



TREASURY DEPARTMENT  
WASHINGTON

DIVISION OF TAX RESEARCH

FEB 1 1943

Dear Mr. Eccles:

Mr. Paul asked me to send you this confidential preliminary draft of the statement he expects to give tomorrow before the Ways and Means Committee. Any comments you may care to make will be very much appreciated.

Sincerely yours,

A handwritten signature in cursive script that reads "Roy Blough".

Roy Blough  
Director of Tax Research

Honorable Marriner S. Eccles  
Chairman, Board of Governors  
Federal Reserve System  
Washington, D. C.

Enclosure



Statement to House Ways and Means Committee on  
Revision of Income Tax Payment Methods

I. Introduction

In response to a request of the Committee, I am here to discuss the income tax payment problem. The problem of putting income taxes on a pay-as-you-go basis was mentioned by President Roosevelt in his recent Budget Message, in connection with his request to Congress for an additional \$16 billion of additional collections for the fiscal year 1944. It is my understanding that the Committee desires at this time to consider the pay-as-you-go question, and my statement today will, therefore, be limited to this subject. It will not deal with other phases of our tax problem.

I should like to say in passing, however, that what the Congress does in solving the payment problem will have a direct bearing on the overall revenue program. To prepare the income tax for its part in dealing with the crucial problem of war finance, an overhauling of payment methods is essential. Moreover, the method employed to put the income tax on a pay-as-you-go basis will directly affect the dollars-and-cents yield of the tax and the timing

of the flow of revenue into the Treasury. Over-all revenue needs, therefore, should be kept clearly in mind in drawing up the specific provisions of a new income tax payment plan.

Owing to the great expansion of the individual income tax now taking place in response to war needs, the strengthening of our system of income tax collections has become a first order of business. The 39 million individual taxpayers paying income taxes of almost \$10 billion for 1942 under the present law must be afforded a way of meeting their tax obligations with a maximum of convenience and a minimum of hardship. In addition, the Treasury should be protected from taxpayer delinquency and resultant loss of revenue. And, finally, the Government needs a flexible instrument of fiscal policy under which revenues will react speedily to changes in tax rates and exemptions and in the national income.

The Treasury Department has been acutely aware of these needs. For more than a year it has urged the conversion of a substantial part of the income tax to a current basis by means of collection at source. The purpose of my statement today is to review the income tax payment problem and to analyze briefly methods which may be helpful in its solution.

## II. Defects in Our Present System of Payment

The income tax is the most direct and equitable method

of reaching taxpaying ability. Since as such it is, and must remain, the backbone of the Federal tax system, every attention should be given to improving its structure and application. For the great masses of taxpayers the present method of collecting the income tax payment has the basic defect that tax payments are not synchronized with the receipt of the income on which the tax is based. This defect arises partly because installment payments are not timed to fit the receipt of income and partly because the taxes on a given year's income are not payable until the following year.

A. Poor Adaptation to Taxpayers' Budgets and Flow of Income.

A system of equal quarterly installments ignores the basic fact that most people "spend as they get," that is, they budget on a weekly, semi-monthly, or monthly basis according to the interval between pay-checks. Such a system also ignores the wide variations in income receipts from one quarter to the next for such persons as farmers and seasonal workers. Equal quarterly installments are, therefore, ill-adapted both to prevailing budget habits and to the flow of income.

This defect was not serious when income tax rates were low and the tax reached only the minority of our population

with relatively large incomes. But in recent years the defect has been greatly magnified. The tax has been broadened to reach many millions of additional taxpayers with small incomes and little experience in planning their finances to meet large bills at infrequent intervals. Moreover, the burden of the tax has been greatly increased for all taxpayers. A suitable pay-as-you-go method will be of great assistance to millions of persons who otherwise will be hard pressed to meet their tax bills.

B. The One-Year Lag of Collections.

Another difficulty of our existing method of payment, from the standpoint of the vast majority of taxpayers, is that this year's tax payments are based on last year's income. The resultant lag caused no serious payment problem as long as the income tax burden was relatively low and the persons principally affected by the tax were accustomed to saving and budgeting for various obligations, including taxes. But with the expansion of the income tax the one-year collection lag has become a vital problem. To be sure, the lag does not cause the taxpayer difficulty as long as his income continues at a steady pace. If, however, his income varies from year to year, his taxes will be poorly geared to his receipt of income. And if his income declines sharply or

ceases entirely, as at unemployment, retirement, disability or death, the overhanging tax debt may cause real hardship.

