

“PAY-AS-YOU-GO”

[THE RUMML PLAN REVISED]

*A full transcript of an interview by
Beardsley Ruml on the CBS “People’s
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THE RUMML PLAN

BRYSON:

This is Lyman Bryson, Chairman of The People's Platform. My guest tonight is Beardsley Ruml, and we are going to talk about plans for paying federal income taxes on a pay-as-you-go basis. Mr. Ruml is treasurer of Macy's and Chairman of the Federal Reserve Bank of New York.

Mr. Ruml, you have suggested a basic reform in our income tax procedure. What is wrong with our present system?

RUMML:

When the federal income tax bill was passed in this country in 1913, it had an important defect which was that a citizen was required to pay in the year 1914 a tax on his 1913 income. In this way, we got started on a vicious practice of paying out of one year's income a tax on the year that had already gone. As a result and in consequence of increasing rates, the debt which people owe to the federal government for income tax has become a national danger. The

present system is a bad system for all of us and should and can be corrected. It is clear that the government cannot continue for long to be the creditor of some 27,000,000 taxpayers and their families, in debt for income tax as they are today, particularly when there is no substantial question of revenue involved in changing the basis of assessment and getting the whole country on a current pay as you go basis.

BRYSON:

Could you make the situation any better by making a change?

RUML:

There are two broad purposes for reforming our historic income tax practice in order to place our income taxes on a current basis and to eliminate the accumulated income tax debt. The first purpose relates to the financing of the war, to the reduction of potentially inflationary purchasing power and to the preservation of the integrity of our income tax system through obtaining the highest possible level of collections and the lowest possible level of defaults. The second purpose springs from the personal and humane desirability of removing from millions of citizens the constant threat of unpaid tax debt, a debt imposed under a faulty tax system, unwittingly unprovided for by our citizens, a debt now grown so large under present tax rates that loss of current income for any reason by the individual taxpayer brings acute financial and personal distress.

BRYSON:

All right, now, concretely, what do you suggest that we do?

RUML:

In order to accomplish the desirable objective of getting our income taxes on a current basis, I suggested to the Treasury in March of last year and to the Senate Finance Committee in July a plan which I called the Pay-As-You-Go income tax plan. This plan is to be applied to individuals, not to corporations. The first problem is how to get out personal income taxes on a current basis without paying two years taxes in one year.

BRYSON:

Can that really be done?

RUML:

The answer is as simple as daylight saving. Let us turn our tax clocks ahead one year. The taxes we have paid last year out of our 1942 income are taxes on our incomes received in 1941. We can best solve the problem now by recognizing these 1942 payments to be taxes on 1941 as they really are; and by beginning 1943 by paying on 1943, thereby dropping out the year 1942 from the tax calendar forever.

BRYSON:

But that sounds like forgiving everybody one year's taxes. Is that what you mean?

RUML:

Not exactly. The tax year of 1942 is gone but not forgiven. I want to stress particularly that the essence of the plan is to make a change in the method of assessing personal income taxes. That change is to assess this year's tax against this year's income. By this change in the method of assessment, the taxpayers go on a current basis and accordingly at the same time they are income tax debt free. Much confusion has been caused by referring to this change as the "forgiving" of one year's taxes. "Forgiving" is a term which I have never used in describing the plan. It suggests, and wrongly, that this year the taxpayers will have a year in which they pay no taxes and that the Treasury will have a year in which it gets no revenue. Nothing could be farther from the truth. Our thinking will be clearer if we think of the plan as a change in the method of assessing income taxes. When we turn the tax clock ahead, we do not stop the clock.

BRYSON:

Mr. Ruml, last week at his press conference, President Roosevelt said that he thought "we are all in favor of getting on to a pay as we go basis," and that a "lot of people think the only way to do it is to forgive the individual either all or a portion of one year's taxes" — "but it means the poor old Treasury is out of pocket just that much money." I think we would all like to have your explanation of how

we can turn the tax clock ahead as you suggest without hurting the Treasury.

