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SUGGESTED INCOME TAX REVISIONS

Address delivered before the National Tax Association, October 14, 1941, at St. Paul, Minnesota.

By Randolph E. Paul

The program for defense spending has now soared beyond the mark of $50,000,000,000. This is considerably more than the value of all building construction in the United States since 1927. It is twice as much as the total investment in American railroads. It is twice as much as the total value of all passenger automobiles produced in this country during the past fourteen years.[1] And there is every indication that the program has not yet reached its peak.

Mr. Morgenthau announced in his Chicago speech of October 2, 1941, that our tax structure, as modified by the recently enacted 1941 Act, will yield about $14,000,000,000 in revenue; he added his opinion that "it still contains many inequalities and many omissions which will have to be corrected next year." When taxes reach such startling proportions, the problem of fair distribution[2] becomes highly acute. On the one hand, a burden escaped by some taxpayers and passed to other taxpayers

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1. Morgenthau, Address delivered in Chicago, October 2, 1941.

2. Cf. Frankfurter, Mr. Justice Holmes and the Supreme Court, p. 42 (1938).

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becomes intolerable, and on the other hand, the effect of hard provisions becomes disastrous for taxpayers. Our revenue system, founded as it is so largely upon the principle of self-assessment, needs the cooperation of taxpayers.[3] Indeed, one may put the matter in the strongest possible terms by saying that our tax system simply will not work in the emergency if it breeds widespread dissatisfaction and resentment. This will most certainly happen if the tax structure does not distribute its enormous burden equitably among taxpayers. The people are willing to pay taxes, but they are unwilling to see some people avoid taxes.

We have also an important policy problem. For years our economy has been running well under capacity. National income reached a low of $40,000,000,000 in 1932. All this is now reversed. Defense has given a blood transfusion to the economy. For 1940 our national income was $76,000,000,000; in 1941 it will probably be in the neighborhood of $87,000,000,000. It has been estimated that national income in 1942 may be 10 to 15 per cent higher than in 1941. There was plenty of reason for a deficit in the lean thirties, but what reason is left today? The ugly question must be faced: If a nation cannot balance its budget when it has reached the peak of its productive capacity through the utilization of its manpower and

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3. Gaskill, Preserving a Willing Attitude among Taxpayers, 16 Tax Mag. 649 (1938).

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facilities, when can it balance its budget? Mr. Eccles, Chairman of the Board of Governors of the Federal Reserve System, while admitting that the drastic tax necessary for balance would be politically impossible at this time, has urgently suggested the need of greater effort in this connection.[4] And the cognate question may be added, why should our tax system not recapture for the government a large part of the defense expenditures it is making.[5] Are we going to allow a part of our population to make an inordinate profit out of war? The President has repeatedly answered this question in the negative, but so far his policy remains unfulfilled.

Taxes also enter into the highly complicated problem of inflation, whatever that word means.[6] The threat of inflation is a dark shadow across the immediate future, and taxes are a principal instrumentality of prevention, for, in the language of Mr. Eccles, they will "reduce consumer demand for goods where the supply is inadequate."[7] Here taxes have a function which may be even more vital than revenue production. The good effect of increased governmental revenue will be more than neutralized if the government must spend in a boom market,

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4. Testimony before the Committee on Banking and Currency, House of Representatives, 77th Cong., 1st Sess., September 29, 1941.

5. Eccles, Price Fixing Is Not Enough, 24 Fortune, No. 2 (1941).

6. See Chase, The Tyranny of Words, p. 291 (1938).

7. Eccles, Price Fixing Is Not Enough, 24 Fortune, No. 2 (1941).

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and the public will lose the benefit of an amplified national income if the purchasing power of that income is reduced in greater effect than the increase of income. Furthermore, inflation is a bubble, which like all bubbles eventually bursts.[8] Mr. Morgenthau's point cannot be too strongly emphasized that every citizen has a "personal stake" in the prevention of the chaos of inflation.