### III. The Payment Problem As It Affects Specific Taxpayer Groups

The problem faced by taxpayers in meeting their tax bills and the nature of the solutions that can be provided depend in large part on the size and source of their incomes. For present purposes the estimated 44 million individuals obligated to pay taxes on 1943 income may be classified into three distinct groups: (1) 30 million wage and salary earners whose incomes after exemptions do not go above the first surtax bracket; (2) 10 million taxpayers whose incomes also do not go above the first surtax bracket, but who receive more than a nominal amount of income from sources other than wages or salaries; and (3) 4 million persons whose incomes from all sources exceed the first surtax bracket. (Table 1). The problem is different for each group.

#### A. Wage and Salary Earners.

##### 1. The Payment Problem

The overwhelming majority of the 44 million taxpayers for 1943 will be wage and salary earners whose incomes after exemptions will not exceed the first surtax bracket of \$2,000.

This group covers single persons with net incomes up to \$2500, married couples with net incomes up to \$3200, and married couples with two dependents with net income up to \$3900. It is this group which is hit hardest by the defects in our present payment system.

Taxpayers in this group are accustomed to weekly or monthly budgeting under which expenditures are directly governed by the pay envelope. They are under considerable pressure to use their income when it is available, that is, to spend as they get. They find it extremely difficult to make adequate provision for meeting lump-sum tax bills which fall due a year after the receipt of the income being taxed. Because of uncertainty of employment, they can not escape uncertainty about future income. Moreover, if their income stops because of unemployment, entrance into the armed forces, sickness, or death, the income tax debt for the last year of income may become a crushing burden.

2. Pay-as-you-go for Wage and Salary Earners.

Under such conditions collection at source provides the only adequate answer to the tax payment problem. Under such a system the income tax on these wages and salaries would be paid by withdrawing it week by week and month by month when the pay envelope is handed to the employee. The wage and

salary earner's taxes would be automatically budgeted because tax payments would coincide with the receipt of income. At the same time the problem of income tax debt would be eliminated for this taxpayer. If the normal tax and the first bracket surtax, that is, the "basic liability" were collected at source in this manner, 30 million of the 44 million taxpayers estimated for 1943, or nearly 77 percent, would be current. (Table 1) No pay-as-you-go plan is acceptable unless it makes substantially current at least this group of wage and salary earners.

A collection at source system must be framed with these criteria in view: The current collections must approximate as closely as possible the employee's liability for the year; the employee must not be required to make quarterly or other unnecessary returns; the machinery of collection must be made as adaptable as possible to the accounting and business methods of the employer. The principal elements of a collection at source plan that would meet these criteria may be summarized as follows:

First. While any pay-as-you-go plan should currently discharge as much as possible of the taxpayer's liabilities, it should also be so adjusted as not to collect more than the

liabilities. This objective can be achieved by collecting at source only on amounts of income in excess of an allowance for exemptions and deductions. In other words, the amount of each wage or salary payment subject to collection at source would be determined by subtracting from the gross payment an allowance for personal exemptions and normal deductions. These allowances would be prorated according to the length of the pay period, that is, weekly, semi-monthly, monthly, or other period. For example, under existing exemptions the weekly allowance might be \$11.00 for a single person, \$26.00 for a married couple, and \$8.00 additional for each dependent. These amounts are made somewhat larger than the prorated annual exemption in order to incorporate an allowance for average deductions. The allowance for personal exemptions would be based on a simple statement furnished by the employee to his employer.

It is important to note that any system of withholding income tax which does not allow exemptions, or which allows only a uniform exemption for all employees without regard to their marital or dependency status, would not meet the need. Substantial under-collection, with resulting large deficiency payments or substantial over-collections with resulting large refunds or both, would result in numerous

cases under a withholding system not geared to actual income tax exemptions.

Second. The rate applied to the wage and salary payments after these allowances would be set so as to collect approximately the basic tax liability, that is, the normal tax of 6 percent plus the minimum surtax rate of 13 percent. However, the rate would be slightly lower than the sum of the normal tax and the first bracket surtax in order to make further allowance for deductions and to allow for vacations without pay, occasional periods of unemployment, and possible fluctuations in income above and below the taxable limit. In this way, refunds for over-payment at the source would be held to a minimum.

