

DIVISION OF TAX RESEARCH

TREASURY DEPARTMENT
WASHINGTON

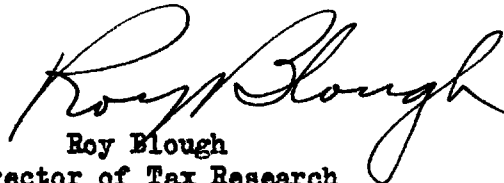
August 4, 1941

Dear Mr. Chairman:

At the request of Secretary Morgenthau, I am enclosing, in strict confidence, a preliminary draft copy of a proposed statement to be made before the Senate Finance Committee regarding the tax bill.

The Secretary has asked me to say that he would very much appreciate it if you would discuss the statement with him at his office Wednesday, August 6 at 9 A. M.

Sincerely yours,



Roy Blough
Director of Tax Research

Honorable Marriner S. Eccles,
Chairman, Board of Governors,
Room 2046
Federal Reserve System
Washington, D. C.

Enclosure

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D R A F T

August 4, 1941
9 A. M.

SUGGESTED STATEMENT OF THE SECRETARY OF THE TREASURY
BEFORE THE SENATE COMMITTEE ON FINANCE

Mr. Chairman and members of the Committee: I am here today to give my support to the pending tax bill H. R. 5417 designed to produce \$3,500,000,000 annually in additional revenue for the defense of our country.

When, on April 24, I made my statement before the House Ways and Means Committee on this Bill the defense program was about \$39 billion including the lend-lease appropriation. Since that time there have been further authorizations and appropriations so that the total program at the present time has risen to _____ billion dollars. Of course, not all of this amount is going to be spent in the present fiscal year, but as these appropriations are spent the fiscal problems of the Government and the economic effects of the defense program will both increase.

Our great problem in providing for the defense of the nation is fundamentally the problem of production; of actually building planes and tanks, ships and guns with the labor, management, machinery and raw materials which we have in our country. As we increase this

production we shall find that it will be necessary to divert to defense production more and more of the resources now engaged in satisfying our civilian needs and wants. The pinch of scarce resources and plants is already being felt and it may be expected to become more aggravated.

Rising prices.

At the same time as this diversion of production is taking place, the amount of purchasing power in the hands of the people of the country will continue to increase due to the large amounts being spent by the Government and to resultant fuller employment. The result of the pressure of this increased purchasing power on the limited amounts of goods and services for which it may be spent threaten, in the absence of vigorous action, to sweep us into a spiral of rising prices.

Apparently we are at the same point in price history as in 1916 -- on the edge of inflation.

The pattern of price rises during the past two years roughly resembles the price movement during the first two years of World War I -- little rise in the cost of living, a moderate rise in the wholesale price index and a sharp rise in the prices of basic commodities.

Since the beginning of the war, September 1939, the wholesale price index has risen from 65 to 87 or about

16 percent. The greater part of this rise has occurred during the past five months.

The cost of living index has increased $5\frac{1}{2}$ percent since September 1940. Half of this increase has occurred in the past two months.

The price index of 28 basic commodities has increased 48 percent during the same period, despite the fact that the prices of many basic raw materials have been controlled by the Office of the Price Administration and Civilian Supply. This increase constitutes a major danger signal of inflation which must not be ignored. The wholesale price index always lags greatly behind the index of basic commodities, while the cost of living index does not show anything like the full effects of inflation until long after the seeds of inflation have taken deep root.

Forces making for price rises.

The forces making for further price rise are both potent and persistent:

(1) The Budget estimates defense spending during the fiscal year 1942 will be \$15 billion or two and one half times as much as in the fiscal year of 1941. This increased estimate does not take account of extensions of the defense program made after June 1 and of additional sums needed for lend-lease.

