BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date April 7, 1942.

To Mr. Goldenweiser

From George Jaszi GJ

Subject: Chairman Eccles' corporate tax proposals

In the course of our interview yesterday Chairman Eccles suggested a combined corporate normal and surtax rate of 45 per cent instead of the Treasury proposal of 55 per cent. He wished to know the reduction in excess profits credit necessary to compensate for the resulting revenue loss. It was my impression that he considered 6 per cent the minimum excess profits credit under the invested capital option.

On the basis of as much figuring as I could do in the course of an afternoon, I estimate that an average earnings credit of 60 per cent of base period earnings, instead of the present 95 per cent, and a capital credit of 6 per cent of invested capital, instead of the present 8 and 7 per cent, would approximately compensate for the reduction of the combined normal and surtax rate from 55 per cent to 45 per cent.

You realize,of course,that these estimates were prepared in a hurry and also that they belong to about the most difficult type of tax estimating problem that exists. I am currently trying to check them by an alternative procedure. I do think, however, that they are sufficiently good first approximations to be given to the Chairman if he needs figures now.

It would be advisable to ask the Treasury for an alternative estimate or for an opinion regarding the reasonableness of my figures. Judging from my experience with Treasury people, I think we would get better service if the request went to them directly from your office. But if you prefer, I am of course willing to get in touch with them myself.

The Chairman also asked for some hypothetical examples that would illustrate the difference between the incidence of his and of the Treasury proposals. They are given in the attached table. The Treasury proposal as it affects large corporations with earnings in excess of 1936-9 earnings consists of an excess profits tax at rates graduated from 50 to 75 per cent on a base as defined in the present law, i.e. on earnings in excess of 95 per cent of base period earnings or of 8 per cent on the first $5,000,000 of invested capital and of 7 per cent on the rest; and of a normal and surtax levied at a combined rate of 55 per cent again on a base as defined in the present law, i.e. on earnings after excess profits taxes.

The Eccles proposal substitutes an average earnings credit of 60 per cent for the present credit of 95 per cent and a capital credit of 6 per cent for the present credits of 8 and 7 per cents; and a combined normal and surtax rate of 45 per cent for the proposed rate of 55 per cent.

You will notice from the last column of the table that the Eccles proposal gives more favorable treatment to corporations that earned high rates of return in the base period and have since substantially increased their income. This is exactly the opposite of what Chairman Eccles wants. And I am afraid it cannot be remedied as long as he confines me largely to a manipulation of the income credit to compensate for the reduction of normal and surtax rates. The reason is as follows: A given reduction in excess profits credit will always result in a constant addition to the excess profits tax -- approximately 75 per cent of the reduction in the credit. But a given reduction in the normal and surtax will result in a growing revenue loss whose size depends on the income of the corporation. Hence a reduction of excess profits credit that will compensate for the loss of normal and surtax revenue in the case of a corporation that has increased its income by a given amount will be insufficient for a corporation that experienced a larger increase, and will put that corporation at an advantage.

The Chairman may feel, however, that this blemish is compensated by the fact that corporations which had a low rate of return in the base period and did not experience a great increase of earnings fare considerably better under his proposals than under the Treasury proposals.

Attachment

Effective Rates of Corporation Income and Excess Profits Tax on Large Corporations under Treasury and Eccles Proposals

(Base period income $1,000,000)

Current income	Base period rate of return on invested capital									
	1 per cent		3 per cent		7 per cent		9 per cent		10 per cent and over	
	Treasury	Eccles	Treasury	Eccles	Treasury	Eccles	Treasury	Eccles	Treasury	Eccles
$1,000,000	55.0	45.0	55.0	45.0	55.0	49.6	56.2	56.7	56.2	59.2
1,500,000	55.0	45.0	55.0	45.0	64.9	61.0	66.0	66.2	66.0	68.1
2,000,000	55.0	45.0	55.0	45.0	70.8	67.3	71.7	71.2	71.7	72.6
3,000,000	55.0	45.0	61.8	57.9	76.8	73.6	77.4	76.2	77.4	77.2
4,000,000	55.0	45.0	68.5	65.0	79.8	76.8	80.2	78.7	80.2	79.4
5,000,000	55.0	45.0	72.6	69.2	81.6	78.7	81.9	80.2	81.9	80.8
6,000,000	55.0	45.0	75.3	72.1	82.8	79.9	83.1	81.2	83.1	81.7
7,000,000	55.0	50.5	77.2	74.1	83.6	80.8	83.9	82.0	83.9	82.4
8,000,000	59.0	55.0	78.6	75.6	84.3	81.5	84.5	82.5	84.5	82.8
9,000,000	62.3	58.5	79.8	76.8	84.8	82.0	85.0	82.9	85.0	83.2
10,000,000	64.9	61.2	80.7	77.7	85.2	82.5	85.3	83.2	85.3	83.5