

Original in
DRAFT FILE 1942

July 14, 1942

Chairman Eccles

R. A. Musgrave

Summary of Tax Bill to be
Reported by the House Ways
and Means Committee

The Revenue Bill of 1942 is scheduled to be reported out of the House Ways and Means Committee in the later part of this week. This discussion is based upon an earlier summary of the Treasury Department which has been corrected for later revisions, but is still subject to minor changes. The bill as reported by the House Committee is likely to be changed considerably before enactment.

Yield - The yield of the bill is estimated at 6.2 billion dollars or 2.5 billion short of the Treasury minimum objective. Of the total, 5.4 billion dollars are to be derived from additional income taxes and 800 million dollars from additional internal revenue taxes. Even more than the Revenue Act of 1941, the present act is predominantly an income tax bill. The estimated yield of the new tax bill is distributed as follows:

	<u>Yield (\$1,000,000)</u>
Individual Income Taxes	2,958
Corporation Income Taxes	2,425
Liquor Taxes	340
Freight and Express Taxes	292
Tobacco Taxes	87
Other	81
 Total	 6,183

Personal Income Tax

Exemptions - Personal exemptions are to be lowered from \$750 to \$500 for single persons and from \$1500 to \$1200 for married persons; \$100 dollars is to be retained as exemption for a dependent. Under the Treasury proposal, exemptions were set at \$600 for single persons and \$300 for each dependent. The Treasury proposal to repeal the 10 percent earned income credit against normal tax liability was rejected as was the proposal for mandatory joint returns, which in one stage of the committee proceedings had been tentatively adopted. Similarly rejected were Treasury proposals for granting exemptions for working wives, for counting children age 16 to 20 and attending school as dependents, and for repealing present exemption of interest receipts on state and local tax exempt securities. A Treasury proposal to permit deductions for extraordinary medical expenses was not acted upon.

Rates - The normal tax rate was raised from 4 to 6 percent, no change having been recommended by the Treasury. Surtax rates were raised in all brackets, but by less than had been proposed by the Treasury. This particularly holds for rates applicable to the income brackets up to about \$10,000. The rate on the first \$2,000 of surtaxable income was raised from 6 to 13 percent, notwithstanding a Treasury proposal to divide the first \$2,000 of surtaxable income into four \$500 brackets subject to rates from 12 to 20 percent. In the higher brackets the Committee rates approach those proposed by the Treasury fairly closely.

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Surtax Rates at Selected Brackets

Surtax Net Income (in \$1,000)	Bracket Rates			Committee Proposal
	Present Law	Treasury Proposal		
0 - .5	11	6%	12%	13%
.5 - 1	1	6	15	13
1 - 1.5	1	6	18	13
1.5 - 2	1	6	20	13
2 - 3	1	6	22	16
4 - 6	1	13	27	20
10 - 12	1	25	38	32
20 - 22	1	41	54	49
50 - 60	1	57	76	66
200 and over	1	67-77	86	82

The effective rates on single and on married persons without dependents as proposed by the Committee are above those proposed by the Treasury for incomes up to \$2,000 but the Treasury rates are somewhat higher for incomes above \$2,000. Due to the more liberal allowance for dependents under the Committee bill, its effective rates for persons with dependents are considerably less in the lower income brackets than the proposed Treasury rate.

Effective Income Tax Rates at Selected Income Levels
Committee Proposal

Net Income before Personal Exemption	Single	Married	Married, two dependents
\$ 600	2.5%	—	—
1300	11.0	1.0%	—
2000	13.7	7.0	—
3000	15.7	10.8	5.7%
8000	21.8	19.2	16.1
20000	34.1	32.5	30.1

Collection at Source - To increase the effectiveness of the income tax as an anti-inflationary device, the Treasury requested that 10 percent of income above exemptions be collected at the source. To this it was objected that the tax burden in the transition period would be excessive. The Treasury then submitted a compromise plan under which one half of the amount collected at source during 1943 would be credited against quarterly payments during that year on 1/2 income, while the balance would be credited against the first quarterly payment on 1943 income due in March 1944. To equalize the position of persons who would be subject to source collection and of others who would not, the Treasury further suggested that all taxpayers be required to pay 5 percent of net income plus one fourth the balance of their 1943 liability in March 1944. The Committee, however, decided that the transition problem could be met more simply by withholding income at a rate of 5 percent in 1943, the withholdings to be applied fully against 1943 tax liabilities and to start withholding over 10 percent in 1944. The Committee

bill, by proposing to start collection at the source later and at a lower level, will be a good deal less effective from an anti-inflationary point of view than the Treasury proposal would have been.