(2) More important in its bearing on the danger of inflation than the figures for expenditures of the coming year are the estimates of deficit spending. The net deficit for the fiscal year 1942 as estimated by the Director of the Budget will be \$12.8 billion compared with \$5.1 billion for the previous fiscal year. This assumes the present tax structure. If the \$3.5 billion tax bill which is before you is passed by Congress at an early date the deficit will be reduced by about \$2 billion (the amount of revenue yield in the fiscal year 1942 of the \$3½ billion total) but it will still be over \$10½ billion. Again this estimated deficit does not take account of the expansion of the defense program after June 1, 1941.

(3) The inflationary force of the Federal deficit has been supplemented during the past year by an expansion of bank credit. Total bank loans expanded by an estimated \$3 billion or about 20 percent during the fiscal year just past. This rise moreover has been proceeding at an accelerated pace.

(4) Prices will be increasingly stimulated by

- (a) the shortage of materials for civilian goods
- (b) increased absorption of idle capacity in many industries and
- (c) further increases in agricultural

prices and wages.

Also making for further price increases are the heightened obstacles to imports such as reduced ship space, higher shipping costs and cutting off of normal foreign sources of supplies.

Although there are some factors in the situation operating to check the inflationary trend, such as surplus stocks of some agricultural commodities, unemployed labor resources and partially employed production facilities, most of these factors were present in the fiscal year 1941 in greater degree and yet did not serve to restrain price rises even though the forces making for price rises were then much weaker.

Steps already taken to check inflation.

Some important steps have already been taken or are being taken to check inflation. Congress has made provision for the Treasury to sell Defense Savings Bonds and Stamps and so to absorb for the defense program funds which might otherwise be used for civilian purchase of goods. This very important program is well under way.

The Treasury Department has also launched a plan for selling tax anticipation notes which will facilitate the prepayment of income taxes and will more promptly withdraw purchasing power represented by such taxes.

The Office of Price Administration is making every effort to obtain the cooperation of producers and distributors in limiting price rises.

Additional measures necessary.

These measures to restrain price rises, although they have unquestionably been helpful, are inadequate to meet the situation confronting us. We have gone only a small part of the way it will be necessary to go. We must attack the problem on all fronts if we are successfully to check inflation.

My purpose in talking to you today about this subject of inflation is primarily to indicate the ways in which the tax program can be designed to help minimize the dangers of inflation. Tax legislation, however, will not, by itself, solve the problem. The control of inflation is too great a load for fiscal policy alone to carry.

Accordingly before discussing taxation I wish to refer briefly to other lines along which action should be taken.

(1) The Office of Price Administration should be given the statutory power to fix prices where necessary. The legislation which the President has requested is essential. Price rises cannot be controlled when inflationary forces are at work without effective power

to impose price ceilings enforced by direct penalties. The mere possession of such power tends to make its exercise unnecessary.

The attempt to prevent unwanted price increases by fiat, however, is bound to break down here as it has elsewhere unless it is accompanied not only by an adequate fiscal program to absorb buying power, but also by other methods.

(2) Vigorous steps should be taken to increase the supply of goods required for military and civilian needs. Increased output is in itself a major objective of our defense program and the most effective and desirable method of preventing inflation. There should be further exploration of the possibilities of inducing expansion of production facilities and labor supplies where such response could not be expected to occur automatically.

(3) There should be authority to provide systematic priorities of scarce supplies among industries making civilian goods. In order to obtain a fair distribution of scarce supplies among consumers it may later prove necessary to extend the rationing to ultimate consumers.

(4) Extension of the general controls over bank credit may be found desirable.

(5) Establishment of controls over the entire field of consumer credit will undoubtedly be necessary.

(6) Controls over capital expenditures should be provided.

(7) It may be found desirable to extend the Social Security Program along lines which would increase the flow of funds to the Treasury from current incomes during the emergency and would increase the outflow of funds when needed in the post defense period.

(8) There should be a reduction of the Federal lending and underwriting program, such as nonemergency housing expenditures and mortgage guarantees.

