

STATEMENT OF MARRINER S. ECCLES
PRESENTED BEFORE
WAYS AND MEANS COMMITTEE

May 7, 1941

Mr. Chairman and members of the Committee: When I was advised of the Committee's request that I appear here today, I undertook to prepare as briefly as possible a general statement of my views on the vitally important tax program which you are engaged in formulating. I would appreciate an opportunity to read the statement first, and then to answer such questions as you may wish to ask. In what I have to say on this subject, I speak only for myself and not for the Board of Governors of the Federal Reserve System.

At the outset I desire to say that I am fully in accord with the proposal of the Secretary of the Treasury that \$3.5 billions of revenue needed for defense be raised from taxation. Likewise, I agree with the objectives of taxation policy set forth by the Secretary when he appeared before this Committee. As he stated then, the purpose is to design our tax program, first, so that we may pay as we go for a reasonable proportion of our expenditures; secondly, so that all sections of the people shall bear their fair share of the burden; third, so that our resources may be mobilized for defense while reducing the amount of money that the public can spend for comparatively less important things; and finally, so that a general rise in prices may be avoided by keeping the total volume of monetary purchasing power from outrunning production.

As a nation we cannot get rich by devoting a large part of our energies and resources to producing the things of war instead of the things of peace. Our standard of living must inevitably suffer. That entails sacri-

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fices which should be borne by all of us. No group should be permitted to profit out of this great national emergency at the expense of other groups. Taxation is the most important instrument of Government in bringing about an equitable distribution of the costs of defense, in preventing profiteering and price inflation.

We know that as the national income rises through defense expenditures, the incomes of many corporations and individuals will be greatly increased. Taxes should be levied in such a manner as to bring back to the Treasury as much as possible of the Government's expenditures. In keeping with democracy, taxation for this purpose should be based on income and ability to pay. Only in this way can we avoid inflationary developments.

With such general principles we are all likely to agree readily enough. When it comes to applying the principles, as the members of this Committee know from long experience, there are always some groups that hope to escape, or hope to shift their fair share of taxation to other groups. In the suggestions I have to make I have sought to apply these principles as fairly and equitably as possible.

Thus, it is my belief that the first source of defense revenue should be the corporation tax and the excess profits tax because, generally speaking, corporations are the greatest beneficiaries, directly and indirectly, from defense expenditures. The proceeds accruing from the expanding national income tend to become concentrated in the first instance in the possession of business corporations. The most certain way to insure against inflation is for the Government to levy on these earnings and divert the proceeds directly

into the defense program before they are distributed into the general income stream through higher wages and higher dividend payments. If these surplus funds are not thus collected in the first instance at the source, but are later distributed through large wage increases and large dividend payments to the community, it becomes necessary subsequently for the Government to abstract excess incomes through the personal income tax, excise taxes, and other forms of mass taxation. The problem is not avoided but only delayed and made more difficult by failure to tap the profits at the source.

High taxation of personal income and excise taxation will be necessary in any event, but the amount needed from these sources will be reduced by a prior collection at the points where the profits originate, namely, in the business units. If excess profits are not tapped, they will lead to demands for higher wages. Apart from the question of equity and the problem of allaying industrial unrest, is the question of going directly to the source of the increased flow of income and diverting it into the defense program before it spreads out into the community and adds private mass purchasing power on top of the Government's demands springing from the defense program.

With increased surtax rates, especially in the middle income brackets, and in the absence of an undistributed profits tax, there will be a tendency on the part of some corporations to hold back disbursements of dividends. This is a further reason for heavy normal and excess profits taxes on corporations.

After we have strengthened our corporation taxes to collect a substantial part of the increased national income at its point of origin, we should

rely predominantly on the individual income tax and on estate and gift taxes to meet most of our remaining revenue requirements. These taxes are based on the established principle of ability to pay. The normal tax and surtaxes on individual incomes have been moderate, compared with other countries, except in the very highest income groups. They can and must be substantially increased. With expanding employment and payrolls resulting from defense expenditures, it is equitable and necessary that some of the benefits be recovered by the Treasury. Exemptions should be reduced, thereby spreading the base and increasing the number of income taxpayers. This is a more direct and equitable way of raising revenue from the lower income groups than by imposition of indirect excise and sales taxes.