Third. After the close of the year, these taxpayers would file simple returns showing their actual income and final liability for the year. Adjustments of actual collections at source to the final liability would be made by means of additional payment or refunds. For the vast majority of wage earners, such adjustments would involve a deficiency or refund of only a few dollars.

Fourth. Apart from the allowance of exemptions according to marital and dependency status, the essential mechanism for such a method of collection at source is already established under the withholding machinery adopted for

collecting the Victory Tax on wages and salaries. Collection at source of the Victory Tax should be integrated with collection at source of the regular income tax. However, the Congress may want to consider the possibility of absorbing the Victory tax into the regular income tax system.

The Committee may wish to consider the desirability of collecting at source the basic liability on dividends, as well as on wages and salaries. In the case of dividends the normal and first bracket surtax could be collected on the gross amount. The administrative problems will, of course, have to be weighed, but since dividend receipts represent a sizeable portion of the income of millions of taxpayers for 1943, collecting the tax on such income at the source would be a considerable contribution to a pay-as-you-go system of tax collection.

**B. Persons With Income from Other Sources Not in Excess of First Surtax Bracket.**

The incomes of many taxpayers do not readily fit into a system of collection at the source. By far the largest group of such taxpayers consists of those who receive income from sources other than wages or salaries, and whose total income is not in excess of the first surtax bracket. For 1943 it is estimated that 10 million of the 44 million

taxpayers will be in this group. Their problem is different from that of wage and salary earners, and the system of current collection which is set up for them must differ accordingly.

1. Payment Problem

The incomes of several million small taxpayers consist of business profits, professional fees, rents, and farm receipts. The flow of income from most of these sources fluctuates widely from year to year, and frequently even from season to season. Under our present system these taxpayers often find that their tax payments are badly out of step with income. The result in many cases is difficulty and even hardship. Moreover, the tax payments of such persons on a quarterly basis may not at all coincide with the receipt of cash income, which may be lumped in one quarter or two quarters of the year. And when income drops off or stops entirely, these taxpayers are faced with the same difficulties as small wage and salary earners. The need for a pay-as-you-go system of tax collection is fully as pressing for them as for wage and salary earners.

Since the incomes of these people come in irregular amounts and from many different payors, the need for current payment can not be met by collection at the source. If persons with small incomes from non-wage sources are to

be put on a current basis, one of two alternative methods may be employed. One method would base tentative current payments on prior-year income. The other method would base tentative current payments on simple quarterly statements of income received in the current year. A further discussion of these two methods may be helpful.

2. Alternative Approaches to a Solution

a. Tentative Payments Based on last year's income

Under the first of the two methods for collecting taxes on non-wage incomes the taxpayer would be required to make tentative payments in the current year on the basis of the previous year's income and to make an adjustment in the following year for overpayment or underpayment. For example, the tentative tax for 1944 would be based on the income of 1943 as reported on March 15, 1944. After the end of the year, on March 15, 1945, a final calculation of 1944 income would be made. If the tax payments in 1944 proved to be too small, the deficiency would be paid at this time. If the payments proved to be too large, the taxpayer would receive a credit or refund of the excess payment.

Under this system the tax payments made in each year would depend not only on what the income had been in the previous year, but also on how much the income of that

previous year differed in turn from the income of the year prior to it. If a person's income were stable from year to year, his tax payments under this plan would be substantially current. If, however, his income were not stable, he might be very far from being current since his tax payments in any year would not be geared to the income of that year. Thus, a person whose income increased from year to year would have deficiencies to make up each year, while a person whose income decreased from year to year would have credits or refunds due him each year. If the fluctuations in income were such that increases and decreases alternated, the deviation from current payment would be all the greater.

To illustrate the inadequacy of this method with an extreme, let us assume that a taxpayer in four successive years had income of \$2,000 in Year 1, \$4,000 in Year 2, \$8,000 in Year 3, and \$2,000 in Year 4. His payment in Year 3 at 1942 rates would be a tentative amount of \$992, based on the \$4,000 income for Year 2. In addition, he would also in Year 3 have to pay a deficiency of \$460 in taxes for Year 2, because in that year he had paid a tentative tax based on an income of only \$2,000, his income in Year 1, whereas his actual income in Year 2 was \$4,000. Thus, the payments which the taxpayer must make in Year 3 depend

upon what his income was in Years 1, 2, and 3. Going on to Year 4, when the taxpayer's income is actually \$2,000, he will pay a tentative tax of \$1,532, based on the \$8,000 income of Year 3, and, in addition, he will also have to pay a deficiency of \$1,392 for Year 3 because in that year he had paid a tax measured by the Year 2 income of \$4,000, while his actual Year 3 income was \$8,000. <sup>He</sup> ~~He~~ is thus required in Year 4 to pay a total of \$2,922, or \$922 more than his income in that year. Thus, when incomes either rise or fall, the tax payments in a given year are based on the income of the two preceding years and are not related to the income of the current year.