(9) Nonessential Federal expenditures should be reduced. In my statement before the Ways and Means Committee I pointed out the desirability of reducing such expenditures by one billion dollars. An appeal should also be made for economy in State and local governmental expenditures and for curtailment of their borrowing for nonemergency expenditures. Such curtailment would not only cut down expenditures during this period but would build up a back log of desirable projects for the post-defense period when public works expenditures may be badly needed to maintain the economy.

Fiscal policy for inflation control.

Even with these controls in operation -- and I urge upon you the necessity of placing them in operation -- a strong fiscal policy for inflation control is necessary. The tax bill before you is an important step. When I appeared before the Ways and Means Committee in April, I recommended a tax bill to yield \$3.5 billion of revenue annually above the yield of the existing tax structure. If at that time I could have foreseen the accelerated rise in prices and the great increase in the defense program which have since taken place, I should have asked for more than \$3.5 billion.

The Ways and Means Committee of the House has labored long and well on this bill and I am not suggesting that you increase the total amount of revenue which it provides. To increase its revenue yield substantially might result in delay, and passage of the bill is important.

When this bill has been passed, however, and you and the members of the Ways and Means Committee have had an opportunity to enjoy a well deserved rest from the arduous labors which it has entailed, I hope you will undertake, as the Treasury has already undertaken, to make a new survey of our tax system. It is now some

years since the tax system has been examined with respect to the many technical changes which from time to time are found necessary as a result of experience, new court decisions, and other new situations. Both the taxpayers and the Government suffer as these uncorrected faults accumulate. Such matters have been kept out of the present bill in order to expedite its passage and not to complicate the issues which it involves, but they should be taken up yet this fall. In addition to correcting the faults in our tax structure, it will again be necessary in the light of the present program for defense expenditures and the threat of inflation to increase further the revenue power of the tax system either late this year or early next year.

From present indications, if the control measures which I have mentioned are placed into operation, and if the tax bill is promptly passed providing not less than \$3.5 billion of new revenue, it is my hope that the situation will remain fairly healthy until the early date when another tax bill designed to absorb substantially more purchasing power can be considered and passed.

Excess profits tax.

Within the \$3.5 billion revenue scope of the present tax bill there appear to be several possibilities for

discouraging inflationary price rises. The first of these is in the field of excess profits taxation. In recent months there has been a noticeable tendency for various groups including business men, farmers and laborers, to endeavor to secure higher rates of return in profits, prices and wages. Such efforts cannot be criticized in normal times. At the present time, however, with the existing pressures for inflation, widespread efforts to increase profits, prices, and wages will result not only in larger purchasing power and thus still greater pressure on our limited supplies of civilian goods, but also in higher costs for the defense program and for goods which civilians purchase. These higher costs in turn necessitate increases in prices and these in turn give rise to new demands for higher wages and higher prices. The spiral goes up and up.

If we are to expect to stop or prevent this spiral we must be able to show those who receive modest incomes from their labor or their production that excessive profits are not being received by great corporations.

The present excess profits tax places special heavy taxes on profits which are in excess of the profits received during the years prior to the defense program.

This is all to the good, -- is indeed essential. It is, however, not enough. A corporation may make 50 percent profit on its invested capital and not be subject to the excess profits tax if the profit is not in excess of 95 percent of its average profits during the base period years 1936 to 1939. This basic weakness is found in the present law and also in the bill before you.

This is not a matter of minor importance. Substantial numbers of companies are in the high-profit group. One out of five profit-making corporations with assets of \$1,000,000 and over averaged more than 10 percent net income on their reported equity capital during the years 1935 to 1938 and one out of twenty-five companies averaged more than 30 percent. These companies can continue to earn profits at virtually these rates without paying excess profits tax under either the present law or the Committee's tentative plan.

Failure to apply excess profits taxation to such excess profits is unfortunate also because of the uneven way in which competing businesses are affected. Concerns which have been making high returns in the base period years are given a competitive advantage over newly organized concerns or concerns which have been struggling to establish themselves. They may

receive free from excess profits tax a much higher rate of return than their new and growing competitors. The effect is to confirm monopolies in their control and to protect well established businesses against competition.

