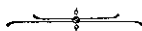


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EXECUTIVE OFFICES OF

R. H. Macy & Co.
Inc.

New York, October 15, 1942.

Dear Marriner:

I thought the enclosed might be
of interest.

Very sincerely yours,



Beardsley Rum1

Mr. Marriner S. Eccles
Federal Reserve Board
Washington, D. C.

PAY AS YOU GO INCOME TAX PLAN

The attached speech which was delivered before the Rotary Club of New York on the PayAs You Go income tax plan on October 15, 1942 contains a certain amount of new material in which I thought you might be interested. It also brings up to date the general statement on the plan itself.

Beardsley Ruml

October 15, 1942

P. 7 missing

G.G.

THE PAY AS YOU GO INCOME TAX PLAN

BEARDSLEY RUMI

OCTOBER 15, 1942

The necessity of getting our personal income taxes on to a current basis and of starting 1943 with our income-tax payers, then to be 27,000,000 of them, substantially free of income-tax debt is now generally conceded. The long standing defect in our income tax practice of paying a tax on last year's income out of this year's receipts has, with higher rates and lower exemptions, become a personal and national danger. It is a personal danger to each of us because loss of income from whatever cause would face us with unbearable income-tax debt. It is a national danger, because any period of depression and unemployment would throw a burden of income-tax debt on to the shoulders of citizens of reduced income or of no income at all, a burden that could not possibly be met and that would compound with difficulties an already difficult national situation.

In order to accomplish this desirable objective of getting our income taxes on a current basis, I suggested to the Senate Finance Committee a plan which I called the Pay As You Go income tax plan. This plan was to be applied to individuals, not to corporations. Since then there has been a great deal of discussion, many suggestions and a little criticism.

Today, I should like to make a statement about the plan which will bring it up to date, adding to and modifying the original plan in the light of the suggestions and criticisms which I have received.

I shall present the plan under five headings.

First, skipping a year to begin 1943 on a pay-as-you-go basis;

Second, making our income tax returns on a tentative basis with a year-end adjustment;

Third, giving relief provisions for those whose income varies from year to year;

Fourth, making provision for minimizing objectionable "windfall" cases;

Fifth, giving equal treatment to all taxpayers under the plan, starting the new year on a current basis for everyone.

Following this presentation I shall take up the three objections which have been raised by the Treasury.

And finally I shall tell you why I think that a Pay As You Go plan will be adopted and just where the plan stands today.

The first question is how to get our personal income taxes on to a current basis without paying two years' taxes in one year. The answer is as simple as daylight saving. Let us turn our tax clocks ahead one year.

The taxes we have been paying this year out of our 1942 incomes are taxes on our incomes received in 1941. We can solve the problem in either of two ways.

First, we can re-define our taxes and simply say that the taxes we are paying in 1942 are taxes on 1942 income, and thereby let 1941 drop out of the tax calendar forever, or

Second, we can go on letting our present income taxes be taxes on 1941, but begin 1943 by paying on 1943, thereby dropping out 1942, instead of 1941.

In my original testimony, I suggested dropping out 1941, but the Treasury preferred that if any year was to be dropped, it should be 1942. As the year grows later, it becomes increasingly likely that the Treasury is right and that 1942 would be a better year to skip. But only on one condition, that the income-tax payers who are serving the people of the United States in the armed forces or in the federal civil service should be allowed to choose whether they prefer to skip 1942 or 1941. Since there is an alternative, they should be allowed to choose the one that serves them best.

If it is finally decided to skip 1941, then, because of the lateness of the year, we shall have to skip 1942 for those who have never paid an income tax. This may not be strictly logical, but it is the only way of giving practical justice to these new taxpayers.

The question at once in everyone's mind arises, how can we drop an income-tax year out of the calendar in this way without having the Treasury lose a lot of money that is badly needed for the war effort? The answer is that we shall all go along paying our income taxes as we have before, only they will be on a current basis. The Treasury will also go along getting its revenues. The only difference is that when a taxpayer dies or ceases to receive income, he does not owe a tax as he does under the present system. Reduction of tax payment by the tax payer as a result of setting the tax clock ahead occurs only at some future date, when and as the tax payer's income ceases or declines. The reduction is therefore spread over the whole lifetime of the present income tax paying generation, and occurs beneficially for each tax payer at the time when his income fails. As for the Treasury, the Treasury has never considered taxes receivable as an asset, and accordingly they can be written off the balance sheet of the government without the change of a single penny.

