Extra copy

April 11, 1941.

My dear Mr. President:

In response to your request, I have gone over the Currie tax memorandum which you gave me. The memorandum herewith attached was prepared in consultation with Dr. Currie, Dr. Hansen, and staff members.

I wish particularly to call attention to the main points stressed, as follows:

1. Public Concern over Debt, Deficit and Inflation

A budget deficit of $13 billions, with existing tax system, is indicated for fiscal year 1942. The public will be much concerned unless this gap is closed by a substantial amount. With respect to inflation, specific price control measures are of primary importance, but the public will not be reassured without substantial tax increases.

2. War Profits and Labor Trouble

Corporate profits in 1941 will rise rapidly. Unless these profits (mainly incident to defense expenditures) are taxed away, labor demands are almost certain to get out of hand. Without an honest program to take the profits out of war, we cannot hope for social and labor stability.

3. Progressive Taxes v. Sales Tax

Interested groups are pressing for a sales tax. If corporations are allowed large profits and sales taxes are imposed, inflammatory labor disturbances will be fed from two sources: (1) large corporate profits, and (2) rising labor costs.

4. Corporate Profits plus Broadening of Income Tax

Excess defense profits must be taxed away. But this is not enough. Everyone above a basic minimum income must contribute to defense. Only by broadening the income tax base and raising the normal rate can we head off a regressive sales tax.

5. Yield

The proposals made will yield about $2.5 billions additional revenue for fiscal 1942. The memorandum also calls attention to the prodigious yield of a strong excess profits tax when the national income reaches $100 billions. It is not only the most equitable tax, but it is also a great revenue producer.

Respectfully yours,

M. S. Eccles
Chairman

The President,
The White House.

AH/nb

April 11, 1941

A TAX PROGRAM

Excess Profits Tax - The present statute, falling far short of the intention stated in your message of July 1, 1940, "to see that a few do not gain from the sacrifices of the many" in the task of arming for national defense, should be drastically revised. Labor can not well be asked to moderate its demands if employers are permitted to retain huge profits. After paying taxes reflecting increases already made and in prospect, many individuals will have less money left than they had before the defense program got under way, while corporate earnings after taxes are sharply higher and many corporations are making more money than they have ever made before. In contrast to individual earnings, these corporate earnings escape the full force of the individual surtaxes because they may be retained without penalty. An effective excess profits tax is the best way to make them bear their fair share of the tax load.

Specific Proposal - Fix the excess profits base at not more than 10 per cent or less than 6 per cent on invested capital, the exact figure within these limits to be determined by past earnings experience. Eliminate borrowed capital from the statutory invested capital base. Retain the present specific exemption of $5,000. On excess profits over this exemption, levy rates as follows:

	(Per cent)
First $20,000	25
Between $20,000 & 45,000	50
Over $45,000	75

Retain the provisions of the present law allowing personal service corporations to escape excess profits tax if stockholders are taxed on their appropriate share of corporate earnings under the individual income tax.

An alternative plan would be to establish a uniform excess profits base of 6 per cent return on invested capital. A tax rate of 10 per cent might be applied to earnings between 6 and 7 per cent of invested capital; a rate of 20 per cent to earnings between 7 and 8 per cent; and the same scale of graduation continued until a rate of 100 per cent would apply to earnings in excess of 15 per cent on invested capital. A modification of this plan, beginning the rates at a level somewhat higher than 10 per cent and fixing a maximum rate of somewhat less than 100 per cent, might meet the objections that the schedule of rates first outlined would produce relatively large differences in taxes for corporations with relatively small differences in earnings, that fiscal productiveness would be impaired by a schedule taxing the very large volume of earnings between 6 and 8 per cent on invested capital at relatively low rates, and that a 100 per cent rate would deprive business of any incentive for efficient management.

Normal Corporation Income Tax - The maximum rate of normal corporation income tax should be increased from 24 to 30 per cent, a step generally anticipated and already reflected in corporate policy.

