Taxation Developments

Exhibit 19.—Extract from the Budget Message of the President, January 17, 1955, on tax policy

Last year we made great progress in reducing tax burdens and improving the tax structure. Total tax reductions of 7.4 billion dollars became effective. This was the largest tax reduction in any single year in the country's history. It was made possible only by large cuts in Government expenditures. The basic tax law was revised to relieve hardships for millions of individuals and to reduce tax barriers to economic growth.

The budget would have been balanced for the current fiscal year if there had been no tax cuts. However, it was desirable to share the benefits from the large expenditure reductions. This enabled the people to have the extra money to spend for themselves which they retained because of the reduction in their taxes.

In view of the prospective deficit, we cannot afford to have any further loss of revenue this year through reductions in taxes. The corporate tax rate would be automatically reduced under existing legislation from 52 to 47 percent on April 1 with a revenue loss of about 2 billion dollars for a full year unless extended. Under existing law, the excise taxes on liquor, tobacco, gasoline, and automobiles would also be automatically reduced on April 1, with a revenue loss of 1 billion dollars unless appropriate legislation is enacted by the Congress extending them.

In the fiscal year 1956, there will be an automatic revenue reduction (as compared with 1955) of almost 2 billion dollars under existing law, wholly apart from any changes in tax rates. The principal reason is the completion of the plan adopted 5 years ago under which payments of corporate taxes have been moved forward into earlier fiscal years. Fortunately, this reduction in 1956 will be more than offset by increases in revenue due to the economic growth of the country.

Because we must keep our existing revenues intact, I have already recommended to the Congress in my State of the Union Message that existing rates on both excises and corporate incomes be extended for 1 year. Any other course of action would result in either (1) inadequate expenditures for national security, or (2) inflationary borrowing.

During the past year the Treasury Department has continued to examine possible changes in the tax laws concerning which no recommendations were made in the revision of the tax laws last year. As final conclusions are reached by the Department they will be sent to the Congress.

I have also directed the Secretary of the Treasury promptly to make recommendations for any other changes in the laws which may be found necessary to prevent anyone from avoiding his fair share of the tax burden.

The present tax take of nearly one-fourth of our national income is a serious obstacle to the long-term dynamic growth of the economy which is so necessary for the future. There must be the means for providing more and better jobs not only for those who are working today but also for the millions of young people who will come of working age in future years. The stimulus of further tax reductions is necessary just as soon as they can properly be made.

We must always make adequate provision for our security and other essential services, and further tax reductions can only be made as savings in governmental expenditures or increased revenues resulting from growth in our economy are in sight.

However, further tax reduction remains a firm goal of this administration, and our policy is directed to achieving both the savings in expenditures and the economic growth that will make such reductions possible.

I hope that tax reductions will be so justified next year. If so, I shall recommend a reduction in taxes to spread the relief fairly among all taxpayers in a way which will be the most effective to relieve individual tax burdens and to increase incentive for effort and investment.

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Exhibit 20.—Statement by Secretary of the Treasury Humphrey, February 28, 1955, before the Senate Finance Committee urging rejection of the $20 tax cut proposal

I am very glad to appear before your committee on this very important matter. I have a short statement, and then I will be prepared to try to answer such questions as may occur to members of the committee.

Your committee has before it this morning a $20 tax cut which was suddenly sprung on the Ways and Means Committee and hurriedly passed through the House of Representatives last week by a scant margin of only five votes with only a limited hearing and no time for thoughtful consideration.

I strongly urge the Senate Finance Committee to reject this proposal as completely contrary to the public interest.

President Eisenhower asked the Congress to continue responsible financial management of the Government's affairs by extension of (1) the corporate income tax rate of 52 percent and (2) the excise taxes on tobacco, liquor, et cetera, both of which otherwise would go down automatically on April 1. These two extensions will give the Government $2.8 billion in revenue and will help to continue the progress toward lower deficit financing and a balanced budget.

The $20 proposal has been hastily tacked on as an amendment to this sound bill.

This $20 proposal would give every taxpayer a reduction of $20 for himself, his wife, and each dependent. It would take about 5 million taxpayers completely off the Federal income tax rolls. And it would lose about $2.3 billion of revenue in a full year.

Now, why is this $20 proposal contrary to the public interest? It is contrary to the public interest because it means reversing the successful trend during the past 2 years in cutting deficits and working toward a balanced budget. The budget deficit for fiscal year 1953 was almost $9½ billion and a deficit projected for fiscal year 1954 was nearly $10 billion.

We cut planned spending in fiscal year 1954 by more than $10 billion. We cut the deficit in fiscal 1954 by more than $6 billion and so moved two-thirds of the way toward a balanced budget. With these spending cuts firmly in sight we cut taxes by $7.4 billion, the largest single tax cut in history.

This administration advocated further tax cuts but only at such times as we can see them justified by further cuts in spending and increased revenues from economic growth that broadens the tax base.

The President said in his State of the Union Message, "I am hopeful that such reductions can be made next year." Both the President's budget message and his economic report also expressed hope for a tax reduction next year but only if expressly justified by spending cuts and increased income from economic growth.

To vote a $20 tax cut now, before we know we can afford it next year, and without any indication of where the money is coming from is nothing but an irresponsible gesture. It is based only on hopes as yet entirely unrealized which may well turn out to mean heading back into heavy deficit financing, with all the inflationary dangers that such borrowing means for the American people.

There has been some misleading talk about justifying the $20 proposal on the ground that the "little folks" have been entirely neglected. Let's look at the record. The $7.4 billion tax cuts last year included an income tax cut for every taxpayer in America. The cut averages about 10 percent for all the lower income taxpayers but was scaled down to only about 2 percent for the highest bracket incomes. These reductions applied to every single taxpayer in this Nation.

Excise taxes were cut by a billion dollars on goods of everyday use. And millions upon millions of Americans got tax reductions in relief provisions for retired people, widows, working parents, and the sick or hospitalized. These reductions were predominantly in the low-income group.

But even more important is the fact that this administration has been slowly getting the Government's financial affairs under control to help the economy expand and so make constantly more and better jobs.

A job is more important than a tax cut.

The investment of money in tools, plants, and equipment which makes jobs has been stimulated. Confidence has increased in the Government and in the maintenance of sound policies in the future as well as in the ability of our free economy under such policies to constantly develop more and better jobs, better

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living, and more security for all. The economic gains we are now enjoying are firm evidence of the fact that this confidence is justified.

This proposed tax cut is entirely unjustified by firm evidence at this time. If it is paid out of borrowed money requiring additional deficit financing, which is all that is in sight at this moment, it can start us right back on the reckless road of inflation with all its cruel thievery.

Inflation, rampant for several past years, has been checked. The cost of living has not increased now for over 2 years as compared with the fact that it almost doubled in the 15 previous years. This has been worth billions of dollars to millions of Americans.

This checking of inflation has protected not only the full purchasing value of peoples' current earnings but has insured the full worth of their savings in savings accounts, insurance policies, pension funds, et cetera, with which they are trying to provide for their own and their loved ones' futures.

And let us always remember this: that it is not the rich who need protection against inflation. It is the little folks who suffer the most when inflation takes hold in a land.

I hope the committee will vote out a bill excluding the $20 tax cut proposal.

Exhibit 21.—Statement by Secretary of the Treasury Humphrey, March 14, 1955, concerning the tax bill pending in the Senate

The United States Senate now appears to have definitely abandoned the original straight $20 Democratic tax cut plan and I am encouraged to believe that it will reject the unsound $20–10 compromise tax cut proposed in connection with the proper extension of the increased corporation and excise taxes.

As Government spending is being reduced, this administration has taken many steps to help the economy make the transition from high to lower Government spending. One of the principal ways in which our economy is being helped to make that transition successfully was the enactment of last year's tax program, giving tax relief to every taxpayer. We are now on the way up on a broad front. To repeal, as this quickie compromise now proposes, some of the important tax changes which have been helping to make new jobs and better times in this recovery would certainly not be in the best interests of the people.

The American people can be seriously harmed by unwise political tinkering with a tax program which has helped set the present economic recovery in motion. It is entirely misleading to argue that this newest proposal which works against the making of new and better jobs is really in the interests of the "little folks."

Their claims of increased revenue to help to balance this year's budget are fantastic. You don't help pay your way this year by proposing to collect more taxes in the future two or three years from now. You don't help to increase the purchasing power of the "little folks" by repealing the laws which are helping to make their jobs and then claiming to increase their purchasing power by $10 and $20 a year tax reductions which they don't even begin to get until nearly a year from now and then at the rate of but a few cents a week for only part of the people.

Confidence in the Government's handling of its financial affairs in a sound and healthy way is far more important to the people, both to the "little people" they talk so much about and to the great middle class of fine Americans who are the great majority of our total population, than any political quickie gimmick can possibly be.

I hope that the administration's request for extension of both increased corporation and excise taxes will be approved without addition of this latest misleading compromise proposal as a crippling amendment.

Exhibit 22.—Statement by Secretary of the Treasury Humphrey, May 11, 1955, before the Senate Finance Committee urging the repeal of Sections 452 and 462 of the Internal Revenue Code of 1954

Mr. Chairman and members of the committee, I am here today to urge the repeal of Sections 452 and 462 of the Internal Revenue Code of 1954.

The original objective of these two sections, which cover prepaid income and reserves for estimated expenses, was simply to conform tax accounting with

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business accounting. It was never intended that these provisions would result in any substantial loss of revenue or result in windfalls to taxpayers. A review of the consideration of this subject by this committee will confirm the impression held at the time by lawyers, accountants, and businessmen that the basic motive for these provisions was simplification of tax accounting procedures, and not radical tax reductions.

This tax law became effective on August 16, 1954. During the fall, as the knowledge of its provisions increased, there began to be rumors that these particular provisions might not work as originally intended.

Before the end of the year, studies by the Treasury staff, working with the staff of your committee, were undertaken to see if the threatened situation could properly and effectively be cured by regulation. Proposed regulations were issued on January 22. However, until the time came when these provisions began to be put into actual practice by taxpayers preparing their income tax returns and the 30 days expired for protests against the proposed regulations, there was not much reliable information available.

It then developed that there is a sharp difference of opinion between taxpayers and the Government as to the scope of these sections. The tentative regulations issued by the Treasury on January 22, in order to carry out the provisions of the law, have come under strong attack as being too restrictive in limiting the intended application of the sections. Taxpayers have already served notice that they intend to litigate this restriction. Should they be successful in the courts, the revenue loss under the law might be far in excess of anything contemplated by the Congress. As soon as the checks were sufficiently conclusive to satisfy the staff that the original objective might not be carried out and that the situation could not be adequately corrected by regulation, they reported their findings and we promptly called the matter to the attention of the Congress.

The original estimate for several so-called bookkeeping items, of which Sections 452 and 462 were the principal revenue items, was $47 million. The limited check that we have made around the country indicates that the loss would be substantially greater than the original estimates. How much greater it might be we cannot now say because we simply do not have the information as to what the bulk of taxpayers concerned might claim should these provisions remain in the law. And with the litigation that would surely be involved in many cases should the provisions remain, we might not have the final figures on the loss for years to come.

Repeal of these two provision will reinstate the legal rights of everyone just as they were under the old law prior to last August and protect the Government from revenue loss which was never intended by the Congress.

The objective of trying to conform tax accounting with business accounting is still a sound one. In trying to do this, however, a serious mistake was made in not sufficiently limiting the application of the provisions and restricting the revenue impact of the changes as enacted. That is why repeal is required rather than amendment, so as to be sure that in any new approach to the original objective the revenue is adequately protected.

We have studied many proposals to correct the situation by amendment of the sections rather than repeal, but we have found no proposal which we can be sure will accomplish the original objective without giving some taxpayers an unintended advantage or producing very involved technical problems creating uncertainty and litigation.

The Treasury Department is firmly opposed to any tax legislation which gives any American an unfair advantage over another taxpayer. We will always recommend prompt action be taken to correct any situation which can result in windfalls to any taxpayer. To firmly follow out our policy of being as fair and just to all taxpayers as is humanly possible, I am urging outright repeal of the two sections which would have resulted in some taxpayers getting a break over others.

As the chairman knows, I sent the chairman of the House Ways and Means Committee last week a letter stating that none of the other approximately 70 suggestions for perfecting the Internal Revenue Code of 1954 require immediate legislation. With this the chairman of the House Ways and Means Committee agreed in a letter which was made public last Friday along with my letter to him. All of the suggestions considered by the staffs of the Joint Committee on Internal Revenue Taxation, the Ways and Means Committee, and the Treasury, are wholly noncontroversial. More than half are clerical errors, such as misprints, misspelling, bad punctuation, and like errata with no legal significance. Other suggestions pertain to items on which the Treasury could issue better regulations

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if somewhat more precise statutory language were adopted. The revenue effect of the suggestions is insignificant, if indeed they have any overall revenue effect.

That completes my statement, Mr. Chairman, except for one thing. I want to say that we are continuously studying the effect of this law as it moves into practice, as the various changes are worked out by the taxpayers in filing their returns. We are keeping very close track of them. And if and when at any time if appears that the intent of Congress is not being carried out as orignally intended, we will be back with suggested amendments.

Exhibit 23.—Letter of Secretary of the Treasury Humphrey, July 26, 1955, to the Chairman of the House Ways and Means Committee suggesting changes in the tax treatment of cooperatives and their patrons

My Dear Mr. Chairman: Recent court decisions have made it clear that certain tax legislation which the Congress enacted in 1951 is not working out as the Congress intended.

Public Law 183, 82d Congress, First Session (now embodied in Sections 521 and 522 of the Internal Revenue Code of 1954) eliminated the tax exemption of cooperatives which had existed previously. A study of the legislative history of this law shows that it had the clearly intended objective of taxing all cooperatives' income in the year earned, either to the cooperative or to the individual member.

Prior law had permitted cooperatives to accumulate necessary reserves tax free. In the 1951 law the Congress removed the allowance for tax-free reserves and provided that cooperatives were to be taxed on earnings at the regular corporate rates. However, in computing taxable income they were allowed deductions not only for cash distributions to their patrons but also for allocations made to patrons of their proportionate shares of the income of the cooperative. The allocations could take any of many forms, including certificates of beneficial interest, and promissory notes with or without due dates or interest.

In taking this action in 1951, the Congress apparently relied on rulings of the Internal Revenue Service that patronage allocations were taxable to patrons when made, regardless of their form. Accordingly, the 1951 act made no specific reference to the taxability of refunds in the hands of patrons. Congress apparently assumed that the rulings of the Internal Revenue Service were valid, that cash refunds would be taxable currently to the patrons in full, and that noncash allocations, in whatever form, also would be taxable currently to the patrons at face amounts.

It thus was intended in 1951 that the cooperative income should be taxable as it was earned either to the cooperative itself, or to its members. Such income was to be taxable to the cooperative as a corporation unless paid in cash or otherwise allocated as patronage refunds, in which cases it was assumed to be taxable to the patrons or members.

However, several courts now have held that when allocation certificates issued to patron-members have no fair market value, they are not properly includible in the taxable income of the patron-members when issued. Notwithstanding the nontaxability of these allocations to the members, they remain currently deductible by the cooperative under the clear terms of the 1951 act. It therefore is possible for cooperatives to take current tax deductions for certificates which are nontransferable, nonredeemable, and noninterest bearing, and not taxable to anyone. Cooperatives thereby may retain earnings, for indefinite periods of time, with no liability for income tax by either the cooperative or its members. Thus, the 1951 act has failed to accomplish its purpose and, contrary to congressional intent, in at least some instances cooperatives may retain earnings with no tax imposed either on them or their members.

The general plan of the 1951 legislation, to tax all income from cooperatives' operations as it is earned either to the cooperative or to its patron-members, might now be made effective by appropriate action of Congress in the following manner.

It could be provided that cooperatives could take deductions in computing their taxable income only for (a) cash distributions and (b) noncash allocations issued in such form or under such circumstances as would make then currently taxable to the patron-members receiving them, and (c) the amount deductible by the cooperative itself should not exceed the amount so currently taxable to patron-members.

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This would not interfere with the proper function or financing of cooperatives, but would make it certain that all income is taxed in one place or the other as it is earned. The traditional handling of cooperative affairs would not be impeded.

Some difficulties are involved in requiring patron-members to pay tax currently on noncash allocations. Where the patron-member gets no cash distribution, he may not have funds to pay the tax. The Internal Revenue Service has received numerous complaints from individual patron-members who object to paying tax on noncash allocations. Many people naturally consider only cash receipts and expenditures in making their income tax returns.

These difficulties can be eliminated by the adoption of a withholding system comparable to that on wages and salaries. The tax could be withheld at the bottom rate for individuals (now 20 percent). As in the case of wages and salaries, refunds automatically would be made to those entitled to them and additional taxes paid by those subject to higher tax rates. Withholding-at-source would help both patron-members in payment of their taxes and the Treasury in its enforcement and administration problems.

The preceding changes would implement the intent and purposes of the act of 1951. They would make it sure that noncash allocations would be taxable, and that tax would actually be paid on behalf of the recipients. Further wholly tax-free additions to the capital of cooperatives would be prevented.

Cooperatives still would be able to retain for their business use the entire amount of their earnings, subject only to the 20 percent withheld and paid on the tax liabilities of patron-members, by allocating all earnings to their patron-members in the form of taxable certificates. At some appropriate time your committee may desire to undertake a careful study to determine whether or not this result is in the public interest, in view of the alleged competitive situation existing between cooperatives in competition with corporate businesses which can expand their activities by retained earnings only after paying tax at the full corporate rate, or by sale of securities to the investing public.

The Treasury Department will be glad to be of such assistance as we can to you and your staffs in any consideration that you may give to the various aspects of this subject.

Sincerely,

G. M. HUMPHREY,
Secretary of the Treasury.

Exhibit 24.—Statement by Secretary of the Treasury Humphrey, June 27, 1955, before the House Ways and Means Committee on the Individual Retirement Act of 1955 (H. R. 10)

Mr. Chairman, I am pleased to accept your invitation to discuss the proposals to allow self-employed people to postpone payment of income tax on a part of their current earnings which they set aside to provide retirement income in later years. The purpose of such a tax allowance would be to give the self-employed opportunities to build up retirement incomes somewhat comparable to those which employees can now receive through pension plans, financed in whole or in part by their employers. Employee pension plans, if arranged on a nondiscriminatory basis, now receive favorable tax treatment.

The Treasury Department has made an extended study of various proposals for special tax treatment of savings by self-employed people to provide themselves with retirement income. We have prepared a report covering what we deem to be the major problems involved in these proposals, and an analysis of their potential effects on the revenue, which Mr. Williams will present to you. This report summarizes our views and suggestions.[1]

In view of the difference of treatment under the present law between self-employed individuals and employees, the Department would be sympathetic to a limited form of special allowances when general tax relief is possible in the future. The self-employed who might qualify for such treatment would be necessarily limited and might well be defined as those who are then covered on a mandatory basis under the social security system. Self-employed groups who are now excluded from social security should have the opportunity to come under the system at the same time as tax provisions for retirement income of self-employment are established.

[1] This report appears in Hearings before the House Committee on Ways and Means, *Individual Retirement Act of 1955*, 84th Congress, 1st session, pp. 7-33.

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As you will see from the analysis of the problems which will be given to you by Mr. Williams, there are many important points to be considered and resolved before any practicable plan can be evolved. We will welcome the opportunity to assist your committee in its further studies of the subject.

However, in view of the revenue loss involved in even a restricted plan, the Treasury Department does not now favor the adoption this year of any plan giving tax exclusions for savings for retirement income to self-employed people.

At this point, I would like to ask Mr. Williams to take up his detailed study and present it to you.

Exhibit 25.—Letter of Secretary of the Treasury Humphrey, July 27, 1955, to the Chairman of the House Ways and Means Committee submitting a suggested draft of legislation relative to the taxation of corporate business income earned abroad

MY DEAR MR. CHAIRMAN: Last year, your committee and the House of Representatives included as part of the tax revision bill new provisions giving a lower rate of tax on corporate business income earned abroad, somewhat similar to that available since 1942 to income earned in the Western Hemisphere. Provision also was made for postponement of taxes on the income of foreign branches until it was removed from the country where it was earned, a treatment somewhat comparable to that now given to the income of foreign subsidiaries. These sections were omitted from the bill as reported by the Senate Finance Committee, but the report of that committee stated the hope that provisions along these lines might be developed in the conference between the House and the Senate before final passage of the tax bill. This was not done. The Treasury Department has continued to examine the problem since that time.

I now submit to you a suggested draft of legislation designed to secure the results which were sought and apparently desired last year.[1] This is in accord with the President's recommendation in 1954, which was reaffirmed in his message on foreign economic policy on January 10 of this year.

The purpose of this recommended legislation is to facilitate the investment abroad of capital from this country. At present, our business firms are at a disadvantage in countries with lower taxes than our own when they have to compete with local capital, or capital from countries which impose lower taxes on foreign income than we do. Foreign countries are also under an incentive to increase taxes on United States enterprises up to the level of United States tax rates.

Capital investment will aid in the economic development of foreign countries. Participation by United States enterprises will encourage development along the lines we have followed in this country which are especially helpful in raising living standards, through high wages and mass markets, and which will promote the flow of international trade with the United States.

The Treasury staffs and I will be glad to be of such assistance as we can to you, your committee, and your staffs in any consideration which you may wish to give to the taxation of foreign business income. A memorandum explaining our analysis of three of the problems we have considered in this area is enclosed.

Sincerely,

G. M. HUMPHREY,
Secretary of the Treasury.

MEMORANDUM ON PROBLEMS IN TAXATION OF FOREIGN INCOME

The principal problem in developing recommendations for new legislation on taxation of income from foreign sources has been in the definition of foreign business income. Some argue for a broad definition, which would include not only income earned from significant business activity actually conducted abroad but also income from products made here and merely sold for delivery abroad. Others favor a definition related to a "permanent establishment" abroad, or to the existence of a business activity subject to taxation in the country where it is conducted. Still others prefer a specific listing of designated activities which

[1] The draft of suggested legislation is omitted from this exhibit. The suggestions are contained in the bill H. R. 7725 introduced in the House of Representatives, July 29, 1955, by Mr. Cooper, Chairman of the Committee on Ways and Means.

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are deemed to be of particular importance. Naturally, the representatives of almost every particular industry or activity argue that they should not be left out of any group which receives favorable tax treatment.

In our analysis of the problems of definition, the following principles have seemed important: (1) As a matter of national policy, it would not be desirable or wise for this country to subsidize exports by taxing profits from exports at a lower rate than profits from domestic sales. For this reason, a definition based on ultimate destination, or place of delivery of goods produced, would not be satisfactory. (2) Small business should have the same potential advantages as larger businesses. (3) The standard selected should not be subject to manipulation by arrangements, for example, to rent an office or pay a small tax abroad to qualify for a substantial tax advantage at home.

The definition of foreign income suggested in the attached draft legislation revolves around the active conduct of a trade or business abroad, with the exception of export trade. It is a broad concept, related to economic activities which often involve capital investment and typically involve full participation and integration in the economy of the country where it is carried on. To avoid any tax motivation for companies to shift to foreign countries their production of goods intended for our own home market, the importation to the United States of any substantial part of the products manufactured abroad would disqualify a company for the special tax treatment.

Inevitably there will be difficulties in administering this or any other definition of foreign income. In some instances it will be difficult to draw the dividing line between manufacturing which would qualify for the lower tax and minor assembly or repackaging which would not qualify. Such difficulties, however, should not stand in the way of an attempt to foster economic development through private capital investment.

Two problems, of more limited scope, exist in connection with the postponement of tax on income earned by foreign branches.

First, under present law the income from a foreign subsidiary corporation is not taxed until it is received by the domestic parent company. There is no legal basis for taxation by this country of such income so long as it is held abroad by the foreign subsidiary, regardless of how it is reinvested or shifted from the country where it is earned to other foreign countries. It has been proposed that foreign branches of United States corporations be given similar latitude to shift funds between countries with no intervening tax imposed by the United States until foreign income is finally repatriated.

A deferral of tax on foreign income until it is repatriated would give the maximum encouragement to foreign investment. However, such a provision would be subject to abuse. There could be indefinite postponement of tax by shifting profits earned in high-risk areas to low-risk investments in other places. The diversification and growth of foreign investment among firms already operating profitably abroad would receive greater benefit than that of firms presently operating solely in the United States. It therefore seems preferable to adopt deferral of tax on branch income on a limited basis, at least in the first instance.

The second problem concerns the simultaneous allowance of both a deduction and a credit for foreign taxes on income received through foreign subsidiaries. At present the earnings of a foreign subsidiary corporation, when received as dividends by the parent corporation here, are subject to the regular United States corporation income tax, but a credit is allowed against the United States tax for any foreign income tax paid by the subsidiary. The United States tax is imposed only on the subsidiary's net earnings after payment of the foreign income tax. The combined effect of the credit and deduction (under some combinations of rates) is a somewhat lower total tax, foreign and domestic, than the United States tax would be by itself. For example, when the foreign corporate tax rate is one-half our rate (26 percent against our 52 percent), the combined effective tax on the foreign income (foreign and domestic) works out to only a little over 45 percent. This feature of the foreign tax credit was adopted in the Revenue Act of 1918. No recommendation has been made to change it, presumably because it has not seemed desirable to increase, directly or through technical changes, the present tax on foreign business income.

A similar treatment of foreign income taxes is suggested in the proposed taxation of income from foreign branches. This is not a necessary or essential part of the program, and is included only to secure similarity with the taxation of income from subsidiaries, along the lines established by the 1918 Revenue Act.

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Exhibit 26.—Statement by Secretary of the Treasury Humphrey, July 18, 1955, before the Subcommittee on Legal and Monetary Affairs of the House Government Operations Committee on accelerated amortization for certain emergency facilities

I welcome this opportunity to appear before you and to express the point of view of the Treasury Department on the provisions in our tax laws which allow accelerated amortization for income tax purposes of the cost of certain "emergency facilities."

I want to make it clear that I am not urging repeal. Final decisions on the scope of the program should not be made until the studies now being made by the Defense Mobilization Board have been completed. I wish at this time simply to make certain suggestions which I believe should be carefully considered in any study of the matter.

The "crash" defense program which was initiated in connection with the Korean War has been substantially completed.

Emergency amortization served a useful purpose during the early phases of rebuilding and expanding defense plant capacity to meet that emergency. However, the accelerated tax writeoff is an artificial stimulus of a dangerous type. Its indefinite continuance involves the very real danger that interests receiving the benefits of it come to rely upon it to the detriment of others who are not so favored. A defense mobilization program on a substantial scale may be essential for years to come. Expansion of our defense facilities should be an integral part of our broad, orderly, long-range, natural economic growth. Our basic defense capacity cannot soundly be separated from the broad base of productive capacity in general on which our Nation relies for its economic strength. Artificial stimulants may well become artificial controls. Because this one is not of universal application but is bestowed only upon some who especially qualify as against others who do not, it could become a hindrance to sound, balanced, vigorous growth of our whole free economy. It is not the American way.

Moreover, I think it important to remember, in any consideration of the problem, that several recent changes in the tax laws have substantially altered the tax picture which existed when accelerated amortization of emergency facilities was first adopted. Then we had an excess profits tax which took up to 82 percent of the profits from corporate business, and thereby tended to discourage large expenditures for new plant facilities. That tax was repealed as of January 1, 1954. The new liberalized depreciation methods under the 1954 Internal Revenue Code now permit faster capital recovery by all taxpayers equally and meet the basic needs of the whole economy. This reduces the need for singling out particular taxpayers or particular facilities for more favorable treatment than others receive.

A highly selective program may well have merit if it is strictly limited to very special cases: where there is present and pressing need for goods that would be a "must" in time of war and which cannot be met by present facilities and where Government contribution is necessary to meet those goals. I suggest, however, that the broader the program, the more it extends into areas other than the direct production of goods that are directly needed for war, the more difficult it becomes to administer wisely, without essentially arbitrary or discriminatory results.

Indeed, the very existence of such a program may lead some taxpayers to construct facilities deliberately colored to meet supposed defense needs. The tax benefits often could more than absorb the waste and extra expense to the taxpayer, but it hardly would be good for the economy.

The revenue effects of the program are significant. I shall present three statistical tables to the committee. They have been prepared by the Treasury staffs. These tables will give you the facts, and our estimates of the direct dollar impact of the present program on the revenue. You will note that the estimated revenue loss this fiscal year will be 880 million dollars. With our budget not in balance, this figure gives us serious concern. Extension of the program well may stand in in the way of future more general tax reductions for all taxpayers which would be of important assistance to all business and to our continued economic growth and expansion.

Finally, I should like to speak very frankly about this use of the tax laws to further special programs and accomplish purposes other than simply the collecting of taxes. The power to tax is the power to destroy and revenue laws should be used only to equitably raise revenue, not for other indirect purposes. It is dangerous to use the tax laws for social purposes, to favor one citizen or group of citizens over others, to exercise economic controls, or to indirectly subsidize any segment of our economy.

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If, in the wisdom of the Congress, such subsidies or assistance to special communities or for special purposes are desired, then appropriations should be made for the purpose which can be submitted to the Congress through regular channels where the amounts will be well known and where the Congress specifically can vote in favor of or in opposition to special treatment for any group. Under this program of tax reduction in special cases, our net revenues can be reduced and our deficits increased without formal action or appropriations by the Congress. This use of the tax laws, where the stimulants are applied by men, not by law, is appropriate only in an emergency or under special conditions under rigid restrictions when usual procedures are inadequate for our protection.

Rapid amortization unquestionably was of real assistance in expediting preparation for the war and still can be useful if limited strictly and exclusively to that end. It induced the investment of large sums of private means for production that was made available under private management far better and far quicker than otherwise would have been obtained. It kept the investment of public funds to a minimum and it left no great burden of public properties to be disposed of when their war purposes had been served.

The Office of Defense Mobilization has recently requested the agencies that make recommendations to it such as the Departments of Commerce and Interior and the Defense Transport Administration, to review all existing expansion goals with the following points in mind:

1. Evaluate goals on the basis of defense need. The need for additional expansion shall be quantitatively measured in terms of wartime supply and requirements.

2. Expansion goals shall be based upon shortages which, in the judgment of the delegate agency, will not be overcome without the incentive of tax amortization.

When the Defense Mobilization Board has completed its review of the program in the light of these criteria, and made its recommendations to the Director of Defense Mobilization, it is expected that the program for the future will be on a proper basis.

This is not critical of the past. Nor is it thought best to abandon the practice entirely. But its usefulness in the future will be greatest for the good of the Nation as a whole if from now on it is used only sparingly and very rigidly and strictly confined to direct war-requirements applications.

Effect of allowance of emergency amortization certificates: based on certificates of $30,521 million issued through June 29, 1955

[In millions of dollars]

Calendar year	Value of completed projects [1]	Amount subject to accelerated amortization	Normal depreciation [2]		Accelerated amortization	Excess of accelerated amortization		Decrease in tax liabilities under accelerated amortization [3] as compared to	
			Straight line	Declining balance		Straight-line depreciation	Declining-balance depreciation	Straight-line depreciation	Declining-balance depreciation
1950	700	420	6	6	21	15	15	7	7
1951	4,167	2,500	87	87	292	205	205	113	113
1952	9,683	5,810	249	249	831	582	582	308	308
1953	16,000	9,600	463	463	1,541	1,078	1,078	593	593
1954	22,000	13,200	684	787	2,280	1,596	1,493	798	747
1955	26,594	15,956	875	1,132	2,895	2,020	1,763	1,010	882
1956	28,244	16,946	987	1,279	2,999	2,012	1,720	931	796
1957	29,479	17,687	1,038	1,289	2,633	1,595	1,344	718	605
1958	30,521	18,313	1,079	1,279	2,060	981	781	441	351
1959	30,521	18,313	1,098	1,228	1,383	285	155	128	70
1960	30,521	18,313	1,098	1,146	743	−355	−403	−160	−181
1961	30,521	18,313	1,098	1,080	372	−726	−708	−327	−319
1962	30,521	18,313	1,098	1,037	200	−898	−837	−404	−377
1963	30,521	18,313	1,098	1,000	63	−1,035	−937	−466	−422
1964	30,521	18,313	1,098	967	----------	−1,098	−967	−494	−435

[1] End of year. These estimates are based on the O. D. M. reported figures, but are modified in order to reconcile with corporate amortization deductions for 1951 and 1952.

[2] Straight-line depreciation rate assumed is 6 percent. Amounts shown for declining-balance depreciation assume that all certificate holders use this method for assets acquired after January 1, 1954, switching to straight-line when it becomes advantageous.

[3] Computations based on effective tax rates reflecting rate decrease on April 1, 1956, scheduled under present law. Minus figures indicate tax liability increase.

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Effect of allowance of emergency amortization certificates

[In millions of dollars]

Fiscal year	Decrease in tax collections [1]	Fiscal year	Decrease in tax collections [1]
1951	4	1959	370
1952	77	1960	87
1953	266	1961	−167
1954	569	1962	−310
1955	776	1963	−374
1956	880	1964	−420
1957	810	1965	−434
1958	625		

[1] Assumes certificate holders use declining-balance method for assets acquired after January 1, 1954. Minus figures indicate tax collection increases.