The gross loss of revenue in any case would be partially offset by better tax collections and collection methods and also recoveries through inheritance tax of part of what otherwise have been payable as income tax.

The question is sometimes raised as to the effect of the plan on inflation. The only persons that would have more cash on hand under the plan are the few who have accrued their income taxes. These are few indeed and they are not spendthrifts. As a matter of fact, since Pay As You Go will make withholding taxes possible at a high level, the total effect will be anti-inflationary rather than otherwise.

The Treasury feels that a withholding tax is highly important in keeping tax payers current. I, too, favor a withholding tax, because it makes it easier for people to keep on a pay-as-you-go basis. But if we want a withholding tax the Pay As You Go plan is the only way to solve the problem of having a withholding without having some amount of double taxation -- that is, of paying two years' taxes in one. If a withholding tax provision turns out to be either un-

desirable or impractical, the Pay As You Go plan stands on its own feet as a sound method of getting the country free of income-tax debt.

The second point in the Pay As You Go income tax plan is designed to solve the problem of how we can pay our income taxes on a current basis, when we do not know at the beginning of a year what our income is going to be in that year. The way of solving this problem is not too difficult. We will go ahead as we do today, filing an income tax schedule about the fifteenth of March declaring our previous year's income. But this will be a tentative return for the year then beginning and we would pay our current taxes on the basis of this tentative return. After the year had ended there would have to be an adjustment up or down depending on whether our actual income for the year was greater or less than that on our tentative return. But this adjustment would be made on the same blank and at the same time as our return for the following year. This return would be at one time the final return for the old year and the tentative return for the new. There would be no doubling of returns involved and only a few extra lines for the adjustment computations.

The third feature of the plan is the provision for relief in case a tax payer knows his income in the current year is going to be less or greater than that of the year of his tentative declaration. The plan provides that he may declare his true knowledge of lower or higher income, as a result of salary changes, and so forth, which have actually occurred, and make his current payments accordingly. This provision eliminates the awkwardness of avoidable year-end adjustments and keeps the plan closer to a true pay-as-you-go basis than it would otherwise be.

The fourth point about the plan are the special provisions for minimizing objectionable "Windfall" cases. These provisions were not included in the original plan and have been added to meet a widespread feeling that, even though the number of cases be few, it is desirable to guard against them.

Any plan that gives equal treatment to all taxpayers would produce a certain number of "windfall" cases, cases of individuals who will benefit unduly because of the fact that for them 1941 or whatever year is skipped, happened to be a year of unusually large income, larger than that of the year that preceded or that followed. Consequently, whatever year is selected, some persons would receive unintended benefits.

I have made the following three suggestions for minimizing the problem of these "windfall" cases:

(1) Do not cancel the 1941 income tax on capital gains. A large part of the true "windfall" problem comes from capital gains because the year in which the gain is taxed is the year in which the transactions happens to be closed. Capital gains are not like ordinary recurring income, and can be properly separated out in the plan.

(2) Provide a special death tax to recover what may be considered "windfall" arising because of death in 1942, or during some appropriate transition period. This tax should be steeply graduated and should take most of the higher bracket income tax that would be otherwise cancelled, but it should leave some balance of the cancelled tax in the estate subject to ordinary estate taxes only.

(3) Take an average of 1940, 1941, and 1942 in all cases where claim for credit exceeds \$10,000, or some other suitable amount. The average of the three years will be a practical way of determining a fair normal income for 1941, instead of "windfall" income. The cancellation of 1941 tax would apply to this average income only, and the balance of tax on actual 1941 income to the extent that it exceeded \$10,000 would not be credited or refunded.

These three provisions will catch all of the most objectionable "windfall" cases. But even so, there may still be a few remaining, - what then?