Mr. Morgenthau promised the bankers assembled in Chicago a genuinely "all-out" tax bill in 1942, to be levied "upon all in accordance with their ability to pay." Of course, no one outside intimate governmental circles knows Mr. Morgenthau's exact plans, and I suspect that his mind is far from closed to what may be revealed by further study of the immense problem before him. He was undoubtedly intending to state policy in the broadest terms, leaving details to the future. But the situation calls in the end for a bill of particulars, and I would like to suggest some points of an increased tax program for your consideration in the months to come when the Treasury's "all-out" tax bill is in the process of gestation. I have to do so in more or less categorical fashion, for you would not have time to listen to a detailed discussion of the reasons for and against each proposed change. Indeed, the subject is so vast that I cannot even list the host of technical amendments our revenue laws demand if they are to be put in condition to

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8. Cf. Foreword of Mr. Wickard, Secretary of Agriculture, to Farmers, Farm Prices, and Inflation, September, 1941.

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endure the strain of an emergency. But if you will permit me to select upon the mixed basis of importance and clarity, I shall now suggest some points of revenue revision that may soon be items of tax history.

1. Interest on State and Municipal Obligations.

The subject of the taxation of interest upon the obligations of the states and their political subdivisions was ably discussed yesterday by Mr. Foley, General Counsel of the U.S. Treasury, Mr. Epstein, Solicitor General of New York, and Mr. Seltzer, of the National Bureau of Economic Research. I may, therefore, merely register my opinion as to the necessity of taxing the income from future issues of such bonds.[9] For too long we have provided a haven from the sweep of the surtax with the result that a mass of tax-exempt securities is endangering the system of the progressive income tax.[10] I have few doubts as to the constitutionality of taxing the income from future issues of state and municipal bonds.[11] It might be constitutional to tax the interest from past issues, but such a step would have elements of unfairness that render it inadvisable.

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9. This involves the elimination of Section 22(b)(4) of the Internal Revenue Code.

10. Paul, Redesigning Federal Taxation, 19 Harv. Bus. Rev. 143, 146 (1941).

11. See Department of Justice Study entitled Taxation of Government Bondholders and Employees, pp. 21, 43 (1938). Cf. Chandler, The Case for the Municipalities against Federal Taxation of Municipal Securities, address delivered before the American Bar Association, September 30, 1941.

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The Glass proposal, that the surtax on income from taxable sources should take into account the existence of tax-exempt income, is perhaps too indirect an approach to provide a satisfactory solution.

2. Capital Gains.

The maximum rate of capital gain tax has been reduced by the 1941 revenue act from 16.5 per cent to 15 per cent.[12] Possibly this reduction was inadvertent, and we may undoubtedly expect a revision of the capital gain rate to the level of 1940.

But the capital gain and loss situation must, of course, be approached from a larger viewpoint. The subject has always been highly controversial. We have complete variety of opinion on the subject from one extreme, which is against all taxation of capital gains and recognition of capital losses,[13] to the opposite extreme, which thinks that no differentiation at all should be made between capital gains and ordinary income.[14]

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12. Section 117 of the Internal Revenue Code remains unchanged by the 1941 Act. Section 101 of the 1941 Act at the same time integrated the defense tax into the surtax rates. Section 15 of the Code, imposing the defense tax, was entirely revamped and no longer deals with the defense tax.

13. Nelson, The Question of Taxing Capital Gains, The Case against Taxation, 7 Law & Contemp. Prob, 208 (1940); 2 May, Twenty-five Years of Accounting Responsibility, p. 144 (1936).