Tax amortization applications and certifications

[Money figures in millions of dollars]

Period [1]	Applications filed during period [2]		Certificates issued (net) during period [2] [3]		Certificates outstanding at end of period [3]	
	Number	Value	Number	Value	Number	Value
1950	1,014	3,923	149	[4] 1,330	149	[4] 1,330
1951	15,909	23,161	5,322	10,104		
1st quarter	6,941	12,695	788	[4] 3,040	937	[4] 4,370
2d quarter	4,030	5,566	1,385	[4] 3,135	2,322	[4] 7,505
3d quarter	2,853	2,628	1,767	[4] 1,805	4,089	[4] 9,310
4th quarter	2,085	2,272	1,382	[4] 2,124	5,471	11,434
1952	7,036	8,101	9,544	12,649		
1st quarter	2,517	2,924	3,267	[4] 5,375	8,738	[4] 16,809
2d quarter	1,802	2,073	3,350	[4] 4,225	12,088	[4] 21,034
3d quarter	1,417	1,559	1,913	[4] 1,825	14,001	[4] 22,859
4th quarter	1,300	1,545	1,014	[4] 1,224	15,015	24,083
1953	3,426	5,765	3,617	4,942		
1st quarter	1,022	1,355	1,176	1,599	16,191	25,682
2d quarter	1,108	1,844	1,235	1,627	17,426	27,309
3d quarter	664	1,503	681	830	18,107	28,139
4th quarter	632	1,063	525	886	18,632	29,025
1954	1,500	2,643	756	635		
1st quarter	374	736	359	477	18,991	29,502
2d quarter	434	609	−107	−568	18,884	28,934
3d quarter	375	917	282	678	19,166	29,612
4th quarter	317	381	222	48	19,388	29,660
1955:						
1st quarter	370	920	223	372	19,611	30,032
2d quarter	660	3,012	350	489	19,961	30,521

Source.—Office of Defense Mobilization.

[1] Based on biweekly progress reports that may not coincide exactly with calendar years or calendar-year quarters.

[2] Derived from cumulative data which reflect revisions, adjustments, and amendments; decumulated data for certain periods may reflect revisions pertaining to other periods.

[3] Data reflect the net effect of certificates issued and canceled; cumulative data reflect revisions, adjustments, and amendments.

[4] Rough approximations.

Exhibit 27.—Letters of Secretary of the Treasury Humphrey, July 7, 1955, to the Chairman of the House Ways and Means Committee concerning the taxation of life insurance companies

My Dear Mr. Chairman: I attach a copy of the letter which we originally had intended to send to you on the proposed bill on taxation of life insurance companies. Since the letter was prepared, the bill has been limited to one year only and I have discussed it with Mr. Mills and Mr. Curtis who assure me of their

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concurrence with our view that the whole problem should have further study, and that further legislation should be developed for enactment next year.

Since the bill contains substantial improvements over the law in effect last year and since the suggestions embodied in the attached letter will have your careful study in connection with next year's legislation, we withdraw our objection to H. R. 7201 and approve its enactment.

Sincerely yours,

G. M. HUMPHREY,
Secretary of the Treasury.

The letter which was attached to that letter and went to the Chairman of the Ways and Means Committee with it is as follows:

MY DEAR MR. CHAIRMAN: I regret that the Treasury Department cannot unqualifiedly endorse H. R. 7201, which provides a new method for the taxation of life insurance companies, even though it will be effective only for the years 1955 and 1956.

The bill would make desirable improvements in the definition of income. It would limit abuses by investment companies which do a small amount of insurance business, and by certain casualty companies which inflate their life insurance business by means of policy loans, to qualify for favorable tax treatment. The bill would be fairer than the present law because it would treat the group annuity business of the life insurance companies more like tax-exempt qualified pension trusts with which they compete. It also properly would eliminate duplication of the 85 percent intercorporate dividend credit and the proposed 85 and other percentage credits for reserve and other policy interest. The proposed segregation and separate taxation of their cancellable health and accident business, on a basis comparable to mutual fire and casualty companies in the same line of business, seems sound, though the wisdom of not taxing substantial amounts of the profits of some of the companies should have further study.

However, the proposed exclusion from the tax base of a flat 85 percent of investment income for ordinary life insurance business does not appear to be justified. The resulting tax currently seems inadequate.

Our estimates indicate that, on the basis of present earnings and contracts with policyholders, the life insurance companies will need only slightly over 75 percent of their 1955 investment income to meet their required reserve and policy interest, as compared with the 85 percent allowance in the bill. On these facts, it does not seem fair to the Government to adopt a formula which will permit the companies to go untaxed on investment income which is not needed under their contracts with their own policyholders. The total annual investment income of life insurance companies now exceeds $3 billion. The corporate tax on almost 10 percent of that total is a very large sum.

Since 1921, life insurance companies have been taxed only on their free investment income, that is, their investment income in excess of the amounts they were committed or required to set aside as reserves under their policy contracts. Their income from other sources has gone untaxed.

The 1942 law assumed that the companies would be required to earn 3¼ percent on a major part of their investments to meet their policy requirements, and determined their taxable free investment income on that assumption. As the companies wrote policies on the basis of lower interest rates, this high assumption of required earnings was so unrealistic that the companies would not have been required to pay any tax at all for several years, even though they actually had very substantial investment income over their contractual needs.

In 1950 a taxing method was adopted under which the tax was based on the actual free investment income for each year. Though probably not ideal (other income continued untaxed; the individual companies were taxed on an industry average of their investment income), this method at least provided a logical basis for taxation. The life insurance industry accepted this method, and even urged its adoption on a long-range basis.

In 1951 the policy requirements were about 87½ percent of actual earnings, which left a free investment income of 12½ percent. The 52 percent corporate tax on 12½ percent of earnings was about equal to 6½ percent on the entire investment income. A 6½ percent tax was imposed on all investment income, and was successively extended through 1954. This taxing method had no logical basis of its own, other than as a short-cut method of computation.

In the years since 1951 the companies' actual free investment income has increased steadily. It is estimated that for 1955 they need only 75.5 percent of

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their investment income to meet their policy requirements. If determined in the same way as was done in 1951, the comparable tax rate on all investment income would have to be almost doubled (increased to 12.7 percent) in 1955.

The Treasury Department has reviewed carefully the history and problems of taxation of life insurance companies. The valuable material in the hearings and the staff studies of the subcommittee of the Ways and Means Committee, published last year and earlier this year, has been examined. On the basis of our review and examination, I suggest that an attempt be made to develop a method of taxing life insurance companies like other business, on the basis of their entire income from all sources, with appropriate deductions for their expenses and additions to their reserves against their policy contracts. The reliance on free investment income alone ignores income and losses from mortality experience, the relation between loading charges and operating costs, and capital gains—which may be quite substantial.

Life insurance companies were taxed like other corporations on the basis of their entire net income until 1921, when the tax base was confined to free investment income. At that time, income taxation was still so new and undeveloped that it was found to be extremely difficult to deal adequately with the specialized problems of the life insurance industry. Substantial advances have been made since that time in tax administration, and the methods and techniques of income measurement. It should now be possible to develop a fairer basis for taxation which will include all of the income and deduction items which properly reflect the earnings position of a life insurance company.

The development of a satisfactory formula for taxing insurance companies on a comprehensive concept of income will take time. In the meantime, the 1950 formula (taxation of actual free investment income) gives a logical standard for measuring free investment income and the industries' capacity to pay. We estimate that this formula for taxing insurance companies would produce revenue of $368 million for this year, as against $189 million under the 6½ percent rate in effect from 1951 through 1954, and $215 million under H. R. 7201. In the absence of any legislation this year, the 1942 formula will become applicable again and produce revenue estimated at $274 million, as compared to $215 million under H. R. 7201 and $368 million under the 1950 formula.

The Treasury is impressed with the need for a fair and sound approach to the taxation of life insurance companies. A satisfactory solution must recognize the special situation of the life insurance industry and its responsibilities to policyholders. At the same time, it should impose a tax which is fairly distributed among the companies and fair in relation to the tax burdens of other savings institutions and taxpayers generally.

I and the Treasury Department staffs will be glad to be of such assistance as we can to your committee and staffs in any further examination of this subject which you choose to undertake.

Sincerely yours,

G. M. Humphrey,
Secretary of the Treasury.

Exhibit 28.—Statement by Secretary of the Treasury Humphrey, July 12, 1955, before the House Committee on Public Works in support of the President's road program

I am pleased to appear before you today in support of the President's road program and to discuss means and methods of financing that program.

When I previously appeared on the same subject, first before the Senate Committee on Public Works and then before your committee, I strongly recommended the creation of a governmental authority with power to issue revenue bonds to finance the highway expenditures which would be paid, both principal and interest, from a dedication of gasoline and diesel fuel taxes over a period of years. I still favor that proposal over any other that has been presented.

You have asked me today to discuss a plan that has recently been proposed for your consideration, suggesting in lieu of the governmental authority and the revenue bonds that certain taxes be increased which, together with certain existing similar taxes, would provide funds to pay the cost of highway construction as currently incurred.

This proposal plans for a Federal expenditure for highways, both for the interstate system and matching funds for local roads, totaling approximately $37 billion over 15 years.

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The taxes suggested include additional gas, diesel fuel, tire, tube, and truck taxes.

It is estimated that, taking into account the growth in the need for and use of highways by automobile and truck traffic, this combination of taxes will produce approximately $33 billion in revenue and will be available, generally speaking, to pay for the proposed highway expenditures approximately as currently made.

I do not think that the general revenues of the Government, outside of the amounts to be raised by the specific taxes previously listed, should be depleted and used for the construction of this highway system. The Treasury must oppose any plan to the extent that the taxes levied by it are insufficient to pay for the expenditures authorized, unless a governmental authority is created to provide for any deficiency in the necessary funds by an issue of bonds.

However, as I testified in my previous appearances both before the Senate and House Committees, the Treasury cannot object to any equally effective program which the Congress sees fit to adopt for the construction of highways with sufficient additional taxes levied to pay as we go.

I would point out most emphatically, however, that when the President presented his plan to Congress he had in mind the need of the States for revenue and the fact that the Governors' Conference had approved and urged his financing plan, which holds the Federal tax take at the present levels and leaves the field thereafter open to the States.

The Federal Government is vitally concerned with the interstate system of roads, and equally concerned that the States should have sufficient ability to provide increased and improved primary and secondary road systems for greater safety and dispatch for both interurban and farm market needs. The President's proposal continues to provide the Federal aid system at an alltime high level and, practically speaking, takes the States out of the interstate program, relieving them of great expense in that field. This would enable the States to devote greater attention to their own road programs with their tax field unimpaired.

Improved highway transportation is one of the great necessities of our times. A large part of our commerce and industry depends upon it. Our farms require it. The jobs of millions of men and women in this country depend upon it, in going to and from their work. The further growth of the great automotive industry and all its ramifications in the use of steel, fuel, rubber, and thousands of products from hundreds of sources cannot continue to develop at its present pace unless our highway systems concurrently develop proportionately. This is a case where time is of the essence. We are already lacking in adequate facilities and further rapid improvement should not be postponed.

These important considerations were all pointed out by the President when he submitted his proposal for your consideration, and in conclusion he said:

"A sound Federal highway program, I believe, can and should stand on its own feet, with highway users providing the total dollars necessary for improvement and new construction. Financing of interstate and Federal-aid systems should be based on the planned use of increasing revenues from present gas and diesel oil taxes, augmented in limited instances with tolls.

"I am inclined to the view that it is sounder to finance this program by special bond issues, to be paid off by the above-mentioned revenues which will be collected during the useful life of the roads and pledged to this purpose, rather than by an increase in general revenue obligations.

"At this time, I am forwarding for use by the Congress in its deliberations the report to the President made by the President's Advisory Committee on a National Highway Program. This study of the entire highway traffic problem and presentation of a detailed solution for its remedy is an analytical review of the major elements in a most complex situation. In addition, the Congress will have available the study made by the Bureau of Public Roads at the direction of the 83d Congress.

"These two documents together constitute a most exhaustive examination of the national highway system, its problems and their remedies. Inescapably, the vastness of the highway enterprise fosters varieties of proposals which must be resolved into a national highway pattern. The two reports, however, should generate recognition of the urgency that presses upon us; approval of a general program that will give us a modern safe highway system; realization of the rewards for prompt and comprehensive action. They provide a solid foundation for a sound program."

Everyone wants roads, more and better roads. And it is for the Congress to say how the Federal Government will participate, how rapidly Federal roads

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should be constructed, and how they should be paid for. The President's original program is effective and sufficient to accomplish the purpose proposed. It is not the only way that the very desirable road construction can be accomplished but after the most thorough and extensive study of the entire subject by large groups of competent people, it still offers the best method for quickest construction of the greatest mileage of necessary and desirable highways throughout the entire country.

Exhibit 29.—Remarks by Secretary of the Treasury Humphrey, October 1, 1954, before the Tax Institute of the University of Texas School of Law on the tax program

Tax program benefits every American

I am very happy to be a part of this four-day institute given over to study of the tax revision law passed by the last Congress and signed into law by President Eisenhower in August.

In addition to the privilege of being in the great State of Texas, I always consider it a privilege to talk about anything as important and vital to our Nation as I think this tax revision law is.

I realize that most of you people here tonight are experts or near-experts on the tax laws of our country. But notwithstanding your special knowledge in this field, I hope you will bear with me if I do not try to get too technical but merely give you some of the basic philosophy which is back of this vital piece of legislation.

The tax revision law, or the Internal Revenue Code of 1954, is one of the most important of our time because it sets a trend that will lead to greater economic progress for the country as well as bring relief to millions of individuals who have suffered specific hardships under the old tax code.

As you people well know, this is the first time in some 75 years that there has been a major revision of the whole Federal tax structure. In addition to reducing restraints on business and removing hardships on individuals, this revision has attempted to make the tax laws more simple and certain and also to close loopholes under which some persons could have avoided their fair share of the tax burden.

The provisions in the law which remove hardships from individuals provide direct benefits which our citizens will note as they come to pay their income taxes next spring. Incidentally, they also will notice the benefits of the rest of the administration's tax program, which in this calendar year has made effective tax cuts totaling $7.4 billion, the largest dollar tax cut in the history of this or any other country. But from the new Internal Revenue Code specifically, tax pressures will be eased where they have hurt millions of taxpayers severely in bygone years. Among those who will benefit are working mothers; parents of children who are helping to pay their way through school; retired policemen, firemen, teachers, and their widows; families with heavy medical expenses; farmers who want to buy new equipment; people with sick and accident policies; taxpayers with nonrelative dependents; farmers doing soil and water conservation; and many, many others.

And in connection with these individual changes, you people here tonight probably already are aware of the work that the Treasury and the Internal Revenue Service are doing to acquaint the taxpayer with his rights under the new law. Big and numerous as the changes are, we expect that many citizens will have to keep going to the Internal Revenue offices for help in large numbers in the year ahead. Regulations are being rewritten and simplified and forces are being prepared and trained to help.

Helpful as these direct benefits are, they can in no way compare in my mind with the indirect benefits which will flow from the tax revision law. By removing restraints, this new law will release new energies throughout our economy. These energies work quietly but steadily to create new enterprises, more and better jobs, new productive efficiencies, larger payrolls, and rising standards of living for all the 160 million people of this Nation. It is these indirect but dynamic benefits which I should like to talk about mainly tonight.

First, however, I would like to say a word about the background of the new law and about the work that went into revising it.

The tax structure that we found on coming to Washington had grown up haphazardly and illogically. In the past 20 years, most of the changes in the tax

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laws were put into effect under the pressure of crisis of war or depression. The Congress reached for income where it could find it. In the process of imposing new taxes to meet new emergencies, stifling burdens were placed upon those very parts of the Nation which provide for progress.

The main purpose of the tax revision bill is to rearrange the tax burden to make it easier for the economy to move forward.

For years America's economy was stimulated by war and inflation, stimulants which concealed the deadening features of our tax structure. Thoughtful people were predicting that such restrictions would rise to plague us as the artificial stimulants were withdrawn. And for ten years or more, congressional committees, including both Democrats and Republicans alike, urged revision of our cumbersome tax structure so as to free normal incentives to business progress. In addition to the congressional committees, such groups as taxpayer organizations, bar associations, farm associations, labor unions, small businessmen, accountants, and many more made demands for tax revision. Among the many recommendations made, there was wide agreement, but little happened. Tax revision became like the weather, which everybody talked about but nobody did anything about.

When this administration came in office, we were told that getting a major tax revision bill adopted early in our administration was simply impossible. The experts said it was so technically difficult and cumbersome that we had better not set our hopes too high.

But President Eisenhower himself had become deeply convinced of the need of tax reform. Also, President Eisenhower has a very deep suspicion about the word "impossible." Very soon after taking office, he instructed the Treasury to proceed with the basic job of recommending tax revision, and he always helped when the going was tough. Last March, in a nationwide television broadcast, he described his tax proposals as "the cornerstone" of the administration's entire effort. This appeal contributed mightily to final congressional approval of the tax revision bill.

In the Treasury proper, the work of producing tax revision recommendations was headed by Under Secretary Marion Folsom, a man of wide experience in business and tax matters, who brought to work with him two other outstanding tax authorities—Dan Throop Smith, Professor of Finance at Harvard; and Kenneth Gemmill, a Philadelphia tax attorney.

Tax revision was also lucky in the leadership on Capitol Hill. Russell Train, the able Clerk of the House Ways and Means Committee, told you on Wednesday of this week of the progress of the tax revision bill through the Congress. As most of you know, a most vital force back of the drive to get tax reform was Chairman Dan Reed of the Ways and Means Committee, an ardent and courageous leader in the tax field. In the Senate, likewise, tax revision came under the wise handling of Eugene Millikin, Chairman of the Senate Finance Committee.

Both the House and the Senate committees, of course, had superb technical assistance from the staff headed by Colin F. Stam, a Government tax man who has been giving expert guidance in this field since the 1920's.

As you gentlemen well know, the tax reform law was a result of very intensive study and hearings conducted for almost a year and a half. More than five thousand pages of testimony were taken, and hundreds and hundreds of witnesses were listened to. Then their suggestions were gone over by teams of experts from both the congressional and the Treasury-Internal Revenue staffs.

Throughout all of this, we tried to keep focused on one basic premise: Are we changing the law so as to help the economy to grow and so create more and better jobs and better living for everyone?

In addition, of course, we tried to see if we couldn't put more certainty into the law. Economic progress and clarity do have a real connection. As you gentlemen also know, many of our tax laws have been vague and ambiguous. This meant that an individual considering a new venture could not figure for sure just what his tax liability would be. Likewise, because of vagueness, the tax liability might be changed, subject to the personal judgment of a tax official. We feel that more certainty is going to permit hundreds of new ideas to be put into actual business practice.

Most significant are substantive changes which we have made in the Internal Revenue Code designed to restore more of the normal incentives to business and individual progress. Probably the most controversial of these has been the provision which partially eases the double taxation of dividend income. Despite

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the political heat which has been kindled by the opposition on this point, it is my sincere opinion that the whole country will benefit from this provision.

Risk capital has made possible the phenomenal growth of our Nation, and dividends are the incentives which make people take risks with their capital. Without this risk capital we never could have developed the wildernesses as we have done. We couldn't have developed the mines, drilled for the oil, built the factories, and done all the things which over the years have led to more and better jobs and higher wages.

During the New Deal of the midthirties the provision for double taxation of dividend income crept into the tax law. Thus the citizen who provided risk capital was tapped twice for taxes. The company earnings bore the full brunt of the corporate income tax and when what was left reached the individual as dividends, it was subject to a second tax, this time the full personal income tax.

Without thinking of the personal injustice of this, let's take a quick look at the effect on the economy. It takes a good deal of money to make a job. A recent survey of one hundred of the largest manufacturing corporations in the United States showed an average of nearly $15,000 of risk capital back of each job. In the development of most of our natural resources it can be much more.

The double taxation of dividends has made it increasingly difficult to attract risk capital to make these jobs. So, more of our business capital has come from borrowing rather than from sale of stock. Companies which are heavy with bonded debt have to move more slowly and carefully than a company which is financed with risk capital, and in times of economic decline companies with a heavy debt burden are less likely to keep their heads above water.

Another most noteworthy change is the provision which provides more flexible allowance for depreciation. Some 600,000 corporations and nearly 10 million individuals, especially farmers and small businessmen, will benefit from this. But the greatest long-term benefit will be to the whole Nation by the stimulation of plant expansion, the buying of more efficient machinery, all-around modernization, and so cheaper products and more and better jobs.

While tax experts talk about "depreciation," I like to think of it more as amortization. Under the new law, a man pays the same total tax but he can get his equipment paid for more quickly. Then he is in a position to look about for something newer and better and the quicker writeoff helps him to finance his new purchase of better, more modern equipment. In other words, the impulse is forward. This is certainly in the best interests of all Americans.

In many other ways the new tax revision law encourages enterprise to go ahead. By removing barriers, it permits greater rewards for successful inventions and for those who develop them. It provides more liberal treatment for research and development expenditures to create new, better, and cheaper products for everyone to enjoy. It gives more leeway to small companies which want to retain earnings for future expansion, which would create new jobs and better things for better living. This removal of barriers to incentive pervades the whole new law, even down to such things as encouraging youngsters who forward their own education by outside work.

The tax reform law does one other thing which is generally overlooked by our critics. It helps the security of our Nation against any potential aggressor. It does this by helping the modernization of our industrial base, upon which all our military strength ultimately rests. This is particularly true in this day when new weapons and techniques are developed with amazing speed. We have no way of knowing what the decisive weapons may be a few years from now. But we have to make sure that our industrial strength is modern and ready to keep abreast.

The tax revision law is not perfect. In spite of all the care, we know that as time goes by we are bound to discover errors and better ways of doing things. There are also additional items in the code which must be the subject of further study before we can come forward with recommendations.

The new law is only a great first step.

But moving beyond the tax revision law itself, I would be the first to admit that there is much left to be done in the whole tax field. Our tax rates are too high. But they must remain relatively high as long as so much of our income has to go for the protection of our Nation against a possible enemy. We will, however, continue to pass on to the taxpayer promptly the benefits of any spending reductions which can be achieved while always giving first priority to our national security.

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Before closing I would like to say something about "who has benefited most" from the whole tax program of this administration.

There has been a good deal of nonsense and misinformation in recent weeks falsely suggesting that the administration's tax program might not be in the best interest of all of our citizens. Such nonsense seems to increase in inaccuracy the closer we get to November.

I would like to explain why this program is in the best interest of every American:

First, every taxpayer in America has benefited directly from the tax cuts totaling $7.4 billion, the largest dollar tax cut in any year in the Nation's history, and possible only because of cuts in spending made by this administration.

Second, 62 cents of each dollar of the $7.4 billion goes to individuals—and almost 25 cents of each dollar to taxpayers with income of less than $5,000 a year. This leaves 38 cents of each dollar tax cut going to corporations.

Third, there is nothing un-American about helping the economy make more and better jobs, which is what our whole tax program is doing. As we cut Government spending by more than $10 billion, we had to help the private economy make jobs for people who used to get their living from Government spending. The tax reductions and the tax revision bill, about which we have been talking, are removing the barriers to business expansion, the starting of new businesses, and so the creation of new and cheaper products and more and better jobs.

What is important is that this administration's tax program has and will continue to help bridge the transition from high to lower Government spending by helping the economy make new jobs.

American citizens are likely to understand that a program which helps make jobs is a program they should support. Despite the erroneous arithmetic of our critics, the average American, who is a very intelligent person, is likely to realize that more jobs and better jobs are more important to him and his family than any amount of political oratory and promises. This is the philosophy that this administration has operated on. It is the philosophy back of the tax revision law and our whole tax program. It is the philosophy which we must continue to follow to help promote ever-increasing propserity for all.

The administration's tax program, with the tax revision law as one of its vital parts, is a mighty effort to bring our tax laws closer to the needs of a modern America. These tax efforts will help foster and maintain a high level of economic activity in this country; activity which means so much in the way of prosperity for all, as well as greater security for our country and peace in the world.

Exhibit 30.—Miscellaneous revenue legislation enacted by the Eighty-fourth Congress, First Session

Public Law 1, January 20, 1955, amends Section 7237 of the Internal Revenue Code of 1954 by correcting a technical error made in the drafting of the 1954 Code, relating to penalties for violation of the narcotics laws.

Public Law 9, March 2, 1955, amends Section 7443 (c) of the Internal Revenue Code of 1954 by increasing the salaries of Tax Court judges from $15,000 to $22,500.

Public Law 66, June 8, 1955, continues until June 30, 1956, the suspension of duties and import taxes on metal scrap.

Public Law 91, June 21, 1955, continues until June 30, 1958, the suspension of certain import taxes on copper.

Public Law 216, August 3, 1955, extends the Renegotiation Act of 1951 for two years to December 31, 1956. This law also directs the Joint Committee on Internal Revenue Taxation to make a study as to the necessity of extending the act beyond December 31, 1956, and to make a report of the results of such study to the Congress not later than May 31, 1956.

Public Law 299, August 9, 1955, amends Section 37 (f) of the Internal Revenue Code of 1954 by extending the retirement income tax credit to members of the Armed Forces who retire before the age of 65.

Public Law 303, August 9, 1955, amends Section 3416 (a) (2) of the 1939 Code by extending from August 1, 1954, to October 8, 1955, the period for filing claims for floor stocks refunds on refrigerators, quick-freeze units, and electric, gas, and oil household appliances authorized by the Excise Tax Reduction Act of 1954.

Public Law 306, August 9, 1955, amends Section 3402 of the Internal Revenue Code of 1954 to provide that an employer shall not be required to deduct or

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withhold taxes on noncash remuneration paid retail salesmen who ordinarily are paid for their services by way of cash commissions. This amendment is applicable to remuneration paid after August 9, 1955, the date of enactment of this act.

Public Law 310, August 9, 1955, provides that if refund or credit of an overpayment resulting from the application of Section 345 of the Revenue Act of 1951 (relating to abatement of tax on certain trusts for members of the Armed Forces dying in service during the period December 7, 1941, to January 1, 1948) was barred by the operation of any law or rule of law (other than a closing agreement or compromise), credit or refund is nevertheless to be allowed if the claim is filed within one year after the date of enactment of this act. No interest is to be allowed or paid on such refunds or credits. Under the 1951 act such refunds or credits could not be granted if barred by the expiration of the period of limitations, by prior court decisions, or for other similar reasons.

Public Law 317, August 9, 1955, amends Sections 4216 and 4217 of the Internal Revenue Code of 1954 to provide that the maximum tax imposed on the leasing of certain passenger automobile trailers and semitrailers is to be an amount equal to the applicable tax rate multiplied by the fair market value of the trailer at the time of the initial lease. The taxpayer is given the option to pay the tax in full at the time of the initial lease or to spread the tax payments over the period of the lease payments. Prior to this change, if a manufacturer leased articles subject to a manufacturers' excise tax, such tax applied to the amount of each lease payment on the same basis as if it were a sale.

Public Law 321, August 9, 1955, amends Section 3401 of the Internal Revenue Code of 1954 to provide that an employer (other than the United States Government) need not withhold income tax on remuneration paid to a United States citizen for services performed in a possession of the United States if the employer is required by the law of any foreign country or possession of the United States to withhold income tax on the remuneration. Under the law prior to this amendment, the wages of a United States citizen employed in a possession of the United States might, for example, be subject to withholding for both the income tax of the possession and the Federal income tax.

Public Law 333, August 9, 1955, amends Section 25 (b) (3) of the Internal Revenue Code of 1939 to permit a taxpayer to claim as a dependent a child born to him, or legally adopted by him, in the Philippine Islands if the child is a resident of the Philippines and the taxpayer was a member of the United States Armed Forces at the time the child was born or legally adopted. This provision applies to all taxable years beginning after December 31, 1946, to which the 1939 Code applies. However, the amendment does not open up years for which the statute of limitations has run. Public Law 333 also amends Section 152 (b) (3) of the 1954 Code to permit a taxpayer to claim as a dependent a child born to him, or legally adopted by him, in the Philippine Islands before January 1, 1956, rather than July 5, 1946. This amendment applies for taxable years beginning after December 31, 1953, and ending after August 16, 1954.

Public Law 354, August 11, 1955, amends Section 4233 (a) of the Internal Revenue Code of 1954 to exempt from the admissions tax admissions to athletic events conducted by the United States Olympic Association, or authorized in advance by such association to be conducted for its benefit, if all the proceeds inure exclusively to the benefit of the association. This exemption applies to amounts paid on or after September 1, 1955, for admissions on or after that date.

Public Law 355, August 11, 1955, amends Sections 4091 and 4092 of the Internal Revenue Code of 1954 to provide a tax of 3 cents a gallon on cutting oils, effective October 1, 1955. Prior thereto the tax was 6 cents a gallon but not more than 10 percent of the manufacturer's sale price. The act also defines cutting oils as "oils sold for use" in cutting and machining operations on metals rather than as oils "used primarily" in cutting and machining operations. Public Law 355 adds a new subparagraph (I) to Section 6416(b)(2) of the 1954 Code, providing for a credit or refund not to exceed 3 cents a gallon in the case of lubricating oil on which a tax of 6 cents a gallon was paid if such oil was used or resold as cutting oil on or after October 1, 1955.

Public Law 363, August 11, 1955, provides for a refund or credit to distillers, winemakers, or rectifiers for the amount of excise tax and customs duties paid on distilled spirits and wines lost, rendered unmarketable, or condemned by a duly authorized health official by reason of the hurricanes of 1954.

Public Law 366, August 11, 1955, adds a new Section 1304 to the Internal Revenue Code of 1954 and renumbers the former Section 1304 as Section 1305.

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This new section provides that the tax attributable to the inclusion in gross income of an amount which represents compensatory damages received or accrued as a result of a judgment for infringement of a United States patent shall not be greater than the aggregate of the increases in taxes which would have resulted if such amount had been included in gross income in equal installments for each month during which the infringement occurred. The amendment is applicable to taxable years ending after August 11, 1955, but only with respect to amounts received or accrued after that date as the result of awards made after that date.

Public Law 367, August 11, 1955, amends the Internal Revenue Code of 1954 as follows:

(1) The first section of this act amends Sections 4063(b), 4112, 4113, 4218(a)(1) and (b), and 4220, to provide for tax-free sales of automotive parts or accessories, refrigerator components, radio and television components, and camera lenses subject to manufacturers' excise taxes if sold to a manufacturer for incorporation in other articles, regardless of whether such other articles are taxable. Section 6416(b)(3)(B) is amended to provide a credit or refund of any tax paid on such components to a manufacturer who purchased and used them in the manufacture of, or as component parts of any article.

(2) Section 2 of the act amends Section 4141 to limit the excise tax on radio and television receiving sets, automobile radio or television sets, phonographs, and combinations of any of these, to entertainment-type sets. The special exemption in Section 4143 and the special credit or refund in Section 6416(b)(2)(G) for communication, detection, and navigation receivers sold to the United States Government are repealed.

The amendments made by the first and second sections of this act generally take effect on September 1, 1955.

(3) Section 4 of Public Law 367 amends Section 354 to make the rule for shifting the burden of proof in cases involving the penalty tax on corporations improperly accumulating surpluses applicable to cases governed by the 1939 Code which are tried on the merits after August 11, 1955.

Public Law 370, August 11, 1955, amends Section 223 of the Revenue Act of 1950 by extending the exclusion from personal holding company income of rents received for use of corporation property by shareholders in certain business operations to taxable years ending after 1945 and before January 1, 1954. Prior to this amendment, the exclusion applied to taxable years ending after 1945 and before January 1, 1950.

Public Law 379, August 12, 1955, amends Section 4061(a)(2) of the Internal Revenue Code of 1954 to repeal the excise tax on motorcycles and on parts and accessories therefor, effective September 1, 1955.

Public Law 383, August 12, 1955, amends the Railroad Retirement Act of 1937 and the Railroad Unemployment Insurance Act to restore retroactively the exemption of railroad retirement and railroad unemployment insurance benefits against attachment or other legal process in connection with the collection of Federal taxes. This exemption had been eliminated when the Internal Revenue Code of 1954 was enacted.

Public Law 384, August 12, 1955, amends Section 112 (n) (8) of the Internal Revenue Code of 1939 to remove a discrimination against those in the Armed Forces of the United States who sold or exchanged their residences before 1954. For such persons, but not for those who have sold such residences since that time, the suspension of time restrictions for replacing the residences without tax consequences ended as of December 31, 1953. The new law provides that the replacement period under the 1939 Code, as is presently provided under the 1954 Code, is to be available to those on active duty with the Armed Forces during a period when an induction law is in effect but not for more than 4 years.

This act also adds to the 1954 Code a new section, Section 1342 which provides that where a taxpayer recovers in a fraud case involving patent infringement an amount of $3,000 or more, the tax for the year of recovery shall be the lesser of: (1) The tax computed by including the recovered item in the income of the recovery year; or (2) the tax computed by excluding the recovered item from the recovery year's income and adding to the tax so computed the increase in tax (including interest) of the prior year resulting from the restoration of the amount deducted in the prior year.

Public Law 385, August 12, 1955, amends the Internal Revenue Code of 1954 by making Section 542 (a) (2), which provides for treating as "individuals" certain charitable foundations or trusts in applying the stock ownership test for personal holding companies, inapplicable to long-established charitable founda-

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tions meeting certain conditions so that they may retain the tax status under which they have operated for many years.

Public Law 385 also amends Section 1233 of the 1954 Code relating to gains and losses from short sales. The amendment makes the short sales rules of subsection (b) (2) of Section 1233 inapplicable in certain arbitrage transactions.

International Financial and Monetary Developments

Exhibit 31.—Remarks by Secretary of the Treasury Humphrey, November 23, 1954, at the meeting of Ministers of Finance and Economy, Rio de Janeiro, Brazil

I am happy to participate in this meeting of Ministers of Finance and Economy. Many of us have met on other occasions, most recently at the annual meetings of the International Bank and International Monetary Fund two months ago. I am delighted to extend my acquaintance with you and to meet with you here.

Just before leaving Washington we discussed with President Eisenhower the views of the United States delegation on the problems we shall discuss here. He emphasized to us his deep interest in this historic meeting and asked that we convey a personal message to our colleagues here. With your kind permission I shall read it:

"I am very pleased to send greetings and best wishes to the meeting of Ministers of Finance and Economy of the American family of nations, convened in Rio de Janeiro, the capital of our great sister nation, Brazil. I am happy to send this message through our Secretary of the Treasury, Mr. Humphrey, who, as Chairman of the United States delegation, speaks for our Nation and will authoritatively present our policies.

"I am confident that this conference will advance still further the unique relationships which have developed among the peoples and nations of this hemisphere. As those relationships evolved and grew, the people of the United States learned to call their own attitude toward their sister nations the policy of the good neighbor. Today, the bonds which unite us as sovereign equals who are working side by side for the betterment of all of us, nations and citizens, have elevated this neighborly relationship to one of genuine partnership.