There are some things that are worse than a few "windfall" cases. One would be not to adopt any Pay As You Go plan at all. Another would be to adopt a plan so complicated or so uncertain in its effect that the great good of Pay As

You Go would not be achieved. Another would be not to give equal treatment to all taxpayers under the plan lest the "windfall" cases receive undue benefits.

Much as I dislike "windfalls", even if they cannot be entirely eliminated, I am still for the plan. I cannot bring myself to the point of refusing to do good for millions simply because I will be doing too much good for a few that don't deserve it.

The fifth point about the Pay As You Go income tax plan is that it proposes to give equal treatment to all taxpayers under the plan. This means to skip a tax year for all alike in every bracket and start the whole country income-tax-debt free.

The Treasury has proposed a modified plan which would apply to the full tax debt of some taxpayers and to only a part of the tax debt of the rest. Concretely, the Treasury proposed that the tax year of 1942 rather than 1941 be skipped, and then for only the lowest two brackets -- that is 10 per cent -- and that the balance of the tax debt remaining should be paid over the next two or three years, this, in addition to current income taxes that will be payable in those years. The Treasury concedes that this would leave between 10 and 20 per cent of our taxpayers still owing the government for taxes on their last year's income. This group of 10 to 20 per cent includes practically all of administrative, technical and professional men and women who need freedom from income-tax debt danger as much as anyone else. The Treasury's proposal to change the year from 1941 to 1942 would eliminate from benefits of the plan the millions of men who have gone into the armed services and into the government this year.

Quite apart from the question as to who is included or excluded, or for how much, I personally favor as a matter of principle the over-all application of the Pay As You Go plan for eliminating tax debt, giving all taxpayers equal treatment under the plan.

Now ability to pay resides in two conditions. The first is property and savings now held and the second is income presently to be received. Past income is realistically ability to pay only to the extent that it is still held by the recipient as current wealth.

Our policy has been to tax progressively. For the living, income is taxed directly and wealth is taxed indirectly through taxing the income arising from the wealth. When the taxpayer dies, the wealth is taxed directly through inheritance taxes, also progressively.

If we now look at our traditional income tax practice fundamentally, we see that what we have really been doing is to estimate ability to pay in terms of last year's income. Now as a matter of observable fact, last year's income is over and gone as income; it is a criterion of ability to pay only insofar as last year's income remains as a residue in current wealth, or as it portends income presently to be received.

The true significance of the Pay As You Go plan is that it denies the applicability of last year's income as a criterion either of current wealth or of income presently to be received; and therefore rejects the use of last year's income as a basis of taxation according to ability to pay. The plan involves only superficially the elimination of income-tax debt; basically it involves a change in the criterion of ability to pay.

The criterion of ability to pay under the Pay As You Go plan is for the living the income presently to be received either from labor or income on savings, and for the dead the property in the estate, each subject to progressive taxation.

Unless the Pay As You Go plan is applied in a manner to put all taxpayers on a current basis by eliminating past income for all as a test of ability to pay, we shall in fact be assessing a tax on savings for all who will have a carry over of income-tax debt remaining; and contrary to our principles, this tax on savings, being based on last year's income and not on current wealth, will not

be related to ability to pay. The point is easily seen if we compare the situation of the person deriving an income of \$40,000 from securities with that of the executive or engineer who earns \$40,000 with hand and brain. Any income-tax debt applicable to the former could be liquidated from current wealth, but for the latter the payments would have to come as an additional assessment above present income taxes on income presently to be received.

The Pay As You Go income tax plan can only be justly and equitably applied under a policy of progressive taxation according to ability to pay, by applying it to all alike, by skipping an income-tax year for all taxpayers in all brackets and for all brackets. By starting the new year with a new criterion of ability to pay, we simultaneously start it with all citizens income-tax-debt free.

The statements in opposition to the plan which have been prepared by the technical staff of the Treasury and which have been presented by Randolph Paul are unimpressive and contribute little to the solution of the problem of income-tax debt.

The first objection is administrative difficulty. But the Treasury position on this point is so weak that it resorts to a statement such as the following: "In effect, the Ruml plan requires two returns and two sets of computations to determine one year's tax." Yes, in effect that is true, but in fact it is all done at the same time and on the same return.