Moreover the capacity of a corporation to pay taxes is affected by the rate of its return on its investment. The highly prosperous, well established corporation which has been making 30, 40, 50 percent or more on its invested capital has amuch larger ability to pay taxes than a corporation which has been earning only 3, 4, or 5 percent on its invested capital even though the dollar incomes of the two companies are the same. Heavy taxes on higherates of profit will not cause the business receiving them to be liquidated or discontinued for lack of a minimum necessary profit, which may occur when heavy taxes are imposed on meager profits. Application to corporations of taxation in accordance with ability to pay calls for higher taxes on the profits of those corporations which have the higher rates of return.

Defense excise taxes.

In more normal times excise taxes have little to recommend them except the fact that they produce revenue. In a period such as this, however, excise taxes may in certain cases promote a more positive objective, namely, to reduce the demand of producers and consumers for

scarce commodities which compete with the defense program and to absorb wind-fall profits which result from scarcity of supply relative to demand.

The achievement of this objective is not a simple matter. It would be unwise to impose numerous excise taxes at low rates. The result would be to clutter up the tax system while not effecting the desired control. It is not possible to handle in the same manner all commodities which it is desired to tax. Some may require one kind of treatment and others another kind. Nevertheless, the further use of excise taxes to divert consumption and to reduce wind-fall profits should be seriously considered by your Committee.

For example, the tax on passenger automobiles might well be made much higher than the 7 percent adopted by the House. The production of passenger automobiles will undoubtedly have to be greatly restricted. Reductions as great as one-half have been mentioned. It will be extremely difficult under such circumstances to prevent retail price rises on automobiles. A high excise tax will help to prevent these higher prices from giving unwarranted wind-fall profits to dealers and middlemen. Such taxes will not likely increase the prices of automobiles to consumers much beyond what they otherwise would be with the restricted supply; to the extent they

do increase prices they will reduce the need for rationing purchases by consumers.

Personal exemptions.

One feature of the bill before you which has received less public attention than it deserves is the fact that the base has been broadened to add about 2,000,000 new taxpayers. This was accomplished by beginning the surtax at the first dollar of surtax net income. The 10 percent earned income credit in effect increases the exemption from normal tax. Since this credit is not applicable in computing the surtax, the bill has in effect reduced the exemption of single individuals by \$55, of married couples by \$222, and of married couples with 2 children by \$311.

In the early stages of this bill the Treasury Department took the position that in view of this substantial broadening of the base personal exemptions should not be further lowered. Equitable taxation requires that taxes be placed on ability. Small incomes have very little taxpaying ability, and this little is decreased as the cost of living rises.

However, the threat of rising prices has become so great that a change of policy is indicated. If the cost of living rises substantially the effect will be to tax small incomes much more than would an income tax

at the rates provided in this bill. If the direct taxation of these incomes will help, as we believe it will, in preventing inflation it will be a great service to the very groups which would be made newly subject to the tax.

Accordingly, in the light of the developments of the past few months it is our recommendation that the personal exemptions of both single and married persons be substantially reduced so that the income tax will reach a much larger percentage of the national income and will affect a much larger percentage of the persons of the country than it does at present.

Alternatives to taxation more onerous.

In closing my remarks I desire to point out that although this is a very heavy tax bill the alternatives to heavy taxation are much more onerous. Rising debts and rising prices would take much more away from our people both now and in the future than higher taxes now will take. Our defense program is an absolute necessity. It must be paid for. It should be finally paid for now insofar as possible, thus reducing the necessity for higher taxes later when they may be harder to pay and less willingly paid than now.

Statement of Secretary Morgenthau
Before the Senate Finance Committee

August 8, 1941.

My purpose in being here today is to discuss taxation as an essential part of national defense. Our great problem in providing for the defense of the nation is fundamentally the problem of production -- of actually building planes and tanks, ships and guns with labor, management, machinery and raw materials. To solve that problem without impairing our economy or weakening the structure of democracy, our fiscal policy must be adapted to the needs of the times.

