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A new legislative year has just begun, a new Congress takes up new and unfinished legislative business, and a new opportunity is presented to correct an old defect in our income tax procedure, a defect which has now had the result of putting 27,000,000 income-tax payers in debt for the tax on their last year's income.

When the federal income tax bill was passed in this country in 1913, it had a defect which at the time seemed of no practical consequence but which has since come to have the greatest importance. This defect was that a citizen was required to pay in the year 1914 a tax on his 1913 income. In this way, we got started on a vicious practice of paying out of one year's income a tax on the year that had already gone.

I have said that at the time this defect seemed of no practical consequence. The reason is that income tax rates were low and affected comparatively few people. In 1913 the rates began at 1% and the top, (normal + surtax) was 7%. Exemption for a single person was \$3,000. Contrast this situation with that which confronts us in the Revenue Act of 1942.

The consequence of these increasing rates is that the debt which people owe to the federal government for tax on their last year's income has become a national danger. Nothing is to be gained by arguing that people ought to have saved the tax on last year's income out of last year's income. The fact is that they did not do it and now they cannot do it.

Statistics showing large increases in aggregate net savings during the past year give cold statistical comfort to the majority of income-tax payers. These savings have gone to liquidate old debts, to provide circulating medium needed by a vastly expanded and a more mobile working population, to cushion the shock of sudden economic reverses, to buy war bonds as a foundation for a normal peace-time

life. Only a small portion indeed has been earmarked for taxes on the income of 1942, earmarked so tightly that it will be at hand to permit two years' taxes to be paid in the one year of 1943, or even to permit one year's payment if 1943 income should for some reason stop. Evidence on this point is everywhere at hand and each can judge by his own experience and by questioning others. The Gallup poll of November 16, 1942 showed 75% are not saving for income tax and 71% underestimated the tax they would have to pay. No substantial portion of the tax on 1942 incomes has been accrued by individual taxpayers in a form either intended or available today to meet the tax debt on 1942, and it would come as a shock to the public if Congress should require that the 1942 tax be paid concurrently with the income tax on the income of 1943.

The fact is that few people seem to realize how much money they owe the government for income tax. They seem to feel that since they have paid an installment on December 15, and since the next payment isn't due until next March, for the time being at least, they are not in debt for income tax. They are wrong. They are in debt now for income tax on what they earned last year. Under our present system this debt will have to be paid whether this year they then have any income or not.

If they die, this amount will be taken from whatever estate they leave. If they lose their jobs, there will be a charge against what they have saved. If their earnings are less, the full tax must be met out of the lower earnings. Nothing can stop the march of the days, and when the due date comes they must pay the tax they owe on the income they have already had. It is a real debt, and practically all income-tax payers are actually in debt continuously for about one year's full income tax.

There are two broad purposes for reforming our historic income tax practice in order to place our income taxes on a current basis and to eliminate the accumulated income-tax debt. The first purpose relates to the financing of the war, to the reduction of potentially inflationary purchasing power, and to the

preservation of the integrity of our income-tax system through obtaining the highest possible level of collections and the lowest possible level of defaults. The second purpose springs from the personal and humane desirability of removing from millions of citizens the constant threat of unpaid tax debt, a debt imposed under a faulty tax system, unwittingly unprovided for by our citizens, a debt now grown so large under present tax rates that loss of current income for any reason by the individual taxpayer brings acute financial and personal distress.

The first purpose, that of financing the war and maintaining the integrity of the income-tax system, appeals powerfully to all students of taxation, in and out of the government. They are well aware that the economic well-being of the country will be safeguarded by collecting the taxes on our rising 1943 income in 1943 and not a year later in 1944. They are also aware of the probability that it will be necessary to supplement the present tax program with a program of compulsory savings, and that the program too must be related to the current income of the citizen.

These authorities are also apprehensive about income-tax collections and default. Can we expect ten million new taxpayers to make declarations and begin to pay income tax under the old scheme on what they earned last year? Can we expect these new taxpayers, or even the old ones, to keep up their payments for tax on their last year's income at present rates if their current income should slacken or abruptly cease? How would the defaults be handled? Would the federal government seize their savings, their war bonds, and their homes?

