3/16/45

Chairman Eccles:

Attached is a summary of Treasury and Joint Committee staff recommendations for tax revision after V-E day. You may wish to begin with the Summary on page 4.

R. A. M.

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date March 16, 1945

To Chairman Eccles

From Richard A. Musgrave R.A.M.

Subject: Revenue Legislation for the Transition Period

At Wednesday's meeting of the Inter-departmental Tax Committee, Mr. Blough reported on the progress of his negotiations with Colin Stam, Chief of Staff of the Joint Committee for Internal Revenue. After having presented extensive background material, the two staffs have now been asked to supply the Committee with recommendations for tax legislation after V-E Day. The recommendations cover the transition period and termination of the excess profits tax only. Nothing is said as yet about later corporation and personal income tax adjustments.

Agreement is near on the following program:

1. Rate Reductions. No "substantive tax reductions" are to be made until the war on both fronts is over. A possible exception to this is Point 5 below.

2. Speed-up of Carry-back Provisions Under the Excess Profits Tax. Various measures are to be taken to speed up the availability of carry-back refunds so that these funds can be used for reconversion.

If the European war ends in 1945, taxpayers are to be permitted to anticipate carry-back claims expected to arise in the income year 1946 when filing their return for 1945, and to offset such anticipated refunds against liabilities on 1945 income. It is understood that these anticipated carry-backs are subject to later revision when the final return for the year 1946 is filed. In case of grossly unjustified anticipation of carry-backs, a penalty is provided. A year's interest will have to be paid on the amount of anticipated and allowed carry-back.

A somewhat similar provision is proposed for speed-up on remaining amortization of war plant and equipment. Under present law, war plant constructed under Certificates of Necessity may be amortized within five years and if Certificates of Non-necessity are obtained or termination of the emergency is declared, the unused amortization quota may be carried back at once and fully against the preceding years. Under present procedure, filing of refund claims is followed by extensive auditing which requires from 12 to 18 months before payments can be made. Under the new procedure the refunds would be paid promptly within sixty days and would then be subject to later auditing and final settlement.

It is clearly understood that these provisions are not to go into effect until after V-E day. If the war in Europe is terminated in Spring or early Summer and legislation can be passed in time, these provisions may go into effect for the third and fourth instalment on the income year 1944, payable in June and September of this year. If V-E day comes later, but still in 1945, these provisions would go into effect in 1946. Legislation introducing these speed-ups may possibly be undertaken prior to the end of the European war, with the proviso however that the speed-ups would go into effect only after the war in Europe is ended.

It should be noted that these speed-up provisions do not involve any change in tax liability but are merely a matter of timing. Mr. Blough indicated that all business groups are very strongly in favor of this adjustment as well as Mr. Hinckley, the Reconversion Cost Subcommittee of the Baruch-Hancock Group and Randolph Paul who made these proposals over a year ago. Mr. Ruml would like to go even further.

3. Discontinuation of Postwar Credit Provisions under the Excess Profits Tax. Again on the condition that the European war is ended, it is proposed that the 10 per cent postwar credit for the tax on 1944 income may be taken currently and be deducted from the last two instalments payable this year. Similarly, the credit could be taken currently against the tax on the income year 1945 payable in 1946. It will also be proposed that the bonds issued in 1942 and 1943 will be paid in cash on January 1, 1946, although there is still some doubt about the latter point.

4. Termination of Excess Profits Tax. While it is agreed (1) that there should be no "substantive tax reduction" while the war on either front lasts, and (2) that later peacetime tax adjustments should not be considered now, Stam insists that something should be said about terminating the excess profits tax. He now agrees that it would be bad to cut the excess profits tax while the Pacific war continues but is extremely anxious to give the businessmen some definite idea as to when the excess profits tax will be discontinued.