To the extent that prices are controlled and wages are then increased, corporation profits, subject to the excess profits tax, are less than they would be otherwise. Federal revenue from this highly productive source would be accordingly diminished, and the Government would, in effect, be paying most of the wage increase. Under these circumstances, it is necessary for the Government to recover some of this loss of revenue. This can be done by broadening the individual income tax base and increasing the rates.

I am opposed to a general sales tax, or to an increase or imposition of excise taxes except where it is necessary to curtail civilian demand for products needed in defense, thus preventing inflation.

Sales taxes may have been appropriate in poverty-stricken countries of the Old World where governments must extract revenue from their citizens in any fashion that is expedient. They are not appropriate taxes in this

country where other sources of revenue are ample and the people are prepared to support an equitable tax program by the payment of direct taxes. Consumer expenditure can be restrained either by an increase in income tax, or by a tax on articles of mass consumption. The difference lies in the fact that the individual income tax does this frankly, directly and on the basis of ability to pay. A tax on articles of mass consumption does it indirectly and in a manner that makes the tax proportionately heaviest on those least able to pay. Indirect taxation is taxation by autocracies, income taxation is democratic taxation.

Our existing tax structure is already heavily weighted with regressive taxes. According to the estimates furnished to this Committee by earlier witnesses, the income group below \$500 paid 22 per cent of its income in taxes of all sorts in 1938-39, while those groups with incomes of from \$500 to \$10,000 averaged approximately 18 per cent. Inasmuch as increases in individual income tax rates will curtail purchase of luxury and semi-luxury goods, it is not advisable at this time to impose further sales taxes on such articles in the interest of defense.

The only appropriate role for further excise taxes in our present economic situation consists in limiting the civilian demand for durable goods competing with defense.

Selective sales taxes, which would have the effect of reducing demand for such products as automobiles and other articles that compete with defense production for materials, man power or plant facilities, are justifiable and necessary at this time. Such selective taxes, by curbing demand in specific

fields, will release facilities needed for defense production. Sales taxes on foodstuffs, clothing and other necessities of which we have surpluses are entirely unwarranted, however. They would tend to throw out of work in various localities men who could not be absorbed into defense industries, or to make idle facilities that are not needed for defense.

While I am, therefore, in general agreement with the Treasury's program both in its aggregate amount and in the general type of taxation it provides, I wish to suggest certain changes in emphasis with respect to the sources of revenue on which it draws. Accordingly, I should like to describe in some detail the changes that I believe would more nearly realize the objectives which I have set forth.

I. Excess Profits Tax

In my opinion an effective excess profits tax is the keystone of a well balanced tax program. Any tax program will have to include a substantial increase in the rates of taxation for corporate incomes in general and for individual incomes. You should not impose increased taxes on the great numbers of business concerns of small and moderate size and on millions of individual taxpayers until you have given them every reasonable assurance that the funds they are being asked to provide will not go to swell the excessive profits of some corporations.

The excess profits tax now on the statute books does not give any such assurance. If you allow the idea to take root in the public mind that through these vast expenditures a few are being made rich and a few who are already rich considerably richer, the result is bound to endanger the success of

our defense effort. In order to prevent an inflationary spiral of price and wage increases, labor should be willing to moderate its demands for increased wages, but labor cannot be expected to follow such a course if employers are permitted to retain excessive profits.

The Treasury has suggested that an additional \$400 millions of revenue be obtained by amending the excess profits tax. I believe \$800 millions to \$1 billion of additional revenue can and should be obtained from this source. The revenue-yielding potentialities of an excess profits tax were well demonstrated by our own experience during the World War. The present statute could be made to realize those revenue potentialities by changes in a few important respects. I shall mention three.

1. Restrict the use of the income method of computing the excess profits credit, either by reducing the 95 per cent of past average earnings now allowable to 75 per cent, or by any other method that may recommend itself to the Committee. I agree with Mr. Sullivan's view that all excessive profits, as well as profits directly or indirectly attributable to the defense program, should be subject to special taxation.

