

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date May 27, 1941

To Chairman Eccles

Subject: Tax Developments

From Martin Krost

M. K.

I talked with Blough this morning at his home; he is not well and will not be in his office for the next few days. He told me that he had received instructions from the Secretary to make arrangements for the fullest possible cooperation with us; it was arranged that he and I should meet twice a week, or oftener if circumstances required, to discuss current developments. I will report to you on these discussions.

The Ways and Means Committee will make an effort to terminate hearings tomorrow. It is Blough's impression that opposition in the Committee to the Treasury's excess profits proposals is so strong that the Committee will attempt to formulate a proposal of its own without further consultation with the Treasury and will then try to clear their proposal directly with the White House. I have been in contact with some of the Committee's own experts and it may be possible to get some idea of their proposals as they develop; I do not believe that any definite ideas have emerged yet.

The Treasury proposes to apply bracket rates of excess profits tax in accordance with the ratio of excess profits net income to invested capital. Excess profits net income means earnings after income taxes but before the deduction of normal earnings and the \$5,000 specific exemption. Thus a company with invested capital of \$100,000, current earnings after income tax of \$35,000, and base period earnings of \$10,000 would be taxed as follows:

	<u>Tax Base</u>	<u>Rate</u>	<u>Tax</u>
Excess profits net income	\$35,000		
Excess profits net income up to 15% of \$100,000	15,000		
Deduct:			
Specific exemption	5,000	0	0
Base period earnings	<u>10,000</u>	0	0
Excess profits taxable in first bracket	0	33	0
Excess profits between 15 & 30% of \$100,000	15,000	52	7,800
Excess profits over 30% of \$100,000	5,000	65	<u>3,250</u>
Total tax			11,050
Effective rate on excess profits	=	<u>11,050</u> 20,000	= 55.25%
Effective rate on total profits after income tax	=	<u>11,050</u> 35,000	= 31.6%
Effective rate of income and excess profits tax on total profits	=	<u>26,050</u> 50,000	= 52.1%