"No longer is it sufficient to maintain the mutual respect and cordiality of neighbors, useful and pleasant as that is. In the world of today, the well-being and the economic development, as well as the security, of all peace-loving nations are so closely interrelated that we must be partners. If this is true in the larger context, it is especially true among the American republics where we share the same traditions and many of the same favorable circumstances for progress.

"As the conference discusses a wide variety of measures for economic and financial cooperation in this hemisphere, and endorses those that are sound and durable, I earnestly hope that the meeting as a whole may join with the delegation of the United States in common dedication to the policy of the good partner.

"To this may I add my best wishes for the success of the conference and warm personal greetings to each of its members."

Let me say that every member of the United States delegation shares those convictions.

While this gathering was called in response to a resolution of the Tenth Inter-American Conference held in Caracas earlier this year, this conference is in reality the realization of a desire expressed repeatedly throughout the rise and development of the inter-American system. It is the desire to strengthen the continental economy so as to benefit all the nations that share the hemisphere.

That desire was first manifested in the act of the United States Congress that convened the first Pan American Conference in Washington 65 years ago. The same desire created the Pan American Union, which has now become the Organization of American States. Today it finds expression in the statutes of the Inter-American Economic and Social Council which provide that it shall "promote the economic and social welfare of the American nations through effective cooperation among them for the best utilization of their natural resources."

We are not gathered here, then, because of an emergency situation, nor is this meeting an impulse of the moment. It is not an isolated or disconnected event in inter-American relations; but it is a new endeavor, one more step in the search for economic cooperation and solidarity toward which your countries and mine will continually strive.

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Taxation Developments

Exhibit 7.—Statement by Secretary of the Treasury Humphrey, February 14, 1956, before the House Committee on Ways and Means on the problem of financing the highway program

I am very glad to have the opportunity to appear before you this morning to discuss the problem of financing the highway program, which we all agree is so important from many standpoints in the national interest.

It is now proposed that the program will be financed on a pay-as-you-build basis, rather than on a pay-as-you-ride basis. The only decision that remains to be made therefore is the selection of the particular taxes which will provide adequate financing.

The decisions on the particular additional or new taxes to be imposed is, of course, a matter for determination for the Congress. In the hearings over these next several days this committee will receive testimony which will be helpful in making this selection and in determining the amounts of the various taxes that will most fairly raise the necessary totals required. The Treasury Department will be glad to continue to work with you and your staffs in preparing the estimates of receipts from various alternatives and combinations of taxes.

We all recognize the importance of having a single, integrated highway program which will make it possible to plan and carry out the development of the interstate system as a unit. I will give you estimates this morning on the basis of a 12-year building and a 12-year spending program.

Over 12 years, total expenditures for the interstate system and for the primary, secondary, and urban programs under 1954 and prior authorizations and H. R. 8836, come to a total of $35.2 billion. The existing gasoline and diesel fuel taxes of 2 cents per gallon in a 12-year period available for this program will bring in $14.2 billion, leaving about $21 billion to be provided by new taxes.

We have figures showing the amount of revenue which would be derived in a 12-year period from an increase of 1 cent or in some cases of 1 percentage point in the rate of tax on various items which have been suggested to us as possible sources of additional revenue. These are:

	Billion
For each 1 cent:	
Gasoline	$6.6
Diesel fuel	.2
Lubricating oil	.2
Tires	.5
Camelback	.05
Tubes	.02
For each 1 percent:	
Trucks and buses	.350
Parts and accessories	.4
Registration fee at $1 per 1,000 pounds of weight:	
Automobiles	3.0
Trucks and buses registered for highway use	1.5

H. R. 9075, which is now before your committee, provides a 1-cent increase in gasoline and other fuel taxes, an increase from 5 to 8 cents a pound on tires and a new tax of 3 cents a pound on camelback, and an increase of 2 percent, from 8 percent to 10 percent, in the excise tax

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on trucks and buses to equal the present tax on passenger cars. These new taxes proposed under this bill in the 12-year period would bring in $9.1 billion, which is less than half the total required over the 12-year period and indicates the need for an additional $11.9 billion to finance the program on a pay-as-you-build basis. The calculation prepared in connection with this bill as used by the committee includes as available for this purpose over a 12-year period $2.6 billion of existing excise taxes on tires which are now included in our general revenues and which if diverted to this use will have to be raised in some other way to replace an equal amount to cover their loss in general revenue.

Estimates of tax receipts extending over a 12-year period inevitably involve the use of various underlying estimates in making the calculations and are subject to substantial margins of error. The projections used in the table which I have just referred to here are the same as those used by the Fallon committee a year ago and they have also been used in the revenue projections made by your committee in connection with H. R. 9075.

I want to call attention to one final point. I have referred to a $35.2 billion Federal expenditure for roads over a 12-year period. This, of course, does not indicate the full scale of road construction under the Federal program. A little over $10 billion or nearly one-third of the total goes back to the States for primary, secondary and urban roads which are financed by a 50–50 Federal matching grant. There will, accordingly, be an equivalent amount of State expenditures in this category. The expenditures on the interstate system would be a total of $25.1 billion on a 90–10 matching system, which means that there will be State expenditures of almost $3 billion in this category making total expenditures for roads under this program in 12 years of $48.1 billion.

Total road expenditures under Federal-aid program

[Billions of dollars]

Federal grants for:	
Primary, secondary, and urban	10. 1
Interstate	25. 1
Total	35. 2
State matching expenditures for:	
Primary, secondary, and urban	10. 1
Interstate	2. 8
Total	12. 9
Grand total	48. 1

With these expenditures, we can look forward to making up the present deficiencies in highway construction and securing a system of roads which we so badly need.

Everyone wants roads—more and better roads. The problem is to provide the money to pay for them on a pay-as-you-build basis.

Improved highway transportation is one of the great necessities of our times. A large part of our commerce and industry depends upon it. Our farms require it. The jobs of millions of men and women in this country depend upon it. The further growth of the great auto industry and all the ramifications in the use of steel, fuel, rubber, and

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thousands of products from hundreds of sources cannot continue to develop unless our highway transportation is developed concurrently. The Treasury is prepared to lend the fullest support to the deliberations of your committee and the Congress to the end that a highway program which all Americans need and want may be realized.

Exhibit 8.—Statement by Secretary of the Treasury Humphrey, May 17, 1956, before the Senate Finance Committee in general support of the highway program

I am glad to have this opportunity to appear before you this morning in general support of the highway program and to discuss its financial aspects, which are now before this committee.

Improved highway transportation is one of the great necessities of our times. A large part of our commerce and industry depends upon it. Our farms require it. The jobs of millions of men and women in this country depend upon it. The further growth of the great auto industry and all the ramifications in the use of steel, fuel, rubber, and thousands of products from hundreds of sources cannot continue to develop unless our highway transportation is developed concurrently. The Treasury is prepared to lend the fullest support to the deliberations of your committee and the Congress to the end that a highway program which all Americans need and want may be realized.

H. R. 10660 has been referred to as a pay-as-you-build program. I heartily endorse this policy of highway financing. But I want to point out to you two important respects in which the revenue features of this proposed program falls far short of the actual pay-as-you-build principle.

The bill as passed by the House showed an estimated balance between expenditures and tax receipts at the end of the 16-year period ending in 1972. However, after an initial 3 years with excess receipts over expenditures, there would be 10 successive years with an excess of expenditures over receipts, with annual deficiencies of from $500 million to $800 million in most of these years. The cumulative deficiency in the trust fund would begin in the sixth year (1962) and would exceed $4,700 million by 1969. This would be made good only in the last 3 years (1970, 1971, 1972). Furthermore, in striking this balance under the House bill, no provision was made during these last 3 years for regular allocation of funds to the primary, secondary, and urban road programs and expenditures for them would be limited to the unexpended balance of prior allocations with some purely arbitrary additions until the last year when any excess over the full amount required for reimbursement of the interstate deficiency would be available for the primary, secondary, and urban programs. This would leave an estimated deficiency in this latter program of approximately $1,450 million as compared with continuing the regular allocations to this program.

For 10 full years these large deficits would be a charge on the general budget. This discrepancy in timing contradicts an essential part of a real pay-as-you-build program.

The substitute authorizations for expenditures made by the Senate Public Works Committee change the total amounts and annual pattern of expenditures somewhat, but they would produce the same short of interim deficits. You will note on the first two tables [1] which you have received the estimates of expenditures, receipts, and the condition of the trust fund under the House bill and under the alternative expenditure program of your Senate Public Works Committee. To maintain comparability, the authorizations for the primary, secondary, and urban road programs in the alternative plan have been assumed to be continued at $900 million annually beyond 1961, as actually authorized, through 1969, the period of authorization of increasing annual authorizations under the House bill, thus providing about the same total amount for this program in each bill. Also, to maintain comparability, the estimated excess of receipts over the amount needed to reimburse the deficiency in the trust fund at the end of the entire period has been allocated to the primary, secondary, and urban program, as was done under the House bill.

You will note from the two tables that there are very few discrepancies between the two bills; the discrepancies are very minor. The expenditures under the Senate program are based upon the cost of a 40,000 mile interstate system, and this is one of the principal differences between the two bills. No provision is made

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in either bill for the cost of the additional 2,500 miles of interstate roads authorized in the Senate program since the routes have not even been specified. In other words, the House program is 40,000 miles, and the finances are based on that and the Senate bill provides the same finances, to all intents and purposes, but adds on this system 2,500 miles for which no money is provided at all.

If the cost of these additional miles were equal to the average costs of the 40,000 designated miles, the total costs of the interstate system as proposed in the Senate bill would be increased by about $1.7 billion.

To eliminate the prospective deficits under either the House bill or the alternative Senate plan, I urge that the bill be amended to permit allocation of funds to be so timed that the estimated expenditures from the allocations will not exceed the estimated available amounts in the trust funds. With this change, the program could be kept from being a charge on the regular budget. It could then be made, from this standpoint, a true pay-as-you-build program, and whenever annual allocations were desired which would exceed the amount of funds that would be then currently available in the trust fund, the Congress could promptly provide adequate additional taxes to cover the estimated deficit.

I am taking it for granted, gentlemen, that you all have in mind that the receipts go into a trust fund, and the expenditures for the roads are paid out of the trust fund under both bills. The system is that the taxes will be allocated to the trust fund as collected, and then the payment will be made out of the trust fund.

Now that is the first departure. Now the second departure from a real pay-as-you-build program comes from the dedication to the highway trust fund of the existing excise taxes on tires and tubes and three-eighths of the existing 8 percent on trucks and buses, beginning in the fiscal year 1958. The estimated annual amounts start at about $275 million and rise to almost $400 million, with a total of about $5 billion through 1972. This diversion of excise taxes which have always been regarded as part of the general revenues means that these amounts must be made up in the general budget by new taxes or by a continuation of old taxes which might otherwise be reduced. It thereby would become the equivalent of a special tax diversion in lieu of a general tax reduction for all taxpayers that might otherwise be possible.

The dedication of the existing gasoline and diesel fuel taxes is reasonable because they have come to be regarded as available for highway expenditures, and in recent years the regular highway program has been based on them. But the tire, tube, truck, and bus taxes are included in our regular excise tax program and have always been considered as part of the general revenue, along with all the other manufacturer's excise taxes. Their diversion to pay for highways is not really consistent with pay-as-you-build financing, and deflects our general revenue receipts.

The various taxes to be transferred to the highway trust fund under H. R. 10660 are shown in the third table [1] which you have before you. Estimates of receipts extending 16 years into the future are inevitably subject to substantial margins of error; but the projections used in these tables are the best available figures developed by the various staffs which have worked on the subject.

The Treasury Department did not make any specific tax recommendations to the House Ways and Means Committee. The new taxes included in H. R. 10660 are thus neither in accord with nor contrary to any recommendations of the Treasury, but I will take this opportunity to say that we have no objection to any of the proposed new taxes.

The Treasury Department will be glad to provide such information and other assistance as we can to this committee in its consideration of highway financing. In conclusion I repeat my strong endorsement of a national highway program, financed on a real pay-as-you-build basis. And I especially commend and urge you to adopt the amendment suggested to balance annual allocations with estimated receipts to be currently available in the fund.

Now, the purpose of that recommendation and my urging you to adopt it is this, that only in that way will this quickly and adequately become a real pay-as-you-build program, because if you adopt that amendment then as the allocations are made you would see immediately where the deficits in the funds are going to come, and that you want to allocate more than the fund will have money to provide and pay for, and therefore, the matter will be immediately raised for congressional consideration as to the imposition as to whatever additional taxes are required to keep the fund solvent currently all during the period, and you will not run into these big deficits that appear as the bill is now drawn.

[1] See also revised table p. 45.

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TABLE I.—*Highway program, H. R. 10660, as passed by the House of Representatives—Estimated expenditures and tax receipts, and status of trust fund, under allocations made by bill, and status of trust fund if present taxes on tires, tubes, and 3 percent on trucks, buses, and trailers are not allocated to trust fund, fiscal years 1957–72*

[In millions of dollars]

Fiscal year	Expenditures				Tax receipts						Trust fund		Trust fund without $4,944,000,000 of present taxes and including increased interest cost	
	Construction	Interest income (−), or expense (+)	Total expenditures		Present taxes			New taxes	Total tax receipts		Net annual credits (+), or charges (−)	Balance, credit (+), or debit (−) at end of year	Net annual credits (+), or charges (−)	Balance, credit (+), or debit (−) at end of year
			Annual	Cumulative	Gasoline and diesel fuel	Tires, tubes, and 3 percent on trucks, buses, and trailers	Total, present law		Annual	Cumulative				
1957	1,025	−5	1,020	1,020	868	....	868	612	1,480	1,480	+460	+460	+460	+460
1958	1,480	−16	1,464	2,484	1,021	277	1,298	688	1,986	3,466	+522	+982	+242	+702
1959	1,993	−23	1,970	4,454	1,059	290	1,349	714	2,063	5,529	+93	+1,075	−207	+495
1960	2,475	−20	2,455	6,909	1,093	284	1,377	730	2,107	7,636	−348	+727	−648	−153
1961	2,700	−11	2,689	9,598	1,129	297	1,426	760	2,186	9,822	−503	+224	−824	−977
1962	3,025	+4	3,029	12,627	1,164	303	1,467	778	2,245	12,067	−784	−560	−1,117	−2,094
1963	3,050	+21	3,071	15,698	1,201	313	1,514	803	2,317	14,384	−754	−1,314	−1,105	−3,199
1964	3,075	+37	3,112	18,810	1,236	322	1,558	826	2,384	16,768	−728	−2,042	−1,096	−4,295
1965	3,100	+53	3,153	21,963	1,271	325	1,596	856	2,452	19,220	−701	−2,743	−1,081	−5,376
1966	3,125	+68	3,193	25,156	1,304	340	1,644	879	2,523	21,743	−670	−3,413	−1,074	−6,450
1967	3,250	+84	3,334	28,490	1,343	347	1,690	901	2,591	24,334	−743	−4,156	−1,162	−7,612
1968	3,075	+98	3,173	31,663	1,378	353	1,731	924	2,655	26,989	−518	−4,674	−953	−8,565
1969	2,700	+105	2,805	34,468	1,412	363	1,775	944	2,719	29,708	−86	−4,760	−541	−9,106
1970	2,025	+99	2,124	36,592	1,445	369	1,814	964	2,778	32,486	+654	−4,106	+183	−8,923
1971	1,296	+75	1,371	37,963	1,475	374	1,849	981	2,830	35,316	+1,459	−2,647	+972	−7,951
1972	505	+30	535	38,498	1,697	387	2,084	1,098	3,182	38,498	+2,647	....	+2,137	−5,814
Total	37,899	+599	[1] 38,498	....	20,096	4,944	25,040	13,458	38,498	....	....	....	−5,814	....

[1] Excluding $150 million estimated to be paid in fiscal years 1973 and 1974.

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TABLE II.—*Highway program, H. R. 10660, as amended by the Senate Committee on Public Works—Estimated expenditures and tax receipts, and status of trust fund, under allocations made by bill, and status of trust fund if present taxes on tires, tubes, and 3 percent on trucks, buses, and trailers are not allocated to trust fund, fiscal years 1957–72*

[In millions of dollars]

Fiscal year	Expenditures				Tax receipts						Trust fund		Trust fund without $4,944,000,000 of present taxes and including increased interest cost	
	Construction	Interest income (−), or expense (+)	Total expenditures		Present taxes			New taxes	Total tax receipts					
			Annual	Cumulative	Gasoline and diesel fuel	Tires, tubes, and 3 percent on trucks, buses, and trailers	Total, present law		Annual	Cumulative	Net annual credits (+), or charges (−)	Balance, credit (+), or debit (−) at end of year	Net annual credits (+), or charges (−)	Balance, credit (+), or debit (−) at end of year
1957	1, 050	−5	1, 045	1, 045	868	----------	868	612	1, 480	1, 480	+435	+435	+435	+435
1958	1, 600	−14	1, 586	2, 631	1, 021	277	1, 298	688	1, 986	3, 466	+400	+835	+120	+555
1959	2, 050	−19	2, 031	4, 662	1, 059	290	1, 349	714	2, 063	5, 529	+32	+867	−268	+287
1960	2, 600	−14	2, 586	7, 248	1, 093	284	1, 377	730	2, 107	7, 636	−479	+388	−779	−492
1961	2, 800	−2	2, 798	10, 046	1, 129	297	1, 426	760	2, 186	9, 822	−612	−224	−932	−1, 424
1962	2, 900	+12	2, 912	12, 958	1, 164	303	1, 467	778	2, 245	12, 067	−667	−891	−1, 001	−2, 425
1963	2, 900	+27	2, 927	15, 885	1, 201	313	1, 514	803	2, 317	14, 384	−610	−1, 501	−961	−3, 386
1964	2, 900	+40	2, 940	18, 825	1, 236	322	1, 558	826	2, 384	16, 768	−556	−2, 057	−924	−4, 310
1965	2, 900	+51	2, 951	21, 776	1, 271	325	1, 596	856	2, 452	19, 220	−499	−2, 556	−879	−5, 189
1966	2, 900	+62	2, 962	24, 738	1, 304	340	1, 644	879	2, 523	21, 743	−439	−2, 995	−842	−6, 031
1967	2, 900	+71	2, 971	27, 709	1, 343	347	1, 690	901	2, 591	24, 334	−380	−3, 375	−799	−6, 830
1968	2, 900	+79	2, 979	30, 688	1, 378	353	1, 731	924	2, 655	26, 989	−324	−3, 699	−758	−7, 588
1969	2, 900	+85	2, 985	33, 673	1, 412	363	1, 775	944	2, 719	29, 708	−266	−3, 965	−721	−8, 309
1970	2, 350	+84	2, 434	36, 107	1, 445	369	1, 814	964	2, 778	32, 486	+344	−3, 621	−127	−8, 436
1971	1, 539	+67	1, 606	37, 713	1, 475	374	1, 849	981	2, 830	35, 316	+1, 224	−2, 397	+737	−7, 699
1972	758	+27	785	38, 498	1, 697	387	2, 084	1, 098	3, 182	38, 498	+2, 397	----------	+1, 887	−5, 812
Total	37, 947	+551	[1] 38, 498	----------	20, 096	4, 944	25, 040	13, 458	38, 498	----------	----------	----------	−5, 812	----------

[1] Excluding $150 million estimated to be paid in fiscal years 1973 and 1974.

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TABLE III.—*Estimated tax receipts allocated to highway trust fund, fiscal years 1957–72*

[In millions of dollars]

Fiscal year	Present law taxes						New or increased taxes							Total receipts	
	Gasoline (2 cents per gallon) [1]	Diesel fuel (2 cents per gallon)	Tires (5 cents per pound)	Inner tubes (9 cents per pound)	Trucks, buses, and trailers (3 percent of manufacturer's price)	Total, present law taxes	Gasoline (1 cent per gallon) [2]	Diesel fuel (1 cent per gallon) [3]	Tires (3 cents per pound) [4]	Tread rubber (3 cents per pound) [5]	Trucks, buses, and trailers (2 percent of manufacturer's price)	Trucks, over 26,000 pounds ($1.50 per thousand pounds, annual tax)	Total, new or increased taxes	Annual	Cumulative
1957	[6] 846	[6] 22	----------	----------	----------	868	407	10	95	8	47	45	612	1,480	1,480
1958	994	27	184	18	75	1,298	472	13	98	9	50	46	688	1,986	3,466
1959	1,031	28	191	18	81	1,349	489	13	100	11	54	47	714	2,063	5,529
1960	1,064	29	197	9	78	1,377	505	13	103	9	52	48	730	2,107	7,636
1961	1,099	30	204	9	84	1,426	522	14	108	11	56	49	760	2,186	9,822
1962	1,133	31	210	9	84	1,467	538	15	111	8	56	50	778	2,245	12,067
1963	1,169	32	217	9	87	1,514	555	15	111	12	58	52	803	2,317	14,384
1964	1,203	33	223	9	90	1,558	571	15	116	11	60	53	826	2,384	16,768
1965	1,237	34	229	9	87	1,596	589	16	124	14	58	55	856	2,452	19,220
1966	1,269	35	235	9	96	1,644	604	17	127	11	64	56	879	2,523	21,743
1967	1,307	36	242	9	96	1,690	622	17	129	12	64	57	901	2,591	24,334
1968	1,341	37	248	9	96	1,731	638	17	132	14	64	59	924	2,655	26,989
1969	1,375	37	255	9	99	1,775	654	18	135	11	66	60	944	2,719	29,708
1970	1,407	38	261	9	99	1,814	669	18	135	14	66	62	964	2,778	32,486
1971	1,436	39	266	9	99	1,849	683	18	140	11	66	63	981	2,830	35,316
1972	[7] 1,650	[7] 47	273	9	105	2,084	777	22	145	14	76	64	[8] 1,098	3,182	38,498
Total	19,561	535	3,435	153	1,356	25,040	9,295	251	1,909	180	957	866	13,458	38,498	----------

[1] After deduction of refunds of tax on farm gasoline, estimated at 6 percent.
[2] After deduction of all use in other than highway-type vehicles, estimated at 10 percent, and use by transit systems, estimated at $4 million annually.
[3] After deduction for transit use, estimated at $1 million annually.
[4] After deduction of tires for nonhighway-type vehicles, estimated at 12 percent.
[5] After deduction of rubber for tires for nonhighway-type vehicles, estimated at 6 percent.
[6] Excludes receipts from taxes accrued prior to July 1, 1956.
[7] Including receipts after June 30, 1972, of taxes accrued on or before that date.
[8] Including receipts after June 30, 1972, of taxes accrued on or before that date, less floor stocks refunds paid in 1973.

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Exhibit 9.—Letter of Secretary of the Treasury Humphrey, March 6, 1956, to the Chairman of the House Committee on Interstate and Foreign Commerce, concerning the opposition of the Treasury to the tax deduction under H. R. 9065 for employee contributions to the railroad retirement fund

My Dear Mr. Chairman: This is in reference to a request for the Treasury Department's views on H. R. 9065 and other identical bills to amend the Railroad Retirement Act of 1937 to provide increases in benefits and for other purposes.

The Department is primarily interested in Section 5 of these bills which excludes employees' contributions to the railroad retirement program from both withholding tax and from taxable income. Such exclusions are not permitted under existing law. After the increase in the contribution rate provided by the bills, such exclusions would amount to 7¼ percent of the covered employee's wages.

Though the bills increase both employee and employer contributions by 1 percent of covered wages to pay for the higher benefits, employees would actually pay a smaller net amount than at present. The income tax reductions resulting from the exclusion would be larger than the increase in their contributions. The bill thus would shift the employee's share of the cost of the proposed increase in benefits to the Federal Government. It would also shift to the Federal Government part of the cost of the existing program.

These exclusions would have far-reaching implications for the income tax system. Employee contributions to the railroad retirement program are a form of savings for retirement and other contingencies. If savings of railroad employees are excluded from taxable income, other groups could be expected to demand comparable exclusions for other types of savings for retirement, including contributions to employer pension plans, the OASI program, and private annuities.

The fact that railroad retirement benefits are already exempt from tax adds to the problem. If, in addition to the present exemption of benefits, employees' contributions were excluded, no tax would be paid on the income represented by such contributions at any time.

Such exclusions would cause very substantial losses in revenue. The exclusion of railroad retirement contributions alone would involve an annual revenue loss estimated at $70 million. If a similar exclusion were given to social security contributions, the cost would be increased by another $600 to $700 million annually.

In view of these considerations, the Treasury Department strongly opposes the enactment of any bill which contains an income tax exclusion for employee contributions under the railroad retirement program.

The Director, Bureau of the Budget, has advised the Treasury Department that there is no objection to the presentation of this report.

Sincerely yours,

G. M. Humphrey,
Secretary of the Treasury.

Exhibit 10.—Letter of Secretary of the Treasury Humphrey, March 15, 1956, to the Chairman of the House Committee on Interstate and Foreign Commerce, urging the committee to act unfavorably on H. R. 9065, to amend the Railroad Retirement Act

My Dear Mr. Chairman: On March 6 I wrote you concerning the opposition of the Treasury to the tax deduction under H. R. 9065 for employee contributions to the railroad retirement fund. I wrote you then that the immediate cost to the Treasury would be $70,000,000 a year. We now find that exemption of employee deductions for social security contributions, which are the same as railroad retirement contributions, would cause a revenue loss of $630,000,000.

Since my first letter, we have continued to study the possible consequences of similar exemptions if applied to additional forms of pension plans. We find that two other groups would involve the following annual revenue loss:

Federal employees under Federal retirement plan	$110, 000, 000
State and local employees under State and local pension plans	$130, 000, 000
Thus the total revenue loss would be about	$940, 000, 000

This loss of nearly one billion dollars is the crux of the situation which makes the action being considered by your committee very serious. Should the tax exemption be given railroad employees it would seem that, out of fairness, similar treatment should properly be given the millions of people who contribute to these retirement systems without having such contributions treated as tax deductions.

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The revenue loss could run to another billion dollars or more if this principle led to demands that all individuals be allowed a deduction of up to 7¼ percent of income provided such percentage of income was paid out as a social security contribution, as a contribution under private pension plans, or as an individual saving for retirement.

For these reasons the Treasury strongly urges this committee to act unfavorably on the bill before it.

Very sincerely yours,

G. M. HUMPHREY,
Secretary of the Treasury.

EXHIBIT 11.—Statement by Dan T. Smith, Special Assistant to the Secretary of the Treasury in Charge of Tax Policy, July 3, 1956, before the House Committee on Ways and Means, on H. R. 10578 and H. R. 11764 to amend the Railroad Retirement Act

The Treasury Department appreciates the opportunity to present its views on H. R. 10578 and H. R. 11764. These bills would amend the Railroad Retirement Tax Act to exclude employees' contributions to the railroad retirement program from both withholding tax and taxable income. After the increase in the contribution rate provided by H. R. 10578, the exclusions would amount to 7¼ percent of covered wages. H. R. 11764, taken by itself, would grant exclusions of 6¼ percent of covered wages, the current contribution rate.

However, if adopted together with a number of bills now pending to increase railroad retirement contributions by 1 percent, H. R. 11764 would provide exclusions amounting to 7¼ percent of covered wages. Exclusions for such contributions are not permitted under present law. It should be made clear, at the outset, that while the bill speaks of "exclusions," and that is the correct technical term, the effect is equivalent to allowing the employee a current deduction from gross income of an amount equal to the taxes paid. No such tax treatment is given to social security taxes, of course, or to contributions to any other public or private retirement systems.

These proposed exclusions would represent a fundamental departure from established principles of Federal income taxation. They would create a special tax advantage not available to any other group of employees in the country. Employee contributions to the railroad retirement programs are a form of savings for retirement and other contingencies. If these savings of railroad employees are excluded from taxable income, other groups could be expected properly to expect comparable exclusions for other types of savings for retirement, including contributions to the OASI program, private pension plans, and annuities leading to a total annual revenue loss of more than $2 billion.

Present law already gives considerable benefits to people covered by the railroad retirement system. It already completely excludes all railroad retirement benefits from taxable income. Unlike private pension plans and annuities, and the proposals for special treatment of private retirement plans of the self-employed, the present law thus excludes not only the part of the railroad retirement benefits representing the employee's contributions but also the part representing the employer's contribution and accumulated interest. If, in addition to the present total exemption of benefits, employees' contributions were excluded, no tax would be paid on the income represented by such contributions at any time. This would clearly discriminate against other taxpayers including self-employed people who are not eligible for any of the tax advantages received by employees under employer-financed pension plans and who save for retirement out of income that has been subject to income tax.

The fact that railroads are permitted to deduct their contributions to the railroad retirement fund is not in any sense relevant to the deductibility or nondeductibility of employees' contributions, as is sometimes claimed. The railroads' contributions are a business expense in the form of indirect compensation to employees, and are properly deductible by the employer as an ordinary and necessary business expense, just as are social security taxes paid by the employer, unemployment taxes, contributions to qualified pension plans, and the like. However, there is no parallel between the allowance of this deduction of a business expense and the proposed exclusion of a part of a railroad employee's own income, which is used to finance part of his own retirement benefit.

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As a result of the exclusions, the net cost to employees of the increased contributions to the railroad retirement fund proposed by H. R. 10578 would actually be reduced below the present level. The income tax reductions resulting from the exclusion generally would be larger than the increase from 6.25 to 7.25 percent in employees' contributions. If the contributions were excluded from the first bracket 20 percent rate, the net cost of employees' contributions to the railroad retirement program would be 5.8 percent of wages compared with 6.25 percent at present. If the contributions to the railroad retirement program remained at the present level of 6.25 percent, the net cost to covered individuals would be cut to 5 percent of covered wages. The effect of enactment of this bill, therefore, would be to shift to the Federal Government and to taxpayers generally not only the employee's share of the cost of any increase in benefits that may be adopted with the proposed increase in contributions, but also part of the cost of the existing program.

Despite claims to the contrary, neither British nor Canadian tax practice offers a precedent for the tax treatment provided by the bill. In Canada, social security is financed by additional rates imposed under general taxes on incomes and sales, and the benefit payments are taxable when received. In Great Britain, employees' contributions to social security plans are currently excluded but in contrast to the exempt treatment in this country the full amount of the pension is taxable when received. Neither country permits both a tax deduction or exclusion of contributions from income and tax exemption of benefits.

I might digress just to interject, here, that this reference to the British and Canadian experience I have put in simply because the point has often been raised when this matter was up for consideration before other committees.

Exclusions for income invested in specified forms of retirement savings would cause very substantial immediate losses in revenue. The exclusion of railroad retirement contributions, amounting to 7¼ percent of covered wages, alone would involve an annual revenue loss estimated at $70 million. Even if the railroad retirement contributions remained at 6¼ percent of covered wages, the annual revenue loss of excluding such contributions would be $60 million. Similar exclusions for employee contributions to the social security system would cost $630 million annually, and for employee contributions to both private and Government pension plans $330 million. The annual cost of all these exclusions combined would exceed $1 billion.

If all individuals were allowed to exclude up to 7¼ percent of their incomes for savings for retirement, and in fact saved the full amount thus allowed, the annual revenue loss could run to $2 billion or more. That is a total figure, including the billion in the preceding paragraph.

In conclusion, I should like to quote from the resolution unanimously adopted by this committee on March 13, 1956, as released to the press on March 14. The points contained therein seem especially significant. The resolution referred to H. R. 9065 and other identical bills providing increases in railroad retirement benefits and giving tax exclusions to employee contributions. The resolution of this committee stated in part:

"Whereas the said bills provide that the employees' contributions to the railroad retirement program shall be excluded from gross income for Federal income tax purposes;

"Whereas such a tax provision represents a complete departure from established principles of Federal income taxation and would create a special tax advantage not available to any other group of employees in the country;

"Whereas, the provision in question thus involves fundamental principles of tax policy, including basic questions of fairness and equity in the tax system as a whole;

"Whereas, such a tax provision, if enacted, would result in shifting to the Federal Government and, thus, to taxpayers generally the employee's share of the cost of the proposed increase in railroad retirement benefits and a portion of the cost of the existing program;

"Whereas, such a tax provision, if enacted, would necessitate logically the extension of a similar tax benefit to the members of other retirement systems at a cost to the Federal revenue of several billion dollars annually;

"Whereas the ultimate revenue effects of the tax provision in question manifestly contain serious implications with regard to the Federal budget and the tax burden of taxpayers generally; and then, after an omission of something dealing with the jurisdictional matter,

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"Whereas if the tax provision in question were enacted the Committee on Ways and Means necessarily would have to consider further legislation to grant equivalent treatment to other retirement systems."

For the foregoing reasons the Treasury strongly urges this committee to act unfavorably on any bill which contains an income-tax exclusion for employee contributions under the railroad retirement program out of fairness to the millions of people who contribute to retirement systems without having any such advantages.

I might add, Mr. Chairman, that the Treasury Department position as I have just stated it was stated previously both to the House Committee on Interstate and Foreign Commerce and the Senate Committee on Interstate and Foreign Commerce, when they were dealing with bills combining the increase in benefits and the tax exclusion. I reviewed this subject with the Secretary of the Treasury yesterday afternoon before coming up here. He advised me that our position, of course, was in no sense changed from that earlier position which had been taken.

I further have checked with the Director of the Budget this morning, and he informs me that the proposed legislation giving tax exemption is not in accordance with the President's general program. So I speak for the Director of the Budget as well as the Secretary of the Treasury this morning.

Exhibit 12.—Letter of Secretary of the Treasury Humphrey, March 26, 1956, to the Chairman of the Senate Finance Committee on H. R. 7225 to provide important changes in the social security program

My Dear Mr. Chairman: This is in response to your request for the Treasury Department's views on H. R. 7225, which would make important changes in the social security program and which the Senate Finance Committee now has under consideration.

The bill would extend the coverage of the old-age and survivors insurance program to include several groups not now covered by the program, notably self-employed professional groups other than physicians. It would lower the age at which women could qualify for retirement benefits from 65 to 62, whether they qualified in their own right or as widows or wives of insured persons. In addition, a new category of cash benefits for total and permanent disability would be created. To finance the proposed changes, H. R. 7225 increases payroll taxes on wages by 1 percent (half to be paid by employees, and half to be paid by employers), and the tax on self-employment income by ¾ percent.