All these considerations force the placing of income taxes on a current basis and at once, even if there were no personal or humane reasons for doing so. But it is impossible to get on a current basis without eliminating the tax debt on 1942 incomes. No current program, whether it be withholding, compulsory savings, or spending tax, can be applied at the rates necessary as long as the 1942 tax debt is also simultaneously payable. There is no escaping the conclusion that the income tax on 1942 incomes must be either dropped or deferred.

The second broad purpose for this income-tax reform rests on personal and humane grounds. On the first of January under our present system some 27,000,000 citizens will be in debt to the federal government for income tax. If we estimate two persons back of each taxpayer, we have 80,000,000 people involved in the hazard of income-tax debt. It is inevitable that every year, even in 1943, some small percentage of our taxpayers will suffer loss of income from one or another cause. Even if as few as 4% were so affected, this would mean more than a million taxpayers in trouble because of income-tax debt. What are the reasons that might make for lower current income for the individual income-tax payer? Men are called into the armed services, others go into government work at lower pay, men and women are displaced from peace-time industry by war-time dislocation, some suffer sickness and accident, others must retire because of advancing years. All of these find that now with the new high tax rates their income-tax debt becomes an intolerable hardship, wiping out savings that have been accumulated over the years. And for the hundreds of thousands that have already been injured, millions of us are in danger, because we are each subject to the same hazards and the same inevitable loss of income.

The present system is a bad system for all of us, and it should and can be corrected. It is clear that the government cannot continue for long to be the creditor of some 27,000,000 taxpayers and their families in debt for income tax, particularly when there is no substantial question of revenue involved in skipping a year and getting the whole country on a current pay-as-you-go basis.

In order to accomplish this desirable objective of getting our income taxes on a current basis, I suggested to the Treasury in March of last year and to the Senate Finance Committee in July a plan which I called the Pay-As-You-Go income tax plan. This plan is to be applied to individuals, not to corporations. Since then there has been a great deal of discussion, many suggestions and a little criticism.

I welcome this opportunity to make a statement about the plan which will bring it up to date, adding to and modifying the original plan in the light of the

gestions and criticisms which I have received.

The first problem is how to get our personal income taxes on a current basis without paying two years' taxes in one year. The answer is as simple as daylight saving. Let us turn our tax clocks ahead one year. The taxes we have paid last year out of our 1942 incomes are taxes on our incomes received in 1941. We can best solve the problem now by recognizing these 1942 payments to be taxes on 1941 as they really are; and by beginning 1943 by paying on 1942, thereby dropping out the year 1942 from the tax calendar forever.

In my original testimony before the Senate Finance Committee, I suggested dropping out 1941, but the Treasury preferred that if any year was to be dropped, it should be 1942. Now that 1943 has already begun it is clear that the Treasury is right, and that 1942 would be a better year to skip. It is unfortunate that action could not have been taken in time to make practical the skipping of 1941. The year 1941 would have been a much better year to be skipped for many income-tax payers who are serving the people of the United States in the armed forces or in the federal civil service. Perhaps some method can be worked out to give them the choice of 1941 or 1942. I hope that this can be done.

The question arises at once in everyone's mind, how can we drop an income-tax year out of the calendar in this way without having the Treasury lose a lot of money that is badly needed for the war effort? The answer is that we shall all go along paying our income taxes as we have before, only they will be on a current basis. The Treasury will also go along getting its revenues. The only difference is that when a taxpayer dies or ceases to receive income he will not owe income tax as he does under the present system. Reduction of tax payment by the taxpayer as a result of setting the tax clock ahead occurs only at some future date, when and as the taxpayer's income ceases or declines. The reduction is therefore spread over the whole life-time of the present income-tax paying generation, and occurs beneficially for each taxpayer at the time when his income fails. As for the

Treasury, the Treasury has never considered taxes receivable as an asset, and accordingly they can be written off the balance sheet of the government without the change of a single penny.