RUML:

First of all, Mr. Bryson, I feel sure that when the President referred to the Treasury, he was not speaking about the old grey building that sits on Pennsylvania Avenue just east of the White House. Nor do I think that he meant the people who work in the building, all the officials and civil servants, who from one point of view are also the Treasury. No, I think he referred to the Treasury as the financial agency of the government. The Treasury is to the people as a pocketbook is to an individual, an instrument of utility but not an end in itself. And so it is the financial soundness of the government and, in a special sense, the economic well being of the country that we must be certain to protect.

BRYSON:

That's right. How do we provide for that?

RUML:

The answer to the question is that we shall all go along paying our income taxes, 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 will not owe a tax as he does under the present system. Reduction of tax payment by the taxpayer as a result of setting the tax clock ahead occurs only at some

future date, when and as the taxpayer's income ceases or declines. The reduction is therefore spread over the whole life time of the present income tax paying generation, and occurs beneficially for each taxpayer 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.

BRYSON:

Then there really would be a reduction in the long run. What would it amount to say, for a generation of taxpayers?

RUML:

If we study the consequences of the plan over the generation we find that since the loss would be spread over a period of some 35 to 50 years, the gross amount of eight billion dollars estimated as tax liabilities on 1942 income would amount to an average of only \$180,000,000 to \$220,000,000 a year. The first big loss would come, if at all, in the year of a post war depression, and it would occur as a timely adjustment both for the economic welfare of the nation and for the help of each individual taxpayer whose income has suffered reduction. Another way of looking at it is that the loss over a generation would be about the same as one month's current expenditure. It seems a small cost to achieve a basic

income tax reform, preserving the integrity of the income tax system, making possible other badly needed war time tax measures, and affecting beneficially 27,000,000 citizens.

BRYSON:

Would there be any way of cutting down the unavoidable loss—the gross loss?

RUML:

The gross loss of revenue in any case would be partially offset by better tax collections and collection methods and also by recoveries through the estate tax of part of what would otherwise have been payable as income tax. Many people feel that these offsets to the gross loss would be very substantial indeed, particularly if a high withholding tax is promptly adopted.

BRYSON:

I take it then, Mr. Ruml, that you do not believe that the adoption of your suggestion for a pay as you go income tax plan would hurt the financial soundness of the government or the economic well being of the country.

RUML:

That is correct, Mr. Bryson, for the reasons which I have given.

BRYSON:

Of course, there are other suggestions for pay as you go plans. Some people seem to feel that it would

be better to defer the tax on 1942 income rather than cancel it. We might pay it gradually, say in five years.

RUML:

This criticism of the plan that has been made by some, but not to my knowledge by the Treasury, stems from a feeling that somehow it is wrong to cancel a debt. These critics would like to get on a pay as you go basis in 1943, but retain the tax liability for 1942 as well, although they recognize that it must be deferred or spread over many years. The effect of all such proposals is to complicate the problem, to leave a disagreeable debt overhanging millions of taxpayers — a debt that would be a perpetual football of politics — and to increase beyond the will of Congress, as expressed in legislated income tax rates, the burden of payments to the federal government assessed on the individual taxpayer.

BRYSON:

Are you suggesting that it may not always be wise for a creditor to insist on the payment of a debt?

RUML:

The feeling that it is somehow wrong to cancel a debt runs very deep and it is respected in quarters where the feeling itself is not shared. It is not easy to find the reason. Certainly it is a common practice as evidenced by the experience of banks and other commercial institutions, to reorganize debtor-creditor re-

lations without prejudice, upon the initiative of either party, whenever it becomes necessary in furthering the best continuing interests of both. Removal of debt liabilities in this way is considered a means of preserving the integrity of the relationship and a recognition of joint interest in a future welfare. It avoids the deceit and bitterness characteristic of evasion and default.

Certainly the cancelling of debt in order to further the welfare of all concerned has had the high approval of age old moral authorities.

BRYSON:

That's certainly true.