The second objection is the "windfall" problem, but the Treasury has ignored the three suggestions that I have made and confuses the "windfall" problem with the high bracket problem, where the question of equal treatment to all taxpayers is the real point at issue.

The third objection is the fact that widely fluctuating incomes might be on an even more widely fluctuating tax basis than at present. But here the Treasury persistently ignores the relief provisions that have been in the plan since the beginning and assumes that every taxpayer behaves in the most stupid way possible.

The lack of force, and even of sincerity, in the objections which have been made to the plan has been apparent to press and public alike and has been the subject of nation-wide comment. Much criticism has been heaped on Congress for not adopting the plan at once, but in my opinion this criticism is unjust. We must remember that the plan was opposed by the Treasury, that a modified plan was submitted by the Treasury, totally inadequate to be sure, but the effect was to put the Senate Finance Committee on notice, and naturally it wanted more study of the problem and the plan before it made a recommendation to Congress contrary to the wishes of the Treasury.

Broadly speaking, what will the plan accomplish?

The Pay As You Go income tax plan is a three-way plan; as I have said, it applies only to individuals and not to corporations. First of all, it is a plan that will relieve thousands of citizens from hardship and distress arising from income-tax debt, and that will bring peace of mind to millions more who are in income-tax-debt danger.

Second, it is a method for clearing the decks for an all-out war-financing program. If we can all be free of income-tax debt on the first of next year, we can start on a pay-as-you-go basis and stay there. If we need high withholding taxes we can have them; if we need to supplement voluntary savings with compulsory savings, we can do that too. But whatever is called for, it would be paid out of the current year's income as an assessment on the same year's income. We would not be paying for dead horses while we are fighting a war.

In the third place, the Pay As You Go income tax plan is the best kind of financial planning for the post-war period. Our policies can then be forward looking, not backward looking. We will not be trying to collect income taxes from people who are unemployed; we will not be debating whether we should collect taxes on 1941 incomes from men recently demobilized from the armed forces. We will not have a spending spree in the first little boomlet, financed on unpaid taxes,

and then a tax debt headache if incomes should drop off for a year or so.

I feel that the Pay As You Go income tax plan in a form acceptable to Congress will certainly be adopted, because income-tax payers want to be free of income-tax debt and they know it can be done without hurting the Treasury and without paying two years' taxes in one. The taxpayers know that Pay As You Go solves the problem simply and fairly by skipping an income-tax year. They know the whole trouble was caused by a basis defect in our income-tax law, which has existed from the beginning: that of paying a tax on last year's income out of this year's receipts. The defect was not their fault, and they know it. They want it corrected this year and they want to be on a pay-as-you-go basis by the beginning of 1943.

As a nation of individuals we will be better able to meet the present and to attack whatever the future has in store for us if we are paid up in our income tax, and, being out of income-tax debt, we can pay as we go out of what we earn.

The chances of starting the New Year 1943 on a Pay As You Go income tax basis with the whole country income-tax-debt free improve visibly from week to week. Today I should say that the chances are distinctly good.

The appointment of Justice Byrnes as Director of the new Office of Economic Stabilization gives us reason to hope that tax matters will be considered in relation to other war economic problems in deciding on the administration's tax policy. This is good news for the Pay As You Go income tax plan. Now the plan may take its proper place in the all-over war time economic program, and be considered from a broader point of view than it has hitherto received from the Treasury.

On the legislative side, the Senate Finance Committee unanimously referred the plan to the joint committee of Congress which is to report by December 1. This means that the plan can be adopted in time to start 1943 on a pay-as-you-go basis for everyone. The plan stands on its own feet and the fact that it is not

now part of the tax bill under consideration today by Congress is irrelevant as far as the early adoption of the plan is concerned.

Of course nothing is decided until the votes are counted. My optimism is based on the urgent need for a solution of the income-tax-debt problem, on the continued absence of convincing criticism to the Pay As You Go plan proposed, and on the enthusiastic job that taxpayers are doing in making themselves heard.