If we study the consequences of the plan over the generation we find that since the loss would be spread over a period of some 35 to 50 years, the gross amount of eight billion dollars estimated as the tax liabilities on 1942 income would amount to an average of only \$160,000,000 to \$220,000,000 a year over this period. This gross loss of revenue in any case would be partially offset by better tax collections and collection methods and also by recoveries through the estate tax of part of what would otherwise have been payable as income tax. The loss in revenue is relatively not substantial in comparison with the gross tax revenues to be received in these years. Another way of looking at it is that the net loss over a generation would be about the same as one month's current expenditures. The first big loss would come, if at all, in the first year of a post-war depression and it would occur as a timely adjustment both for the economic welfare of the nation and for the help of each individual taxpayer whose income had suffered reduction. It is a small cost to achieve a basic income-tax reform, preserving the integrity of the system and affecting beneficially 77,000,000 citizens.

The question is sometimes raised as to the effect of the plan on inflation. The only persons who would have more cash on hand under the plan are the few who have accrued their income taxes and who hold them in liquid form. These are few indeed and they are not spendthrifts. On the contrary, it is a matter of common

observation that the American people will not spend their savings, or their War Bond purchases when they have once been acquired, except under conditions of real economic pressure. Striking evidence of this is found in the familiar Christmas Savings Clubs, where money is purposefully saved to buy Christmas presents; and yet when the time for expenditure comes, under all the pressure of the holiday season and in spite of the identification of the savings with the season, only 30% of the Christmas Club resources are actually spent for consumer purchases. As a matter of fact, since the Pay-As-You-Go plan will make withholding taxes possible at a high level, and since we will be collecting for 1943 in 1943, the total effect will be anti-inflationary rather than otherwise.

The Tax Research Department of the Treasury feels that a withholding tax at a high rate is important in keeping taxpayers current. I too favor a withholding tax, because it makes it easier for people to keep on a pay-as-you-go basis. And if we want a withholding tax at a high rate, the Pay-As-You-Go plan does solve the problem of having a withholding tax without having some amount of double taxation; that is, of paying two years' taxes in one. However, if a withholding tax provision at a high rate turns out to be either undesirable or impractical, the Pay-As-You-Go plan stands on its own feet as a sound method of getting the country free of income-tax debt.

The second point in the Pay-As-You-Go income tax plan is designed to solve the problem of how we can pay our income taxes on a current basis, when we do not know at the beginning of a year what our income is going to be in that year. The way of solving this problem is not too difficult. We will go ahead as we do today, filing an income tax schedule about the fifteenth of March declaring our previous year's income. But this will be a tentative return for the year then beginning and we will pay our current taxes on the basis of this tentative return. After the year had ended there would have to be an adjustment up or down depending on whether our actual income for the year was greater or less than that on our

tentative return. But this adjustment would be made on the same blank and at the same time as our return for the following year. This return would be at one time the final return for the old year and the tentative return for the new. There would be no doubling of returns involved and only a few extra lines for the adjustment computations.

The third feature of the plan is the provision for relief in case a taxpayer knows his income in the current year is going to be less or greater than that of the year of his tentative declaration. The plan provides that he may declare his true knowledge of lower or higher income, as a result of salary changes, and so forth, which have actually occurred, and make his current payments accordingly.

This provision eliminates the awkwardness of avoidable year-end adjustments and keeps the plan closer to a true pay-as-you-go basis than it would otherwise be.

The fourth point about the plan covers the special provisions for minimizing objectionable "windfall" cases. These provisions were not included in the original plan and have been added to meet a widespread feeling that, even though the number of cases be few, it is desirable to guard against them.

To meet this feeling, I have made the following three suggestions for handling these "windfall" cases:

(1) Do not cancel the income tax on capital gains. Capital gains are not like ordinary recurring income, and can properly be separated out in the plan.

(2) Provide a special death tax to recover what may be considered "windfall" arising because of death in 1942, or during some appropriate transition period.

(3) In all cases where claim for credit exceeds \$10,000, or some other suitable amount, take an average of 1941, 1942, and 1943. The average of the three years will be a practical way of determining a fair normal income instead of "windfall" income.

These three provisions will catch all of the most objectionable "windfall" cases. But even so, there may still be a few remaining. What then?

Much as I dislike windfalls, even if they cannot be entirely eliminated, I am still for the plan. In all fairness, we should not refuse to do good for millions simply because we will be doing too much good for a few that don't deserve it.

The fifth point about the Pay-As-You-Go income tax plan is that it proposes to give equal treatment to all taxpayers under the plan. This means to skip a tax year for all alike in every bracket and start the whole country income-tax-debt free.