On April 24 I discussed with the Ways and Means Committee of the House the need of producing \$3,500,000,000 annually in additional revenue. The Treasury Department presented a suggested program for raising that amount of money. As it passed the House, this bill will produce approximately \$3,200,000,000 annually in additional revenue. In my opinion

it is very important that the revenue yield be raised to at least the original \$3.5 billion level. It is also important that the bill be passed as promptly as possible. Income taxpayers and excess profits taxpayers should know as quickly as possible what their taxes on 1941 income and profits are going to be, since more than seven months of the year have already elapsed. The excise taxes and the estate tax cannot be imposed retroactively and every day's delay in the passage of this tax bill costs the Treasury several million dollars in revenue from those sources.

The rapid developments of the last few months have made this bill inadequate even before it is passed. Since my statement before the Ways and Means Committee, many things have happened. Two and one half months ago the President proclaimed the existence of an unlimited national emergency. He called upon "all loyal citizens to place the nation's needs first in mind and in action to the end that we may mobilize and have ready for instant defensive

use all of the physical power, all of the moral strength and all of the natural resources of this nation."

Since I appeared before the Ways and Means Committee, the amount of appropriations, authorizations and recommendations over and above the Budget has increased by about \$14,000,000,000, thus completely changing the fiscal picture and greatly increasing the need for revenue.

Since I appeared before the Ways and Means Committee, prices and the cost of living have increased at an accelerated rate, thereby accentuating the need for a strong fiscal program.

In the light of these and other developments resulting from "all out" defense, I should like to point out what, in my opinion, will be necessary in "all out" taxation to support such a program.

First of all, we shall need more revenue -- much more revenue. The defense program is an absolute necessity. It must be paid for. Insofar as possible, it should be paid for now. Borrowing should be kept to a minimum to maintain our fiscal strength. The rise in the Federal debt means merely that the taxpayer's burden is being postponed--that both principal and interest must be paid later out of higher taxes collected at a time when they may be harder to pay and less willingly paid than now.

Along with increased taxation should go the maximum reduction in the ordinary non-defense expenditures of Government. The burden of paying for defense is so heavy that it should be relieved at every possible point.

Increased taxation is needed also to maintain economic stability. Rising purchasing power is exerting increasing pressure on the prices of many kinds of goods, while at the same time production of these goods is being

increasingly curtailed by the necessity of diverting our resources to defense uses. This complication of increased demand and restricted output is causing inflationary price rises which threaten to increase the cost of the defense program, unbalance family budgets and seriously disturb our economic life.

This larger needed revenue should come from all sources where there is ability to pay -- that's what an "all out" tax program means. The people of this country have never been more ready to make sacrifices for the common good. Our tax program has not kept pace with the defense program. We are still thinking too much of helping this group or that to escape its share of the burden. We have now come to the point where it is a matter not merely of fundamental equity, but of the utmost necessity that all exemptions from taxation be reduced to the absolute minimum.

An "all out" tax program for defense should reach ability to pay at several points not now fully tapped:

1. In my opinion such a tax program might well involve a substantial lowering of personal exemptions and a consequent broadening of the base of the income tax, if simultaneously we take immediate steps to remedy defects in the application of the principle of ability to pay in other parts of the tax structure. Under the bill before you, the base has been broadened to add about two million new taxpayers, but even so there will remain a relatively large proportion of the population in the lower income groups which will not be directly affected by the income tax. A further lowering of the exemptions would produce some additional revenue and in addition it would give millions of Americans an opportunity -- a welcome opportunity -- to make a direct contribution through taxes to the

defense of their country. It would enable them to feel that they were participating personally and directly in the defense program. As the President wrote to Chairman Doughton on July 31, "Most Americans who are in the lowest income brackets are willing and proud to chip in directly even if their individual contributions are very small in terms of dollars."