2. Increase sharply the rates now applicable to excess profits. In the light of the maximum 80 per cent rate in force in this country during the last World War, a maximum rate of 75 per cent is not too high. It is also important that the tax brackets used in the present law be revised. I recognize the strength of the arguments for graduating the rates according to the percentage of excess profits to invested capital, the method used at the time of the World War, but if the present method is continued, there is no reason why the maximum rate should not apply to excess profits at a very much lower level than \$500,000. A corporation with this amount of excess profits cannot fairly claim favored treatment as a small enterprise.

3. Reduce the rate of return allowed under the invested-capital method of computing the excess profits credit from the present figure of 8 per cent to 6 per cent. The figure of 8 per cent was used during the days of the World War. The rate of return that investors could reasonably hope to realize on investment in securities has been materially reduced since that time. We should make a similar adjustment in our ideas about an appropriate rate of return on equity capital.

II. Surtax on Corporation Income

If the excess profits tax is revised along the lines I have just indicated, it will then be fair and reasonable to ask American corporate enterprise as a whole to pay the surtax on corporate net income which the Treasury proposes. The argument for enacting a surtax, instead of raising the rate of the corporation normal tax, seems to me to be clear and convincing. Since we have now stopped issuing tax-exempt Federal securities, there is no reason why we should confer additional tax benefits upon holders of outstanding securities by further increasing the normal corporation income tax rate.

III. Individual Income Tax

If the tax principles to which most of us adhere are to be effectively implemented, a substantial increase in the individual income tax must play a major part in the tax program now undergoing formulation. I am in accord with the view that the present normal tax and the present earned income credit be retained, and I agree also with the proposal that the present \$4,000 surtax exemption be abolished. I have felt, however, that the Treasury's suggested surtax rates impose too abrupt an increase on the middle brackets of individual

incomes. I should recommend, instead, a somewhat less drastic revision in the surtax schedule, combined with a reduction in the married persons' exemption to \$1,500 and in the credit for dependents to \$300. I should like to leave with the Committee a detailed schedule of rates which I have had prepared along these lines. No additional defense tax would be superimposed on the tax resulting from the application of these rates. According to our estimates the changes in rates and in exemptions which I propose would yield \$1.2 billions of additional revenue.

The middle income groups include many salaried people and others living on relatively fixed incomes who would be especially hard hit by even a small rise in the cost of living. Too drastic an increase in their tax bill would necessitate many difficult and painful readjustments which it would seem unwise to impose suddenly. It is for this reason that I urge some modification of the Treasury's proposed rates in this range of incomes.

At the same time, I attach great importance to the changes in the married persons' exemption and credit for dependents which I have proposed. Without some such broadening of the individual income tax base, this tax cannot perform its full job in financing defense. An important segment of the national income, including the incomes of many skilled workers who are receiving substantial wage increases as a result of the defense program, is now excluded from the individual income tax base. Unless we tax the incomes of the better-paid wage earners through progressive taxation, we may be unable to resist the pressure for taxing such incomes and our very lowest income groups as well, through the inequitable, shot-gun method of a sales tax. Any tax program which

failed to include such a broadening of our tax base would be unbalanced.

Should more revenue be required in the future, a further broadening of the income tax base would be preferable to additional sales taxes.

IV. Estate and Gift Taxes

The strengthening of estate and gift taxes is one of the most needed reforms in our whole tax structure. In a message to Congress in June 1935, the President said:

"The transmission from generation to generation of vast fortunes by will, inheritance or gift, is not consistent with the ideals and sentiments of the American people. Such inherited economic power is as inconsistent with the ideals of this generation as inherited political power was inconsistent with the ideals of the generation which established our government."

The task, begun in the Revenue Act of 1935, of bringing law into conformity with our American ideals should be completed now.

