The Pay-As-You-Go Income Tax Plan

March 25, 1942

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The plan outlined below is proposed as a method whereby individual taxpayers can be put on a current taxpaying basis so that the income taxes they pay in any one year represent the taxes on that year's income rather than on the income of the preceding year.

I. The Problem

Under our present system of paying income taxes every taxpaying individual is always in debt to the government. In 1942 we are now paying taxes on the income we received, and probably spent, in 1941; but the tax on the income we are now receiving in 1942 has not yet been paid, and by the end of 1942 we shall each owe the government one year's tax. In many instances, when income continues from year to year without much change and when there is little change in the tax rates, the present system may not seem to work any hardship. We receive income in every year, and we pay a tax every year, and we may not be concerned by the fact that the tax we have paid is on last year's income and that we still owe a tax on this year's income. Nevertheless, whether we are conscious of it or not, we are always in debt.

There are times in nearly every taxpayer's life when the existence of debt creates particular hardship. Every taxpayer dies some time; most taxpayers suffer at some time during their lives a decrease in income which may be very sharp, as when an individual retires, or suffers an accident, or finds his income sharply cut by general economic dislocations. A man earning $10,000 a year may retire on an income of $3,000 a year; in the first year in which he receives $3,000 he has to find the money to pay a tax on his last year's $10,000 income. **Many men now going into the Army and Navy will receive during this year incomes far below their 1941 incomes; but out of their small 1942 incomes they must pay a tax on the higher incomes of the preceding year. Even if collection of this tax is deferred, the debt remains.** When a taxpayer dies, his estate is liable for the payment of a tax on the income he received in the year of death. But in the year in which payment is due there may be no income out of which to pay the tax. The tax, if it is paid at all, must be paid out of whatever capital the decedent leaves which may seriously deplete the amount remaining for his surviving family.[1] For many people who have not saved a great deal, the payment of tax on one year's income at the present high rates can be a serious problem when there is no more income coming in.

There are unquestionably some taxpayers who are careful enough to provide in advance for their tax liability, but they are a minority. These are the people who, for instance, in 1942 would try to estimate their probable 1942 income and their tax on that income; and would then set aside out of 1942 income funds with which to pay the tax. These people, although they owe the government a debt, will have provided funds with which to meet it. But most taxpayers do not provide for their taxes in that manner, partly because of a general tendency not to provide for the payment of a debt until the period when the payment is due, and partly because estimating the amount of tax is often impossible. For example, the Congress will undoubtedly this spring change the tax rates applicable to 1942 income. With the best will in the world, the taxpayer lacking the quality of omniscience cannot estimate the tax that will be due on 1942 income, even if he knows in advance the amount of his 1942 income.[2]

Certainly the majority of people do not even try to provide in advance for their tax liability. They somehow find the money in 1942 to pay the tax for 1941, and wait until 1943 to worry about their 1942 tax. The consequence is that at the end of every year they are in debt for a year's taxes and have not provided out of their income for the payment of that debt. **The present proposal is made in an effort to find some way to get taxpayers out of tax debt and on a pay-as-you-go basis, so that the tax they pay during any year is the tax on the income received during that year, and so that at the end of the year they will not owe money to the government.**

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[1] This problem may be particularly acute if there is accrued income which must be included in the decedent's final return, pursuant to Sec. 42 of the Internal Revenue Code.

[2] Heretofore taxpayers, generally, have not been conscious of the problem, primarily because they did not have to face the possibility of paying last year's taxes and also paying, in the event a withholding tax is initiated, this year's taxes.

Nothing is gained by arguing that people ought to save out of this year's income enough money to pay the tax on this year's income. The fact exists that they do not do it. We need, rather, to develop some system which automatically shifts taxpayers to a current basis. It would have done little good to argue with employers or employees that, in order to save power, everyone ought to go to work at eight o'clock in the morning instead of at nine; the same result in power saving was achieved much more simply by moving all the clocks forward an hour, so that we actually go to work at eight o'clock, although we nominally still go at nine.

The present tax collecting system has developed out of apparent necessity. Taxes are not paid on 1941 income until 1942 because it is not until 1942 that the taxpayer knows certainly what his income was in 1941 and what rate of tax is applicable. But in spite of the seeming necessity for the present system, if it does produce unnecessary hardship, it is worth some effort to find out if there is a feasible method by which taxpayers can pay their tax on a current basis.