But I believe this Committee will agree with me that we ought not to accept such sacrifices, even though willing sacrifices, from millions of people with low incomes on whom the burden of other types of taxes falls most heavily, unless we reach in other places ability to pay which is escaping its fair share of taxes. Among these are the following:

2. The excess profits tax exempts profits of even the most prosperous corporation, except to the extent that such profits are in excess of its average profits for the years 1936-1939. Surely Congress will not wish to impose

additional taxes on millions more of our low income group, unless it also imposes the excess profits tax on the exempt excess profits of such corporations.

3. Families pay lower Federal income taxes when both husband and wife receive income than when the same total amount of income is received by only one of them. This is a discrimination of which many wealthy people have taken advantage by large gifts of income-producing property between husband and wife. Furthermore, in at least eight States of the Union, Federal income taxes are made substantially lower than in the remaining States because the local law permits the splitting of income between husbands and wives. Here are discriminations against the rest of the taxpayers which, I believe your Committee will agree, must be eliminated if we are to extend the income tax downward to include millions of persons with low incomes. The discriminations can be eliminated by requiring husband and

wife to file a single joint return with appropriate relief granted only where both husband and wife work outside the home.

4. For years, the concerns engaged in extracting certain of our natural resources, notably oil, have been granted far greater allowances for depletion than can be justified on any reasonable basis of tax equity. If the income tax is to be extended to lower incomes, this privilege of tax escape should simultaneously be removed.

5. A few months ago, the Congress eliminated the tax-exemption privilege from new issues of Federal securities. The purchasers of new State and local securities still enjoy this exemption. The exemption was inequitable and expensive even in more normal times. It cannot be borne longer in a time like this, and especially if we are to increase the direct tax burdens of persons with small incomes.

6. In its suggestions to the Ways and Means Committee, the Treasury recommended substantial increases in estate and gift taxes, and lower exemptions. In part, this recommendation was followed, but, in my opinion, the estate and gift taxes should reach more estates and provide more revenue if we are going to tax smaller incomes.

Those are some of the things that I mean when I say that an "all out" tax program for defense must go far beyond the present bill.

There is another condition which I would attach to lowering the personal exemptions. I think we ought not to take into the income tax system millions of new taxpayers with small incomes without simplifying the way in which their tax is computed.

Take, for example, a person with a \$900 salary. Under the present law, he first figures out what deductions he has -- taxes paid, interest paid, contributions and so on. Then he computes

his earned income credit. Then he subtracts his personal exemptions from his income after deductions. On the balance, under rates of the bill before you, he computes a surtax at 5 percent. Then he goes back to the income and deducts his earned income credit. On the balance, he computes a normal tax at 4 percent. He then adds the normal tax and the surtax and takes 10 percent of the total for defense tax. He adds the defense tax to the normal tax and surtax and finally arrives at his income tax.

When he started to fill out his return, he may have been full of patriotic enthusiasm to pay his share toward the defense program, but by the time he has finished his last computation his cheerfulness may well have collapsed under the strain. It is difficult enough for persons with substantial incomes who are used to dealing with financial papers and who can afford high-priced lawyers and accountants to make their computations for them.

The person with a small income should not be put to this annoyance and possible expense.

Furthermore, the checking of these tax computations by the administrative authorities takes time. Frequent errors are found which must be rectified, requiring correspondence and further annoyance of the taxpayer as well as expense to the Government. We in the Treasury do not enjoy pestering the taxpayer any more than he enjoys being pestered by us.

For taxpayers with relatively large incomes, refinements in determining income and computing taxes are troublesome but are necessary in the interest of equity. For small taxpayers, however, especially those now taxed for the first time, these refinements are cumbersome and confusing without serving any important purpose. The income taxes of millions of people can be determined with acceptable accuracy by less involved methods.

As the President suggested to Chairman Doughton, there should be a provision in the case of the small taxpayer "for a straight, simple payment of some small contribution to the national tax income through a simple agency and on a simple form."

For such taxpayers a plain and easily understood table could be provided with the aid of which the small taxpayer could compute his tax bill in a very few moments. He would be spared time, trouble and annoyance and the Government would be spared expense.

