings which are in excess of a credit based on average earnings, or on a certain return on invested capital, it is possible to lower excess profits taxes simply by increasing the credit in one way or another, since that will give him less profits subject to the excess profits tax. Or, you can lower excess profits tax by exempting certain income from excess profits income or by granting special deductions. Both general techniques are found in this bill.

Glancing through the amendments we find special relief provisions tailored to particular cases--such as sections 518 and 519, which grant discriminatory benefits to television and radio and broadcasting and the publishing industries. Where the average corporate taxpayer has several different types of business operations, one or two of which operate at a loss, his earnings credit is based on the average earnings of all his operations. Section 519 for particular segments of the television and radio broadcasting industry which can qualify, allows them in effect to ignore the loss parts of their business in computing the average earnings credit.

This special group of taxpayers is given two favorable alternatives for computing its average earnings credit. The first alternative is arrived at by applying to the total of both television and radio assets the favorable rate of return on radio assets alone, ignoring completely the fact that there was a loss on the television business. The second alternative gives to members of this industry alone an industry rate of return on the total of all assets, even though they do not otherwise fit the general categories of taxpayers now entitled to use an industry rate of return when it is more favorable than their own actual overall earnings credit.

This is the most disciminatory type of approach to building up a credit, a patchwork quilt of (1) earnings unreduced by losses, and (2) a special relief industry rate, with the taxpayer picking the particular square most favorable to him. If this approach were applied generally, the excess profits tax would be a tax in name only.

Section 503 is a similar example of discrimination on a broader and more expensive scale. Certain fiscal year corporations contended they were discriminated against because computation of their earnings credit required use of low quarters in 1945 and 1946. However this may be, the cure proposed in the bill causes greater discrimination than it set out to cure, since it will not allow these taxpayers to be among the favored few who may use the highly profitable early months of 1950 in computing the credit, while the great mass of taxpayers must ignore 1950.

Another amendment, Section 517, apparently is designed to give special relief to the multi-million dollar Monsanto Chemical Company for the situation described on page 1652 and ff. of the hearings. The present law provides a method of relief for taxpayers in general suffering "abnormalities", such as fires, strikes etc., during the base period. These taxpayers, in lieu of the actual earnings credit for the period covered by the abnormality, may use the industry rate of return as applied to the average total assets of the taxpayer during such years. Monsanto suffered an explosion in 1947 which affected its production. It clearly comes within the abnormality provision - but is not satisfied with the relief generally available to other taxpayers; since that would only give it a $28.5 million tax-free excess profits credit, when it should have - so the company states - what it would have made if the explosion had not occurred. The bill gives a sort of compromise, which is still higher than the relief available to other taxpayers with abnormalities. It gives Monsanto for each month of the abnormality year, the monthly average of its earnings for the preceding years.

Discussion of one more section appears warranted before leaving the excess profits tax sections. The Committee bill decides that purchasers in taxable exchanges should be allowed to carry over the earnings experience of predecessors. Perhaps this is a correct decision, at least where the permission is generally available, where it is limited to cases involving the sale of all the assets, where the old corporation is liquidated and goes out of business, where new money of the purchaser (i.e., assets not previously in the business) is used to make the purchase, and where only purchases prior to the excess profits law come within the privilege.

Section 520, on p. 526, would grant to a purchasing corporation the earnings base of its predecessor even though an important source of earnings of the predecessor corporation, a franchise, had to be obtained from another source. This provision violates two of the above concepts: first, it is tailored to a particular case, and second, it grants a full credit even though all the earning assets were not purchased. The particular case the provision is apparently drafted for appears on page 1615 of Vol. 3 of the hearings - a Cadillac dealer who wants a credit of $247,000 when his credit under present law is $30,000. His problem is that he could not buy the most important earning asset of the preceding company - its sale franchise - but wants its full earnings credit despite that. Without that franchise the other assets are a shell, usable only for a garage. If the prior company had been able to sell its franchise (which was not transferable) the purchase price of its assets would have been much higher. The purpose of the excess profits credit in such cases is to allow a fair return on the investment of the taxpayer. Under this section the taxpayer will receive many times more than a fair return on his investment prior to being subject to excess profits and it is likely that he will receive each year without paying anything in excess profits tax a 100% return on his investment. (Gross sales, $3 million; 10% profits, $300,000; credit, $247,000.)