Individual Capital Gains and Losses - Capital gains and losses are to be grouped into only two classes, depending on whether the assets have been held for more or less than fifteen months. Short-term losses, which under present law can be offset against short-term gains of the succeeding year only, are to be allowed against either short- or long-term gains and may be carried over for a five-year period. Long-term losses allowed in full against other income under the present law, are to be treated the same as short-term losses. Furthermore, joint long- and short-term losses are to be allowed up to \$1,000 of other income.

Corporation Normal and Surtaxes

The normal tax on corporation income is retained unchanged in the Committee proposal but the surtax rates are raised considerably. The proposed surtax rates are 10 percent on the first \$25,000 of net income and 21 percent on income in excess thereof, giving a combined rate of 45 percent for larger corporations, as compared with a combined rate of 55 percent proposed by the Treasury.

Additional relief was granted small corporations under the alternative form of computing normal tax liability. The top income to which the alternative tax computation may be applied was raised to \$50,000 and the rate applicable under this provision to income in excess of \$25,000 was reduced from 37 to 31 percent. A similar alternative for the computation of surtax liabilities, not contained in the present law, was also provided for in the Committee bill. A special relief provision for corporations with decreasing earnings proposed by the Treasury was withdrawn when the Committee failed to adopt the higher surtax rates which the Treasury had requested. A proposal for inventory reserves was accepted in principle, the reserves to be deductible in computing income and excess profits tax bases. Under the Committee bill normal and surtax rates do not apply to the balance of adjusted excess profits net income remaining after excess profits taxation.

Excess profits tax

Credits - The specific exemption of \$5,000 is discontinued in the Committee bill and the excess profits credit granted under the invested capital method is reduced from 7 to 6 percent on invested capital in the 10 million dollar to 200 million bracket and from 7 to 5 percent on invested capital in excess of 200 million dollars. The credit rates applicable to the first 10 million dollars of excess profit income are unchanged. This downward revision of the invested capital credit will not affect the bulk of corporations which had large earnings in the base period and hence apply the base period method, but will be of concern primarily to larger corporations with low base period earnings.

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The Committee bill retains the provision that the excess profits tax is to be applicable on incomes above 95 percent of base period earnings. By lowering this percentage considerable revenue could have been raised. Reduction of this credit would have tapped corporations with large earnings in the base period which are now permitted to continue to earn 95 percent of these profits

size, without being subject to excess profits taxation.

Rates - Excess profits tax rates under the Committee bill were raised much above the level proposed by the Treasury, but this increase will only partly compensate for the revenue loss due to the non-acceptance of the higher surtax rates which the Treasury had requested. The new rates which are to be applicable to all corporation incomes after January 1, 1942 are as follows:

Excess Profits Tax Rates		Treasury	Committee
Adjusted excess profits net income	Present	Proposal	Action
First \$20,000	35%	50%	37.5%
\$20,000 to \$50,000	40	55	37.5
\$50,000 to \$100,000	45	60	37.5
\$100,000 to \$250,000	50	65	37.5
\$250,000 to \$500,000	55	75	37.5
Over \$500,000	60	75	37.5

Refund - When a 9½ percent rate on excess profits had been contemplated at one stage in the Committee's deliberations, it was suggested by various officials, including Secretary Morgenthau and Mr. Nelson that an excessive rate of "perhaps 80 percent" (Secretary Morgenthau) might leave little incentive for the maintenance of efficient production and that it might therefore be desirable to render the tax in excess of such rate refundable after the war. The committee adopted a net excess profits rate of 80 percent plus a refund rate of 1½ percent but later reversed itself in favor of a flat rate of 37.5% without refunds.

Other Taxes

The capital stock tax, repeal of which had been suggested by the Treasury, was retained, but provision was made for annual revaluation of capital stock values. A flat estate tax exemption of \$60,000 was substituted for the existing basic and insurance exemptions of \$40,000 each. Gift tax exemptions were lowered to a basic exemption of \$30,000 plus \$3,000 annually for each donee. There was no change in estate or gift tax rates. Excepting the freight and express tax, the Committee proposed to obtain new excise revenue largely from increased taxes on liquor and on cigarettes. The 5 percent excise tax on freight and express charges is scheduled to produce nearly 300 million dollars and was adopted notwithstanding Mr. Henderson's warning that the resulting increase in freight rates might seriously disrupt O.P.A. price ceilings.

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