Extension of the old-age and survivors insurance program to noncovered groups in the population is highly desirable. It is in the interest of the individuals and their families who would come under the plan and, insofar as it improves the financing of the plan, it is in the interest of those already covered. However, we would urge the committee to extend coverage beyond that provided in the bill, particularly to Federal civilian employees and the Armed Forces. The recommendation to cover Federal civilian employees was made in 1954 by the committee established under congressional authorization to study retirement programs of the Federal Government. The inclusion of members of the Armed Forces, which would also be desirable, is provided in H. R. 7089, which is now pending before your committee.

The provisions of the bill lowering the age at which women qualify for retirement benefits and for the establishment of cash benefits for total and permanent disability and the necessary increases in payroll taxes to finance these new benefits have been commented on by Secretary Folsom in his testimony before your committee. The Treasury Department concurs in the recommendations made by the Department of Health, Education, and Welfare, and I have nothing to add in terms of elaboration or additional comment.

In the light of these considerations, the Department recommends that your committee report a bill to expand the coverage of the old-age and survivors insurance program and eliminate the increased taxes and new benefit features of H. R. 7225.

The Director, Bureau of the Budget, has advised the Treasury Department that there is no objection to the presentation of this report.

Sincerely yours,

G. M. Humphrey,
Secretary of the Treasury.

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Exhibit 13.—Statement by Dan T. Smith, Special Assistant to the Secretary of the Treasury in Charge of Tax Policy, October 4, 1955, before the Subcommittee on Excise Tax Technical and Administrative Problems of the House Committee on Ways and Means

The Treasury Department welcomes the opportunity afforded by these hearings of the Subcommittee on Excise Tax Technical and Administrative Problems of the Ways and Means Committee to secure, through the testimony which will be presented to you, comprehensive and up-to-date suggestions of taxpayers on the technical and administrative aspects of excise taxation. We share the committee's interest in the subject. The extensive material which will be presented in the hearings will be of great benefit to us in our own continuing review of problems in this area.

In 1953, as part of the preparation of recommendations concerning tax legislation for 1954, the staffs of the Treasury Department and the Internal Revenue Service examined the proposals which had been made up to that time by taxpayers and various groups outside the Government for modifications of the administrative and technical aspects of excise taxation. Discussions were also carried on with those responsible for the administration of these taxes in the Internal Revenue Service to get their suggestions for improvements. Several joint conferences were held with the staff of the Joint Committee on Internal Revenue Taxation on the subject. It was contemplated, for a time, that it would be possible to develop a number of recommendations to present to the Ways and Means Committee in connection with the general revision of the Internal Revenue Code in 1954. Under the time pressures which developed, however, it was not possible to include excise-tax problems in the Department's tax recommendations. In the intervening months, various other suggestions have come in to the Department, but it has not been feasible to secure a comprehensive set of proposals by taxpayers on the interrelated aspects of this general problem.

We find it especially important to deal with individual problems in the excise-tax area only after full consideration of their possible connections with other problems. So often, a change which might appear to solve a problem or relieve an inequity will create more serious new problems or inequities, which with greater foresight might have been anticipated and avoided.

The testimony which will be presented at the hearings will, we are sure, be of great value by providing a full and up-to-date coverage of suggestions by taxpayers. We hope it will be possible to have joint conferences with your staff in reviewing and examining the material which will be presented to you here.

After conferences with members of your staff, the Treasury Department has prepared three different items for presentation to the subcommittee. In the first, embodied in my present statement, I shall indicate briefly the principal categories into which the complaints and suggestions which we receive, other than those having to do with rates, seem to fall. In doing so, I shall attempt to list some of the alternative ways in which the problems which give rise to those suggestions may be approached.

After I conclude my presentation, Mr. Justin Winkle, Assistant

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Commissioner (Technical), who has had extensive experience in many aspects of the work of the Internal Revenue Service, will describe the procedures used in the Service in connection with the preparation and publication of rulings on excise tax matters, collections, and audits.

The third item in our presentation will be a working draft of a revision of chapter 51, and certain parts of chapters 52 and 53, of the Internal Revenue Code. This is being made in accordance with the direction of the Ways and Means Committee in its report on H. R. 8300 which stated (H. Rept. No. 1337, 83d Cong., 2d sess., p. 95):

Due to a lack of time the revision of the distilled-spirits provisions was more limited than in the case of the provisions relating to the other alcoholic beverage and tobacco taxes. In view of this, at the direction of your committee an Alcohol Tax Survey Committee of the Treasury Department is now working with a committee of the distilled-spirits industry to consider further changes for submission to the next Congress.

This will be presented by Mr. Dwight E. Avis, Director of the Alcohol and Tobacco Tax Division of the Internal Revenue Service. I wish to emphasize that the material which he presents will be a working draft, as developed by the committee in his division working with a committee of the distilled-spirits industry on technical and administrative matters. This draft was not available in the Treasury Department until the end of last week, and in the intervening days it has not been possible to have it reviewed by the Treasury staff and the officials concerned with policy in this area. It is almost inevitable that some things which may be deemed appropriate by those who administer the law will have to be modified when they are reviewed from the standpoint of general policy.

Specifically, and merely as one example, to the extent that there is any adverse effect on the revenues from the proposed changes, the Treasury Department will withhold favorable recommendations at this time. With the understanding that the draft which Mr. Avis presents does not constitute a recommendation of the Treasury Department, it seems useful to take this occasion to make it available for examination and comment.

As Mr. Avis will indicate, the proposed revision of chapter 51 does not deal with five controversial areas. Each of these involves complex administrative problems, has serious competitive and economic ramifications, and is the basis for intense and conflicting feeling within the industries affected. Many of them have existed for generations. In the belief that the existence of these controversial problems should not delay consideration of the other noncontroversial improvements, we have studiously avoided suggesting any change in the law in these five areas. The draft which will be presented to you simply carries forward the old law on these issues.

On the technical aspects of the law, the following classifications have seemed helpful to us in our own analysis of the suggestions which come to us. First, there are numerous suggestions for exemption for particular items from one or another of the excise taxes. These invariably have an adverse effect on the revenue and from this standpoint are as serious as reductions in rates.

We have found that there are at least four reasons given for proposed exemptions. Sometimes they are advanced on the grounds that

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the thing subject to tax is believed to have an important social purpose. Various exemptions now in the law appear to be based on these grounds, especially the exemptions from admissions tax for activities which are cultural or educational in purpose, or the proceeds of which go to charitable activities.

The second reason advanced for giving exemptions is an alleged need to redress a competitive inequity between competing activities or industries. This, for example, is the basis for the elimination of the tax on Sen-Sen, as provided in H. R. 4668, passed by the House in the last session of the Congress. Inevitably some things taxed will be more or less competitive with other things which are not taxed.

The third reason for asking for relief is a state of distress in a particular industry, either temporary or arising from long-term secular changes in the demands for particular products.

The fourth reason sometimes advanced for exemption is simply that the dollar amount of revenue involved is relatively small, and the administrative burden on both taxpayers and the Government is not justified, so it is claimed, by the revenue collected. This argument is usually associated with one of the preceding reasons.

Experience has indicated that any exemptions granted, no matter how justifiable they may appear at first sight to be, are likely to lead to claims for other exemptions. Exemptions for a particular activity on the basis of a charitable or social purpose almost inevitably lead to claims for exemptions by others with somewhat similar activities. Those who consider that their activities are equally worthy of special treatment contend that they are being discriminated against if they do not get an exemption. Also, when exemptions for charitable or social purposes are granted, charges of unfair competition are likely to be made by those whose products are subject to tax. The admissions tax has raised many problems of this sort.

A second set of problems arises in connection with the classification of a particular item into one or another of two categories which may be subject to different rates of tax, or one of which may be taxed and the other untaxed. Examples of this sort of problem occur in connection with the determination whether jewelry of a religious nature is exempt because it is used for religious purposes or is taxable because it is ornamental. Also, cigarette lighters may be taxable either as such at 10 percent of manufacturer's price, or, if they are sufficiently decorated they may be taxed as jewelry at 10 percent of the retail price.

The third type of problem arises in developing a line of demarcation between the process of manufacturing and mere repair activity in the application of a manufacturer's excise tax. In most cases, no problems are involved, but there are some borderline situations in which the amount of new material or the extent of reprocessing really converts what is asserted to be a repair into a manufacturing operation.

It is quite understandable that in these borderline situations, some taxpayers will argue that their activities do not constitute manufacturing, while representatives of competing manufacturers insist that they would be placed at an unfair competitive disadvantage if those engaged in extensive processing are not subject to comparable taxes. While the statute contains specific provisions to deal with trade-in

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allowances on rebuilt automobile engines, it remains a problem to distinguish between rebuilding and repairing operations.

Another sort of problem in the definition of a manufacturer has to do with fixing the point of manufacture when a succession of companies handle various stages of production. There is a natural desire by taxpayers to have a tax imposed at the first possible stage of production because the tax base is thus kept at a minimum. For example, it may be argued that even though a company advertises, guarantees, distributes, and puts its own brand name on a product, it should be taxed to another company which physically produces the product. Other companies, however, which carry on all these production processes contend that if the tax is based only on physical processing, they would be placed at a disadvantage or forced to create artificial arrangements to secure an equal competitive treatment.

Another type of problem arises in determining the proper excise tax base for manufacturers who carry on their own distribution up to the retail level as compared with those who sell finished products to jobbers and wholesalers. It is sometimes urged that manufacturing companies which have extensive distribution systems and costs should be permitted, instead of paying the tax on their actual sales prices, to use a lower price which it is presumed they would have charged if they sold to jobbers and wholesalers in the same manner as their competitors do. Suggestions of this sort often seem well founded because the greater tax burden on a firm which does carry out its own distribution is very real. However, any attempts to determine proper presumptive prices would inevitably lead to controversy and would involve a delegation of a large amount of additional administrative discretion to the Internal Revenue Service. The rule of basing the tax on invoice price does assure the important element of certainty.

Another set of problems arises in connection with the treatment of taxable items which may be incorporated by other manufacturers into nontaxable products. The question is whether a taxed item in some sense loses its identity and hence should become nontaxable when it is used as a component in a larger or more elaborate article. This problem appears in connection with tires and radios used in the manufacture of automobiles.

The final set of problems deals with the technique of establishing refunds, credits, or exemptions on items destined for tax-exempt uses, as, for example, sales to States and municipalities and in connection with exports. This, however, is largely a procedural matter and hence may be better handled in connection with the consideration of collections and audits.

In all the foregoing areas, it is of course quite natural for taxpayers to advance arguments to justify either administrative treatment or special statutory provisions which will minimize their tax burdens. They will also be on the alert to arrange their affairs in such a manner as to take advantage of any special provisions which may exist.

In the Treasury Department, we feel it is our responsibility to administer and apply the tax laws, as they are passed by the Congress, in a way to place a minimum inconvenience on taxpayers, combined with full protection of the revenues and reasonable administrative

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burdens upon the Government. We recognize a further responsibility to observe the operation of the laws and to make recommendations for their improvement, both for the purpose of removing unnecessary compliance burdens and inequities on taxpayers, and for the purpose of protecting the revenues.

Our own investigations in these areas are not yet complete, and it would be premature at this time to make any specific recommendations to the committee on possible changes in the technical and administrative aspects of the excise-tax laws.

Mr. Winkle and a number of specialists from the Internal Revenue Service are here and we shall undertake jointly to provide such information as may be desired by the committee on such aspects of the subject as you may wish information.

EXHIBIT 14.—Announcement by the Treasury Department of an agreement negotiated with the French Ministry of Finance and Economic Affairs concerning the application of French turnover taxes to license fees received by American owners of patents, copyrights, etc., licensed for use in France (memorandum to the Press, February 14, 1956) [1]

The Treasury Department announced today that an agreement had been reached with the French Ministry of Finance and Economic Affairs concerning the application of French turnover taxes to license fees received by American owners of patents, copyrights, trademarks, and manufacturing processes or formulas licensed for use in France.

The agreement is effective February 15, 1956, in accordance with an exchange of letters by the Secretary of the Treasury and the French Minister of Finance.

Under the terms of the agreement an American licensor who qualifies as an inventor is exempt from the French turnover tax. American firms have six months within which to establish their status as inventors.

The agreement was reached in connection with a proposed protocol to the existing Franco-American tax convention which has been negotiated and will soon be submitted to the Senate.

EXHIBIT 15.—Miscellaneous revenue legislation enacted by the Eighty-fourth Congress, Second Session

Public Law 396, January 28, 1956, adds a new paragraph to Section 381 (c) of the Internal Revenue Code of 1954 to make available to a successor corporation as a deduction in years beginning after December 31, 1953, and ending after August 16, 1954, the carryover of unused excess contributions made by a former subsidiary corporation to a pension plan in cases where (1) the corporate laws of the State of incorporation of the subsidiary required the surviving corporation in the case of a merger to be incorporated under the laws of the State of incorporation of the subsidiary, and (2) the properties were acquired in a tax-free liquidation of the subsidiary under Section 112 (b) (6) of the 1939 Code.

Public Law 397, January 28, 1956, amends Section 311 (b) (4) of the 1939 Code to permit an extension of time for claiming credit or refund of income tax by transferees or fiduciaries where an agreement has been entered into extending the period of limitation for assessments. This amendment is effective in all circumstances in which it would have been effective if it had been enacted on August 17, 1954.

Public Law 398, January 28, 1956, amends Section 37 of the Internal Revenue Code of 1954 to lower from 75 to 72 the age at which the maximum credit for retirement income will not be reduced as the result of the earned income of the individual, and to increase to $1,200 the amount of income which may be earned by a person between 65 and 72 years of age without reduction of the credit. The

[1] For text of agreement, see Senate report "Executive J.," 84th Cong., 2d Session, pp. 6–15

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rule with respect to persons under 65 years of age remains unchanged. These changes are applicable to taxable years beginning after December 31, 1955.

Public Law 399, January 28, 1956, amends Section 117 (c) (1) (A) of the 1939 Code to provide that in the computation of corporate credits for intercorporate dividends received, for dividends paid on certain preferred stock, and for Western Hemisphere trade corporations, a corporation's net income for taxable years beginning after December 31, 1951, and before January 1, 1954, is to be determined without reduction for the excess of the long-term capital gain over the short-term capital loss.

Public Law 400, January 28, 1956, amends Section 4332 of the Internal Revenue Code of 1954, relating to the exemption from tax on sales or transfers of certificates of indebtedness, by inserting a new subsection (b) to provide that the tax imposed by Section 4331 shall not apply to any instrument under the terms of which the obligee is required to make payment therefor in installments and is not permitted to make in any year a payment of more than 20 percent of the cash amount to which entitled upon maturity of the instrument.

Public Law 408, February 15, 1956, amends Section 120 of the 1939 Code relating to unlimited deductions for charitable contributions to provide that the 90 percent test need be met in only 8 out of 10 of the preceding taxable years instead of in each of the prior 10 years. Any refund attributable to an overpayment of tax resulting from this amendment is to be permitted only if the amount of the refund is paid immediately as a charitable contribution.

Public Law 414, February 20, 1956, amends Section 2011 of the Internal Revenue Code of 1954, by adding a new subsection (e) which provides that no credit shall be allowed for any State death tax for which a deduction is allowed under Section 2053 (d), and that the amount allowable as a credit for State death taxes shall not exceed the lesser of (A) the amount that is allowable for a taxable estate determined by allowing the deduction provided in Section 2053 (d), or (B) the amount of the credit computed without regard to Section 2053 (d) which is attributable to the State death tax on transfers other than those described in Section 2055, or in the case of nonresident aliens, Section 2106 (a) (2). The act also adds a new subsection to Section 2053 which provides that, if the executor elects within the period provided, a deduction may be taken, subject to certain conditions, for the amount of any estate, succession, legacy, or inheritance tax imposed by a State upon a transfer by the decedent for public, charitable, or religious uses as described in Section 2055 or, in the case of nonresident aliens, Section 2106 (a) (2). This provision is applicable to the estates of decedents dying after August 16, 1954. These amendments to the 1954 Code are made applicable to Chapter 3 of the 1939 Code with respect to estates of decedents dying after December 31, 1953.

Section 1 of Public Law 414 amends Section 208 (b) of the Technical Changes Act of 1953, which grants relief from the estate tax in certain disability cases, by extending its application to estates of decedents dying after December 31, 1947, instead of December 31, 1950.

Public Law 417, February 20, 1956, adds a new Section 814 to the Internal Revenue Code of 1939 which provides that an executor of an estate may elect, with respect to estates of decedents dying after December 31, 1951, to take a credit against the estate tax for the amount of tax paid on property passing to the decedent from a person who was the spouse of the decedent at the time of such person's death and who died within two years prior to the decedent's death. If the executor claims the credit provided by the new Section 814, he may not take a deduction under Section 812 (c) for property previously taxed.

Public Law 495, April 27, 1956, amends Section 1237 (a) of the Internal Revenue Code of 1954, to extend the capital gains treatment to corporations in the case of certain property acquired through the foreclosure of a lien thereon, but only if no stockholder directly or indirectly holds real property for sale to customers in the ordinary course of trade or business. Subsection (b) (3) of Section 1237 is amended to add "drainage facilities" to the improvements which a taxpayer may install, and to provide that in determining whether an improvement is to be considered a substantial improvement in the case of property acquired through the foreclosure of certain liens the requirements of subparagraphs (B) and (C) are not to apply.

Public Law 511, May 9, 1956, "Bank Holding Company Act of 1956," amends subchapter O of Chapter 1 of the Internal Revenue Code of 1954 by adding a new part VIII. This part specifies the extent to which gain will not be recognized upon receipt of property by a shareholder of a bank holding company if such

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distribution is made pursuant to a certification by the Board of Governors of the Federal Reserve System that such a distribution is necessary or appropriate to effectuate the act. The new provisions are applicable only to gain directly attributable to the receipt of property in such distributions. Special rules for determining the basis of property so distributed are also provided.

Public Law 545, May 29, 1956, extends to June 30, 1961, the period during which the excise and import compensating tax is applicable to sugar. Sections 4505 and 6418 (a) of the Internal Revenue Code of 1954 are amended by Section 19 of the act to provide that either the excise tax or the import compensating tax, whichever is applicable, may be refunded on sugar used for livestock feed or for the distillation of alcohol.

Public Law 628, June 29, 1956, amends Section 373 of the Internal Revenue Code of 1954 and adds a new Section 374. Under Section 373 of the 1954 Code no loss is recognized where property of a railroad corporation is transferred pursuant to a court order in a receivership proceeding or in a proceeding under Section 77 of the Bankruptcy Act to another railroad corporation organized for purposes of effectuating a plan of reorganization approved by the court. The amendment to this section limits it to transfers before August 1, 1955. The new Section 374, applicable to transfers after July 31, 1955, provides for nonrecognition of gain or loss in such receivership or bankruptcy reorganizations except in the case of certain transfers resulting in gain where "boot" is received but is not distributed in pursuance of the plan of reorganization. The basis of the property acquired after July 31, 1955, is the same as it would be in the hands of the transferor, increased by the amount of gain recognized. The act is applicable to taxable years beginning before December 31, 1957.

Public Law 629, June 29, 1956, amends the Internal Revenue Codes of 1939 and 1954 as follows:

The first section of this act adds a new subsection (q) to Section 117 of the 1939 Code providing capital gains treatment for royalties received after May 31, 1950, from the sale or exchange of patent rights, in the same manner as under the 1954 Code.

Section 2 of the act amends Section 106 of the 1939 Code. Section 106 limits the surtax on individuals to 30 percent in the case of amounts received from the United States on claims involving acquisition of property. This amendment extends the application of Section 106 to payments received from the United States arising under a contract for the construction of installations or facilities for any branch of the armed services of the United States and remaining unpaid for more than 5 years from the date the claim first accrued and paid prior to January 1, 1950. The amendments are applicable to taxable years ending after December 31, 1948, notwithstanding the operation of any law or rule of law other than provisions relating to closing agreements and compromises. The period of limitation for allowance of an overpayment in no case expires before June 29, 1957.

Section 3 of Public Law 629 adds a new subsection (n) to Section 115 of the 1939 Code relating to distributions by corporations. Under certain court decisions, corporate distributions of property are taxed as dividends to shareholders in amounts greater than the earnings and profits of the corporation available for dividend distribution. This amendment provides that corporate distributions of property be treated as dividends only to the extent they represent distributions of earnings and profits of the corporation. The general effect of the amendment is to overrule such court decisions. The amendment is effective as if it were a part of Section 115 on the date of enactment of the 1939 Code but there is no provision for reopening barred cases.

Section 4 of the act adds a new Section 177 to the Internal Revenue Code of 1954 which permits, at the election of the taxpayer, amortization of the cost of acquiring, protecting, expanding, registering, or defending trademarks and trade names over a period of not less than 60 months. Such costs must not be part of the consideration paid for the purchase of an existing trademark, trade name, or business. This amendment applies only to expenditures paid or incurred during a taxable year beginning after December 31, 1955.

Section 5 of the act adds a new subsection (f) to Section 1033 of the 1954 Code. This new subsection permits farmers to treat as an involuntary conversion the sales of draft, breeding, or dairy livestock in excess of the usual business practice, if sold solely because of drought. The amendment applies only to sales and exchanges of livestock after December 31, 1955.

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Public Law 700, July 11, 1956, extends until July 11, 1958, the existing authority of the Secretary of the Treasury in respect to transfers of distilled spirits for purposes deemed necessary to meet the requirements of the national defense.

This act also adds a new subparagraph (D) to Section 852 (b) (3) of the 1954 Code which requires the shareholders of a regulated investment company, for taxable years beginning after December 31, 1956, to include in their income as long-term capital gains their shares of undistributed long-term capital gains as designated by the company. The shareholder is deemed to have paid his share of the 25 percent capital gains tax paid by the company on such gains, which is to be credited or refunded to him. The basis of his shares is increased by 75 percent of the amount of the undistributed long-term capital gains.

Public Law 723, July 16, 1956, continues until June 30, 1957, the suspension of duties and import taxes on metal scrap, with additional exclusions therefrom; and permits under certain conditions the abatement or refund of taxes on distilled spirits lost by theft from a customs bonded warehouse after January 1, 1945.

Public Law 726, July 18, 1956, adds a new paragraph to Section 1441(c) of the 1954 Code to remove any requirement for the deduction or withholding of tax on the per diem payments by the United States Government to trainees brought to the United States under the mutual security program.

Public Law 728, July 18, 1956, "Narcotic Control Act of 1956," amends Sections 4744 (a), 4755 (b), 7237, and 7607 of the Internal Revenue Code of 1954 to make it unlawful to transport or conceal, or in any manner to facilitate the transportation or concealment of any marihuana acquired or obtained without having paid the transfer tax, to provide a specific penalty in any case where a person sells or transfers narcotic drugs or marihuana without a written order, and to permit personnel of the Bureau of Narcotics to carry firearms, execute search warrants, and make arrests without warrants in certain situations. The act also adds a new sentence to Section 4774 of the 1954 Code, relative to territorial extent of the law, which makes the provisions inapplicable to Puerto Rico unless the Legislative Assembly there expressly consents to their application. The effective date of these amendments is July 19, 1956.

Public Law 870, August 1, 1956, "Renegotiation Amendments Act of 1956," amends the Renegotiation Act of 1951 and extends it for two years to December 31, 1958.

Public Law 881, August 1, 1956, "Servicemen's and Veterans' Survivors Benefits Act," amends Sections 3121 and 3122 of the 1954 Code to provide that in the case of individuals serving after 1956 in the uniformed services, only the first $4,200 of basic pay in any calendar year will count as wages for purposes of the Federal Insurance Contributions Act tax. New subsections define the term "member of a uniformed service" and provide that service performed after 1956 by a member of a uniformed service on active duty will constitute employment for FICA purposes. Section 3122 is amended to make it clear that payments of the employer's Federal Insurance Contributions Act tax with respect to service performed by members of the uniformed services after 1956, will be made from appropriations available for the pay of such members.

Public Law 896, August 1, 1956, adds a new subsection (d) to Section 4735 of the 1954 Code which authorizes enforcement in Guam of Code provisions relating to narcotic drugs (except opium for smoking) by territorial officers, and covering of all taxes collected in Guam into the territorial treasury, effective November 1, 1956. A new Section 4716 is inserted in the 1954 Code which makes the provisions relating to opium for smoking applicable to Guam, and provides that administration of the provisions shall be performed by officers of Guam, with all revenues accruing to that government. Section 4774 of the 1954 Code is amended to make Code provisions relating to marihuana inapplicable to Guam.

Public Law 901, August 1, 1956, permits in the case of persons who died after February 10, 1939, refund or credit of estate tax overpayments resulting from application of subsections (a) and (b) of Section 7 of the act of October 25, 1949 (63 Stat. 891; Public Law 378, Eighty-first Congress), if refund or credit was prevented on October 25, 1949, by any law or rule of law other than by a closing agreement or a compromise. Claim for refund of the overpayment must be filed by August 1, 1957. In determining the amount of refund, the overpayment of estate tax must be reduced by any gift tax refund resulting from the inclusion in the gross estate of the property causing the overpayment of estate tax. No interest is to be allowed on the overpayment.

Public Law 1011, August 6, 1956, adds a new paragraph (2) to Section 2055 (b) of the Internal Revenue Code of 1954, to allow a deduction for estate tax purposes

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in the case of certain bequests in trust with respect to which no deduction has been allowable. Under this act, a deduction is allowed to the extent that the donee of a testamentary power of appointment over the corpus of the trust declares by affidavit within one year of the decedent's death his intention to exercise the power in favor of specified charitable organizations and the power is exercised in the manner stated in the affidavit. The donee of the power must be over 80 years of age at the time of the decedent's death. The act also adds a new subsection to Section 6503 under which the running of the period of limitations for assessment or collection of the estate tax in respect of the estate of a decedent claiming a deduction under Section 2055 (b) (2) is suspended until 30 days after the expiration of the period for assessment or collection of the tax imposed on the estate of the surviving spouse. These amendments apply in the case of decedents dying after August 16, 1954.

Public Law 1022, August 7, 1956, amends Section 170 (b) (1) (A) (iii) of the 1954 Code to extend the additional ten percent deduction for charitable contributions to medical research organizations which are directly engaged in the continuous active conduct of medical research in conjunction with a hospital. This amendment applies only to taxable years beginning after December 31, 1955.

International Financial and Monetary Developments

EXHIBIT 16.—Statement by Secretary of the Treasury Humphrey, March 2, 1956, before the House Ways and Means Committee

I appear before you in support of H. R. 5550. This bill is designed to carry out the President's recommendation that Congress authorize United States membership in the Organization for Trade Cooperation. The President in his message on the State of the Union explained why this is highly desirable.

While the United States is not as dependent on foreign trade as many other countries, our prosperity is greatly influenced by the flow of goods out of and into the country. The policies which other countries follow in their trade have serious impact on us. Our trade policies in turn have a great effect on others because our commercial trade is 17.5 percent of world trade.

Our membership in the OTC will indicate our desire to deal with matters of trade in the same cooperative way we do with military matters in the North Atlantic Treaty Organization, and with financial matters in the International Monetary Fund and in the International Bank for Reconstruction and Development. Our acceptance of membership would give practical evidence to our free world partners that our desire for sound working relationships extends to the field of trade.

The purpose of the OTC is to provide a continuing international body for the discussion of international trade problems and to administer the General Agreement on Tariffs and Trade. Up to now there has been no such continuing body and mutual trade arrangements have depended on occasional international meetings or negotiations between individual countries.

We can expect concrete advantage to the United States if there is such an organization through which our chosen representatives can press for action beneficial to us, such as reduction of trade restrictions which discriminate against American goods. This organization would provide a more effective forum to which our representatives could promptly take complaints and press our point of view.

We in the Treasury Department are primarily concerned with the relationship of the OTC to balance of payments questions, currency convertibility, and customs administration.

One of the major problems of international trade since the war has been the widespread use of quotas or quantitative restrictions on imports as the principal means of dealing with balance of payments difficulties. Progress toward removing these quotas has been made during the past few years. But it has not been easy, and it is not going to be easy, to reach the point where countries will substantially reduce use of import restrictions as a means of protecting their currencies, and instead rely on firm monetary policies and competitive enterprise to keep themselves financially strong. American exporters, in particular, have felt the adverse effects of quota restrictions since the war, because these restrictions have generally discriminated against our products as compared with those of other countries.

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Legislation

EXHIBIT 10.—An act temporarily increasing the public debt limit

[Public Law 678, 84th Cong., 2d Sess., H. R. 11740]

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That, during the period beginning on July 1, 1956, and ending on June 30, 1957, the public debt limit set forth in the first sentence of section 21 of the Second Liberty Bond Act, as amended, shall be temporarily increased by $3,000,000,000.

Approved July 9, 1956.

EXHIBIT 11.—An act increasing the maximum interest rate on United States savings bonds

[Public Law 85-17, 85th Cong., H. R. 5520]

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That the proviso in the second sentence of section 22 (b) (1) of the Second Liberty Bond Act, as amended (31 U. S. C., sec. 757c (b) (1)), is amended to read as follows: "*Provided,* That the interest rate on, and the issue price of, savings bonds and savings certificates and the terms upon which they may be redeemed shall be such as to afford an investment yield not in excess of 3.26 per centum per annum, compounded semiannually".

SEC. 2. The authority granted by the amendment made by the first section of this Act may be exercised with respect to United States savings bonds and United States Treasury savings certificates bearing issue dates of February 1, 1957, or thereafter. For purposes of section 22 (b) (2) of the Second Liberty Bond Act, as amended, such authority may be exercised with respect to those series E savings bonds maturing on or after February 1, 1957, which are retained after maturity, but only with respect to the investment yield after maturity.

Approved April 20, 1957.

Taxation Developments

EXHIBIT 12.—Statement by Secretary of the Treasury Humphrey, March 19, 1957, before the Senate Finance Committee on H. R. 4090 to provide a one-year extension of the existing corporate normal tax rate and of certain excise tax rates

I appreciate this opportunity to appear before you in support of H. R. 4090, which was passed by the House of Representatives on March 14, 1957. This legislation would extend for one year the existing excise rates on liquor, tobacco, and autombiles, and the tax rate on corporate income. If this legislation were not adopted, the tax rates would drop on April 1.

The full year effect of the one-year rate extensions would be slightly more than $3 billion; $2.2 billion of this comes from the corporation income tax; $231 million from various alcohol taxes; $185 million from the tax on cigarettes; and $436 million from the tax on automobiles and automobile parts and accessories.

Of the total of more than $3 billion we estimate that $186 million will be collected in the current fiscal year; $2,166 million in the fiscal year 1958; and virtually all of the rest in the fiscal year 1959.

The President made his recommendation for these rate extensions in his budget message in the following terms:

"It is my firm belief that tax rates are still too high and that we should look forward to further tax reductions as soon as they can be accomplished within a sound budget policy. Reductions in tax rates would give relief to taxpayers and would also release funds for the activity and investment necessary for sustained economic growth through private initiative. However, the reduction of tax rates must give way under present circumstances to the cost of meeting our urgent national responsibilities.

"For the present therefore I ask for continuation for another year of the existing excise tax rates on tobacco, liquor, and automobiles, which, under present law, would be reduced next April 1. I must also recommend that the present corporate tax rates be continued for another year. It would be neither fair nor

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appropriate to allow excise and corporate tax reductions to be made at a time when a general tax reduction cannot be undertaken."

The estimated surplus for the fiscal year 1958 is considerably less than the revenue which will be received during that year from the legislation which is now before you. Therefore, if these rates are not extended we would have a substantial deficit in 1958. After 2 years of balanced budgets as a result of the combined hard work of the Congress and the administration, it would be inexcusable to slip back into deficit financing for next year.

We must have the revenue that a continuation of existing tax rates would provide.

As I have said many times, the present tax rates are too high for long continued retention and would in the long run seriously hamper our vigorous economic growth. The most important and effective tax change that can possibly be made to promote steady economic development is a reduction in all rates for all taxpayers when our fiscal situation permits.

To make this general reduction possible for all taxpayers we must avoid new special relief provisions for particular groups of taxpayers which will dissipate our revenues.

Such relief provisions would not only still further complicate a law that is already too complicated, but they also, in the aggregate, might involve so much revenue loss as to postpone indefinitely the time when it will be possible to have such general relief for all taxpayers.

I have been asked about two bills which would modify the corporate tax structure to give lower taxes to corporations with smaller incomes. Before commenting on the two bills, I would like to present a few figures which show the present vitality of new enterprises in our private enterprise system.

The following facts stand out:

(1) At the end of 1955, the last full year for which figures are available, the total business population stood at an alltime high of 4,252,000 firms. The net increase during 1955 was 63,000 firms. This was the largest increase in any year since 1948, when the surge of new business formations that followed World War II came to a close. During the first half of 1956 there was a further growth in the business population. The Small Business Administration estimates that the total number in operation was between 4,275,000 and 4,300,000 firms on June 30, 1956.

(2) In 1956 the record number of 140,775 new corporations were formed. This exceeded the previous record of 139,651 estimated in 1955. There has been an increase in the number of new corporations in every year beginning with 1952.

(3) Though the number of business failures increased in 1956 over 1955, the rate of business failures is still far below the prewar level and in fact it is far below the average rate for the entire period since 1900.

Specifically stated in the last report of the Small Business Administration, December 31, 1956:

"In 1956 the number of business failures per 10,000 firms was 48. In 1954 and 1955 there were 42 business failures per 10,000 operating businesses; in 1949, 34 per 10,000; and in 1952, 29 per 10,000.

"In the prewar period of 1939, however, the failure rate was 70 per 10,000 firms, and in 1940, 63 per 10,000. For the whole period, 1900–1956, the rate was 70 per 10,000 firms."

The increase in the number of failures should be appraised in perspective as related to the earlier record. On that basis the present vitality of business concerns is good.

Amendment 2–27–57–B would reduce the existing normal tax on corporation income from 30 percent to 22 percent and increase the surtax on corporation income over $25,000 from 22 percent to 31 percent. This is the Fullbright proposal.