It is my belief that the foregoing discussion illustrates that we are moving too rapidly to amend the technical workings of the excess profits law. If there are difficulties in the relief provisions, if computations of the credit produce anomalous results, if taxpayers as a group find particular provisions burdensome, then let us approach the problem with a view to finding satisfactory changes which will grant the relief to all taxpayers -- not by tailoring a special provision to a particular taxpayer which leaves others out in the cold. It seems unreasonable to suppose that in these brief months since enactment of the law we could know enough of its operations to make changes which cut equitably across the board. As the distinguished Chairman of the Finance Committee said, in guiding the Act through this Chamber in December of 1950,

> ". . .we have taken the extraordinary step of providing for the rewriting of this bill by the end of December, 1952, in order that we may meet the problems which, through experience (and I emphasize these two words, through experience) are then presented to us in a clearer light..." (Congr. Rec. Dec. 20, 1950, p. 16944).

I remind the members of the Senate that we are now being asked to hand $120 million of relief 14 months before we were to have gained the experience necessary to appraise the operation of the excess profits tax law.

For each excess profits tax relief provision, I should like to request the distinguished Chairman of the Finance Committee to supply the following information: (1) how many tax payers are involved; (2) what will be the cost of each provision; (3) why is it necessary to enact these provisions before we have the results of the study of 1950 excess profits tax returns.

IV SUMMARY

Mr. President, I have taken the time to analyze this tax bill -- not out of any particular love or talents that I have for the subject -- but because the bill determines who shall pay the cost of running the Government and how much. This vitally affects every man, woman, and child in this country.

Workers find their cost of living increases overshadowed by the impact of higher income and excise taxes. Those who haven't received such increases will be hit both by inflation and higher taxes.

For many families this cuts into the bacon, eggs, and milk on the breakfast table.

It's all right to say that everyone must sacrifice for the defense effort. But let's see that everyone pays his fair share of the additional tax load.

At the very least, let's not increase the load on taxpayers in the bottom brackets by shifting to them the cost of legalizing the loopholes which the bill now provides, as well as the relatively higher increase in tax rates under the Committee bill!

The bill does not raise enough money for a sound fiscal program. It imposes the higher taxes without proper regard for consideration of ability to pay. It increases the inequities of existing law by widening existing loopholes and adding new ones.

Mr. President, this is another tax bill for the greedy -- not for the needy. It should not pass without drastic revision.

TAXES AND SMALL BUSINESS

I want to talk to you today about taxes and how they affect the small businessman. In the past two years, I have made a special effort to understand a few of the intricacies of our tax laws. This is not an easy job for a person who is not a technician. I have tackled this difficult subject because it became apparent to me within a short time after I entered the Senate that knowledge about how our tax system works is essential for an understanding of what makes our economy tick. This has been a difficult job and I want to assure you that there is still a great deal to learn. Nonetheless, my experience in the debates over three tax bills has been invaluable and I believe that I am beginning to see through some of the rest.

PRINCIPLES OF TAXATION

The requirements of a good tax system are easy to state. First and foremost, taxes should be high enough to pay for the cost of Government services. There may be differences of opinion about the scope and nature of Government activities. However, once the people, through their duly elected representatives in Congress, have decided on a given amount of expenditures, it is our duty to provide the revenues to finance those expenditures. Only in this way can we hope to keep the economy on an even keel. Continuing large deficits will inevitably lead to inflation and all its terrible consequences. Inflation is a tax, but it is one of the worst taxes man has contrived. It strikes hardest at people and businesses that need the most help; it distorts management decisions, it reduces productivity and must inevitably lead to lower standards of living. We must levy sufficient taxes to pay for government expenditures in order to avoid unbalanced budgets and inflation.

The second requirement of a good tax system is that the structure must be designed to interfere as little as possible with economic growth and stability. It cannot be denied that taxation is intended to reduce incomes in the hands of private individuals and businesses. They are levied for that purpose. However, a properly designed tax system will minimize restraints on the economy and will maximize, so far as possible, the opportunities for growth and achievement.

The third requirement is that taxes must be levied equitably. We must be sure that everybody shares the burden of paying for the cost of government in proportion to his ability to pay. These are not empty words. There are numerous instances in history when the wrong kind of taxes have not only hindered growth, but also created revolutionary upheavals which have ripped apart the very foundations of society. Inadequate taxes can result in such upheavals by bringing on inflation. Inequitable and oppressive taxes can do the same thing.

