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Office Correspondence

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To Dr. Goldenweiser

From George Jaszi GJ

Subject: Individual Income Tax Program of Ways and Means Committee

The Ways and Means Committee has now come to a tentative agreement regarding the second item on its agenda, the individual income tax. It has already dealt with corporate taxes in previous sessions. The main subjects which it will have to take up in coming weeks are excise taxes and the general sales tax. But decision will also have to be reached on estate and gift taxes and on a large number of smaller issues that have not yet been settled.

There is little evidence so far when enactment of the revenue bill can be expected. Last year five months elapsed between the opening of the hearings of the Committee and the signature of the revenue act by the President. Hearings started almost two months earlier this year; but progress to date has certainly not been faster. On the basis of last year's record enactment of the measure could be expected around the beginning of August. But further delay would not be surprising.

From the standpoint of the inflationary danger all delay is to be regretted. Whatever incentive there may be for individuals to provide currently on an accrual basis for tax payments on 1942 incomes is greatly diminished by the fact that for more than one half of the year they do not even know to what taxes they are subject on the incomes which they are earning. In the case of commodity taxes, which are collected currently, the effects of delayed enactment are even graver.

The following are the main features of the individual income tax program of the Ways and Means Committee.

1. Reduction of Personal Exemptions

Personal exemption for married persons and heads of families is reduced from $1,500 to $1,200 and for single individuals from $750 to $500. Under the Treasury proposals the married and head of family exemption would have been reduced to the same level, but $600 instead of $500 would have been allowed to single individuals.

The credit for dependents and the earned income credit remains unchanged. The Treasury has recommended a reduction of the credit for dependents from $400 to $300 and abolition of the earned income credit.

2. Tax Rates

Normal tax is imposed at 6 per cent instead of the 4 per cent of the present law and of the Treasury proposals.

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Surtax starts at 12 per cent on the first $2,000 of surtax net income and rises to 81 per cent on income in excess of $200,000. Under the present law surtax starts at 6 per cent and rises to 77 per cent on income in excess of $5,000,000. The Treasury suggested an initial surtax rate of 12 per cent, confined, however, to the first $500 of surtax net income. Subsequent graduation of rates under the Treasury proposals would have been much sharper.

A few significant comparisons between the Committee proposals, on the one hand, and the present law and the Treasury proposals on the other follow:

a. Representative tax payers now at exemption limits would pay approximately $40 under the Committee proposal.

b. Tax liability on incomes up to $5,000 of representative married couples, and up to $3,000 on incomes of single individuals would be more than doubled, the percentage increase being of course larger the smaller the income.

c. The percentage increase for larger incomes would be smaller. Tax liability on incomes of $10,000 would be increased by 50-60 per cent depending on the family status of tax payers. The corresponding increases for incomes of $25,000 would range around 30 per cent, and around 20 per cent for incomes of $100,000.

d. One-quarter of incomes of approximately $15,000, one-half of incomes of $50,000, and almost two-thirds of incomes of $100,000 would be taken in taxes if the Committee proposals were enacted.

e. The Treasury program would have resulted in more drastic rates on all incomes except the following low income groups (1) single individuals earning less than $1,900 are actually harder hit under the Committee proposals than they would have been under the Treasury program. (2) Families without dependents earning up to $2,000 are treated about the same under both schemes. Typical lower and upper middle class incomes would have been hit considerably harder under the Treasury proposals than under the Committee proposals.

3. <u>Mandatory Joint Returns</u>

The Committee voted to require married people living together to file joint returns.

It is the aim of this proposal to eliminate the existing discrimination in favor of (a) families in which both spouses contribute to income (b) families receiving property income and (c) families domiciled in the community property states. Under the separate filing option now in force such families can reduce their tax liability below that of other families. Mandatory joint returns eliminate these discriminations, but

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only at the expense of grossly over-taxing families as compared with single individuals at moderate income levels. It is regrettable that the Committee chose this method of eliminating existing discriminations. Separate taxation of married person on the basis of one half of the family income would have eliminated these discriminations just as effectively without introducing any new ones.

4. Continued Tax Exemption of Existing and Future Issues of State and Local Securities

Overruling the recommendations of the Treasury the Ways and Means Committee voted to continue tax exemption of existing and future issues of State and local securities.

5. Capital Gains and Losses

The triple holding period which distinguishes short term assets and two types of long term assets under the present law is replaced by a double holding period setting the dividing line between short term and long term assets at 15 months. Net long term gains, included in income to the extent of 50 per cent (the percentage now applicable to assets held 24 months) are taxed under the income tax at an effective ceiling of 25 per cent, as compared with present ceilings of 15 and 20 per cent.