14. Simons, Personal Income Taxation, p. 148 (1938); Kent, The Question of Taxing Capital Gains, The Case for Taxation, 7 Law & Contemp. Prob. 194 (1940). On this subject see also Haig, Taxation of Capital Gains, Wall Street Journal, March 23, 25, 29, April 2, 8, 13, 1937; Blough and Hewett, Capital Gains, contained in Studies in Income and Wealth, vol. 2, p. 191 (New York, National Bureau of Economic Research, 1938); Colm, The Revenue Act of 1938, 5 Social Research 255 (1938).

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Without going the full length in either direction one may at least point out that the present capital gain rate is the most favorable in our income tax history. The capital gain rate in the twenties was 12.5 per cent, but we ended this period with a highest surtax bracket of 20 per cent. At this time the capital gain rate was, therefore, five-eighths of our top surtax bracket. This relative position of the capital gain rate should be compared with a relationship of a rate of 15 per cent to 77 per cent. The fraction mentioned has dropped from five-eighths to one-fifth.

Whatever may be the answer to the capital gains problem, it seems clear that the present relationship of the capital gain rate to the surtax brackets involves an inexcusable discrimination against individuals who derive their income from personal services and sources other than capital gains. The capital gain rate should, therefore, be substantially increased. Perhaps we should go back to the flexible rule established by the 1934 Act, which at least recognized the period of accrual of capital gains in a more refined way than does the present act. At the very least, the tax on capital gains should, in deference to the principle of ability to pay, take into account other non-capital gain income of the taxpayer. An increase in capital gain rates should perhaps be accompanied by a longer loss carry-over.

3. Pension Trusts.

Pension trusts in their many variations are a growing

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menace to governmental revenue. The institution of pension trusts has in its favor many of the arguments put forward on behalf of social security. But in practice the deferment of tax granted in the case of pension trusts[15] is being grossly abused by the establishment of trusts in favor of high salaried key employees and stockholders.[16] Some limiting provisions should be placed in the revenue act to make the pension trust exemption applicable only in the case of bona fide trusts with a valid social, as distinguished from a tax-avoiding, purpose. The underlying legislative purpose should not be lost sight of in any further consideration of this problem, because some taxpayers have abused the pension trust provision. Innocent beneficiaries should not be punished with the guilty when amendments will serve to draw a line between those who deserve a postponement of the tax and those for whom the benefits of tax postponement can hardly have been intended. This is an example of a problem constantly faced in revenue legislation. One must find a way of reaching particular cases of avoidance without striking, like Herod's massacre, indiscriminately at all cases irrespective of deserts.[17]

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15. I.R.C., Secs. 23(p), 165.

16. See Altman, Pension Trusts for Key Men, 15 Tax Mag. 324 (1937); Paul, The Background of the Revenue Act of 1937, 5 U. of Chi. L.R. 41, 77 (1937); Hearings before the Joint Committee on Tax Evasion and Avoidance, 75th Cong., 1st Sess., p. 294.

17. Cf. Paul, Studies in Federal Taxation, p. 65 (1937).

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4. The Interest Deduction.

The interest deduction now allowable[18] for all interest paid or accrued, except interest on indebtedness incurred or continued to purchase tax-exempt securities, unduly encourages corporate financing by borrowing rather than by capital contributions. The difference between many preferred stock and bond issues is often more legalistic than real; yet the corporation issuing the stock does not have the interest deduction allowed to the corporation issuing bonds. Every tax practitioner is familiar with the process of converting stock issues into bond issues in order to reduce taxes.[19] Some limitation should be placed on the interest deduction not only to raise revenue, but also to put equity financing upon a reasonable parity with financing on a less sound business basis.

5. Percentage Depletion.

Oil and mining companies are granted a special depletion deduction, or "subsidy," consisting of a percentage of gross income from depletable property limited to a percentage of the net income from the same property.[20] This depletion allowance is optionally greater than the ordinary allowances for loss of wasting assets; it is not restricted to a recovery of

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18. I.R.C., Sec. 23(b).

19. We cannot discuss today the question whether such reorganizations or recapitalizations have the benefit of the statutory exemption. Cf. Paul, Studies in Federal Taxation, Third Series, p. 121 (1940).