The total tax rate on income above $25,000 would thus be increased from 52 percent to 53 percent.

About 85 percent of small-business firms are proprietorships and partnerships and are not taxed as corporations. Thus amendment 2–27–57–B provides tax relief for only the 15 percent of small-business concerns which are organized as corporations.

Special tax relief of the sort contemplated by S. 150 therefore directly discriminates against the overwhelming majority of small businesses which are not

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conducted as corporations, and most importantly, discriminates against individual taxpayers generally.

In view of the very high rates now in effect, it would be unfortunate to increase the relative tax burden on such a large group of taxpayers as would be done by S. 150, especially for the benefit of such a comparatively small favored few.

S. 352, which is Mr. Sparkman's proposal, would make the corporate tax generally progressive, starting at 5 percent on the first $5,000 of income and rising by 5 and 10 percent steps to 55 percent on income over $100,000.

There is no justification for a progressive corporate tax. The analogy with the progressive individual income tax is not correct.

Smaller and medium-sized corporations may be, and in fact often are, owned by a few individuals each of whom has a sizable individual income, while the larger corporations are most likely to be owned by a great many individuals, large numbers of whom have quite modest incomes.

The most recent figures on the ownership of companies listed on the New York Stock Exchange show that two-thirds of the eight-million-six-hundred-and-thirty-odd shareowners of listed securities have incomes of less than $7,500 a year. Almost 38 percent of all share owners have incomes of less than $5,000 a year.

The effect of a progressive corporate tax thus in many respects would be altogether unfair in that it would indirectly impose a disproportionately large tax burden on the small investors who buy stock in large companies.

Moreover, a progressive corporate tax would actually work against the small business itself which is seeking tax relief to permit its growth and expansion. Under a progressive tax system the moment a company does in fact grow larger it will have to pay a higher rate of tax. Thus the progressive tax scheme actually has a built-in mechanism to retard the continued growth of a successful small business.

The present two levels in the corporate tax (this is referring to the Fulbright proposal) are justified if at all only because the smaller companies are especially dependent on retained earnings until they prove themselves to have become sufficiently successful to induce more investors to put their funds into their securities.

But it would be a great mistake to go from the present two levels to a generally progressive corporate tax and thereby reduce investment incentive at the very time when increasingly successful proven operations make the need for expansion and more capital investment continually more important.

Even if the proposed graduated rates (these are the graduated rates in the Sparkman proposal) could be so balanced that there would be no net loss of revenue from the proposed tax changes, the Treasury would still oppose the proposal because any action to change the spread between tax rates on different sizes of corporate income has such a far-reaching implication. This committee should certainly not initiate any such sweeping changes in our tax system until their full effects can be determined by the most extensive public hearings and after full consideration from every standpoint.

Certainly small business would be helped if its taxes were lower, just as every other group in America would be better off with lower taxes. But we must hold to the line and we must now avoid giving preferential tax treatment, group by group, to any special group and so discriminate against all other groups and delay that happy day when general tax relief can again be given to every taxpayer in America.

EXHIBIT 13.—Letter of Secretary of the Treasury Humphrey, April 16, 1957, to the Chairman of the House Ways and Means Committee reaffirming the Treasury's position with respect to revision of the taxation of cooperatives

DEAR MR. CHAIRMAN: This is in reply to your letter of March 15, 1957, which referred to my letter to you of July 26, 1955. In that letter I described the problem which had arisen, because court decisions had made ineffective the 1951 legislation regarding the treatment of cooperatives. We have no thought of double taxation. Our position as stated in our letter to you of July 26, 1955, remains unchanged.

Since sending you that letter, the court decisions have continued to go against us, with some additional points raised in the opinions. We have also been increasingly impressed with the very considerable differences of opinion among various groups as to the precise way in which the objective of 1951 could best be realized.

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We assume that your committee will expect to hold public hearings on the subject to assure a full and systematic presentation of all of these views. We look forward to the testimony in such hearings as a basis for developing specific recommendations. The benefit of the material which can only be secured through comprehensive and extensive public hearings is highly desirable for the preparation of useful statutory language.

I and my associates will be glad to work with your committee and its staff in this area.

Yours very truly,

G. M. HUMPHREY,
Secretary of the Treasury.

EXHIBIT 14.—Statement of Secretary of the Treasury Humphrey, May 7, 1957, before the Senate Finance Committee on S. 1795 to limit emergency amortization strictly to defense items

I am very glad to appear before the Senate Finance Committee in response to your invitation to testify on your bill, S. 1795. I strongly support the general purpose of this proposed legislation to limit emergency amortization to strictly defense items.

In July 1955, I first expressed publicly before this very committee my growing concern about the emergency amortization program before a subcommittee of the House Committee on Government Operations. I stated that while emergency amortization may have served a useful purpose during the Korean emergency, it was an artificial stimulus of a dangerous type.

From November 1950 to March 20, 1957, almost 22,000 certificates were issued under the 5-year amortization program. The total cost of these projects was almost $39 billion. Almost $23 billion, or about 60 percent, was made eligible for the 5-year writeoff.

Some degree of defense mobilization on a substantial scale may be essential for years to come. But expansion of our major productive facilities should be an integral part of our long-range, natural economic growth. Our basic defense capacity, except for a few very special items, cannot be separated from the broad base of our productive capacity.

Artificial stimulants may well become artificial controls. Because rapid amortization is not applied universally, it could create a competitive imbalance in the sound, vigorous growth of our free economy. It is not the American way.

The revenue lag from certificates issued through 1956 probably exceeds $5 billion during these early years which will be recovered in the years after 1960. But the interest cost to the Government, over the entire period of lag in tax collections, will be roughly $3 billion.

The effects of a broadly applied amortization program go far beyond the effects on Government revenue. First, there is the stimulating effect which can temporarily add to inflation, with the possibility of a lag later. Then when rapid writeoffs are permitted for facilities which will be largely used to supply eventual regular civilian demand, there inevitably will be dislocations and unfair advantages between whole industries—and individual companies within an industry.

Much of the total has been of this type. For example, over 14 percent of the total amortizable cost of facilities through December 28, 1955, was granted to utilities and sanitary services; over 16 percent more went to railroads; and about 20 percent went to primary metal industries. Other whole industries had none.

There are many industries where some percentage of production would be required in the event of war; but where without war our increased population and productivity will require their continued expansion. These are in sharp contrast to limited-purpose defense facilities such as shell loading or specialized aircraft or armament plants.

Five-year amortization may be an alternative to direct Government construction and ownership of limited-purpose facilities since private capital is not likely to go into them. But this is far different than giving rapid writeoff to selected industries for general-purpose plants or equipment in an expanding economy.

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There is no fair or logical end to such a program. The margin of excess capacity in such industries at any time will regularly be absorbed by growing civilian demand and have to be regularly reestablished in later years. There would be continuing costs and revenue lags and the creation of new competitive problems.

We are not unaware both of the desirability as well as of the financial problems involved in modernizing and replacing old capital equipment. Nothing is more important than obtaining the capital to increase our productivity and make new and better jobs.

Our high productivity of labor is possible only because of tremendous capital investment—over $10,000 per man in general manufacturing, and over $50,000 in several industries.

Getting funds for the construction of new plants or facilities is a continuing serious problem. High tax rates make it harder to save from current income. They also lessen the incentive and discourage the productive and perhaps risky use of savings.

It is essential to reduce tax rates as rapidly as can be done soundly. But tax reduction for favored groups only postpones the day when general tax reduction can be enjoyed by all the people.

The program, cut back by the executive branch of the Government, now applies only and strictly to limited direct-defense items. I have consistently advocated this and feel sure that the present limitations should be continued.

S. 1795 is in line with this administration's policy in granting emergency amortization certificates. Subject to some possible changes in language consistent with its objectives to be worked out by the technicians, I am glad to support this legislation.

Exhibit 15.—Report of the Treasury Department, May 13, 1957, on S. 1795 to amend Section 168 of the Internal Revenue Code of 1954 to limit emergency amortization strictly to defense items

My Dear Mr. Chairman: This is in reply to your request for a report on your bill, S. 1795. This would impose a strict statutory limitation on the use of 5-year amortization certificates. Future certifications would be confined to facilities to produce new defense items or components of new defense items or to provide research, development, or experimental services during the emergency periods for Department of Defense or the Atomic Energy Commission, as a part of the national defense program. Such a limitation is, in principle, consistent with the limitations imposed under present administrative policy.

The Treasury Department favors a statutory limitation which would restrict amortization certificates to strict defense purposes. Widespread use of amortization certificates is very costly in terms of revenue during the period when they are effective. Their availability and use in other than strict defense applications will result in dislocation and unfair advantages both as between whole industries and as between individual companies within an industry.

The use of 5-year amortization for some part of the cost of general purpose plants or equipment to stimulate earlier construction of capacity is neither fair nor logical. The margin of excess capacity, deemed to be needed for defense purposes at any one time, will regularly be absorbed by civilian demands in a growing economy and would have to be regularly reestablished in later years. There would be continuing revenue lags and continuing creation of new competitive problems.

Subject to possible technical changes consistent with the bill's objectives, the Treasury Department strongly supports the general purpose of S. 1795 to limit emergency amortization to strictly defense items.

The Director, Bureau of the Budget, has advised the Treasury Department that there is no objection to the presentation of this report.

Sincerely yours,

G. M. Humphrey,
Secretary of the Treasury.

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EXHIBIT 16.—Letter of the President, July 15, 1957, to the Chairman of the House Ways and Means Committee regarding tax relief for small business

DEAR MR. CHAIRMAN: This is in further reply to your letter regarding small business. As you will recall, the Cabinet Committee on Small Business made fourteen recommendations, including suggested changes in the tax laws, the latter conditioned on the budgetary outlook. It was suggested, subject to the existence of appropriate budgetary conditions:

(1) That the taxes imposed on business corporations be modified by reducing the tax rate from 30 percent to 20 percent on incomes up to $25,000.

(2) That businesses be given the right to utilize, for purchases of used property not exceeding $50,000 in any one year, the formulas of accelerated depreciation that were made available to purchasers of new property by the Internal Revenue Code of 1954.

(3) That corporations with, say, ten or fewer stockholders be given the option of being taxed as if they were partnerships.

(4) That the taxpayer be given the option of paying the estate tax over a period of up to ten years in cases where the estate consists largely of investments in closely held business concerns.

It now appears that the excess of income over disbursements in the fiscal year 1958 will be so small that no action should be taken by the Congress at this time which will involve any substantial tax reduction for anyone. In the economic conditions that prevail currently and can be expected during the next fiscal year, all the income which the present tax laws provide should be reserved in order to maintain the balance between income and outgo as now estimated and to make modest reductions in our national debt.

Therefore, it would be ill-advised to consider the first recommendation noted above, because of the substantial revenue loss that it would entail. Also, in the absence of a general tax reduction, which the budgetary situation does not permit at this time, a tax reduction of this character would discriminate against all the many small businesses which are conducted in the form of partnerships or individual proprietorships.

The Congress should, however, in connection with its study of cases of unusual hardship or unfairness in the operation of tax laws, appropriately consider some of the other suggestions, which involve no more than a minimum loss of revenue.

On that basis, I commend for your committee's consideration the second, third, and fourth recommendations in the committee's report as noted above, and one additional change in the law to permit an original investor in small business the right to deduct from his income, up to some maximum amount prescribed by Congress, a loss, if any, realized on a stock investment in such business. At the present time the deduction of such losses from income is subject to the general limitation on net capital losses of $1,000. Each of these proposals could be helpful in the financing, operation, or continued independent existence of small businesses.

In your letter you asked for my views concerning the Fulbright proposal for reducing the normal tax on corporations from 30 percent to 22 percent and increasing the surtax on corporate incomes over $25,000 from 22 percent to 31 percent. This proposal would increase the tax rate on the portion of the income in excess of $25,000 to 53 percent. Since about 85 percent of the small business firms are proprietorships and partnerships, it is not fair to give tax relief to small business concerns which are organized as corporations at the expense of other taxpayers.

I earnestly look forward to reductions in tax rates for all taxpayers as soon as that becomes possible. Until that time, selective relief of the sort contemplated by the Fulbright proposal—and indeed by the first recommendation of the Cabinet Committee—would discriminate against the overwhelming majority of small businesses which are not conducted as corporations at a time when we must stand against any tax revision for anyone which might jeopardize our small budget surplus. Furthermore, in view of the very high rates now in effect, it would be unwise to increase the taxes on any group of taxpayers in order to provide a tax reduction for another group, as would be done by this proposal. For these reasons, I am opposed to the Fulbright Resolution.

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I know you are also interested in the status of the several Cabinet Committee recommendations relating to matters other than taxes. As I mentioned above, the committee gave me fourteen recommendations for governmental action, only four of which dealt with taxes. Of the remaining ten recommendations, some have been carried out by the executive branch; others must await congressional action before the executive branch can act upon them. The following is a current status report on these ten.

In its Recommendation No. 5, the Cabinet Committee proposed: "That the President arrange for a comprehensive review of procurement policies and procedures of all departments and agencies, including the legislation pertaining thereto, with a view to facilitating and extending the participation of small businesses in work on Government contracts."

On September 26, 1956, I directed the Administrator of the General Services Administration to plan and conduct such a review, in cooperation with other major procurement agencies. The First Summary Report of the Task Force set up by the Administrator of the General Services Administration under this directive was issued on March 1, 1957. Several important improvements in procurement procedures have already been accomplished as a result of the Task Force efforts, and a comprehensive proposal for amendments to the procurement laws has been developed by the Task Force and is currently being reviewed by the cognizant executive agencies. The purpose of the amendments being reviewed would be to bring about greater uniformity and simplification of Government procurement procedures, and to improve the opportunities of small businesses to participate in Government work.

In its Recommendation No. 6, the Cabinet Committee proposed: "That the President direct departments and agencies engaged in extensive procurement to adopt procedures which would insure that a need for advance or progress payments by a bidder will not be treated as a handicap in awarding a contract, and which would facilitate and accelerate the making of such progress payments as may be requested by small suppliers under Government contracts."

In my letter of August 18, 1956, I directed the procurement agencies to implement Recommendation No. 6. In order to ensure uniformity among the various agencies the General Services Administration on December 31, 1956, laid down a Government-wide regulation prescribing policy and procedures in consonance with Recommendation No. 6. Federal agencies are taking steps to comply with this.

In its Recommendation No. 7, the Cabinet Committee proposed: "That the Renegotiation Board clarify the fact that, although a contractor who subcontracts work may not reasonably expect to be allowed as large a profit thereon as if he had done the work himself, the practice of subcontracting, especially the extent to which subcontracts are placed with small businesses, is encouraged by giving it favorable consideration in determining allowable profits."

On September 24, 1956, the Renegotiation Board amended its regulations to give effect to this recommendation.

In its Recommendation No. 8, the Cabinet Committee proposed: "That the life of the Small Business Administration, which is now scheduled to expire in mid-1957, be extended at the earliest opportunity."

Administration bills (S. 1789 and H. R. 6645), would remove the time limit on the life of the Small Business Administration, thus giving it permanent status.

In its Recommendation No. 9, the Cabinet Committee proposed: "That the maximum amount of an issue of corporate securities which the Securities and Exchange Commission may exempt from registration be increased from $300,000 to $500,000."

I have recommended this change. Legislation (S. 810 and S. 843) is now before the Congress to carry out this recommendation.

In its Recommendation No. 10, the Cabinet Committee proposed:" That the President call a conference on technical research, development, and distribution, for the benefit of small business."

I have directed the Secretary of Commerce and the Administrator of the Small Business Admnistration to make plans for this conference.

These plans have been announced and a Conference on Technical and Distribution Research for the Benefit of Small Business will be held in Washington September 24–26.

In its Recommendiaton No. 11, the Cabinet Committee proposed: "That legislation be enacted to enable closer Federal scrutiny of mergers."

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Legislation to accomplish this objective is before the Congress, and the Attorney General has outlined administration views in testimony before the House Judiciary Committee.

In its Recommendation No. 12, the Cabinet Committee proposed: "That procedural changes be made in the antitrust laws to facilitate their enforcement."

I have recommended three procedural changes in this area: first, that cease and desist orders of the Federal Trade Commission under the Clayton Act be final when issued, unless appealed to the Courts; second, that the Attorney General be given the power, where civil procedures are contemplated, to issue a civil investigative demand, thus making possible the production of documents before a complaint is filed, and without the need of grand jury proceedings; third, that the Federal Trade Commission, in merger cases where it believes a violation of the law is likely, be authorized to seek a restraining injunction before filing a formal complaint.

In its Recommendation No. 13, the Cabinet Committee proposed: "That wage reporting by employers for purposes of social security records and income tax withholding be simplified."

Legislation (H. R. 8309) to give effect to this recommendation has been submitted to the Congress.

In its Recommendation No. 14, the Cabinet Committee proposed: "That the Office of Statistical Standards of the Bureau of the Budget undertake a comprehensive review of the reports and statistics required of small businesses."

The Bureau of the Budget has under way a study designed to determine whether the reports and statistics which small business must now maintain for, or supply to, the Government are unduly burdensome and, where necessary, to suggest remedial measures.

Pending the achievement of budgetary conditions that will permit a general program of tax reduction, these proposals for changes in our tax laws would appreciably improve the ability of small businesses to get started and, once started, to grow. Along with the administrative actions taken in other areas, and with favorable attention by the Congress to administration proposals for measures to benefit small business not yet enacted, they would provide a balanced program of constructive aid at a minimum loss of tax revenues. Such aid is keenly needed by small business, the economic position of which is vitally important to the soundness and vigor of our system of free competitive enterprise.

With kind regard

Sincerely,

DWIGHT D. EISENHOWER.

International Financial and Monetary Developments

EXHIBIT 17.—Remarks by Secretary of the Treasury Anderson, August 19, 1957, before the First Plenary Session of the Economic Conference of the Organization of American States, Buenos Aires, Argentina

It is an honor to participate in this Conference with so many of the ministers who deal with the financial and economic questions which continually arise in the conduct of Government affairs in our American Republics. It is a particularly happy occasion to come here as one of my first official acts as Secretary of the Treasury.

As a Texan, who has lived most of his life close to Latin America, I have always had a deep and warm personal interest in its people, its culture, its traditions, and its progress. One of my earliest employments was to teach Spanish in a town near the place where I grew up. While I must confess a neglect of the language in the intervening years, it is a fault I hope to correct. It is my earnest hope that my present duties will give me new opportunities to visit the other American Republics and to experience more direct and personal contacts with this great region, and to continue and enrich the friendships which I have established here with the delegates of these American Republics.

This Conference follows in logical succession from the Conference at Quitandinha in 1954. I was deeply impressed by the enthusiasm with which my predecessor, Secretary Humphrey, viewed the Quitandinha meeting. He was convinced at that meeting that there was unanimity among the delegates as to the great and inspiring objectives which we seek in this hemisphere.

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Taxation Developments

Exhibit 23.—Statement by Secretary of the Treasury Anderson, January 16, 1958, before the House Ways and Means Committee on general revenue matters

I am glad to have this opportunity to meet for the first time with this distinguished committee. The distinctive position of the House Committee on Ways and Means is known to all students of our governmental processes. My predecessor has told me of his very pleasant relations with you and of your assistance to him in discharging his responsibilities in the Treasury. I look forward to continued close collaboration with you in developing such tax and other legislation as becomes appropriate within your jurisdiction.

You have already received the President's Budget Message. The increased requirements for expenditures for security, even after the strictest reviews of expenditures in all other programs, bring total estimated spending to a level such that it is necessary to recommend a continuation of the corporation income tax and the excise tax rates, which, in the absence of legislation, would be reduced on July 1. A reduction in the normal corporation income tax rate from 30 percent to 25 percent, which would also have the effect of reducing the rate on income above $25,000 from 52 percent to 47 percent, would involve a revenue loss of about $2 billion a year. A reduction in the excise tax rates on liquor, cigarettes, and automobiles would involve an additional revenue loss of over $900 million.

I regret that a continuation of existing rates has to be my first recommendation to you on tax matters, because I am anxious for tax reductions of various sorts, as I know you are, and as the people of the country are. But under the conditions as they are foreseen at present, such tax reductions do not seem prudent. If present rates are continued, and if business activity resumes its upward growth during the year, as I believe it will, we estimate a small surplus for the fiscal year 1959.

I am glad to say that we have been able to provide in the budget for the tax relief measures for small business which the President recommended in his letter to the chairman of this committee last July 15. There was not, of course, time to give full consideration to these proposals in the last session of the Congress, but we do recommend that they receive attention in the present session. Specifically those recommendations were:

(1) That businesses be given the right to utilize, for purchases of used property not exceeding $50,000 in any one year, the formulas of accelerated depreciation that were made available to purchasers of new property by the Internal Revenue Code of 1954.

(2) That corporations with, say, ten or fewer stockholders be given the option of being taxed as if they were partnerships.

(3) That the taxpayer be given the option of paying the estate tax over a period of up to ten years in cases where the estate consists largely of investments in closely held business concerns.

(4) That original investors in small business be given the right to deduct from their incomes, up to some specified maximum, a loss, if any, realized on a stock investment in such business. At the present time the deduction of such losses from income is subject to the general limitation on net capital losses of $1,000.

I am especially glad to recommend this tax relief for small business because of the great importance of new and small companies in the American economy. Our country has grown strong in competition and in the introduction of new products and techniques. We must have as many independent business concerns as possible because each company is a separate center of initiative as well as a source of livelihood for its employees and owners. Small businesses are a real and important part of our American way of life. We believe that the foregoing recommendations for tax changes will give important relief for the revenue loss involved.

Loopholes or unintended benefits are always a matter of concern. They are particularly serious when tax rates have to be maintained at high levels. It is particularly important that we maintain respect for our voluntary tax system, which should continue to be a source of national pride. This gives added emphasis to the necessity of maintaining fairness and equality in the application of our

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country's tax burden. H. R. 8381, on which this committee worked so long in the last session, and which is now before the House of Representatives, is important legislation to close tax loopholes and make technical changes which was developed in consultation and cooperation with our staffs. We will always have our tax laws and regulations under close, continuous observation and will call to your attention any inequities that we observe.

Last October, the Supreme Court denied a petition for certiorari in a series of cases dealing with the so-called cutoff point for percentage depletion in the manufacture of bricks and cement. The net result of the cases is to apply the percentage depletion allowance to the price of finished manufactured products, bricks and cement, rather than to the value of the clay and the cement rock before it is manufactured. In both cases, the effect of the decision is to increase the depletion deductions several-fold over the amounts previously allowed under Treasury regulations. While we support the principle of depletion for these materials, we do not believe that depletion on this scale is reasonable or was intended. The problem appears to arise from the application of the phrase "the commercially marketable mineral product or products" in the statute. I recommend the law be revised to prevent these excessive depletion deductions. The revenue loss in the two industries directly covered by the cases is about $50 million a year.

The proper taxation of cooperatives continues to be a troublesome problem. We have already called to your attention the fact that a series of court decisions have made largely ineffective the 1951 legislation which was intended to assure that all cooperative income would be taxed either to the cooperative or to its members as it was earned. The Treasury rulings under which all patronage refunds in the form of certificates were held to be taxable at their face value, which were assumed to be valid at the time of the 1951 legislation, have been held invalid where the certificates do not have a determinable market value. Thus, it is possible for the cooperative to receive a deduction in computing its taxable income, while its members are not taxable on the certificate they receive. While we are fully aware of the important place which cooperatives occupy in the life of our agricultural and farming communities, we believe that some single tax liability should be assumed by all who participate in the business activities of the country, as was contemplated in the 1951 legislation, and that legislation which is fair and reasonable, both from the standpoint of the availability of retained earnings for expansion and tax benefits to cooperative members, should be developed. During the course of the deliberations of this committee, the staff of the Treasury will be available to work cooperatively with the staffs of your committee in developing such legislation.

We have already advised the committee that the Treasury is agreeable to the application of the stopgap legislation concerning taxes to be applied against the income of life insurance companies for the calendar year 1957. We are giving a great deal of thought to the development of a fair and equitable system of taxation that can be permanently applied, and will be working cooperatively with your staff in the development of concrete proposals which we hope to submit to you in the near future.

Simplification in the tax law and in tax computations are important objectives. Our staffs are studying with great interest the reports of the advisory groups to your subcommittee on income taxation on technical aspects of the law concerning corporate reorganization, partnerships, and the income of estates and trusts. The 1954 Code made important changes in all of these fields. Experience since its enactment may well have shown opportunities for still further improvements to increase the fairness and simplify the application of the laws in these difficult areas. Testimony which you receive in your hearings will be of help to us, as it will doubtless be to you, in appraising the current proposals for change.

While I have no additional recommendations at this time for major tax legislation, we shall continue to appraise situations as they develop and shall make such recommendations as become appropriate.

We in the Treasury are, of course, following with great interest the material presented in these hearings. I am sure these data will be of help to us in developing recommendations to you. In the meantime, my associates in the Treasury and I will be ready and anxious to be of such assistance as we can in working with you and your staffs.

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Exhibit 24.—Statement by Secretary of the Treasury Anderson, February 18, 1958, before the Subcommittee on Intergovernmental Relations of the House Government Operations Committee

On behalf of Governor Dwinell and myself may I first express our great appreciation for the courtesy you have extended us as Cochairmen of the Joint Federal-State Action Committee in arranging for our initial presentation of this program to the Congress before your subcommittee. For many reasons, we think it particularly appropriate that our joint committee's action recommendations should first be reviewed and discussed with the House Intergovernmental Relations Subcommittee. One of the most important of these is that you are currently engaged in nationwide hearings gathering information from people representing all levels of government as well as private organizations of citizens which will give you a special understanding of the feasibility and desirability of our proposals. When the specific legislation to carry out these recommended actions reaches the Congress, we anticipate that your evaluations and judgments will be a major factor in determining the fate of this first effort by the executive branches at the Federal and State levels. The purpose of this effort is to strengthen our Federal system by channeling increased authority and responsibility to the State governments instead of centralizing power in the Nation's capital. It is therefore a privilege for us to present to you at this time Progress Report No. 1 of the Joint Federal-State Action Committee.

One of the characteristics of this report that I feel will most favorably impress each of you without regard to your personal reaction to its content is the fact that it's only 14 pages in length. The conciseness of the report is a striking indication of the spirit of action with which the joint committee approached its assignment.

I, for one, believe that the dedication of the members of our task force stems from a recognition of the validity of the President's repeated conviction that "unless we preserve the traditional power and responsibilities of State government, with revenues necessary to exercise that power and discharge those responsibilities, then we will not preserve the kind of America we have known; eventually, we will have, instead, another form of government and therefore, quite another kind of America."

It was in the spirit of this conviction that on June 24, 1957, the President suggested that the national Governors' Conference join with the executive branch of the Federal Government in creating a task force for action which would be charged with three specific responsibilities. In his words, these were:

"(1) To designate functions which the States are ready and willing to assume and finance that are now performed or financed wholly or in part by the Federal Government.

"(2) To recommend the Federal and State revenue adjustments required to enable the States to assume such functions; and

"(3) To identify functions and responsibilities likely to require State or Federal attention in the future and to recommend the level of State effort, or Federal effort, or both, that will be needed to assure effective action."

At the opening session of our first meeting I made an observation which seems to reflect the constructive attitude of the entire committee.

"The most important thing, it seems to me, that we can hope to accomplish by our initial effort is an actual agreement embodying certain specific functions and sources of revenue which can be returned to the States. This will be the surest evidence of our intention to be objective and of our determination to achieve accomplishment. When these pegs of progress have been set, we can move from the area of accomplishment into the more difficult and complex areas of things we mutually agree ought to be done and to be worthy of our continued efforts."

Within this general framework, the committee began the job of preparing action recommendations that, in turn, the President and the forty-eight governors might recommend to their legislative bodies. It was set up and has operated—not as a study group—but as an action committee.

I have been deeply impressed by and want to pay public tribute to the dedicated sense of cooperation which the member governors have shown during our several meetings. The discussions and decisions reaffirm to me that there is widespread basic understanding of the proper relationships between the State and Federal governments. In working to better that relationship the governors with whom we have worked have demonstrated beyond all question their patriotic desire to do

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what is best not for the short-term result but for the long-range benefit and welfare for the greatest number of our people.

I am confident that as an action committee in this field we will enjoy the continued fine cooperation we have had in the past. We anticipate that additional agreements will be reached which will further clarify and strengthen the relationships between the States and Federal Government.

Many of us share President Eisenhower's concern over the trend of our intergovernmental relationships as he summarized it last June . . . "So, slowly at first, but in recent times more and more rapidly, the pendulum of power has swung from our States toward the central Government."

There are many factors behind this shift in governmental power: The economic problems of the 1930's; the emergency of war; the view of some that almost any problem common to localities is to some extent a national problem and therefore subject to Federal "responsibility"; the reluctance in many cases of State governments to work out solutions to local problems; and on occasion the readiness of the Federal Government to relieve local interests of local responsibilities. All these help to account for the growing centralization of governmental power so evident in recent decades. With this growth of Federal power the position of the States has been weakened.

The steps taken by the President and the Conference of Governors, and the recommendations of their Joint Committee, are designed to strengthen State governments. The States can properly assume a larger share in the work of government. By the same token many present Federal activities can and should be relinquished to the States—and without impairment of programs. In our work as a committee we have examined a number of programs receiving partial Federal financial support and subject to Federal controls which could more advantageously be handled entirely by States and localities. In such cases, we believe Federal intervention is unnecessary.

In our first report two of these programs are proposed for transfer out of Washington to the States—vocational education and waste treatment plant construction. In making this recommendation the committee seeks only to transfer authority and financial responsibility—not to curtail or abolish programs. I stress this point because there are some who seem to think we would adversely influence these worthwhile activities. Our report to the President and to the Conference of Governors makes it clear that this is not our purpose at all. The committee, of course, has a broader interest than just recommending the shift of certain programs to full State responsibility. For example, it defines and clarifies a responsibility that may continue to be shared. This we did in our natural disaster relief recommendation.

Furthermore, we recommended to the States the assumption of certain responsibilities that they have not generally undertaken to date. This is the point of our urban renewal proposal.

Additionally, we agreed that the States should be encouraged to exercise their proper powers in a new field. This is the substance of our suggestion for Federal and State legislation that would permit the States to establish and enforce health and safety standards in the atomic energy field.

On the revenue side, we proposed that a part of the Federal tax on local telephone service be relinquished by the Federal Government. This could be used by the States where desired.

All these proposals point in one direction: to increased State authority and responsibility.

The committee also proposed criteria for future stimulative grants. This could be called a preventive approach. Special situations often seem to call forth new Federal programs, which sometimes involve grants to stimulate State action. We know that Federal programs, once started, develop a certain stubborn capacity to survive. Many times continued Federal support does no more than supplant local initiative and responsibility.

With this in mind, the committee urged caution in the use of the grant-in-aid technique. Stimulative grants should be made selectively and only where a clear-cut national interest exists. Legislation authorizing Federal grants to States should include a closeout provision to prevent Federal usurpation of State responsibility. We urged the utmost flexibility and control for the States in the administration of such programs.

Again, the point of view is clear and consistent. If we must establish new grant programs, let them be: (1) Limited to national need; (2) limited in duration; and (3) limited to the stimulation of State action.

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Recommendations

Committee recommendations are set forth in Progress Report No. 1.

Vocational education.—The committee considered to be unnecessary the continued Federal financial support of vocational education. This program began in 1917. Since then all States have established such programs, with State and local funds now comprising over 80 percent of the annual cost. The administration of this work is almost entirely in State-local hands. The President endorsed the committee proposal by recommending to the Congress in his budget message that grants for vocational education be continued through fiscal year 1959. This will give the States time to take the necessary steps to handle this added financial responsibility.

Waste treatment construction grants.—These grants were first provided by Congress in fiscal year 1957. They are intended to encourage accelerated construction of municipal waste treatment plants. The committee felt that municipal sewage treatment problems are essentially the responsibility of the municipalities themselves. Beyond this, the States should help the municipal governments if help is needed. Here, too, in endorsing the committee's recommendation, the President has proposed continuation of Federal grants through fiscal 1959 to allow time for orderly readjustment.

Natural disaster relief.—The immediate problem was to clarify responsibility. In the past, neither the Federal Civil Defense Administration nor the States knew at what point the States should be eligible for Federal aid to restore damaged public facilities. The committee agreed on a schedule of minimum amounts based on fiscal capacity that must be spent or committed during a year from State sources before the governors were eligible to apply for Federal aid. This recommendation of the committee does not entail legislation. An Executive order has already been issued by the President which will make it possible to implement this recommendation after time has been allowed for preparations by the States.

Atomic energy.—Problems raised by the nonmilitary uses of atomic energy pose difficulties for the States and for the Atomic Energy Commission. The Atomic Energy Act gives the Federal Government a monopoly in this field. Yet the States have a traditional and inherent right to regulate activities affecting the health and safety of their citizens. Accordingly, the committee recommended amending the act to permit the States to adopt standards governing the use of nuclear materials, to inspect facilities, and to enforce legislation for the protection of public health and safety, not in conflict with Federal law.

To handle this work effectively requires the training of State employees. This we proposed, with the States paying the salaries and expenses of their people during the training to be provided by the appropriate Federal agencies. The Budget document for fiscal 1959 reflects the steps being initiated in this direction by the Atomic Energy Commission. We also proposed certain organizational and administrative actions for the States to take to ready themselves for the tasks ahead.

Urban renewal.—The action recommended by the committee on urban renewal is a first step towards increasing State responsibility for urban problems in the future. It is proposed that the States set up planning agencies to give consideration to problems in urban development, housing, and metropolitan planning. The President's strong support of this proposal is contained in his budget message. Once established, these agencies will be in a position to assume enlarged responsibility in these areas.

Taxes

The President asked the committee to consider the tax adjustments that might be made to enable the States to carry the added costs of functions shifted to them from the Federal Government. A variety of taxes were examined by the committee. At this point in its work, the committee recommended and the President endorsed a partial relinquishment of the Federal tax on local telephone service as a practicable source of State revenue. We also are studying the Federal estate and cigarette taxes to see if the States should share to a larger extent in these tax sources. Any tax proposals along these lines will be contingent on the States taking over other existing Federal functions.