Personal Income Tax - This is the most equitable of all taxes and should be made the backbone of our tax structure. Up to now, however, we have failed to make as full use of the personal income tax as other democratic countries have done, with the result that it yields only about 20 per cent of total Federal revenue. Pressures on the Congressional Committees have resulted in an income statute shot through with inconsistencies, inequities and immunities for minority groups of taxpayers.

Specific Proposal -

(a) Disallow the personal exemption and credit for dependents for purposes of surtax. Present practice amounts to granting a subsidy that increases in value as income increases.

(b) Tax the incomes of husbands and wives as a single income. The privilege of filing separate returns is a tax-avoidance device that in practice is valuable only to wealthy couples, and practically all wealthy couples make use of it. Professional services of a high order at the Government's disposal are adequate to remove the legal obstacles to this proposal if the use of those services is not blocked by objectors whose opposition rests basically on political conservativism rather than on legal grounds.

(c) Lower the surtax exemption to $3,000 and increase surtax rates.

(d) Increase the normal tax rate from 4 to 8 per cent. The comparable British rate is now 32 1/2 per cent. Lower personal exemptions for married persons from $2,000 to $1,600. This exemption should not logically be more than double the present exemption for single persons of $800. Recognizing all the disadvantages of ~~shmply~~ increasing taxes on large numbers of comparatively low-income citizens, it now seems imperative to increase the number of citizens participating by the payment of direct taxes in the financing of the defense program.

Estate and Gift Taxes - On June 19, 1935, you said "The transmission from generation to generation of vast fortunes by will, inheritance or gift, is not consistent with the ideals and sentiments of the American people. Such inherited economic power is as inconsistent with the ideals of this generation as inherited political power was inconsistent with the ideals of the generation which established our government." The task of bringing law into conformity with popular ideals, begun in the Revenue Act of 1935, ought to be finished now.

1. Establish a single schedule of rates applicable to the cumulative total of gifts during life plus estate passing at death. Under present practice, gifts subject to tax in the lowest brackets of the gift tax can be used as a means of avoiding taxes in the highest brackets of the estate tax. Great accumulations of wealth can be transmitted by gift as well as by bequest, and a consistent public policy would tax both types of transfer at the same effective rates. But if it were thought desirable to leave an incentive for the making of gifts, the total tax assessed on a gift might be arbitrarily reduced by ten per cent from the tax assessed on a transfer of the same amount made at death. Raise the now unduly low rates applicable to estates under $10 million.

2. For the present exemptions of $40,000 under the gift tax, $40,000 general under the estate tax, and $40,000 insurance under the estate tax -- a total of $120,000 -- substitute a single exemption of $25,000, applicable to insurance proceeds or property in any other form.

3. Limit the right to make tax-exempt gifts and bequests to educational and charitable institutions either by limiting the amount of such transfers or by requiring the gift or bequest to be certified as truly in the public interest by qualified expert opinion. Such transfers often merely reflect the whims of the donor and serve no useful public purpose.

4. Broaden the legal concept of "gifts" and "transfer at death" to include all transfers of property that transmit wealth from one generation to the next.

Revenue Yield - The yield of these proposals in the calendar year 1942 may be roughly estimated as follows:

	(Millions of dollars)
1. Excess profits tax revisions	800
2. Normal corporation tax	600
3. Individual income tax: 1/	
(a) Disallow credits against surtax	200
(b) Tax incomes of couples as single income	200
(c) Raise surtax rates and lower exemption	250
(d) Raise normal tax rates and lower exemptions	500
4. Estate and gift tax 2/	---
	2,550

With a national income of $100 billion, the proposed changes in the excess profits tax would result in an addition of $1,750 to the yield of the present law or a total revenue from excess profits tax of $3,500 million.

1/ In the estimates of individual income tax yields, full account has been taken of the effect of increased corporate taxation on dividends.

2/ Because of the long lag in collections, no appreciable yield is to be expected in calendar 1942, but about $500 in revenue would be realized in 1943 and subsequent years.