20. I.R.C., Secs. 23(m), 114(b)(3)(4).

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cost or value at March 1, 1913, of the producing property; and it goes on as long as production continues without relation to the recovery of cost or value at March 1, 1913. The elimination of the deduction was recommended as long ago as 1933 when the Secretary of the Treasury said:[21]

> "Our experience shows that the percentage depletion rates set up in the law do not represent reasonable depletion rates in the case of the designated properties, but are much higher than the true depletion to which the taxpayer is fairly entitled. Moreover, these provisions enable a taxpayer to obtain annual depletion deductions, notwithstanding the fact that he has already recovered the full cost of the property. The deduction is, therefore, a pure subsidy to a special class of taxpayers. For this reason the Treasury recommends that these provisions be eliminated, in order to put all taxpayers upon the same footing."

In 1937 the President recommended the elimination of percentage depletion.[22] Congress has steadfastly failed to act on this recommendation, but the existence of the emergency may change legislative attitudes.

6. <u>Joint Returns</u>.

The subject of joint returns for husband and wife has received much publicity in the last few months. Much of this publicity, with its emphasis upon constitutional and moral aspects of the problem and its effect upon the institution of marriage

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21. Testimony of Under Secretary Magill, Hearings before the Joint Committee on Tax Evasion and Avoidance, 75th Cong., 1st Sess., p. 33 (1937).

22. Letter of President Roosevelt dated June 1, 1937, quoted in Report of the Joint Committee on Tax Evasion and Avoidance, 75th Cong., 1st Sess., p. 1 (1937).

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and women's rights, has established a new record for irrelevance. Professor Griswold, who has stated the arguments against the proposal in the strongest possible way, has admitted the speciousness of these arguments,[23] stating that "he who puts his trust in unconstitutionality today in matters of this sort seems to disclose a rather surprising unawareness of the happenings of the past few years." As to moral grounds, Professor Griswold calls attention to A. P. Herbert's chapter "Rex v. Pratt and Merry - The Tax on Virtue" in his "Uncommon Law," and says that it would be hard to show that the British institution of marriage has been impaired by the long-standing practice of requiring joint returns. Along with my partner, Mr. Harry Rudick,[24] I venture to suggest a reconsideration of this whole problem for purposes of an "all-out" revenue act, for the following reasons:

(a) There seems to be no politically practicable method other than joint returns of eliminating the unfair advantage enjoyed by residents of the community property states.[25]

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23. Griswold, Letter published in New York Times, July 27, 1941.

24. See letter of Mr. Harry Rudick to Chairman Doughton of the Ways and Means Committee, July 17, 1941, reprinted in the Congressional Record, vol. 87, No. 139, p. 6618 (1941). See also Rudick, The Problem of Personal Income Tax Avoidance, 7 Law & Contemp. Prob. 243, 252-3, 264 (1940), where Mr. Rudick advocates that joint returns cover not only spouses, but also minor children. Cf. Shoup, Married Couples Compared with Single Persons under the Income Tax, 25 National Tax Assn. Bulletin, No. 5, pp. 130-135.

25. I have discussed the community problem at length in forthcoming volumes (Sec. 1.09) on estate and gift taxation, to be published by Little, Brown & Company.

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Obviously there is no sound foundation for a rule that makes the federal income tax depend upon where the taxpayer lives, and which requires a married couple living in New York, for example, to pay a much higher tax than a married couple living in California.

(b) There is no convincing reason for a tax disparity between a family in which the husband is the sole source of income and a family in which the wife contributes to the family economic unit. The family, generally speaking, will spend approximately the same amount for rent, food, support of children, etc.,whether its income stems entirely from the husband or derives in part from the wife. The income tax should recognize these basic economic realities.