There is no easy way to design a tax system which will conform with all of these requirements. The tax structure is a delicate instrument; it balances many different elements, any one of which may upset the equilibrium of the economy. As times change, as the economy grows, as new industries are formed and other industries disappear, we must be alert to change the tax system to meet the needs of changing conditions. A democracy makes such changes and even experimentation possible. When there is free interchange of opinion and public awareness of the issues at stake, there the correct decisions will be made. Progress may appear to be slow, but progress is inevitable if the people have a voice in the making of economic policy.

Let me illustrate this by the recent history of the tax bills to finance the defense program. As soon as it became clear that the country was to embark on a vastly expanded security program, there was immediate recognition on the part of the public that effective stabilization policies would be needed.

Part of this stabilization program, which the country approved, was a tax system which would be adequate to finance these increased expenditures. In the space of about a year, Congress approved higher taxes amounting to almost $16 billion in a full year. There is no question that these higher taxes meant sacrifices to us all. But there is also no question that these higher taxes are one of the major reasons for the stability of prices during the past twelve months. Common sense dictated that we follow the prudent, sound course of financing the defense program on a current basis. The people demanded prompt action on taxes and they got it. We need have no fear about the stability of our political and economic institutions if the people continue to exercise such sound judgement.

EVIDENCE OF ECONOMIC PROGRESS

There are, of course, defeatists among us who deny these basic principles. They argue that the country is going to ruin, that the end is in sight. What are the facts? Have our economic policies helped or hindered progress? Has the standard of living increased or decreased? Have profits of business risen or fallen? Is our productive capacity larger or smaller?

The figures are, of course, well known to all of you.

Production has risen to peace time records since the end of the war. In 1939, the Federal Reserve Board index stood at 109; now it is around 220.

Despite higher taxes, the per capita income left after direct taxes have risen in real terms -- that is, after correction for price changes -- by over 40 per cent since 1939.

Corporate profits after taxes have risen by 260 per cent since 1939; there is no good index to correct this figure for price changes, but I have no doubt that the increase is at least 50 per cent in terms of constant dollars.

Finally, our productive capacity is at an all-time high. Since the end of the war, industry has invested over $100 billion in plant and equipment, and it is continuing to invest at record rates even now. To me, this is proof positive that business has faith in the future of our economy.

In the midst of all this progress, all segments of our society have prospered. We are now better equipped, better-fed, better-housed than ever before. And we still look forward to greater prosperity.

The small businessman has also shared in this prosperity. There is no group in the community whose economic health and vigor is more vital to continued progress. The history of our country is the history of the small businessman, who starts with modest means, and creates large and successful enterprises. Without the stimulation, the drive and the competition of the small businessman, our economy would quickly lose its forward motion. Are we sure that small business has grown along with the rest of the economy. I believe that the facts show that it has.

In 1939, the income of non-farm entrepreneurs amounted to only $7 Billion; in 1951, it was 24 Billion. Figures on the small corporation demonstrate the same growth. In 1939, 172,000 corporations with assets of less than $1,000,000 reported profits. In 1948, the latest year for which data are available, 336,000 corporations with assets of $1,000,000 or less reported profits. The net income after corporate taxes of corporations with assets under $1,000,000 increased from $435 million in 1939 to $3.3 Billion in 1948, a seven-fold increase.

Congressional Interest in Small Business

I do not exaggerate when I say that every Congressman, regardless of party affiliation, is keenly aware of the importance of the small businessman in the economy and of the need to design policies which will help him not only to exist, but also to expand. Few pieces of legislation involving economic policies pass through the Congress before a searching inquiry is made by the committees to make certain that the interest of the small businessman will be protected. Whether the legislation involves price controls, appropriations, regulation of interstate commerce, defense production, or taxes, the role of the small businessman is never forgotten. To be sure, more needs to be done, but I believe the record indicates conclusively that Congress is determined to provide all the protection and encouragement that it is practical for the small businessman.

Tax Provisions for Small Business

Taxation is an example of the kind of protection that I have in mind. Few people realize how much of the basic structure of our tax system is designed specifically to aid the small businessman. From the time our income tax was adopted, Congress has sought to write provisions into the tax laws to mitigate the effect of the ordinary tax rates on small business. Now, after almost forty years of experience with income taxation, the Internal Revenue Code is liberally sprinkled with such helpful provisions. We may take them for granted now, but they represent solid progress in a field which is fraught with difficulties. It is to the credit of the Congress, the tax writing committees, the Treasury Department, and the Joint Committee on Internal Revenue Taxation that these provisions have been devised, enacted and put into effect with a minimum of controversy and with little or no fanfare and publicity.