II. The Main Difficulties in the Way of a Pay-As-You-Go System

In order to put taxpayers on a current basis, we must find some system under which the tax paid in any one year is the tax that is owed on the income received during that year. Three main difficulties stand in the way:

(1) **Since we are one year behind in our tax payments, how are we going to catch up with ourselves—what do we do with the extra year?**

(2) **If we are to file a tax return, say in March 1942, representing tax on 1942 income, how are we to know in advance the amount of the 1942 income?**

(3) **If we are to file a tax return in March 1942, representing tax on 1942 income, how are we to know in advance the tax rate applicable to 1942 income?**

Taking up these problems in order, we make these suggestions:

(1) **We are paying a tax in 1942 anyway. It is now considered a tax on 1941 income. Suppose we re-define it and say**

that the tax paid in 1942 represents a tax, tentative to be sure, on the income we are going to receive in 1942. In 1943 we continue to pay a tax which becomes a tax paid with respect to income which will be received in 1943. **The tax on 1941 income apparently drops out of existence, but the taxpayer continues to pay a tax every year. The only difference is that he is now on a current basis.** He continues to pay a tax every year on the income received or to be received that year. But when he dies or ceases to receive income, he does not owe a tax, as he does under the present system. **Although the tax on 1941 income seems to have been presently canceled, cancellation actually occurs only at the time the individual ceases to be a taxpayer.** As is pointed out below, so far as the government is concerned, the cancellation of the 1941 tax is largely offset by an acceleration in collection of tax from new taxpayers and from present taxpayers receiving increased incomes, and by an increase in estate tax collections.

(2) It is perfectly clear that most taxpayers could not have filed a return in 1942 on the basis of their 1942 income, since they would not know the amount of the income until the end of the year. To avoid this obvious difficulty we suggest that each year a taxpayer should compute his tax for *that* year, measured by the income of the preceding year; that is, the return filed on March 15, 1942, would be a return of tax due on 1942 income, but because of practical necessity it would be based on the 1941 income. **Suppose a taxpayer received $5,000 taxable income in 1941. He would file a return on March 15, 1942, showing a tax measured by 1941 income; but this would be his tentative tax on 1942 income. If at the end of 1942 he finds that his taxable income actually was $5,000, the same income as in 1941, his full tax has been paid. If he finds, instead, that his 1942 income was $5,500, he owes the government a tax on the additional $500. (But this is far better than his owing the government, as under the present system, a tax on the full $5,500.) If he finds that his 1942 income was $4,500, rather than $5,000, the government owes him a refund or a credit of the tax paid on the additional $500.**

(3) The problem of how the taxpayer will know what tax rate is applicable can be solved by a technical change. Under the present system, when the Congress changes the rates this spring,

the new rates will (if the usual procedure is followed) be made applicable to 1942 income. But this 1942 tax will not be paid until 1943. **We suggest that under the Pay-As-You-Go system, the new rates be made first applicable to income received in 1943.** Thereupon the taxpayer filing a return in 1942 would use the old rates and would not need to worry about any change in rates. In 1943 he would use the new rates in computing the tentative tax payable in 1943 measured by 1942 income. **In so far as the government is concerned, there is no difference in result between this suggestion and the present system; under the present system, as well as under this proposal, the new rates first affect payments of income tax made in 1943.**

III. The Essential Points of the Pay-As-You-Go Plan

The proposed plan is intended to apply only to individual income, including partnership income and the income of trusts taxable to the beneficiary or the grantor. It would not apply to corporations, to estates, or to the income of trusts taxable to the trustee, since corporations normally report on an accrual basis, and executors and trustees necessarily provide for the payment of taxes before distribution is made.

The plan contemplates the following modifications in the present tax system. (In the following statements it is assumed that the plan goes into effect in 1942.)

(A) Tentative Tax.

In March of each year the taxpayer would file a return showing a tentative tax for that year; the tax would be measured by the income of the preceding year but computed according to the rates and exemptions applicable to the current year. That is, the tax shown on the return filed in 1942 would represent a tentative tax on 1942 income, measured by 1941 income but computed according to the rates and exemptions applicable to 1942 income.[3]

[3] Since we are suggesting (see (B) immediately following) that any change in rates and exemptions should first become operative the first of the year following enactment, the rates and exemptions applicable to 1942 income would be the rates and exemptions of the 1941 Revenue Act. However, under the proposed plan the tax on 1942 income, computed at the 1941 Act rates and exemptions, is collected in 1942; under the present system the tax *collected* in 1942 is also computed at the rates and exemptions of the 1941 Revenue Act.

(B) Changes in Rates of Tax and Exemptions.

Whenever changes are made in tax rates or exemptions, the new rates and exemptions would not become operative until the first of the year following enactment. That is, a change in rates enacted in 1942 would be applicable to 1943 income but not to 1942 income. However, this does *not* postpone the *effect* of a change in the rate scale or in the exemptions. Under the present system, a change in rates enacted in 1942 would (if the usual procedure is followed) apply to 1942 income, the tax on which is collected in 1943; under the proposed plan the change would first apply to 1943 income, the tax on which would also be collected in 1943.[4]

(C) Adjustment of Tentative Tax to Actual Tax Liability.

The tentative tax is necessarily measured by the income of the preceding year, since the actual income of the current year cannot be known until the end of that year. Therefore, at the end of each year the taxpayer may find that he has paid too little or too great a tax on the current year's income.[5] Suppose, for instance, that a taxpayer received income of $5,000 in 1941 and $5,500 in 1942. The tentative tax paid in 1942 would have been measured by his 1941 income of $5,000. At the end of 1942, since the taxpayer's income in 1942 was actually $5,500, he would owe the government a tax on the additional $500 at rates applicable to 1942 income; this differential could be made pay-

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[4] The plan originally contemplated that the rates about to be enacted should be applicable to 1942 income. However, it was found that where the year of transition is one of increased rates, the increase in tax payments (as distinguished from tax liability) in the year following the year of transition is probably too steep. It is true that this burden would be more than offset by the complete or relatively complete freedom from obligation at the time of death or retirement. Moreover, the increase in tax payments in 1943 would, in most cases, probably not be substantially greater than the amount that would be payable if a withholding tax were initiated in that year. But people generally are more interested in immediate consequences than in ultimate effects.