The following proposals on termination of the tax have been agreed upon:

> If the war on both fronts should end prior to June 1945, the tax would continue to apply to the income year 1945 but be discontinued for the income year 1946.
>
> If the war on both fronts ends in 1945 the excess profits tax will be continued for the income year 1946 at a reduced 65 per cent rate.
>
> If the war on both fronts ends in 1947, the full tax is to apply on 1947 income but will be discontinued for 1948 income.

If the war on both fronts ends in 1946 or later, the excess profits tax is to continue at the full rate on 1946 income.

On the whole Stam's agreement to this schedule is a substantial improvement from the Treasury point of view since originally Stam wanted to insist on a rate reduction on the excess profits tax after V-E day but before victory in the Pacific. As the arrangement now stands, the tax will continue at the full rate through the income year during which the Pacific war ends. The provision referring to victory on both fronts prior to June 1945 looks rather dubious but it was felt that the assumption is so unrealistic that it makes no difference anyhow.

The unused excess profits credit carry-back is to be discontinued together with the excess profits tax itself. Thus, if 1946 is the last income year to which excess profits tax rates apply, this will also be the last year for which a credit can be claimed. There is, however, the exception that if the war should end on both fronts prior to June of this year and the tax be discontinued for next year, the credit carry-back would nevertheless continue for 1946. Again, this would not seem of much importance because the assumption is too unrealistic.

The loss carry-back provision is to continue for one year after the excess profits tax is discontinued. This was felt to be fair since the loss carry-back would be claimed only by those who are particularly hard hit by the transition period.

The specific exemption under the excess profits tax is to be raised as of January 1946 from $10,000 to $25,000 if the European war is over.

5. Capital Stock and Declared Value Excess Profits Tax. It is generally agreed that these taxes are a nuisance and that they should go out as soon as possible. Present discussion with Stam indicates that they should be discontinued for the first year after the termination of the European war. However, this would be incompatible with the principle of "no substantive rate reduction while the war lasts" and may therefore have to be reconsidered.

6. General Considerations. It was Mr. Blough's intention to have these recommendations preceded by a preamble stating in rather strong and explicit terms that they are made on the assumption that underlying economic developments after V-E day and V-P day will be such as to render them desirable. Mr. Stam is insistent, however, that the recommendations with regard to termination of the excess profits tax be made without such conditional

clause and it looks as if Mr. Blough will be willing to yield the point. However, he believes that it will be possible to introduce some phrases which will leave an "out" if conditions require it. He feels that the omission of an explicit conditional statement may not be too bad since this report is not to be given to the public but only to the Committee. However, I indicated to him that you would probably be in strong disagreement with this.

SUMMARY

The staffs of the Joint Committee and the Treasury (Mr. Stam and Mr. Blough) will present to the Joint Committee certain proposals for tax legislation in the transition period. They will cover:

1. Speed-up of carry-back provisions to become effective after V-E day. These will not include any rate reductions but make carry-back refunds available at an earlier date by permitting them to be offset against current liabilities. Legislation on this point may be expected perhaps in late Spring or early Summer, depending on the course of the European war.

2. General considerations determining the termination of the excess profits tax. The tax will continue at the full rate until after the Pacific war and will be discontinued for the income year following termination of the Pacific war. The excess profits credit carry-back will be discontinued with the tax, the loss carry-back will be retained for one year thereafter.

3. The capital stock and declared value excess profits tax to be discontinued for the income year following victory in the Pacific or possibly earlier.

Originally it was intended to precede these recommendations with a strong conditional statement that they should go into effect only if conditions permit, but Mr. Stam is insistent that the excess profits tax recommendations be made without such proviso. Mr. Blough may yield the point because he feels that Stam has been willing to give in on other matters and that it will be possible in any case to introduce some conditioning sentences which will give an "out" if necessary. I want to bring this to your attention because you may wish to voice your objections.

With the exception of omitting the conditional statement, these recommendations appear quite reasonable if it is assumed that by and large the transition period will be on the deflationary side.