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Legislative recommendations

As indicated, the work of the committee has received wholehearted support from the President. This is particularly emphasized by that part of his budget message in which he said:

"Cooperation of this nature is a highly desirable and, in my judgment, a long overdue experiment in public administration and finance. The success of the venture depends upon further cooperation among the executive branch, the Congress, the governors, the legislative bodies of the States, and the local governments involved. As for this administration, I can say that the executive branch is eager, as well as willing, to do its part to insure that success."

As indicated, specific legislation will be submitted in the near future which will allow adequate time for the States to make necessary adjustments in fiscal and administrative policies. The administration attaches great importance to these first steps outlined by the committee. The President and the Conference of Governors expect the committee to continue its work and to develop further proposals for the strengthening of State governments. In its work the committee is moving toward the very important objective of decentralizing governmental authority and responsibility. I am sure we all agree that every effort should be made to assure proper balance in our Federal system.

We will continue to examine both programs in being and those that are proposed, with the objective of providing proper distribution of responsibilities among the Federal Government, the States, the municipalities, and other political subdivisions—this to insure that the functions of government are properly and more effectively performed within our traditional and constitutional structure.

EXHIBIT 25.—Statement by Secretary of the Treasury Anderson, March 12, 1958, concerning the economic situation

The economic situation in all its aspects is under constant study and review. The President's discussion with us this morning was a continuation of this kind of analysis.

Of course, this analysis includes tax studies and estimates of revenue losses and the benefits which might result from various approaches to this problem. We must carefully weigh both the current implications and the long-term effects which might result. This is a part of the continuing normal function of the Treasury Department.

The President has already taken a number of executive actions and has made a number of recommendations to the Congress, designed within the framework of the proper functions of the Government, to assist in a resumption of sustainable growth in the economy. A number of the suggestions and actions proposed and taken will help promote a higher level of private economic activity and employment. Some will result in accelerated expenditures in a number of existing Federal programs without involving us in huge, slow-acting public works programs of dubious value.

However, we will continue to examine all the facts and data as they become available and if, upon the basis of further developments in the economy it appears that other actions are necessary and desirable, they will be taken.

No decision regarding taxes has been made. Whatever decision regarding taxes is taken will be reached only when the impact of current developments on the future course of the economy has been clarified and after consultation with congressional leaders.

EXHIBIT 26.—Letter of Secretary of the Treasury Anderson, April 10, 1958, to the Chairmen of the Senate Finance and House Ways and Means Committees concerning permanent legislation for taxation of life insurance companies

MY DEAR MR. CHAIRMAN: In our letter to you of January 10 concerning temporary legislation for the taxation of life insurance companies, the Treasury indicated that it would propose a method for more permanent legislation in this field. In accordance with this and subsequent statements made in the public hearings of the House Ways and Means Committee on various tax legislative matters, January 16, and before the Senate Finance Committee on the "stopgap" extension legislation, March 5, there are submitted for your consideration suggested approaches to the taxation of life insurance companies.

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In developing these recommendations for a more permanent basis of taxation, we have approached the task with full recognition of the difficulties in this complicated area, which stem in part from the complex nature of the life insurance business as conducted on the level premium basis. We are also aware of the fact that we are dealing with institutions which are the custodians of the life insurance protection and savings of millions of American families.

The problem of developing a satisfactory long-range basis of taxation for the life insurance industry is not a new one. The problem has resisted solution since 1947 when the then applicable formula, adopted in 1942, resulted in no tax whatsoever on the life insurance business, and was replaced by a series of stopgap formulas. You are familiar with the resulting extensive legislative history in this area and the long study which has been given to the question by your committee and the Congress over these years.

A Subcommittee of the Ways and Means Committee on the Taxation of Life Insurance Companies was established in 1949 which conducted studies and recommended stopgap legislation, deferring a permanent solution of the problem to a later date. The temporary legislation subsequently adopted, termed the 1950 formula, was applied only to 1949 and 1950 income.

In 1951 further stopgap legislation was enacted, converting the reserve and other policy liability deduction under the 1950 formula into a reduced rate of tax on net investment income without deduction for required interest. The 1951 method was extended from year to year through 1954.

Late in 1954 extensive studies and hearings were conducted by a subcommittee of the Ways and Means Committee, leading to the adoption of the present law. This provided a reserve and other policy liability deduction of 87½ percent on the first $1 million of net investment income and 85 percent on net investment income in excess of $1 million. The 1955 law also provided certain structural improvements, including a broadening of the net investment income base, the correction of certain abuses, and a more adequate treatment of the health and accident business of life insurance companies.

The 1955 formula was originally made applicable to 1955 income only, subject to the provision that the 1942 formula would reapply automatically in any year if there were not an extension. The 1955 formula was subsequently extended to 1956 and more recently to 1957 income.

The Treasury has reviewed carefully the facts, issues, and alternative approaches developed in the course of these past deliberations. You are cognizant of the staff work which the Department has conducted cooperatively with the congressional tax staffs, and for a considerable period in 1955 and 1956 in consultation with a group of distinguished actuaries whose services were made available by the life insurance industry to the Treasury. While the technical assistance of these actuaries has been invaluable to our work, they do not, of course, have any responsibility for the policy suggestions which have been developed from it.

On the basis of our review and study, it seems evident that there are certain inadequacies in the present method of taxing life insurance companies. The present method does not recognize sources of net income other than investment income. Furthermore, it utilizes an averaging system, whereby the net taxable income of a life insurance company is measured by reference to an arbitrary or industry-wide standard of interest deductions, not by the actual experience and requirements of the individual company.

Two possible solutions are presented herewith. The method of taxation to which it is suggested the committee give first consideration would provide a long-range basis of taxation for life insurance companies bringing their taxable income concept into closer conformity with that of other corporate business. Such a concept should be designed to reflect, to the fullest extent practicable, the full net earnings of life insurance companies. It should at the same time provide comprehensive deductions for all expenses, interest, and reserve requirements, and all amounts paid or made available to policyholders.

We suggest that the starting point for measuring the net earnings should be the figure for "Net Gain From Operations After Dividends to Policyholders" which appears in each company's annual statement to the State insurance departments and which summarizes the operating results for the year. This figure is based on carefully developed life insurance accounting practices which have general acceptance in the industry. Adjustments, such as those for tax-exempt interest, Federal income taxes paid, and depreciation on the insurance business property account, would conform it with general rules for computing taxable income.

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The resulting tax base would include the margin of investment income above amounts needed on policy reserves, gain from better than assumed mortality experience, and profit arising from the difference between the expense "loading" portion of premiums and actual expenses. Deductions would be allowed for all dividends paid to policyholders and amounts added to policy reserves.

Under this suggested method, life insurance companies would be entitled to net operating loss carryovers. To assure the best possible long-range measurement of life insurance company earnings and to preclude taxing annual amounts which are not true net earnings because of uneven experience, a longer loss carryback provision should be provided for life insurance companies than for other corporations, ranging up to 10 or 20 years.

Consideration may also need to be given to some kind of special allowance or relief feature for small and new companies. Such a provision might be designed to recognize the special problems of the growing company. For example, a deduction might be allowed of 50 percent, or some other fraction, of amounts up to some specified amount retained by a company as contingency reserves for the protection of policyholders.

Provision should be made for a gradual transition to the new method over a three- to five-year period. During this transition, the tax would be computed as a weighted average of the tax under the new method and the tax under the present stopgap method, with gradually increasing weight to the new method.

The taxation of life insurance companies inevitably raises the question of its possible impact on policyholder savings, benefits, and insurance costs. The tax base discussed above would exclude all amounts paid to, or set aside irrevocably for the benefit of any policyholder or group of policyholders. It would exempt additions to policy reserves including interest thereon; all cash insurance benefits made available to policyholders or their beneficiaries; and all policy dividends or similar rebates paid or refunded to policyholders.

In our studies and discussions with the consultants made available by the life insurance industry, we have given attention to possible adjustments in policy reserves and related items for tax purposes. The objective of such adjustments would be to take account of, or in some cases to neutralize, the effect of different methods of reserve valuation, varying reserve interest assumptions, past and future reserve strengthening operations, and certain other factors.

We believe that there is substantial merit in an adjustment for companies with reserves based on a preliminary term method of valuation. Such an adjustment would compensate for the fact that in the case of a company using a preliminary term method the addition to reserves on new business in the first policy year is substantially smaller than for a company which uses the net level premium valuation method.

Another adjustment which appears to deserve favorable consideration is one which would take account of deficiency reserves in existence on the effective date of the suggested plan. These particular reserves may be considered equivalent to an allocation of previously accumulated surplus, and in this light their recovery back into surplus would not constitute current earnings which should be subject to tax.

At this time we have no recommendations for or against other specific reserve adjustments. We recognize, however, that other possible refinements and modifications, including contingency reserves, adjustments for reserve strengthening, and special allowances for some segment of surplus, merit further review in the light of the expert views and comments of members of the life insurance industry which will be made available in the course of your future deliberations. However, every departure from the allowance for policy reserves used in determining the net gain from operations reported in the annual statement to the State insurance departments would represent a complication which could be justified only by persuasive equity and technical considerations.

The Treasury is fully aware that problems exist with respect to the plan just discussed. It will, of course, increase the tax paid by some companies, just as it will relieve others, resulting in shifts in burden as compared with the present stopgap method. This is inevitable in a change from a tax based on an industry-wide formula to a tax based on the income of individual companies. Another problem is that the suggested method may result in a changed approach to policy reserves in order to reduce or eliminate tax.

We do not minimize the difficulties which your committee may encounter in its evaluation of the plan. Accordingly, you may wish to consider an alternative

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more in line with the present method of taxation of life insurance companies which will nevertheless make tangible improvements.

In this event, we suggest that you consider modification of the present law which will increase the portion of investment income subject to tax to accord more closely with the prevailing margin of investment income above required interest for policyholders, which margin is now about 30 percent for the industry as a whole. Such a revised formula should not only bring the deduction for interest needs into closer line with the current situation, but should also be responsive to future changes in industry conditions from year to year. Consideration should be given to a further refinement of the present type of special interest deduction for companies with substantially less than the average margin of investment income.

A second modification of the present formula which the committee might consider is one which would assure a more reasonable tax on those companies with relatively small amounts of investment income and substantial earnings from insurance or underwriting sources, now entirely exempt from taxation. It is suggested that this might be made effective by means of a minimum tax provision, which would require that the tax should not be less than the liability computed at regular corporate tax rates on a specified proportion of the net gain from operations after policy dividends.

Whatever tax formula is applied to the ordinary income of life insurance companies, their capital gains and losses should no longer be disregarded for tax purposes.

A fair and more lasting method of taxing life insurance companies to replace the series of temporary formulas will fulfill a long-standing need in our tax structure.

Sincerely yours,

ROBERT B. ANDERSON,
Secretary of the Treasury.

EXHIBIT 27.—Letter of the President, May 26, 1958, to the Vice President and the Speaker of the House recommending continuation of corporation and excise tax rates

DEAR MR. VICE PRESIDENT:
DEAR MR. SPEAKER:

The budget message in January recommended a continuation, without change, of the corporation income tax and excise tax rates which in the absence of legislation would be reduced on July 1. This recommendation is now renewed.

This renewed recommendation is made after consultation by the Secretary of the Treasury with leaders of both political parties in the Congress. Consideration of fiscal measures will continue to be made in the light of the developing economic situation and with full regard to both the short and long-range effects of any proposal.

The administration deeply appreciates the thoughtful and full cooperation with which the leadership of both parties in the Congress has worked with us in these matters.

With kind regard,

Sincerely,

DWIGHT D. EISENHOWER.

EXHIBIT 28.—Statement by Secretary of the Treasury Anderson, May 28, 1958, before the House Ways and Means Committee concerning extension of corporation and excise tax rates

As you know, the President last Monday renewed the recommendations made in the budget message in January asking for the continuation of existing tax rates on corporation income and certain excise taxes otherwise scheduled for reduction July 1. In January it was estimated that such reductions would cause a revenue loss of $2.9 billion. Because of changes in the economy we now estimate the loss at somewhat less or in the neighborhood of $2.6 billion in revenue.

When the President's budget message for 1959 was sent to Congress in January, it was then estimated that the budget for 1959 would be in balance with a very small surplus.

Since January additional appropriations for defense and for measures designed to help facilitate the resumption of growth make it evident that expenditures for

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fiscal year 1959 will rise to an order of magnitude of 78 to 80 billions of dollars. This is an increase of from 4 to 6 billion dollars above the January estimate. On the receipts side, economic conditions are such that in revised estimates our budget receipts for the fiscal year 1959 will be in an order of magnitude of 70 billion dollars. Thus, we are confronted in fiscal 1959 with a probable budget deficit ranging from 8 to 10 billions of dollars.

The budgetary situation for the year ending June 30, 1958, now indicates a deficit of the order of 3 billions of dollars against the estimate last January of $400 million. Substantially all of this increased deficit will result from a decline in revenues.

During the past several months, many proposals have been put forth suggesting that certain selected tax reductions would encourage an early resumption of economic growth. All of them have had our most careful and serious consideration.

We do not believe that at this time to propose a general reduction in individual income taxes is in the Nation's best interests. Such reductions would widen the gap between revenues and expenditures and thereby substantially increase the deficits. Nor can the serious disadvantages of so increasing the deficit be offset by a reasonable certainty that any particular individual income tax adjustment would predictably assure resumption of growth either in specific areas of the economy or the economy as a whole. From both the long-term and short-term point of view, our competitive, private-enterprise economy is putting on an impressive performance of resistance to further decline without so-called "massive" intervention by the Government.

The Treasury is of the opinion that a reduction of corporate rates is not justified at a time when the reduction in the rate on individuals cannot properly be made.

We also do not believe that it is appropriate or logical to select certain excise tax rates for reduction and decline to make reductions in others.

Should any excise taxes be recommended for reduction, contentions would undoubtedly be made that others were entitled to like treatment. We believe that in fairness and in the best interest of the country, the excise rates that currently exist should be extended without change for another year.

We recognize that the burdens of taxation and the burdens of debt are exceedingly heavy at all levels of government. We must continue to be concerned with restraints which weigh on our economic growth and our system of incentives. The very fact that taxes are high emphasizes the requirement that we utilize our best efforts to achieve economical operations at all levels of our Government and to work diligently to make the tax system as fair and as simple as possible with minimum repressive effects on individual and business activities.

We all look forward to a period when the Government can again operate with a reasonable balance between its expenditures and its revenues. We must be equally careful not to widen unduly the gap between revenue and expenditures. To do so would add to the burden of an already heavy debt which encumbers our economy not only by the cost of interest but by substantial interference in the financial markets where private business, States, municipalities, and other political subdivisions compete for our national savings. Increases in the debt also make it more difficult for the Federal Reserve System to discharge its monetary and credit responsibilities.

I think we must bear in mind that we are looking forward not to a peak of expenditures which we now see sure ways of reducing in subsequent years but rather to a level of expenditures which in the absence of changing conditions offer little prospect of declining. Even with a resumption of a rate of sustainable growth and the consequent recovery of tax receipts which would result therefrom, the deficits will run into the recovery period.

Mr. Chairman, we of the Treasury are grateful for the thoughtful and cooperative consideration which has been given by the leadership of both parties to this difficult problem.

EXHIBIT 29.—Statement by Secretary of the Treasury Anderson, June 12, 1958, before the Senate Finance Committee in executive session on continuation of corporation and excise tax rates

As you know, the President on May 26 renewed the recommendation contained in the January budget message, which asked for a continuation of existing corporation income and certain excise tax rates which otherwise would be reduced on July 1 of this year. The House last week voted such continuation in H. R. 12695.

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In January when the President asked for the continuation of these rates, it was estimated that such reduction, if allowed to take place, would cause a revenue loss of $2.9 billion. This figure, because of present conditions, we now estimate to be about $2.6 billion.

The legislation now before the committee should be considered in the light of the present budgetary situation. For the fiscal year ending June 30, 1958, we now face a deficit in the magnitude of $3 billion due in the main to a decline in revenues.

For fiscal 1959 we now expect expenditures in an order of magnitude of $78 to $80 billion. This increases the earlier January estimate by $4 to $6 billion. Receipts during that same year are expected to be in the general range of those for 1958. Thus we face in fiscal 1959 a budget deficit probably ranging from $8 to $10 billion.

Many proposals in recent months have been put forward suggesting certain tax reductions as a means of encouraging prompt resumption of economic improvement. We in the Treasury, as well as you, have given them most careful consideration and analysis. In the best interests of the Nation we cannot at this time propose any general reduction in individual income taxes. To do so would further widen the gap between revenues and expenditures. Nor can the serious disadvantages of so increasing the deficits be offset by a reasonable certainty that any particular individual income tax adjustment would predictably assure resumption of growth either in specific areas of the economy or the economy as a whole.

Holding the conviction as we do that there is lack of justification for reducing the rate of individual income taxes at this time, it follows that to reduce corporate rates now is not justified.

The suggestion has been made by some that it might be appropriate to select certain excise tax rates for reduction without similar reduction in others.

Should any excise taxes be recommended for reduction, contentions would undoubtedly be made that others were entitled to like treatment. We believe that in fairness and in the best interest of the country, current excise rates should be extended without change for another year.

This committee, I know, has as its continuing interest the assurance that we are utilizing our best efforts at all levels of Government to operate efficiently and economically. The burdens of taxation and debt are heavy. We must continue to be concerned with these restraints which weigh on our system of incentives in our competitive economy. It follows then that we must continue to work diligently toward a tax system as fair and as simple as possible which will have the least repressive effects on business activities and individual initiative.

Increases in the public debt would add to the already heavy burden of interest on an already heavy debt and also further interfere with the normal flow of new security offerings in the financial market by private businesses, States, municipalities, and other political subdivisions.

In the absence of basic world changes we face a level of Federal expenditures which offers little prospect of decreasing in the near future. Even with a resumption of a rate of sustainable growth and the consequent recovery of tax receipts which would result therefrom, the deficits will run into the recovery period.

Mr. Chairman, we in the Treasury appreciate sincerely the thoughtful and cooperative consideration which has been given by the leadership of both parties to this difficult problem.

EXHIBIT 30.—Miscellaneous revenue legislation enacted by the Eighty-fifth Congress, Second Session

Public Law 85–318, February 11, 1958, adds a new provision to Section 812 (e) (1) (D) of the 1939 Code to make the marital deduction available in the case of terminable interests passing to a surviving spouse where the event which could terminate the interest becomes impossible of occurrence within 6 months of the death of certain decedents adjudged incompetent before April 2, 1948. The provision is effective with respect to decedents dying after April 2, 1948. No interest will be allowed on overpayments resulting from this amendment.

Public Law 85–319, February 11, 1958, amends Section 223 of the Revenue Act of 1950 to extend its provisions, which exempt certain rents from the provisions of Section 502 (f) of the 1939 Code pertaining to the use of corporation property by shareholders in the case of personal holding companies, to years ending in 1954 to which the 1939 Code is applicable. No interest will be allowed on overpayments resulting from this amendment.

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Public Law 85–320, February 11, 1958, adds a new subparagraph (C) to Section 421 (d) (6) of the 1954 Code and repeals subsection (d) of Section 1014 so that, where an option is held by an employee at the time of his death, it receives a new basis reflecting the appreciation in value of the stock in respect of which the option was granted, between the time of the granting of the option and the date of death (or optional valuation date), subject to certain specified adjustments. The amendments are effective with respect to taxable years ending after December 31, 1956, but only in the case of employees dying after that date.

Public Law 85–321, February 11, 1958, adds a new Section 7512 to the 1954 Code which provides that where an employer is required to collect and pay over income or employment taxes withheld from an employee or excise taxes on facilities and services, and fails to do so, he can by notice be instructed to collect the taxes in the future and deposit them in a special trust account. Persons who fail to comply are, except in certain cases, guilty of a misdemeanor under new Section 7215 and upon conviction will be fined or imprisoned or both.

Public Law 85–323, February 11, 1958, adds a new Section 6423 to the 1954 Code which denies, except in the case of drawbacks and certain withdrawals, returns, or losses, a credit or refund of alcohol or tobacco tax unless the claimant establishes that he either bore the ultimate burden of the amount claimed or has unconditionally repaid the amount claimed; and unless the claimant, except in the case of certain suits, files a claim after April 30, 1958, and within the time prescribed by law. The amendment does not apply to any credit or refund allowed or made before May 1, 1958.

Public Law 85–345, March 17, 1958, extends the 1955 formula for taxing the income of life insurance companies to taxable years beginning before January 1, 1958.

Public Law 85–367, April 7, 1958, adds a new paragraph 13 to Section 512 (b) of the 1954 Code which provides that where a limited partnership interest is held by a charitable trust which meets all of the four conditions enumerated therein, there shall be excluded from the definition of unrelated business taxable income the trust's share of gross income and deductions, to the extent such income is distributed. The amendment applies to taxable years of trusts beginning after December 31, 1955.

Public Law 85–380, April 16, 1958, (1) substitutes the words "certain musical or dramatic performances" for the word "concerts" in Section 4233 (a) (3) of the 1954 Code, thereby extending to musical comedies and reviews the exemption from the admissions tax for performances conducted by nonprofit civic or community membership associations; (2) amends Section 4233 (a) (1) (C) to exempt from tax admissions to athletic games played between college teams where the proceeds are divided between hospitals for crippled children and the educational institutions involved; and (3) adds a new paragraph 11 to Section 4233 (a) to exempt from tax admissions to all-star athletic games played between teams composed of students from various schools or colleges where the proceeds from the game are turned over to tax-exempt educational, charitable, or religious organizations operated exclusively for the purpose of aiding retarded children.

Public Law 85–441, June 4, 1958, provides under Section 104 that the total credits allowed under Section 3302 (c) of the 1954 Code to taxpayers with respect to wages attributable to a State for taxable years beginning on and after January 1, 1963, are to be reduced in the same manner as that provided by Section 3302 (c) (2) for the repayment of advances made under Title XII of the Social Security Act, unless or until it is found that by December 1 of the taxable year certain amounts paid and certain costs incurred have been restored to the Treasury.

Public Law 85–517, July 11, 1958, extends for two years (until July 11, 1960) the authority of the Secretary of the Treasury to permit emergency transfers of distilled spirits for national defense purposes.

Public Law 85–785, August 27, 1958, provides social security coverage for certain employees of tax-exempt organizations which did not have in effect, during the entire period in which the individuals were employed, the required waiver certificate and which paid the FICA taxes without knowledge that a waiver certificate was necessary or on the assumption that such a certificate had been filed.

Public Law 85–881, September 2, 1958, repeals certain obsolete provisions relating to adulterated butter and filled cheese.

Public Law 85–920, September 2, 1958, provides that a corporation suing for refund can bring the suit in the judicial district in which is located its principal place of business or its principal office or agency. If neither of these is located in any judicial district, the suit may be brought in the judicial district in which is

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located the office to which the corporation made its return. If no return was filed, the suit may be brought in the District of Columbia.

Public Law 85-921, September 2, 1958, permits the printing, publishing, or importation of black and white illustrations of postage and revenue stamps, and, within certain size limitations, of other obligations and securities of the United States and of a foreign government, bank, or corporation for philatelic, numismatic, educational, historical, or newsworthy purposes in articles, books, journals, newspapers, or albums (but not for advertising purposes other than certain illustrations); and permits the making or importation, except for advertising purposes, of motion picture films, microfilms, and slides of postage and revenue stamps and other obligations and securities of the United States and of a foreign government, bank, or corporation. No reproductions may be made from such films or slides without the permission of the Secretary of the Treasury.

Public Law 85-930, September 6, 1958, extends the Renegotiation Act of 1951 from its present expiration date of December 31, 1958, to June 3, 1959.

International Financial and Monetary Developments

EXHIBIT 31.—Remarks by Secretary of the Treasury Anderson, January 28, 1958, before the Mississippi Valley World Trade Conference, New Orleans, La.

In the framework of history, America has always been a Nation dedicated to friendship with others—in actions as well as words. From the time of the first ships that sailed from the harbor of New Orleans with the products of the Mississippi Valley, American traders have opened the way for friendly exchanges with other nations, exchanges of ideas as well as goods and services.

Today, as the President recently pointed out, we are the world's greatest trading nation, with world trade providing employment for four and a half million American workers. Yet our most valuable export, and the one most prized by others, is still, as it was in 1776, the concept of freedom and humanity for which our Nation stands.

In recent years, as the threat of communist enslavement has grown, we have extended a helping hand to others on a scale never before known in the world's history. We have not just talked freedom; we have entered into arrangements for mutual security. And the free world has attained a strength which only an alliance of independent and self-respecting peoples can achieve. No free nation is cowering in fear of America, and no free nation ever will!

There are certain profound convictions with which I approach all our international relations. They are convictions which I have held throughout a lifetime. The first conviction is this: No difference exists between free nations as to the objectives we seek. They are objectives that can be defined only in terms of freedom, human well-being, and progress. We all agree that man does not exist to enhance the importance and power of the state. The state should respect man in his dignity as a child of God, to preserve his rights as an individual, and provide opportunities which will release the full creativeness of every human being.

This is the end we seek when we speak of promoting commerce, industry, agriculture, and development of all of our resources. We promote them because they make for the better employment of our citizens, better homes for our families, better education for our children, greater satisfaction of our aspirations; in short, a better world for all of us.

A second conviction which I hold strongly is that there is no question incapable of resolution if reasonable men of good will bring to bear on it their best and united efforts. This is one of the strengths of our democratic system.

My third great conviction is that the progress and welfare of every free nation is closely related to the progress and welfare of each. We cannot afford to be indifferent to the problems and the suffering of others. Freedom is indivisible. Our best interests clearly lie in pursuing a policy of cooperation.

A basic aspect of this policy of cooperation is a firm determination on the part of our own country to preserve a climate that will lead to the maintenance of dynamic growth. A fixed point in our national policy is the avoidance of any return to the depressed conditions of an earlier decade. Such avoidance insists on growing markets and demands here and abroad.

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tion of primary dealers themselves, working through a dealers' association. Various specific functions that an association might perform to improve the market's functioning were indicated, including: (*a*) the adoption of standard rules to assure fair treatment of buyers and sellers in both large and small transactions; (*b*) the development of standard practices to help maintain dealer solvency; and (*c*) greater liaison between the Treasury and the dealers in Treasury financing operations. It was also suggested that a dealers' association could be useful in identifying primary dealers in Government securities both to improve dealer service and to apply any market rules which may be adjudged in the public interest. Since the possible advantages of such an organization as well as its possible disadvantages obviously require careful and detailed examination, the task of this supplementary study has been to make this much-needed evaluation.

A question that naturally arises at this point is whether in the light of the present study there will be any occasion later for special legislative requests pertaining to the operation of the Government securities market. This question cannot be answered yet. Before it is, we must try to determine what can be accomplished in improving market processes and mechanisms without legislative action and then ask whether these improvements are enough. The fact of the study itself, together with educational efforts undertaken by the Treasury and Federal Reserve System, has already set in process a fuller appreciation on the part of market participants of the undesirable effects of certain market practices. If we find that desired improvement of market mechanisms and institutions requires new statutory authority, we will propose appropriate legislation to the Congress.

Markets are dynamic economic institutions. They require succesive adaptation to changing needs. From the standpoint of the public interest, study of these adaptations is never ending. Study efforts may be intensified from time to time as the case of the present Treasury-Federal Reserve study, but they are basically continuous. Continuing observation and study of the Government securities market is a responsibility which both the Treasury and the Federal Reserve recognize.

In conclusion, we repeat that improvement in the processes and mechanisms of the Government securities market will in no way solve our problems of fiscal imbalance. Nor can they correct our problems of too much short-term public debt; of our need for continuous flexibility in our approach to monetary policies; of attaining a volume of savings which will match our expanding investment needs; or of the cyclical instability of our financial markets. These are basic problems. We must all work toward their ultimate solution in the public interest.

Taxation Developments

EXHIBIT 21.—Statement by Secretary of the Treasury Anderson, February 5, 1959, before the Joint Economic Committee on the Government's fiscal outlook and some of its implications for the Nation's economy

I welcome the opportunity to appear before your committee and to discuss the Government's fiscal outlook and some of its implications for the Nation's economy.

First, I should like to discuss the budget for the fiscal year 1960. We estimate total receipts of $77.1 billion. Of this total $40.7 billion is expected to come from individual income taxes, and $21.4 billion from corporation income taxes. The assumptions for the calendar year 1959 underlying these figures are $374 billion for personal income, and $47 billion for corporate profits.

These income assumptions were arrived at after careful studies and consultations utilizing all data and judgment available both inside and outside the Government. The increases they represent imply a continued vigorous recovery, but at a slightly lesser rate than we experienced after the 1954 recession. Somewhat larger revenue gains, too, were attained in moving out of the recession of 1954, if we adjust the timing of corporate tax payments for comparability. The personal income figure of $374 billion compares with a rate for December 1958 of $359 billion; the corporate profits assumption of $47 billion for 1959 compares with a rate for the fourth quarter 1958 of $44 billion.

I present these estimates with the full realization that the revenue results for fiscal 1959 will turn out to be substantially less than we originally estimated.

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I believe, however, that our assumptions for fiscal 1960 are sound and will turn out much closer to the mark. They are within the range of calculations made by private estimators, and I understand that similar figures have also been mentioned by some of the experts that have testified before your committee.

Let us now look at our present situation in a broader perspective. We are well along in the recovery from a recession which is now substantially contributing to the largest peacetime deficit in our history—$12.9 billion at present estimates. Of this deficit, about half will result from a shortfall in revenues. The remaining is the result of increases in expenditures over original budgetary estimates.

The drop in revenues in fiscal 1959 is the direct result of the recession. The increase in expenditures reflects for the most part increases that came about automatically or through actions not primarily related to the recession. Among these are the higher cost of the agricultural program because of larger crops, the Federal Government pay increases, higher defense expenditures, and the proposed subscription to the International Monetary Fund. Some $2 billion of spending, chiefly FNMA mortgage purchases, the extension of unemployment benefits, and direct housing loans by the Veterans' Administration, represent actions designed to combat the recession.

What conclusions seem to follow from this experience? First, it seems to me that the economy has once more demonstrated remarkable resilience and resistance to recession. This is indicated by the fact that personal income declined very little, and that the recovery set in very quickly. I attribute this good performance to the inherent qualities of our economy, to the confidence and good sense maintained by our people, and to the automatic stabilizers that have become a part of the economy.

Second, I am concerned with the size of the deficit that the recession in large part produced and with its continuation in a period of growing prosperity. A deficit of this magnitude, unless quickly corrected, can produce serious inflationary pressures in the longer run, even though in the short run these pressures are held in check by excess plant capacity and other factors. The extended unemployment benefits proved timely, but the economy turned around before several of the others could have their full budget effect. Meanwhile these expenditures will continue as we move closer to increased prosperity.

Third, the decision by the administration and the Congress to avoid a major tax cut last spring has been justified by events. Had we resorted to a tax cut we would not have had this demonstration of the economy's inherent recuperative powers. We would have helped develop a philosophy that tax relief was necessary to pull us out of a downturn. Also, a tax cut would have increased our present deficit and our public debt, and with them the danger of inflationary pressures in the future.

I fear, however, that price pressures may eventually revive, if we do not finally close the budget gap. I sincerely believe that a nation as rich and productive as ours must, in times of prosperity, at least pay its way. We can afford to do all that is necessary, and much that is desirable, and pay for it. But we should not reach for everything at the same time. Even a rich country can get into trouble if it keeps spending beyond what it pays for currently.

Some people seem to feel that to be for meeting current expenses from current revenues means to be "against" or "negative." Let us not be misled. The fact of the matter is there is almost nothing which is more positive and more important to be for than fiscal soundness. This is an essential condition of our economic health, without which we can have neither adequate military security nor the adequate provision of other needed governmental services. Meeting our expenses currently and all that that means in the way of fiscal soundness and a healthy economy is a highly positive objective which deserves the support of everyone.

Growth requires capital formation, through saving and investment. As a consequence, we should meet our expenditures out of current revenues in prosperous times. A Federal deficit financed outside the banks tends to absorb resources that could otherwise go into private capital formation. A deficit, during prosperity, which is financed through the banks, in itself of course brings inflationary consequences.

A current deficit and the fear of future deficits can keep people from saving because of possible loss of these savings to inflation. If we ever reach the point where people believe that to speculate is safe but to save is to gamble then we are indeed in trouble.

If rising prices which will follow from continued deficits cut into saving habits, the result will be further to diminish the supply of capital for economic growth.

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We cannot indefinitely expect people to continue their saving if they expect prices to go on rising indefinitely. Our habits of saving, our financial institutions, our monetary system, must not be jeopardized.

Our needs for capital will increase as our labor force begins to expand more rapidly in the early sixties. This expanding labor force, the result of the high birth rate of the forties, will give a powerful impetus to the economy. But if job opportunities are to be found, with a rising degree of productivity, investment in plant and equipment will have to advance correspondingly.

Finally, orderly finances in our country are a key to maintaining the strength of the free world, and our role in it. Our prestige in the world is not enhanced if we fail to practice what we preach. The world watches us very closely. On my trip to and from New Delhi, for the annual meetings of the International Bank and Monetary Fund, I was impressed to discover how well informed foreign officials are about even the details of our budget.

But more than prestige is at stake here. If we run continuing large deficits in prosperity and so almost inevitably drive up prices, we may price ourselves out of world markets. Aside from the losses that this will mean to us, how are we to discharge our world-wide responsibilities if our international economic position weakens?

Because we are for sustainable and healthy growth, because we are for increasing job opportunities, because we look to the long run and a possibly long period of world tension, we must be for the maintenance of orderly finances and a stable dollar. I believe that the time to face this issue is now. Americans have faith in their money. That faith is justified. Confidence, if shaken, is hard to reestablish. That is why we must keep our expenditures under control, and the budget in hand.

