

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM**Office Correspondence**Date December 4, 1941To Chairman EcclesSubject: Developments on TaxationFrom Martin Krostat the Treasury

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Mr. Blough asked me to come to his office this afternoon for further discussion of the tax program. He indicated that the Secretary had been impressed by the force of the objections that you had made to the withholding tax in its present form and had asked the staff to reconsider the program as a whole in the light of these objections. The opposition expressed by Senator George to further increases in taxation and other developments made it seem unlikely that the congressional committees would agree to hear detailed suggestions from the Treasury until after the first of the year.

Even after the first of the year, it seemed probable that action would be delayed. Congressional leaders were anxious to give first consideration to an administrative bill containing provision for remedying inequities on which they had been promising their constituents action for several years. (This would include a provision dealing with the personal holding company problem which was brought to your attention last summer.) The Treasury hoped to include in this bill some loophole closing provisions particularly with respect to tax exempt securities and to the taxation of insurance company net income.

As an alternative to the suggestion of the withholding tax they were at present considering a number of proposals. One of these was for a tax on increases in income. So far as their consideration had gone they were impressed with the difficulties of making adequate allowance for selecting a base year which would be fair to the taxpayer, finding a method of making adequate allowance for unusually high expenses in the taxable year due to illness or other causes, the fact that the tax would have a low yield unless it reached down to very low income levels and the fact that it was not possible to adapt the tax to a collection at source basis. In spite of these difficulties some fairly simple tax which would not attempt to make allowance for special circumstances might be devised.

Another proposal was to remove the privilege of paying taxes on 1942 income on a quarterly basis during 1943. The due date of payment might also be moved up from March to January or February. This would force people to make provision for their 1942 taxes currently through the purchase of tax anticipation certificates. This suggestion might be combined with collection at source of the 10 per cent basic rate. So far as the drastic character of the increase in the cash provision for taxes which people would have to make during 1942, the proposal would not differ much from the withholding tax. There was the additional problem that in 1943 it would be necessary to raise rates on 1943 incomes very drastically in order to keep collections up to the level of 1942, during which two years' taxes would have been collected (taxes for 1941 on the customary basis and taxes for 1942 on the new basis).

To: Chairman Eccles

-2-

Several methods for securing increased revenue from the excess profits tax were also under consideration. One of these was to use the average of the credits computed under the income method and under the invested capital method. A modification of this would be to allow the credit computed under the average earnings method only to the extent that it did not exceed the credit computed under the invested capital method by say 10 per cent or some similar percentage. They were also thinking of reviving the suggestion of a 10 per cent tax on the excess over average earnings in cases where corporations had a high credit under the invested capital method because of a large capitalization.

They felt that there was full agreement at the Treasury with the general idea of high excise taxes on scarce durable goods. A list of commodities with suggested rates had been received from Henderson's office and they were now studying it. They felt that with the exception of automobiles and accessories the yield of taxes on such commodities would be rather small because most of them were of minor importance from the point of view of money value.

I indicated that we were working on a list of similar suggestions. Mr. Blough offered to provide us with some statistical information which will be extremely valuable in our work and it was agreed that the conferences should continue currently. At several points in the conference references were made to the undesirability of having matters discussed in these meetings leak out to the press, and I gave assurances that no such leaks would occur so far as anyone at the Reserve Board was concerned.