These are my reasons: For those in the lower brackets, the plan will obviously have far-reaching beneficial results since unfortunate circumstances of loss of income will not be doubly unfortunate because of last year's debt.

For those in the middle brackets, the plan will eliminate countless personal and family tragedies, free many able citizens for public service, and step up the efficiency of American industry by making possible the retirement and pensioning of executives who are holding on, largely to pay their income tax and never catching up.

For those in the upper brackets, it will make much less practical difference than might appear. First, because like anybody else, as long as they have their income they continue to pay their taxes; and, when they die, what otherwise would have been payable as income tax on the taxpayer's previous year's income is subject to estate taxes in his highest brackets.

But apart from the practical considerations, the reason I favor over-all application of the principle is because it gives equal treatment to all taxpayers under the plan. In adopting Pay-As-You-Go by skipping a year, I believe we should treat all citizens alike. As we turn the tax clock ahead for some, we should turn it ahead for all, and get the whole nation out of income-tax debt ^{AS OF} the beginning of 1943.

In so far as we want more equality of income and of wealth we can have these

through the progressive income tax and the progressive estate tax, but we should not use this general income-tax reform, Pay-As-You-Go, unequally to accelerate indirectly the impact of progressive taxation. Let us achieve such levelling, or lack of it, as we desire, directly through legislative action on measures explicitly drawn to serve that purpose.

There is a deeper and perhaps a truer way of looking at this problem of correcting our income tax practice equitably. Most agree, I suppose, on a policy of taxation based on ability to pay, with graduated rates as steep or as mild as Congress from time to time determines proper. We are not unmindful of other social criteria for the imposition of taxes, but presumably these would all be consistent with ability to pay.

If we now look at our traditional income-tax practice fundamentally, we see what we have really been doing is to estimate ability to pay in terms of last year's income. Now as a matter of observable fact, last year's income is over and gone as income; it is a criterion of ability to pay only in so far as last year's income remains as a residue in current wealth, or as it portends income presently to be received.

The true significance of the Pay-As-You-Go plan is that it denies the applicability of last year's income as a criterion either of current wealth or of income presently to be received; and therefore rejects for all alike the use of last year's income as a basis of taxation according to ability to pay. The plan involves not only the elimination of income-tax debt; basically it involves a change in the criterion of ability to pay. By starting the new year with a new criterion of ability to pay, we simultaneously start it with all citizens income-tax-debt free.

The Treasury has devised a modified plan which would apply to the full tax debt of some taxpayers and to only a part of the tax debt of the rest. Concretely, the Treasury proposed that the tax year be skipped for only the normal tax and

the lowest bracket rate of surtax (that is, a total of 10 per cent and that the balance of the tax debt remaining should be paid over the next two years), this in addition to current income taxes that will be payable in those years. The Treasury conceded that this would leave between 10 and 20 per cent of our taxpayers still owing the government for taxes on their last year's income. This group of 10 to 20 per cent includes practically all of the country's technical, administrative, and professional workers, men and women vital to the creative and dynamic evolution of our country who need freedom from income-tax-debt danger as much as anyone else.

I am invariably asked what the Treasury's objections are to the plan. In order to answer this question, I have analyzed the sources known to me of official Treasury pronouncement on the plan. These consist of the following:

- (1) Statement to the press by Randolph Paul, August 19, 1942, as reported in the New York Times.
- (2) Press release of August 24, 1942, from the Treasury.
- (3) Radio speech by Randolph Paul on August 31, 1942, over the Mutual Network.
- (4) Speech by Randolph Paul to the National Lawyers' Guild, September 26, 1942.
- (5) Letter by Randolph Paul in reply to Louis Bromfield in the Washington Post of December 17, 1942.

On analyzing these several statements, there appear to be four principal points of difference.

(1) The Treasury raises the point of administrative difficulties. Here the objection is so weak that the following statement is used. "In effect, the Ruml plan requires two returns and two sets of computations to determine one year's tax." Yes, in effect, that is true, but in fact it is all done at the same time and on the same return.