For this reason I am thoroughly in accord with the Treasury proposals, but for this reason I believe also that we should go a great deal farther. Even a lowering of exemptions and a considerable increase in the rates of estate and gift taxation are only a part of the task. The avenues for tax avoidance are both broad and numerous under our existing system of estate and gift taxes, and so long as these avenues are allowed to remain open, the task of bringing transfers of wealth within the framework of a progressive tax structure will remain incomplete. A rather extensive redrafting of existing statutes is, therefore, essential.

Since detailed recommendations on methods of closing existing loopholes can be furnished only by qualified legal experts, I shall merely indicate

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the general principles which, in my judgment, should guide the revision of our estate and gift tax laws. I think there is little disagreement regarding the underlying purpose of estate and gift taxes. It is to subject the passage of wealth -- from individual to individual and from generation to generation -- to an effective system of taxation at graduated rates. The amount of tax ought not to depend in any significant degree upon the form in which wealth is transmitted -- whether directly or through life insurance or through tax-avoidance trusts -- nor upon the time of transfer -- whether during life or at death. The following proposals are presented with these considerations in mind:

1. For the present exemptions of \$40,000 under the gift tax, \$40,000 under the estate tax and an additional \$40,000 for life insurance -- a total of \$120,000 -- there should be substituted a single, consolidated exemption of \$40,000 applicable to the sum of gifts and estate, including insurance proceeds.
2. Because the gift tax schedule is 75 per cent of the corresponding estate tax rates, many people have inferred that the net saving through transfers by gift is only 25 per cent. This inference is incorrect. At present tax liability at the highest estate tax rates to which an estate would be subject can be avoided by incurring tax liability at the lowest gift tax rates. This type of avoidance can be prevented only by combining gift and estate taxes into a single tax on transfers of wealth. I prefer to leave to lawyers the explanation of the several possible methods of effecting such a consolidation. If consolidation were effected the taxpayer would be free to choose how much of his property to dispose of during life and how much at death, but his tax liability would not be influenced by his decision. Until this step is taken, the opportunity to save a great deal on estate tax by payment of a small gift tax will remain open.
3. Under existing statutes estate and gift taxes can frequently be either entirely avoided or substantially reduced through the use of various devices involving long-term trusts. This avenue of avoidance should be closed, so that the estate tax may reach all transfers of property from one generation to another.

V. Consumer Taxes

For the reasons previously indicated, excise taxes should be imposed only on consumers' durable goods. The rates should be substantial and should be fixed to achieve the required degree of curtailment in civilian demand. Although revenue should not be the primary consideration in fixing the level of rates, the revenue obtained from this source will be large. Adequately high rates on this range of goods should yield close to one billion dollars.

A large part of this revenue can be obtained through taxation of automobiles alone. The automobile industry has already committed itself to curtailing production by 20 per cent in its next model year, at a time when the national income, and the civilian demand for new cars, are rising rapidly. A rise in prices of considerable magnitude is in prospect. The Government should take a much greater share of the increased price people will be paying for both new and used automobiles than the Treasury proposes. A tax of 20 per cent on all automobile sales would be more appropriate than the suggested rate of 7 per cent on new cars only.

Increase in the tax on gasoline and other commodities that are in abundant supply will make no significant contribution to our defense effort. The proposed check tax is another case in point. Checks, rather than currency, are used to settle some 80 per cent of our total transactions. There is no more reason to tax checks than currency payments. For many it will be a simple matter to avoid the tax by using currency instead of checks. Depositors of small means, already subject to bank service charges, will be the group most likely to avoid the tax in this way, but they will thus be deprived of a safe and convenient way of making money payments, as well as a record of receipts

and payments. The tax will not come out of bank earnings, but will be charged to the individual accounts.

VI. Revenue Yield

The following table, which I ask permission to insert in the record, summarizes the yields from various revenue sources under the suggestions I have made. There is no significant difference between the aggregate yield of this program and the Treasury proposals.