[5] This would result solely from an increase or decrease in income over the preceding year, or a change in status as regards the personal exemption or credit for dependents during the preceding year.

able the following March (1943)[6] **at the time the tentative tax for 1943 is returned. In the same way, if at the end of 1942 the taxpayer found that his actual 1942 income was $4,500 rather than $5,000, the government would owe the taxpayer a refund or a credit on the differential of $500. The tax on that amount could be credited against the taxpayer's tentative tax liability for 1943.**[7] No substantial administrative difficulty or expense would be involved because the taxpayer's return of tentative tax for the following year, 1943, would show his actual income for 1942; any deficiency due on 1942 income, or claim for credit because of an overpayment on 1942 income would be computed and shown on the 1943 tentative tax return.

Under the proposed plan, all individuals would *pay* the same amount of tax in 1942 as they would under the present law, *i. e.,* each individual would pay a tax measured by 1941 income but at the rates and exemptions applicable to 1942 income.[8] But instead of this being a tax on 1941 income, it would be a tentative tax on 1942 income. At the end of the year 1942, if the taxpayer's 1942 income was different in amount from his 1941 income, he would owe to the government or be owed by the government the tax on the differential. But if at the end of 1942, he found that his 1942 income was the same as his 1941 income, his full tax on his 1942 income would be paid and there would be no differential to be adjusted. In 1943 he would pay a tentative tax measured by 1942 income but at the rates and exemp-

[6] If the deficiency were very large in proportion to the total liability, provision could be made for paying it in instalments. To encourage payment on March 15th, a small discount might be offered as an inducement.

[7] In normal times there would actually be relatively few refunds for the reason that, except for taxpayers who had died, or who had ceased to receive taxable income, the overpayment could be credited against the tentative tax of the ensuing year.

[8] The tentative tax paid in any year under the proposed plan would always be the same as the actual tax liability that would be paid under the present system, except if there had been a change in status as regards the personal exemption or the credit for dependents. Under the proposal the tentative tax paid, for example, in 1943 would be computed according to the taxpayer's status with regard to the personal exemption and credit for dependents as of the beginning of the year; if the status had changed during the preceding year, the tentative tax under the proposal would be slightly different from the actual tax that would be paid that year under the present system.

tions applicable to 1943 income; this would be the same amount of tax he would pay in 1943 under the present system. However, he would also pay to the government or be credited by the government in 1943 for any difference in the tentative tax paid for 1942 and the actual tax liability for that year. **Thus in 1943 and in each succeeding year the taxpayer would pay a tentative tax measured by the income of the preceding year, plus or minus any differential between the tentative tax and the actual tax liability for the preceding year.**

IV. **Effects of the Plan**

(A) **From the Viewpoint of the Government.**

(1) **The Treasury would collect in 1942 substantially[9] the same amount that it would under existing law. Therefore, the government's cash position in that year would not be disturbed by the changeover. Similarly in 1943 (except with respect to taxpayers who die during 1942[10]) the Treasury would collect in cash at least as much as it would under the existing system.** This is because the tentative tax paid in 1943 would be a tax measured by 1942 income but computed according to the new rates applicable to 1943 income; under the present system the actual tax collected in 1943 would be a tax on 1942 income at the new rates applicable to 1942 income. Further, the government would collect in March 1943 any deficiencies representing the excess of the actual tax liability over the tentative tax on 1942 income. Since 1942 is expected, on the whole, to be a year of higher income than 1941, it may reasonably be anticipated that the deficiencies due in 1943 would exceed the refunds or credits in that year.[11]

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[9] The Treasury would collect *exactly* the same amount were it not for the relief provision suggested under IV(B)(5).

[10] And also with respect to taxpayers who cease to receive income during 1942, and where certification is made under the relief provision (see IV(B)(5)) that no income will be received during 1943.

[11] The refunds and credits would be made only to those persons whose 1942 incomes were lower than their 1941 incomes. This group would consist, to an overwhelming extent, of people who either gave up lucrative positions to enter the Army, Navy or other government service at lower pay, or were thrown out of employment by reason of the economic dislocations resulting from the war. The plan would thus afford some relief to such persons.

(2) Nevertheless, it is true that in 1943 the Treasury would not, under the proposed plan, collect the tax on the 1942 income of decedents who died in 1942. This loss of tax should, however, be at least partially offset, and perhaps more than offset, by the following increases in tax collections that would occur under the plan.

(a) **There would be an acceleration in the collection of tax from new taxpayers—those whose incomes first reached a taxable level during the preceding year.** In 1943 a taxpayer whose 1942 income first brought him into the taxpaying group would pay in March as a deficiency tax his full tax on 1942 income (since he would not have returned a tentative tax in 1942), and would also pay in instalments the tentative tax for 1943. The amount of the deficiency tax represents an increase over the collections which would be received in 1943 under the present system.