(c) In the vast majority of families in the United States practically all the family income is earned by the husband. If joint returns are not required, the families of this vast majority will have to pay a higher tax than the families in the minority group. Recently increased rate brackets make this discrimination all the more unworthy of continuance.

Amendments to Eliminate Hardship

At a time when we are considering amendments of the statute designed to eliminate discriminations, it is certainly not out of order to consider changes which may reduce revenue. We can be intelligently generous; we need not raise our revenue by the hardship method. Several changes of this sort are dictated by considerations of equity. The provision of the last Senate

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bill, allowing the deduction of expenses incurred in conserving and conducting business affairs, should be passed.[26] With rates at their present level a limited deduction for medical expenses would be no more than a reasonable concession to taxpayers. The same is true of the credit for dependents, which now stops when the dependent reaches the age of 18 years, unless the dependent is physically or mentally incapable of self-support.[27] It need hardly be argued that many dependents are at the peak of their dependency immediately after the age of 18 years. The treatment of alimony has been a sore spot in our tax system for many years,[28] and the provision inserted in the last Senate bill[29] taxing alimony to the wife should be enacted. The law surrounding the status of mortgage foreclosure transactions should certainly be clarified.[30] We could no doubt afford to legislate away some of the hardship caused by the Supreme Court decision in Helvering v. Bruun;[31] at least we might arrange for some postponement of payment where so much non-liquid income is precipitated in the hands of a lessor by

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26. Senate Bill, 1941 Act, Sec. 119. See Conf. Report No. --, 77th Cong., 1st Sess., p. 12.

27. I.R.C., Sec. 25(b)(2).

28. See Paul, Five Years with Douglas v. Willcuts, 53 Harv. L.R. 1 (1939).

29. Senate Bill, 1941 Act, Sec. 117; Sen. Finance Comm. Report No. 673, 77th Cong., 1st Sess., p. 11.

30. See Helvering v. Hammel, 311 U.S. 504 (1941); Electro-Chemical Engraving Co., Inc. v. Comm., 311 U.S. 513 (1941). See also Paul, Studies in Federal Taxation, Third Series, p. 296 (1940).

31. 309 U.S. 461 (1940).

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the termination, cancellation or forfeiture of a lease.

There is real need for relief from the hardships latent in Section 42 of the Internal Revenue Code, especially when the income tax rates have been so sharply increased. The possibilities of unfairness have been accentuated by the Supreme Court's decision in Helvering v. Enright[32] that a partner's share of partnership fees accrues at the date of death even though partner and partnership have filed returns on the cash basis. Lawyers will sometimes be flattered at the high estimates which the Bureau places on the value of their unfinished legal services under this doctrine. It would seem more fair to provide, however, that regardless of accrual for estate tax purposes, the recipient of the income should have the privilege of reporting the income as taxable when received. Any such provision should apply equally to accrued income arising from personal services or any other type of accrued income.[33] Consistency would require an amendment to Section 43 eliminating from the decedent's final return any accrued deduction in the event that the decedent's estate availed itself of the option to report income when and as received. The underlying purpose of Section 42 - that no income

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32. 312 U.S. 636 (1941). See also Pfaff v. Comm., 312 U.S. 646 (1941).

33. An amendment to this provision might be framed along the lines of the provisions of Section 44(d), relating to the transmission of installment obligations at death. In order to protect the revenue, the government might be empowered to require the filing of a bond as is required under Section 44(d).

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should escape tax - could thus be accomplished without the gross inequity of throwing several years' income into one return. Perhaps at the same time the estate should be required to report the income on the same basis - cash or accrual - as the decedent used prior to death, and perhaps it should also be required to use the same accounting period.[34]

Further Questions for Consideration

The foregoing suggestions are not intended to be all inclusive. Many possible amendments of the statute should be canvassed in order to determine whether changes are advisable.[35]

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34. Cf. Estate of Cyrus H. K. Curtis, 36 BTA 899.