As has been pointed out, this method works well for stable incomes, but without further refinement does not work well for fluctuating incomes. Stability is the exception rather than the rule. Most incomes are characterized by fluctuation - up one year, down the next, or up for several years, and then down for several years. It is estimated that the incomes of nearly 70 percent of the taxpayers for 1943 will vary substantially, either up or down, from their 1942 incomes.

To base the tentative payments on last year's income when that income will generally be something higher or lower

than this year's income, is not pay-as-you-go but pay-as-you went. It is just this pay-as-you-went aspect of our present system that we seek to avoid.

It may be suggested that the defects of such a system can be patched by a relief provision which would permit adjustments in the tentative tax when the current year's income is expected to differ from the prior year's income. But since fluctuation in income is the rule, a provision designed to handle exceptions would to the extent it was followed actually become the rule. Taxpayers might be expected to take advantage of a permissive provision when their incomes were declining, but they could not be expected to make the correction when their incomes were increasing, unless the provision were made mandatory instead of permissive.

b. Tentative payments based on quarterly statements of this year's income

Since corrections to take care of fluctuations in incomes would depart in so many cases from the prior year's income, it may be helpful to consider a method which would go more directly to current income. Thus, a system of quarterly payment based on quarterly statements of current income might be put into effect. Such a quarterly statement and payment system would be a supplement to collection at source on wages and salaries. It would enable taxpayers with seasonal incomes — for example, farmers and many types of

businessmen -- to gear their tax payments much more closely to income than is possible under the present system of equal quarterly installments. The quarterly statement of current income would be simple in form, as shown in Table 2. It should be noted that similar statements would be necessary under the method of basing payments on last year's income.

3. Quarterly statement method for income from sources other than wages and salaries.

Persons of small means with income from such sources as business profits, professional fees, and farm incomes, could be put on a pay-as-you-go basis by the following steps:

a. Every three months they would file a simple statement of their best estimate of net income from sources not subject to collection at source.

b. On the basis of such income less prorated exemptions, they would pay a tentative tax each quarter at the basic-liability rate used in collecting taxes at source.

c. After the close of the year, they would report actual income, compute the actual liability, and make the necessary adjustment.

0. The treatment of taxpayers with higher incomes.

If current collection at the basic-liability rate were

adopted, only a small minority of taxpayers would not become current with respect to the greater part of their liabilities. Of the 44 million taxpayers estimated for 1943, only 4 million would have surtax net incomes in excess of \$2,000, that is in excess of the first surtax bracket. To provide complete current collection for this group in the higher income brackets presents obvious difficulties because of the graduation of the tax rates depending on the amount of income received. Fortunately this is also the group for whom full current collection is least essential. Those taxpayers have been accustomed to paying taxes for many years, and they have the resources and the expenditure habits suitable to an advance accumulation of tax funds. If their income stops suddenly, they would generally still be in position to meet their tax liabilities over and above the currently paid basic liability. Moreover, most of this group of higher bracket taxpayers would become substantially current if the methods previously described for collecting currently the normal tax and minimum surtax were put into operation. It should be observed that such current collection methods would apply to all of the income of the taxpayer regardless of the surtax bracket in which it fell. Thus a person with an income of \$10,000 above exemptions would, at a 19 percent basic liability rate, pay currently \$1900 of a total

liability, or \_\_\_\_ percent.

Continuing the present method of collecting liabilities in excess of the normal tax and surtax at the first bracket rate would, as previously mentioned, leave not fully current only 10 percent of the taxpayers. Of these nine-tenths would have more than three-quarters of their total liability currently paid. For only one taxpayer in a hundred would the tax liability not paid currently amount to more than one quarter of his total liability.