(Yield in millions of dollars)		
Source		Yield
Corporation incomes:		
Excess profits tax (lower credits, raise rates)		900
Surtax as proposed by Treasury		534
Individual incomes:		
Increase in surtax rates, reduction of married person's exemption and credit for dependents		1,200
Estates and gifts (close loopholes, raise rates)		500
Excise taxes, primarily on durable goods		<u>950</u>
Gross yield		4,084
Less: Loss of excess profits revenue due to surtax on corporate income	300	
Loss of individual income taxes due to increases in corporation taxes	<u>150</u>	<u>450</u>
Net yield		3,634

EXISTING AND PROPOSED SURTAX RATES

Surtax net income (\$000)	Existing		Proposed	
	Rate (per cent)	Total surtax on upper limit	Rate (per cent)	Total surtax on upper limit
0 to 1	0	0	4	40
1 to 2	0	0	6	100
2 to 4	0	0	10	300
4 to 6	4	80	14	580
6 to 8	6	200	18	940
8 to 10	8	360	21	1,360
10 to 12	10	560	24	1,840
12 to 14	12	800	27	2,380
14 to 16	15	1,100	29	2,960
16 to 18	18	1,460	31	3,580
18 to 20	21	1,880	33	4,240
20 to 22	24	2,360	35	4,940
22 to 26	27	3,440	38	6,460
26 to 32	30	5,240	43	9,040
32 to 38	33	7,220	47	11,860
38 to 44	36	9,380	51	14,920
44 to 50	40	11,780	54	18,160
50 to 60	44	16,180	58	23,960
60 to 70	47	20,880	61	30,060
70 to 80	50	25,880	64	36,460
80 to 90	53	31,180	66	43,060
90 to 100	56	36,780	67	49,760
100 to 150	58	65,780	69	84,260
150 to 200	60	95,780	70	119,260
200 to 250	62	126,780	71	154,760
250 to 300	64	158,780	71	190,260
300 to 400	66	224,780	72	262,260
400 to 500	68	292,780	73	335,260
500 to 750	70	467,780	74	520,260
750 to 1,000	72	647,780	74	705,260
1,000 to 2,000	73	1,377,780	75	1,455,260
2,000 to 5,000	74	3,597,780	76	3,735,260
5,000 and over	75	---	76	---

INCOME TAX: COMPARISON OF PRESENT AND PROPOSED INDIVIDUAL INCOME TAXES
 ON NET INCOMES OF SELECTED SIZES; MARRIED PERSON, NO DEPENDENTS
 (Maximum earned income credit)

Net income before personal exemption	Amount of tax ^{1/}				Effective rates ^{1/}			
	Present law	Treasury	Stam	Eccles	Present law %	Treas-ury %	Stam %	Eccles %
\$2,000	0	0	0	\$32	-	-	-	1.6
2,500	\$11	\$72	\$44	70	0.4	2.9	1.8	2.8
3,000	31	152	97	118	1.0	5.1	3.2	3.9
4,000	70	312	202	234	1.8	7.8	5.1	5.9
5,000	110	506	352	370	2.2	10.1	7.0	7.4
6,000	150	700	502	526	2.5	11.7	8.4	8.8
8,000	317	1,131	889	898	4.0	14.1	11.1	11.2
10,000	528	1,628	1,364	1,345	5.3	16.3	13.6	13.5
12,500	858	2,316	2,013	1,990	6.9	18.5	16.1	15.9
15,000	1,258	3,073	2,853	2,729	8.4	20.5	19.0	18.2
20,000	2,336	4,800	4,756	4,429	11.7	24.0	23.8	22.2
25,000	3,843	6,824	7,055	6,394	15.4	27.3	28.2	25.6
50,000	14,128	19,540	20,794	19,234	28.3	39.1	41.6	38.5
75,000	27,768	35,127	36,689	35,184	37.0	46.8	48.9	46.9
100,000	43,476	52,474	54,124	52,639	43.5	52.5	54.1	52.6
500,000	330,156	346,122	347,598	354,049	66.0	69.2	69.5	70.8
1,000,000	717,584	738,086	739,598	744,034	71.8	73.8	74.0	74.4
5,000,000	3,916,548	3,937,050	3,938,598	3,934,004	78.3	78.7	78.8	78.7

^{1/} Under the Treasury and Stam proposals, the 10 per cent defense tax would be retained; under the Eccles proposals it would be dropped.