35. Two clearly advisable amendments may be mentioned in a footnote. The statute has a flagrant defect in its provision permitting value at date of death as a basis even in cases in which an executor has elected under Section 811(j) of the Internal Revenue Code to report assets of the estate at their value a year after the death of the decedent. To illustrate the point: A decedent may leave assets having a value of $1,000,000 at the date of his death which a year after death have dropped in value to $500,000. In such a case an executor paying estate tax on only $500,000 secures a basis of $1,000,000. Obviously the statute should insert a new subdivision in Section 113 to the effect that where the optional valuation privilege is exercised, the basis of property shall be the value as used in the estate tax return.

In the case of contributions in the form of property the law now permits deduction to the extent of the value of the property transferred at the date of the gift. Thus, where a taxpayer has transferred securities costing $1,000, but having a value at the date of the gift of $5,000, he is allowed a deduction of the latter amount without any tax on the appreciation in value of $4,000. Although the donor may have received income under the doctrine of vicarious satisfaction established by Helvering v. Horst, 311 U.S. 112 (1940), some provision should be inserted in the statute to settle this question. A possible provision would be to allow a deduction only in the amount of the adjusted cost basis of the property to the donor or its value at the date of the gift, whichever is lower.

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It is a serious question whether we should allow the basis of value at the date of death for the purpose of determining gain or loss on the sale or exchange of property transmitted at death. Our system of taxing nonresident alien individuals and foreign corporations involves a marked discrimination in their favor.[36] It should not be taken for granted that we ought to allow as a deduction non-business casualty losses,[37] non-business interest,[38] non-business bad debts,[39] and non-business taxes.[40] For example, the deduction for taxes on residential property could well be eliminated. It is well worth consideration whether we should return to the principle of consolidated returns in the case of affiliated corporations. The problem of intercorporate dividends is far from solved.[41] Perhaps we should frankly admit the impossibility of preventing the avoidance of the regular surtax on gains from preferred stock redemptions, and apply the capital gain rate to such redemptions.[42] The Chandler Act in its relationship to the basis provision

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36. This discrimination was only partly corrected in 1937. See Paul, The Background of the Revenue Act of 1937, 5 U. of Chi. L.R. 41, 86-7 (1937).

37. I.R.C., Sec. 23(e)(3).

38. I.R.C., Sec. 23(b).

39. I.R.C., Sec. 23(k).

40. I.R.C., Sec. 23(c).

41. I.R.C., Sec. 26(b).

42. Cf. John D. McKee, 35 BTA 239.

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should again be revised.[43] Dividends on fully paid-up life insurance or endowment policies should be taxable, as proposed in 1938, regardless of whether the consideration paid has been recovered. Finally, without attempting to exhaust the list, one may recall the perennial inadequacy of Section 102.[44] For years corporate taxpayers have successfully argued that they may pile up surpluses for the mythical rainy day of the unpredictable future, or that they may in the same sort of future go into a new business in the manner of the White Knight, who kept a bee-hive on his horse because he might someday wish to keep bees.[45] Both of these arguments have acquired new vitality in the uncertainty of our post-war future.

The Excess Profits Tax

I have left for the end the controversial excess profits tax, and I shall leave most of that subject to tomorrow morning's session. But since the excess profits tax is a corporate income tax, it is relevant to mention the subject in this session under the heading "Evaluation and Suggested Revision in View of Present and Prospective Needs."

The excess profits tax, as it is now constituted, is designed to recapture a part of the excess profits of the emer-

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43. See Paul, Debt and Basis Reduction under the Chandler Act, 15 Tulane L.R. 1 (1940).

