

BOARD OF GOVERNORS  
OF THE  
FEDERAL RESERVE SYSTEM

# Office Correspondence

Date July 25, 1940

To Mr. Despres

Subject: Revenue Act of 1940

From Mr. Krost

## Revenue Yield

The following table shows the additional revenue attributable to the Revenue Act of 1940 as estimated by the Treasury Department.

	Millions of dollars
Corporation income and capital stock taxes	217
Individual income taxes	375
Estate and gift taxes	32
Subtotal income, estate and gift taxes	624
Liquor and tobacco taxes	192
Gasoline taxes	112
Other commodity taxes	78
Subtotal commodity taxes	382
Total	1,006

These are the estimates for a full year of application of the increased rates under the act. For the fiscal year 1941 it is estimated to yield about \$700 million of which \$380 million is the yield of commodity taxes and \$320 the yield of income, estate and gift taxes.

In the language of the Act part of the increase in the corporation, individual, income and estate and gift taxes are referred to as super taxes and earmarked for the retirement of the special series of National Defense obligations authorized by the Act but since this difference in name does not correspond to any difference in economic effect, it will be disregarded in the following description.

## Changes in the Individual Income Tax

Personal exemptions are reduced from \$2,500 to \$2,000 for married persons and from \$1,000 to \$800 for single persons. Surtax rates are increased on the surtax income brackets between \$6,000 and

\$100,000. Finally a ten per cent increase in the amount of the tax as computed after these changes is imposed for net incomes below \$200,000, with smaller increases above this level. The following table compares the taxes paid and the effective rate of tax on the income of a married person with no dependents, all of whose income is earned, under the former law and under the Revenue Act of 1940.

	Taxes (Dollars)		Effective Rate (Per cent)	
	Previous law	New Act	Previous law	Net Act
3,000	8	30.80	.267	1.03
4,000	44	70.40	1.10	1.76
5,000	80	110.00	1.60	2.20
10,000	415	528.00	4.15	5.28
50,000	8,869	14,128.40	17.7	28.3
100,000	32,469	43,476.40	32.5	43.5
500,000	304,144	330,155.60	60.8	66.0
1,000,000	679,044	717,583.60	67.9	71.8

It should be noted that (disregarding taxpayers with net incomes of less than \$4,000, who paid negligible income taxes under the previous law) the percentage increase in income taxes reaches a high level of between 50 and 60 per cent for incomes between \$30,000 and \$75,000. For incomes of less than \$10,000 the percentage increase amounts to about 30 per cent.

The requirements as to filing returns have been made more stringent. It is estimated that the changes in these requirements together with the lowering of exemptions will make approximately 2,200,000 new persons subject to income tax. These new persons will pay about \$14 million of the additional revenue expected from the Act.

Changes in the Corporation Income Tax

Increases of 1 per cent are made in all the rates in the present graduated structure of corporation income tax rates. In addition to this a super tax of 10 per cent of the tax as thus computed is imposed. For corporations with net incomes in excess of \$25,000, which pay the bulk of corporation income taxes, the effective rate on taxable net income is increased from the present level of 18 per cent to 20.9 per cent.

Excess Profits, Capital Stock, Estate and Gift Taxes

The so-called excess profits tax now on the statute books is increased by 10 per cent of the amount of the tax. Similar increases are made for the capital stock tax, the estate tax, and the gift tax.

Commodity Taxes

The following tax increases are made on articles of common consumption.

	Percentage Increase in Rate	Increase in cents on Unit Consumed
Cigarettes	16 $\frac{2}{3}$	.5 ¢ a pack
Beer	20	---
Whiskey	33 $\frac{1}{3}$	19 ¢ a quart
Gasoline	50	.5 ¢ a gallon
Lubricating oil	12 $\frac{1}{2}$	.5 ¢ a gallon
Radios	10	
Automobiles	25	

There are a number of other increases in commodities of minor importance. The exemption on the tax on admissions to theaters is decreased from 40 ¢ to 9 ¢. On theater admissions of 40 ¢, formerly tax-free, the tax is now 4 ¢.

Official Justification

In a brief account it is difficult to do full justice to the arguments used by the Treasury in support of the Act. The main argument was that the vast increase in defense expenditure made some additional revenue necessary. The Treasury originally asked for only 700,000,000, an amount sufficient to amortize over a five year period the \$4 billion of special National Defense Obligations authorized by the Act in excess of the existing debt limit of \$45 billion but in the course of Congressional action on the measure the yield of the proposal was increased to \$1 billion. As for the selection of the particular taxes whose rates were increased, it was said that the increases represented an equitable distribution of the additional revenue although no facts or figures of any nature as to the groups from whom the additional revenue will be derived were presented to Congress or to the public.

The following table<sup>1/</sup> shows the estimated distribution by income groups of the additional revenue:

1/ Based on a confidential report to the TNEC by Gerhard Colm.

Income groups (in dollars)	Distribution of additional tax payments (per cent)	Percentage of additional tax payments to income in each group
Under 3,000	37.2	0.8
3,000 to 10,000	16.7	1.4
Over 10,000	<u>46.1</u>	<u>7.0</u>
All groups	100.0	1.6

In further justification Treasury spokesmen indicated that this particular set of tax increases could be passed without calling forth violent Congressional or public opposition. The nature of the reaction in Congressional committees, on the floor of Congress, and in the press during the consideration of the legislation, shows that a large sector of public opinion looked upon the measure as inadequate appears to indicate that any tax program vigorously advanced and defended by the Administration could have been passed.