To indicate more clearly what I have in mind, I have had prepared a sample table showing how this might be worked out in practice for incomes up to \$3,000. This is only a preliminary table, and improvements and changes will no doubt be desirable, but it will illustrate how the proposal can be applied.

The taxes imposed by the bill before you are very heavy; the taxes of an all-out program would be even heavier. I am convinced that the

people are not opposed to heavy taxes, that in fact they favor heavy taxes because they know that the alternatives are much more onerous. At a time when expanding incomes are operating to force prices upward many kinds of measures must be employed if prices are to be kept under control. without heavy taxation, the other measures have little chance to succeed.

Rising prices would take much more away from our people now and in the future than higher taxes now will take. Under the tax bill in its present form, a married couple with no dependents, having a net income of \$5,000 a year, will have its Federal income tax increased by \$198, or 4 percent of its income. Assuming that two-thirds of the family's income is spent on items affected by a changing cost of living, an increase in the cost of living of 6 percent would impose as great an additional burden on this family as would the proposed income tax. The cost of living index has increased 5-1/2 percent since September, 1940. It is clear from this simple illustration

that rising prices tax the family income just as surely as do income taxes. Although, as prices rise, the incomes of some families will increase, many incomes will not increase and most incomes will not increase as fast or as much as prices.

If, in an attempt to protect the incomes of our people, we hold down taxes and as a result the cost of living rises, we shall have taxed them just as surely as if we had levied on them directly -- and we shall still have the inflated costs of defense to pay later from taxes.

An all-out tax program will build public morale in an all-out defense program. By reducing the necessity for borrowing, it will strengthen confidence in the impregnable fiscal position of the Government. By contributing to the control of prices, it will help prevent the demoralization which would result from inflation. By distributing the defense burden fairly, it will help unite the nation. It will make all the people equal partners in sharing the cost of the defense of our country.

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date August 5, 1941

To Chairman Eccles

Subject: Proposed Statement before the

From Martin Krost

Senate Finance Committee

MK

I am returning the proposed statement by Secretary Morgenthau, with the verbal suggestions you made over the phone written up on a separate sheet.

I should like to call your attention to the fact that the section of the statement dealing with the excess profits tax, beginning on page 10, suggests no alternative to the old Treasury proposal involving the elimination of the average earnings method. In view of the continuing reluctance of Congress to eliminate the average earnings option, you may wish to revive at this time the suggestion made in your Ways and Means Committee statement to restrict the use of the average earnings method by reducing the percentage of average earnings allowed in computing normal profits from the present 95 per cent. The reduction might be parallel to the reduction already made in the invested capital credit on capital over \$5,000,000, that is 12 1/2 per cent (from an eight to a seven per cent rate of return.) This would mean reducing the present 95 per cent of average earnings allowed to about 83 per cent.

With respect to the effect of lowering the personal exemptions, the argument often made that the bulk of the increased revenue would come from existing rather than new taxpayers does not imply, as it seems to, that this measure is not an effective means of curtailing mass purchasing power. Families subject to income tax under the exemptions of the bill passed by the House make about 40 per cent of all consumer expenditure. Most of the revenue would come from the taxpayers of lowest income within this group. Such taxpayers are comparatively lightly taxed at present. Married persons with incomes of as much as \$8,000 pay an effective rate of less than 10 per cent under the proposed bill. This percentage seems especially low when it is considered that total governmental expenditures may soon amount to as much as a third of the national income.

August 5, 1941

Suggestions on Proposed Statement

before the Senate Finance Committee

Page 7, numbered paragraph (4) -- Instead of the present language, "Present limitations on the powers of the Board of Governors of the Federal Reserve System to define and increase reserve requirements should be removed."

Page 8, numbered paragraph (5) -- Instead of the present language, "It will undoubtedly be necessary to control all installment credit covering the sale of consumer durable goods, including housing."

Page 12, middle paragraph -- Would it be possible to give the proportion of profits made by these high-profit corporations, as well as the proportion of the total number of companies that they represented?