I should like to discuss some of these provisions briefly and to indicate the reasons for their enactment.

The "Notch" rate

The first and most obvious concession to small business is the elimination of the so-called "notch" rate under the corporation income tax. Now that the "notch" rate is no longer in the law, we may wonder how it was ever permitted to creep in. The history of it is relatively simple.

When the corporation income tax rate was increased during the early 1930's, Congress attempted to provide a lower rate for small corporations. However, graduation in the sense that we know it under the individual income tax cannot be applied in the corporation area. While we can be sure that an individual with an income of $50,000 has more ability to pay than another individual with $5,000, we cannot be sure that a corporation with a $500,000 income has more ability to pay than one with a $50,000 income.

The $500,000 income may represent a return on an investment made by 20 stockholders, while the $50,000 income may represent the income of only one stockholder. In the first case the average income per stockholder is only $25,000; in the second case it is $50,000. I believe there are good reasons for levying a separate corporate tax, but the case for graduation is weak.

Despite this theoretical weakness, Congress felt that the small corporation, especially if it is new and growing, deserves special treatment. To square the two objectives, it was decided to levy a flat rate on the most profitable corporations but to provide a lower rate on those with profits below $50,000. Technically, it is impossible to levy a flat rate above a certain level if there is full graduation below that level. This can be easily demonstrated by simple arithmetic, but it can perhaps best be understood by explaining the "notch" rate.

Under the rates which were levied in the years 1946 through 1949, there were five brackets and the rates in these brackets were as follows:

Bracket	Rate	Cumulative Tax
Under $5,000	21%	$1,050
5,000 - 20,000	23	4,500
20,000 - 25,000	25	5,750
25,000 - 50,000	53	19,000
50,000 and over	38	

The so-called "notch" was the $25,000-$50,000 bracket where the rate jumped from 25 to 53 percent. What did this accomplish? The purpose was to make the transition from the 14 percent rate at the $25,000 level to the 38 percent rate which was desired exactly at the $50,000 level. (As can be seen from the above table, it was necessary to make up $13,250 in tax -- $19,250 less $5,750 -- over a $25,000 income range, which gave 53 percent.) The 53 percent rate was the only rate which would do this exactly.

It was soon found, however, that while we accomplished our objective of levying a flat rate of tax on most corporation profits, we had put a very heavy penalty on any business which was in the $25,000-$50,000 bracket. As soon as any corporation earned a dollar of profits above $25,000, it was "socked" by a 53 percent rate on that dollar of income. By contrast, the largest corporations were subject only to a 38 percent rate on each dollar of additional profits. Instead of helping small business, the "notch" provision actually penalized it. Small companies had great difficulty getting through the $25,000-$50,000 bracket. Once beyond $50,000, they had the advantage of a lower rate.

All of this was changed by the Revenue Act of 1950. We forgot about our qualms over graduation and adopted a simple two-rate system: one rate for profits up to $25,000 and another for the amount of profits over $25,000. The rate up to $25,000 is now 30 percent, and above $25,000, 52 percent. This is one of the most outstanding examples of tax revision made specifically to ease the tax burden on small business.

Averaging of profits and losses

Another important provision which is of assistance to small business is the allowance in the Internal Revenue Code for business losses. Under our annual income accounting concept, if it were strictly followed, a business would be taxed during those years when it earned profits but would not be permitted to deduct any losses from such profits when it incurred them. As a result it is conceivable that without an allowance for losses a business could break even over 5 years and yet pay Federal income tax. The method used in the tax laws to prevent this from happening is called carry back and carry forward of business losses. Thus, if a business makes a loss in one year it can carry back that loss against profits in the preceding years or, if there were no profits in the preceding years, carry it forward against profits in the succeeding years. In this way profits and losses are averaged out for tax purposes.

Before the Revenue Act of 1950, businesses were allowed to carry back losses to the two preceding years or to the two succeeding years. Including the current year, this provided in effect a five-year averaging period for business incomes. In the post war period, many representatives of business, especially those from the small business sector, pointed out that a five-year period is not sufficient to average out profits and losses. Consequently, in the Revenue Act of 1950, the averaging period was changed to seven years and the method of computing the carry-back and carry-forward was altered to be especially beneficial to new and growing businesses.