Long term losses are disallowed as deductions from ordinary income, just as short term losses are already disallowed. But there is to be complete offsetting of short and long term gains and losses against each other, the latter of course being reckoned at 50 per cent. Under the present law there is no offsetting between short term gains and long term losses or vice versa. A five year carry-over of all net capital losses is substituted for the present one year carry-over of short term losses. As a relief provision to small tax payers $1,000 of capital loss, whether short or long term, is allowed as offset against ordinary income.

These revisions resemble closely the proposals originally made by the Treasury. The most important differences are as follows: (1) The dividing line between short and long term assets is set at 15 months instead of 18 months as suggested by the Treasury. (2) Net long term gains are taxed at a maximum effective rate of 25 per cent instead of 30 per cent as suggested by the Treasury. (3) Banks and insurance companies receive special concessions under the Committee proposals. Banks may continue to offset capital losses from bonds or other evidences of indebtedness against ordinary income. Similar treatment is granted to insurance companies.

6. Minor Provisions

The Committee voted to raise tax rates on mutual investment companies, personal holding companies, non-resident foreign corporations and

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non-resident alien individuals to bring these rates into line with the increased rates of individual and corporation income tax.

Withholding Tax

The Treasury is urging the Committee to enact a withholding tax of 10 per cent on incomes in excess of personal exemptions and credits for dependents by means of which part of the 1942 tax liability would be collected currently at source.

Yield of Proposals

The individual income tax proposals of the Committee will yield $2.7 billion (gross, before allowance for decreases in the individual income tax base due to higher corporate tax rates). This compares with $4.3 billion under the Treasury proposals (and not $3.2 as given in press reports), a shortfall of $1.6 billion.

Prospects

The corporate tax program of the Committee falls short of the Treasury program by another $600 million, and the Committee lost another $300 million through its refusal to abolish percentage depletion and tax exemption of State and local securities. Up to date, therefore, the Committee is $2.5 billion short of the Treasury program (and not $1.5 billion as reported in the press).

It is possible that this gap will be filled by the enactment of a sales tax. Sentiment in favor of such a tax is strong among the members of the Committee. Some observers, however, believe that the lowering of personal exemptions was intended as a substitute for a sales tax at least for the present; and that the Committee, with or without agreement on the part of the Treasury may decide to enact a tax program whose yield falls short of the $8.7 program suggested by the Treasury. In that case the Treasury might attempt to obtain a boost in the program when the bill reaches the Finance Committee of the Senate.

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COMPARISON OF PRESENT AND PROPOSED INDIVIDUAL

INCOME TAX LIABILITIES

Income	Amount of tax ($)			Effective rates (per cent)		
	1941 law	Ways and Means Committee	Treasury	1941 law	Ways and Means Committee	Treasury
			(Married, no dependents)			
$ 1,300	--	$ 12	$ 16	--	0.9	1.2
1,500	--	45	48	--	3.0	3.2
3,000	$ 138	306	357	4.6	10.2	11.9
5,000	375	708	889	7.3	14.2	17.8
10,000	1,305	2,064	2,549	13.1	20.6	25.5
15,000	2,739	3,914	4,673	18.3	26.1	31.2
25,000	6,864	8,982	10,143	27.5	35.9	40.6
100,000	52,704	63,072	69,229	52.7	63.1	69.2
1,000,000	732,554	844,012	879,205	73.3	84.4	87.9
			(Married, two dependents)			
2,000	--	--	32	--	--	1.6
2,300	--	40	80	--	1.8	3.5
5,000	271	540	721	5.4	10.8	14.4
10,000	1,117	1,800	2,321	11.2	18.0	23.2
15,000	2,475	3,586	4,397	16.5	23.9	29.3
25,000	6,480	8,526	9,777	25.9	34.1	39.1
100,000	52,160	62,416	68,701	52.2	62.4	68.7
1,000,000	731,930	843,316	878,665	73.2	84.3	87.9
			(Single)			
600	--	14	--	--	2.4	--
750	--	41	24	--	5.5	3.2
2,000	117	258	263	5.9	12.9	13.2
3,000	221	447	509	7.4	14.9	17.0
5,000	483	875	1,069	9.7	17.5	21.4
10,000	1,493	2,295	2,777	14.9	22.9	27.8
15,000	2,994	4,221	4,961	20.0	28.2	33.1
25,000	7,224	9,361	10,509	28.9	37.5	42.0
100,000	53,214	63,646	69,757	53.2	63.6	69.8
1,000,000	733,139	844,621	879,745	73.3	84.5	88.0

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