IOWA STATE COLLEGE
OF AGRICULTURE AND MECHANIC ARTS
AMES, IOWA

DEPARTMENT OF ECONOMICS AND SOCIOLOGY

September 23, 1941

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

Dear Mr. Eccles:

As you will have gathered from my correspondence about your article in Fortune, I am very much concerned with the urgency of establishing a system for the prompt collection of income taxes--through collection at the source, with the aid of various supplementary devices.

Just at the present time this issue is especially acute, since we are plainly going to have to struggle with inflationary tendencies through much of 1942. Once the year opens, if we continue the present collection system, income tax enactments must refer to taxes collectible in 1943. This will largely disqualify income taxes for anti-inflationary use, increasing the likelihood both that the price advance will go too fast and that we shall be saddled with more sales taxes, payroll taxes without exemptions, etc., etc.

A meeting of the Executive Committee of the Conference on Resear in National Income and Wealth obliges me to be in Washington this Saturday (4th); and I am planning to reach Washington the morning of the 3rd. If you can arrange to spare me a few minutes of your time that day to discuss the problem of income taxes for combatting inflation, I shall appreciate it very much. I shall ring your secretary up from the station on Friday morning to see how your schedule stands.

Very truly yours,

A G Hart

Albert Gailord Hart

see Krost

10-3-41 - Mr. Hart called from the station at nine and said that he would take a cab right over to see Mr. Krost. He was delighted to do so as it seems Mr. Krost is an old friend of his.

Form F. R. 131

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date October 3, 1941

To Chairman Eccles

Subject: Interview with Mr. Hart

From Martin Krost
MK

Mr. Hart has an interesting proposal for shifting the method of collecting income taxes from the present one-year lag basis (taxes on this year's income not payable until next year) to a current collection basis (taxes on this year's income payable this year). He is interested in making the income tax a flexible weapon of inflation control and believes that only by putting collections on a current basis can the income tax be used to meet the inflationary dangers that will develop in 1942.

His proposal is to collect a 1 per cent income tax at source on all income payments in 1942. This is to be regarded as partial payment in advance on 1942 taxes. Such taxes are to be finally fixed, as at present, on the basis of returns filed at the end of the year. Six per cent interest to March 15, 1943, would be allowed on amounts collected at the source and the same interest rate is to be offered for voluntary payment of additional 1942 taxes. Taxpayers could make a rough estimate of 1942 tax liabilities on the basis of 1941 tax returns; relatively small final payments would be made on filing year-end tax returns. Interest would not be paid unless some considerable proportion, say 50 per cent, of taxes due for the year as a whole, had been paid in advance. The Government would make a year-end refund to very low-income taxpayers, for whom the one per cent collected at source would exceed taxes due on the basis of an annual return.

The transition from the present one-year lag basis to a current collection basis is to be eased by eliminating the normal tax and reducing the first surtax bracket rate from 6 to 1 per cent on 1942 incomes. That is, 1941 taxes are to be payable in 1942 in accordance with the present procedure; but 1942 taxes are also to be payable in 1942 on a compulsory basis with respect to the one per cent collected at source and on an optional basis but with a high interest rate inducement with respect to the rest of the tax.

All these arrangements are proposed in order to make it possible to raise the one per cent rate collected at source in the course of the year 1942, if that should seem desirable in the light of price movements, -- and it is contemplated that a considerable increase in the rate will be desirable. Theoretically, such changes could be made on a month-to-month basis. An increase decided upon in one month could be put into effect and actually taken out of income in the following month. In contrast, under present collection methods any change in income tax rates made during 1942 can not influence disposable income until March, 1943 (except for the relatively few people who make provision for income taxes out of current income).

The theoretical advantages of the proposal are clear. It would make it possible to adapt tax collections to the needs of the economy on a short-run basis by varying the rates of the individual income tax, the tax which most nearly represents ability to pay. Practically, the proposal is likely, because of its novelty, to encounter serious obstacles, perhaps the most important of which would be Congressional reluctance to modify its constitutional power to levy taxes to the extent of giving the President or the Treasury authority to change tax rates. It is doubtful whether Congressional opposition would be significantly decreased by providing that executive authority to change rates should be confined within statutory limits or should be exercised only in accordance with the movements of prices and other economic indexes.

October 20, 1941.

Mr. Albert Gailord Hart,
Department of Economics
and Sociology,
Iowa State College,
Ames, Iowa.

Dear Mr. Hart:

This will acknowledge yours of September 28, in which you advised that you were arriving in Washington on October 4 and desired to discuss with me the suggestions you have for re-vamping the income tax law so as to shift over from the one year lag to a collection system which would be practically current in its operation. As I was tied up that day, you saw Mr. Krost, who, I understand, is an old friend of yours.

From a memorandum of your discussion with Mr. Krost, it appears that you have a clear notion of the weakness in our present tax mechanism as a factor for economic stability since any increase or decrease in the tax burden is not effective until a long time after the statute is passed. In the meantime, on the inflation side, as you point out, the price index and increasing incomes may well take away a good part of the anti-inflationary effect of the increased income tax.

While I am entirely sympathetic from a theoretical standpoint with your suggestion for meeting the problem, I doubt that the Congress could be prevailed upon to pass a tax law that would leave with the Treasury discretionary power to vary the rates, even within certain specified limits. Perhaps at some later stage in our political development, we can hope for a change of this sort. It should be an important part of a very considerable program of streamlining in our governmental machinery. Only by such a process can we hope to bring governmental powers into action with sufficient promptness to meet the fluctuations in the country's economic activities.

Yours sincerely,

M. S. Eccles,
Chairman.

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