The 1950 provision permits business to carry back losses in any
7 year against the income of the prior year and against income in the five succeeding years. Emphasis was placed on the carry-forward rather than the carry-back because it was found that the carry-forward is of greater assistance to the expanding firm. Ordinarily when a firm starts operations it takes several years before the business is profitable. For such firms the carry-backs are not very useful, because there is no income history in the past against which losses can be offset. The carry-forward on the other hand gives the business a five-year opportunity to offset losses against profits.

We have not yet had a good opportunity to determine how this provision is working out. In the first place the provision became effective first for calendar year 1950 incomes and we do not yet have any statistics for that year. In the second place, incomes since the adoption of the provision have been generally high and losses relatively infrequent. I have no doubt that the Congress will adjust these provisions further if they prove to be inadequate.

Excess Profits Tax Relief

The excess profits tax passed in 1950 is an excellent example of legislation which protects small business. Most of the provisions in the law are of a technical nature and are too detailed to discuss here. However, three of these provisions are worth mentioning.

First is the minimum credit which exempts all corporations with profits of less than $25,000 from excess profits tax. Excess profits are computed by subtracting from current income a credit which is based either on average earnings in the three best years of the base period, 1946-49, or on the basis of a predetermined rate of return on capital. However, corporations with profits of less than $25,000 are not required to pay excess profits tax even though their current income exceeds the "earnings" or "invested capital" credits.

Second, for those corporations whose earnings are in excess of $25,000, the law provides what is known as the "growth" formula in computing the earnings credit. This formula bases the credit not on the average of the three best years in the base period, but on either (1) the average of profits in 1948 and 1949, (2) 1949 profits, or (3) a weighed average of profits in 1949 and 1950. Not all corporations can qualify for this formula. It is restricted only to corporations with assets of less than $20,000,000 at the beginning of 1946 which had substantial increases in sales and payrolls between 1946 and 1949. In effect, this provision recognizes that small corporations grow. Accordingly, part of the increase in their profits since the base period is not considered "excess", but is attributable to growth and is, therefore, tax exempt.

Third, businesses which started operating some time in the base period are allowed to compute their credit on the basis of the growth formula; or, if they started after the base period on the basis of the average rate of return of the other established firms in the same industry during the base period.

These and other provisions in the law exempt the large bulk of corporations from excess profits tax. Over 600,000 corporations file returns at the present time, and it has been estimated that only 75,000 pay excess profits tax. Most of the exempt corporations are, of course, the smaller ones. This is appropriate because the excess profits tax is not intended to impede the growth of the smaller corporations.

A PROGRAM FOR SMALL BUSINESS

As I indicated earlier, the provisions I have outlined are only a few examples of the protection afforded to the small businessman via the tax laws. We intend to do more, if that is possible. I believe that there are at least two important considerations which we must keep in mind in discussing further protective measures.

First, the most important protection we can give to small business is a full-employment, growing economy. No matter how many gadgets we add to the tax laws, they will be insufficient unless we provide the environment for the combined expansion of business. History proves that the fate of small business depends on the health and vigor of our economy.

Second, small business has a vital stake in the development of tax laws which are fair and equitable for all. As you know, I have devoted a great deal of my energies to uncovering loopholes in the tax laws which are costing billions of dollars of tax revenue. The benefit of many of these provisions are not shared by all, but are restricted to a few special groups. When these special groups get tax relief, all other groups -- the laborer, the farmer, and the small businessman -- are taxed more to make up the difference. Elimination of loopholes is a measure which can eventually provide the basis for easing the tax burden on the majority of taxpayers and businessmen. I wonder how many small business men realize that the excessive percentage depletion allowances which are now costing the government about three-quarters of a billion dollars in tax revenue actually exceeds last year's entire tax increase on all corporations with net incomes below $100,000. I believe it is unconscionable to require small corporations to pay taxes on their entire income at the same time that the giant oil companies are handed tax benefits of these magnitudes.

Many tax proposals for assisting small business have been made. They range from outright exemptions to technical provisions regarding depreciation allowances and the treatment of dividends. Most of these proposals raise difficult equity, revenue, and economic issues. Nonetheless, I have no doubt that we will continue to find ways and means to refine our tax structure, as we have in the past, so that the interests of small business will be protected. Members of Congress can be guided in making these decisions only if they know what the problems of small business are. I, for one, would welcome any suggestions you may have on legislative matters relating to taxation or any other economic policies which affect the operation of your business.