(b) **There would also be an acceleration in the collection of tax on an increase of income received in 1942 over income received in 1941.** Under the plan, any increase in income in 1942 would result in a deficiency tax payable in March 1943 which would be in addition to the tentative tax payable in instalments in 1943 on 1943 income. The amount of this deficiency tax also represents an increase over the collections which would be received in 1943 under the present law.

(c) **Further, there would be some increase in estate tax.** Under the plan the estate would not be liable for the tax on the income of a decedent in the year of death, since the tax would have been paid currently.[12] The net estate would, therefore, be increased by the amount of that tax liability and, if the estate were taxable, the estate tax would be increased by the amount of tax on the increase in value of the net estate.

(3) **Any cancellation in tax that would occur under the plan would be a cancellation with respect to present taxpayers only. New taxpayers would immediately be on a current basis and as to them there would be no possible loss in tax receipts. Any net loss in tax**

[12] The maximum tax for which the estate could be liable would be the tax on 2½ months' income, the period between the beginning of one quarter and the due date for payment of tax on that quarter, *e. g.,* April 1-June 15.

receipts which might result under the plan would last only during the taxpaying period of the present generation of taxpayers.

(4) **Under the plan a withholding tax could be immediately instituted without hardship.** A monthly or quarterly withholding tax on this year's income could be credited against the quarterly instalments of the tentative tax payable on this year's income. The instituting of a withholding tax would not necessitate a payment of more than one year's income taxes in any one year, as it would under the present system where a withholding tax on 1942 income would have to be credited, not against taxes *paid* in 1942, but against taxes on 1942 income *payable* in 1943.

(5) Nominally the Treasury would lose a potential asset, *i. e.,* income taxes receivable. However, from a practical viewpoint this is hardly a serious disadvantage, since the Treasury does not carry this asset in its balance sheet. Moreover, the loss of this potential asset would be counterbalanced to a considerable extent by an increase in another potential asset, estate taxes receivable.

(6) **In a period of rising incomes the Treasury's collections would be accelerated, which is as it should be. An inflationary rise in income would be counteracted to some degree, at least, by the collection of higher taxes,[13] with a consequent diminution of spending power. On the other hand, in a period of declining incomes, the Treasury's net collections would be reduced sooner, leaving in the hands of taxpayers an increased amount for spending at a time when they need it and should have it. The refunds of taxes might minimize the government's relief obligations.**

(7) **Delinquencies in the collection of taxes would be virtually eliminated.[14] This is an important point.** In a period of depression and unemployment, there is a strong possibility of wholesale defaults

[13] This results from the fact that in a period of increasing incomes there would be a deficiency tax on the preceding year's income to be paid in March; the amount of the deficiencies represents an increase in tax collections under the proposed plan as compared with the present system.

[14] The resultant saving in administrative expense would probably compensate for the increase in expense that a large number of refunds might necessitate. However, as stated in footnote [7], the number of actual refunds in normal times would be relatively low.

in payment of tax liabilities.[15] At such a time, the government is unlikely to enforce collection and the whole tax-collection structure tends to deteriorate with a consequent deleterious effect on general ethics and morals.

(8) **The nation would gain in morale, because taxpayers would be easier in their minds.** They would not have to worry about meeting last year's income taxes. Many people who are faced with a reduction in their income or with possible temporary unemployment now have the additional worry of an income tax liability based on a previous year's income. Their economic basis would be sounder if they could pay their income taxes in the same year in which they received the income. This is particularly true at the present time when the war is affecting the incomes of many individuals, such as the men going into the armed forces and the industrial workers who are temporarily thrown out of employment during the shift from peace-time to war-time production. These men would be in a much better situation if in the year of reduced income they were liable only for a reduced tax.

(B) **From the Viewpoint of the Taxpayer.**

(1) **In a period of stable incomes and stable tax rates, individual taxpayers would be at all times solvent so far as income tax liability is concerned.**[16]

(2) **In a period of rising incomes, individual taxpayers would in nearly all cases have paid the major portion of their tax liabilities in the year in which the income was earned, and could therefore more easily adjust their spendable income to their actual income after deducting tax liability.**

(3) **In a period of declining incomes individuals would be entitled to refunds, which would ease the hardship of reduced income.**

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[15] With exemptions as low as they now are, the number of taxpayers who would be in default in the event of a depression and period of unemployment would be tremendous.

[16] Except as to a maximum of 20.83% of the annual tax. (This percentage is the proportion of 2½ months to 12 months. See footnote [11].)

(4) **When an individual died, his heirs would be free from the burden of paying any income taxes except as to any deficiency that might be due to increased income** (and also a current tax on a maximum of two and one-half months' income during the year of death). On the other hand, if the individual left an estate large enough to be subject to estate tax, the latter tax would be higher by reason of the elimination of the income tax liability.