(2) The Treasury suggests the possible danger of inflation. This objection falls into two parts: first, people who have saved for taxes may spend their **savings and, second, people would not have the repressive influence on their**

spending of a large impending tax liability. This argument has been presented strongly only in the December letter to Mr. Bromfield. As I have said earlier, the few who have accrued their taxes are not second-thrifts, and second, the burden of current tax payments under the Pay-As-You-Go plan will be as great, or greater than; payments against the debt on last year's income under our present practice. In a later sentence, Mr. Paul states, "as desirable as collection at the source is, it is unnecessary to adopt it at the cost of forgiving a year's tax liability." This sentence seems to imply that there is thought of collecting two years' taxes in one year, in whole or in part for some or all income-tax payers. This is exactly what we want to avoid. Congress fixes the income-tax rates according to its judgment as to what is proper at the time. These rates are fixed openly, and no carry-over of debt liability should be permitted to carry us beyond the decision of Congress as to the assessment to be imposed currently on the income-tax payers. If, in the opinion of some, the burden should be greater, the evidence can be presented to Congress and it will make an explicit determination of its own for the country.

(3) The Division of Tax Research of the Treasury has persistently insisted that the Pay-As-You-Go plan be linked with collection at the source. I have from the beginning favored collection at the source and have said so. I think collection at the source improves the Pay-As-You-Go plan. But collection at the source is not indispensable for Pay-As-You-Go. Accordingly, if collection at the source proves impractical or unacceptable there is no reason for not having the benefits of the Pay-As-You-Go plan anyway. I became particularly apprehensive about linking Pay-As-You-Go too closely with a withholding tax after an incident before Senator Clark's sub-committee on the withholding tax which Senator Clark described in the New York Times of August 20, 1944. On the same day that the Division of Tax Research was advocating collection at the source, the Collector of Internal Revenue, another department of the Treasury, "raised a number of objections" to it. Under the circumstances, it seemed to me that I had gone far enough in expressing favor

for the withholding tax without tying up the Pay-As-You-Go plan in a controversy that was in no way crucial as far as the Pay-As-You-Go plan was concerned. I gladly support the recommendation for collection at the source, but not at the risk of the Pay As You Go plan itself. As a matter of fact, I doubt whether we can have a withholding tax at the needed high rates without first adopting the Pay-As-You-Go plan.

(4) The last objection of the Treasury centers around the question of giving equal treatment to all taxpayers. I have made the suggestions which you have heard for eliminating "windfall" cases, but these seem not to satisfy the Treasury since they do not and are not intended to affect the higher brackets that are not "windfall" cases. It has been my feeling that, except for "windfalls", all citizens should be treated alike and the tax year should be skipped for all.

I feel that the Treasury misjudges the political tides because it is too close to the waves. I believe that the country is tired of indirection in the attempt to achieve a levelling beyond the explicit acts of Congress. Equal treatment for all by turning the tax clock ahead for all alike has been a point of principle that I have felt worth while defending.

But this point of principle is one that Congress properly will decide. If the principle is not so important, or if I have wrongly construed it, then I must point out frankly that it is entirely practical to draw up a Pay-As-You-Go plan that would leave a residue of debt remaining to be paid by taxpayers in the higher brackets. Several proposals of this sort have been suggested, but none of them, as they stand, is satisfactory because the residue of debt remaining is not sufficiently closely related to ability to pay. But a plan could be drawn up that would leave a residue of debt payable and at the same time relate this debt sharply to the taxpayer's ability to pay.

One criticism of the plan that has been made by some, but not to my knowledge by the Treasury, stems from a feeling that somehow it is wrong to cancel a debt.

These critics would like to get on a pay-as-you-go basis in 1943, but retain the tax liability for 1942 as well, although they recognize that it must be deferred or spread over many years. The effect of all such proposals is to complicate the problem, to leave a disagreeable debt overhanging millions of taxpayers--a debt that would be a perpetual football of politics--and to increase beyond the will of Congress, as expressed in legislated income-tax rates, the burden of payments to the federal government assessed on the individual taxpayer.

The feeling that it is somehow wrong to cancel a debt runs very deep and it is respected in quarters where the feeling itself is not shared. It is not easy to find the reason. Certainly it is a common practice, as evidenced by the experience of banks and other commercial institutions, to reorganize debtor-creditor relations without prejudice, upon the initiative of either party, whenever it becomes necessary in furthering the best continuing interests of both. Removal of debt liabilities in this way is considered a means of preserving the integrity of the relationship and a recognition of joint interest in a future welfare. It avoids the deceit and bitterness characteristic of evasion and default.