RUML:

There is also a special reason why the liabilities which have arisen under our income tax procedure may properly be set aside as I have suggested. These liabilities are not debts such as those which arise in the exchange of money, property, or services between private individuals. They cannot be removed by bankruptcy proceedings. On the contrary, they are the result of a unilaterally imposed levy by a legislative body under a traditional practice of assessment recognized by all to be defective. There would therefore, appear to be neither practical nor ethical grounds of a general character for not changing the basis of assessment of income tax and removing the old income tax liability if that seems the best way of

solving our problem. Moreover, in view of the defect and delay in our income tax law there is sound and just reason why the correction should now be made.

BRYSON:

Don't you feel that it would be desirable to have a withholding tax or payment at the source as part of our tax program? Why not ask our employers to take the taxes out of our wages?

RUML:

Most people feel that a withholding tax at a high rate is important in keeping tax payers current. I have from the beginning favored withholding or collection at the source, and have said so. I think collection at the source improves the pay as you go plan because it makes it easier for people to keep on a pay as you go basis. And if we want a withholding tax at a high rate, the pay as you go plan does solve the problem of having a withholding tax without having some amount of double taxation, that is of paying two years taxes in one. However, if a withholding tax provision at a high rate turns out to be either undesirable 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.

BRYSON:

What about inflation, Mr. Ruml? That's still a danger in the minds of a great many people. Would your plan effect that problem?

RUML:

I do not believe that pay as you go plan would lead to inflation. The only persons who would have more cash on hand under the plan are the few who have saved up for their income taxes and who hold them in ready cash. These are few indeed, and they are not spendthrifts. On the contrary, it is a matter of common observation that the American people will not spend their savings, or their War Bond purchases when they have once been acquired, except under conditions of real economic pressure. Striking evidence of this is found in the familiar Christmas Savings Clubs, where money is purposefully saved to buy Christmas presents; and yet when the time for expenditure comes, under all the pressure of the holiday season and in spite of the identification of the savings with the season, only 30% of the Christmas Club resources are actually spent for consumer purchases. As a matter of fact, since the pay as you go plan will make withholding taxes possible at a high level, and since we will be collecting for 1943 in 1943, the total effect will be anti-inflationary rather than otherwise.

BRYSON:

All right, suppose we do decide to turn the tax clock ahead, and assess this year's tax on this year's income instead of on last year's, there are still difficulties. How can we 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?
How do we figure what we owe the government?*

RUML:

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 15th of March declaring our previous year's income. But this will be a tentative return for the year then beginning and we will 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.

BRYSON:

It doesn't sound as if it would be much more difficult than what we have to do now.

RUML:

It won't be.

BRYSON:

But some taxpayers will have sharp reductions or increases in their regular income after the year has already started. What will you do about them?

RUML:

One feature of the plan is the provision for relief in case a taxpayer 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.

BRYSON:

What about "windfall" cases; I mean cases where a taxpayer's income for some reason was very much greater in 1942 than in either the year that preceded or that followed. What would you do about such a case?

RUML:

The plan includes 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. To meet this feeling I have made three suggestions for handling these "windfall" cases.

BRYSON:

But suppose these three special rules do catch all of the most objectionable "windfall" cases. There may still be a few remaining cases of too much good luck for somebody. What then?

RUML:

Much as I dislike "windfalls," even if they cannot be entirely eliminated, I am still for the plan. In all fairness, we should not refuse to do good for millions simply because we will be doing too much good for a few that don't deserve it.

BRYSON:

Does the plan apply to everybody, to all taxpayers?

RUML:

The Pay-As-You-Go income tax plan 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.

BRYSON:

For the lower brackets?

RUML:

For those in the lower brackets, the plan will obviously have far-reaching beneficial results, since unfortunate circumstances of loss of income will not be doubly unfortunate because of last year's debt.

BRYSON:

And the middle brackets?

RUML:

For those in the middle brackets, the plan will eliminate countless personal and family tragedies, free many able citizens for public service, and step up the efficiency of American industry by making possible the retirement and pensioning of executives who are holding on, largely to pay their income tax . . . and never catching up.

BRYSON:

What about those who pay really heavy taxes?