44. Rudick, Section 102 and Personal Holding Company Provisions of the Internal Revenue Code, 49 Yale L.J. 171 (1939).

45. Paul, Redesigning Federal Taxation, 19 Harv. Bus. Rev. 143, 145 (1941).

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gency. It is not intended to take any part of what might be called ordinary excess profits not attributable to the present emergency. In this respect the tax seems to me to go on the false premise that it is possible ever to make a clear-cut differentiation between emergency profits and non-emergency profits. No one can tell what part of the profits of any particular concern in 1941 are attributable to the emergency and what part of such profits are the natural culmination of previous years of effort. The tax should discard this ephemeral distinction and frankly exact a contribution from corporate profits not attributable to the emergency, as well as corporate profits which are undoubtedly the result of governmental defense expenditures.

It will be unhealthy for all of us if the large corporations, which are being given the bulk of the emergency orders, are permitted to keep for their own such a share of emergency profits that small business is put at a further disadvantage. Corporations as well as individuals must carry their part of the load, and a stiffer excess profits tax than we now have is essential for that purpose. For the theory of that tax I go along with Mr. Eccles in the belief that we should return to the original scheme of the Treasury, making a flexible invested capital determinative of the exemption of excess profits. That formula provided an exemption from the tax, dependent upon the previous earnings of the corporation, of at least 5 per cent

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and at most 10 per cent of the invested capital.[46] Such a formula serves the double function of recapturing emergency profits and of collecting a share of defense cost from corporations which were highly prosperous in the depression period. The income credit in the present bill[47] gives an undue advantage to corporations with established records, and puts new corporations and corporations without high depression earnings at an undue disadvantage. If the income credit is retained, it might be subordinated in importance by making the excess profits tax consist of one-half of the tax computed on the basis of the income credit plus one-half of the tax computed on the basis of invested capital.

With all my belief in the principle of the excess profits tax, as compared with the crude instrumentality of the straight corporate income tax, I must confess to misgivings as to the treatment of concerns in which capital is a relatively minor income-producing factor. We may as well admit that we are far from a solution of this problem. The personal service corporation provision[48] does not afford a complete solution; neither do the so-called relief provisions.[49] I cannot but feel that

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46. H.R. Rep. No. 2894, 76th Cong., 3d Sess., pp. 4, 22 (CB 1940-2, pp. 498, 512). The floor percentage recommended by the subcommittee was 4 per cent. Hearings before Ways and Means Committee and Finance Committee on Excess Profits Taxation, 76th Cong., 3d Sess., pp. 4, 12 (1940).

47. I.R.C., Sec. 713.

48. I.R.C., Sec. 725.

49. I.R.C., Secs. 721, 722, 723.

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there is some solution of this problem which we have all missed. Perhaps we could optionally exempt from the tax certain types of corporations on the condition that they would accept some fair substitute tax.

A final word may be said with respect to the much advertised difficulty of computing invested capital. On this point one hears much defeatism. In view of better records and a more efficient Treasury personnel, the job is relatively easy compared with what it was in 1917 and 1918, particularly with the adoption of the unadjusted basis for loss as the measure of the inclusion in invested capital of property paid for with stock. Invested capital is not the esoteric concept many try to make it appear to be. It is simply the capital, surplus, and undivided profits, or net worth of the corporation without taking into account any unrealized appreciation or depreciation in value of assets. It is true that stock dividends, liquidations, and reorganizations raise problems, but they are far from insuperable. We could afford a little greater degree of optimism about the possibility of computing invested capital.

Conclusion

There will be some who think some or all of the proposals made in this paper are drastic and even confiscatory.[50] The answer is, first, that times are extraordinary. The old formulae of postponement and evasion are inadequate in the face

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50. Cf. Lawrence, High Court "Captured" in Tax Cases, The Evening Star, Washington, D.C., October 9, 1940.

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of three imperative necessities, (1) unprecedented demands for revenue, (2) the control of price inflation, and (3) the elimination of profit from war. It would be fatuous at such a time to soft-pedal our policy. And it may be an expensive luxury to neglect the thorough-going reconstruction job so sorely needed by our revenue system. Tomorrow may be too late.

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