(5) **If an individual retired, say on a pension equal to half pay,** he would nominally have to pay a tax in the year of half pay measured by the year of full pay; but actually **he would be subject to tax on only the half pay,** and if he paid a tentative tax based on the full pay, he would be entitled to a refund at the end of the year. Provision could be included for eliminating payment of a portion of the tentative tax in a year of reduced income upon appropriate certifications. To avoid too great administrative difficulty, this provision could be restricted to cases of reduced compensation for personal services.

(C) **From the Viewpoint of the Employer.**

Employers stand to benefit from the plan by reason of the fact that their employees, when they retire, would be better able to get along on their retirement pay; or if they die, the employer would not be faced with even a moral obligation to put the decedent's heirs in funds with which to meet his tax liabilities. Similarly, if in a period of depression it became necessary to lay off employees, their right to receive tax refunds would lessen the employer's obligations to the discharged employees. **With respect to executives, the plan would tend to accelerate retirements and to avoid prolongation of employment beyond the point of decreasing efficiency.**

V. Some Examples

In all of these examples it is assumed that the taxpayer is married and has no dependents.[17]

(A) Adams has an income of $5,000 in 1941, gradually increasing by $500 increments to $6,500 in 1944. In 1942, under the present system he would pay a tax on 1941 income at 1941 Act rates amounting

[17] When the "new rates" are mentioned, reference is to the rates proposed by the Treasury Department, March 3, 1942.

to $375. Under the proposed system he would pay in 1942 a tentative tax on 1942 income measured by 1941 income and at 1941 Act rates—also amounting to $375. At the end of 1942, since his actual income had been $5,500 rather than $5,000 he would owe the government a tax on the additional $500 computed at 1941 Act rates—amounting to $63. This deficiency tax would be payable in March 1943. In March 1943, under the proposed system, he would return a tentative tax measured by 1942 income at the new rates applicable to 1943 income—amounting to $945; this is the same amount that he would pay in 1943 as an actual tax liability under the present system. However, under the proposed plan his actual *payments* in 1943 would be the tentative tax of $945 on 1943 income, payable in instalments, plus the deficiency of $63 on 1942 income, payable in March, a total of $1,008. If he dies at the end of 1944, under the proposed plan his estate would be liable for only the deficiency of $155 on 1944 income; while under the present system his estate would be liable for tax on the full 1944 income—amounting to $1,255 (Table I).

(B) Baker, an engineer, whose 1941 taxable income amounted to $7,500, obtains a commission in the armed forces. His taxable income in 1942 is $2,000. Under existing law he will somehow have to pay a tax of $770 out of his income of $2,000. (This assumes, as will generally be the case, that Baker lived up to his $7,500 income in 1941.) Under the proposed plan Baker would still nominally be required in 1942 to pay $770, but at the end of the year he would be entitled to a rebate of $728. In view of the fact that he would be entitled to this refund, it would be possible for the Treasury to waive collection of the full tentative tax measured by 1941 income and substitute a tentative tax measured by 1942 income.[18] If at the beginning of 1944 Baker returns to private life and returns to his former taxable income level of $7,500, he would in 1944 be required to pay a tentative tax on only $2,000. This would also be the result under existing law and may be all to the good, as the period following his return to private life is likely to be one of readjustment requiring capital expenditures. However, in the absence of a withholding tax,

[18] If a taxpayer's current income decreased sharply, the tentative tax could be decreased correspondingly. See IV(B)(5). If the taxpayer's current income increased sharply, a withholding tax would serve to reduce the deficiency payable the following March.

Baker in 1945 would have to make good the deficiency of $1,485 on 1944 income, and also pay a tentative tax of $1,565 on 1945 income based on an income of $7,500. Admittedly, it would be difficult to pay a total tax of $3,050 out of an income of $7,500; but this difficulty could be partially met by a withholding tax on the $7,500 received in 1944. Moreover, this difficulty pales before the prospect of his widow's having to pay a tax of $1,565 out of an income of possibly zero, if Baker dies toward the end of the year (Tables IV and IV-A).

(C) Clark, a worker in a defense plant, earned $2,500 in 1941. In 1942 he will earn $4,000. Under existing law, and under the proposed plan as well, Clark in 1942 would pay $90. However, in 1943, whereas his payments under existing law at the new rates would be only $535, his payments under the proposed plan would be $694. This may result in a pinch in 1943, but the pinch will hurt less if it comes when Clark is earning $4,000 than if it comes when he dies or when he returns to his former income level of $2,500 (Tables V and V-A).

(D) Daniel has a fixed annual income of $10,000. In 1942 he will pay under both existing law and the proposed plan $1,305. In 1943 he will pay $2,435 at the new rates under both the existing law and the proposed plan; this increase is due wholly to the increase in rates. Under the plan, however, he would save his estate an income tax liability, assuming he died at the end of 1944, of $2,435. The net income tax saving would be equal to the tax on 1941 income plus the difference in the tax on 1942 income computed at the new rates and at the 1941 Act rates; but if Daniel left a taxable estate, part of the saving would be offset by the increase in estate tax liability (Table III).