Full current payment with only minor adjustments after the end of the year could be devised for all taxpayers if this were desired. To accomplish this the current quarterly payments previously discussed would be enlarged to include not only the basic liability, but also liability in the higher surtax brackets. Each quarterly payment could be based either on an estimate of income for the year or on an estimate of income for the quarter, in either case with appropriate adjustments during and after the year.

#### IV. The problem of transition

##### A. The nature of the problem

Two distinct problems are involved in putting the income tax on a pay-as-you-go basis -- first, the method of current payment that is best for steady year-in year-out use; and second, how to shift to that method. So far, I have been

discussing the first problem. I should like now to turn to the second problem -- that of transition.

A transition problem arises because if we start collecting this year the tax on this year's income without any other action, taxpayers will be obliged to meet in a single year both the tax on last year's income and the tax on this year's income. To the extent that we go on a current basis in 1943, taxpayers will be paying in 1943 their liabilities on 1943 income while still owing their 1942 liabilities. If they are required to pay both years' liabilities this year, there will clearly be a doubling up of tax payments. The extent of the doubling-up depends on the amount collected currently. For example, if current collection applies to normal tax and the surtax at the first bracket rate, there is doubling-up with respect to this part of the tax, but there is no doubling-up with respect to the higher surtax rates. If current collection applies to the entire tax, there is doubling-up with respect to one year's whole tax.

#### B. Possible methods of Achieving Transition

One method of achieving transition is to forgive part or all of a year's tax liabilities. A second method is to require individuals to continue to pay their 1942 taxes as at present, and at the same time, begin current collection of 1943 taxes. A third method is to postpone part or all of a year's liabilities, permitting the postponed amounts to be amortized over a period longer than a year.

1. Forgiveness of a year's taxes.

A method of achieving transition that has been widely discussed is to forgive a year's liability. The overlapping of two year's tax liabilities can be completely eliminated only through forgiveness. The amount of forgiveness would be geared to the degree of current collection achieved. If current collection were to apply to the total liability, the complete elimination of over-lapping would require the forgiveness of the whole of a year's tax. If current collection were to apply to the basic liability -- the normal tax and the surtax at the first bracket rate - the complete elimination of over-lapping would require the forgiveness of a year's basic liability, but not of the rest of the tax.

Considerable confusion has arisen in the course of the widespread discussion of proposals to forgive a year's taxes as a means of shifting to current collection. Two main points need clarification: (1) the effect of forgiveness on Federal revenue; and (2) its effect on the economic position of individuals.

a. The Effect of Forgiveness on Federal Revenues.

The effect on the amount of money taken into

the Federal treasury resulting from placing the income tax on a current basis and forgiving a year's taxes can not be determined except by comparing this treatment with some alternative. If the comparison is with the present payment method at existing rates, the cancellation of 1943 liabilities combined with current collection of subsequent liabilities need not involve either an increase or decrease in the amount of money taken into the Treasury in any given span of years. Each individual subject to taxation in 1942 has one year's liability cancelled, but he is at the same time required to pay another year's liability sooner than he otherwise would. Individuals who were not taxpayers in 1942 but who become taxpayers subsequently will be obliged to pay their liabilities one year sooner than under existing law. Individuals who die, or who cease receiving an income, pay the Government one year's less taxes, but the money loss on their account is offset by and large by the fact that new taxpayers begin paying their taxes a year earlier. The net result in money paid into the Government depends on whether the payments dropped out exceed or fall short of the payments added in the same year. The payments dropped out will be spread over a period of years. If these years are in general years of higher national income than 1942, the actual receipts of the Government should be increased by the

change. If they are years of lower national income, governmental receipts should decrease on account of the change.

The amount of money that comes into the Treasury each fiscal year is not the whole story. A Government with large debts would, by forgiving a year's taxes, be discarding one of its assets, just as would a business that cancelled all its accounts receivable from customers. Such a business could maintain its receipts by going on a cash sales basis. Yet no one would say that the business had not lost assets to the extent of the accounts cancelled. In exactly this sense the forgiveness of a year's taxes would cost the Government close to 10 billion dollars -- the estimated amount of liabilities on 1942 income.

b. The effect of forgiveness on the economic status of individuals.