RUML:

For those in the upper brackets, it will make much less practical difference than might appear. First, because like anybody else, as long as they have their income they continue to pay their taxes; and, when they die, what otherwise would have been payable as income tax on the taxpayer's previous year's income is subject to estate taxes in its highest brackets. The reason I favor over-all application of the principle is because it gives equal treatment to all tax-

payers under the plan. In adopting pay as you go by skipping a year, I believe we should treat all citizens alike. As we turn the tax clock ahead for some, we should turn it ahead for all, and get the whole nation out of income-tax-debt as of the beginning of 1943. Insofar as we want more equality of income and of wealth we can have these through the progressive income tax and the progressive estate tax, but we should not use this general income tax reform, pay as you go, unequally to accelerate indirectly the impact of progressive taxation. Let us achieve such leveling, or lack of it, as we desire, directly through legislative action on measures explicitly drawn to serve that purpose.

BRYSON:

Let us take a concrete case. Here is a married man with one dependent that made 2,400 dollars in 1942 and who makes the same amount in 1943. What would he pay under the present plan and what would he pay under pay as you go?

RUML:

This taxpayer would pay \$129.00 under pay as you go, exactly the same amount as under the present system, only it would be a tax on his 1943 income instead of 1942. At the end of the year he would be free of income-tax-debt instead of owing a year's taxes as the present system requires.

BRYSON:

Suppose this man's income dropped because of lay-off so that in 1943 he only had 1900 dollars instead of 2400 dollars. What would his tax be?

RUML:

His tax would \$42.00 in 1943 instead of \$129.00 as under the present system and still at the end of the year he would be free of income-tax-debt instead of owing a year's taxes as he does under the present system.

BRYSON:

Do I understand that if the pay as you go plan goes through, we will all have to make an income tax return and a quarterly payment on March 15 just as under the present system?

RUML:

You certainly will. The pay as you go plan provides for identically the same declaration on March 15 as the present system. The only difference is that it is a tentative return for 1943 instead of a final return for 1942. But this means you will owe nothing for last year and what you are paying on March 15 is a payment for tax on your 1943 current income.

BRYSON:

There are many citizens whose income is irregular. What about farmers, contractors and professional men? How do they calculate what they owe?

RUML:

Farmers, contractors and professional men would be on a current basis just like everybody else. But the method of collection should be adapted to the kinds of income. For example, deduction at the source would be a good plan for salaries, wages and dividends. Professional men and contractors could be on a quarterly basis as at present, using their last year's income as a basis for a tentative declaration and making a year end adjustment. Farmers should be aided by having their payments come due when their receipts come in. But in every case we should all of us pay our income tax in any year on the income of that year and not be a year in debt.

BRYSON:

Broadly speaking, what will the plan accomplish?

RUML:

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.

BRYSON:

And there are also advantages to the government?

RUML:

Yes, for the government, too. 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.

BRYSON:

What about the post war period?

RUML:

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 have a spending spree in the first little boomlet, financed on unpaid taxes, and then a tax debt headache if income should drop off for a year, or so.

BRYSON:

But, Mr. Ruml, why did such a plan as this have to wait so long for someone to propose it?

RUML:

As I said earlier, when the income tax law was passed in 1913 it had this defect of paying income tax assessed on last year's income. At the time the defect was of no practical consequence because income tax rates were low and affected comparatively few people. In 1913 the rates began at 1% and the top (Normal and surtax) was 7%. Exemption for a single person was \$3,000. It is only with the recent high tax rates and the lowered exemptions that the problem of income tax debt has become so acute and so general that we must eliminate it.

BRYSON:

What are the chances of Pay-As-You-Go in 1943?

RUML:

The chances of getting the new year 1943 on a pay as you go basis seem to me to be distinctly good. I feel that a pay as you go plan in a form acceptable to Congress will certainly be adopted, because income taxpayers want to pay their taxes on a current basis, they 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 basic 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.

This defect was not their fault and they know it. They want it corrected and they want to be on a pay as you go basis in 1943.