Certainly the cancelling of debt in order to further the welfare of all concerned has had the high approval of age-old moral authorities. An interesting contemporary comment has been made on the plan itself. A writer in the Information Service of the Federal Council of Churches, after describing the Pay-As-You-Go plan, goes on to say, "At the meetings of various inter-denominational organizations held at Cleveland in December, a member of this Department's staff informally interviewed a number of church officials and found these consulted uniformly in favor of the plan."

There is also a special reason why the liabilities which have arisen under our income tax procedure may properly be set aside as I have suggested. These liabilities are not debts such as those which arise in the exchange of money, property, or services between private individuals. They cannot be removed by **bankruptcy proceedings. On the contrary, they are the result of a unilaterally**

imposed levy by a legislative body under a traditional practice of assessment recognized by all to be defective. This practice was in fact so defective that in 1942 not only was the income-tax debt itself so imposed, but the amount of the debt was not established until October 21, 1942, nearly ten months after the taxable year began.

There would therefore appear to be neither practical nor ethical grounds of a general character for not cancelling the old income-tax liability if that seems the best way of solving our problem. Moreover, in view of the defect and delay in our income-tax law there is sound and just reason why the correction should now be made. At this time when citizens will bear more tax burden than ever before, and when the expectation of additional burdens is in the minds of all, Congress may well extend a friendly and a helping hand to the nation's taxpayers. Congress may well remove the distress of income-tax debt from the unfortunate whose incomes fail, and the fear of income-tax debt from the rest of us.

Broadly speaking, what will the plan accomplish?

The Pay-As-You-Go income tax plan is a three-way plan.

First of all, it is a plan that will relieve thousands of citizens from hardship and distress arising from income-tax debt, and that will bring peace of mind to millions more who are in income-tax-debt danger.

Second, it is a method for clearing the decks for an all-out war-financing program. If we can all be free of income-tax debt on the first of next year, we can start on a pay-as-you-go basis and stay there. If we need high withholding taxes we can have them; if we need to supplement voluntary savings with compulsory savings, we can do that too. But whatever is called for, it would be paid out of the current year's income as an assessment on the same year's income. We would not be paying for dead horses while we are fighting a war.

In the third place, the Pay As You Go income tax plan is the best kind of financial planning for the post-war period. Our policies can then be forward looking, not backward looking. **We will not be trying to collect income taxes from**

people who are unemployed; we will not be debating whether we should collect taxes on 1941 incomes from men demobilized from the armed forces. We will not have a spending spree in the first little boomlet, financed on unpaid taxes, and then a tax-debt headache if incomes should drop off for a year or so.

The chances of getting the new year 1943 on a pay-as-you-go basis seem to me to be distinctly good. I feel that a Pay-As-You-Go plan in a form acceptable to Congress will certainly be adopted, because income-tax payers want to pay their taxes on a current basis, they want to be free of income-tax debt and they know it can be done without hurting the Treasury and without paying two years' taxes in one. The taxpayers know that Pay-As-You-Go solves the problem simply and fairly by skipping an income-tax year. They know the whole trouble was caused by a basic defect in our income-tax law which has existed from the beginning, that of paying a tax on last year's income out of this year's receipts. This defect was not their fault and they know it. They want it corrected and they want to be on a pay-as-you-go basis in 1943.

Enough time has elapsed since the plan went to the Treasury and since it was made public before the Senate Finance Committee to permit the development of criticism, suggestions, and modifications of the plan. The critics have not been negligent and I feel sure that the objections which have been raised are the result of painstaking examination. At the same time, the lack of force in the objections which have been made to the plan has been apparent to press and public alike and has been the subject of nation-wide comment.

It seems to me that we are rapidly approaching the time when the Pay-As-You-Go plan will be in the realm of legislative action. The needed decisions and compromises are the appropriate responsibility of Congress. The evidence is in. Let us have earnest consideration and early action.

As a nation of individuals we will be better able to meet the present and to attack whatever the future has in store for us if we are paid out of our income tax, **and, being out of income-tax debt, we can pay as we go out of what we earn.**