Your committee has asked me to deal with certain questions. I would now like to turn to the first three of these. With your permission, I shall then ask Mr. Charles Gable, who assists Under Secretary Baird and myself in debt management matters to discuss with you the fourth question, relating to the management of the public debt.

Question 1.—What would you regard as the proper division of labor between tax policy and monetary policy as instruments of economic stabilization during the coming year?

Answer.—The first consideration of tax policy is, of course, to keep intact the system by which the United States Government raises its revenues to finance the Government service that the Nation requires.

Tax policy and monetary policy should continue to work closely to foster economic health with stability of prices as our economy grows.

After a deficit of $12.9 billion expected for fiscal year 1959, the President's budget proposes a budget balance for the fiscal year 1960. For quite a few months ahead, the net effect of fiscal policy will still be to stimulate the economy. As prosperity advances, so will our revenues until the deficit is eliminated at a high level of economic activity if spending is under control.

At the income levels projected in the budget, the tax system is expected to produce revenues approximately equal to proposed expenditures in fiscal 1960. If we achieve our objectives there will be no need, consequently, for an increase in taxes.

By eliminating the deficit, tax policy will greatly ease the task of monetary policy. If we fail to keep 1960 expenditures within income, we contribute to inflationary pressures and complicate the problems of monetary management. Tax policy will render additional assistance to monetary policy by avoiding further permanent borrowing by the Treasury in the market. This will also facilitate the Treasury's own job of handling the public debt.

Question 2.—Is the present structure of the Federal tax system adequate in light of the Nation's economic growth and stability requirements? If not, what changes would you recommend?

Answer.—I believe that any tax structure can always be improved. By that I do not mean to say that we cannot live with our present taxes. We certainly can. If new imperative revenue needs should arise, we could live with higher taxes than the present. Ours is the most productive economy in the world and I do not believe that it would be crushed by its tax burdens, if we are reasonable.

We must constantly evaluate in terms of continuing economic growth both elements of tax reform and, when proper, tax reduction. While these are closely related, they are not necessarily identical.

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The Treasury has been studying and continues to study various improvements in the tax system and in tax administration. In this we are cooperating, and shall continue to cooperate, with the appropriate committees of Congress. Many of the adjustments under review are of a technical character. Their application depends in many cases on the resolution of administrative difficulties. It depends further on future business conditions and other factors that cannot now be foreseen. As this is a continuing study both in the Treasury and the committees of the Congress, it would be premature to attempt any detailed discussion.

The committee questions deal also with the relation of taxes to the stability of the economy. I take it that this refers principally to the cushioning effect that declining tax collections can have during a recession. Illustrative of this effect, of course, is the sharp decline in collection of corporate taxes growing out of the recent recession. It also focuses our attention on the fact that deficits may well continue after the economy has moved up and is advancing toward full prosperity. This sort of complex problem deserves, and will have, our continuing study.

The high degree of resilience which our economy has just demonstrated seems to suggest that we should be cautious and analytical in our evaluations and flexible enough, if some future downturn should require it, to be willing to use whatever instrument seems most appropriate to the occasion. In this connection, some advance planning is proper so that the right decisions can be appropriately taken when we are confronted with cyclical movements in our economy.

Question 3.—Under what circumstances can we reduce Federal taxes? What are the prospects for realizing these circumstances?

Answer.—The circumstances and prospects of tax reduction would first depend very much on future expenditures and the maintenance of our economic growth. Economic growth can be expected to raise our revenues, but it will produce no surplus if we do not control expenditures. Unless we spend wisely we will have trouble taking care of such new requirements as may prove really essential.

Next, tax reduction must be weighed against debt reduction out of surplus. I believe that in years of prosperity we should endeavor to achieve some debt reduction. This policy commends itself as an act of fiscal soundness. It would ease the task of monetary policy and the management of the public debt.

Circumstances for a tax reduction would depend further upon the degree to which we can succeed in avoiding inflation. At times of inflationary pressure we should aim at some budget surplus.

I would not now want to prescribe a precise formula or to try to predict a precise time when tax reduction might properly be considered. I have tried to point out the varying factors which would influence our judgment at the time when such a judgment seems to be appropriate.

EXHIBIT 22.—Statement by Deputy to the Secretary of the Treasury Smith December 1, 1958, before the Subcommittee on Foreign Trade Policy of the House Committee on Ways and Means on the existing tax treatment of foreign income

I am glad to be here today on behalf of the Treasury Department to discuss with you some of the tax aspects of the very important problem that your subcommittee is considering. We look forward to the testimony that will be presented before your subcommittee. We believe that out of it will emerge a significant contribution toward facilitating the flow of private capital especially to the less developed countries and will help to establish an increasingly firm bond between free institutions here and free institutions in the other countries.

A free flow of capital funds is important for economic development. The general investment climate is by far the most important influence on the flow of funds. Inherently unattractive situations cannot be made attractive by artificial stimulants. But at the same time, barriers and impediments to the flow of funds should be kept to a minimum and private capital should be encouraged to fulfill its proper role in economic development.

The administration is giving intensive study to various proposals designed to promote our foreign economic policy. At this time, however, while the budget and general legislative recommendations are still being developed, it is not possible to make specific recommendations in this area. We believe that these

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hearings will be most helpful in the formulation of any recommendations that may be made.

As this subcommittee, perhaps more than any other, is aware, on almost every occasion that something in the public interest is to be achieved through private business activity, proposals are made for tax incentives to encourage the desired action. This is true in connection with the present issue. It seems appropriate therefore to review briefly the present method of taxing income from abroad, and to show the factors in the law today that encourage international trade and investment.

The existing tax treatment of foreign income rests on the basic tenet that all income, irrespective of source, shall be taxed equally. This is achieved by the inclusion of foreign income in the tax base and by the allowance of a credit against the U.S. tax for the taxes imposed by foreign countries on income derived within their borders. Without a foreign tax credit, income from foreign sources would bear an aggregate tax load substantially above that imposed on domestic income. The foreign tax credit provision reflects the view that each country has a primary right to tax income originating within its borders. One effect of the provision is to eliminate U.S. tax completely in many cases, for where a foreign country's taxes are equal to or exceed those of the United States, no additional tax on income derived within its borders is collected by the United States. In other cases, the United States collects only small amounts of tax, the difference between the foreign rate and our own.

It may be of interest to note that this treatment of foreign taxes is considerably more favorable than the treatment accorded taxes imposed by the State governments. A foreign income tax (whether national or local) is treated as if it had been paid to the United States, but State income taxes are considered a cost of doing business, deductible from gross income rather than from the tax itself. It may be noted in passing that, for reasons that are largely accidental, the method of computing the credit for foreign taxes is such that income derived abroad through the medium of foreign subsidiaries is frequently taxed at a combined foreign and domestic rate which falls short of the tax rate that applies to income derived from domestic business operations.

The treatment of income derived abroad by American companies operating through foreign subsidiaries merits attention. A corporation which is created under the laws of a foreign country and derives its income abroad does not fall within the scope of our tax system, irrespective of the fact that ownership rests in the United States and its management and control are also located in the United States. This has been a basic feature of our income tax structure since its enactment, but it is not a universal rule for the tax treatment of companies. In some countries, a corporation that is managed and controlled by residents of the country is considered to be a legal entity of that country and subject to its tax laws. This is true not only in the United Kingdom and countries influenced by British law, but in a number of the continental countries as well. One result of our approach is that a substantial proportion of the income each year from investments made abroad by U.S. firms does not fall within the scope of our tax system. Consequently investments through foreign subsidiaries benefit from whatever advantages foreign countries are prepared to offer by way of tax rate concessions, development allowances, accelerated depreciation, and the like.

Despite the underlying philosophy of uniformity in our tax system there is in our tax structure a rate differential for certain investments abroad. The principal provision is the Western Hemisphere trade corporation deduction which provides a rate reduction of 14 percentage points. A corporation that qualifies is taxed at a rate of 38 percent instead of the 52 percent imposed on corporate income generally. The application of this differential rate has spilled over into other activities somewhat removed from the type of enterprise for which the provision was originally intended. The combination of the reduced rate and the credit for foreign taxes means that income from the Western Hemisphere, even more so than from other parts of the world, produces little revenue for the United States Government.

The basic provisions of the tax law applicable to income from foreign sources are supplemented by a network of 21 income tax treaties, which help eliminate tax barriers to the international movement of trade and investment. Their principal purpose is to set forth agreed rules of source, either explicitly or implicitly through reciprocal tax rate reductions and exemptions, which reduce the cases in which two countries impose tax on the same income without either one giving

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recognition to the tax imposed by the other. Let me illustrate the problem. While we allow a credit for the tax imposed by Country X on income derived in that country, our concepts of source may differ from those accepted in the foreign country. As a result there may be a flow of income to an American firm which is considered under U.S. law to be income from sources within the United States, but which under the laws of the foreign country may be considered income from sources within its borders. Both countries would impose a tax on that income, but we would not allow a credit for the foreign tax, since the income does not have its origin in that country so far as the U.S. law is concerned. With tax rates as they are, the combined tax burden in such a case might well exceed the total income involved. This problem arises, in greater or lesser degree, in connection with various types of international transactions, including trading activities, the rendition of personal services, licensing arrangements, and the like.

Of late we have undertaken another step in connection with the tax treaty program which holds considerable promise of facilitating the international movement of investment. I refer to the credit for "tax incentives" or "tax sparing" which some less developed countries have chosen to use as part of their programs to attract capital and know-how from abroad and to encourage reinvestment of profits. The tax credit mechanism designed to achieve equality of tax burdens operates so as to offset, to some extent, tax incentives granted by a foreign country. For as the tax imposed in a foreign country is reduced, whatever the reason may be, the amount of the tax credit allowed against U.S. tax is also reduced. When the tax credit declines, the amount of U.S. tax payable tends to increase and thus to negate the tax reduction offered by the foreign country. This has been a source of irritation among some foreign countries. Though it may not be desirable from the point of view of an ideal tax system, uniformly administered, to give a credit for an amount of tax which has not been collected by a foreign government, it is our view that in the interest of foreign economic policy we should recognize, rather than nullify, the revenue sacrifices made by a foreign government under certain conditions. This question is developed more fully at a later point.

From this brief sketch it is evident that our tax system offers several inducements to foreign investment as compared with domestic investment. Nevertheless various proposals have been made in recent years to modify further the U.S. tax treatment of income from foreign sources. Doubtless new ones will emerge in the hearings before your committee. By way of introduction some of the main proposals that have been made may be listed and some of their features discussed.

The suggestion that has probably evoked most interest in recent months is that there be created a special class of domestic corporation for tax purposes which would be permitted to conduct business operations abroad or otherwise derive income from foreign sources without incurring any liability for tax in the United States unless and until its income is repatriated to the United States. So-called base companies can now be created under the laws of certain other countries, and can, through subsidiaries or directly, carry on business outside the country of incorporation under favorable tax conditions. Indeed, a number of other countries are making a determined effort to attract the formation of such corporations within their jurisdiction. The proposal to create a special class of foreign business domestic corporations is to make possible the creation of a so-called base company under United States law.

Your committee will recall that the administration's tax recommendations in 1954 included the deferral of tax on income derived abroad through a branch of a domestic corporation. Of course a domestic corporation that was engaged exclusively in business abroad would have qualified for deferral just as under the proposals currently under discussion. The major argument for such a domestic base company, or foreign business corporation, or overseas trading corporation, is that it would give some impetus to foreign investment without appearing to make any serious incursion into the principle that equal amounts of income should bear equal tax burdens. A supplementary argument is that American firms are now in a position to create such a company abroad and no sound public purpose is served by requiring American firms to subject themselves to foreign jurisdictions. It is argued that they should be able to organize such companies under U.S. law. This would at the same time bring under the scrutiny of our own tax authorities transactions that might otherwise go unnoticed. Whatever the merits of the proposal, it should be borne in mind that as a practical matter tax deferment is tax exemption to the extent that the income of a base company is not

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distributed. Given the reinvestment policies of American firms, therefore, a substantial portion of profits would in fact be exempt for an indefinite period from U.S. tax. Attention may also be called in passing to the many questions which must be answered if a foreign business corporation law were adopted. What kind of operations could such a company engage in? Would it have to be engaged in business operations directly in foreign countries, or could it own stock in other companies which are engaged in business? If the latter, must it have a substantial equity interest in the foreign operating company or could it have a small portfolio interest? Should the company be allowed to transfer its profits freely from one company to another or from one country to another, or should it be required to restrict its investments in certain channels? In other words, should it be possible for a company deriving profits from mining in a high-risk country to invest excess funds in portfolio investment in a low-risk country. At what stage would its profits become subject to U.S. tax? When dividends are declared to a U.S. shareholder, or when it transfers assets to a bank account in the United States or invests them in the United States in some other way? If the company is to engage in operating activities, should these activities be restricted in any way? Should a firm which exports goods from the United States qualify? And if such an enterprise can qualify, should a company which manufactures for export also qualify? If passive portfolio investment is to be encouraged, should other income flows be similarly treated—such as interest or royalties from patents and copyrights? These are some of the questions that would have to be resolved in connection with the enactment of any legislation along this line. A more fundamental question is whether enactment of this legislation would in fact promote the kind of investment flows to the regions of the world where U.S. investment could do the greatest good.

This question of how much additional foreign investment will be generated by a particular course of action applies equally to other proposals besides tax deferral. A second frequently proposed suggestion is to reduce the tax rate on income derived from foreign sources. In its most extreme form, this proposal involves complete tax exemption for income derived abroad. In its more common form, the suggestion is that the rate on foreign income be reduced by 14 percentage points, just as in the case of Western Hemisphere trade corporations. While it is often referred to as an extension of the Western Hemisphere provisions to a world-wide basis, the Treasury proposal of 1954 on this subject contained certain important restrictions. One was that the corporation eligible for the reduced rate could not also take a percentage depletion deduction. It was also our recommendation that the reduced rate should apply only where a taxpayer was engaged in an active business role abroad through the firm commitment of tangible resources. Passive portfolio investment did not appear to merit special treatment any more than portfolio investment in domestic enterprises. To be sure, the risks associated with portfolio investment in some foreign countries are greater than the risks in the United States. But this is not uniformly true in foreign countries and there is also great differentiation in risk among domestic investments. In addition foreign income eligible for the preferential rate was so defined as to exclude profits derived from the export of domestic goods. This was deemed essential to avoid giving a tax subsidy to exports and unfairly undermining the position of other countries in international markets.

These considerations apart, it should be noted that while a general tax rate reduction for foreign income may arouse new interest in foreign investment, it may not have the incentive effect that first appears. A reduction in the U.S. tax rate of 14 percentage points on foreign income may produce an incentive effect of only 7 percentage points in a country which has a 45 percent tax rate. In a country with a tax rate of 50 percent, it may have the incentive effect of only a 2-point reduction. It is ironic to note in this connection that some of the countries most in need of capital both from foreign and from domestic sources impose taxes at rates that are higher than those in the United States. A tax reduction would have no impact on investments in such countries over the long haul, and if a generally applicable rate reduction were adopted with these countries in mind, it would merely provide windfalls for investors in other countries where new investment may need no special stimulus.

In appraising a 14 percent rate reduction it is necessary to keep in mind that it would apply uniformly across the board to income from both old investment and new and to all countries unless made specially selective. Tax rate reduction may have an effect quite opposite to that intended by its proponents so far as concerns the reinvestment abroad of income derived in foreign countries. If the U.S. tax

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rate on dividends from a foreign subsidiary is to be 38 percent, the incentive to repatriate profits rather than to plow them back in the business venture abroad will be greater than is the case today when a 52 percent rate may apply to such income. Thus a rate reduction, instead of promoting investment abroad, may have a contrary result.

It should not be inferred from these comments that a general 14 percent tax rate reduction might not have a beneficial effect on investment flows abroad. The foregoing comments are intended to bring out certain aspects of the problem which are often overlooked.

Another proposal which has received some attention in the past is to scrap completely the present method of taxing foreign income, including the credit for foreign income tax, and to levy a special corporate tax at the rate of, say, 5 or 10 percent on such business income, whether in the form of dividends from a foreign corporation, profits from the active conduct of a trade or business, interest, royalties, and so on. The tax base would be foreign income after the deduction of foreign taxes. Depending upon the rate imposed, such a tax could either produce the same amount of revenue that we now get from taxes on foreign income or it might even provide for a modest increase.

The simplicity of this proposal has much to commend it. Such a low flat rate tax would leave considerable scope for whatever tax inducements might be offered by a foreign country to new investment. Any dollar of foreign tax saved would be subject to the U.S. tax, but in view of the low rate the major portion of any foreign tax rate reduction would accrue to the benefit of the investor. All foreign income would pay some tax to the United States, including income which is now exempt because of the effect of the foreign tax credit. But this advantage also reveals the principal disadvantage of this plan. Since all foreign income would be subject to tax, profits derived abroad which are already subject to a tax of 52 percent, or 38 percent, or even 60 percent would bear an additional tax.

The arithmetic may be clarified by an illustration. Suppose that Country X imposed a tax of 30 percent on income derived within its borders. One hundred dollars of income derived in that country would leave $70 available to the American investor, and this $70 would be subject to the flat rate tax of, say, 10 percent, or a liability of $7. The total foreign and U.S. tax on the $100 of profits would come to $37. Suppose the foreign tax rate were 10 percent, then the combined tax on such $100 of profit would be $10 abroad and $9 in the United States, or a total of $19. If the foreign tax rate were 60 percent, then the combined tax liability would be $60 to the foreign country and $4 to the United States. This type of tax on foreign income would doubtless involve a tax reduction in some cases, but in other instances it would mean an increase in the aggregate taxes now imposed. In general, it may be said that if the U.S. tax were fixed at 10 percent this approach would involve a tax reduction where the foreign tax rate is 46.7 percent or lower, and would involve a net addition to tax where the foreign rate is above that figure. In the Western Hemisphere the comparable breakeven point is 31.1 percent. Whether the benefits to be derived from this approach are significant enough to justify its adoption is a matter to which your subcommittee will want to give careful consideration.

One objective of the tax proposals under review is to make it possible for American firms investing abroad to benefit from the tax inducements offered by foreign governments to attract new capital. As previously noted, such inducements can now be taken advantage of by a foreign subsidiary engaged in business abroad and seeking to plow back its earnings. However, if a business is conducted abroad through a branch, or if the opportunity and desire to reinvest are lacking, then the tax incentives offered by a foreign country are offset by operation of our tax system. This problem has already been mentioned, but the declaration of policy which the administration has made in connection with the tax treaty program may be repeated at this point. It has announced that we are prepared to consider the inclusion in tax treaties with less developed countries of a provision by which recognition would be given to tax incentive schemes under so-called pioneer industries legislation or laws for the development of new and necessary industries. Briefly, what we are proposing is this: If a country believes that by giving up tax revenues in certain cases, it will be serving the cause of economic development, we will forego the opportunity to increase our tax revenues by nullifying their concessions. However, we would be prepared to forego this only under certain conditions. First, there should be a firm commitment to eliminate unnecessary and inequitable tax barriers to the flow of private investment in accordance with sound rules of taxation such as are generally embodied in our

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income tax treaties. This includes agreement not to discriminate against American business enterprises. Second, its tax incentive laws should be of general application, thus assuring maximum benefit to the economy from such legislation. Third, the conditions and terms under which the tax incentives are available should be those provided in an existing law with full disclosure of the conditions under which they are granted, and with procedures for granting or withholding tax incentives which involve a minimum of administrative discretion. Fourth, the tax incentive should be for a limited duration of time, and preferably limited in amount. Finally, the tax from which exemption is granted must be a genuine part of the country's tax structure and not a spurious levy created for the occasion. Whatever one may think about a credit for "taxes spared" as an element in an ideal tax system, and there are some who have misgivings, it is our view that this is a sensible way to approach an issue that is of considerable importance to foreign countries and that has the seeds of substantial growth in promoting private investment abroad at a minimum cost.

It may be said of the tax treaty program that a credit for taxes spared permits foreign governments to determine the tax burden imposed on American firms and to vary that tax burden among American firms in different ways. In a broad sense, this is quite correct. However, it is a charge that is equally true of any method of taxing foreign income which in any way removes income from the scope of the U.S. tax. It is true in large measure today of income derived abroad through foreign subsidiaries.

Another suggestion which appears to merit careful attention would extend the principle of the loss treatment found in the Small Business Tax Revision Act of 1958 to certain foreign corporations. Under the 1958 legislation, losses incurred by an individual or partnership on stock issued to the shareholder by a small business corporation may be treated as an ordinary loss within certain limits. However, only a domestic corporation can qualify as a small business corporation. You may wish to consider whether this limitation should be removed so that business ventures abroad conducted through foreign corporations could also qualify. Or conditions other than those applicable under the Small Business Tax Act might be made to apply where a foreign corporation was involved. This would mean that losses incurred in connection with business venture abroad would be deductible from ordinary income, but gains would be treated as a capital gain. The loss of revenue is kept to a minimum by the self interest of the investor, while the opportunity of offsetting losses against other income might represent a significant step in promoting foreign investment.

You will recall that in the case of certain regulated investment companies which devote more than 50 percent of their assets to investments in foreign corporations, a so-called pass-through of the foreign tax credit to shareholders is permitted which the corporation would itself be entitled to take if it were a taxed entity. The suggestion has been made that this pass-through of the foreign tax credit should be expanded to include companies which have a smaller proportion of their assets in foreign securities. This might stimulate some interest in foreign investment by regulated investment companies which now place their funds largely, if not exclusively, in domestic investment outlets. On the other hand, the complaint has been made that the amount of tax credit passed through to a shareholder in a regulated investment company which qualifies under existing law is so small in view of the complexity involved that it is not much of an incentive to the ordinary shareholder. The tax credit that would be available in the case of a regulated investment company with more diversified investments may involve an even smaller credit and be correspondingly less attractive to its shareholders.

Another proposal, incorporated in a bill introduced by the chairman of this subcommittee, would permit a domestic corporation to transfer assets without any tax consequences to a foreign corporation if such assets are connected with business activities conducted abroad. Such a step would introduce greater uniformity of treatment as between companies that are engaged in business abroad through domestic subsidiaries or branches and companies engaged in business abroad through foreign subsidiaries which are controlled by a foreign holding company. If legislation authorizing a foreign business corporation of the type previously discussed were to be adopted, consideration would have to be given as to whether to permit the transfer of property to a foreign business corporation as if it were a tax-free reorganization. If it adopts such an approach then transfers to foreign corporations would presumably not need to be encouraged. But if the subcommittee does not adopt the foreign business corporation device, then the tax-free transfer of assets to foreign corporations will continue to be of

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interest to many firms. In our view the issue is not very different from that which involves tax-free reorganizations of domestic corporations. However, to prevent such reorganizations from becoming avenues of tax avoidance through the transfer of appreciated property to a foreign corporation and the subsequent liquidation of the foreign corporation either tax-free or at capital gain rates, your subcommittee would want to consider whether the gain on liquidation or otherwise should be taxed at ordinary rates. In 1950, when the Ways and Means Committee was considering legislation relating to the liquidation of foreign subsidiaries, the Treasury then recommended such ordinary income treatment.

Finally, I would draw your attention to the proposal that an election be permitted taxpayers to choose between the per country limitation in computing the foreign tax credit and the overall limitation. The per country limitation gives companies operating at a loss in some countries the right to continue to take tax credits for the taxes paid in countries where they operate profitably without having to offset for losses in the other countries. The overall limitation would give companies operating in countries with tax rates above the United States rates the right to offset those higher taxes against income tax in other countries where the tax rates are lower than the United States rates. Prior to 1954, both limitations applied. In that year the overall limitation was removed to eliminate the tax barrier which discouraged companies from going into ventures in new countries where they might be expected to have a loss in the first few years. This was a sound change in the law. It is questionable whether it would be reasonable to permit higher taxes than those imposed in the United States to be offset, indirectly, against U.S. taxes, as would be possible if the overall limitation were now established as an alternative to the per country limitation.

The theoretical justification for the overall limitation appears to be that taxpayer income can be separated into two baskets, one of which includes domestic income only and the other includes foreign income only. One may doubt whether this type of separation is indeed a valid one. There would seem to be little in common between income derived in Canada or the United Kingdom and income derived in Iran. In any event, if such a dichotomy were to be adopted, consistency would require the elimination of the per country limitation and, indeed, of the deduction of foreign losses from domestic income. Moreover, the need for making the choice involved in this proposal seems largely to have disappeared as a result of the recent legislation allowing the carryover of foreign tax credits.

This list of tax proposals to promote private foreign investment is likely to be expanded by subsequent witnesses before your subcommittee. As you may know, there are several groups in the executive branch of the Government giving intensive study to various proposals. It is our hope that these hearings will assist in this purpose. The Treasury Department will be glad to cooperate with the subcommittee in whatever way it can in the further work in this area.

EXHIBIT 23.—Letter from Secretary of the Treasury Anderson, May 6, 1959, to the Chairman of the House Committee on Ways and Means on a bill, H.R. 5. to provide tax relief for foreign income

MY DEAR MR. CHAIRMAN: This is in reply to your request for the comments of the Treasury Department on H.R. 5, a bill entitled "Foreign Investment Incentive Tax Act of 1959," introduced on January 7, 1959, by Mr. Boggs. The purpose of this bill is to provide in certain areas tax relief for foreign income in order to provide incentives for the expansion of United States investment abroad.

The need to enlist the vast resources and talents of American enterprise in helping to improve the economies of the less developed countries is particularly important today with a hostile Communist bloc actively pressing a massive economic offensive against the free world. The Departments of State, Commerce, and Treasury have given careful study to various proposals designed to promote this country's foreign economic policy, with a view to facilitating the flow of private capital abroad and especially to the less developed countries of Asia, Africa, the Middle East, and Latin America. As indicated by administration witnesses during the hearings last December before the Subcommittee on Foreign Trade Policy, many of these proposals are aimed at the creation of a more favorable investment climate abroad through removal of present barriers impeding private investment. Such obstacles include problems of currency convertibility, customs difficulties, political instability, threats of expropriation,

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inflation, and the like. In recent years various proposals have been made for changes in our tax laws in order to encourage investment abroad by American business. A number of these proposals are embodied in H.R. 5.

These are: Broadened deferral of tax on foreign income (sec. 2); the liberalization of present restrictions on tax-free transfers of property to foreign corporations (sec. 3); a 14 percent reduction in tax rates (sec. 4); modification of the foreign tax credit to include an "overall" limitation (sec. 5); a credit for taxes spared by foreign countries to attract American industry (sec. 6); and nonrecognition of gain on the involuntary conversion of property of foreign subsidiaries (sec. 7).

While recognizing that tax incentives alone cannot successfully stimulate private investment in the critical underdeveloped areas of the free world where the need is greatest, the Treasury Department has given sympathetic consideration to these and other proposals for changing the present methods of taxing income from abroad. In this connection, we have reviewed the hearings before the Subcommittee on Foreign Trade Policy of the Committee on Ways and Means held in December 1958, the special report prepared at the request of the Department of State on "Expanding Private Investment for Free World Economic Growth," which was prepared under the direction of Ralph I. Straus, a special consultant to the Under Secretary of State for Economic Affairs, and a report of the Committee on World Economic Practices of the Business Advisory Council, dated January 22, 1959, which committee was chairmanned by Mr. Harold Boeschenstein.

While private U.S. investments abroad nearly doubled between 1950 and 1957, the real problem is that almost half of our private investments are in Canada and Western Europe, 35 percent are in Latin America with extractive industries such as petroleum, iron ore, and bauxite predominating, and less than 9 percent of our direct private investments (again mostly in the extractive industries) are in the critical areas of the Middle East, Asia, and Africa. The Treasury Department would favor adoption of legislation which would in fact promote the flow of United States investment into the less developed regions of the free world, including Latin America, Asia, the Middle East, and Africa. Measures to bring about this desirable result, which the Treasury would support, include:

(1) The deferral of tax on income derived by a foreign business corporation which obtains substantially all of its income from investments in one or more of the less developed areas of the free world.

(2) Ordinary loss treatment for losses incurred by original investors on stock of such a foreign business corporation.

(3) The early implementation; by treaty or by negotiated agreement authorized by legislation, of the principle of tax sparing in order to make it possible for American firms investing in an underdeveloped country to benefit from the tax inducements offered by such country to attract new capital.

In the interest of fiscal soundness, however, the Treasury Department must oppose at this time the enactment of legislation providing tax benefits to encourage foreign investment in the more industrialized areas of the world. It has been argued that United States private investment in industrialized countries will eventually result in more private investment in the less developed countries. Even if this should occur to some extent, it would seem to be an inefficient means of stimulating economic growth in the less developed areas where a relatively small amount of capital is required to put a laborer to useful work as compared with the situation in the highly industrialized countries. In practice tax deferral on income earned in industrialized countries would result in substantial tax benefits to existing U.S. investment in those countries at considerable cost to the revenue.

In presenting herein the Treasury views on the provisions of this bill, we shall set forth the position of the Treasury on each section of the bill in order, and include where appropriate certain additional recommendations.

Tax deferral, general comments (section 2)

This provision would permit the creation of a special domestic corporation, referred to as a foreign business corporation, which would be entitled to tax deferral on its foreign earnings until they are repatriated. The Treasury Department favors, on a basis limited to the less developed countries of the free world, deferring the imposition of tax on income earned by a U.S. foreign business corporation from the active conduct of a business abroad until such time as the earnings are distributed in this country.

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The postponement of tax provides an effective incentive for companies to reinvest their profits abroad for a longer period of time, without relieving them of their obligation to share in the tax burdens of this country when the profits are eventually brought back. Moreover, under existing law American firms are able to defer United States tax on income earned abroad by operating through foreign subsidiaries. Indeed, an argument frequently made in support of the provisions under section 2 is that it is illogical to require U.S. taxpayers to incorporate in a foreign country in order to obtain tax deferral on foreign income.

Although recognizing the merits of section 2 of H.R. 5, the Treasury Department nevertheless is compelled to oppose unlimited deferral at this time because of the substantial revenue losses involved in extending the deferral provisions to include investments in and exports to all regions of the world by American firms. While the estimates are exceedingly difficult to make, it is believed that section 2, if enacted, would involve a revenue loss ranging from $300,000,000 to $500,000,000 annually, depending upon the dividend policies followed by foreign business corporations. If export income were entirely excluded the revenue loss would be in the neighborhood of $100,000,000 a year. Revenue losses of this magnitude cannot be accepted at this time without contributing to an unsound fiscal position.

As indicated above, the Treasury Department does support a more limited deferral provision which would apply to foreign business corporations which obtain substantially all of their income from investments in the less developed areas of the free world. Possibly income derived from exports to such areas might also qualify for deferral provided it is reinvested by the foreign business corporation in one or more of the less developed countries. It may be necessary, as suggested in the Straus report, to limit the deferral provision to foreign business corporations which do not earn more than 50 percent of their gross income from exports. This would prevent purely trading activities that take place without substantial investments in underdeveloped areas from utilizing the tax benefits of a foreign business corporation.

We believe that enactment of a deferral provision limited to the less developed countries would have a relatively small impact upon the revenues, although in this connection additional study would be needed to determine whether a ceiling should be placed upon the amount of export income of a foreign business corporation which may qualify for deferral treatment.

As a further stimulus to investment overseas where the need is greatest, the Treasury recommends enactment of a provision permitting deduction as an ordinary loss, within prescribed limits, of losses incurred by the original investor on stock of a foreign business corporation deriving substantially all of its income from the active conduct of a trade or business, utilizing plant and equipment, in one or more of the less developed countries. The objective of this selective tax relief would be to induce American firms to invest in manufacturing facilities in the areas of greatest need by reducing the after-tax cost and thus the risk of incurring losses.

These two proposals—tax deferral and ordinary loss treatment for investment losses—coupled with the early implementation of the tax sparing principle and the expansion of our investment-guaranty program, should do much to encourage U.S. firms to operate in the less developed areas.

As the adoption of either section 2 of H.R. 5 or the more limited deferral proposal of the Treasury would provide tax deferral for foreign business corporations, there are a number of important technical questions arising under section 2 which the committee may wish to consider. For convenience we have placed our detailed comments on section 2 in an appendix to the report.

Liberalization of the present restrictions on tax-free transfers to foreign corporations (section 3)

Under present law (section 367 of the 1954 Code) assets held by United States corporations cannot be transferred tax free to foreign corporations without the Commissioner's advance approval based on a showing that the transaction does not involve tax avoidance. Section 3(a) of H.R. 5 would modify section 367 by eliminating the requirement of advance approval by the Commissioner in the case of transfers of certain business assets to a foreign corporation.

It may be appropriate to consider section 3 in connection with section 2 of the bill, which provides for the United States foreign business corporation. One of the chief arguments for the enactment of section 2 is that it will encourage Americans to conduct their business abroad through U.S. corporations. However,

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section 3 would encourage freer transfers of assets to foreign corporations and thus provide additional incentives for the increased use of foreign corporations as opposed to domestic corporations by U.S. investors. Accordingly, consideration might well be given to a provision permitting tax-free transfers of business property from a foreign corporation to a United States foreign business corporation. A limited amendment of the advance ruling requirement may also be desirable in the case of transfers of business property from a foreign business corporation to one or more of its foreign subsidiaries, provided distribution limitations are placed on the foreign subsidiaries, similar to those provided in section 2 for the foreign business corporation itself.

Further liberalization in this area might tend to encourage further the use of foreign corporations as avenues of tax avoidance. Accordingly, unless amendments were adopted, along the lines suggested above, that are generally applicable to foreign corporations controlled by U.S. interests, the Treasury would be opposed to further liberalization of section 367 of the present law.

The foregoing comments on the proposed amendment of section 367 apply equally to the amendment of section 1492 proposed in section 3(b) of the bill.