(E) Edwards, an industrialist, has an income of $100,000 per year. He has a net estate for federal estate tax purposes of $2,000,000. In 1942 he will pay $52,704. In 1943 he would, under the proposed plan, pay $68,965, the same amount that would be payable under the present system. Assuming he dies at the end of the year, the plan would save his estate an income tax liability of $68,965, but the estate tax on his estate would be increased by $44,958. This assumes that Edwards will have spent only such part of his income as is left to him after taxes and has left his capital intact. This, however, is a likely assumption (Table VI).

March 25, 1942

Appendix

TABLE I. EFFECT OF THE PLAN ASSUMING AN INCREASING INCOME

MARRIED PERSON—NO DEPENDENTS[1]

	1941	1942	1943	1944	1945	Total 1942-1945
a) Net income	$5,000	$5,500	$6,000	$6,500	0[2]	
b) Tax liability under present system	375	945	1,100	1,255	0	
c) Tax liability under proposal	....	438[3]	1,100	1,255	0	$2,793
d) Tax paid March-December under present system	....	375	945	1,100	$1,255	3,675
Tax paid under proposal:						
e) Tentative tax—March-December	....	375	945	1,100	0	
f) Deficiency to be paid (+) or excess to be refunded (—) following March	....	+ 63	+ 155	+ 155	0	
g) Total actually paid each year[4]	....	375	1,008	1,255	155	2,793[5]

For footnotes, see page 27.

Table I-A. Effect of the Plan Assuming an Increasing Income

Married Person—No Dependents[1]

	1941	1942	1943	1944	1945	Total 1942-1945
a) Net income	$10,000	$11,000	$12,000	$13,000	0[2]	
b) Tax liability under present system	1,305	2,815	3,215	3,635	0	
c) Tax liability under proposal.......	....	1,551[3]	3,215	3,635	0	$8,401
d) Tax paid March-December under present system	....	1,305	2,815	3,215	$3,635	10,970
Tax paid under proposal:						
e) Tentative tax—March-December ..	....	1,305	2,815	3,215	0	
f) Deficiency to be paid (+) or excess to be refunded (—) following March	....	+246	+400	+420	0	
g) Total actually paid each year[4]	....	1,305	3,061	3,615	420	8,401[5]

For footnotes, see page 27.

Table I-b. Effect of the Plan Assuming an Increasing Income

Married Person—No Dependents[1]

	1941	1942	1943	1944	1945	Total 1942-1945
a) Net income	$100,000	$110,000	$120,000	$130,000	0[2]	
b) Tax liability under present system	52,704	77,935	86,935	95,935	0	
c) Tax liability under proposal.......	....	59,589[3]	86,935	95,935	0	$242,459
d) Tax paid March-December under present system	....	52,704	77,935	86,935	$95,935	313,509
Tax paid under proposal:						
e) Tentative tax—March-December ..	....	52,704	77,935	86,935	0	
f) Deficiency to be paid (+) or excess to be refunded (—) following March	....	+ 6,885	+ 9,000	+ 9,000	0	
g) Total actually paid each year[4]	....	52,704	84,820	95,935	9,000	242,459[5]

For footnotes, see page 27.

Table II. Effect of the Plan Assuming a Decreasing Income

Married Person—No Dependents[1]

	1941	1942	1943	1944	1945	Total 1942-1945
a) Net income	$6,500	$6,000	$5,500	$5,000	0[2]	
b) Tax liability under present system	604	1,100	945	805	0	
c) Tax liability under proposal.......	....	521[3]	945	805	0	$2,271
d) Tax paid March-December under present system		604	1,100	945	$805	3,454
Tax paid under proposal:						
e) Tentative tax—March-December ..	....	604	1,100	945	0	
f) Deficiency to be paid (+) or excess to be refunded (—) following March	....	— 83	— 155	— 140	0	
g) Total actually paid each year[4]	....	604	1,017	790	— 140 (refunded March 1945)	2,271[5]

For footnotes, see page 27.

TABLE II-A. EFFECT OF THE PLAN ASSUMING A DECREASING INCOME

MARRIED PERSON—NO DEPENDENTS[1]

	1941	1942	1943	1944	1945	Total 1942-1945
a) Net income	$13,000	$12,000	$11,000	$10,000	0[2]	
b) Tax liability under present system	2,103	3,215	2,815	2,435	0	
c) Tax liability under proposal.......	....	1,817[3]	2,815	2,435	0	$7,067
d) Tax paid March-December under present system	....	2,103	3,215	2,815	$2,435	10,568
Tax paid under proposal:						
e) Tentative tax—March-December ..	....	2,103	3,215	2,815	0	
f) Deficiency to be paid (+) or excess to be refunded (—) following March	....	— 286	— 400	— 380	0	
g) Total actually paid each year[4]	....	2,103	2,929	2,415	— 380 (refunded March 1945)	7,067[5]

For footnotes, see page 27.

