BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

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To Chairman Eccles

From Richard A. Musgrave R.A.M.

Subject: Treasury Meetings on Postwar Tax Policy

The Treasury group on Postwar Tax Policy continued to meet weekly or more frequently during the last month or so, and is now about to draft a report with recommendations for postwar tax adjustments. I expect to have a draft of the report within a week or two.

In the draft recommendations will be made for tax legislation in 1945 and 1946 to become effective for those two years and there will also be suggestions for the later postwar period. The recommendations for 1945 and 1946 will be made on the basis of certain assumptions regarding the termination of the war and may have to be readjusted later. As it appears now, the following approach will be taken although it is still subject to change:

1) Level of yield -- The report will shoot at a yield level of approximately $22-$23 billion (including payroll taxes) on the basis of a $140 billion national income. Thus the proposed revenue goal will be higher than that suggested by the CED, Ruml-Sonne, etc.

2) Excess Profits Tax -- It will be recommended that the excess profits tax should be repealed effective approximately six months after the termination of the Pacific War. After the termination of the European War it is recommended that the excess profits tax rate be reduced somewhat, perhaps to 65% and that specific exemptions be increased so as to exclude the bulk of small corporations. The carry-back of unused excess profits credits is to be repealed together with the excess profits tax sometime after the end of the Pacific War.

3) Corporation Income Tax -- On the whole the report will argue against a decimation of the corporation income tax but will meet the double taxation of dividend argument to some extent by proposing that the corporation be permitted to exclude from its taxable income one-half of dividends paid out. Given a 40% corporate rate, this would mean a 20% rate on distributed income and a 40% rate on retained income although probably the basic rate will have to be reduced to 35%. In addition specific exemptions under the corporation income tax are to be increased and a certain amount of income, perhaps as much as $100,000, is to be considered as distributed for statutory purposes. This latter provision will permit smaller corporations to retain without tax penalty all the funds needed for expansion.

For a number of reasons this approach is considered preferable to the alternative of giving credit for dividend income on the individual level. One main reason is that the latter approach is likely to lead to an excessively low corporate rate or an excessively high basic individual rate because it would be argued that in order to avoid refund problems, the two rates ought to be the same.

Also it will be recommended that capital gains and losses be treated like other corporate income and that the carry-foward of losses be extended to five years. The recommended timing for the corporation income tax adjustment has not yet been decided upon but it is agreed that there ought to be some relief under the corporation income tax when the excess profits tax is reduced.

4) The capital stock tax and assessed value excess profits tax are to be repealed at an early date after victory in Europe.

5) Personal Income Tax -- A yield from the personal income tax of approximately $13 billion is anticipated. It is recommended that exemptions be increased to $600 per person and a basic rate of around 13% is expected. The top bracket rate will be set at 65% but it is not yet agreed upon at which level this rate should be reached.

Taxation of future issues of state and local securities will be recommended.

6) Excise Taxes -- A substantial reduction in excise taxes, with the exception of liquor and tobacco, will be recommended.

7) It will be recommended that estate and gift taxes be tightened and coordinated so as to close loopholes.

8) As a part of the tax program it will be recommended that Social Security Benefits should be extended but that payroll taxes should not be raised beyond the one-point increase scheduled for January 1, 1946.