Reduction in tax rate (section 4)

This provision would reduce the tax on foreign income by 14 percentage points and is commonly referred to as an extension on a world-wide basis of the present Western Hemisphere trade corporation provisions. As drafted, the proposed rate reduction applies to export income and is expanded to cover royalties, dividends, and other investment income. Moreover, the provision would apply equally to earnings from existing as well as new investments. A major effect of such a provision would be to create an incentive to repatriate foreign earnings rather than reinvest them abroad. A rate reduction as broad as that proposed would benefit taxpayers who have established investments in foreign countries where economic development needs no special stimulus and others who have made no capital investment abroad. The revenue loss from this provision alone is in the order of magnitude of $200,000,000. Considering the doubtful effect of a rate reduction as an incentive for the expansion of American business abroad, it is difficult to justify a loss in revenue of this magnitude. Therefore, the Treasury Department is opposed to section 4 of H.R. 5.

Liberalization of the foreign tax credit allowance in cases where foreign operations are carried on in two or more foreign countries (section 5)

Section 904 of the present law permits taxpayers to offset their United States tax liability by the amount of income taxes paid to each foreign country, but this credit is limited to the amount of the United States tax attributable to foreign income on a "per country" basis. Taxpayers operating in two or more countries sometimes pay taxes to one foreign country in excess of this limitation and thus under the per country limitation receive no credit for the excess amount. Section 5 of the bill would give the taxpayer the benefit of the so-called overall limitation, limiting the foreign tax credit to the aggregate United States tax on all foreign income, wherever such limitation would be more advantageous than the per country limitation.

The proposal to give the taxpayer the advantage of the "overall" limitation might encourage investment in some of the underdeveloped countries which are most in need of capital but which impose taxes at rates that are higher than those in the United States. On the other hand, if section 5 were enacted, the immediate revenue loss, based upon existing United States private investments abroad, would be substantial. Most of this tax relief would go to a few large corporations. Our studies indicate, for example, that in the case of one company alone the revenue loss would be $19 million.[1] On revenue grounds, the Treasury Department must oppose section 5 at this time, unless amendments are adopted which would considerably reduce the impact on the revenue. This might be accomplished, if deemed fair and appropriate, by two changes in the computation of the overall limitation: first, treat dividends and interest from domestic subsidiaries operating abroad as other than foreign source income and, second, exclude any unused foreign tax credit attributable to the lower United States tax rate paid by Western Hemisphere trade corporations.

[1] Based on a special survey of foreign income for the year 1955.

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Tax sparing by underdeveloped countries (section 6)

Section 6 of the bill amends section 903 of existing law to provide for a foreign tax credit where the laws of certain countries provide for a reduction of tax in order to provide incentives for the expansion of investment. Under present law the effect of such laws may be nullified to the extent that the foreign tax credit is reduced and the United States tax correspondingly increased. Under the bill the taxpayer would be entitled to a credit only if the waiver of taxes by the foreign country is certified by the Secretary of State to be an inducement extended and accepted by the taxpayer in good faith to continue certain business activities in such country. A credit for taxes waived would be allowed only for a period not exceeding ten taxable years.

The Department favors, in general, the policy of allowing a foreign tax credit where taxes are waived by the foreign country pursuant to investment incentive legislation. Under the bill, however, it appears that the United States would be required to accept the application of tax sparing on an unlimited and unilateral basis, the only qualification being that the taxes otherwise payable are waived as an inducement extended and accepted in good faith in order to encourage certain industrial development in the foreign country involved. It is believed that policy considerations guiding the selection of foreign taxes for this purpose should remain flexible, and that "tax sparing" should be implemented on a selective basis either by treaties or by negotiated agreements authorized by statute.

Nonrecognition of gain or involuntary conversion of property of a foreign subsidiary (section 7)

The proposal contained in section 7 of the bill would amend section 1033 to provide nonrecognition of gain arising from the involuntary conversion of property owned by a foreign subsidiary where the insured is a domestic parent corporation. Under present law the nonrecognition principle in section 1033 applies only where the entities receiving insurance proceeds also own the property which is involuntarily converted. It has been suggested that this provision is necessary because in many foreign countries it is impossible or difficult to obtain adequate insurance coverage. The Department wishes to reserve its position on section 7 until information can be obtained as to the countries involved and the precise nature of the conditions or restrictions which result in the absence of adequate foreign insurance protection.

Subject to further study as to the need for such an amendment, the Department would favor the proposal contained in section 7 if it was limited in application to foreign business corporations. We would oppose a general application of such an amendment of existing law for the same reasons that we do not favor a general liberalization of the advance ruling requirement under section 367 of present law. Before adopting any provision which would tend to encourage the use of foreign corporations and foreign holding companies as the medium for investment abroad, we believe that restrictions should be placed upon the opportunities for tax avoidance now offered by the favorable tax treatment accorded liquidations and other transactions affecting foreign corporations.

Other recommendations

In view of the omnibus nature of H.R. 5, the committee, in reviewing the present provisions of the Code applicable to foreign investment, may find it appropriate to consider a number of other legislative proposals. In this regard we believe the following items have merit and deserve favorable consideration:

(1) *Information returns as to formation, organization, or reorganization of foreign corporations.*—Section 6046 of the 1954 Code provides that every attorney, accountant, fiduciary, bank, trust company, financial institution, or other person, who aids, assists, counsels, or advises in, or with respect to, the formation, organization, or reorganization of any foreign corporation, shall, within 30 days thereafter make a return in accordance with regulations. Each person required to make a return must set forth, in respect of each such corporation, to the full extent of the information within his possession or knowledge or under his control, such information as the forms, or regulations prescribe, except that an attorney, at-law need not furnish information with respect to any advice given or information obtained by him through the relationship of attorney and client.

The foregoing provisions have not been effective in securing for the Service any appreciable amount of really helpful information concerning the formation,

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organization, and reorganization of foreign corporations, because of the widespread claim of the right of privileged communications between attorneys-at-law and their clients. It is, therefore, recommended that the existing provision be repealed and that there be substituted therefor a requirement that such information be furnished by every citizen or resident of the United States who is an officer or director of the corporation within 60 days after its formation, etc., and by every United States shareholder of the corporation who at any time within 60 days after its formation, etc., owns 5 percent or more in value of its stock then outstanding.

(2) *Information returns by officers, directors, and shareholders of foreign personal holding companies.*—Section 6035 of the 1954 Code provides that officers and directors of a foreign personal holding company shall on the 15th day of each month make a return setting forth with respect to the preceding month the name and address of each shareholder, the class and number of shares held by each, together with any changes in stockholdings during such period, the name and address of any holder of securities convertible into stock of such corporation, and such other information with respect to the stock and securities of the corporation as the forms or regulations require. Section 6035 also provides that officers and directors of a foreign personal holding company shall on the 60th day after the close of the taxable year of the company make a return setting forth in complete detail the gross income, deductions and credits, taxable income, and undistributed foreign personal holding company income of such company for such taxable year. A United States shareholder, by or for whom 50 percent or more in value of the outstanding stock of a foreign personal holding company is owned, directly or indirectly, is required to file a monthly return setting forth the same information as is required of officers and directors in their monthly returns, but is required to file an annual return only if he has not filed the required monthly returns.

It is recommended that the requirement of monthly returns from officers, directors, and certain shareholders of foreign personal holding companies be eliminated and that the annual return of officers and directors combine the information now required of such persons on the present "monthly" and annual returns, and the annual return of shareholders be expanded to include the same information as is required of officers and directors. This recommendation would relieve officers, directors, and stockholders of filing a great number of unnecessary returns and in lieu thereof would require the filing of a limited number of returns which are more informative and of much greater value in the administration of the tax laws. It is also recommended that the filing requirement with respect to officers and directors be changed to require returns from only those officers and directors who are citizens or residents of the United States (the proposed regulations would so provide). It is further recommended that the filing requirement with respect to shareholders be extended to cover those United States shareholders of a foreign personal holding company who own 5 percent or more in value of the outstanding stock of such company.

(3) *Deduction for dividends paid by foreign personal holding companies which fail to file timely returns.*—Under section 882 of existing law a foreign personal holding company which fails to file a return is, in computing its undistributed personal holding company income, denied all deductions allowed in Subtitle A, including the deduction for dividends paid. The rule under the 1939 Code was to allow deductions of such dividends. The harsh rule under the 1954 Code appears to result from a drafting mistake in section 882(c) wherein the term "Subtitle" was substituted for the term "Chapter" as used under the 1939 Code.

The denial of the deduction for dividends paid can lead to the imposition of a confiscatory tax. Thus, if a foreign corporation subject to the personal holding company tax filed no return, but paid 30 percent on its United States income by way of withholding and distributed its remaining income to its shareholders, the corporation might still be liable to an additional 85 percent tax on its undistributed personal holding company income, which would be its gross income if the deduction for dividends paid was not allowed. This would make its total tax at least 115 percent of its income.

It is believed that present law imposes a penalty out of proportion to that which should apply in the case of a failure to file a timely return by a foreign personal holding company, particularly where the failure to file is due to reasonable cause. Accordingly, we would recommend that Congress enact corrective legislation in this area.

The State and Commerce Departments agree with the substance of the conclusions stated in this report.

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The Bureau of the Budget has advised the Treasury Department that there is no objection to the presentation of this report.

During the consideration of H.R. 5 by your committee, the Treasury staff would be pleased to work cooperatively with the congressional tax staffs in the development of the legislation.

Sincerely yours,

ROBERT B. ANDERSON,
Secretary of the Treasury.

APPENDIX

DETAILED COMMENTS ON SECTION 2 OF H.R. 5

(1) Limitation on dividends received from a foreign holding company

One of the significant justifications for the adoption of deferral is to permit the simplification of existing corporate structures employed in connection with investment abroad. In particular, it has been suggested that the foreign business corporation provision will be an inducement for the repatriation of foreign holding companies which are set up for the purpose of obtaining tax deferral under present law. Under the bill, however, a taxpayer who elects foreign business corporation status may, nevertheless, continue operating abroad through foreign holding companies.

Paragraph (2) of section 951(a) provides that income from the active conduct of a trade or business includes dividends received from a 10 percent owned corporation whether domestic or foreign and regardless of whether or not the related corporation is itself engaged in the active conduct of a trade or business. We believe that dividends from a 10 percent owned corporation should be treated as income from the active conduct of a trade or business only where that corporation itself derives at least 95 percent of its gross income from foreign sources and at least 90 percent from the active conduct of a trade or business abroad.

(2) Limitation of deductions in determining taxable distributions

Under proposed new section 951 (b)(2) of the Code, the amount subject to tax as a result of a distribution is limited to the earnings and profits of the distributing corporation. Thus, although tax is imposed at the corporate level, amounts which are not deductible in computing taxable income would reduce earnings and profits and may very likely, therefore, reduce the taxable income attributable to a distribution. For example, capital losses incurred by a foreign business corporation as in the case of other corporations reduce earnings and profits. The same is true of charitable deductions in excess of the limitation in section 170 of existing law. Similarly, foreign taxes paid by the corporation reduce earnings and profits even though such taxes are also available for the foreign tax credit. In each case, therefore, the possibility arises that such items would have the same effect as ordinary deductions in computing taxable income. A special problem arises in connection with reduction of earnings and profits by the amount attributable to foreign taxes paid. If limitations are not added in the bill, a foreign business corporation under certain circumstances would be entitled in effect to a deduction for foreign taxes as well as a foreign tax credit. Moreover, the tie-in of distributions to earnings and profits may open a loophole in that under certain circumstances the earnings and profits of a foreign business corporation might be wiped out by the acquisition of all the assets of a concern having substantial deficits.

For these reasons it is recommended that the amount includable in income with respect to a distribution by a foreign business corporation be determined by reference to taxable income without regard to adjustments in earnings and profits.

(3) 100 percent dividends received credit

Under present law dividends paid by domestic corporations are subject to tax when received by a corporate shareholder at the rate of 52 percent after the allowance of an 85 percent dividends received deduction as provided in section 243 of the Code. Section 2 of the bill, however, would allow a 100 percent deduction in the case of dividends received by a corporate shareholder of a foreign busi-

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ness corporation. To this extent section 2 of the bill provides for a significant reduction in existing tax rates otherwise applicable to repatriated foreign income. It would, for example, give an immediate and, we think, unwarranted tax reduction of more than $25 million to the corporate shareholders of one domestic subsidiary which would qualify as a foreign business corporation, without any change or increase whatsoever in its investments abroad. The overall loss in revenue has not been pinpointed to date, but it would be substantially in excess of $25 million. The Treasury, therefore, opposes the 100 percent dividends received deduction allowed under the bill and suggests that it should be limited to the 85 percent deduction under present section 243.

(4) Additional limitations of a technical nature

In addition to the above general comments, we believe that the following additional limitations of a technical nature should be noted briefly:

Requirements for qualifications.—Paragraph (1) of proposed section 951(a) requires that 90 percent of the gross income of a foreign business corporation be derived from foreign sources. Under the present provisions applicable to Western Hemisphere trade corporations as well as under proposals in prior years for tax deferral, the comparable limitation is 95 percent. A possible justification for such a modification is suggested in the explanation accompanying the bill in which it is stated that the reduction in the percent of foreign income required is necessary to avoid disqualification arising from the receipt of major items of nonrecurring income such as interest received in connection with tax refunds. In the case of a foreign business corporation, however, some measure of protection against such disqualification is already available to the extent that termination of foreign business corporation status requires disqualification for two successive years. We believe, therefore, that the foreign income requirement should remain 95 percent.

Limitations on "distribution".—Proposed section 951(b)(3) defines the term "distribution" to include a distribution treated under present law as a dividend as well as certain other transactions. In several respects these provisions should be further limited and clarified.

Subparagraph (B) of paragraph (3) provides that a distribution includes a transfer covered by section 361, relating to certain transfers which constitute a reorganization as defined in section 368. An exception to this rule is created where such transfers are made in connection with a statutory merger or consolidation under section 368(a)(1)(A) or a recapitalization under section 368(a)(1)(E) if the acquiring corporation has foreign business corporation status for the taxable year of the transfer. The justification for the selection of a statutory merger or consolidation for application of this exception is not clear in view of the fact that tax-free reorganizations under other provisions having the same general effect are excluded. Moreover, the application of the exception in this context to recapitalizations is not understood since it is doubtful whether such transactions are covered by section 361. It is believed that the scope of this paragraph should be reconsidered in the light of the foregoing comments.

Third, subparagraph (C) of proposed section 951(b)(3) includes as a distribution any payment to acquire, or to reduce a debt incurred to acquire, property situated in the United States. For this purpose, however, local bank deposits, United States obligations, and stock in another domestic corporation which qualifies as a foreign business corporation are not considered to be property situated in the United States. In addition, the purchase of United States property used in connection with the conduct of a business, 90 percent of the gross income of which is from foreign sources, is also permitted. As compared with the treatment of foreign corporations under existing law, there is precedent for the exclusion of bank deposits, but interest derived from investments in obligations of the United States is fully taxable in the case of a foreign corporation. It is believed that appropriate limitations should be made applicable to income derived from the latter source in order to reduce the opportunity for tax avoidance through the accumulation of funds in the United States in the form of Government interest-bearing obligations.

Although a distribution is stated to include payments made in connection with the acquisition of United States property, there is no clear limitation upon transactions under which the foreign business corporation makes available to its parent corporation or other domestic entities funds representing foreign income in the form of loans. The possibility of such transactions constitutes a significant means

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of diverting funds from foreign investment to domestic purposes and express limitations to prevent such a result should be made applicable.

The exclusion of payments made to acquire property used in a business which derives 90 percent of its income from foreign sources appears to permit continued deferral with respect to payments made in connection with the acquisition of property used in a business having substantial activities in the United States and, possibly, no activities abroad. This exclusion should be limited to property used by a foreign business corporation in the conduct of its foreign business operations.

Finally, subparagraph (D) includes as a distribution the ownership of any property on the last day of the taxable year if payment for such property would have been a distribution under subparagraph (C). The purpose of this provision is to treat as a distribution the ownership of property, the acquisition of which was not taxed as a distribution under subparagraph (C), if the property is converted to a purpose other than described in subparagraph (C). The taxable amount (adjusted basis or fair market value, whichever is lower) is reduced by indebtedness on the property. Because of a drafting oversight, payments in reduction of such indebtedness, after subparagraph (D) applies, are not considered distributions, although it appears they should be.

One of the troublesome problems connected with foreign business corporations is that there is nothing in H.R. 5 to prevent such companies from accumulating profits and investing them in portfolio securities abroad, as for example in nondividend paying stock of certain Canadian investment companies. Consideration should be given to imposing a limit upon accumulations of income which are not reinvested in active businesses abroad.

Includable reinvested foreign business income.—Under paragraph (4) when a distribution is made, the amount to be reported in gross income apparently includes both the amount actually distributed and the deferred United States income tax attributable thereto. A number of difficult administrative problems will inevitably arise in connection with determining the amount includable in gross income under this "gross up" technique. As drafted, the language of paragraph (4) is not completely clear and may be susceptible to various interpretations. In addition, the paragraph should be expanded to include rules as to the treatment of such items as net operating losses and the foreign tax credit.

The above comments, while not intended to be exhaustive, do point out what now appear to us to be the most significant of the technical problems under section 2 of the bill.

EXHIBIT 24.—Statement by Assistant to the Secretary of the Treasury Lindsay, March 3, 1959, before the Senate Finance Committee on H.R. 4245 relating to the taxation of the income of life insurance companies

I welcome this opportunity to appear before your committee and to present the views of the Treasury Department on H.R. 4245, the Life Insurance Company Income Tax Act of 1959.

The Treasury Department supports this important measure. We believe that it provides an equitable, long-range basis for the taxation of life insurance companies.

Before commenting on the proposed legislation in greater detail, I wish to express the appreciation of the Treasury Department for the careful and objective study which your committee and the Congress have given to this difficult area over the years. These studies and discussions have contributed greatly to the present understanding of the problems involved in the taxation of life insurance companies.

The formulation of a reasonable net income basis for taxing life insurance companies has been complicated by the fact that the industry comprises both stock and mutual sectors which represent alternative and competitive ways of conducting the life insurance business.

At the end of 1958 the life insurance industry had assets of around $107 billion. Its investment portfolios have been growing at a rate of about 6 percent annually. For 1958 the industry had net investment income of $3.75 billion, total income from premiums and investments of around $20 billion, and a net operating gain of some $1.2 billion. Insurance in force was on the order of $500 billion.

The number of life insurance companies has been increasing rapidly in recent years, having more than doubled since 1950. Of about 1,350 life insurance com-

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panies in operation in 1958, less than 200 were mutual and about 1,200 were stock companies.

Mutual companies hold about three-fourths of the assets of the industry, have about 63 percent of the insurance in force, and account for some 58 percent of the net operating gain after policy dividends. There have always been certain difficulties in applying the same tax formula to both stock and mutual companies, and it is important that the tax law should not damage the competitive situation of either type of company.

Since 1921 life insurance companies, both stock and mutual, have been taxed only on a portion of their net investment income, after deducting an allowance designed to cover the interest required to meet obligations to policyholders. The various tax formulas have ignored premium receipts and the underwriting profit which results when premiums exceed actual mortality costs, other policyholder claims or benefits, and related expenses. Capital gains and losses of life insurance companies have also been disregarded for tax purposes.

In 1947 the then applicable law, adopted in 1942, resulted in no Federal income tax on the life insurance business. In the last 10 years a series of "stopgap" formulas were adopted. The latest of these, adopted in 1955, taxed each life insurance company on a fraction of its net investment income after a reserve and other policy liability deduction of 87½ percent on the first $1 million of net investment income and 85 percent on net investment income in excess of $1 million.

The 1955 stopgap formula was originally enacted for 1 year only and was extended on a year-to-year basis. For any year in which it is not extended, the 1942 formula automatically reapplies.

The present situation, therefore, is that in the absence of further legislation, the 1942 formula would apply to 1958 income, resulting in revenues of about $500 million. The 1955 stopgap, if extended, would produce $319 million.

The latest extension of the 1955 stopgap was adopted, as the committee will recall, in March of 1958, applicable to income for the calendar year 1957.

While the Treasury went along with the extension of the 1955 stopgap to 1957 income, it was made clear that recommendations for permanent legislation would be submitted by the Treasury Department in the near future. The Department has opposed a further extension of the 1955 stopgap.

In April of 1958 the Secretary of the Treasury in similar letters to the chairman of this committee and the chairman of the House Ways and Means Committee submitted suggestions for the development of a permanent tax formula for life insurance companies. These proposals became the basis of intensive study and helpful discussions within the life insurance industry.

In the April 1958 letter, the Treasury recommended that the Congress consider alternative methods for taxing life insurance companies, giving first consideration to a "net operating gain" or "total income" approach which would reach underwriting profits.

In the course of subsequent consultations with industry representatives, it was urged that a change to the total income approach would shift much of the burden of taxes to stock companies and permit mutual companies to avoid a share of the tax, thus placing stock companies at a competitive disadvantage.

Stock companies typically write nonparticipating life insurance contracts (with fixed net premiums and no dividends to policyholders), and have relatively lower reserves and higher surpluses than mutual companies. Mutual companies write participating life insurance contracts, charging higher premiums at the outset but distributing dividends to policyholders throughout the life of the policies. Since the total income approach would start from "net gain from operations after payment of dividends to policyholders," the stock companies have contended that the mutuals, by increasing the size of their dividends, would greatly minimize their tax burdens in a manner not available to the stock companies.

As a result of the conversations with industry representatives, stock and mutual alike, the Treasury suggested a combination formula which would combine elements of the net investment income and total income approaches. This suggestion was outlined by Under Secretary Scribner in his statement before the Subcommittee of the Ways and Means Committee November 17, 1958. It invoked favorable response, some of which is reflected in the public hearings of the subcommittee. The combination approach, with some constructive modifications, was adopted by the Ways and Means Committee and is contained in the bill now before your committee.

In brief the bill would tax life insurance companies on an income base consisting of three parts: (1) the taxable investment income margin above interest needs,

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(2) one-half the excess of net operating gain over the investment income margin (this part would comprise chiefly underwriting gain), and (3) to the extent distributed to shareholders, the other half of the "underwriting gain" on which tax was postponed in step 2.

Capital gains of life insurance companies would be taxed separately at a 25 percent rate, beginning in 1959. Gains would be measured with reference to the December 31, 1958, market value or cost, whichever is higher.

The bill differs from the present treatment in several important respects.

The proposed new formula provides an improved approach in measuring the deduction for interest needs and the taxable margin of investment income. The deduction is determined with reference to the situation of the individual company rather than on the basis of a fixed percentage based on an industry average, as do the 1955 stopgap and 1942 formula.

The bill recognizes that underwriting gains are part of the income of life insurance companies. Trends in the industry toward group, credit, and term insurance which produce underwriting profits but relatively little investment income make it increasingly unrealistic to confine the tax base to investment income.

The bill also recognizes underwriting losses. If the net operating gain computed in step 2 is less than the investment income base, the net operating gain is the tax base. If there is a net operating loss, there would be no tax liability. Present law imposes a tax on investment income even if the company is operating overall at a loss.

Policy dividends would be deductible in computing net operating gain but not to the extent this would reduce the net operating gain below the taxable investment income. This is intended to keep the investment income tax as a kind of stabilizer or minimum to prevent mutual companies from deriving an undue tax or competitive advantage by deducting policy dividends.

The proposed recognition of only half the "underwriting gain" on a current basis takes account of the long-term nature of the insurance business and the resulting difficulty in making a final determination of profit in any one year. This approach postpones the tax on the other half of such income if it is kept in the company for the protection of the policyholders. No tax is imposed on this other half until it exceeds certain limits or is paid in cash to stockholders.

For the assistance of small companies, the bill provides a special deduction equal to 5 percent of investment income, up to a maximum deduction of $25,000. This allowance is similar to the additional 2½ percent deduction on net investment income up to $1 million under the 1955 law, but is more liberal for the smaller companies.

For future years H.R. 4245 also provides a special deduction for investment income on qualified pension plan reserves in computing the investment income tax base. This deduction, equal to the actual earnings rate of the company on pension plan reserves, is made gradually effective in three steps, becoming one-third effective in 1959 and fully effective in 1961. This special treatment is in recognition of the existing exemption of qualified pension trusts and the fact that small business employers frequently insure their pension plans through insurance companies rather than set up pension trusts.

It is estimated that H.R. 4245 would produce between $540 and $560 million revenue on the 1958 income of life insurance companies. This compares with the $500 million under the 1942 formula and $319 million under the 1955 stopgap, if extended. Some $500 million of the total would arise from the step 1 tax on investment income. The 1958 estimate takes no account of the tax on capital gains or distributions which might arise in future years.

Of the total estimated tax under H.R. 4245, about 72 percent would be paid by the mutuals and 28 percent by the stock companies. This represents a small shift of burden percentagewise to stock companies. However, it brings the shares of tax more closely in line with the shares of business in force.

Basically H.R. 4245 embodies a net operating gain or total net income approach. The following more detailed discussion indicates how the bill provides for arriving at a tax on the net operating gain in three steps, with features which help meet the special problems encountered in the taxation of the income of life insurance companies.

Phase 1.—*Determination of taxable margin of investment income*

One of the major features of H.R. 4245 is an improved formula for measuring the taxable portion of net investment income. In general outline the proposed formula appears to afford the best available approach in determining the amount of

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investment income subject to tax after deducting all interest needed for solvency and competitive requirements.

Under both the 1955 stopgap and the 1942 formula, the deduction for required interest is a specified percentage of investment income, fixed by statute or determined on the basis of an industry-wide ratio of interest needs to earnings. This percentage deduction is 85 percent under the 1955 stopgap, and about 75½ percent under the 1942 formula for 1958. Under each of these formulas the percentage deduction is the same for each company regardless of its own experience or situation.

H.R. 4245 provides a deduction for investment income required to meet reserve and other policy contract obligations in a manner which reflects each individual company's surplus position and the relationship between its earned and assumed rates of interest.

Part of this deduction is for interest paid on policyholder deposits, policy dividend accumulations, and similar indebtedness. Past formulas have subjected this deduction like the reserve interest needs to an averaging process.

The most important part of the deduction for required interest is for reserve interest needed to build up life insurance and annuity reserves. In this important area the bill provides that the deduction is computed as a certain percentage, termed a "deduction rate," of each company's adjusted insurance reserves. This deduction rate is the mean of the actual rate earned by the company on its investments and the rate of interest assumed by the company in computing its reserves (or the industry assumed rate, if higher). In no case is the deduction rate to be higher than the earned rate.

In applying the "deduction rate," the policy reserves are adjusted to the extent the deduction rate differs from the actual assumed rate used in computing reserves. This adjustment is designed to make the reserves consistent with the deduction rate used. If the deduction rate is higher than the assumed rate, as would almost always be the case, the reserves are adjusted downward.

The adjustment of reserves is carried out on the basis of a statutory rule, the validity of which has been demonstrated by industry experience. Under this rule, for each 1 percentage point by which the deduction rate exceeds the assumed rate, the reserves are reduced by 10 percent.

The use of a deduction rate which combines an assumed rate and the actual earnings rate of the company not only takes account of interest needed to maintain solvency. It also recognizes that competition within the industry generally requires companies to build into their premium structure a credit to policyholders for interest which is somewhat greater than the more conservative rate generally assumed in building up reserves.

In computing the deduction rate, the industry average assumed rate is permitted as a possible relief measure to avoid a possible tax penalty on a company that has been more conservative than the industry consensus. On the other hand, in permitting a company to use its own assumed rate, where this is higher than the industry average, the bill provides for unusual needs of individual companies.

Since the deduction rate is a combination of the earned and assumed rate, the effect of varying reserve interest assumptions on the deduction rate would appear to be minor. Consequently, this provision of the bill serves to minimize the problem of possible reserve manipulation for tax reasons.

Phase 2.—Excess of net operating gain over the taxable margin of investment income (chiefly underwriting gains)

The second phase of the proposed tax formula deals with a problem presented by past formulas based on investment income only, namely, the omission from the tax base of underwriting gains.

Important changes within the life insurance industry since 1921 have increasingly outmoded the old formulas based on the concept that the only income of life insurance companies is their investment earnings. Between 40 and 50 percent of the life insurance now in force involves relatively little investment income. Yet it may produce substantial underwriting profit or loss.

Phase 2 of the bill reaches such underwriting profits by means of a simple and direct procedure. The company would first compute its net operating gain from all sources. Net operating gain would represent gross receipts from all sources less all expenses and all additions to reserves and benefit payments to policyholders.

From the amount of net operating gain thus determined, the company would deduct the taxable investment computed in phase 1, since this amount has already

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been included in the company's tax base. The excess would represent primarily underwriting profit, plus whatever excess of investment income over interest requirements was not reached in step 1.

After determining the excess of the net operating gain over taxable investment income, the company would add one-half of the excess to its taxable investment income base to arrive at the combined tax base under phases 1 and 2. The 50 percent reduction in the so-called underwriting gain for purposes of current taxation takes account of the point on which the life insurance industry has insisted that it is difficult, if not impossible, to establish with certainty the true net income of a life insurance company on an annual basis. This uncertainty is said to reflect the long-term nature of the contracts and the resulting need to retain what may temporarily appear as income in the current year as surplus or contingency reserves.

The 50 percent reduction also has the effect of applying a reduced rate of tax on underwriting gains so long as they are kept in the company for the protection of policyholders. Consequently, the incentive to alter reserves and adopt other changes in business or accounting practice merely for tax purposes is correspondingly reduced.

If the net operating gain is less than the taxable investment income or if there is an actual net operating loss, the bill provides for the appropriate recognition of underwriting losses. The amount by which the net operating gain is less than the taxable investment income margin may be subtracted in full from the step 1 income base. If there is a net operating loss for the year there would be no tax liability.

This feature of the bill should be of particular importance to small new companies, which characteristically have net operating losses in the early years when the business is being established. These small new companies have been required in the past to pay tax on their investment income regardless of the fact that they may have had an overall loss situation.

The bill also provides for a three-year carryback and a five-year carryforward of net operating losses in a manner comparable to that applicable to corporations generally.

Phase 3.—Tax upon distributions of stock companies

The third step provided under the bill provides a supplement for the partial tax on underwriting gains under step 2. One-half of the underwriting gains are taxed currently under step 2 but tax is postponed on the other half in view of the uncertainty as to the ultimate earnings results. Tax is deferred on this portion of the underwriting gain so long as it is kept in the company for the protection of policyholders or until it is accumulated beyond stated limitations.

The tax on distributions would apply under any of the following conditions: (1) if the company pays cash dividends or cash distributions to stockholders which are in excess of the amounts of investment income and underwriting income which have previously been taxed; (2) if the cumulative amount on which tax is postponed exceeds 25 percent of life insurance reserves or 60 percent of the net premium income, whichever is greater; or (3) if the company ceases to be a life insurance company.

Provisions for equalization of stock and mutual companies

One of the major considerations in the formulation of an equitable long-range formula for the taxation of life insurance companies is the comparative treatment of mutual and stock companies.

Throughout the development of this legislation, stock companies have been concerned that the mutuals, by increasing the size of their dividends, might greatly minimize their tax liabilities in a manner not available to the stock companies. To meet this objection, the bill has provided that policy dividends may be deducted from the step 2 tax but are not allowed to reduce the investment income base.

The portion of the tax base established in step 2 consists chiefly of underwriting gain arising primarily from the excess of premiums paid over mortality cost and other expenses. Consequently, it represents moneys contributed by the policyholders themselves which it would be inappropriate to tax if returned to the policyholders. On the other hand, the investment income base represents income received from third parties which it would be inappropriate to exempt after a reasonable allowance is made for the amount of interest required to build up

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policy reserves and meet other interest obligations on a sound and competitive basis.

Because of the redundant premiums charged by mutual life insurance companies, they have an additional cushion besides their surplus with which to meet possible adverse operating experience. Stock companies, with their lower initial premiums, do not have this cushion and, consequently, must maintain a larger surplus. In recognition of this situation, the bill provides a deduction of 10 percent of the net increase in reserves on nonparticipating life insurance contracts. This special deduction is limited to the step 2 or underwriting gain portion of the tax base. It would not be permitted to reduce the net investment income base

Other features of the bill

In computing the net operating gain, the companies are allowed a special deduction of 2 percent of net premiums on group life and group accident and health insurance business. This allowance is patterned after the reserve requirements of two States for purposes of strengthening the financial safety of companies conducting this kind of business.

The bill also permits companies using the preliminary term method of computing reserves to determine their income tax as if they were on the stronger net level premium reserve basis. This feature would generally be of assistance to smaller companies.

In view of the more adequate taxation which the bill provides of the entire net operating gain from all sources, it also extends the generally applicable individual dividend-received credit and exclusion to stockholders of life insurance companies.

Conclusion

The income tax liability under H.R. 4245, as compared with the liability under past formulas, would be more in accordance with the true taxable capacity of life insurance companies. The bill would remove the inequities and inadequacies of the past formulas which have required some companies to pay tax although they had no true net earnings while imposing a disproportionately low tax based on investment income in the case of other companies with large profits.

The staff of the Treasury will be ready to assist the committee at its request in its further consideration of the bill and related aspects of its work on the taxation of life insurance companies.

International Financial and Monetary Developments

Exhibit 25.—Statement by Secretary of the Treasury Anderson, March 9, 1959, before the Senate Foreign Relations Committee on increasing the resources of the International Bank for Reconstruction and Development and the International Monetary Fund [1]

I welcome the opportunity to appear today to support legislation to carry out the recommendations made by the President to the Congress on February 12, 1959. The purpose of S. 1094 is to authorize increases in the United States quota in the International Monetary Fund, in the U.S. subscription to the capital of the International Bank for Reconstruction and Development, and the capital of the Bank, by amending the Bretton Woods Agreements Act of 1945.

I know that this committee, with its great interest in the foreign policy of the United States, is well acquainted with the problems with which the Bank and Fund were established to deal. Vigorous growth of the economic system is the concern of every country, but particularly of those countries whose economic development is less advanced. Sound currencies which encourage savings and investment and are the basis of foreign exchange stability are also a leading objective of all responsible governments. These matters are, of course, major points of emphasis in our economic foreign policy.

The International Monetary Fund and the International Bank were created by international agreement arrived at during the conference at Bretton Woods, N.H., in 1944. United States participation was authorized by the Congress in 1945 through the adoption of the Bretton Woods Agreements Act. The two

[1] Secretary Anderson also testified on the same subject on March 3, 1959, before the House Committee on Banking and Currency.

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