TABLE II-B. EFFECT OF THE PLAN ASSUMING A DECREASING INCOME

MARRIED PERSON—NO DEPENDENTS[1]

	1941	1942	1943	1944	1945	Total 1942-1945
a) Net income	$130,000	$120,000	$110,000	$100,000	0[2]	
b) Tax liability under present system	73,389	86,935	77,935	68,965	0	
c) Tax liability under proposal.......	....	66,489[3]	77,935	68,965	0	$213,389
d) Tax paid March-December under present system	....	73,389	86,935	77,935	$68,965	307,224
Tax paid under proposal:						
e) Tentative tax—March-December ..	....	73,389	86,935	77,935	0	
f) Deficiency to be paid (+) or excess to be refunded (—) following March	....	— 6,900	— 9,000	— 8,970	0	
g) Total actually paid each year[4]	....	73,389	80,035	68,935	— 8,970 (refunded March 1945)	213,389[5]

For footnotes, see page 27.

TABLE III. EFFECT OF THE PLAN ASSUMING A STABLE INCOME

MARRIED PERSON—NO DEPENDENTS[1]

	1941	1942	1943	1944	1945	Total 1942-1945
a) Net income	$10,000	$10,000	$10,000	$10,000	0[2]	
b) Tax liability under present system	1,305	2,435	2,435	2,435	0	
c) Tax liability under proposal	....	1,305[3]	2,435	2,435	0	$6,175
d) Tax paid March-December under present system	....	1,305	2,435	2,435	$2,435	8,610
Tax paid under proposal:						
e) Tentative tax—March-December	....	1,305	2,435	2,435	0	
f) Deficiency to be paid (+) or excess to be refunded (—) following March	....	0	0	0	0	
g) Total actually paid each year[4]	....	1,305	2,435	2,435	0	6,175[5]

For footnotes, see page 27.

TABLE IV. EFFECT OF THE PLAN ON A HYPOTHETICAL PERSON SERVING IN THE ARMED FORCES IN 1942 AND 1943 AT AN INCOME OF $2,000 AND RETURNING TO HIS ORIGINAL INCOME LEVEL IN 1944

MARRIED PERSON—NO DEPENDENTS[1]

	1941	1942	1943	1944	1945	Total 1942-1945
a) Net income	$7,500	$2,000	$2,000	$7,500	$7,500	
b) Tax liability under present system	770	80	80	1,565	1,565	
c) Tax liability under proposal.......	....	42[3]	80	1,565	1,565	$3,252
d) Tax paid March-December under present system	....	770	80	80	1,565	2,495*
Tax paid under proposal:						
e) Tentative tax—March-December ..	....	770	80	80	1,565	
f) Deficiency to be paid (+) or excess to be refunded (—) following March	....	— 728	0	+ 1,485	0	
g) Total actually paid each year[4]	....	770	— 648 (refunded)	80	3,050	3,252[6]

* Under the present system, the liability of $1,565 on 1945 income would be paid in 1946, so that the total payments on 1941-1945 income would be $4,060.

For other footnotes, see page 27.

TABLE IV-A. EFFECT OF THE PLAN ON A HYPOTHETICAL PERSON SERVING IN THE ARMED FORCES IN 1942 AND 1943 AT AN INCOME OF $2,000 AND RECEIVING NO INCOME IN 1944

MARRIED PERSON—NO DEPENDENTS[1]

	1941	1942	1943	1944	Total 1942-1944
a) Net income	$7,500	$2,000	$2,000	0[2]	
b) Tax liability under present system	770	80	80	0	
c) Tax liability under proposal	....	42[3]	80	0	$122
d) Tax paid March-December under present system	....	770	80	80	930
Tax paid under proposal:					
e) Tentative tax—March-December	....	770	80	0	
f) Deficiency to be paid (+) or excess to be refunded (—) following March	....	— 728	0	0	
g) Total actually paid each year[4]	....	770	— 648 (refunded)	0	122[5]

For footnotes, see page 27.

TABLE V. EFFECT OF THE PLAN ON A HYPOTHETICAL PERSON RECEIVING INCREASED INCOME IN WAR INDUSTRY DURING 1942 AND 1943, AND RETURNING TO HIS ORIGINAL INCOME LEVEL IN 1944

MARRIED PERSON—NO DEPENDENTS[1]

	1941	1942	1943	1944	1945	Total 1942-1945
a) Net income	$2,500	$4,000	$4,000	$2,500	$2,500	
b) Tax liability under present system	90	535	535	175	175	
c) Tax liability under proposal.......	....	249[3]	535	175	175	$1,134
d) Tax paid March-December under present system	....	90	535	535	175	1,335*
Tax paid under proposal:						
e) Tentative tax—March-December ..	....	90	535	535	175	
f) Deficiency to be paid (+) or excess to be refunded (—) following March	....	+ 159	0	— 360	0	
g) Total actually paid each year[4]	....	90	694	535	— 185 (refunded March 1946)	1,134[7]

* Under the present system, the liability of $175 on 1945 income would be paid in 1946, so that the total payments on 1941-1945 income would be $1,510.

For other footnotes, see page 27.

