

June 11, 1937

Chairman Eccles

Report of the Sub-Committee
on current taxation policy.

Lauchlin Currie

I think you will be interested in the enclosed report which was adopted by the Industrial Committee and is being presented to the National Resources Advisory Committee. I prepared it. It occurs to me that the subject might be raised in your next conference with the President, Wallace, Morgenthau, Merriam, and the others.

REPORT OF THE SUB-COMMITTEE ON CURRENT TAXATION POLICY

1. The continuance of basic policy relative to the effective use of national resources will require a continued high level of spending. The work relief, farm tenancy, education and housing programs, and other measures to raise the standard of living of the lowest third of the population will all result in federal expenditures.

2. In order to be in a position to combat the next recession by maintaining consumer buying power it is essential that a substantial volume of the debt incurred in the depression be retired in the next few years.

3. The present tax base will not yield sufficient revenues over and above necessary expenditures to make a serious dent on the national debt.

(a) For the fiscal year 1937 the Federal Reserve Board Index of Production will average approximately 114 as compared with the average of 117 in 1929. Yet, leaving aside bonus payments and debt retirements, the federal deficit will amount to \$2 billion, as contrasted with a surplus of \$738 million in 1929. For the fiscal year 1938 production is expected to average higher than in 1937, and yet a small budgetary deficit is in prospect. For the fiscal year 1939 a moderate surplus may be anticipated, but hardly comparable to the deficits incurred in the fiscal years 1932-1937. Thus, we will have gone a long way on the road to full recovery without having made any inroad on the public debt.

(b) The excess of cash collections over disbursements on social security account will not reduce the total public debt. In fact it will have the effect of increasing somewhat the interest charge on the debt. Moreover, the reduction in the publicly-held debt which it will make possible may not be as great as at present anticipated, as there is a distinct possibility of reduced contributions and/or increased benefits.

(c) The gold sterilization program may be expected to necessitate the continued incurrence of debt or the use of surplus tax receipts that would otherwise be available for the retirement of the debt.

4. A drive to reduce the present inadequate tax base must be expected with the approach of elections and the appearance of a small budgetary surplus.

5. The present session of Congress, therefore, probably presents the last opportunity for a long period to pass legislation that will result in additional revenue over a period of years.

6. Since the President has declared against new taxes and higher rates and has approved the program of closing loopholes and checking evasions, additional revenue must be sought within this mandate. Not only technical loopholes but also more basic loopholes, contrary to the essential structure of the income tax law, should be closed.

The Treasury proposals so far center around excessive depletion allowances for mining and petroleum companies, various devices by which wealthy people are enabled to reduce their tax liability, and increased taxes on foreign holdings of American securities. While all these reforms are desirable, there appear to be others that would be more productive of revenue and yet would come under the broad heading of loopholes. Certain illustrations may be cited:

1. The purpose of the various personal, dependent, and earned income exemptions permitted in the income tax is to reduce the burden of taxes on the low income brackets. They are not, however, specifically limited to such brackets and as a consequence they offer loopholes by means of which people in the higher income brackets, who can present no real justification for such exemptions, may reduce their tax liability with respect not only to their normal taxes but also to their surtaxes. This could be prevented by providing that the exemptions should diminish as income increases. The application of "the principle of vanishing exemptions" would permit the retention of exemptions where they are needed, would remove them where they are not needed, and would be productive of considerable additional revenue.

2. The same principle could be applied in the case of the \$40,000 exemptions for estates. It could be provided, for instance, that for every two dollars an estate exceeded \$100,000, the exemption would be reduced one dollar.

3. In the same way the exemption of \$40,000 for insurance benefits from the estate tax could be made to vanish.

4. Another loophole in the present law is the exemption of estates from the capital gains tax.

5. Still another loophole is provided by the facilities that the present law offers for disposing of an estate without the payment of either gift or estate taxes. In addition to the \$40,000 gift tax exemption, there is an annual exemption of \$5,000 to any one donee. It is evident, therefore, that a man with a wife and four children can give away an estate of \$400,000 in twenty years without being liable to a gift tax. This could be prevented by removing the exemption of \$5,000 to any one donee, or by providing that the \$5,000 exemption should hold once and for all, and not for the period of a year as at present.

Your Committee is convinced that a search would disclose other loopholes, the closing of which would result in a substantial increase in revenue over a period of years.