The fact that the Government may take in as much money in a fiscal year, despite the forgiveness of a year's tax liabilities, reflects larger payments by some taxpayers, offsetting smaller payments by others. The taxpayers who pay less are those whose incomes have declined or ceased. The taxpayers who pay more are those whose incomes have increased so that they become taxable for the first time or have to pay a larger amount of tax sooner than they

otherwise would. The forgiveness of 1942 liabilities thus affects tax payments in different years for different taxpayers. So long as an individual's income is stable, forgiveness combined with corresponding current collection, will not immediately affect his tax payments. However, if he has accumulated liquid funds to discharge his tax liabilities, these will be available to him for other uses. And, in any event, he will ultimately escape the payment of a year's taxes, when he dies or his income ceases.

While the effect of forgiveness on tax payments is not felt until the individual dies or his income declines or ceases, cancellation has a significant immediate effect on his economic status. The amount of taxes cancelled represents an immediate addition to the individual's net wealth. This addition, which depends on the income of the individual in the year for which taxes are cancelled, varies widely from individual to individual. If an individual had no income in that year, and was not subject to tax, his economic position would not be improved. If he had an income of \$3,000, and the entire tax was cancelled, he would gain \$324. If he had an income of \$1,000,000, he would gain \$354,000.

The existence of an immediate gain has been denied on the ground that tax payments continue. The fact is, however, that throughout the history of the income tax, our taxes

have been computed on a liability basis; that is, we have taxes for the year 1942, for the year 1943, and so forth, measured by the incomes of those years. The tax liability for each year depends on the income of that year and the rates applicable to that year. Under standard accounting practice they must be accrued for that year. A shift to the current collection basis wiping out a year's liability, adds that much to the assets of each person by diminishing his liability. In the only sense in which we have computed our income taxes, the result is a real gain to the taxpayer. That this is the sense in which the income tax has been regarded not only by the accountants, but by the general public is sufficiently evidenced by the demands for forgiveness.

One way to judge the effect of forgiving the 1942 tax is in terms of the increases in tax liability which have been imposed to finance the war and which have given rise to the need to shift to a current collection system. This is shown in the attached table 3, where it appears that the complete forgiveness of the 1942 tax liability would, in these terms, benefit persons with large incomes relatively more than persons with small incomes. A married person with no dependents having a net income of \$2,000 owes \$140 tax for 1942, or 7 percent of his income; with a \$10,000 net income, he owes \$2,150, or 21 percent of his net income; with

a net income of \$100,000 he owes \$64,060, or 64 percent of his net income; with a net income of \$1,000,000 he owes \$854,000, or 85 percent of his net income.

The increase in income taxes for the 3-year period 1940-42 amounts to \$182 for a married person with no dependents and a net income of \$2,000. The amount that would be forgiven this individual is \$140, or 77 percent of the increase for the three years. At the \$100,000 level, the amount forgiven equals 102 percent of the increase in taxes and at the \$1,000,000 level, 320 percent. For an individual with a \$1,000,000 income in each of the five years 1938-1942 the reduction in tax liabilities resulting from complete forgiveness would more than offset all tax increases enacted since 1935.

The attached Table 4 shows the effect of cancellation on the individual's wealth in another way. The amount available to an individual each year to use for consumption or to add to this wealth is the income he has left after taxes. Table 4 shows the amount of tax forgiven as a percentage of the income left after taxes. For the individual with \$2,000 income the forgiven tax represents only about 7 1/2 percent of a year's income after taxes -- or the equivalent of less than one month's income. For the individual with \$1,000,000 income, the forgiven tax represents

almost 600 percent of a year's income after taxes. The forgiveness of a year's taxes enables him to add to his wealth at one stroke as much as he could add in 6 years by saving every cent he had left after paying taxes and spending nothing, and as much as he could add in 12 years by saving half of what he had left after paying taxes.

It has sometimes been urged that the gain from forgiveness is offset by the resulting increase in estate tax when the individual dies. But the gain would be subject to the estate tax only if it is not spent or given away in the meantime and if the estate is sufficiently large to be taxable under the liberal estate tax exemptions. And even if subject to the estate tax, the offset is only partial, reaching 50 percent only for net estates in excess of \$2,500,000. A special estate tax could, of course, be devised to recapture a larger part of the forgiven amount if it were not spent or given away in the meantime. These loopholes, too, could be closed by still other special taxes. But any of these devices for recapturing to the extent that they are effective amount simply to not forgiving as much in the first place.