TABLE V-A. EFFECT OF THE PLAN ON A HYPOTHETICAL PERSON RECEIVING INCREASED INCOME IN WAR INDUSTRY DURING 1942 AND 1943, AND NO INCOME IN 1944

MARRIED PERSON—NO DEPENDENTS[1]

	1941	1942	1943	1944	Total 1942-1944
a) Net income	$2,500	$4,000	$4,000	0[2]	
b) Tax liability under present system	90	535	535	0	
c) Tax liability under proposal.......	....	249[3]	535	0	$784
d) Tax paid March-December under present system	....	90	535	$535	1,160
Tax paid under proposal:					
e) Tentative tax—March-December ..	....	90	535	0	
f) Deficiency to be paid (+) or excess to be refunded (—) following March	....	+159	0	0	
g) Total actually paid each year[4]	....	90	694	0	784[5]

For footnotes, see page 27.

Table VI. Increase in Estate Tax Partially Offsetting Decrease in Income Tax: Net Tax Effect of Plan

Married Person—No Dependents[1]

Average net income (1)	Net estate before exemption[2] (2)	Decrease in income tax under plan (tax on (1) at 1942 Act rates)* (3)	Increase in net estate under plan (tax on (1) at 1942 Act rates)[3] (4)	Increase in estate tax under plan (estate tax on (4) at 1942 Act rates)[4] (5)	Net tax effect of plan (3)-(5) (6)
$5,000	$10,000 (x)	— $805	$805	0	— $805.00
	100,000 (y)	— 805	805	+ $235.06	— 569.94
10,000	20,000 (x)	— 2,435	2,435	0	— 2,435.00
	200,000 (y)	— 2,435	2,435	+ 1,012.96	— 1,422.04
25,000	50,000 (x)	— 9,960	9,960	0	— 9,960.00
	500,000 (y)	— 9,960	9,960	+ 5,179.20	— 4,780.80
50,000	100,000 (x)	— 27,145	27,145	+ 8,655.04	— 18,489.96
	1,000,000 (y)	— 27,145	27,145	+ 16,938.48	— 10,206.52
100,000	200,000 (x)	— 68,965	68,965	+ 29,948.04	— 39,016.96
	2,000,000 (y)	— 68,965	68,965	+ 44,958.27	— 24,006.73

* The decrease in income tax is equivalent to the tax on one year's income at the new rates; or, in other words, the tax on (1) at 1941 Act rates, plus the difference between the tax on (1) at the new rates and at 1941 Act rates.

For other footnotes, see page 28.

Footnotes to Tables I-V

[1] The tax liability on 1941 income is computed according to the 1941 Act rates. The tax liability on 1942-45 income under the present system is computed according to the rates proposed by the Treasury Department, March 3, 1942; under the proposal the new rates would apply to income received beginning January 1, 1943, and therefore the tax liability on 1942 income under the proposal is computed according to the 1941 Act rates. It is assumed that there is no taxable income from Government obligations; and, in computing the tax under the 1941 Act, the maximum earned income credit is allowed.

[2] Assuming that at the end of the preceding year the taxpayer dies (or ceases to receive taxable income and certification is made under the relief provision that no income will be received during the current year).

[3] Tax on 1942 income at 1941 Act rates.

[4] This total is the tentative tax payable under the proposal March to December plus or minus any deficiency to be paid or any excess to be refunded for the previous year.

[5] The difference between item (d) and item (g) equals the tax on the 1941 income, plus the difference in tax on 1942 income computed according to the new rates and the 1941 Act rates.

[6] The difference between item (d) and item (g) of —$757 plus the tax liability on 1945 income ($1,565) to be paid, under the present system, in 1946 (not shown in row (d) of the table) equals $770, the tax on 1941 income, plus the difference in tax on 1942 income computed according to the new rates and the 1941 Act rates.

[7] The difference between item (d) and item (g) of $201 plus the tax liability on 1945 income ($175) to be paid, under the present system, in 1946 (not shown in row (d) of the table) equals $90, the tax on 1941 income, plus the difference in tax on 1942 income computed according to the new rates and the 1941 Act rates.

Footnotes to Table VI

[1] The following assumptions are made for the purposes of this table:

a) Income is relatively stable, so that the income in 1941, the income tax on which is canceled under the plan, is of the same magnitude as income in the year of death, the tax on which measures the increase in the value of the net estate under the plan.

b) Two assumptions are made as to the size of the net estate before exemption which corresponds to a given income level: if the income is entirely salary income, the net estate may be roughly equivalent to two years' income (assumption labeled "x"); if the income is entirely dividend income, the net estate may be roughly equivalent to the income capitalized at 5 per cent (assumption labeled "y"). (No adjustment has been made, however, for the earned income credit under the 1941 Act, under the assumption that the income is entirely dividend income—the maximum earned income credit is allowed in the computation of the tax under the 1941 Act.)

[2] The net estate before exemption is assumed to be the net estate before exemption *after* deduction of the tax liability for the year of death (as under the present system).

[3] Under the proposed plan, the income tax on the income of the year of death would not be a liability of the estate as under the present system, but would have been paid in the year the income was received; the net estate would therefore be increased, under the plan, by the amount of the tax. The tax is computed according to the rates proposed by the Treasury Department, March 3, 1942.

[4] This is the increase in the *net* federal tax, after allowance for the maximum credit for state death taxes. The tax is computed according to the rates proposed by the Treasury Department, March 3, 1942.