

**BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM**

Office Correspondence

Date March 3, 1941To Chairman EcclesSubject: Excess Profits TaxFrom Martin KrostAmendments of 1941*MK*

The attached memorandum gives a brief account of the Excess Profits Tax Amendments of 1941, which passed the House on February 25 and is now under consideration in the Senate. Solely a tax relief measure, it provides

1. a two-year carry-over for all corporations of amounts by which income falls short of excess profits base
2. a stepping-up of the average earnings base for corporations that have expanded rapidly during the base period
3. more specific methods of adjusting both base period income and taxable period income for abnormalities.

Certain significant aspects of this legislation have been neglected in the current newspaper interpretation of the measure.

Although there had been intensive discussion in Washington circles of the need for excess profits tax legislation since the fall of 1939 and various concrete proposals had been informally circulated, the Treasury had shown no interest in the problem and thus was able to argue during the consideration of the (First) Revenue Act of 1940 (approved June 25) that adequate legislation of this character would require such a long period of preparation that it was futile for Congress to take up the problem until the legislative session of 1941. A rapid about-face in this attitude became necessary when the President requested an excess profits tax in a special message to Congress on July 1. The message, although making the general nature of the President's wishes perfectly clear, contained several technical imperfections in draftmanship that suggested that up to that time the Treasury had provided the President with no information or assistance on the problem whatever.

It soon became clear that the conservative leadership of the House Ways and Means Committee and the Senate Finance Committee had no enthusiasm for an excess profits tax and that the Treasury was not prepared to make a vigorous fight for an effective piece of legislation. Nevertheless the political circumstances of the time, with the Selective Service Act and the defense plant amortization provisions awaiting enactment, required that some sort of an excess profits tax be enacted and the present Act, the defects and inadequacies of which are well known to you, was finally passed.

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At the time of the passage of the Act it was explicitly understood that the problem would be reopened at the current session of Congress and that changes of the sort embodied in the current bill would be made. It was only after this understanding that conservative forces in the Congressional committees, under the leadership of Senator George, permitted the Act to be passed at all. On the other hand, it was also understood, although less explicitly, that the Treasury, and in particular Assistant Secretary Sullivan, had strong objections to the Act as passed and wanted revisions designed to make the tax a more effective revenue-raiser and more effective check on excess profits. These changes were supposed to be in the direction of placing greater emphasis on the invested capital base and restricting the use of the average earnings base.

It would be natural to suppose that the Treasury would have brought forward the revisions that it desired to obtain at the same time that the taxpayer-relief provisions were under consideration, in order to be able to concede the relief provisions on a trading basis in return for the tightening-up provisions that it presumably wanted. But the Treasury has not done anything of the sort. The relief bill is solely a relief bill and is being rushed through in time to apply to the computation of tax on 1940 incomes. If a bill designed to make revisions desired by the Administration is being contemplated, it can not be passed soon enough to apply to taxes on 1940 excess profits.

I am under the impression from informal contacts with the Treasury's technical staff that not only was the plan suggested above not executed but that it was never even considered. The full time and energy of the members of the Treasury staff who would be preparing a more effective excess profits tax measure if such a measure was desired have for the past two months been devoted to work on the relief bill now before Congress. There is no indication from public statements or information obtained through personal contacts that the Treasury is not perfectly satisfied with the excess profits tax as it now stands. Mr. Sullivan's original objections to the Act have apparently been forgotten.

Not only has there been no work directed to stepping up the effectiveness of the excess profits tax but so far as I can make out the Treasury is at the present moment making no preparation for the general revenue legislation which will surely be forthcoming before the end of the present session of Congress. I find an attitude, not so much of opposition as of complete lack of interest, in any program following the general lines of the proposals that we prepared last summer at your request.