2. Simultaneous collection of 1942 and 1943 taxes.

A second method of achieving transition is to require individuals to pay their 1942 taxes at the same time as they are paying their 1943 taxes. The ability of particular

taxpayers to pay two years' tax liability in one year would vary widely. Those who had accrued their taxes during 1942 and saved to pay them could pay the two years' taxes in 1943 with no difficulty whatever. Others, who had not accrued or saved especially to meet taxes but who had other credit or accumulated liquid savings could also meet the two years' liability in 1943 without undue hardship. Still other taxpayers, the amounts of whose income subject to tax were small, and whose taxes were small, might be able to meet the two years' taxes out of 1943 income without much difficulty.

There would be, however, some taxpayers who failed to accumulate tax reserves in 1942, and who counted on paying them out of 1943 income, whose rates of tax would be so high and whose financial circumstances so pressing that the payment of two years' taxes in one year would be a severe hardship, even using their available sources of credit. Accordingly, a policy of paying 1942 and 1943 taxes all in 1943 may need to be moderated in view of the substantial hardship it would cause some taxpayers.

In this connection, it is imperative to note that in his Budget message, the President asked that collections for the fiscal year 1944 be increased by \$16 billion. Practically all of this \$16 billion increase in collections

must be derived from individuals in the final analysis. Revenue measures to meet the President's request would take from individuals in the fiscal year 1944 an additional amount larger than the total expected 1943 income taxes at present rates. Clearly, carrying the President's Budget message into effect will mean partial or complete doubling of payments for individual taxpayers generally. Of course, the doubling would not fall on the same taxpayers in the same proportions as would result from collecting 1942 income taxes in 1943.

Under these circumstances, shifting to a current collection system and at the same time requiring that individuals continue to pay their liabilities on 1942 income is one way of raising some of the additional revenue we need. The extra burden involved in paying part or all of 1942 tax liabilities must not be compared with no burden at all. The correct comparison is between that burden and the burden of other methods of raising the same amount of additional revenue. Accordingly, the simultaneous collection of 1942 and 1943 taxes should not be compared with complete cancellation and no change in tax rates; but with complete cancellation combined with a rise in tax rates. Otherwise, the comparison is simply between more taxes and less taxes.

### 3. The Postponement of 1942 Liabilities

In view of the hardships for some individuals involved in the simultaneous collection of 1942 and 1943 taxes, it may be desirable to postpone or defer the payment of part of the 1942 liabilities. One method of collecting the postponed tax would be simply to require the taxpayer to pay the postponed tax at his discretion within a certain number of years, say before March 15, 1945. A second method would be to divide the postponed tax into fixed installments that the taxpayer would have to meet.

If the Congress should decide to adopt some plan of compulsory lending collectible currently, the problem of collecting postponed taxes would be simplified. The amounts collected under compulsory lending could be considered an offset to the postponed taxes, i.e., a liquidation of the postponed tax liability. This would be equivalent to increasing the rate of current collection, whether at source or by quarterly payments, and treating the additional amount collected as an offset to the postponed liabilities.

I should like to repeat that the method of transition must be determined in the light of the revenue problem of the Federal government, to which I have previously referred. Very great increases in Government revenue are going to

be required in the coming years. It seems more equitable to collect at least to a substantial degree the tax liabilities which have been imposed by past legislation than to cancel a year's liability and raise the additional revenue by increases in rates. The method of rate increases, combined with cancellation, would largely free higher incomes from a year's taxes while imposing the additional burden more heavily on the low income groups, since it is at this level that the income tax is capable of further expansion. In addition, the increase in rates would involve a large contribution from new taxpayers than either of the other alternatives. There will be some 5 million or so individuals who were not taxable on their 1942 income but will be taxable on their 1943 income. This group consists primarily of persons newly entering the labor market, persons who will be working longer and harder at war jobs, and persons who will be shifting from civilian to war work. This group, predominantly in the lower income classes, would have to pay tax at higher rates than if current collection were achieved either by continuing payments on 1942 liabilities or by postponing these payments. And this group has not counterbalancing gain from cancellation.

Further, in view of our revenue needs, the forgiveness of a year's tax liability might be generally misconstrued as an indication that tax burdens could be made lighter instead of being made heavier. Indeed, there is considerable evidence that even the recent discussions of tax forgiveness

have confused and demoralized the public and caused them to doubt whether they will really have to bear tax burdens as high as those imposed by the Revenue Act of 1942.